

## Japan-Indonesia Relations: New Opportunities, New tensions

Geoffrey Gunn

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By Geoffrey C. Gunn

The late January visit to Tokyo by Indonesian Vice President Muhammad Jusuf Kalla was full of surprises, just as the two nations announced their expectations that a Free Trade Agreement (FTA) would be signed before the end of 2006.



Vice-President Jusuf Kalla

The last few years have witnessed a wave of bilateral Free Trade Agreements linking, respectively, the US and trade partners across the Pacific, and Japan and trade partners in the Asia-Pacific region. Countries as disparate in economic profile as Australia, Thailand and Indonesia are currently striving to reach agreement with Japan, in part driven by the free market logic symbolized by the World Trade

Organization, as much as by neo-liberal economics. But there is also a sense of scramble not to be left behind by their neighbors.

Discussions on a Japan-Indonesia FTA can be traced back to the visit by Indonesian President Susilo Bambang Yudhoyono to Tokyo in June 2005. But in the official chronology, the newly elected staunchly pro-US Indonesian President first raised the issue of an Economic Partnership Agreement (EPA) with Prime Minister Koizumi Junichiro at the APEC Summit Meeting of November 2004. Following agreement in December 2004 between the respective trade ministers of the two nations a Joint Study Group for the Japan-Indonesia EPA was launched. Preliminary discussions commenced on 31 January 2005, the first of three exploratory meetings, engaging relevant ministries and representatives of academic and private sectors of the two countries.



President Yudhoyono and Prime Minister

## Koizumi

At that time there was an overriding sense in Jakarta that Singapore, the Philippines, Thailand and Malaysia had moved faster than Indonesia in pursuing FTAs with Japan, though only Singapore – as might be expected given its economic profile - had actually signed an agreement.

In Tokyo, in June 2005, the Indonesian President and the Japanese Prime Minister jointly announced commencement of negotiations on the “Japan-Indonesia Economic Partnership Agreement” (JIEPA).

Certain facts stand out: namely, that Japan is Indonesia’s largest trade partner in both export (19.06 percent) and import (13.07 percent) in 2004.

Japan is also the largest provider of Official Development Assistance (ODA) to Indonesia, a program that reaches back to the provision of war reparations commencing in 1958.

Indonesia is an important energy supplier to Japan although it should also be understood that Indonesia, currently a net importer of oil, remains a steady supplier of LNG to other nations. In Tokyo, Kalla made clear the obvious, that competition among international clients for Indonesia’s remaining gas reserves (Natuna in

the South China Sea and the Bird’s Head area of Papua are promising) is already acute and that Japan must play its cards accordingly.

In the discussions, Indonesia expressed strong interest in Japan’s reduction of both tariffs and non-tariff barriers for trade in goods.

Indonesia also welcomed expanded Japanese investment, while Japan sought the improvement of market access through the elimination of excessively high tariffs on industrial goods including auto, steel, textiles, electronics, etc. Reciprocally, Indonesia sought improved access for its exports to Japan of plastic goods, organic chemicals and, over Japanese objections, footwear and leather products (deemed “sensitive historically” by Japan). See Japan Focus (<http://japanfocus.org/article.asp?id=491>)

Obviously, Indonesia’s economic profile has changed over the decades from a primarily agricultural- and resource-based economy to an export platform of value added manufacturing goods based upon comparative advantage. Under the long years of the Suharto dictatorship Japan could count upon forms of economic plunder of resources – as alluded by Kalla – a competitive labor cost structure, and a docile labor force. An implicit understanding existed not to link aid with political reform, democratization or human rights.

The status quo has also changed. Indonesia’s

economic recovery from the devastating Asian Economic Crisis has been weak, resources depletion is evident and, in the wake of the reform movement, which led to the ouster of the Suharto dictatorship and reigned in the military, even an elected President faces a more sophisticated electorate. The rise of China and its competition with Japan for economic leadership of Southeast Asia are closely watched in Jakarta.

Kalla, the chairman of Golkar, Indonesia's largest political party, didn't arrive in Tokyo as a supplicant of the old style crony business network that marked the Suharto era, but the bearer of some blunt truths. But at the end of a long queue of potential beneficiaries of freer trade with Japan, Kalla could also observe the snail pace at which the regional FTAs were moving, especially in opening up Japan's notoriously restricted agricultural sector.

Kalla's reported concern that Japan had dispersed too many unaffordable loans to Indonesia is not without meaning. Indonesia is also a major client of the Japanese-dominated Asia Development Bank. In the wake of the Asian Economic crisis, Japanese loans to Indonesia added up to a staggering Yen 7.7 trillion, half of which is currently outstanding.

On 26 April 2001, Japan, Indonesia's largest creditor nation for the previous thirty years, made a radical break with tradition by canceling

a Yen 35.9 billion loan, citing failure on the part of the Abdulrahman Wahid administration to meet aid conditions. In so doing, Japan followed a decision made earlier in the year by the World Bank to cancel a US\$300 million loan, along with the IMF's decision in December 2000 to delay continuation of its US\$5 billion program in Indonesia. Key Indonesian officials, seeking a rescheduling of loans, reacted with dismay at this element of "blackmail."

Undoubtedly Japan also surprised Jakarta by falling into the new Washington consensus on loans. The major victim of the loan crisis of 2001 was President Wahid, who was impeached in August of that year, ostensibly over personal scandals. Wahid, who was known for drawing the line at military interference in politics, was replaced by his vice-president Megawati Sukarnoputri, a staunch military-backed nationalist and no economic manager. The amount of default on loans is not public knowledge, but is believed to be considerable. [1]

Not mentioned in the Indonesia Post article is the reported meeting in Tokyo between Kalla and Japanese Foreign Minister Aso Taro on human rights, unthinkable not only during the Suharto era but virtually unprecedented in the history of relations between the two countries (see Japan Focus no. 501 <http://japanfocus.org/article.asp?id=501>). Reportedly, Aso told Kalla (who agreed), that

“once a country has achieved a degree of economic development, such matters as freedom of information and protecting human rights takes on importance” [2]

Times have certainly changed since the Suharto dictatorship essentially milked loans from Japan in return for virtual cart blanche in economic contracts and resources exploitation. It seemed incongruous, but was Japan in 2006 actually playing the human rights card to Jakarta just as the Indonesian vice president was displaying an uncharacteristically Javanese shoot from the mouth style of public discourse on Japan’s economic legacy in the sprawling tropical archipelago nation?

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## Notes

[1] The background to the financial scandals and international loans in discussed in Geoffrey C. Gunn, “Japan, Post-crisis Indonesia, and the Japanese Role in East Timor Development,” in Rolando B. Tolentino et.al. *Transglobal Economies and Cultures: Contemporary Japan*

and Southeast Asia, The University of the Philippines Press, Manila, 2004, pp.35.

[2] “Japan, Indonesia Agree to Hold Talks On Human Rights.” (AP, January 23 2006).]

## Appendix:

### **If it Comes From Japan, Call it a Loan, Not Aid: Vice-President Jusuf Kalla**

By Muninggar Sri Saraswati, The Jakarta Post, Tokyo, January 2006

Japan has disbursed too many "support" loans to Indonesia at rates Indonesia could not afford, Vice President Jusuf Kalla told a group of Indonesians in Tokyo during his four-day visit to the country.

In an offbeat, sometimes amusing get-together with Indonesians living in Tokyo on Tuesday evening, Kalla took some time out to take a few potshots at his Japanese hosts. Kalla told the group about his earlier meeting with Japanese entrepreneurs, where he had answered questions about Indonesia's trade relations with China, and about Indonesia's decision to prioritize LNG supplies for domestic needs in the future. Without disregarding Indonesian-Japanese relations, Kalla said, Indonesia's trade ties with China had improved because the China had offered affordable products to Indonesia.

Indonesia should work to improve bilateral relations with as many countries as possible if it was beneficial to the country, Kalla said. "Never become dependent only on one nation," he told the meeting. Kalla said Japan had been too eager to provide Indonesia with many loans. Their high repayment rates had meant the loans had ended up benefiting the Japanese more than Indonesians, he said.

He said he had ordered Indonesian diplomats and other officials to stop using the word "bantuan keuangan (financial support) packages" for overseas loans offered to Indonesia. "I would never ever use the word 'support' for loans. The correct word is cooperation. Japan always considers a loan 'support' while we are required to repay it," he said. The construction of a dam in North Sumatra with a Japanese loan was once considered a milestone in the relations between the two countries, he said. But Indonesia was still being crippled by the repayment rates on the project, Kalla said. "We lent lots of money from (the Japanese) but after more than 30 years, the project is nothing but a loss. I said I would buy it for US\$600 million and told (the Japanese businessmen) there to go home. My statement shocked (Finance Minister) Pak Boediono, but that's what it is."

Concerning the LNG issue, Kalla said Indonesia would do anything to fulfill its gas contracts with other countries. This had even led to the closure

of a fertilizer company in Aceh. However, after the contracts expired, it was Indonesia's right to prioritize its LNG supplies for domestic needs, he added. The government has announced a plan to cut LNG exports by 6 percent this year due to the lower production in aging gas fields in Aceh and East Kalimantan. This has concerned Japanese entrepreneurs, who are still awaiting a commitment from Indonesia about future supplies of LNG after contracts expire in 2010.

"What's wrong if we buy cheap products from China? What's wrong if we decide to prioritize domestic LNG needs after the gas contracts with other countries expire?" Kalla said. "Like other countries, we will do our best for the most benefit to our people. I realize it is a sensitive issue, but this is our stance and they should understand it."

Indonesia should no longer rely on developed countries to move forward, he said. "We are a bit unwise because we have become too dependent on other people's foreign consultants to set up road maps and evaluate development programs. We can do it on our own. We have plenty of smart people."

The vice president said he told Indonesian embassy staff overseas not to accept foreign loans with many conditions that would hinder development. "Let's be serious about how we handle this. We were rich with oil, wood and had huge amounts of foreign loans. But now our oil is

depleted and we are a net oil importer, our forests are destroyed, causing floods and landslides, while we have still to repay the loans. How could this be a good time for me to become the vice president?" Kalla said.

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