NOTES ON A MEETING OF THE INDONESIAN EMBASSY AND THE CENTER FOR INTERNATIONAL STUDIES
DECEMBER 20-21, 1954, WASHINGTON, D. C.

PARTICIPANTS

Indonesian Embassy
His Excellency, The Ambassador
Dr. Ismael M. Thajeb
Dr. S. Surjotjondro
Dr. Zairin Zain

Mr. Djoko Soeroto
Mr. Usodo Notodirdjo
Dr. D. W. Rengers
Mrs. Jo Kian Tjay
Miss R. A. Oetoyo

Center for International Studies
Dr. Benjamin Higgins
Dr. Douglas Paauw
Miss Priscilla Moulton

Mr. John Rodrigues
Dr. Eugene Grasberg
Dr. Guy Pauker
Dr. Sioma Kagan

Others
Professor Everett Hawkins, Mt. Holyoke College
Mr. A. Natanagara, Consul General, Republic of Indonesia
Mr. Basri Hasnan, Consul, Republic of Indonesia
Dr. Soetikno Slamet, Alternate Governor, International Monetary Fund
Mr. Trasno Kaliprogo, Bank Indonesia
Mr. Sujud, United Nations
The following papers were circulated prior to the meeting:

Dr. Benjamin Higgins

"Encouragement of Foreign Investment in Indonesia" and Supplementary Remarks.
"Encouragement of Foreign Investment in Indonesia: Supplement II. The Report of the Canadian Advisory Committee on Overseas Investment".
"Foreign Investment in Indonesia: Supplement III. Factors Limiting American Foreign Investment".

Dr. Eugene Grasberg

"Indonesia's Investment Requirements"

In addition, an outline of the proposed study of the Standard-Vacuum Oil Company in Indonesia and a questionnaire for the Center study of foreign investment in Indonesia were circulated for discussion.

FIRST SESSION*

The discussions were chaired by Dr. Benjamin Higgins, Director, Indonesian Project, Center for International Studies. Documentation and discussion focussed on conditions affecting foreign investment in Indonesia. The first item of discussion was concerned with the total capital needs of the Indonesian economy. Dr. Eugene Grasberg was asked to summarize his conclusions and to present his recent refinements on his study of investment requirements. It was pointed out that the amounts of capital required to produce significant increases in per capita consumption are very great in terms of Indonesia's present rate of domestic investment. It was agreed that annual investment of the order of Rp. 12 to Rp. 15 billion per year would be needed to raise per capita consumption by one or two percent per annum. Investment of this magnitude is perhaps double or triple the current rate now taking place in Indonesia. This underscores the necessity for attempting to induce a flow of foreign investment in order to reduce the amount of domestic sacrifice necessary to make economic progress.

A member of the Indonesian representation suggested that this type of analysis is indeed useful in providing background for discussion of the foreign investment problem in Indonesia. However, he stressed the fact that the enlistment of the support of the Indonesian government and the Indonesian people to foster a program designed to attract foreign investment is a major problem. He suggested that the discussions at this particular meeting might center around this general issue: What steps can be taken to make foreign investment more acceptable to the Indonesian nation, while at the same time making conditions of investment attractive to potential foreign investors?

1. I wish to thank Miss Priscilla Moulton for painstakingly recording these discussions as they took place and in assisting me in putting them together in meaningful sequence.
This task involves demonstrating to the Indonesian people that a new concept of foreign investment need not imply exploitation. Also, a clear and explicit foreign investment policy on the part of the Indonesian Government should be formulated. Yet another requirement is a strong executive agency powerful enough to undertake necessary negotiations and to effectively administer the program designed to induce the flow of foreign investment.

The chairman agreed that this issue was most pertinent for discussion. He indicated that the original approach from the quantitative side had been intended only to set the sights as to the scale of foreign investment which might best fit Indonesia's developmental needs. The first objective is to determine how large the job is. There is agreement that investment must be increased several fold. Some of this increase could be obtained at home. However, in light of the low level of private investment now taking place in Indonesia, it appears that an effective developmental program which would not involve sacrifices beyond the capacity of the Indonesian economy would require some external financing. Such external financing would ideally be partly in the form of foreign investment and partly in the form of foreign aid.

An Indonesian representative asked whether the Center for International Studies could, at the present stage of its research, provide a rough estimate of the amount of foreign aid and investment which would be required to round out an Indonesian development program. A member of the Center team answered that on the basis of Dr. Grasberg's estimates of the capital requirements of the economy and Dr. Paauw's recent estimates of current investment resources, it appeared that a minimum of $1 to $2 million (roughly Rp. 1 to 2 billion) in foreign capital would be required.

An Indonesian speaker indicated that in his opinion the Indonesian nation is not yet mature enough for a completely rational acceptance of foreign investment. The problem, therefore, is essentially one of constructively molding public opinion in Indonesia. How can this best be done? It was suggested that the government might first undertake a program of domestically financed investment. It would then become clear to the Indonesian people that the rate of economic progress could be increased and the economic cost of development reduced if foreign investment on a considerably expanded scale were accepted. Another Indonesian participant pointed out that awareness of the necessity for foreign investment is growing among the Indonesian people, with the exception of the left wing which does not represent the dominant opinion. Indonesia's development depends in part on inducing a flow of foreign investment and highest priority should be given to educating the Indonesian people more broadly on this score. As stated previously, the Government should assume the leadership by issuing a clear statement expressing its attitude toward foreign investment. Further research is needed on the question of what sectors
are now remunerative to foreign investment and what can be done to improve conditions for investment in those which are not now favorable. When foreign firms are adding to the productivity of the Indonesian economy, they should be given the right to transfer their gains. It is also important that Indonesians be granted a greater sense of responsibility in the operation of foreign enterprises. To the extent that qualifications exist in Indonesia, management and operation of foreign firms should be placed in Indonesian hands.

A Center participant inquired about the current status of Indonesian draft legislation on foreign investment. Specifically, he asked whether or not the forthcoming legislation intended to define certain fields of enterprise as open to foreign investors, while closing other fields. An Indonesian speaker replied that this was the intention. In order to increase Indonesian foreign exchange earnings, the government intends to limit some fields of development to Indonesian investors. This speaker also mentioned that there is too sharp a gap between the laws relating to foreign enterprise and those concerned with domestic enterprise. Relationships between the Indonesian Government and foreign enterprise might better be conducted on an ad hoc basis rather than on a more narrowly legalistic basis. Questions pertinent to the operation of foreign firms—profit transfers, tax burden, employment of Indonesian personnel—could then be negotiated with a foreign investment board.

An Indonesian representative asked how investors would feel about allowing Indonesians to occupy managerial and other important posts in foreign firms, which imply a claim to a share of profits. A Center member suggested that in his opinion some firms would not object to this type of arrangement, while a limited number might feel that this provision was too restrictive. However, he felt that the prevailing view among investors would be a willingness to accept an Indonesian staff as long as profitable returns could be made on their investment. Few firms will insist on completely foreign owned and managed enterprises.

Two Center participants elaborated on their reactions to the suggestion of negotiating foreign investment on an ad hoc basis. They agreed that it would be entirely within Indonesia's right to provide this basis for negotiating relationships between foreign firms and the Indonesian Government. It was believed that foreign investors find this approach attractive. Most companies appreciate having room for discussion and welcome the opportunity to approach some definite government agency on matters relating to their operations in Indonesia. Hence, it would be useful to have a foreign investment board, perhaps with foreign advisers, responsible for administering the foreign investment law. This would provide a place for a meeting of minds on such major questions as profit transfers, taxation, scope of investment and other recurring problems such as land leases, visas, etc. Through such a board a formula attractive to both the Indonesian
Government and foreign investors might be sought. Foreign investment should not be strangled but should be encouraged in such a form that it contributes to domestic Indonesian development. Indonesia should retain long-run control of Indonesian resources. Foreign investment might operate under the concept of non-permanent concessions to develop particular industries, while reaping profitable returns on invested funds. The new concept that foreign investment would eventuate as Indonesian industry, intended for Indonesia's own economic and political welfare, should be emphasized.

The role of foreign investment in the future development of Indonesia can be expected to be more similar to the role that foreign investment played in development of countries like the United States and Canada than to foreign investment in a colonial context. In the cases of both the United States and Canada what began as foreign ownership has usually ended as domestic ownership. Yet, even today, mining and power have ingredients of foreign control in Canada. This suggests that foreign investment in and of itself under non-colonial conditions should hold no fear.

Another Center representative further elaborated on the old and new concepts of foreign investment. It was true that the disappearance of imperialism left in its wake suspicion that foreign investment brings abuse and exploitation. It is only recently that foreign investors in newly independent countries have tried to find new forms of investment and engender new attitudes towards such investment. Perhaps the process of natural selection will curtail the operations of investors not yet disabused of the old philosophy of investment, making room for investors willing to accept the challenge of new conditions. Attitudes toward foreign investment are one of the major problems which must be solved in newly independent countries.

Technical assistance and its contribution to the development of a country like Indonesia has by and large been accepted. The next step, that of allowing foreign financing to play a part in the development of the country, is now in the process of being resolved. This resolution, however, implies that the domestic will for development should replace emotions which are now outmoded in the context of independence. It is agreed that the process of development must be begun through domestic financing. When this is done, the people will see the necessity for inducing a flow of foreign investment to complement the domestic program of sacrifice.

An Indonesian participant pointed out that this implied that Indonesians and foreign investors should seek to understand the aims, purposes and values of each other. Since backgrounds are different, the basis for an understanding should be sought through what one authority has called "cultural mediation". There are many points of mutual interest which suggest that mutually advantageous terms can be concluded.
In response, a Center speaker suggested that this implied that foreign investors and students from countries undertaking foreign investment in Indonesia should make a serious effort to understand the politics and background problems pertinent to foreign investment in a country like Indonesia. Efforts of the Indonesians to convert a colonial economy into a national economy should receive full sympathy and understanding. The relationship between the standard of living and foreign investment should be made more explicit if planning for economic development were undertaken partly on a decentralized basis. This would allow people to see that economic progress requires local sacrifice and that the local burden could be reduced by financing development through inflow of foreign capital. These more positive attitudes, it was pointed out by another Center speaker, might be further engendered if Indonesians were convinced that the development program was predominantly Indonesian in flavor. As it became recognized that foreign investment was only a complementary factor in a much larger Indonesian development program, Indonesian fear of foreign economic domination might well subside.

SECOND SESSION

An Indonesian speaker opened the discussion of the second session with a review of some of the most critical economic problems which have received government attention during the past few years. In the early years of the Indonesian nation, the government made several attempts to stimulate the interest of Indonesian nationals in the import business. After the collapse of the Korean boom, however, it became clear that the development of an Indonesian business community to handle imports was not as critical as the expansion of exports to provide foreign exchange for Indonesian development. It was immediately recognized, however, that there are serious problems involved in short-run expansion of exports. Hence, the government began to turn its attention to the possibility of obtaining resources through foreign investment, but found that prevailing Indonesian attitudes limited the adoption of aggressive policies designed to increase the role of foreign investment in Indonesia. In the next stage, attention shifted to the necessity to plan imports in order to conserve foreign exchange for importing commodities essential to economic development. This prompted interest in the question of what goods could be produced domestically. It is felt in Indonesia that small-scale and relatively light industry are the best short-run solutions to the problem of replacing imports by domestic production. Hence, policy has concentrated on encouragement of this type of industry through credit, and technical and organizational aid.

A Center participant suggested that the diversity of resources existing in Indonesia makes it difficult to decide where the problem of developing indigenous industry should first be attacked. This problem is compounded by the fact that during the colonial regime little
thought was given to this question. Thinking was in terms of promoting the production of exports rather than in terms of promoting domestic development or production for local consumption. As a consequence, even the basic studies of the supply of resources for indigenous development do not exist. This is an important area for current research. Some attention has been given to this question by the natural resources expert in the National Planning Bureau, but further work is needed. Plans for economic development must be based on assessment of the resources pattern of the economy. In fact, even discussion of the potentialities of foreign investment should be related to developmental plans based on an appraisal of existing resources.

An Indonesian participant suggested that international agencies, such as the International Bank for Reconstruction and Development, have been giving increasing attention to financing the development of small-scale industry in Indonesia.

This prompted further discussion of the role that small-scale industry might assume in Indonesian development and its relationship to foreign investment. A speaker from the Center felt that investment in small-scale industry could be effective in replacing imports. High and quick returns on investment in this sector make it attractive for short-run development objectives. The Center for International Studies is undertaking a study to investigate the possibility of replacing imports now drawing on Indonesia's limited foreign exchange resources by domestic production.

A Center representative opposed this arguing that small-scale industry would have difficulty in attracting foreign investment. Moreover, economic development does not consist of proliferation of handi-craft industries.

An Indonesian speaker indicated that in his opinion American bankers and financiers are not greatly interested in financing small-scale industry which produces for Indonesia's domestic market. They are primarily interested in enterprises which produce goods which can be used in their own country. In effect, this means that they are interested in expanding the types of industries in which foreign investment is now active in Indonesia. Another Indonesian speaker suggested that there are arguments for expansion of small-scale industries notwithstanding the objections presented. In the first place, expansion of domestic production from these industries is within the investment means of the Indonesians. Heavy industry is obviously not within the financing capacity of private Indonesian entrepreneurs. The spirit of development can best be engendered by small beginnings. Indonesian entrepreneurs must be convinced that production for the domestic market can be a money making proposition. Because of the cheapness of domestic labor, it is believed that domestic production can compete effectively with imported products, in spite of differences in quality. Once this process
took hold, the Indonesian people would become increasingly appreciative of the benefits of local industrial development.

A member of the Center agreed with this line of argument. Observation in Indonesia had convinced him that opportunities for profitable domestic production, aimed at replacing import of consumer goods, were abundant. It was apparent that these opportunities were already being recognised and exploited. In several areas of Indonesia local governments were engaged in small-scale productive enterprises, which consisted of processing goods for export as well as producing a number of essential commodities for domestic consumption. This trend should be encouraged by the government. As this observer saw it, the problem is that these opportunities are ordinarily not seized upon by private entrepreneurs, but go unexploited until some governmental body takes the initiative in financing or encouraging the project.

Another Center participant argued that these small-scale industrial opportunities would not attract foreign investment. Hence, they should be regarded as the logical outlet for private Indonesian capital. Larger scale industrial projects could then be left to foreign and public investment. Large-scale production for the domestic market itself might indeed become an attractive area for foreign investment. A Center speaker elaborated by pointing out further that there is no reason why large-scale enterprise cannot evolve from small-scale industrial development, as it has done elsewhere. Indonesia should commence diversified production at the scale which is most consistent with its present labor, capital and entrepreneurial resources.

An Indonesian representative suggested that the supply of entrepreneurship is just as short for small-scale industry as it is for large-scale enterprise. In response to this statement, a Center speaker suggested that the experience of Japan might be pertinent. When Japan began the process of its development it was also short in its supply of entrepreneurs. Yet the Japanese Government undertook to organize industry on the basis of its own resources. Foreign experts were imported for technical and managerial functions as well as to train the Japanese in these roles. As these specialised abilities were developed in Japan, industry was turned over from public to private ownership. An Indonesian participant agreed that this pattern of development would indeed be appropriate for Indonesia. However, he doubted whether foreign investment would be adequate to supply the technical and capital needs of a program of this type. Because of the political and economic situation in Indonesia, the greater part of these costs would probably have to be met from state resources.

Some of the problems of implementing a development program in a newly independent country like Indonesia were emphasised by an Indonesian speaker. One of the most critical of these problems is the current commercial philosophy of the group (the merchant, middleman class) which has the capacity to initiate indigenous development.
This group feels independence gave them the prerogative of making money quickly in ventures which do not lead to productive employment of their capital. This has been accompanied by efforts to transfer such earnings abroad, putting pressure on the foreign exchange reserves of the country. Secondly, among the Indonesian population generally there is a demand for more and better quality consumer goods. However, the facilities to produce this type of goods domestically are not available in Indonesia, and it is difficult to get them from abroad. Perhaps it would be a reasonable compromise to begin the production of those goods which do not require the most modern types of machinery. Capital goods for Indonesian domestic development must be adapted to the entrepreneurial and labor skills available in the country.

A Center participant reiterated his objections to development with heavy accent on small-scale industry. He pointed out that in the experience of Eastern Europe industrialization of small-scale industry had little to contribute. Industry continued to produce with rather outmoded, unproductive methods, making little technological progress. It was only when large-scale industries were introduced that more productive and efficient methods began to be used.

Issue was taken against this point of view. It was pointed out that even at the present stage of development in the United States, small-scale industry plays a very crucial role. Moreover, industry of this type in the United States shows a good deal of initiative and invention. Some of the most fruitful innovations have been introduced at this level of industrial organization. A Center member indicated also that there is not necessarily a conflict between large and small-scale industry; in fact, both are essential to economic development. He pointed out that Japanese experience showed that a superstructure of large-scale industry required the support of a diversity of small-scale industries. In Japan a good deal of the initial processing of raw materials is accomplished through the use of small-scale industry, while large-scale industries serve the function of producing capital goods for the economy as a whole, as well as providing other external economies.

The proponent for development through large-scale organization replied that most small-scale industry, even in Japan, produces gadgets primarily of a consumption nature. This sort of production plays no critical role in economic development. Exception was taken to this view and it was pointed out that neither in Japan nor in Indonesia is small-scale production anywhere near the margin in supplying "gadgets" which are essential to the livelihood of the population. An Indonesian speaker warned that the organisation of a large-scale industry might be beyond the administrative and entrepreneurial resources of Indonesia at the present moment. On the other hand, these skills are not as scarce in existing small-scale industry. It would be unrealistic to believe that the entrepreneurial talent
available could be transferred to large-scale administration. A Center participant submitted that Indonesian banking agencies and international institutions might be induced to offer large-scale aid for distribution to small-scale industries. This would then relate domestic development on a scale which appears to be most appropriate for Indonesia to large-scale internal and external financing.

The chairman of the meeting suggested it might be well to turn to a discussion of Indonesia's draft legislation regarding foreign investment, and to consider the ways in which factors affecting foreign investment might best be handled by legislation. He suggested that the question of the whole "climate" of foreign investment in a country like Indonesia was quite as important as specific legislative recommendations. "Climate" is developed from the experience which all firms now investing in Indonesia see fit to call to the attention of the world at large. The question of discrimination between old and new firms is important since new investment is related to the experience of old firms. Clarification was asked on two particular items: (1) the extent to which discrimination was implied in the legislation now being contemplated, and (2) the basis on which the negotiations between the Indonesian Government and foreign firms would be carried out. It was again emphasised that foreign investors would appreciate opportunities for ad hoc discussions on relevant points. It is important that foreign firms have access to clearly defined channels of authority to undertake discussions with the government. A secretariat or foreign investment board, adequately empowered and accepted, might answer these needs. Further, it is important that uniformity of treatment be given to all foreign investors, and that such regulations as the Indonesian Government deems necessary should fit the existing conditions for inducing a flow of foreign investment. Policies outlined in foreign investment legislation as well as specific regulations should coincide with actions representing the real conditions of foreign investment. Though an ad hoc basis for negotiations is desirable, there is still room for a general statement of policy and regulations governing foreign investment. The foreign investment community is waiting for an Indonesian pronouncement on these general principles.

The Indonesian reply to this query brought out a number of points. In the first place, it was emphasised that the present draft legislation was not intended to provide legalistic regulations but rather to serve as the basis for progressive action to stimulate foreign investment. The general provisions of the legislation will open the way for ad hoc discussions between existing and potential foreign investors and the Indonesian Government. The creation of a foreign investment secretariat representing top government personnel concerned with foreign investment is envisaged. This group would have full authority for specifying in detail the conditions under which foreign investment would enter Indonesia. It would have the authority to overrule several government departments; such as those concerned with immigration, land
rights and financial regulations. The recommendations in the pro-
posed legislation with regard to these specific points is indeed
favorable. The exact application of the law of course depends on the
particular individuals who are charged with carrying out the decisions,
once the law comes into effect. At this point it is impossible to
predict how the draft legislation will be received by Parliament.
With regard to the distinction in regulations applying to old and new
companies, the underlying philosophy of the legislation is that all
companies will be treated the same, if the factors bearing on current
investment and investment status are the same. The problem with re-
gard to old investment is that most of the machinery now operating
in Indonesia is obsolete and new investments to replace depreciated
machinery have not been undertaken. The initial investments which
supported the construction of the new obsolete capital goods has by
and large been repatriated. To the extent that rehabilitation and
replacement of the capital stock of these companies has been under-
taken during the postwar period, it has actually been at the expense
of the Indonesian economy, i.e. on the profits made in Indonesia
rather than on the basis of new inflow of capital. Whether or not
this type of investment still has claims on Indonesian foreign exchange
resources for transfer purposes is an extremely delicate question. It
is clear that some investors have no such rights on the basis of old
investment long since repatriated.

This point was elaborated by another Indonesian speaker. Old
firms cannot expect to transfer profits and dividends as they did
when capital was legitimately being repatriated. If foreign exchange
essentially produced by the Indonesian economy rather than by foreign
investment is being utilised for replacement of obsolete and depreciated
facilities, there is no justification for transferring profits from
such "investment". The point was also made that with the great dis-
parity between the official and free exchange rates, repatriation at
the official rate is actually a levy on the economy. Hence, repatria-
tion and transfer of funds on the basis of old investment no longer
entitled to these claims is a double levy on the economy's resources.

Various suggestions concerning the problem of further repatriation
of old investment were made by members of the Center for International
Studies. It was agreed that some understanding should be reached with
individual companies as to the value of their investment still subject
to repatriation demand on foreign exchange. It was suggested that this
could best be done on an ad hoc or expediency basis rather than on the
basis of inflexible or legal determination. One of the Center members
suggested that it might be well to initiate a capital tax which would
be applied to old investments. This would make it necessary for the
companies to give an accurate evaluation of their existing investment
or pay a considerably higher capital levy. Another member from the
Center suggested that the problems of repatriation of prewar invest-
ment largely pertained to Dutch investment. It might be best to con-
sider this as a separate problem since actually these transfer arrange-
ments are not pertinent to investment now flowing into Indonesia
(i.e. primarily from non-Dutch sources).
THIRD SESSION

The third session began with the submission of the outlines of the proposed Center-Stanvac and foreign investment studies for the consideration of the group. The Indonesian participants, in particular, offered constructive suggestions for the formulation of these studies. In general, it was suggested that the foreign investment questionnaire be rephrased in order to provide the opportunity for responses indicating favorable conditions to foreign investment in Indonesia, as well as those which are considered obstacles to the flow of foreign capital. With regard to the Stanvac study, a number of speakers emphasized the importance of an objective appraisal. The uniqueness and commanding position of Stanvac in the Indonesian economy should be explicitly recognized; Stanvac should not be regarded as a typical foreign firm. Hence, comparison with foreign firms of similar influence in other economies would be helpful.

The greater part of this session was devoted to the presentation and discussion of a paper by Dr. Douglas Paauw. A revised copy of this paper, entitled "Financing Economic Development in Indonesia: A Suggested Program,"1 accompanies these notes.

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1. This paper was originally entitled, "Observations on the Financing of Economic Development in Indonesia". 