The road to drain or gain: Dutch private investment and economic development in late colonial and early independent Indonesia

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Summary

This dissertation is about the effects of Dutch private investment in the Netherlands Indies and early independent Indonesia. The aim of my analysis is to contribute to the current discourse about the extent to which the Dutch presence in Indonesia was beneficial, economically speaking. In this dissertation three different topics are discussed: investment, profits and linkages.

With respect to investment, I focus on numbers of companies, their size and nationality, and the industry in which they operated. The relationship between economic development in the Netherlands Indies and foreign direct investment (FDI), in particular Dutch investment, forms the core of my analysis. In discussing profits, my purpose is to determine whether profit rates from investment in Indonesia were higher than elsewhere and whether they could be considered excessive, constituting a drain of resources away from the colony. The topic of linkages, serves to identify the economic impact of foreign private investment in terms of direct and indirect effects that to some extent would have compensated for the drain. Two time periods are considered: the late-colonial period from 1910 until the outbreak of the Pacific War in 1942, and the time period from the Pacific War onwards, including early independence, up to about 1960, when full economic decolonization had been achieved. Three case studies: Billiton Maatschappij, Deli Maatschappij and Handels Vereeniging Amsterdam are also discussed. My main research question is as follows: To what extent did Dutch private investment contribute to the economic development of the Netherlands Indies and Indonesia between 1910 and 1960?

Chapter 1 presents a general introduction. Here I give an overview of the methodology, theoretical framework, research questions and the sources used for this research. In this chapter I introduce the debate about whether Dutch presence in Indonesia was eventually beneficial for the economic development of Indonesia. The effect of operations by foreign business enterprises on the development of the indigenous economy still raises many questions. Any statement about Dutch contributions to the indigenous economy inevitably elicits criticism and refutations from either side of the debate. There is a need for scholars to address such issues and shed light on the legacy left behind by Dutch colonialism in Indonesia.

In chapter 2 I show that after the Cultivation System was dismantled in 1870 the colonial government opened up the archipelago for private foreign investment. The years from 1870 to around 1900 formed a period of expansion of private foreign investment in colonial Indonesia. In theory, the doors were

open to both private Dutch investment and to non-Dutch foreign investors. In practice, however, Dutch companies were favoured by a tight network of businessmen and Dutch officials. In order to gain a foothold in the Netherlands Indies, non-Dutch foreign investors often cooperated with Dutch investors, for example in the formation of Royal Dutch Shell.

The number of foreign firms active in the Netherlands Indies rose rapidly until 1920. In some industries, for instance oil, the smaller companies were taken over by larger ones. Most companies remained small in size, especially in industries where production was less capital-intensive such in agriculture, manufacturing and trade.

Investors in the Netherlands Indies can be divided into five categories. The largest category consisted of Dutch investors in the Netherlands who managed business operations in the colony from a distance. A second category can be labelled Netherlands Indies investors. They could be Dutch or have a mixed ethnic origin and were residents of the colony. Investors from third countries formed the third category. The fourth category consisted of Chinese investors in colonial Indonesia. The fifth and final category consisted of indigenous Indonesians. Even though the number of Indonesian companies incorporated under Dutch law was very small, these Indonesian companies were responsible for three-quarters of the total economic activities.

Most companies operating in late-colonial Indonesia were incorporated either in the Netherlands or the Netherlands Indies. Before the Second World War, their combined share exceeded 70% of the total number of incorporated companies under Dutch law. British investors formed the second largest group. Around one-quarter of total Dutch investment went to the Netherlands Indies. This corresponded to nearly half of total Dutch foreign investment in 1938. It is safe to state that up to 1940, nearly ƒ4 billion was invested by Dutch private investors alone, against about ƒ1 billion by other foreign investors.

In chapter 3 the focus is on profits and colonial drain. Profitability of Dutch-owned firms is assessed in order to find out whether profits can be considered to have been excessive.

Based on profit and dividend rates, it can be said that, on average, they were excessive, in the sense that they were higher than the profits that could be attained in the Netherlands. However, this does not hold true for the entire period 1910–1940.

During the period 1910–1930 the Netherlands Indies saw some economic expansion. The situation for indigenous Indonesians only seemed slightly brighter in the second half of the 1920s. As a result of the economic depression of the 1930s, many indigenous employees working in export production were laid off. Although only a minority of all indigenous Indonesians was employed in foreign enterprises and most wages were earned in the indigenous economy, many of them produced for export markets and thus suffered from the economic depression.

I made several calculations of the colonial drain and concluded that a drain of 12% in 1920–1930 and 9.5% of GDP in 1931–1939 is a plausible estimate. If around 10–20% of GDP was primarily the result of foreign activity, then gains did exceed the drain. Whether the colonial drain should be considered excessive is hard to ascertain. However, the colonial drain *did* represent a very substantial proportion of GDP. Can the drain be better identified by focusing on profits? Between 1910 and 1939, two-thirds of total profits were paid out as dividend, while one-third was reinvested in the Netherland Indies. The amount reinvested was comparable to more than half of all foreign direct investment entering the colony.

A substantial part of profits in fact remained in the Netherlands Indies. Although not quite comparable, we see that average rates of return were higher in the Netherlands Indies than in the Netherlands. However, the results are mostly based on small samples of firms that performed above average compared to the total of all foreign incorporated companies in the Netherlands Indies. The lowest nominal dividend rates were relatively high until the economic depression of the 1930s. Proceeds from investment in the Netherlands Indies were more volatile and vulnerable to external shocks which made them riskier. During the 1930s, returns were lower, but when the 1920s and 1930s are taken together, returns in the Netherlands Indies still exceeded those in the Netherlands.

Beside profits that flowed abroad, land use has to be taken into account. Land was occupied by foreign investors for purposes of production. Based on differentiation between crop and region estimates of land occupation in Java vary from 3% to 18% of total irrigable land. In East Java, however, sugar estates occupied around 70% of the soil in some villages. Therefore, this occupation of land undoubtedly had a significant impact on indigenous agriculture. It should also be borne in mind that probably the best land was being used by foreign producers.

In chapter 4 the linkage effects are examined in order to find out how society in the Netherlands Indies benefitted from the presence of foreign investment. Backward linkages (when goods and services are used to enable a production process) were most prominent. Irrigation and infrastructure are good examples. Although the sugar estates and indigenous agriculture initially competed for the same land and water supply, indigenous producers benefitted from irrigation works once the land became available again as a result of the crop rotation.

Many foreign companies constructed roads and railways. The railways connected plantations, ports, villages and regions that were difficult to reach. Paved roads and bridges were constructed in order to facilitate the transport of sugar and other products and they improved the prospects for further economic development. Large-scale production by foreign firms did put stress on existing infrastructure which required new roads. Compared to Java, the physical infrastructure in the Outer Islands was less developed. Although roads were primarily constructed in the interest of the company, the indigenous population clearly benefitted from the improved infrastructure as well. During the economic depression and even after independence, the effects on infrastructure are still present in Indonesia.

The output of these foreign companies consisted of primary export commodities, and even though local processing took place, forward linkages were relatively rare. Oil was refined and processed in the Netherlands Indies before being shipped abroad and by the end of the 1930s, nearly all processing of rubber took place in colonial Indonesia.

Regarding the compensation for land use, wages and other final demand linkages, it is debatable whether the firms did enough for their workers. Although compensation for land use would be considered adequate by making a comparison of proceeds from land lease with yields from cultivation by landowners themselves, we must not lose sight of the fact that the indigenous population could not make use of the confiscated land for a long period of time. This was an opportunity cost that was aggravated by land displacement. Sometimes coercion was applied and the indigenous population was forced to lease out land.

Most wages were earned in the indigenous economy and it is difficult to argue that indigenous Indonesians were dependent to a high degree on employment in foreign firms. Estimates of the contribution of wages paid by foreign firms to the total income of indigenous Indonesians in Java vary from 5.5% in 1924 to 7.7% in 1939 of total Indonesian income. In the Outer Islands this proportion was in the range of 8–10%. Wages earned by the Indonesian population employed by foreign companies did not differ much from what Indonesians were able to earn in other businesses. Foreign companies also used immigrant labour. Their wages were often lower than those paid to local labourers and foreign companies.

Food, housing, healthcare and some education were also provided for labourers. The provision of these services was vital for the productivity of the companies. These benefits could trickle down further as other people living near the production sites could in some cases make use of hospitals and other facilities even if not employed by the firm in question.

Companies also contributed indirectly to irrigation, infrastructure, healthcare and education through taxation. The operations of foreign private companies contributed to around 10% of the total tax revenue, or roughly 5% of total government revenue between 1910 and 1940. However, as around 10–20% of GDP originated from the presence of foreign capital, by comparison, the foreign firms can be said to have been under-taxed.

In chapter 5 three case studies concerning respectively: Billiton, Deli Maatschappij and HVA are discussed for the period 1910–1942. These companies were profitable pioneers. Their operations were in different key industries and do not fully represent the colonial economy. All three companies had matured before 1910, the peak of their operations was between 1910 and 1942 and they remained active in independent Indonesia. All three companies were highly profitable during the 1910s and 1920s. They suffered during the economic depression of the 1930s but managed to recover afterwards.

They contributed to the development of the local economy. Infrastructure was one of the most visible aspects. Railroads and roads were constructed by the Deli Company, Billiton and HVA. The workforce of the companies was supported with healthcare, housing and schooling. This made the workforce more productive and the surrounding population could also draw some benefit from these services. The provision of education, on the other hand, was likely to affect only a marginal share of the indigenous population. Schools were built by the companies for the children from the labourers and training was provided, but the possibilities of getting promoted were meagre.

Forward linkages were not present on a substantial scale. Smelting of tin ore did not take place in Belitung as tin was usually processed elsewhere. The Deli Company did not produce cigars from its tobacco leaves and besides processing the harvested sugar cane, not many forward linkages materialised at HVA. The main priority of the companies was to increase efficiency and profitability.

In chapter 6 the post-independence developments are discussed. The various themes of the previous chapters are again examined, specifically for the time period 1942–1960. At the start of the Japanese occupation companies were taken over by the Japanese or had to start producing for the Japanese war machine. After Indonesia's proclamation of independence on 17 August 1945, the Dutch wanted to restore colonial rule and continue its business as usual. The Dutch also made two attempts to enlarge the area under their control by military force in 1947 and 1948–1949. They did succeed in doing so and many factories and estates again came under Dutch control. Politically, however, these military actions were a failure. On 27 December 1949 the Netherlands officially transferred sovereignty to Indonesia. Indonesia promised that operations of Dutch companies could continue and Indonesia agreed to pay the debt of the colonial government to the Netherlands.

Operations of Dutch private businesses were continued until the late 1950s. The firms recovered and became profitable again. In the mid–1950s, foreign firms still played a key role in the Indonesian economy. Most new investment was now done by American oil companies. About 10–20% of GDP is likely to have been generated by foreign firms, resembling the situation in the late colonial period.

The importance of foreign private companies for the economic development of independent Indonesia now became visible through fiscal linkages in particular. Company taxes increased and it became more difficult to transfer profits overseas compared to earlier periods as a result of the policy of the Indonesian government. Other linkages became less important. Although companies complained about high taxes, they were still willing to continue their activities even though the prospects grew bleaker as time passed. This suggests that even if taxes had been higher during the colonial period, these companies would probably still have been willing to operate in colonial Indonesia. If so, then here was a missed opportunity for Indonesia, which could have benefitted from higher taxes at an earlier stage.

In the meantime, there was an increase in Indonesian employees in middle and higher positions in foreign firms. Especially from the mid–1950s, this so-called *Indonesianisasi* became more important. Slowly it became more difficult for Dutch companies to bring Dutch replacements to Indonesia. For the Indonesian government and the labour unions progress was too slow. The failure to reach a settlement about New Guinea, still a Dutch colonial possession, angered Indonesia and this irritation spilled over to the presence of Dutch companies in Indonesia. On 3 December 1957 Indonesian labour unions took control of numerous Dutch companies. This was endorsed by the Indonesian government that placed the seized firms under military supervision.

KPM was the first company to be taken over. It was soon followed by other companies. On 27 December 1958, a law on the nationalisation of Dutch companies was passed by the Indonesian parliament. The companies now had new owners, but the companies remained important productive assets in Indonesia. This can be seen as a lasting legacy.

Initially, the nationalisation in 1957–1959 had a profound impact on the economic development of Indonesia. Economic decolonization appeared near-complete by 1959. By the early and mid–1960s, economic development was virtually stagnant with a level of GDP per capita lower than in 1941. Trade with the Netherlands vanished almost altogether but American and British companies continued their activities unimpeded. American oil companies were the most important new investors.

In 1966 the Dutch and the Indonesian governments made an agreement for compensation of the nationalisation of the Dutch companies. In total an amount of nearly ƒ700 million, including interest, was paid by the Indonesian government. This payment was estimated to be around 10–20% of the value of the companies. Taking into account depreciation over time, exceeding more than 10% per year, this compensation seemed more than fair.

In order to receive international aid and funding, which was supported by the Netherlands, the United States and Japan, Indonesia was required to make these payments to the Netherlands. After the regime change in 1966, foreign investment would soon rush back to Indonesia to help rescue an economy struck by its isolation from the outside world.

In conclusion, in this thesis I have analysed the development of private Dutch business in Indonesia and its effect on the Indonesian economy during the late-colonial and early independence periods. The time has come to return to my main research question: to what extent did foreign private investment, particularly from the Netherlands, contribute to the economic development of late-colonial Indonesia? Three topics have been discussed in detail: investment, profit and linkages. Between 1910 and 1940, significant amounts of Dutch capital were invested in colonial Indonesia. Around one-quarter of all Dutch private investment was made in colonial Indonesia. Although these investments were considered riskier than domestic investment, in the long run substantially large profits were pocketed by firms operating in Indonesia than in the Netherlands. Large dividend payments to Dutch shareholders resulted in a considerable flow of capital back to the home country. This can, in my view, be reasonably described as a colonial drain. On the other hand, a substantial share of the profits was also reinvested in the Indonesian economy.

In terms of output, profits, employment, or tax revenue, foreign private enterprises amounted to a relatively small part of the Indonesian economy. In both the late-colonial and early-independence periods, the activities of foreign capital contributed to no more than 10–20% of GDP. During peak years, up to 10% of indigenous employment and income originated from those sources. On a macroeconomic level, indigenous Indonesians were therefore not heavily dependent on foreign investment.

Nevertheless, these estimated figures do not take into account the indirect economic effects of foreign companies or the wider effects of reinvestment of profits in Indonesia. The indirect positive effects are difficult to quantify and need to be balanced against the colonial drain.

Another question that also needs to be addressed is whether Indonesians would have been better off, in economic terms, in a non-colonial situation. Undeniably, foreign companies and their European owners and employees did contribute to the public purse but they were only lightly taxed. In this context, the under-taxation of foreign companies represents a missed opportunity for the Indonesian economy during the colonial period.

The compensation provided by colonial businesses for Indonesian labour, land and natural resources, can best be described as moderate. In some cases, coercion was involved in gaining access to land and labour and making production possible for the foreign firms in the first place.

In contrast to this negative image, it cannot be denied that certain businesses in some parts of Indonesia did provide the local population with indirect benefits in the form of infrastructure and irrigation systems, alongside other linkage effects like housing, hospitals and schools. In the long run, Indonesia did benefit from this. Up to the present day, infrastructure has remained a visible legacy of Dutch private investment in colonial Indonesia. The overall picture of the colonial past remains a mixed message. There were regions where foreign investment was minimal, or seems to have brought no net benefit to the indigenous population; but there were also areas where both European capital and local interests were well served.