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Implementing the Indo-Pacific: Japan's region building initiatives

August 2019

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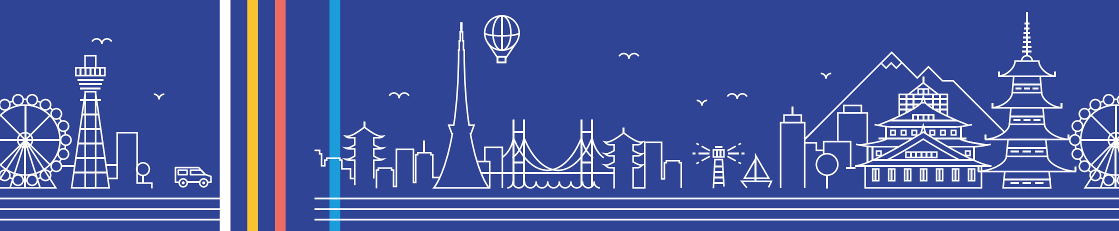
Perth USAsia Centre



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Introduction
By Kyle Springer

Japan is an active player in the development of the economic and political architecture of the Indo-Pacific region. Japan's economic diplomacy has been low profile but successful. Since 2000, Japan has completed infrastructure projects in Southeast Asia worth $230 billion. However, Japan's leadership in this area has been overshadowed in recent years by China's establishment of the Asian Infrastructure Investment Bank (AIIB) and its Belt and Road Initiative (BRI). The fact that Japanese firms still outspend their Chinese counterparts in infrastructure in Southeast Asia despite these developments is telling. On the trade front, Japan worked closely with partners like Australia to finish negotiating the Trans-Pacific Partnership (CPTPP) even after the U.S. exit from the agreement.

Meanwhile, Japan's ability to contribute to the security of the region is growing after it redefined Article 9 of its constitution. For Australia-Japan relations, the Indo-Pacific region has emerged as a key driver of bilateral cooperation. At the Perth USAsia Centre's Japan Symposium in March 2019, discussions focussed on how both could work with ASEAN states to shape the future of the region.

This Perth USAsia Centre Special Report examines Japan's role in the evolving Indo-Pacific regional order. This report brings together a diverse mix of authors with a variety of perspectives to offer analysis of the opportunities and challenges facing Japan's economic, security, and diplomatic role in the Indo-Pacific.

KEY QUESTIONS:

1. What are Japan's objectives with respect to regional governance in the Indo-Pacific, across the economic, security and architectural domains?
2. What are Japan's principal contributions to regional institutions and governance mechanisms in key issue areas?
3. How has its Indo-Pacific diplomacy with regard to these issues evolved in recent years, and what is driving these changes?
4. How and why are Japan's relationships with key diplomatic partners changing?
5. What are the implications of Japan's new approaches for the regional architecture?

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Acknowledgements:

The Editor would also like to thank the following individuals for their significant contributions to this volume:

- **Isabella Leunig**, Intern, Perth USAsia Centre for significant editorial assistance
- **Davina Kuntjoro**, Davina Designs for her efforts in design and layout of this publication

INPEX

Partner Foreword

INPEX was founded in the 1960s as a Japanese government-owned entity with a mandate to boost Japan's energy security. Today, INPEX is listed on the Tokyo Stock Exchange but remains Japan's flagship energy company.

We aim to become a top-ten energy company by 2040. We want to support global economic growth and social development as a stable supplier of energy to Japan and the region—and see our investment in Australia as key to that ambition.

INPEX is involved in over 70 projects across more than 20 countries, but it is Ichthys LNG, in Northern Australia, that is the crown jewel in our global portfolio. It represents:

- the largest discovery of liquid hydrocarbons in Australia in more than 50 years
- the largest semi-submersible platform in the world, Ichthys Explorer
- the largest ever Japanese overseas investment
- the longest subsea pipeline in the southern hemisphere

Ichthys is a practical but important example of the strength of the long-standing Australia-Japan partnership. For Australia, it demonstrates the economic benefits of collaboration with Japanese partners on projects of regional significance. For Japan, it exemplifies the importance of Australia in achieving its strategic and economic security goals.

The PerthUSAsia Centre's Special Report on Japan explores the role Japan plays in the development of the economic and political architecture of the Indo-Pacific, and the importance of an evolving regional order.

On 16 November 2018 at INPEX's first gas celebrations, Prime Minister Shinzo Abe reminded us of the contribution business can play through trade and investment to shape cooperative partnerships between countries in our regions:

"As a great nation of both the Pacific and Indian Oceans and a country that respects democracy, Australia is an invaluable partner of Japan in promoting peace, prosperity and the rule of law in a free and open Indo-Pacific. ...

The relationship between our countries has become one of true soul mates who share the great responsibility of protecting and fostering prosperity and order of the region and the world.

The commencement of Ichthys is not only timely, but extremely symbolic as I believe the project reflects an even stronger bond between Japan and Australia."

It is our hope that we can continue to play this part.

Hitoshi Okawa

INPEX, PRESIDENT DIRECTOR AUSTRALIA

CHAPTER 1.

An economic justification for Japan's free and open Indo-Pacific vision

Dr Tomoo Kikuchi, S. Rajaratnam School of International Studies, Nanyang Technological University

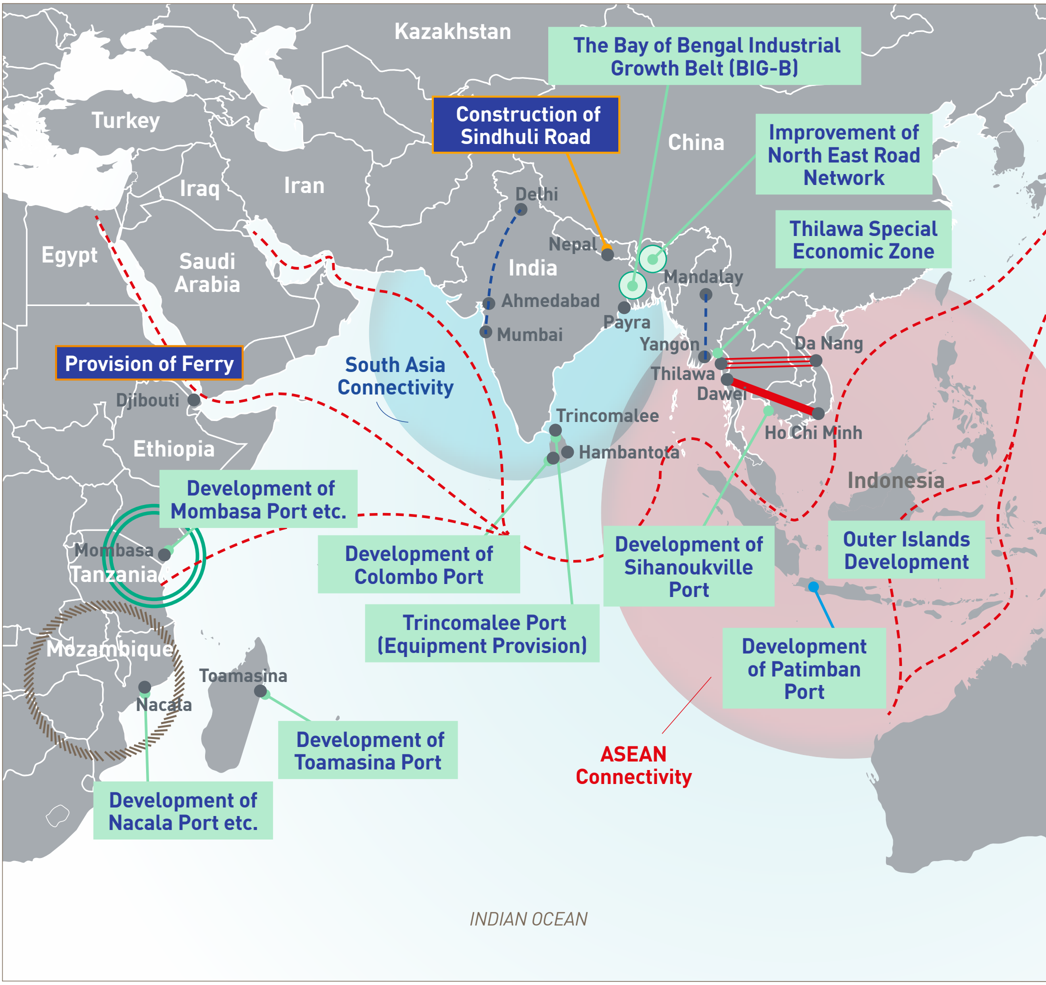
Introduction

This chapter seeks to find an economic justification for Japan's "Free and Open Indo-Pacific" (FOIP) vision. In August 2016, Prime Minister Abe announced his vision for FOIP in his keynote address at Tokyo International Conference on African Development (TICAD) VI held in Kenya[1]. FOIP, according to the Government of Japan, is a vision to combine "Two Continents" and "Two Oceans" to create dynamism for stability and prosperity of the international community[2]. By envisioning the above as an overarching, comprehensive concept, FOIP broadens the horizon of Japanese foreign policy. Three pillars to realize FOIP are 1) Promotion and establishment of the rule of law, freedom of navigation, free trade; 2) Pursuit of economic prosperity; and 3) Commitment to peace and stability.

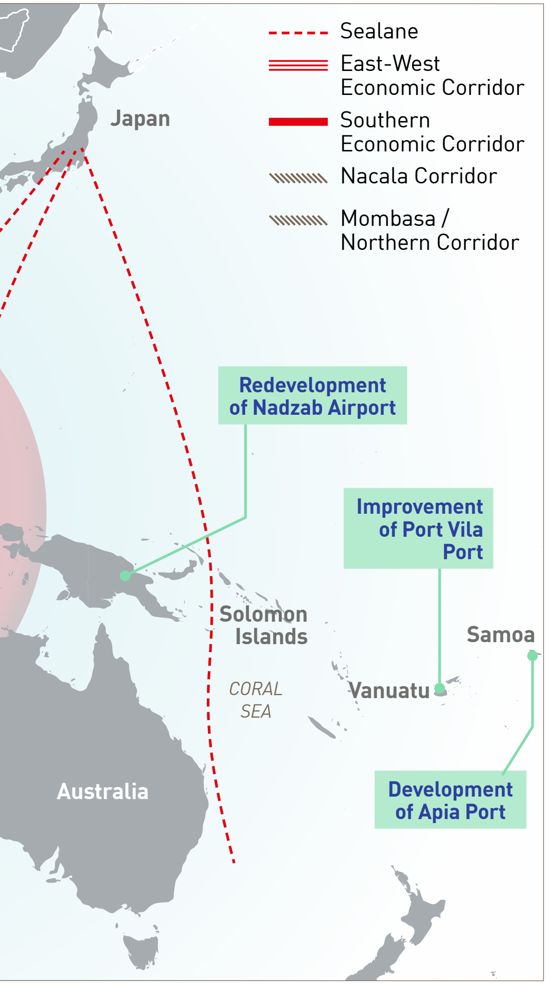
The Government of Japan does not draw clear boundaries of the Indo-Pacific region but emphasises that "Japan will cooperate with any country that supports this idea." In FOIP, Japan views the Association of Southeast Asian Nations (ASEAN) as "the hinge of the two oceans" connecting Asia and Africa.

To this end, the Government of Japan singles out connectivity initiatives in East Africa, South Asia and Southeast Asia including the Northern Corridor connecting East African countries; the Nacala Corridor in Mozambique; the Delhi-Mumbai Industrial Corridor in India; the Bay of Bengal Industrial Growth Belt in Bangladesh; the Yangon-Mandalay Railway in Myanmar; the East-West Economic Corridor connecting Vietnam, Laos and Myanmar; and Southern Economic Corridor connecting Vietnam and Cambodia[3].

Japan's Connectivity Initiative



It is well-known that Japan has consistently run a current account surplus since the 1980s. This means that the Japanese economy has saved more than it has invested domestically. The excess saving is invested in foreign assets (the current account equals the change in net foreign assets). Foreign investment has made Japan the world's largest creditor nation, a position that it has kept since 1990, with the net value of assets held by the government, businesses and individuals standing at USD 3 trillion at the end of 2017.



Completed
Ongoing

EAST-WEST
ECONOMIC CORRIDOR

- ↗ Construction of Hai Van Tunnel (Vietnam)
- ↗ Improvement of Da Nang Port (Vietnam)
- ↗ Construction of Second Mekong International Bridge (Laos)
- ↗ Improvement of National Road No.9 (Laos)
- ↗ Improvement of East-West Economic Corridor (Myanmar) etc.

etc.

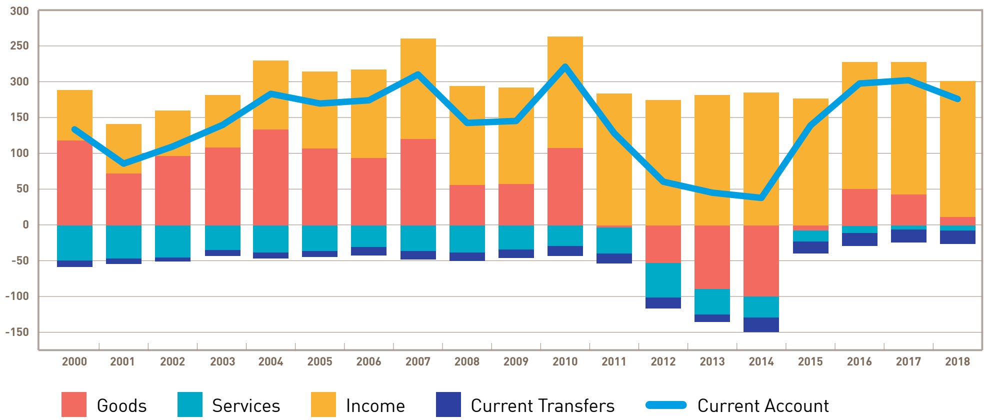
SOUTHERN
ECONOMIC CORRIDOR

- ↗ Construction of Neak Loeung Bridge (Cambodia)
- ↗ Construction of Cai Mep-Thi Vai International Port (Vietnam)
- ↗ Improvement of National Road No.1 (Cambodia)
- ↗ Improvement of National Road No.5 (Cambodia)

etc.

Less known is that there has been a fundamental shift in contributing factors to the current account surplus in Japan. Looking at the breakdown since 2000, we see that the balance of trade in goods turned negative in 2011 for the first time, meaning that exports became smaller than imports (Figure 1). The balance of trade in services is negative throughout the period from 2000 to 2018. On the other hand, net income has been positive and growing; earnings on foreign investments have been growing faster than payments made to foreign investors*. In fact, earnings on foreign investments have become the largest contributor to Japan's current account surplus after the 2008 global financial crisis. This shows a fundamental shift in Japan's international economic engagement: from a focus on trade to investment.

Figure 1. Japan's current account (USD, billions). *Source: JETRO*



It is widely acknowledged that Japan's Official Development Assistance (ODA) has focused on infrastructure projects and paved the way for Japanese foreign direct investment (FDI)[4]. The Organisation for Economic Co-operation and Development (OECD) defines ODA as flows to developing countries and multilateral institutions provided by official agencies, including state and local governments. ODA needs to be administered with the promotion of economic development as its main objective and needs to convey a grant element of at least 25 percent. In the 2019 budget, the Government of Japan referred to using ODA to substantiate its FOIP vision[5].

* Foreign investments are recorded in the capital account, but income from foreign investments is recorded in the current account.

This chapter first examines Japan's ODA by region to identify its geographic distribution from 1960 to 2017, the longest data set available on the OECD database. Second, we will examine Japan's other official flows (OOF) and foreign direct investment (FDI) by region, from 1996 to 2017, the longest data set available for all countries on the Japan External Trade Organisation's (JETRO) database. Third, we analyse Japan's success in linking ODA and OOF with FDI in Southeast Asia. Lastly, we identify the main challenges facing Japan's FOIP vision in the coming decades.

Japan's ODA

Japan in 1954, joined the Colombo Plan, the earliest intergovernmental effort for development assistance after World War II. Japan's ODA began the same year as reparations to Burma (now Myanmar), the Philippines, Indonesia, and Vietnam (then South Vietnam) and offering grants-in-aid to Laos, Cambodia, Malaysia, and Singapore[6]. Japan's reparations ended in 1976, and its ODA expanded with the growing Japanese economy. In 1989, Japan became the largest donor country in the world (since 2002, the second largest donor after the United States).

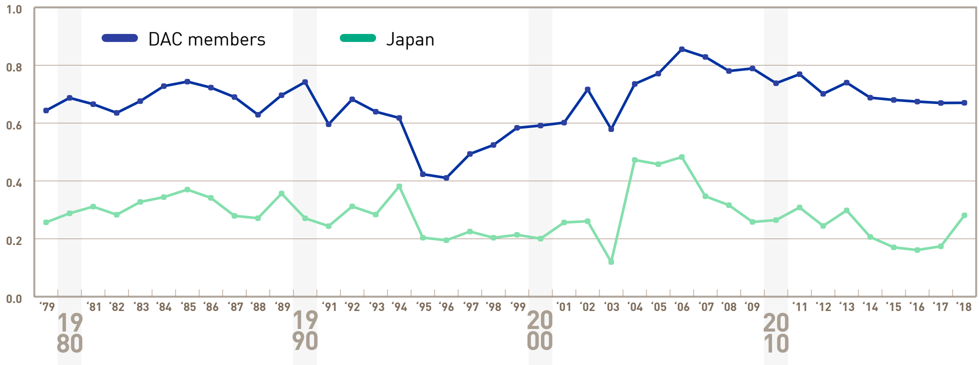
In 1992, the Cabinet of Japan established the ODA Charter in response to the post-Cold War world, clarifying its principles and strengthening its policies. Thereafter a shift has taken place from quantity to quality, strengthening cooperation with non-governmental organisations (NGOs) and the private sector. In 2003, the Cabinet revised the ODA Charter for the first time including new keywords such as "human security" and "peace building".

On February 10, 2015, the Cabinet established the Development Cooperation Charter in conjunction with the National Security Strategy that presented the policy of "Proactive Contribution to Peace" (decided by the Cabinet on December 17, 2013). The Development Cooperation Charter acknowledges that private sectors, local governments, and NGOs play important roles in attracting private flows to developing countries, and that Japan needs to address development challenges, not only through ODA, but also by mobilising various other resources[7]. Here, OOF and United Nations peacekeeping operations (PKOs) are explicitly mentioned to enhance synergetic effects for development.

What distinguishes Japan's ODA is its percentage of loans in total bilateral commitments (grants plus loans). The average percentage of grants from 1979 to 2017 has been 28 percent, far below the Development Assistance Committee (DAC) members' average of 68 percent (Figure 2)[8]. This shows Japan's preference for a more market-based approach for development assistance, although ODA loans still need a grant element of at least 25 percent.

Figure 2. Percentage of grants in ODA (total bilateral commitments)

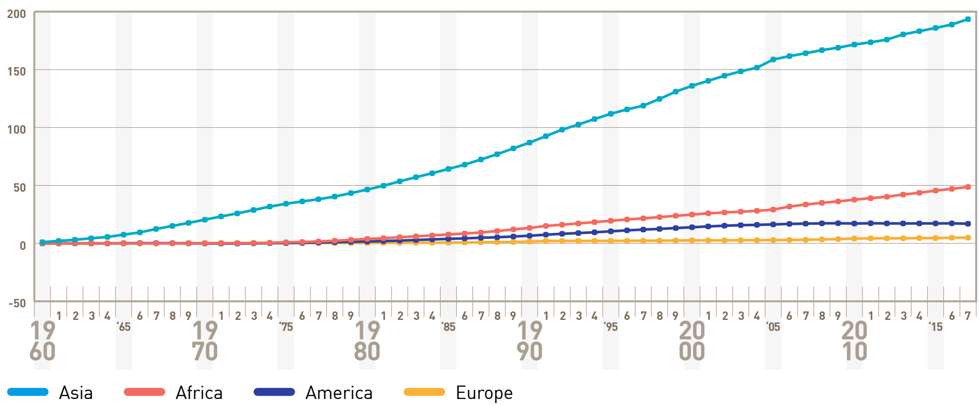
Source: OECD, Aid (ODA) tying status [DAC7b]



Globally, Japan's ODA has fluctuated around USD 7 trillion in the last three decades. By region, Asia has been the largest recipient of Japan's ODA from 1960 to 2017 (Figure 3). Africa has become the second largest recipient since the mid-1970s, after most African nations gained independence from European countries. America has become the third largest recipient from the mid-1970s but has largely "graduated" from Japan's ODA in the late 2000s, meaning that most countries have either stopped receiving ODA or loan repayments have become larger than new ODA. Today, roughly 60 percent of Japan's ODA goes to Asia and 20 percent to Africa.

Figure 3. Japan's cumulative ODA (USD, billions).

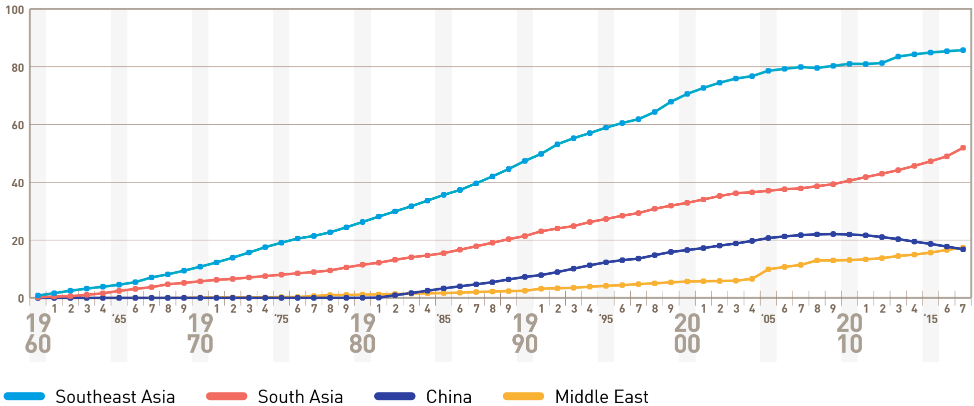
Source: OECD, Aid (ODA) disbursements to countries and regions (DAC2a).
Note: When loan repayments are higher than new ODA, net ODA is shown as a negative number.



Within Asia, Southeast Asia has been the largest recipient of Japan's ODA by regions although its volume has significantly fallen in recent years (Figure 4). Country-wise, China has been the largest recipient after its economic reform started in 1978. Since 2010, however, Japan's ODA to China is negative, indicating that China's loan repayments are higher than new ODA. Replacing Southeast Asia and China, South Asia (in particular, India and Bangladesh) has emerged as a top destination for Japan's ODA in recent years and the cumulative amount to the region now amounts to $52 billion, three times of that to China. This shows the increasing importance of South Asia for Japan and substantiates its focus on the Indo-Pacific region.

Figure 4. Japan's cumulative ODA (USD, billions).

Source: OECD, Aid (ODA) disbursements to countries and regions (DAC2a).



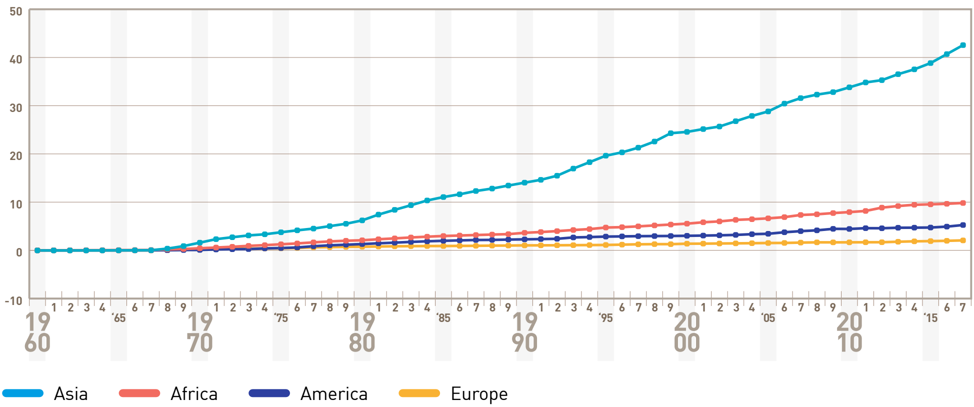
Within Africa, East Africa has been the largest recipient, followed by West Africa and North Africa. In comparison, Japan's ODA to Southern Africa and Central Africa has been small. East Africa received almost 40 percent and West Africa over 20 percent of Japan's ODA to Africa in 2017. Japan's continuous and growing ODA to East Africa shows why the region is a key for Japan's FOIP vision as we will elaborate below. We note, however, that Japan's cumulative ODA to East Africa is around USD 20 billion in 2017, which is still lower than USD 30 billion that Indonesia alone had received before it "graduated" in 2004.

Japan's OOF and foreign direct investment

We next look at OOF, which are official bilateral transactions that are either not concessional or are primarily trade facilitating in their character. OECD defines OOF as official sector transactions that do not meet ODA criteria including official direct export credits, the net acquisition of securities issued by multilateral development banks at market terms, subsidies to the private sector to soften its credits to developing countries, and funds in support of private investment. By region, nearly 70 percent of Japan's cumulative OOF, USD 426 billion, goes to Asia (Figure 5), which is more than twice Japan's cumulative ODA to Asia (USD 194 billion). In contrast, both ODA and OOF from Japan to Africa are around USD 50 billion cumulatively. We find that Japan's ODA ratio between Asia and Africa is 3.9, which is roughly equal to the population ratio between Asia (4.5 billion) and Africa (1.2 billion) in 2016. However, Japan's OOF ratio between Asia and Africa is 8.5 showing a strong bias of OOF to Asia.

Figure 5. Japan's cumulative OOF (USD, billions).

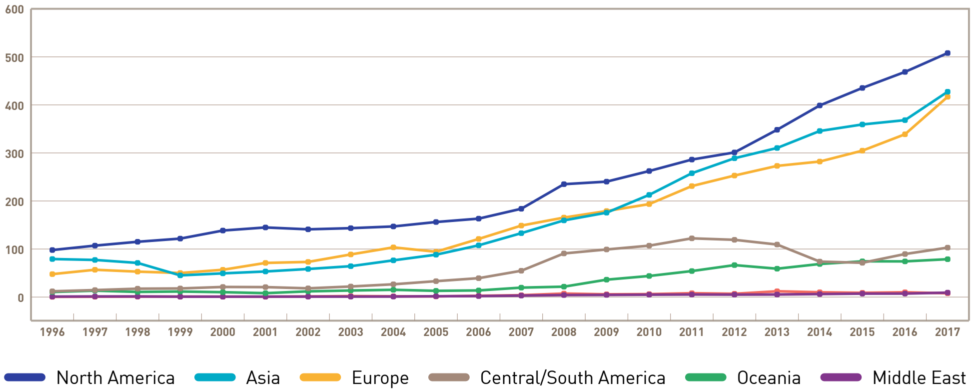
Source: OECD, Total official flows by country and region (ODA+OOF).



The high OOF from Japan to Asia reflects high market-transactions (i.e. trade) between Japan and Asia. In fact, the cumulative OOF to Asia is almost as high as Japanese FDI stock in Asia (including the Middle East, USD 417 billion). This indicates high complementarity between Japan's OOF and FDI in Asia.

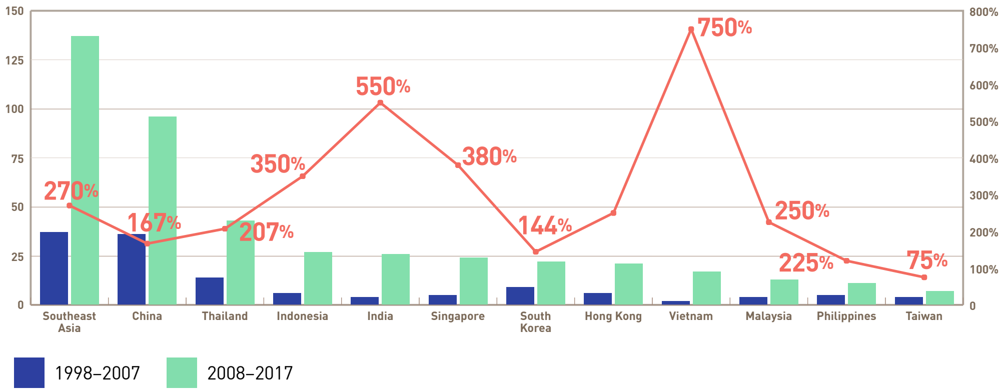
From 1996 to 2017, Japanese FDI stock has grown six times from USD 260 billion to USD 1.5 trillion globally. When we analyse the Indo-Pacific region, it is important to keep in mind that 60 percent of Japanese FDI stock is still in North America (33 percent) and Europe (27 percent) indicating that the FOIP vision is primarily Japan's overarching, comprehensive concept for developing countries (Figure 6). Japanese FDI stock in Asia declined after the Asian financial crisis in 1997, started to increase again from 1999, and surpassed that of Europe after the global financial crisis in 2008. In 2017, Asia accounted for 28 percent of Japanese global FDI stock. On the other end of the spectrum, the Middle East and Africa accounted only for 0.6 and 0.5 percent of Japanese FDI stock respectively in 2017. This shows that Japan's ODA and OOF in the Middle East and Africa have not yet led to Japanese FDI in the region.

Figure 6. Japanese FDI stock (USD, billions). *Source: JETRO*



To understand further the dynamics of Japanese FDI within Asia, we examine the cumulative Japanese FDI flows in two periods of 10 years each (Figure 7). The first 10 years from 1998 to 2007 represent a decade after the Asian financial crisis to the onset of the global financial crisis. The following 10 years from 2008 to 2017 represent a decade after the global financial crisis. First, we see there is an acceleration of Japanese FDI across countries in the last decade. Second, while Japanese FDI flows in China and in Southeast Asia were equally large in the first decade, Southeast Asia surpassed China by a wide margin in receiving Japanese FDI in the following decade.

Figure 7. Japanese FDI flows (USD, billions). *Source: JETRO*



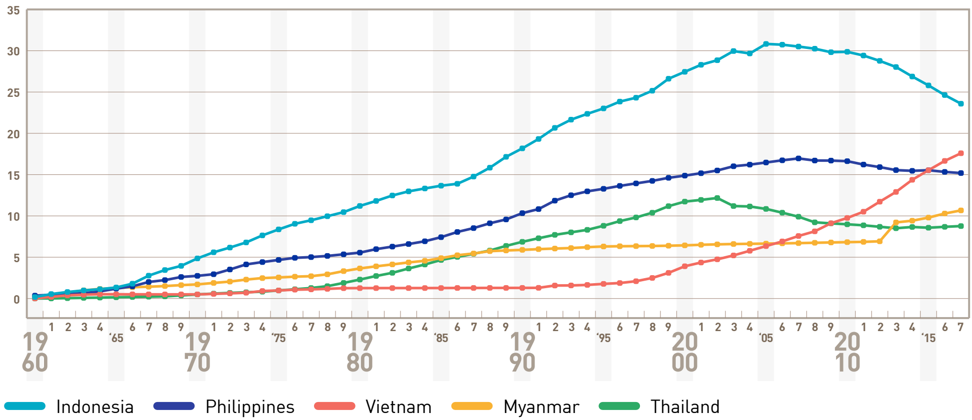
Singapore, as the regional financial hub, and Thailand, as the manufacturing hub, have received the largest volumes of FDI from Japan. Indonesia has been the third largest recipient while Malaysia, the Philippines, Vietnam have received almost the same amount. These six countries have, on average, received 99 percent of Japanese FDI to Southeast Asia so far. What stands out is that Japanese FDI in Vietnam has grown 750 percent in the last decade, compared to the preceding decade. It shows that Japanese supply chains are expanding in Southeast Asia. Outside the region, Japanese FDI to India has grown 550 percent in the last decade from the preceding decade.

Japan's success in Southeast Asia

We saw above that Japan's ODA to Southeast Asia has amounted to USD 86 billion from 1960 to 2017 (28 percent of Japan's ODA). Within Southeast Asia, Indonesia, the Philippines and Thailand have historically been the main recipients of Japan's ODA until they stopped being net recipients. Disbursements to Thailand turned negative for the first time in 2003, followed by Indonesia in 2004 and the Philippines in 2008 (Figure 8). Replacing them, Vietnam and Myanmar have become the main recipients of Japan's ODA in Southeast Asia.

Japan's relationship to Southeast Asia has evolved over time. Historically, Japan has supported the region in infrastructure and human resource development[9]. The wave of following Japanese business activities, however, caused a backlash culminating in anti-Japanese demonstrations in Indonesia and Thailand in 1974. To assuage growing regional concerns, Prime Minister Takeo Fukuda visited Manila in 1977 and

Figure 8. Japan's cumulative ODA (USD, billions)

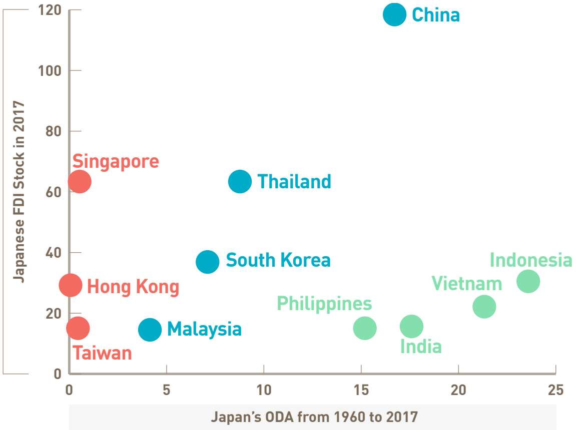


Source: OECD, Aid (ODA) disbursements to countries and regions (DAC2a).

articulated Japan's foreign policy, which became the blueprint of Japan's foreign policy towards Southeast Asia[10]. The so-called Fukuda doctrine promised that "(1) Japan is committed to peace, and rejects the role of a military power; (2) Japan will do its best to consolidate the relationship of mutual confidence and trust based on "heart-to-heart" understanding with the nations of Southeast Asia; and (3) Japan will cooperate positively with ASEAN while aiming at fostering a relationship based on mutual understanding with the countries of Indochina and will thus contribute to the building of peace and prosperity throughout Southeast Asia."[11] Since then, Japan has become ASEAN's "Dialogue Partner" and participates in regular summit meetings with its leaders. The diplomatic efforts have yielded fruits resulting in Southeast Asia attracting nearly half of Japanese FDI to Asia. In 2017, the region accounted for 13 percent of Japanese FDI stock globally or USD 205 billion.

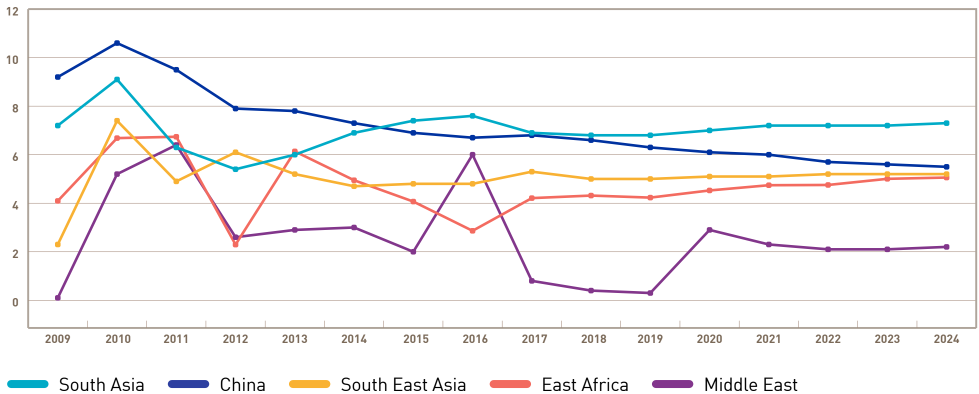
We can group countries in Asia into three categories according to their relationship to Japan (Figure 9). The first group consists of those who have received a relatively small amount of ODA from Japan and stopped receiving it relatively early such as Singapore, Hong Kong, and Taiwan. Singapore stopped receiving Japan's ODA in 1990, Taiwan in 1996, and Hong Kong in 1997. Singapore and Hong Kong have attracted high Japanese FDI inflows. The second group consists of countries who have received a sizable amount of ODA from Japan and attracted proportionally high Japanese FDI inflows such as Malaysia, South Korea, Thailand, and China. The third group consists of countries who have received a large amount of ODA from Japan but have not yet attracted Japanese FDI inflows in proportion to the ODA they have received such as the Philippines, Indonesia, Vietnam, and India. This group has the highest potential to attract Japanese FDI inflows in coming decades.

Figure 9. Japan's ODA from 1960 to 2017 and Japanese FDI stock in 2017 (USD, billions). *Source: JETRO and OECD*



Southeast Asia has shown remarkable resilience after the global financial crisis and has outperformed other emerging market and developing economies in real GDP growth, achieving an average growth of 5.1 percent up to 2018 (Figure 10). The IMF forecasts the growth trajectory to continue until 2024. In the same period, South Asia achieved the second highest average GDP growth rate of 7 percent after China's 7.9 percent. The IMF forecasts China's growth to slow down but South Asia's growth to keep its momentum.

Figure 10. Real GDP growth (annual percent change). From 2019 to 2024 are IMF forecasts.
Source: IMF.



Note: South Asia includes Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. Southeast Asia includes Brunei Darussalam, Cambodia, Indonesia, Lao P.D.R., Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste and Vietnam.

Free and Open Indo-Pacific

Being at the frontier of the dynamic Indo-Pacific region, Southeast Asia and South Asia are a focus of the FOIP vision. The shift of Japan's ODA from the "graduates" to India, Bangladesh, Vietnam, and Myanmar can be seen in the FOIP connectivity initiatives in South Asia and Southeast Asia. These include the Delhi-Mumbai Industrial Corridor in India, the Bay of Bengal Industrial Growth Belt in Bangladesh, the Yangon-Mandalay Railway in Myanmar, the East-West Economic Corridor connecting Vietnam, Laos and Myanmar, and the Southern Economic Corridor connecting Vietnam and Cambodia.

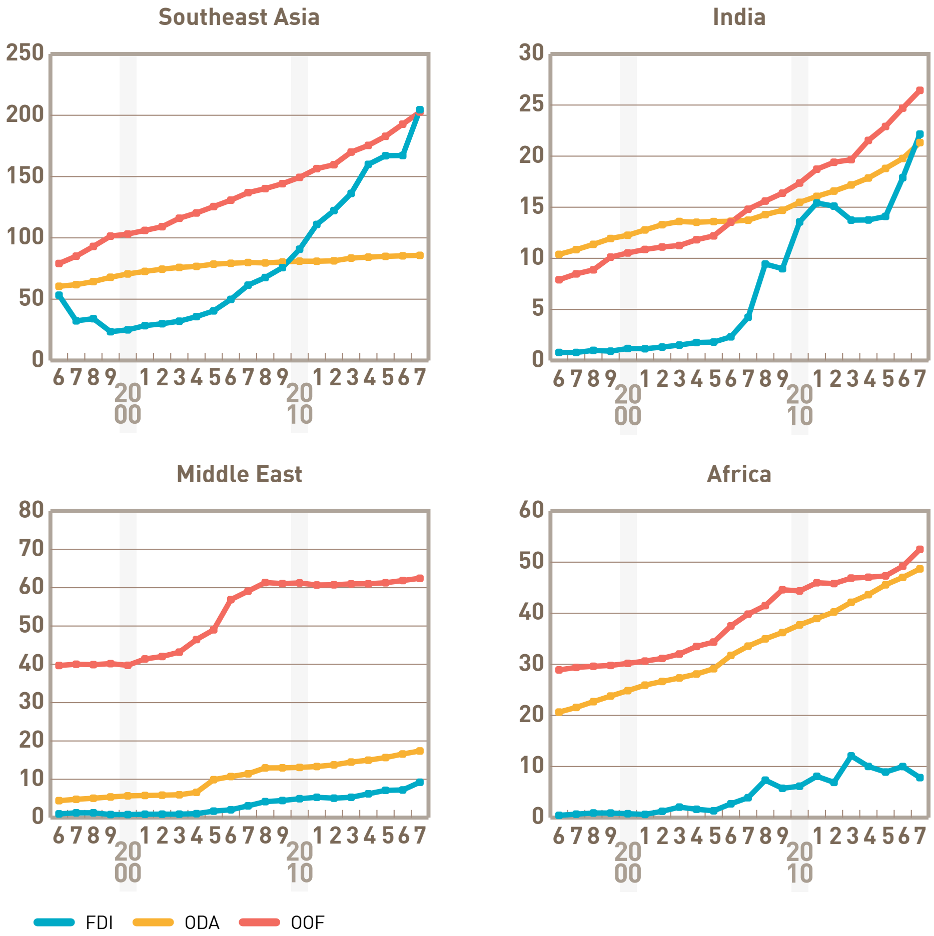
On the other hand, it is not immediately obvious why the Middle East and Africa, which account only for 0.6 and 0.5 percent respectively for Japanese FDI stock globally, is a focus of the FOIP vision too. The Middle East and Africa, after all, lagged behind in its average GDP growth rate, 2.6 and 3.9 percent respectively, in the past decade, which is below 5 percent of the emerging market and developing economies.

On the other hand, East Africa has performed better achieving average GDP growth rate of 4.6 percent. The IMF forecasts the GDP growth rate of East Africa to converge to that of the emerging market and developing economies by 2024. From 1960 to 2017, East Africa has 7 percent of Japan's ODA globally and 42 percent of Japan's ODA to Africa. The FOIP connectivity initiatives found in East Africa include the Northern Corridor connecting East African countries and the Nacala Corridor in Mozambique.

To realize the FOIP vision, the Government of Japan aims to "expand Southeast Asia's success to the Middle East and Africa." Despite Japan's substantial and continuous ODA, these two regions have not yet attracted sizable Japanese FDI. They have been attractive for Japanese businesses primarily as potential markets and a source of natural resources; Japan imports 86 percent of crude oil from the Middle East and Africa's population is expected to grow from 1.2 billion (16 percent of global population) to 2.5 billion (26 percent of global population) in 2050[12].

We can clearly see challenges of the FOIP vision in the Middle East and Africa by comparing the three types of Japanese financial flows we have examined above, namely, ODA, OOF and FDI (Figure 11). First, we can see that FDI has the lowest volume in the Middle East and Africa. This shows that FDI has barely taken off in those regions. Second, both OOF and FDI are rising in Southeast Asia and India and FDI has surpassed ODA and shows an accelerating upward trend to surpass OOF. This shows that FDI has gained momentum independently from OOF in Southeast Asia and India. Third, OOF are stagnant but there is a large gap between FDI and OOF in the Middle East and Africa. ODA is just above FDI in the Middle East and just below OOF in Africa. In the case of the Middle East, the relatively high OOF can be explained by the high volume of crude oil trade with Japan. However, the low FDI shows that there is little investment beyond the natural resource sector. In the case of Africa, the relatively high ODA has not contributed much to attracting FDI.

Figure 11. Japanese FDI stock, OOF (cumulative), and ODA (cumulative) (USD, billions).



Source: JETRO; OECD, Total official flows by country and region (ODA+OOF), Aid (ODA) disbursements to countries and regions (DAC2a).

We must acknowledge that the Middle East and Africa face unique development challenges. In the case of Africa, poverty and terrorism are issues of "human security" and "peace building" as stressed in Japan's ODA Charter. Therefore, the Development Cooperation Charter is linked to the National Security Strategy, which articulates the "Proactive Contribution to Peace." To this end, Japan should cooperate with any country that supports the rule of law, freedom of navigation, and free trade.

If Japan were to expand ASEAN's success in attracting Japanese FDI to the Middle East and Africa, the relationship must go beyond merely trading transportation equipment, machinery, and automobiles for natural resources. Government, business, and NGOs need to cooperate more to enhance synergetic effects for development. In Asia, we find that Japan's ODA and OOF have contributed to the region's growth and stability through developing infrastructure and human resources, facilitating trade and investment, and enhancing the business environment. This has laid the foundation for developing regional supply chains. The improved business environment has created a virtuous cycle, in which Japanese FDI has increased employment and consumption contributing to high economic growth, which in turn has attracted Japanese FDI. It is this virtuous cycle that needs to take place to realize Japan's FOIP vision.

Japan should leverage its experience in Southeast Asia to "provide nation-building support in the area of development as well as politics and governance, in a way that respects the ownership of African countries, and not by forcing on or intervening in them."[13] The FOIP vision will be put on test whether Japan can replicate the successful process in Southeast Asia, from nation-building support through bilateral development assistance to private investment in the Middle East and East Africa. I propose the Government of Japan to announce a version of the Fukuda Doctrine for Africa to elevate Japan-Africa relationship in cooperation with the African Union in TICAD 7 to be held in Yokohama on August 28-30, 2019.

CHAPTER 2.

Dr Kei Koga
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Japan and Southeast Asia in the Indo-Pacific

Southeast Asia has been geo-strategically important for Japan, and ever more so in advent of Japan's "Free and Open Indo-Pacific" (FOIP) concept, which Prime Minister Shinzo Abe launched at TICAD VI (the Sixth Tokyo International Conference on African Development) in August 2016. The FOIP emphasized the importance of fundamental values, such as freedom, the rule of law, and the market economy; the economic development and the connectivity between African and Asian continents; and the confluence of the Indian Ocean and the Pacific Ocean[14]. There are other examples in the past of other speeches and actions Japanese leaders and their governments have undertaken that focus on what we now call the Indo-Pacific, but this 2016 speech has become a point of reference as the origin of the current FOIP strategy.

That said, Japan's concept of FOIP is evolutionary. While its geographical scope, focusing on the Indian and Pacific Oceans, remains constant, its emphasis has changed over time, by explicitly including areas such as the Pacific Islands[15]. Even the name changed from the "Free and Open Indo-Pacific Strategy" (FOIPS) to the "Free and Open Indo-Pacific" in the second half of 2018 due to political concerns raised by some ASEAN member states[16]. The actions that the FOIP focuses on were not necessarily clear at the beginning, but they now more clearly fit into the context of the regional strategic environment as many official documents stated. In particular, the freedom of navigation and overflight, connectivity through quality infrastructure development, and rule of law enhanced by maritime law enforcement capacity building.

Among them, one of the most important changes in Japan's FOIP concept was the inclusion of ASEAN. Surprisingly, the notion of how ASEAN geopolitically fits within the concept was absent despite Southeast Asia's strategic location at the geographical centre of the Indo-Pacific. Japan's 'Diplomatic Bluebook 2017' discussed FOIP, but it did not touch upon ASEAN's role[17]. It was only around 2018 that concepts such as ASEAN unity and centrality have come out as some of the most important principles that Japan endorsed and began to reconcile with its FOIP concept[18]. This poses the question: how does Japan situate Southeast Asia and ASEAN in its current FOIP concept or strategy?

This chapter first discusses Japan's objectives in the Indo-Pacific region and its policy toward regional institutions, including ASEAN and the quadrilateral cooperative framework between Japan, the United States, Australia, and India, known as the "Quad." Second, the chapter analyses the evolutionary process of FOIP's strategic focus and its causes, and examines Japan's relationship with regional partners, including the ASEAN member states. Third, the chapter will discuss Japan's current plan of cooperative actions with ASEAN/ Southeast Asian states with regard to the Indo-Pacific region. Finally, it draws out the implications of Japan's approaches to Indo-Pacific regional architecture.

Objectives of Japan's FOIP

The primary objective of Japan's FOIP is to maintain the existing rules-based order in Asia, which is currently led by the United States. This order mainly consists of a balance of power in favour of the United States, U.S.-led global institutions, and liberal democratic values. This U.S.-led order designed and constructed in the post-World War II era has enabled Japan to achieve rapid economic development. In fact, Japan followed the so-called "Yoshida Doctrine", by which Prime Minister Shigeru Yoshida formulated a post-war strategy that Japan kept a low profile, concentrating its resources on economic modernisation and growth rather than strengthening its military and its strategic position. This became possible largely because the U.S. military presence in Northeast Asia and its extended nuclear deterrence have long contributed to the strategic stability in East Asia and guaranteed Japan's security. Japan supported this U.S. military presence by providing bases in Japan in order to deter regional adversaries (e.g. the Soviet Union during the Cold War) and prevent rising powers from becoming a regional hegemon (e.g. China in the post-Cold War). The alliance also reassured others in the region, including Southeast Asian states, by keeping Japan's post-war behaviour and remilitarisation in check.

Nevertheless, this order has faced an acute emerging challenge, particularly due to the shift in the balance of power caused by China's economic and strategic rise starting in the 2000s. China has strengthened its political and economic influence in developing states in Southeast Asia and beyond, and Japan acknowledged that the United States, although it will likely remain the most powerful state in the world in the foreseeable future, is now in a relative decline vis-à-vis not only China but also other rising regional powers such as India. In this changing strategic environment, Japan attempted to enhance its alliance with the United States by relaxing its own political and legal constraints on its defence capabilities, which derived from Japan's constitution, particularly Article 9[19].

Despite these efforts, China's influence has become more visible since the mid-2010s. Particularly before the announcement of Japan's FOIP, two incidents have become salient. One is the strategic narrative of the Belt and Road Initiative (BRI). In Southeast Asia and beyond, BRI was welcomed as a much-needed economic development opportunity for those states which were suffering from a gap in physical infrastructure. This trend became a certain concern for Japan as the standard of the BRI infrastructure investment did not meet internationally recognised standards, such as environmental protection and labour rights. BRI has also come under criticism as a duplicitous tool for expanding China's influence and saddling smaller countries with unsustainable amounts of debt. The other is China's rejection of the 2016 South China Sea Arbitration Tribunal's Award. Although China expressed its intention to reject the Tribunal's decision well before the Award was announced in July 2016, the issue was that the international community, including ASEAN, did not have a diplomatic, legal, economic, or military tool to enforce the ruling. It was in this context that Abe announced a new strategy—FOIPS (now FOIP).

Specifically, Japan now pursues three main principles under its FOIP concept:

1. Promotion and establishment of the rule of law, freedom of navigation, free trade, etc.;
2. Pursuit of economic prosperity; and
3. Commitment to peace and stability[20].

Apparently, Japan's power projection capabilities have been limited; however, in order to uphold the existing international norms and rules, Japan has made diplomatic efforts and used indirect methods to inform a wider international community of the danger of failing to follow the existing international rules and norms and empower other states' capabilities, such as the capacity-building efforts. For example, Japan uses international conferences, such as the G-7, to ensure consensus on the importance of international laws, including peaceful resolution of territorial disputes and non-unilateral actions in the South China Sea[21].

In addition, Japan attempted to strengthen diplomatic, economic, and security ties with regional states and organisations, particularly the United States, Australia, India, and ASEAN. Since 2017, the Quad states have frequently held senior official meetings and discussed the Indo-Pacific strategic situation. They agreed with the three basic principles that Japan raised while emphasizing the importance of ASEAN unity and centrality in the region[22]. On the other hand, other mini-lateral frameworks began to conduct wider strategic cooperation. For instance, the Joint Statement of Japan-Australia-the United States Trilateral Partnership in November 2018 indicated further cooperation on physical infrastructure, energy infrastructure, and digital connectivity in the region[23].

Further, Japan has concentrated its capacity-building programs to enhance maritime-law enforcement capabilities in Southeast Asian states. Japan provided support to strengthen the law enforcement and defence capabilities of the Philippines and Vietnam, which face increasing pressure from China on the South China Sea, by providing important assets such as coast guard ships and radars[24]. Japan also issued the "Vientiane Vision" in 2016, aiming to enhance Japan-ASEAN defence cooperation for the purpose of protecting international rules and norms, facilitating maritime security, and managing complex security issues[25].

In this context, Japan's FOIP strategy is largely directed toward the challenges to the existing international order posed by China and can be summarized as "US in, China down, and Australia/India/ASEAN up":

- To keep the United States engaged in the region;
- To constrain China's challenge against the existing international order and shape China's behaviour to follow the international rules and norms; and
- To coordinate its strategy with Australia, India, and the ASEAN member states to cooperatively and visibly consolidate the current international order[26].

31st ASEAN Summit

ASEAN, Japan, and Evolving Concepts of the Indo-Pacific

For its part, ASEAN's main objectives as a regional organisation include the maintenance of regional autonomy and independence and was initially cautious about Japan's FOIP strategy. This is because the strategy (1) was perceived as a potential containment strategy against China, (2) lacked a clear role for ASEAN, and (3) seemed to be based on the Quad framework. Singapore's Foreign Minister Vivian Balakrishnan's speech in May 2018 clearly illustrates these concerns. While Balakrishnan pointed out that the FOIP concept was rudimentary, he stated that Singapore would not join the Quad; ASEAN would need to be central in the Indo-Pacific, and ASEAN needed to maintain relevance in great power competitions[27].

To be sure, this was not ASEAN's consensual view on the FOIP. While many did not explicitly express their posture, Cambodia, Vietnam, and Thailand supported Japan's FOIP concept, focusing on its infrastructure investment efforts, by early 2018[28]. Moreover, given different conceptual frameworks that Japan, the United States, Australia, and India had for the Indo-Pacific, it was not clear to which FOIP concept Balakrishnan was referring. Nevertheless, given ASEAN's consensus-building decision-making process, Singapore's position toward FOIP became a certain reference point to understand ASEAN's cautious diplomatic posture.

It is also true that Japan's FOIP concept does not constitute a containment strategy against China, which would aim to block China's influence in the Indo-Pacific region. While some observers consider it as such, the Japanese government has explained FOIP as a non-exclusive concept. In the 2017 US-Japan summit, Abe clearly expressed that Japan and the United States would "cooperate with any country that shares this vision of a free and open Indo-Pacific."[29] Additionally, despite Japan's behaviour mentioned above to counter China's assertive behaviour in particular domains, including the maritime sphere, Japan has continuously engaged with China as illustrated in the 2018 Japan-China summits, discussing potential bilateral cooperation in infrastructure development, one of the FOIP objectives. In this sense, it is similar to a traditional "engagement" strategy—engaging and shaping the target state's behaviour.

Despite Japan's reassurance, ASEAN remains cautious about its FOIP concept, partly due to two factors. First, Japan has maintained a certain degree of vagueness vis-à-vis FOIP. This is because Japan has been conducting "tactical hedging." Tactical hedging refers to "a declaratory policy doctrine that aims to utilize temporal strategic ambiguity to understand and determine whether any long-term strategy shift is necessary or possible."[30] In the midst of a shifting balance of power, the state has an advantage if it can first understand the changing dynamics of the strategic environment surrounding it and then formulate its policy accordingly. However, if the "wait-and-see posture" is not sufficient to examine such environmental changes, the state would issue a vague declaratory policy to elicit reactions from other states, including allies, partners, and adversaries, which can reveal other states' strategic thinking and plans. In response, the state can change the meaning of doctrine and shape its own policies. If the FOIP concept falls into this category of a declaratory policy, it is deliberately vague and evolutionary on purpose[31]. While this provides ASEAN with an opportunity to shape Japan's FOIP, nevertheless the outcome of the doctrine remains uncertain.

Second, the United States, Japan's foremost ally in the Indo-Pacific, has begun to take a tougher approach toward China. The 2017 National Security Strategy, the 2018 National Defense Strategy, and the 2019 Indo-Pacific Strategy Report all indicate China as a "revisionist" state that challenges the existing rules-based international order[32]. To date, the Trump administration has clearly engaged the strategic competition against China in areas such as the maritime, trade, digital infrastructure, infrastructure investment, and cyber domains. Since policy coordination between the United States and Japan is tightly institutionalized, and since Abe has consistently advocated a stronger Japan-US alliance, ASEAN needs to consider the possibility that with the United States, Japan quickly takes a tougher diplomatic posture against China.

Given this, ASEAN has begun to discuss its own concept of the Indo-Pacific, the "Indo-Pacific Outlook."[33] Indonesia's Foreign Minister Retno Marsudi took the initiative in May 2018, at the Global Dialogue organized by the Centre for Strategic and International Studies (CSIS), Jakarta, to facilitate discussions about the Indo-Pacific as a cooperative concept. Its principles include "open, transparent and inclusive, promoting the habit of dialogue, promoting cooperation and friendship, and upholding international law" by focusing ASEAN's role on nurturing friendly environment through dialogues, tackling non-traditional security issues, and facilitating an open and fair economy[34]. In fact, Indonesia was the first ASEAN member state to propose an idea regarding ASEAN's role in the Indo-Pacific. The former Indonesian Foreign Minister Marty Natalegawa discussed its Indo-Pacific concept as early as May 2013. As the power shift in the Indo-Pacific region occurs, Natalegawa believed that promotion of trust-building, peaceful resolution of territorial disputes, and a "dynamic equilibrium," were necessary. Natalegawa proposed the idea to extend ASEAN's "Treaty of Amity and Cooperation in Southeast Asia" to the Indo-Pacific region[35].

However, Indonesia's proposals have faced difficulty in reaching a consensus among the ASEAN member states. Natalegawa's proposal was only noted in the ASEAN Foreign Ministers and Summit from 2013 to 2014, and it was not adopted as ASEAN's plan of action[36]. Likewise, Marsudi's proposal has faced diverging views among the ASEAN member states. Subsequently, ASEAN agreed to further discuss the concept and set up the Senior Official Meeting (SOM) for this purpose, and the members have agreed with the existing principles, such as "inclusiveness," "openness," "transparency," "rules-based," and "ASEAN centrality."[37] In addition, emphasizing the importance of developing the "habit of dialogue," Indonesia agreed to convene the "High-Level Dialogue on Indo-Pacific Cooperation" in March 2019 by inviting the member states of the East Asia Summit to seek conceptual synergies of the Indo-Pacific and discuss "concrete collaboration."[38] However, it is not clear the extent to which such principles can translate into new actions for Indo-Pacific cooperation. In fact, the newly created "ASEAN Outlook on the Indo-Pacific" (AOIP) in June 2019 reiterates ASEAN's principles and its political proclivity to prevent inter-state rivalry, particularly great powers, from dictating regional politics and the discussion on concrete collaborative actions remain to be seen[39].

Furthermore, ASEAN faces internal and external challenges in this conceptualisation process. Internally, each ASEAN member state has different interests and perspectives towards the Indo-Pacific, which makes it difficult for ASEAN to expand its roles beyond East Asia. Of course, ASEAN's geographical scope of the Indo-Pacific is still unclear. The AOIP only refers to its geographic scope "not as contiguous territorial spaces but as a closely integrated and interconnected region"[40]. However, if the scope covers the entire Indian Ocean and Pacific Ocean, ASEAN's limited political and material capability can be easily over-stretched, weakening the principle of the ASEAN Centrality and diluting its own diplomatic strength. On the other hand, if ASEAN defines the Indo-Pacific narrowly, little difference exists between a new concept and the current engagement of ASEAN. Externally, as the pressure of major powers rivalry between the United States and China increases, it will become more difficult to facilitate regional cooperation through emphasizing the habit of dialogue. The intensification of these strategic rivalries also pose threats to ASEAN unity since each member state has a different diplomatic stance towards China and the U.S.

Given this, if ASEAN's cooperative concept of the Indo-Pacific Outlook fails, its second-best strategic option is to neutralize any Indo-Pacific concepts that exacerbates great power rivalry. To this end, ASEAN would likely engage further with regional powers other than China and the United States, which facilitates the Indo-Pacific concept, namely Japan, Australia, and India. As such, it attempts to prevent major powers from creating a concrete regional bloc against China.

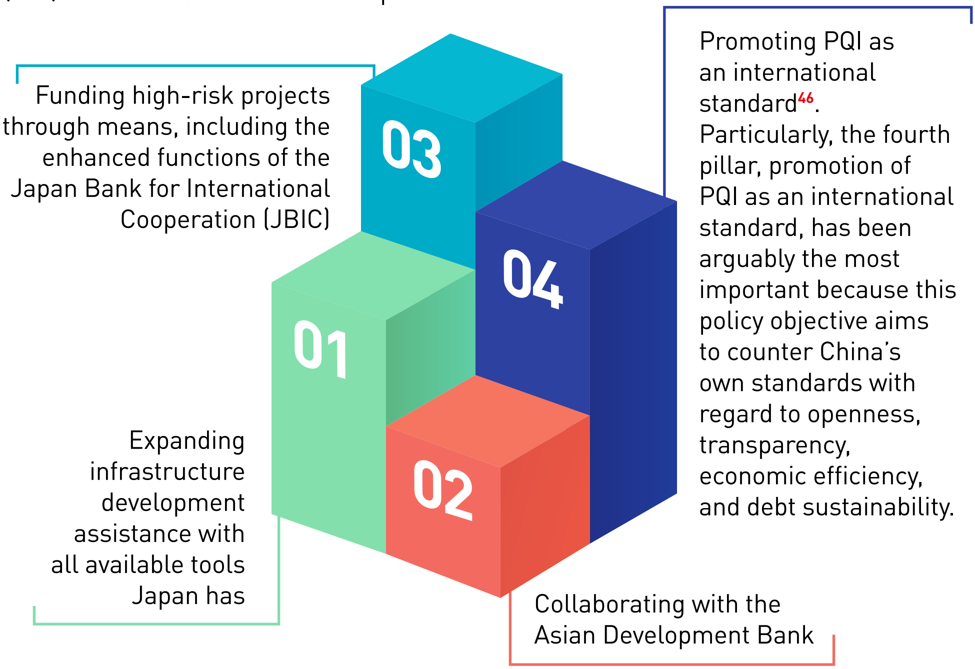
The Opportunities and Challenges for Japan and ASEAN over the Indo-Pacific

While the conceptualisation process is ongoing, collaborative actions between Japan and ASEAN have continued. Indeed, Kentaro Sonoura, Special Advisor to Prime Minister Abe, stated that Japan would make the year 2019 "a year of action to realize a free and open Indo-Pacific."[41] Specifically, Japan's FOIP focused on three elements—peace and security, connectivity, and rule of law, which can be illustrated by cooperation over maritime capacity building, physical and digital infrastructure development, and fundamental rights. To pursue Japan-ASEAN cooperation in these areas, there are both opportunities and challenges.

Japan's maritime security cooperation with the ASEAN member states has been steadily institutionalized. While the legal, political, and military limitations still exist that Japan's defence capacity building programs need to be separate from its official development program, Japan has continued to enhance its coast guard and naval capacity building. For maritime law enforcement, Japan in 2013 provided ten coastguard vessels to the Philippines, including two Parola-class patrol boats, while it promised to provide Vietnam six new patrol vessels in 2017, in addition to providing older Japanese vessels in the past[42]. Furthermore, the Japanese Coast Guard Ship "Echigo" made a port call at Davao, Philippines and Da Nang, Vietnam, in 2017, and participated in joint training near the Port of Manila in 2018 for the purpose of surveillance of the sea-lanes of communication[43]. Confidence-building and educational exchanges have also been enhanced, such as the Maritime Safety and Security Policy Program in the National Graduate Institute for Policy Studies (GRIPS), Japan[44]. In fact, maritime ASEAN member states, like Vietnam, the Philippines and Indonesia, are the most important states to enhance maritime law enforcement capabilities for not only non-traditional security purposes, such as anti-piracy missions, but also countering paramilitary and coast guard advancements made by other states, particularly China.

For capacity building, the Japanese Self-Defense Force (SDF) has increased the number of programs in Southeast Asia since 2016. According to the Ministry of Defense, the total number of capacity building programs from 2012 to June 2019 is 145, but two-thirds have been conducted in the ASEAN member states[45]. Among them, Japan provides maritime security-related seminars, such as humanitarian assistance/ disaster relief (HADR), underwater medicine, aviation safety, and international maritime law. Also, in order to facilitate transferring Japan's defence assets or skills more smoothly, Japan has several bilateral agreements with Southeast Asian states, such as a defence agreement with the Philippines in 2016, a defence memorandum of understanding with Malaysia in 2018, and a defence cooperation and exchange memorandum between Japan and Vietnam in 2019. Japan's defence cooperation is still constitutionally constrained, but Japan and Southeast Asian states attempt to find ways of enhancing cooperation by institutionalising defence dialogues.

Japan is historically active in providing infrastructure development assistance to Southeast Asia. Since 2015, Japan launched the Partnership for Quality Infrastructure (PQI) in 2015. PQI consists of four pillars:



These recent active development policies were triggered by China's strong presence in large infrastructure development assistance through the Belt and Road Initiative (BRI). A case in point is China's successful bid to build Indonesia's High-Speed Rail between Jakarta and Bandung in 2015. Through PQI, Japan has focused on not only infrastructure itself, but infrastructure sustainability, such as human development in Myanmar and Vietnam; peace-building in Laos, Thailand, Myanmar; and the Philippines, and environmental protection in Myanmar, the Philippines, and Indonesia[47]. To date, PQI has put Japan's investment in infrastructure on an upward trend and has contributed to positive views of Japanese investment overall. Meanwhile, Southeast Asian states have become more cautious about China's investment due to its increasingly negative image stemming from "debt-trap" diplomacy, such as Sri Lanka's Hambantota port, and problems with poorly managed projects like the delayed implementation of the Jakarta-Bandung High-Speed Rail[48]. China has also begun to hold dialogues with Japan to explore cooperation on infrastructure projects in a third country, which would lay a foundation for future healthy business competition in infrastructure development[49].

More recently, digital infrastructure has become a centre of international attention in the context of the emergence of Industry 4.0. This field has yet to have concrete rules and norms, and transformation into automated, networked socio-economies supported by digital infrastructure, including big data, artificial intelligence, and 5G, would yield the tremendous economic and technological opportunities. Further, although it is not yet clear the degree to which these technological and economic benefits would empower the states, given that the international and domestic rules and norms are created by the states, they are the primary actors in this field[50]. Japan and Southeast Asian states thus aim to collaborate together through the "ASEAN-Japan Fourth Industrial Revolution Initiative" which aims to facilitate private sector-led innovation, human development, and e-commerce[51]. However, the current fierce digital rivalry between the United States and China could hinder Japan-ASEAN cooperation. The United States is seriously concerned about the Huawei 5G technology, through which information can be monitored by the Chinese government. The U.S. has explicitly taken a tougher political stance against Chinese technologies. Take for instance the *Executive Order on Securing Information and Communications Technology and Services Supply Chain* on May 15, 2019, which prohibits the private sector from acquiring foreign telecom devices or services if it presents risks to U.S. national security[52]. This would potentially force Japan and the ASEAN member states into an either/or choice between the U.S. or China in the digital field, as the U.S. would potentially prohibit doing business with those companies that acquire or use Chinese technologies[53]. As such, digital infrastructure looks likely to become one of the emerging areas of strategic competitions between the United States and China, which has serious implications for Japan-ASEAN relations.

Chinese president Xi Jinping (R) welcomes Japanese Prime Minister Shinzo Abe (L) in G20 summit in Hangzhou, 4 September 2016

The other pillar of Japan's FOIP is to facilitate rule of law, but it is unclear whether Japan can apply this to both the international and domestic arenas. Considering FOIP includes the term, "free", and that Japan's diplomatic principles have long included democratisation and human rights, Japan's "rule of law" would apply to the domestic arena. In fact, the earlier statement made by Japanese government officials touched upon the importance of democratisation. Nevertheless, this emphasis gradually disappeared within the conceptual framework of the FOIP. In fact, the current three pillars do not indicate democratic values, human rights, or democratisation, are a part of the strategy and the rule of law focuses on international application[54].

This does not mean that Japan completely ignores such values. For example, before and after the 2018 Cambodian general elections, Japan continuously raised the issue of the democratic process of elections[55]. Moreover, Japan held the 9th Japan-Cambodia Human Rights Dialogue in May 2018, received Cambodian judicial officials to inform Japan's democratic process in February 2019, and continuously supports Cambodia's infrastructure development without disruption. Japan's softer approach to facilitate democratisation in Southeast Asia and beyond has been traditionally different from those of the Western states, including the United States, which would likely impose negative sanctions if they observe the violation of those fundamental rights. This is because Japan tends to be sensitive with regard to the non-interference principle. However, if FOIP were to counter China's international practices that put little emphasis on the fundamental rights, which challenges the existing international order, on the contrary, Japan would be propelled to emphasize the importance of these issues, including human rights and democratisation, taking a tougher stance with the United States and other Western allies and partners. If this becomes the case, ASEAN would raise its concerns with Japan. Thus, fundamental values could become a diverging strategic point for Japan.

In sum, most of Japan's actions to facilitate FOIP are not necessarily new. Rather, FOIP as a concept has repackaged Japan continuous activities in Southeast Asia. The difference is that, through the FOIP concept, Japan enhanced the existing programs in maritime security and infrastructure development. Japan has provided its FOIP programs with a larger budget and, the FOIP framework lends strategic meaning to each of Japan's activities in Southeast Asia. This is important because the concept clarifies and signals Japan's broader objectives within the changing strategic environment. On the other hand, the challenge that Japan likely faces are the issues of fundamental human rights and digital infrastructure in the region. How Japan handles these issues is likely to shape the direction of Southeast Asia, either dividing the region or bridging the strategic needs of the region with those of Japan's Western partners.

The Future of Japan-ASEAN Cooperation in the Indo-Pacific

Japan, despite its earlier neglect of Southeast Asia in the FOIP concept, Japan now places ASEAN as the most important of FOIP factors. While ASEAN is still cautious about Japan's FOIP concept, this change makes it easier for ASEAN to cooperate under its name. Nevertheless, as the US-China rivalry intensifies, the concept itself would become a political obstacle because it can entrap those supporters into one camp despite their political intentions.

Of course, actions are important, as action reveals the credibility, substance, and commitment of the FOIP concept. However, the concept itself should not be taken lightly. Each state's strategic concept is imperative in determining its national budget and spending on strategic projects, its defence posture, and expectations for the behaviour of other states[56]. Without taking it seriously and clarifying its meaning, the FOIP concept would end up producing unintended consequences in the region. In this sense, the strategic concept is deeply consequential.

In this sense, the bilateral discussion on the FOIP/Indo-Pacific concept between Japan and ASEAN through closer communication becomes essential to further enhance their cooperation and avoid miscommunication and misunderstanding in the future.

CHAPTER 3.

Accommodating the Past, Present, and Future: Japanese aid and investment in Indonesia

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Introduction

Over the past six decades, trust, investment, and a spirit of partnership have enabled Japan and Indonesia to avoid colonial and post-war animosity and deepen their bilateral relations across economic and political spheres. Japanese investment realisation reached US$ 4.95 billion in 2018 with hundreds of joint ventures and partnerships established across a range of industries[57]. Japan has also played significant role to the country's infrastructure development, contributing to 20 percent of the toll road construction around greater Jakarta, port development, power plants, and the development of five airports, including Bali, Surabaya, Jakarta, Palembang, and Kertajati International Airport, as well as Jakarta's long-awaited first Mass Rapid Transit (MRT)[58]. Aside from contributing to the regional economic growth, other distinctive Japanese infrastructure projects include three large-scale multipurpose dams (known as 3K) – Karangkates, Kali Konto, and Riam Kanan – and the Brantas River Basin Development project. These projects have also secured full-scale technology transfer mechanisms, knowledge on the water resource management, and trust developed between Japanese professionals, the Indonesian government, and the public over the past forty years[59]. During the 60th anniversary of Japan-Indonesia relations in 2018, the two countries deemed the quality of their strategic partnership as 'sahabat sejati' or 'kokorono-tomo' meaning 'true friend'[60].

That Japan and Indonesia would reach such robust a partnership would have been unthinkable 60 years ago. Sueo Sudo (1992) and Lam Peng Er (2012) argue that the antecedent to the strategic partnership was former Prime Minister Takeo Fukuda's 1977 'Fukuda Doctrine', which constructed a model of relations with Southeast Asian countries that simultaneously advanced 'heart-to-heart' relations with Indonesian communities[61]. While this constructivist idea might be partially true in explaining Indonesia's warm welcome to Japanese aid and investment, Japan's persistently dominant position in Indonesia reveals the political-economic settlements it made in the background. Despite losing its bid for the contract to build the controversial Jakarta-Bandung High Speed Railway Project, six decades of Japan's engagement in Indonesia clearly demonstrates its indisputable capability to weather political upheavals in Indonesia and trade disputes. It is also apparent that Japan has increasingly grown very adept at accommodating a contradictory mix of Indonesian economic policies – a mixed system of massive state regulation and liberalisation, an old nationalist and the pro-market liberalisation.

Against this background, the core idea of this chapter is to examine the ways Japan served its long-term interests in Indonesia, and how it directed its Official Development Assistance (ODA) and investment alongside Indonesia's ever-changing economic orientation and political landscape. The remaining discussion proceeds as follows; Section 1 begins with how Japanese aid and investment historically operated on Indonesia's own political and economic terms and ultimately enhanced Japan's leverage. The next section then examines how Japan maintained its leverage over Indonesian infrastructure development, arguing that there is a significant and growing effort in Japan, at a governmental level as well as the private sector, to 'institutionalise' the infrastructure business aiming at reconciling Japan's ever-changing economic needs with Indonesia's developmental trajectories. This chapter closes with a discussion of contemporary challenges amidst the fragmented power and sectoral interest, and implications for Japan's efforts to harmonise policy and bilateral relations with Indonesia.

Navigating the Japanese "Aid Trinity" in Indonesia

It would not suffice to underpin Japan's long-standing presence and the way it has incorporated its interests with Indonesian political and economic institutions without elucidating the so-called "aid trinity" (*san-mi ittai*). The concept refers to a comprehensive economic cooperation packages with the three areas or "trinity" of aid (ODA), direct investment, and importation (from developing countries)[62]. The aid trinity has a "vanguard effect", whereby Japanese aid promotes FDI from Japan to the recipient countries by deepening information-sharing and minimising investment risk through close cooperation between the government and private sector[63]. Different from the approach of OECD-dominated Western countries that place a high priority on grants for eradicating poverty, the salient characteristic of Japanese ODA was the support for large-scale infrastructure, credit for resource development projects, and heavy use of concessional loans. The loan projects are tied to the procurement of Japanese products to boost trade volume and eventually serve to help establish Japanese industry in the host country[64]. In short, investment and aid are equally important as trade in goods and services. In Indonesia, Japanese trade, aid (particularly loan), and investment are "three cards held in one hand."[65]

Table 1. The Actual Amount of Japanese ODA to Indonesia (millions of USD)

Type	1960-1970	1971-1980	1981-1990	1991-2000	2001-2010	2011-2016
Loan	326.16	1,982.21	5,753.25	12,129.72	15,231.90	4,791.44
Grant	232.1	101.72	383.56	770.01	727	109.82
Technical Cooperation	5.25	141.52	638.69	1,525.17	1,026.89	447,14

Source: Author's calculation, based on JICA Data and Japan MOFA.

In a remarkable sequential process, the workings of the Japanese aid trinity in Indonesia has been driven and reshaped by the alignment of interest and power relations between political forces and economic groups in two countries. During the 1950s and 1960s, Japan's isolation from Northeast Asia natural resources had been a problem limiting Japan's industrialisation efforts. Southeast Asia, particularly Indonesia, came into the picture when Japan wanted to redirect its capital to find an alternative market and supply base for raw materials[66]. Nonetheless, during that time, the initial plan was to invest in resource extraction sectors, but this was constrained by revolutionary forces in Indonesia, mainly from Soekarno-led nationalist camp that were largely opposed to the flow of foreign capital. Japan backed off its investment plan and Tokyo moderated the language of its strategic vision by using "economic cooperation" (*keizai kyoryoku*) as the key word and paid war damage reparations requested by Soekarno's administration[67].

Consequently, reparations combined with soft loans in exchange for resources appeased Indonesia and the sectors Japanese capital tapped into were not confronting local capital[68]. Not only successfully accommodating nationalist interests in Indonesia, the approach ultimately contributed to the rehabilitation of Japanese manufacturing and to the revival of its consulting firms and trading companies (*sogo sosha*, which grew in number from sixteen in 1958 to sixty in 1965)[69]. With payment guaranteed by the Japanese government, Japanese companies would be given a subsidy to export their products such as industrial machinery, fertilizers, agricultural machinery, and to also to undertake construction projects in Indonesia. Among these construction projects were the Brantas River Development Project and Tanjung Priok Port[70]. Japan's economic entry into Indonesia was further strengthened by the establishment of institutions that later were in charge of the 'economic cooperation' (*keizai kyoryoku*) activities – the Overseas Economic Cooperation Fund (OECF) in 1961, and the Overseas Technical Cooperation Agency (the future Japan International Cooperation Agency 'JICA') in 1962, and the Institute of Developing Economies (IDE) for research and information exchange[71].

Soon after Soeharto took office in 1968, the Five Year National Development Plan Phase I (Repelita I 1969-1974) began. Tokyo pledged US$30 million to Soeharto's Indonesia for economic recovery efforts and provided them with one-fourth of Indonesia's foreign aid from 1967 to 1970[72]. Yet, having lacked their own development specialists such as engineers and economists, JICA and OECF heavily relied on the private sector to work for development projects[73]. Japanese consulting firms and trade associations were quick to see the connection between aid, services, and capital-intensive products and cashed in on the opportunities. The central position of commodity loans was replaced by loan projects, for example roads, water supply, power plants, factories, etc. *Puro-fai* activities (project-finding missions) for infrastructure projects were frequent throughout Repelita I. The *puro-fai's* key focus was large-scale preliminary project proposals to reach high-level, informal agreements with Indonesian agencies in charge of ODA over which large aid projects to implement. It was thus commonplace for line agencies in Indonesia to have several ready-made proposals on hand, which were submitted by Japanese private companies, such as Nippon Koei and Pacific Consultants International. In other words, much of the aid would remain tied to goods and services of Japanese origin because in many cases it was Japanese companies that prepared and were awarded ODA projects on behalf of the Indonesian government making the requests[74]. Those companies were supported by the largest and most powerful chamber of commerce, *Keidanren* (Japan Business Federation)[75]. Established in 1946, the highly influential business lobby group in Japan had the power to exert and command influence over economic policies, including the implementation of ODA in recipient countries.

In addition, *Repelita's* heavy emphasis on the establishment of state-owned (SOE) resource companies and restrictions on foreign ownership in the resources sector had also opened another point of entry for Japan. Japanese capital was involved at every level in joint ventures in resource development, textiles, car assembly, and pharmaceuticals throughout the 1970s. Japanese loans were issued for major projects in petrochemicals and natural gas[76]. The North Sumatra Offshore Petroleum Exploration company (NOSOPEX) signed a contract with Pertamina in 1966– the only Indonesian SOE authorised to operate in the oil and gas sector. Through this contract Japan actively promoted development of overseas oil resources and entered into a production sharing contract (PSC) for Attaka Field in Offshore Mahakam Block[77]. Reportedly, since Japan made long-term purchase contracts to hedge risks, the price of Indonesian oil exported by Pertamina to Japan was determined through consultations between Indonesian and Japanese officials instead of being indexed to the London Exchange[78]. Likewise, in the case of liquefied natural gas (LNG), the Japanese had also secured a twenty-year sales contract beginning in 1977. Indonesian LNG export prices were similarly tied to prices received for Indonesian crude-oil exports. These contracts and extension of loans for exploration were nothing more than projects by which trading companies pursued profits through shipping arrangements and resales to Japanese domestic industries[79]. For Indonesia, endowed with extensive reserves of oil and gas, but tending to be weak in management and capital inflows, Japan's long-term commitment to develop such capital-intensive sector in this fashion was definitely a boon.

Because Soeharto's administration enforced regulations restricting local ownership, using majority ownership as an indicator of Japanese capital flow can be very misleading. In many cases, the Japanese lent the partner money with which to buy shares; the loan could have been repaid out of future dividends, or the Japanese may simply have purchased shares in the name of influential army generals. The generals were powerful figures involved in numerous joint ventures where a substantial source of Japanese leverage was on loans for the import of equipment for daily operating expenses[80]. More interestingly, as there were also government regulations in Indonesia prohibiting foreigners from engaging in domestic trade, the responsibility for local sale of the product was therefore assigned to the Indonesian partner. Partners were mostly ethnic Chinese Indonesians, who were not only distribution partners, but also served as advocates and trouble-shooters for the Japanese to resolve problems that might arise with the military and bureaucracy[81].

Furthermore, as the oil boom began, Soeharto's Repelita II (1974-1979) pressed ahead with import substitution and reopening of capital market and it indeed was linked with the increasing operations of Japanese firms in Indonesia. As of 1974, nine out of the ten multinational companies with the largest investments in Indonesia were Japanese. The top four investments during the oil boom period were the basic metal industry, amounting to US$963.2 million, the metal goods industry amounting to US$746.1 million, the chemical industry amounting to US$250.8 million, and textile industry amounting to US$218.5 million[82]. The increasing number of investment projects also led to strong dependency of Indonesia's economy on imports from Japan. For the whole period of Repelita II, an average of 64 percent of imports from Japan consisted of capital goods and industrial raw materials. One of large-scale industry projects included the controversial Asahan project[83]. Under a Master Agreement for Asahan Hydroelectric and Aluminium Project, Japanese government prepared a grant and loan for 12 Japanese investors for equity participation totalling 411 billion Yen[84]. On 6 January 1976, PT. Indonesia Asahan Aluminium (INALUM) was established and recorded as a pioneer and the first aluminium smelting industry[85].

Entering 1980s, several issues like the appreciation of the Yen against the US dollar, negative association with the debt from Japan, globalisation, and Indonesia's entrenched vested interests among competing ministries and powerful groups in the country, added both complexities and opportunities to the workings of the aid trinity. Learning from the 1974 Tanaka Riots[86], also known as the Malari Incident, Japan reckoned signs of a vastly more complicated set of investment, trade, and institutional relationships in Indonesia. It was not Japanese capital and business practices that provoked the riot[87]. It was also aggravated by competition between two generals, among them, Soedjono, one of four Inspector-Generals of Development and members of the Economic Stabilisation Council. Indeed, the biggest challenge for Japan is how to position itself within Indonesian political landscape that have become the "field" of many actors with competing and sometimes conflicting interests. Having foreseen the kind of political environment that it could have encountered in 1980s, Japan increasingly placed the importance of political settlement among various scale of groups and interests to ensure the sustainability of its aid trinity. Accordingly, the concentration of Japanese ODA and investment in Indonesia had produced a distinctive pattern that enabled political settlements to be reached among four key camps, namely: (1) The Military (ABRI); (2) technocrats; (3) nationalists; and (4) CSIS Intellectuals[88]. Despite trade friction and rising debt to Japan, these camps were aware that few real alternatives could really match Japan in the short-term, particularly in helping Indonesia to become an industrialised economy. More interestingly, CSIS Intellectuals consisting of a group of important civilian and military figures, namely Benny Murdani and Ali Murtopo, who had the closest access to the top leadership in Indonesia have also provided Japanese think-tanks a variety of information and knowledge considered useful in mitigating conflict. Over a period from 1987 to 1992, politico-economic settlements such as this were indeed the cue for Japan to step in with its New Asian Industries Development Plan (New AID Plan). The MITI-led strategy attempted to create an industrial plan for Asia that would harmonise with the needs of Japanese industry. For Indonesia, the targeted sectors were handicrafts, rubber-based products, electrical machinery, plastics, aluminum downstream products, and ceramics[89]. This was followed by high volume of machinery and equipment imports from Japan, which amounted US$5.3 billion in 1994 (see table 2)[90].

Table 2. Japan's trade balance with Indonesia 1950-2017 (millions of USD

	1950	1960	1970	1985	1990	2000	2010	2017
Exports	46.20	110.80	316.40	2,190.50	5,051.93	7,603.74	15,918.21	15,240
Imports	-	63.90	452.30	8,593.50	10,923.44	14,415.19	25,781.81	17,790.81

Source: Statistics Indonesia and IMF Trade Statistics

Japan's relations with Indonesia have broadened and is underpinned by economic interdependence particularly since the 1998 Asian financial crisis. Following the announcement of the New Miyazawa Plan[91], Tokyo provided yen loans to Indonesia worth 150 billion yen in 1998 and additional loans totalling 500 billion yen over the next three years. The primary focus of these loans was on renovations to existing infrastructure[92]. There continued to be criticism from Indonesian economists regarding projects born out of the plan. Huge volumes of aid instead went to Japanese affiliates and subsidiaries in Indonesia that had difficulty securing funds. Half of the amount of the Miyazawa package was spent to underwrite short-term trade insurance for infrastructure development projects in Thailand, Indonesia, and South Korea which required procurement of Japanese goods[93]. At any rate, the loan package demonstrates how the Japanese government had for too long put an emphasis on economic growth that served the interests of Japanese firms. However, such a mercantilist aid tradition barely faded away as it somewhat has served to prevent economic backsliding in Indonesia. Both countries are fully aware that Japanese capital was incorporated into the domestic production process which allowed broader spill over effects into local economies and made the market work well. This was possible because Japanese investment has always been cyclical in Indonesia; investment has been the largest in economic infrastructure, where economies of scale in processing encourages investment in large-scale production entities. The expansion of independent or state-supported smallholders is seen by many in the infrastructure sector. For example, PT Yokogawa Indonesia, set up in 1994, has been the leading automation provider in the LNG industry (the industry in which Japan has large stake). Aside from gaining profit and enlarging business through its involvement in the gas sector, they also contribute to Indonesian capacity through technology transfer and co-innovation in the areas of engineering, measurement, control and automation.

Rationalising Infrastructure Development

Regardless of changes in external and domestic factors, there has been a parallel pattern showing how different stages of Japanese economic rationalisation have been well aligned with every phase of political transformation and economic reform in Indonesia[94]. This was possible because Japan had always continuously paid a great deal of attention to bridge differentiated institutional mechanisms and sectoral foci across Indonesia. Particularly with regard to the export of infrastructure systems, the Japanese government had always found ways of effectively facilitating a closer working relationship between different interests groups in the two countries. After the revision of the ODA Charter in 2003, Japan actively promoted poverty eradication


Jakarta Mass Rapid Transit Tunnel

programs through its human development program and environmental projects. However, the assistance modalities influenced by MITI and the private sector (or often coined 'Japan Inc.'[95]) remained intact to consolidate the foundation for investment, to strengthen the role of the private sector, and establish production networks through economic infrastructure. Likewise, Indonesia has also understood that its own economic recovery and Japanese-driven regional integration was dependent upon harnessing the benefits of globalisation, trade, and infrastructure development.

The basic policy of assistance modalities is clearly stated in the Japanese Ministry of Foreign Affairs' (MOFA) published paper in 2004, entitled *The Country Assistance Policy for Indonesia*, emphasised that Japan's concessional loans are directed at a wide range of areas to achieve "sustainable growth driven by the private sector" and the "development of the economic infrastructure" must be one of the supporting measure[96]. The policy was in line with the Special Terms for Economic Partnership (STEP) loans launched in 2002 by JICA, for which procurement of Japanese goods and service, including contractors and consultants for designated infrastructure projects are required[97]. In relations to the STEP loans, the High-Level Public/Private Sector Joint Forum on Investment between two countries was established in December 2004. The forum drew up a Strategic Investment Action Plan (SIAP) in May 2005, in which concrete measures and a time schedule in the four key policy areas of infrastructure were presented while the biggest immediate beneficiaries of the plan were the automotive, electronics, and construction sectors[98]. Through the scheme of STEP, Japan's aggregate loans to Indonesia totalled about US$4 billion used for financing several large-scale projects (see table 3).

Table 3. JICA STEP Loans in Indonesia

No.	Project name	Sector	Year of Approval	Amount of approval (millions Yen)	Tying status
1	Patimban Port Development Project	Transportation	2017	118,906	Japan tied
2	Construction of Jakarta Mass Rapid Transit Project (MRT) II	Transportation	2015	75,218	Japan tied
3	Construction of Jakarta MRT I	Transportation	2009	48,150	Japan tied
4	Construction of Jakarta MRT I	Transportation	2009	48,150	General untied
5	National Geo-Spatial Data Infrastructure Development Project	Social services	2007	6,373	General untied
6	Engineering Services for MRT Project	Transportation	2006	1,869	Japan tied (consulting)
7	Tanjung Priok Access Road II	Transportation	2006	26,620	Japan tied
8	North Java Corridor Flyover Project	Transportation	2005	4,287	Japan tied
9	Tanjung Priok Access Road I	Transportation	2005	26,306	Japan tied
10	Lahendong Geothermal Power Plant Project	Electric Power and Gas	2004	5,866	Japan tied

Sources: Compiled by author, using data from JICA ODA Loan Project Data.

More interestingly, Japan's approach also transitioned from a reliance on informal business relationships and bilateral ties to a strategy founded upon multiple channels to institutionalise government-business partnerships. Since 2010, Tokyo has been pursuing seemingly coordinated policies to integrate the regional production chain with the Indonesian infrastructure development blueprint and to harmonise competing ideas and interests regarding infrastructure at all levels. Starting from the early development of Partnership for Quality Infrastructure (PQI) to date, continued synergy among different levels of policy – Japan's grand strategy of aid modalities, the regional connectivity approach, and Indonesian national plan – has been evident. Long before China's economic expansion in Indonesia, the original form of the PQI has been inherently existent – reflected within the New Growth Strategy that formulated in June 2010. The grand strategy was used as a framework for supporting private companies' initiatives in the field of infrastructure with a 'one-voice and in a united front' approach, aiming to expand the market of exports to 19.7 trillion yen by 2020[99].

This was also followed by the establishment of internal organs of each key ministries to deal with the deployment of infrastructure systems overseas. In October 2010, MOFA established the Promotion Headquarters on Deployment of Integrated Infrastructure Systems in October 2010, while the Ministry of Land, Infrastructure, Transport, and Tourism set up a new senior post of Director-General for International Affairs as well as two new sections within the Policy Bureau. These were done in order to advance integrated policy formation, which have been carrying out various collaborative environmental projects with key Indonesian agencies and local

Table 4. External Debt Position of Indonesian Government to Japan

	2010	2011	2012	2013	2014	2015	2016	2017	2018 (Q3)
Japan	30,488	30,932	26,382	20,950	17,014	15,544	14,634	13,960	12,978
Share of Total Indonesia's Gov. External Debt to creditor's country (%)	67.7	69.5	66.6	60.4	55.8	55.2	54.8	52.9	51.9
In Comparison									
USA	1,854	1,709	1,575	1,634	1,584	1,504	1,422	1,235	1,104
Australia	855	819	816	752	664	580	528	506	437
China	486	787	833	921	986	984	1,035	1,278	1,518
Germany	2,521	2,240	2,070	1,983	1,769	1,650	1,882	2,101	2,209

Source: Compiled by author, using data from Indonesian Ministry of Finance.

governments until recently[100]. The grand strategy also allowed the Japan Bank for International Cooperation (JBIC, the successor of Japan EXIM) to take a more proactive role in its guarantee operations and Other Official Flows (OOF) for Public Private Partnership (PPP) projects[101]. By the same token, the function of JICA-led ODA has also been increasingly diversified, among others supporting viability gap funding (VGF), equity-backed finance (EBF), credit enhancement facility for government guarantees and Two-Step Loan to guarantee infrastructure risks[102].

The leverage of New Growth Strategy (later, PQI) is evident in Indonesian regional initiatives. There have been serious attempts of Tokyo and private sectors to make the strategy and the use of financing modalities compatible with the Indonesian infrastructure master plan. In 2011, Indonesian government formulated the Master Plan for Economic Development for Acceleration and Expansion of Indonesia's Economic Development (MP3EI) in which 33 PPP projects are listed and divided into three categories: potential projects, priority projects, and projects ready for offer. One of the primary goals of the MP3EI is to develop six economic corridors, namely Sumatra, Java, Kalimantan, Sulawesi, Bali-Nusa Tenggara, and Papua-Maluku corridors, where the government is inviting investors to participate in designing, financing, operating infrastructure projects and finally contributing to the national connectivity[103]. Here, JICA subsumed the deployment of infrastructure systems through the Master Plan of Jabodetabek (Greater Jakarta) Metropolitan Priority Area (MPA) by cooperating with Indonesian Coordinating Ministry for Economic Affairs and Bappenas, Indonesia's Ministry of National Development. The final version of the MPA published in 2013 listed 45 Projects, including 5 Flagships and 18 Fast Track Projects as well as Java High Speed Railway/Jakarta-Bandung High Speed Train[104]. The Master plan study estimated that roughly 1 billion Yen (US$10 billion) is expected to be forthcoming externally, including Japanese ODA. Furthermore, Japan's unified approach also succeeded in making sure most of the planned projects were included in the Indonesian National Strategic and Priority Projects (PSN)[105]. They include Cilamaya (replaced by Patimban Port[106]), the successful Jakarta MRT, and Batang Coal Fired Power Plant, which is considered the largest PPP in the power sector in Asia[107]. Presently, coinciding with PQI's launch, Japan and Indonesia are also focusing on advancing their ties through Vision 2045 roadmap. Japanese assistance will contribute to human development, science and technology mastery, sustainable economic development, equal development and national resiliency and good governance – with infrastructure development are the main foci aiming at making Indonesia become the world's fifth-largest economy[108]. The number of infrastructure projects under the scheme of Vision 2045 will also pave the way for further involvement of other key agencies attributed to the PQI, namely Japan Overseas Infrastructure Investment Corporation for Transport and Urban Development (JOIN) and Nippon Export and Investment Insurance (NEXI).

More interestingly, between Japan's grand strategy and its footprint in the Indonesian national plan, these are also multi-layered regional initiatives driven by "Japan Inc." to bring about synergistic effects of Indonesian infrastructure development, Japanese scale of investment, and regional value chain. It is apparent that Japanese infrastructure export strategy is executed in a way coherent with a regional plan within which Indonesia has a large stake. Deepening politico-economic ties with Indonesia by using a regional plan might also match Indonesia's interests as achieving its 'largest-economy' status in Southeast Asia is hinged upon its integration with the regional value chain. Enhancing regulatory harmonisation between national and regional level strategies also allows Japanese policy makers and various interest groups to open up partnerships to share risk. For example, Japanese-proposed projects in PSN, such as Cilamaya (now Patimban) port development, the Jakarta 3rd Airport Development Projects is also included in Japan-led regional initiative, namely CADP 2.0 (Comprehensive Asia Development Plan) addressed for the East Asia Summit. The projects are also listed in the Master plan of ASEAN Connectivity that is strongly supported by Japan. It is clear that private capital and International Financial Institutions (IFIs) like the Asian Development Bank (under de facto Japanese control) will have to become significantly more involved, both on multilateral and bilateral basis. This kind of multi-layered financing vehicle is clearly seen in the Leading Asia's Infrastructure Fund (LEAP), jointly set up by ADB and the JICA to provide co-financing to infrastructure projects, including the Muara Laboh geothermal power project in Indonesia.

Challenges Ahead

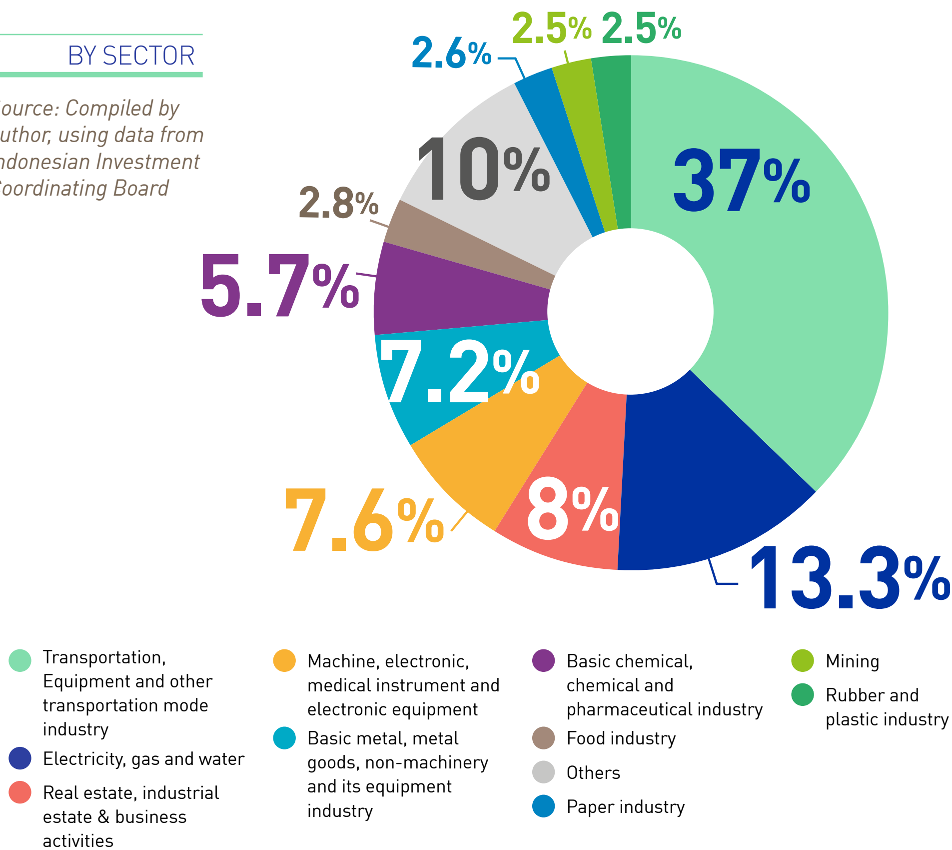
As a leading scholar on Southeast Asian political economy, Jomo KS once argued, "There is more to East Asia's development than the flying geese model or China's emergence. There are also serious risks inherent in the development paths adopted since the 1997-1998 crisis." It is true that Japan-Indonesia relationship has been overshadowed by the rapid rise of China. The Jakarta-Bandung High Speed Railway also illustrates how China has bested Japan by winning a high profile infrastructure project in Indonesia. The project was expected to be awarded to a Japanese consortium since 2011, but China won the bid after offering more generous terms. However, Japan in fact has far more daunting tasks beyond simply competing with China. Several sets of problems merit note, some of which reflect the very nature of Japanese institutions, combined with Indonesia's inherent weaknesses.

First, from the demand-side perspective, Indonesia is still chasing the US$150 billion needed to fund the infrastructure plan, concerning only US$15 billion can be used from the state budget[109]. In a nutshell, this should give Japanese business leeway to boost infrastructure exports. However, inherent structure and operational logic of Japan does not always meet Indonesia's growing needs. Although Tokyo has been diversifying its financing vehicles and loosening the conditions, three tacit preconditions remain intact, namely: (1) Large-scale projects with long-term and significant spill-over, (2) higher return on investment, and (3) projects supported by government guarantee[110]. It is thus not uncommon that Japanese-funded ports and railway construction have always been located close to both concurrent and prospective industrial areas built by Japanese companies and the investments tend to be concentrated on Java Island, the main hub of Indonesia economic activities (as shown by the following diagram). For instance, Tanjung Priok Port and the North

Diagram 1. Investment Realisation (excluding oil sector) from Japan by Location and Sector (2013-2018 Q3)

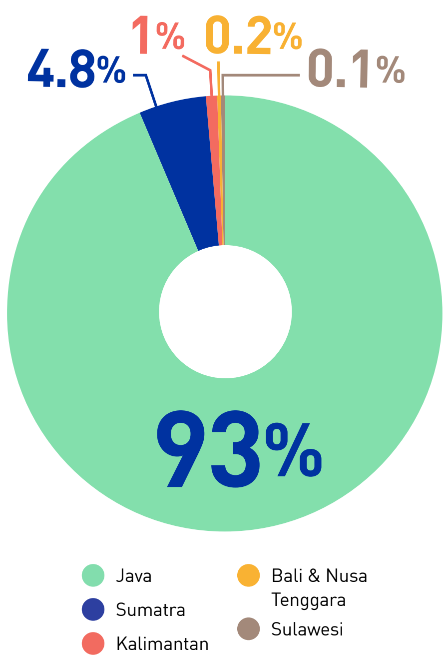
BY SECTOR

Source: Compiled by author, using data from Indonesian Investment Coordinating Board



Java Corridor Flyover Construction Project, which are financed under the scheme of STEP loan, are easily connected to Karawang International Industrial City (KIIC) of which 80 percent of tenants are Japanese companies[111]. Moreover, a JETRO survey counted at least 1,517 Japanese firms operating in Indonesia are mostly located in industrial zone east of Jakarta[112]. Most of Japan-funded electrification projects in Indonesia are considerably large-scale projects and located in Java Island, such as 2,045 MW Paiton power plant and 2,640 MW Tanjung Jati coal-fired power-plant. Both plants have government guarantees and involve an agreement by the "off-taker", namely PLN (The Indonesian state-owned Electric Company). This simultaneously ensures revenue for the Japanese companies involved and helps them recover their outlay[113].

BY LOCATION



There are indeed greater tendencies among Japanese companies to finance brownfield infrastructure projects that pose less construction risk than greenfield projects and are already backed by particular off-taker. A case in point is the Jokowi administration pledges an ambitious agenda and even has pushed a controversial decision to relocate the capital city from Jakarta to Palangkaraya in Central Kalimantan with the view to develop industrial estates and economic infrastructure off Java and in outer islands[114]. The Indonesian president has also called for around 70 percent of the infrastructure plans to be financed by the private sector. In this sense, there would be many projects that are unlikely to generate much cash but require significant investment, and the risks involved already deter prospective Japanese investors. For decades, the Japanese 'playing field' in infrastructure relatively faced moderate risks. Japanese companies have been especially eager to promote private financing of infrastructure projects in Indonesia through build-operate-transfer (BOT) and build-operate-own (BOO) schemes. Both financing schemes mean that Japanese companies involved in a given infrastructure project through an ODA mechanism (with government guarantee) and can later recuperate their profits by operating what they have built[115]. As a result, such a 'safe' playing field has caused Japanese companies to become more segmented. They also do not have enough experience in the transit-oriented development (TOD) models that Jokowi's administration strongly promotes.

In addition, as PPP projects will be the core means to advance its infrastructure targets, Jakarta has started simplifying investment procedures and relaxing regulations. For instance, Jokowi's administration has introduced the one-stop integrated service (PTSP) at the Investment Coordinating Board (BKPM) in order to create a business-friendly bureaucracy and simplify around 42,000 regulations along with 3,000 bylaws that have been impeding the implementation of development-related projects. Yet, Japan for its part, has its own challenges. Some key agencies in Indonesia that are mandated by Jokowi to shorten time gap between planning and implementation often lament the Japanese decision-making approach on PPP projects. Although Tokyo has started loosening its rigid loan procedures, Japanese risk-averse private sector and bureaucratic inertia makes it difficult for fast decisions to be made. This can be somewhat frustrating alongside Indonesia's "build fast, fix later" approach to a proposed PPP project[116]. The widely differing developmental mindset has indeed been problematic. Therefore, it is important for two countries to find an alternative model for infrastructure financing that could bridge the gap of time, 'quality', and risk and combine the strength of each Indonesian and Japanese private sector.

Another challenge is the wide distribution of power and authority in Indonesia. Decentralisation has been underway and consequently there is no such narrative that the president's preference carried weight. During Soeharto's era, Bappenas (whose key figures had strong connection with Japan) was a powerful superagency with combined authority over development budget, planning, and foreign aid mobilisation. At times, the chair of Bappenas also doubled as the Coordinating Minister of Economic Affairs. Yet, now it tells different story in Indonesia[117]. The transfer of the development budget to the Ministry of Finance in 2013; overlapping authorities between Coordinating Ministry of Maritime Affairs and Economic Affairs; Indonesia's SOEs "crowding out" infrastructure sectors; the ever-changing regulations; and growing influence of local government have added complexities further. Political reform and economic liberalisation has led to the fragmentation of power, which to some extent rattled Japan's confidence in the government's ability to manage the infrastructure sector. A key illustration is, since 2005, Japan has actively promoted waste management system by using water-to-energy (WTE) technology in Mamminasata Metropolitan Area, Makassar which basically gained support from the central government[118]. However, with the application of Law No. 23/2014 on Regional

Governance and the Law No.38/2007 delegates the allocation of governmental affairs to national, provincial, and district/city governments, responsibility of handling infrastructure projects (except for ones deemed as National Strategic Projects) has shifted from central to local (province/city/district government)[119]. While a detailed engineering design (DED) for regional landfill carried out by JICA was already implemented, the construction plan was unfortunately backed off due to site disapproval by the new Head of a District in Mamminasata[120]. Instead of addressing structural problems, the development of regulatory frameworks only compounded complexities among different agencies and sectors.

Another point worth noting is the rise of economic nationalism amidst economic globalisation and national deregulation. The conflicting nature of these two trends is evident in the working of Japanese capital in Indonesia. On the one hand, the liberalisation of state policies has led to increasingly globalised circuits of capital accumulation. This has to some extent paved the way for Japan to tap into the finance industry and have more diversified equity-based investments. On the other hand, the traditional principle of Indonesian public interest is that economic policy should protect and preserve competition as the most appropriate means of ensuring the efficient allocation of resources and protection of local enterprises. As such, what tends to happen is that many sectors which Japan actually could have involved in and contributed to technology transfer are centred around political constraints and public opposition. Aside from being pushed to divest stakes in the extractive sectors, Japan also struggles in the Indonesian infrastructure sector. Its leverage over infrastructure development is constrained by inward-oriented policies. Recent example includes Indonesian government's plan for extending the East-West corridor of Jakarta Mass Rapid Transit (MRT) with a length of 37 km. Different from the previous phase that used JICA STEP loan, Jokowi has been encouraging private sector involvement as well as Indonesian SOEs to finance the extended corridor[121]. In fact, for the capital-intensive and technology-intensive project like MRT, pure private sector involvement, let alone SOEs is not always a panacea. Yet, under popular mobilisation and electoral politics in a bid to attract voters, it is understandable that Jokowi's government needs to avoid "rising debts".

Conclusion

It is clear that trading companies and small-and medium-scale enterprises (SMEs) have gained an advantage through Japanese loan and investment projects in Indonesia. However, the preceding discussion does not simply cast Japan as acquisitive. Rather, from a political standpoint, Japan's rational moves gave it greater flexibility to curry favour with competing ideas and interests in Indonesia while gradually enforcing good governance practices. In terms of development, such multi-layered policy and master plans are critical to making sure the Indonesian government addresses short-term, medium-term, and long-term infrastructure issues and stay consistent with its domestic and regional development strategy. Prominent features of Japan's political economy – vigorous institutions and a proactive approach to state transformation – place particular importance on such a large and complex country such as Indonesia. Far from being at odds, Japan's strong presence in Indonesia largely demonstrates that collective capacities – the ability to reconcile interests, to provide infrastructure, and to encourage cooperation – have functioned well. Yet, ensuring the combination of home-based practice and modification arrangements in infrastructure cooperation concurrently provides the best way to maintain a mutually beneficial relationship between Indonesia and Japan, the two key middle-powers in the region.