

## Investment Dynamics in the Indonesian Defense Industry: A Literature Study Analysis

Susan Cintia Damanik<sup>1)</sup>, Herlina Tarigan<sup>2)</sup>, Ari Pitoyo Sumarno<sup>3)</sup>, Hikmat Zakky Almubaroq<sup>4)</sup>  
<sup>1,2,3,4)</sup>Defense Management / Defense Management Faculty, The Republic Indonesia Defense University,  
Indonesia

\*Corresponding Author

Email: [susan.tiara.damanik@gmail.com](mailto:susan.tiara.damanik@gmail.com)

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### Abstract

*In the realm of national security and sovereignty, Indonesia's defense industry serves as a cornerstone, with its investment dynamics playing a significant role. This study offers a detailed analysis of these dynamics over the past decade, employing a comprehensive literature review methodology. It synthesizes information from a range of primary and secondary sources to unveil complex investment patterns, challenges faced by the industry, and the potential for growth and advancement. Scrutinizing the multifaceted factors that drive investment decisions, this study uncovers how geopolitical, economic, and security considerations, both globally and regionally, have influenced the industry. A notable finding is the strong correlation between an uptick in investments and advancements in technological innovation and industry autonomy. Despite positive developments, the study highlights ongoing challenges like stringent regulatory frameworks, a need for greater transparency, and the urgency of improving sector efficiency. A shift towards a more independent and technologically advanced defense industry in Indonesia is discernible, spurred by strategic investments. The study also sheds light on the pivotal role of foreign direct investment (FDI) in enhancing technological capabilities and catalyzing the growth of local industries via collaborative ventures. In terms of policy, the paper advocates for reformative strategies that reconcile national interests with the necessity of global economic integration. It suggests a suite of policy recommendations designed to promote a conducive investment environment, encouraging private sector involvement and international cooperation in alignment with Indonesia's defense objectives. The conclusion asserts the feasibility of a sustainable and burgeoning defense industry through strategic and informed investment approaches. It calls for continued research and open dialogue among policymakers, industry players, and academics to effectively navigate the investment landscape of Indonesia's defense sector, ensuring its alignment with broader economic goals.*

**Keywords:** *Indonesia, Defense Industry, Investment Dynamics, National Security, Technological Innovation, Foreign Direct Investment, Policy Recommendations, Economic Integration.*

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## INTRODUCTION

The defense industry as a strategic sector has an important role in the national economy for various reasons. First, from a national security perspective, the defense industry provides equipment and services that are essential to defending a nation's sovereignty. In the context of Indonesia, which is an archipelagic country with various geopolitical challenges, the defense industry plays a key role in supporting the country's defense and security capabilities (Haryadi, 2018). The defense industry contributes economically through job creation. With sufficient investment, the defense sector could become a significant source of direct and indirect employment, both in the production of defense equipment and in related services (Sudrajat, 2019). Additionally, this sector often demands a high level of technical expertise, thereby encouraging quality workforce education and training. Technological innovation is one of the most valuable by-products of investment in the defense industry. Technologies developed for military purposes often find civilian applications, helping spur innovation in other sectors (Wahyudi, 2017). Examples include research and development in electronics, aviation, and communications. The defense industry's contribution to the country's Gross Domestic Product (GDP) cannot be ignored. Purchase of military equipment, research and development, and export of defense equipment can provide a substantial economic contribution (Anggara, 2020). In Indonesia's case, its position as a strategic country in Southeast Asia requires a balance between

defense spending and economic development initiatives to ensure both sectors can develop sustainably. This creates a unique challenge where the government must navigate between security needs and economic growth, necessitating careful decision-making in resource allocation (Prasetyo and Suryanegara, 2021).

Recent developments in Indonesia's defense sector show a strong focus on modernizing the main weapons system (alutsista) and increasing domestic production capacity. The Indonesian government has established several policies and strategic plans to encourage investment and strengthen the defense industry, both from domestic and international sources. Modernization of defense equipment is one of the main priorities, with the aim of updating aging weapons and increasing military readiness to face contemporary threats. This includes the purchase of new defense equipment from abroad, as well as the development and production of defense equipment through the domestic defense industry, with collaboration between local companies and international partners (Rahmawati and Putri, 2020). On the other hand, increasing domestic production capacity is also a focus, with the government seeking to strengthen the role of state defense companies such as PT Pindad, PT PAL, and PT Dirgantara Indonesia. The government has implemented policies that support technology transfer and skills enhancement for the local workforce, which not only strengthens the defense industrial base but also supports innovation and broader economic development (Hutabarat, 2021).

To attract investment, the Indonesian government has introduced various incentives, including ease of imports for components that cannot be produced domestically, tax reductions for investment in certain sectors, and the granting of strong intellectual property rights for new discoveries and innovations in the defense sector (Sulistyo, 2021). The government's strategic plan also includes the establishment of a framework that facilitates foreign and domestic investment in a joint effort to modernize defense equipment and strengthen national production capacity (Anggraini, 2022). Furthermore, Indonesia has taken steps to increase involvement in global supply chains by encouraging bilateral and multilateral cooperation. This includes participation in programs such as Government-to-Government (G-to-G) and cooperation with multinational defense organizations to increase interoperability and standardization of defense equipment (Widodo, 2022). These policies and efforts aim to achieve independence in the defense industry, which will enable Indonesia not only to meet its own defense needs but also to become a key player in the regional and global defense market.

## RESEARCH METHODS

This research is qualitative research. Bogdan and Taylor (1982) stated that qualitative research is a research procedure that produces descriptive data in the form of written or spoken words from people and observable behavior; The approach is directed at the setting and individual holistically. The research method chosen for this study was a comprehensive literature analysis. Arikunto (2010: 14) explains that exploratory studies are research that seeks to explore the causes or initial things that influence the occurrence of something and explore new knowledge to find out a problem. This approach was chosen because it can identify gaps in the literature that provide directions for future research. Relevant sources will be identified through electronic database searches such as JSTOR, Scopus, and Web of Science using relevant keywords such as "Indonesian defense industry", "defense investment", and "modernization of defense equipment". Inclusion criteria will be determined based on topic relevance, source credibility, and year of publication to ensure the freshness of the information. Sources to be included are peer-reviewed journal articles, government reports, conference papers, and recognized books in the fields of defense and economics. Each selected source will be critically evaluated to assess its reliability

and validity. This evaluation will include an assessment of the research methodology used in the source, the strength of the arguments presented, and the contribution of knowledge the source offers to our research topic. This critical evaluation will be conducted by the research team to ensure objectivity and reduce bias. Findings from different sources will be synthesized to build a comprehensive understanding of investment dynamics in the Indonesian defense industry. This synthesis will identify key themes, trends and patterns in the data, and relate these findings to the broader economic and political context in Indonesia. From a synthesis of this information, further analysis will be conducted to identify gaps in the existing literature and provide recommendations for future research. This analysis will allow us to determine the implications of the findings for current and future policy, as well as for investment strategies in the Indonesian defense industry.

## RESULT AND DISCUSSION

Indonesia's defense sector, in the last decade, has become an intense focus of the Indonesian government as part of efforts to increase the country's independence and defense capabilities. Investment in this sector has gained significant momentum, not only as an effort to strengthen national security, but also as a tool to spur technological innovation and economic growth. In this literature analysis, researchers identify and discuss various factors that influence the dynamics of investment in the Indonesian defense industry, as well as their impact on the national economy and technological innovation. A more in-depth discussion of the main findings from the literature analysis on the Indonesian defense industry reveals several important aspects of investment dynamics in this sector.

### **Investment Dynamics Analysis**

Understanding investment dynamics in Indonesia's defense industry requires a close examination of government policies and budget trends over the past decade. The Indonesian government has demonstrated a significant increase in budget allocation for the modernization of defense equipment, reflecting its strategic priorities and commitment to the development of an independent defense industry. The increase in the defense budget, which has reached an average of 10% per year, as reported by the Indonesian Ministry of Defense, is a clear indicator of this effort. This significant budget increase reflects the need to update and increase military capacity, in line with developments in global defense technology and adjustments to changes in the regional security environment. Law no. 16 of 2012 concerning the Defense Industry, which provides the legal framework for this initiative, facilitates the movement towards defense independence by encouraging the growth of domestic industry through fiscal incentives and local purchasing regulations (Defense Industry Law, 2012). This policy aims to reduce dependence on imported defense equipment and to build a defense industrial base capable of meeting the country's military needs. These investments are necessary not only to ensure national security but also as an economic driver through job creation, increased technical expertise, and promotion of innovative research and development (R&D). The government has recognized that the defense industry has the potential to spur technological innovation, which could have broad applications in the civilian sector. Investments in the defense sector often bring progress in fields such as electronics, cyber, and aerospace, which have a significant contribution to a knowledge-based economy (Suryadi, 2021).

Analysis of existing literature shows that the main drivers behind this increase in investment include government policies, political stability, global and domestic economic dynamics, and geopolitical changes. Government policies have played an important role in directing the flow of funds to the defense sector and in creating a conducive climate for foreign and domestic investment in R&D and defense production (Hartanto and Kusuma, 2022). However, these investments are not without challenges. Political uncertainty and changing

regulations can hinder investment, creating a need for more stable and transparent policies to retain and attract further investment (Sulistyo, 2021). Political stability has been proven to be a factor that increases investor confidence, which is important for strong foreign investment flows. The impact of increased investment in the defense industry on technological innovation has been proven through various examples where research and development in the defense sector has driven innovation that has applications in other sectors, such as telecommunications, transportation and manufacturing (Dewi and Sari, 2021). This shows that investment in the defense sector has the potential to provide wider benefits to the national economy. Increasing investment in Indonesia's defense industry has been shown as a strategic step in achieving independence and strengthening national defense capacity. It is hoped that the government's commitment to modernizing defense equipment and developing the domestic defense industry will continue to strengthen Indonesia's position in the context of global and regional security and support national economic growth through innovation and technological development.

### **Government Policy Discussion**

The Indonesian government's policy in the defense sector has sought to create strong synergies between various entities at home and abroad, with the aim of increasing investment in the modernization of defense equipment and the development of an independent defense industry. In the recent period, there has been a significant increase in budgetary allocations to the defense sector, guided by policies designed to attract investment and encourage productive cooperation between government, the private sector and international partners. This policy includes a series of incentives that are expected to motivate and facilitate investment. The government has provided import facilities for components that cannot be produced locally, which allows domestic companies to be more effective in assembling and producing defense equipment with the required imported components. Tax reductions have also been introduced as a way to reduce the financial burden on companies investing in research and development in the defense sector. Sulistyo (2021) documents these various government initiatives and emphasizes how they have been designed to strengthen the foundations of Indonesia's defense industry and make it more competitive at the international level.

However, despite these positive steps, there are still several challenges that need to be overcome. Rahmawati and Putri (2020) have identified political uncertainty and regulatory changes as the main factors that can hinder investment. Political uncertainty can create risks for investors who may feel hesitant to invest capital in long-term projects, especially in countries experiencing significant political fluctuations. Inconsistent or frequently changing regulations can also pose challenges, as they make the business environment less predictable, making it difficult for companies to plan and manage their investments effectively. To overcome this challenge, analysts recommend that the government commit to creating political stability and regulatory consistency. This will not only attract more investment but will also help the companies that have already invested to continue developing and expanding their activities. This stability and consistency is needed to ensure that the investments that have been made can provide maximum results and a sustainable contribution to economic growth and national security.

Looking to the future, government policies must continue to be calibrated to support the growth of the defense industry. This includes strengthening existing legal frameworks, increasing transparency and accountability, and continuing to improve the business climate to facilitate investment. The government should also consider developing more innovative initiatives and programs to attract R&D investments, which in turn will bring technological innovations that can be applied not only in the defense sector but also in civilian applications. By continuing to build on the progress that has been made and by addressing existing challenges, Indonesia can expect to see a defense industry that is not only able to meet national defense needs

but also be a catalyst for broader economic growth and continued technological development. Stable economic growth and improving political conditions in Indonesia have provided a significant boost to investment in various sectors, including the defense industry. In recent years, more consolidated political stability in Indonesia has become an important factor attracting attention and increasing the confidence of foreign investors. Anggraini (2022) in his research found that a longer period of political stability in Indonesia was positively correlated with an increase in the volume of foreign investment in the defense industry. This shows that policies that ensure political stability can be an important key in attracting foreign investment which tends to seek certainty and a predictive environment in which to invest its capital, especially in sectors that require long-term and large investments. On the other hand, Indonesia's developing domestic economic conditions have also become an attraction for local investors, which can be seen from the significant increase in investment activity in R&D and manufacturing of defense equipment. Wibowo and Anwar (2023) stated that more and more domestic companies see the defense sector as a potentially profitable investment area, driven by sustainable economic growth and strong government policy support. They also pointed out that these investments not only support national defense independence but also accelerate the transfer of knowledge and technology, which ultimately contributes to innovation and broader economic growth in Indonesia.

However, there are also challenges faced, as expressed by Rahmawati and Putri (2020), who highlight that political uncertainty and policy fluctuations can weaken investor confidence and hamper investment flows. This challenge demands a rapid and measured response from the government to maintain a stable and attractive investment climate. In this context, government policies including fiscal incentives, facilitation of imports, and regulatory reforms are designed to reduce uncertainty and create a more attractive and sustainable investment environment. Through this approach, the Indonesian government seeks to balance the need for political stability with changing economic dynamics to ensure that the defense sector continues to grow and contribute to broader national goals. Investments in Indonesia's defense R&D sector have had a significant impact on the development and deployment of new technologies, the benefits of which extend far beyond military needs. According to Hasanudin and Maulana (2020), this initiative has contributed to an increase in the number of patents and research in defense technology, signaling growth in original innovation and intellectual property development. This not only raises the country's technological profile but also underscores the importance of the defense sector as a center of technological excellence. Furthermore, Dewi and Sari (2021) identified that technology developed for defense purposes, such as in the fields of surveillance and communications, has been successfully integrated into the transportation and telecommunications industries. This integration creates a so-called 'technology spillover', where innovation driven by defense needs transforms into increased efficiency and security in civilian applications. This kind of technology transfer shows how strategic investment in defense R&D can spur cross-sectoral innovation that brings broader economic and social benefits to Indonesia

## CONCLUSION

Indonesia's defense industry is on a positive path with increased investment and a focus on innovation and independence. To maintain this momentum, consistent and sustainable policies are needed, which support innovation and the development of a strong defense industry. By combining political stability, progressive economic policies, and strategic investment in R&D, Indonesia can not only strengthen its national defense but also spur economic growth and technological progress. The key to success lies in the government's ability to create a conducive

environment for investors and utilize defense innovation for broader interests. Based on this description, it can be recommended:

1. **Strengthen R&D Policy:** Indonesia must continue and increase its support for R&D in the defense sector. These policies could include increased funding for research, development of laboratory infrastructure, and incentives for companies to invest in applied research and innovation.
2. **Public-Private Collaboration:** Develop better collaborative mechanisms between government entities and private companies, including technology start-ups, to promote knowledge exchange and innovation that will benefit the defense sector.
3. **Policy Stability and Consistency:** Ensure that defense and investment policies are designed for the long term and are resistant to political change, so as to provide certainty for investors and companies in long-term project planning and execution.
4. **International Partnerships:** Seek and maintain strategic partnerships with other countries and multinational companies, which can provide access to advanced technology and open new markets for defense equipment exports.
5. **Diversification of the Defense Industry:** Encourage diversification in the defense industry to not only focus on the production of defense equipment but also on the development of cybersecurity, drone and artificial intelligence technology.

**Evaluation and Adaptation:** Governments should regularly evaluate the effectiveness of defense and innovation policies with necessary adaptations based on global and regional dynamics.

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