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Document Version
Final published version

Publication date:
2011

CIBEM WORKING PAPER SERIES
Copenhagen Business School

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CIBEM Working Paper Series
November 2011

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CHINESE FOREIGN DIRECT INVESTMENT IN INDONESIA[i]

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ABSTRACT

China's increasing integration with the world economy is met with much anticipation and much anxiety in the Southeast Asian region. In Indonesia, there is intense interest in Chinese foreign direct investment (FDI), not only among academics but also among policy makers, industrialists and the general public. So much more surprising is the fact that no systematic study of Chinese FDI in Indonesia has been undertaken to date. The current paper contributes to filling this gap and analyses the current composition as well as the historical evolution of Chinese FDI in Indonesia. Relying on a survey conducted in 2008 among Chinese invested enterprises supplemented with available official statistics and secondary data, the study finds that Chinese FDI in Indonesia is performed by mixed entities: some are owned by central government, some by regional government and some are private firms. In the case of joint ventures, their local partners are mostly local Chinese, except in the infrastructure, mining and energy sector where their local partners are Indonesian state-owned enterprises. Where the local developmental effects are concerned, a picture emerges where Chinese investments, at this early period of their internationalization, are likely to give rise to a more modest extent of positive spillovers than investor from more economically advanced countries. This stems from the sectors, investment motives and operational strategies of Chinese investors, the heritage of ethnic tension and segmentation of the economic system along ethnic lines in Indonesia, and the likelihood that Chinese MNCs as latecomers are more vertically integrated than their developed-country counterparts. Finally, considering the evolution of Chinese investments in Indonesia over time, investments have evolved from being individual and isolated projects to acquiring more systemic properties. Chinese companies have acquired a broader sectoral presence in Indonesia and Chinese invested companies in e.g. extractive or manufacturing activities can increasingly rely on complementary Chinese investments in logistics, travel, finance etc.

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INTRODUCTION

From an occasional trickle foreign direct investment from China to Indonesia has grown rapidly to make China the tenth largest investor in 2008. Not only have investment flows grown in size, they have also become more diversified, sectorally and in motives and operating modes. On the Chinese side, Chinese government and companies engage evermore actively in commercial relations with Southeast Asia. On the Indonesian side there is a strong and increasing interest in the extent and nature of Chinese business activities in the region.

So much more surprising is it that to date no systematic study has been undertaken of Chinese investments in Indonesia. The current study set out to remedy this paucity of research. Through the provision of a more comprehensive and systematic overview of Chinese investments in Indonesia the study will also enable identification of stylized characteristics of Chinese investments in the country as well as an assessment of the local economic developmental effects.

In the following we will first discuss the methodology applied and then account for the scarce existing literature on the subject. Next we will briefly discuss drivers of Chinese outward investments and then turn to a macro analysis of Chinese investment flows into Indonesia. The subsequent section accounts for the Indonesian policy environment vis-à-vis Chinese FDI. In the last section preceding the conclusion, statistics is provided for the firm-level survey of Chinese invested companies in Indonesia, which was conducted as part of the study.

METHODOLOGY

In this study Chinese FDI is defined as FDI from the People's Republic of China or mainland China, and excludes FDI from Hong Kong, Macau, Taiwan, or overseas Chinese living outside the country. It might take the form of a wholly owned capital investment or a joint venture with other investors.

Throughout the study the principle of triangulation was applied to information collection. Rather than rely on any single source of data, information was generally sought from several different and independent sources allowing for more valid, reliable and robust results. Hence, among the sources of information relied upon were the following: primary data collected through a firm-level survey in Indonesia; interviews with managers and staff of Chinese invested companies in Indonesia; official statistics from international and national agencies; academic journals, books and papers; policy studies and reports; business, trade and daily press; expert interviews with academics, business associations, and Chinese embassy staff.

Initially a number of leading scholars were consulted on the topic of Chinese outward investment and investments into Indonesia in specific.[ii] Through these consultations it was also established that no comprehensive studies had yet been undertaken of Chinese FDI into Indonesia. Apart from scattered and anecdotal evidence in Indonesian and English language Indonesian media virtually no studies had been done of Chinese FDI in Indonesia. This was surprising given the traditionally strong interest in Indonesian academia, government, industry and general public in issues and activities related to China.

Given the absence of data, statistics and studies on Chinese investments in Indonesia it was necessary to assemble and analyze a collection of primary data in order to establish more accurately

the extent and characteristics of Chinese FDI. Two datasets in particular were constructed to this end: one based on official investment statistics and one based on a firm-level survey.

Official investment statistics

In order to establish the magnitude and sectoral and geographical composition of Chinese FDI into Indonesia, tabulated datasets were acquired from the Indonesian Investment Coordinating Board (BKPM). Among BKPM's mandates is to issue licenses for foreign and domestic investment. The longitudinal datasets spanned the period from 1966, when BKPM was first established, up until 2008. Sector was given according to two-digit ISIC code and location according to province. Both the number of investment projects and the investment values were given. BKPM records both approved and realized investment and while both datasets were acquired realized investment is the better foundation when probing the extent of Chinese FDI into Indonesia. These datasets are not publically available but were tabulated by BKPM specifically for this study.

Care should be taken in the interpretation of official FDI statistics however, as there are many well-known limitations and inaccuracies. Reporting and registration problems are abound, particularly in developing countries. For example, capital flight and portfolio flows are often misclassified, as is indirect outward investment by foreign affiliates.

FDI is customarily broken down into three components: equity capital; inter-company loans, mainly from the principal to their overseas subsidiaries; and reinvested earnings. Whereas equity capital and inter-company loans are captured in balance of payment statistics reinvested earnings are not and can consequently lead to underestimation of FDI and inaccuracy of official statistics. Furthermore, there is evidence that companies have different inclination to reinvest their earnings, with companies having stayed long in the host economy and companies of US origin having a higher propensity to rely on reinvested earnings for example (Athukorala 2003).

In the case of China in specific the problems are compounded by the fact that financial and non-financial FDI are registered by different authorities, that FDI in financial services was only included from 2006, the issue of round-tripping through Hong Kong and the fact that the Chinese definition of FDI is different from the one recommended by IMF, e.g. by applying an ownership threshold level of 25 percent instead of 10 percent (UNCTAD 2007). Furthermore, many large mergers and acquisitions undertaken by Chinese companies are financed outside of China, possibly leading to a significant underestimation of Chinese investment abroad in official Chinese OFDI statistics (UNCTAD 2006).

Firm-level survey

Due to the absence of prior studies or data the choice was made to carry out a representative firm-level survey rather than rely on a few case studies only. This was done well knowing that it would be difficult to persuade the companies to respond. On the other hand a national firm-level survey was previously carried out by one of the authors with good results, even though it was conducted under difficult circumstances at the peak of the Asian financial crisis (Gammeltoft 2003). Consequently, a survey was deemed to be difficult but not impossible to carry out. For the execution of the survey, in addition to the participation of Prof. Gammeltoft and Prof. Tarmidi, two fluent Mandarin-speaking student assistants were hired from the Department of Chinese Studies, University of Indonesia, Ms Seny Lewi and Ms Yuli Yao. Some Chinese executives would speak little or no English and thus Chinese language assistants were required.

A survey questionnaire was elaborated and care was taken to make it as short and concise as possible. The English-language questionnaire was translated into both Indonesian and Mandarin and

to ensure accuracy back translations were performed and the results compared and aligned with the original version. Before administering the questionnaire, a pilot study was conducted by visiting a small number of companies and interviewing an appropriate executive or staff on the basis of the questionnaire with the purpose of testing out its formulation and design.

Since BKPM does not release data, which allows individual firms to be identified, a directory of Chinese invested companies in Indonesia had to be constructed by other means. To this end the commercial business directory 'Standard Trade & Industry Directory of Indonesia' published by PT Kompass Indonesia in Jakarta was purchased. It nominally provides complete coverage of firms in Indonesia and includes profiles with company name, address, phone and fax numbers, names of top executives, activities (sector), and lines of business. The companies which from their name or the names of their top executives appeared as possible Chinese subsidiaries were tentatively included in our directory.

In Indonesia three business associations cater specifically for Chinese firms: the Chinese Business Association in Indonesia (CBAI), the China Committee of the Indonesian Chamber of Industry and Commerce (KADIN), and the Indonesia China Business Council (ICBC). The best data is provided by the Members Handbook of the CBAI, which contains information about firm name, cellular phone numbers of the chief executive and contact person, company phone and fax number, and line of activities, but no address. These three associations were contacted and their member directories were included in our directory.

Chinese subsidiaries, which had been mentioned in Indonesian media, were also added to the directory along with cases identified in an earlier study by one of the authors (Tarmidi 2003). Finally, for the largest and most important Chinese MNCs, which were not already included in the directory, searches were made on their websites and the internet in general to establish whether or not they had subsidiaries in Indonesia.

This resulted in a list with a total of 73 companies. It was likely that some firms on the list did in fact not have any Chinese capital, e.g. agents, importers and purely Indonesian firms with Chinese-looking names for the company and its executives. These firms could be removed from the list when the companies were contacted later on. At this stage, some entries in the directory included only company name and telephone number; others only the company name. In these cases additional information was sought through the information service of the telephone operator and through the internet. In a few cases no additional information could be acquired and we were left with only a telephone number and no postal address.

In February 2009 the Indonesian and Chinese language questionnaires along with an introductory letter were sent to the 54 companies for which we had a postal address. The letters were sent with a private courier service, which is faster and more reliable than the public postal service. A small number of letters were returned due to erroneous address. About a week later, all companies for which we had a phone number were called up on the phone and the appropriate contact person sought out. Those who had received the questionnaire were encouraged to respond and those who had not were sent the questionnaire by post or fax. Companies were also given the option to respond directly over the phone, by email, or by receiving a personal visit by our assistants to help them fill out the questionnaire. Over the subsequent weeks the companies were called up repeatedly to encourage them to respond. Later on, due to a low response rate all firms in Jakarta were visited in person by the authors or the assistants, with or without an advance appointment. Further, an online web questionnaire was set up for the companies to use if they found the internet a more convenient media.

The survey was concluded in August 2009. At this point there were 87 companies in the directory. Of these, 14 had proven not to be Chinese FDI, e.g. companies which were merely agents or producing Chinese products on a license. Another 24 companies had been impossible to locate or contact in any way. In all likelihood these companies did not exist, e.g. companies which had ceased to exist or companies which had planned to invest but never did. This left us with a directory of 48 Chinese invested companies. Of these, 15 responded and the remainder refused. Even though the resulting response rate of 31 percent is very decent for this type of survey, the small absolute number of firms limits the types of analyses, which can be performed, as well as the generalizability.

In addition to the survey, a number of companies were visited and interviews carried out with appropriate executives or staff. Company interviews were generally structured, based on the survey questionnaire, while allowing for open-ended excursions into especially interesting issues which might arise during the interview process. Interviews were also conducted with the Vice Chairman of the Chinese Business Association in Indonesia, staff at the Chinese embassy in Jakarta, the Secretary General of the Association of Indonesian Automotive Industries, and the Director General of the Indomobil Group, the second largest car producer in Indonesia. These interviews were open-ended according to prepared flexible interview guides. The Chinese Business Association representative spoke openly and in detail about the status and evolution of Chinese FDI in Indonesia. The Chinese embassy on the other hand did not want to give out information about individual Chinese firms in Indonesia.

LITERATURE REVIEW

In Southeast Asia there is a profound interest in the evolution of mainland Chinese overseas investments in the region. So much more surprising is the paucity of research and publications on the matter. That so little seems to be published in spite of the general interest is probably related to the fact that the inflows of FDI to Southeast Asia from China are still comparatively modest and that the topic is inherently difficult to research due to scarcity of reliable statistics, the extent of informal capital flows in overseas Chinese communities and that Chinese businesses abroad are often relatively reclusive. For Indonesia in specific, no comprehensive analyses of Chinese FDI in the country have been undertaken to date and only a few articles touch upon the subject.

Foreign direct investment, i.e. investment by a company incorporated in one country into productive assets in another country with the aim of exerting control and reflecting a lasting interest, is generally considered a more stable and more virtuous source of development finance than portfolio flows. While disputes remain concerning the extent and character of developmental spillovers from FDI, spillovers are generally considered mediated through five different channels: demonstration, backward linkages, forward linkages, training, and competition. Local firms can imitate MNC affiliates and learn how to better procure, produce, sell, manage, and adapt technology. MNCs may build local supplier networks and work actively with suppliers to upgrade their product and process standards, creating a backward linkage effect. They may also link forward into distribution networks and directly to customers, supplying them with services related to their products. By training local employees who might later change workplace or otherwise share their knowledge locally, spillovers of skills can occur. Finally, MNCs may increase the level of competition in their sector and induce local companies to increase their productivity and product quality.

Based on the industry surveys of Indonesia's national statistical bureau Takii (2007) analyses whether spillovers from FDI in Indonesia vary among investor home countries, distinguishing

between Japanese, other Asian, and non-Asian firms respectively. Takii notes that there has been a surge in FDI from emerging economies into Indonesia since the late 1980s and that a considerable amount of FDI has come from developing countries in eastern Asia. He finds that these investments were mainly export-market oriented, as opposed to the domestic-market oriented FDI in earlier protectionist periods: faced with appreciating currencies and rising wages companies relocated production abroad to maintain competitiveness. Among the findings is that productivity spillovers from MNCs from Asian emerging economies are greater than those from developed-country MNCs. This supports the claim forwarded by Kokko (1994) and others that a wider technology gap can diminish spillovers.

Using official statistics from the Chinese Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and other available data, Frost (2005) describes the extent and nature of recent Chinese FDI into Southeast Asia and discusses possible implications. He emphasizes that capital is often invested outside China through private channels and therefore omitted from official data, why the latter should be treated with caution as discussed earlier. In terms of consequences of increasing Chinese FDI into the region Frost speculates it might have certain adverse effects on universal promotion of human rights and compliance with international labor standards.

Thee (2006) analyzes investment flows from Northeast into Southeast Asia and how they have evolved in response to changing economic conditions in home countries and shifting policy positions in host countries. China is only sporadically dealt with as an outward investor, however. The paper details how foreign investment policies have varied over time in Southeast countries. Thee finds that with its large market, abundant and cheap labor supply, and natural resources Indonesia has good prospects of attracting more FDI, providing the general business climate is improved.

Tarmidi (2003) analyzes a small number of companies in the motorcycle and electronics industries with Chinese partners. Given the case-based methodology the paper says little about the overall trends of Chinese investments in Indonesia. Yet, by providing details about specific Chinese invested companies it demonstrates the increasing involvement of Chinese investors in Indonesia, not only in resource extraction but also in manufacturing activities.

A special characteristic for Chinese outward investments is that they can engage with the vast global overseas Chinese network. Investors can find business partnerships and form alliances more easily with communities sharing the same culture, tradition and language, and the overseas Chinese are generally successful in business and seen as trustworthy partners. Much has been written about the role of the Chinese diaspora and overseas Chinese networks in understanding both local economic dynamics within a variety of Asian countries and international exchange relationships between mainland China and other Asian countries. These networks are made up of reciprocal relationships (*guanxi*) built on trust (*xinyong*).

Some authors consider the recognition of these networks pivotal to a proper understanding of contemporary economic affairs in most Asian countries (Redding 1993; Luo 2000). Other authors, however, argue that their influence is overstated and that ethnic Chinese economic communities, like others, are predominantly driven by motives of profit maximization and risk reduction (Gomez and Hsiao 2000; Yao 2002). Buckley et al. (2007) argue that the ability to tap into networks of overseas Chinese might be construed as an ownership-specific advantage and constitute a particular location-specific relational asset for Chinese firms. Certain ownership specific advantages are likely to be more pronounced among emerging economy MNCs, such as flexibility, economizing on capital and other resources, familiarity with operations in emerging economy institutional

environments, etc. and any ability to engage in trust-based reciprocal relations with pre-established and economically influential communities abroad would constitute a special relational asset for Chinese firms. Within these networks, market information about the most suitable and profitable investment opportunities can circulate with ease, fruitful commercial relationships can be established that facilitate market entry and development, and investment and commercial risk can be reduced (Buckley et al. 2007).

On the basis of official government data on approved outward investment projects from China, Buckley et al. test the hypothesis by correlating the level of FDI from China with the proportion of ethnic Chinese in the host population. With a highly significant and positive coefficient in their multivariate analysis they find strong support for the hypothesis that familiarity between populations is important in the flow of Chinese FDI. It should be remembered, though, that while strong overseas Chinese networks can well make Chinese FDI operate differently than FDI from other countries, the importance of social networks in general is not alien to extant FDI theories, particularly not to network theory and the Uppsala model.

It is especially important to consider the influence of overseas Chinese networks in an Asian context given that Asia is home to close to 90 percent of ethnic Chinese living outside of China. In 1990 there were around 37 million overseas Chinese and two thirds of these were distributed more or less evenly among Indonesia, Thailand, Hong Kong SAR and Malaysia (Poston et al. 1994).

Specifically in Indonesia, the role of ethnicity has been central to the shaping of the modern Indonesian economy. The number of Indonesians of Chinese origin is relatively low, probably around 3 percent of the total Indonesian population. With a total population in 2007 of around 226 million, the Chinese population in Indonesia accounts for around 6.8 million people. These include Chinese descendants holding Indonesian citizenship, another small number with mainland China citizenship, and probably some with Taiwan citizenship. Today there are only few elderly Chinese left who were born in China, since there were no new waves of Chinese immigrants coming from China for the past 60 to 80 years. There is no exact data on the number of Chinese in Indonesia (see Tan 1979: ix)

Though their number is small Indonesian Chinese have dominated Indonesian economic activities for many years, particularly after the colonial Dutch enterprises left the country in the late 50s. They are still a dominant player in the private sector today (Tan 1979: xiii-xviii; Ong Eng Die 1979; Suryadinata 1986). Most of them are active in the private sector because both in the past and today it has been difficult for them to work in government or join the army and police forces.

Originating from the same ethnic group, sharing common cultural backgrounds, having a common language in Mandarin etc. it can be expected that Chinese foreign investors, if they form joint ventures with local partners, would prefer to choose Indonesian Chinese rather than indigenous firms as business partners (Tarmidi 2003: 203). Further, investment projects often grow out of business contacts established through business trips of Indonesian Chinese visits to mainland China.[iii]

DRIVERS OF OUTWARD FDI FROM CHINA

There are several important drivers of Chinese OFDI, the most important of which are gaining access to and building markets, securing natural resources, acquiring strategic assets, burgeoning foreign exchange reserves, proactive government policies, international competitive dynamics, and extra-productive motives.

When China embarked on allowing the outward flow of foreign direct investments during the period 1979-1983, it was politically driven primarily to search for natural resources to guarantee the fast growth of the domestic economy. Only state-owned trading and regional-based enterprises were allowed to invest abroad. But as time passed by and along with political change in China privately owned enterprises were increasingly allowed to invest abroad and the overseas investments became increasingly commercially oriented. This evolution is also reflected in the sectoral composition of outward FDI from first natural resources security based to the manufacturing sector and lately more to the knowledge-driven sectors.

Today, most investments are made to access and develop markets abroad in response to, on the one hand, the increasing accessibility of these markets with global market liberalization and integration and, on the other hand, increasing foreign competition in domestic markets. In addition to acquiring natural resources and developing markets, gaining access to strategic assets such as technology, brands and distribution networks is increasingly a motive. As mentioned above efforts to secure access to natural resources have been a strong driver for Chinese investments, especially in Africa, and the three largest outward investing companies as measured by outward FDI stock are petrochemical companies (see Appendix 1).

One respect in which Chinese MNCs tend to differ from their Western counterparts is by having less firm-specific advantages to support their internationalization. FDI is to a larger extent made with the intent to compensate for weaker firm-specific advantages or to acquire firm-specific advantages e.g. through acquisitions of firms abroad along with the technological assets they posses.

Chinese multinationals are characterized by being large, by having entered the global economy relatively recently and almost all of them are state- or regional-owned enterprises. Most large Chinese companies are owned by central or local government and this applies equally to companies with investment abroad: going through the official list of China's 40 largest MNEs as measured by FDI stock, only four of these companies are not state owned (see Appendix 11).

These multinationals are representing the activities of their mother companies in China within the confines of technological capabilities and quality standards. China's industrialization is characterized by being low-wage, low-tech, low-productivity manufacturing at the low end of global supply chain on the one hand, and high investment, high resource consumption and pollution, high exploitation, and high degree of foreign capital/trade dependency on the other' (Lin Chun 2007: 11). In contrast to multinationals from other developing countries, which operate in a limited number of foreign countries, Chinese multinationals operate in a large number of countries world-wide (compare Chan-Fishel and Lawson 2007: 64), similar to some South Korean large firms. The position of Chinese multinationals among developing countries was conspicuous: as of 2001, out of the 50 largest multinational corporations from developing countries, China was represented by no less than 12 firms (Gammeltoft 2008: 19).

The burgeoning Chinese foreign exchange reserve accumulated from a persistent trade balance surplus in itself brings about an inducement to invest abroad as a non-inflationary and productive outlet of funds. Traditionally these funds have been invested in US securities, particularly government bonds, also with the intent to support the value of the US dollar but investment strategies have become more activist, increasing the focus on direct investment vis-a-vis portfolio investments.

Chinese MNCs differ from their counterparts in other East Asian late-industrializing countries by not having been through an import-substituting period prior to their drive to internationalization. Companies in Japan, Korea, Taiwan and some extent Singapore were able to build up their capabilities in protected domestic markets before venturing abroad. Chinese companies on the other hand are exposed earlier to foreign competition at home and to the opportunities of global markets abroad. In other words, compared to companies in other Asian late-industrializing countries they have more opportunities to internationalize. At the same time foreign competition in home markets induce them to seek markets abroad and also give them a stronger incentive to seek assets abroad, which they can leverage to compete better at home.

Even though Chinese outward investment has gradually moved from being policy-driven and government-led towards becoming more commercially-driven and enterprise-led, a significant element of policy inducement remains. Proactive government policies have helped push up Chinese FDI outflows, as discussed in the section ahead.

INWARD FDI TO INDONESIA: RECENT TRENDS

With its large population and wealth of natural resources Indonesia is an attractive destination for foreign investments. Though the income per capita is still relatively low, with rapid economic growth it promises a good prospective market for selling consumer goods. Because of the low level of wages, investors from more advanced economies are attracted to relocate their sunset industries to Indonesia to be more competitive in the world market. From here they can sell their products to the domestic market and export to other countries. However, due to internal economic, social and political conditions and instability, the business climate is less favorable so that many investors refrain from coming to Indonesia (see Schill 2007).

Table 1 Realised Foreign Direct Investments by Selected Country, 2006 – Jan/Febr 2009 (number of projects and USD million)

	2006		2007		2008		Jan/Febr 2009	
	P	Value	P	Value	P	Value	P	Value
China	11	32	22	29	27	140	7	8
Malaysia	36	408	56	217	74	363	8	7
Singapore	81	508	124	3,748	184	1,487	26	41
Japan	113	903	113	618	130	1,365	17	67
South Korea	140	476	164	628	182	301	31	214
Taiwan	36	64	33	470	35	69	3	1
Netherlands	24	35	36	147	34	90	7	61
United Kingdom	49	661	63	1,686	57	513	8	121
U.S.A.	32	66	31	145	35	151	6	2
Australia	23	9	26	195	34	36	2	7
Total	869	5,992	982	10,341	1,138	14,871	176	1,531

Notes: P = Number of projects; Value = Value in USD million
Source: BKPM, August 2009

During the past three years, from 2006 to 2008, the trend of the total number of realised projects has increased quite significantly from 869 projects to 1,138 projects (see Table 1).[iv] And the value of investments also increased drastically to two and a half fold during the three-year period from USD6 billion to USD14.9 billion respectively. In terms of number of projects in 2008, Singapore with 184 projects ranked number one, followed closely by Korea with 182 projects while Japan ranked third with 130 projects. China, though on the increase, realized only 27 projects and ranked 10.

In terms of investment value in 2008, Singapore ranked first with USD1,487 million followed closely by Japan with USD1,365 million, and far behind on the third place by the United Kingdom with USD513 million. China ranked 7 in terms of investment value, though the trend was increasing rapidly, from 11 investment projects with a value of USD32 million in 2006 to 27 with a value of USD140 million.

Table 2 Realised Foreign Direct Investments by Sectors, 2006 – Jan/Febr 2009

	2006		2007		2008		Jan/Febr 2009	
	P	Value	P	Value	P	Value	P	Value
1.Food crops & plantation	13	352	16	219	10	147	9	199
2.Livestock	7	19	7	46	1	5	2	24
3.Forestry	1	31	-	-	-	-	-	-
4.Fishery	5	33	5	25	3	2	-	-
5.Mining	13	99	34	310	41	181	6	172
6.Food processing	45	354	53	704	42	491	4	116
7.Textile	61	424	63	132	67	210	10	20
8.Leather goods & footwear	11	52	10	96	20	146	3	13
9.Wood	18	59	17	128	19	120	6	14
10.Paper & printing	16	747	11	673	15	295	3	5
11.Chemical & pharmaceutical	32	265	32	1,612	42	628	4	917
12.Rubber & plastic	33	113	36	158	50	272	9	13
13.Non-metallic minerals	7	95	6	28	11	266	1	0.2
14.Metal, machinery & electronics	86	955	99	714	141	1,281	13	18
15. Medical, optical instruments, watches & clocks	1	0.2	1	11	7	16	1	1
16.Motor vehicles & transport equipment	28	439	38	412	47	756	8	50
17.Other industries	25	117	24	30	34	35	3	4
18.Electricity, gas & water supply	3	105	3	119	4	27	-	-
19. Construction	18	144	16	448	21	427	3	385
20.Trade & repair	266	434	312	483	375	582	60	112
21.Hotel & restaurants	31	111	22	136	22	157	5	43
22.Transport, storage & communication	37	647	43	3,305	35	8,530	7	11
23.Real estate, industrial estate & business activities	16	254	8	65	19	175	-	-
24.Other services	96	144	126	489	112	123	27	52
Total	869	5,992	982	10,341	1,138	14,871	176	1,971

Notes: P = Number of projects; Value = Value in USD million
Source: BKPM, August 2009

Looking at the distribution of realized FDI into Indonesia according to economic sectors (Table 2), in 2008 the sector trade and repair saw the most activity in terms of number of investments with 375 projects, followed by the metal, machinery and electronics industry on the second place with 141 projects, and the textile industry ranked third with 67 projects. In terms of investment value, the largest capital investment by far was undertaken in the sector transport, storage and communication, amounting to USD8.5 billion. Next in ranking on the second place came the metal, machinery and electronics industry with USD1.3 billion, followed by the motor vehicle and transport equipment industry with USD756 million, the chemical and pharmaceutical industry with USD628 million, trade and repair with USD582 million. The fastest growing sector in terms of investment value during the period 2006-2008 was the sector transport, storage and communication, which increased from USD647 million investment value to USD8,530 million, though the number of projects declined slightly from 37 to 35.

European investments in Indonesia tend to focus on covering the domestic market for selling their products and services. On the other hand wealthy Asian nations concentrate more on using Indonesia as their export-oriented production base of manufacturing like garments and consumer electronics, and Americans on oil and gas exploration and mining activities (Schill 2007).

Chinese foreign investments in Indonesia

Indonesia's economy is dominated by ethnic Chinese which makes the country attractive to multinationals from China. Many Indonesian Chinese still speak Chinese, and as by now all of them were born in Indonesia, they know the local market and conditions well. On the other hand, many expat mainland Chinese do not yet speak English well.

Multinationals from industrialized countries and newly industrializing economies relocate their labor-intensive low-technology sunset industries to low-wage developing countries to benefit from low wages and maintain competitiveness. Multinationals from China do not have the same incentives to do so as wages in China are already relatively low. Rather, they tend invest to serve local markets or extract resources. In some sectors, e.g. infrastructure and motorcycles, Chinese technology is more advanced than Indonesian and Chinese investors can benefit from combining their technology with location-specific assets.

The Bank of China was established in Indonesia as early as the 1930s. Only since diplomatic relations between China and Indonesia were resumed in 1990, Chinese FDI started to flow into Indonesia. The majority of Chinese FDI is performed by state owned enterprises. It is not uncommon to enter through joint ventures for a number of reasons: the investment law in Indonesia does not permit full foreign capital investment in certain economic activities, e.g. the Chinese investor in PT Ocean Global Shipping owns only 49 percent of the shares; (b) to avoid conflicts with Indonesian laws and regulations; (c) to better negotiate the sometimes difficult business environment in Indonesia.[v]

Table 3 Realized FDI from China by sector, 1966-2007 (number of projects)

	1995	1996	1997	2000	2001	2002	2003	2004	2005	2006	2007	Total
PRIMARY												
Mining							1		1	2	2	6
SECONDARY												
Food Industry						1			1			2
Textile Industry					2					1	2	5
Wood Industry							2		1			3
Paper, Paper Products & Printing							2					2
Chemical & Pharmaceutical Industry	1	2		1		1		1		1	1	8
Rubber & Plastic Goods Industry						1						1
Non Metallic Mineral Products Industry			1									1
Basic Metal, Metal Products, Machineries & Electronics Industry							1		2	5	1	9
Transport & Transport Equipment Industry				1			3		1		3	8
Other Industry								1				1
TERTIARY												
Construction							1					1
Trade & Reparation					1	1	2	2	5	2	11	24
Transport, Storage & Communication				1	1	1	1					4
Real Estate, Industrial Estate & Office Building			1									1
Other services		1						2	1		2	6
TOTAL	1	3	2	3	4	5	13	6	12	11	22	82

Table 4 Realized FDI from China by sector, 1966-2007 (USD million)

	1995	1996	1997	2000	2001	2002	2003	2004	2005	2006	2007	Total
PRIMARY												
Mining							0.5		0.2	1.5	0.8	3.0
SECONDARY												
Food Industry						3.9			7.8			11.7
Textile Industry					9.1					8.7	14.7	31.9
Wood Industry							54.7		0.2			54.8
Paper, Paper Products & Printing							3.3					3.3
Chemical & Pharmaceutical Industry	1.4	3.3		0.5		0.5		1.6		2.3	2.6	12.1
Rubber & Plastic Goods Industry						0.3						0.3
Non Metallic Mineral Products Industry			6.9									6.9
Basic Metal, Metal Products, Machineries & Electronics Industry							2.5		7.6	18.3	1.0	28.8
Transport & Transport Equipment Industry				2.0			3.9		13.0		6.1	24.1
Other Industry								0.7				0.7
TERTIARY												
Construction							0.1					0.1
Trade & Reparation					0.2	0.1	0.3	2.0	11.6	0.8	4.6	18.8
Transport, Storage & Communication				0.2	0.6	1.5	18.8					21.2
Real Estate, Industrial Estate & Office Building			1.0									1.0
Other services		1.0						3.8	5.3		0.3	1.5
TOTAL	1.4	4.3	7.9	2.7	9.8	6.3	83.3	8.1	45.5	31.5	28.9	229.0

Looking at the statistics from the Investment Coordinating Board (BKPM) discussed in the methodology section, total realized Chinese FDI in Indonesia from 1966 to 2007 amounted to 82 projects (see Table 3) with a value of USD229 million (Table 4).[vi] According to the BKPM data, the first Chinese FDI that came to Indonesia was a single investment project in 1995 with a value of USD1.4 million in the chemical & pharmaceutical industry in East Java. Until the year 2003 the number of investment projects was less than ten projects yearly, but the number started to increase and reached its peak in 2007 with 22 projects. The value of investments increased rapidly and reached its peak in 2003 amounting to USD83.3 million but then dropped sharply to USD28.9 million by 2007. By regional distribution, the highest value of investment took place in Central Kalimantan with USD51.6 million, although it was only for one project in the wood industry. Next came Banten with USD51.3 million and Jakarta with USD45.5 million. Other provinces absorbed only small value of investments.

Realized Chinese FDI in the manufacturing sector 1966-2007 total 40 projects worth USD174 million (see tables over). Hence the majority of Chinese FDI in Indonesia by value is in the manufacturing sector. The value of investments first increased from USD1.4 million in 1995 to its peak of USD63.6 million in 2003 but then declined to USD23.7 million in 2007. Most of the investment projects are located in Java, particularly in Jakarta. The metal, metal products, machineries & electronic industry is leading in the number of projects with nine projects, followed with each eight projects in the chemical & pharmaceutical industry and the transport equipment industry. In terms of investment value, the highest investment value was in the wood industry with a total of USD54.8 million, followed by the textile industry with USD31.9 million, the basic metal, metal products, machineries & electronics industry with USD28.8 million and the transport & transport equipment industry with USD24.1 million. The absorption in the other industries was relatively small.

On 26 September 2002 an 'Energy Forum' between Indonesia and China was established. This constitutes an umbrella agreement for China to undertake investments in the field of energy in Indonesia. The rapid growth of the Chinese economy increases a high demand for energy and to secure energy supply from abroad. China has three big oil companies, where the government holds the majority shares, the China National Petroleum Corporation (CNPC), the China Petrochemical Corporation (Sinopec), and the China national Offshore Oil Corporation (CNOOC). The other shareholders are private individuals and institutions. CNOOC, established in 1982, is a joint venture with foreign capital and its activities is in offshore oil exploration. Sinopec, established in 1983, is a holding company encompassing the whole area of petrochemical industry like oil refinery, oil derivative products, petrochemical products, chemical fertiliser, synthetic fibre and rubber. CNPC or Petro China, established in 1988, is engaged in the upstream activities of oil and gas exploration (Wibowo and Kusuma 2009).

All three oil companies are presented in Indonesia. They did not establish new ventures in Indonesia, but rather acquired shares from existing foreign oil companies. CNOOC was already active in Indonesia since 1993, when it bought 32.5 percent shares of the oil fields in the Malacca Strait and another 6.93 percent in 1995. In April 2002, the company acquired the shares of five of the seven oil field blocs owned by Repsol YPF, a Spanish oil company. These are in the offshores of West Java (37 percent), Southwest Sumatra (65 percent), West Madura (25 percent), Poleng (50 percent) and Blora in Central Java (17 percent). A big project on the development and exploration of natural gas was signed on 26 September 2002 between the government of Indonesia and CNOOC. CNOOC will invest USD8.5 billion in the project located at Tanguh, Papua Province, and the liquefied natural gas will be exported to Fujian Province and Shanghai in China. The agreement will take effect in 2008. Petro China in 2004 obtained the rights to operate an oilfield in Sukowati. CNOOC in 2007 with PT SMART from Indonesia and a Hong Kong firm agreed to invest a capital of USD5.5 billion to produce biofuel. In its further expansion CNOOC acquired 50 percent of the shares of Husky Energy to develop an offshore natural gas field in the Madura Strait, in East Java. On the other hand Sinopec in Juli 2005 signed a co-operation contract with the Indonesian government to explore oil production in Tuban, East Java. The project is planned to start in 2007. The third Chinese oil company, the CNPC, together with Petro China in April 2003 have acquired 30 percent shares of Amerada Hess Indonesia Holding Ltd. to explore an oilfield in Jabung, Sumatra. (Wibowo and Kusuma 2009).

Still another private Chinese oil company, the CITIC Seram Energy Ltd., in 2006 acquired 50 percent of the shares of KUTEC, a Kuwaiti oil company. The company operates on the island

of Ceram in the Moluccas. The CITIC mother company started as a private bank in China, but expands to many fields of economic activities.

The Synohydro Corporation, founded in 1950, is the largest company in China in water conservation and hydropower industry. Its main business covers investment, project financing, consultation services, construction, mechanical and electrical plant manufacturing and installation, construction equipment manufacturing and trading in the industry of water conservation, power generation, expressway, railway, harbour and sea-routes, airport, municipal public utility and building. It now operates world-wide. In 2007, Sinohydro expands its investments from hydropower and coal power projects to wind power, real estate, infrastructure and water supply projects (www.sinohydro.com). On 25 April 2008, the Synohydro Corporation signed a contract with the Indonesian electricity company PLN to build a coal-burning electricity power plant in the province of Nanggroe Aceh Darussalam with a capacity of 200 MW (Krismantari 2008)

The Industrial and Commercial Bank of China (Indonesia) Co. Ltd. was established on 28 September 2007 as a foreign exchange licensed commercial bank. It now has 12 branches located in three big cities in Indonesia, Jakarta, Bandung and Surabaya. The ICBC took over 90 percent of the shares of an Indonesian private commercial bank, the Bank Halim, owned by an Indonesian Chinese (International Herald Tribune 2007).

In the manufacturing industry, China often exports their final products to Indonesia rather than to undertake investments as Indonesia offers few cost advantages over China and trade is liberalized. Chinese products are generally of low to medium quality and they can capture market shares because of the low prices (cf. Tarmidi 2003: 205).

In the car assembling industry, some companies are producing for one principal only like Honda, Hyundai Indonesia Motor, and the Krama Yudha Group who is only producing for Mitsubishi. But some other companies, although they are producing for a main principal they are also assembling other car brands as well. E.g., the main principal of the Astra Group is Toyota Motor, but they also assemble other car brands like MAN, Renault, Nissan, and Daihatsu. The PT Gaya Motor, an affiliate of PT Astra International, assembles BMW, Isuzu and Peugeot cars (see Gaikindo 2001). The entrance of Chinese cars in Indonesia is of very recent date and the domestic market is already dominated by mostly Japanese brands. Back in July 2007, the Indonesian company PT Gaya Motor with full capital investment launched the Chinese Geely car. However, the production volume remains very small, because the brand is a latecomer and competition is very stiff. The Geely International in China has already 20 years experience behind them in the automotive industry and has strategic alliances with Daewo from Korea and Maggiora from Italy. Its production capacity is 650,000 units annually.

Another company, the Indomobil Group, whose main principal is Suzuki, is also producing other car brands like Hino, Volkswagen, Volvo, Ssangyong, Audi, Nissan, and Mazda (Gaikindo 2001). But since 2006 the company is also assembling the Chery passenger cars from China, followed in 2007 by Foton trucks, and since early 2008 the double cabins SUV by the name of Great Wall. These are all domestic investments by Indomobil based on technical assistance agreement with the mother companies in China. The Chinese car producers are all state-owned enterprises and they do not invest any capital in the Indomobil enterprise. Indonesia is chosen as the production base for the Chery car for the ASEAN market. The market for Chinese automobiles in Indonesia is still very small. Production

targets by Indomobil for 2009 are 1,000 units of Foton trucks, 250 units of Great Wall SUVs and 1,500 units of Chery cars. Sales of Chery personal cars in Indonesia increased from 269 units in 2006 to 759 units in 2007.

The Indomobil Group was originally fully owned by an Indonesian Chinese businessman but during the financial crisis in 1998 the company ran into financial difficulties and had to sell most of its shares to the Japanese. Now the Indonesian partner is only a minority shareholder in the company. The reason for the Indonesian shareholder to produce Chinese cars is one of long-term strategic consideration. The Indonesian partner has no power anymore in the policy of the Indomobil Group, all are now in the hands of the Japanese top executives. The Indonesian partner founded three separate independent companies for each Chinese car brand, where they have full control over it and can determine the future of the three brands. Hence they can reduce their dependence on the Japanese partners. To be economically viable, a car producer must fulfill a minimum scale of production capacity and therefore it needs a large amount of capital investment. This is a highly risky investment venture, as the domestic market is already dominated by many foreign brands from Japan, Europe/Germany, the US and Korea. But for an existing large car assembling plant like the PT Indomobil, it has already a relatively large production plant, has capital and disposes of a well-established marketing channel chain, besides a long time experience in production and sales. The initiative for assembling Chinese cars in Indonesia came from the Indonesian side, since the Chinese carmakers themselves were not interested in investing directly in Indonesia.[vii] The reason the Chinese brand owner does not invest directly in Indonesia might be that building a new assembling plant would involve high investment costs, whereas the future market is uncertain due to intense competition in the automobile market in Indonesia. Another reason might be that by joining a local assembling plant it can capitalize on the existing sales network and marketing system.

The Indonesian government protects the automotive assembling industry in the country with relatively high import tariffs for completely built-up (CBU) vehicles, whereas imports of completely knocked-down (CKD) kits enjoy a much lower tariff, so that there is less incentive to import automotive vehicles in CBU condition. While before 1999, imports of CBU cars were prohibited and only cars in CKD condition could be imported, today cars in CBU condition may also be imported. However, import duty for CBU cars is much higher than for CKD cars. In September 2007, the Indonesian government increased the tariff rate for CBU passenger cars with a capacity of over 1,800cc from 20 percent to 45 percent. On the other hand it reduced the tariff rate for imports of cars over 2,500cc in CKD condition from 45 percent to 20 percent (*Kompas* daily news, 29 October 2007).

Unlike the car assembling industry, the motorcycle assembling companies in Indonesia have only one principal and are producing only for that principal, e.g. like Honda, Yamaha, Suzuki, and others. The Chinese motorcycle companies in Indonesia also do not form alliances with the existing motorcycle assembling companies (Tarmidi & Gammeltoft 2008: Attachment 3). This may also be related to the fact that the capital investment value required in these plants is much less than in the car manufacturing industry.

Assembling of CKD and importation of CBU motorcycles from China started around 1995. At the beginning there were over 100 firms in the business and could sell quite a large number of motorcycles, because the price is very low. Importer firms were exclusively owned by Indonesian Chinese, as were the motorcycle assembling companies. Only few of these assembling companies were FDI from China, and few were also joint ventures with

local Chinese, but the vast majority of the companies were fully owned by Indonesian Chinese. Motorcycles from China found a market niche in particular during the financial crisis from 1997 to around 1999 but there are no records as to their activities in Indonesia. But pretty soon many of them were closed due to failing sales: though they could offer low prices, the quality was notoriously bad. There is an Indonesian Motorcycle Industry Association consisting of Japanese producers, but none of the Chinese motorcycle assemblers are members of this association. Supposedly there is an Association of Indonesian Motorcycle Producers consisting of around 20 members, all of them producing Chinese motorcycles, however not much is known about their location or their activities.

Most of the companies are fully owned by Indonesian Chinese, notably former motorcycle agents. One of the very few fully-owned Chinese assemblers is the Lifan Indonesia. Their plant is located is the eastern part of Jakarta, employing some 200 workers. The company started production in 2000 producing 30,000 motorcycles per year. But sales fluctuated from 10,000 units in 2001, 30,000 units in 2002 and dropped back to 10,000 units in 2003. The parent company, the Chongqing Lifan & Honda Motorcycle Manufacture Co., Ltd., was founded in 1992 and is located in Chongqing, China. Though relatively new, Lifan produced 1.5 million motorcycle engines in 2000 and exports its products to around 70 countries in the world (Tarmidi 2003: 192).

Some of the companies are joint ventures with local Indonesian Chinese. The local partners are usually agents of existing Japanese motorcycle brands. So the Chinese investors capitalize on the knowledge of local market conditions and sometimes on the existing marketing networks, but they do not form alliances with the established motorcycle assembling companies. One of them is the PT Buana Jialing Sakti Motor, a joint venture between the China Jialing Industrial Co., Ltd., and the PT Buana Jaya Makmur Sakti Motor from Indonesia with each 50 percent shares. The company was established in 1996 and started production in 1997. The company imports motorcycle components and parts in CKD condition from China and uses also local components. The plant is located on two sites in the western part of Jakarta. The company employed around 200,000 workers in 2002 with a production capacity of 10,000 units per month and actual production of around 5,000 units. The parent company in China started producing motorcycles in 1979 and in 2000 the company produced 2 million units per year and claims to be the fourth largest motorcycle producer in the world. Another joint venture company is the PT Sanex Qianjiang Motor International, where the Chinese investor is a minority shareholder. The distribution of the shares is as follows: PT Sanex Motor Indonesia from Indonesia (65 percent), and the rest is divided between Qianjiang from China, Lion Group from Malaysia and CPI Motor from Taiwan. The plant has a production capacity of 6,000 units/month and is located in the western part of Jakarta, in the province of Banten. But actual production in 2002 was between 2,500 and 3,000 units a month with a total of some 500 employees, 300 of which were working in the factory (Tarmidi 2003: 189-192).

Today, the euphoria for cheap Chinese motorcycles in the late 90s and early 2000s is gone and consumers have realized that the quality of most of the brands is very low. For some brands spare parts are not available and there is a lack of after sales service and financing facilities. Most of the assembling plants and some brands like Sanex, Jialing and Lifan appear to have suspended production. Some surviving brands known are Viva produced by Vivamas Qingqi Motor Indonesia, a fully owned Indonesian Chinese company, and another brand, TPS. Vivamas survives because it is probably the only company in Indonesia producing three-wheel motor vehicles with a small cart attached at the back, which is very handy for

small shops in transporting small merchandise for short distances. The company also still produces a small number of motorcycles.

For the following reasons, Chinese automotive producers do not invest full scale in Indonesia: (a) they are latecomers in the Indonesian automobile and motorcycle industry, which is already overwhelmingly dominated by well established Japanese brands. They are not able to compete head on in the market; the best they can achieve is to win a relatively small market niche. The agent importers then set up distribution and services centres in several cities in Indonesia to support their sales operations, because they know the local market conditions better. Therefore, it does not make sense for the Chinese company to invest heavily in this sector. (b) Typically it is the agent importer, who first imports the products in completely- built-up (CBU) condition, who then subsequently builds an assembling plant because they have already established related distribution and services centers. The importers are generally of ethnic Chinese. (c) The Association of Southeast Asian Nations (ASEAN), of which Indonesia is a member, has signed a Free Trade Agreement with China. So trade has become more open and free between China and Indonesia, and Chinese goods are highly price competitive in the world market; the incentive to look for other low-wage countries is limited.

INDONESIAN POLICY VIS-À-VIS CHINESE FDI

Generally, Indonesia's FDI regime is very open. In 1967 Indonesia for the first time enacted Law No. 1 on Foreign Investment and in 1968 Law No. 6 on Domestic Investment. Before, approvals for investments were being extended by individual ministries and foreign investments were being treated differently than domestic investments in terms of facilitation and field of activities. The fields of activities for foreign investments were much more restrictive than that for domestic investments. The goal of the two laws is to provide a one-stop service to investors in order to simplify investment application and approval, and to this purpose the government founded the Investment Co-ordinating Board (BKPM).

In compliance with the Trade-Related Investment Measures (TRIMs) agreement in the WTO, Indonesia has in 2007 revised and enacted a new Law No. 25 on Investment, indicating that there should be no discrimination between domestic investment and foreign investment. Article 4 paragraph 2a stipulates that domestic as well as foreign investment will receive equal treatment in terms of taxation and regulations, however there will be unequal opportunities as certain economic activities are closed for FDI (Article 12 paragraph 2b). To that purpose the government issues a negative investment list. The negative investment list distinguishes six categories of investment: (1) Sectors that are closed for domestic as well as foreign investments; (2) Sectors that are open for domestic investors; (3) Sectors that are open for foreign investors under certain prerequisites; (4) Sectors that are open for foreign investments in form of joint ventures, in which the minimum capital share of local partner(s) is fixed at 5 percent; (5) Sectors that are open for local small-scale investors; (6) Sectors that are open for foreign investments, when they have a joint venture with local medium- and large-scale enterprises.

Foreign relations between China and Indonesian have fluctuated from amicable (under President Sukarno) to antagonistic (under President Soeharto) to laissez-faire (under Presidents Habibie and Sukarnoputri) to activist (today). Indonesia had amicable foreign relations with China under Sukarno. Diplomatic relations were broken off in 1967 when Soeharto came to power and were not restored until 1990. Even after 1990 relations were

uneasy, also due to the plight of the Indonesian Chinese. Only when Abdurrahman Wahid became President in 1999, have relations became more positive - also reflected in increasing flows of investment, trade and finance. The increasing engagement of Chinese MNCs, many of them state owned, in Southeast Asia is also reflective of a broader regionalist agenda with closer integration between Asian nations, diplomatically as well as commercially.

Indonesia-China political and economic relations are generally good, though at times hampered by atrocities against the local Chinese minority and by the Indonesian government's position to Taiwan. Diplomatic relations between the two countries were established in late March 1950. This diplomatic relationship was suspended on October 31, 1967, when the Chinese government was accused of supporting and sympathizing with the alleged Indonesian Communist Party coup in 1965. Twenty five years later, on August 1990, diplomatic relations were resumed. The peak of bilateral relations was reached when 25 April 2005 both sides signed a Strategic Partnership Agreement on the occasion of President Hu Jintao visit to Indonesia. The Agreement consists of three pillars: political and security co-operation, economic and development co-operation, and social cultural co-operation. (Hadi 2009: 58).

From the Indonesian side, the government is interested to attract as much FDI as possible from abroad including from China. This agenda was pursued e.g. during the visit of President Yudhoyono to China in late July 2005 and Vice President Jusuf Kalla in June 2007. On the other hand China is more interested in having open trade than in undertaking investments because prices of Chinese products are very competitive in the world market. During the Vice President's visit, China prepared a loan of USD800 million for various projects in Indonesia. A loan of USD250 million is reserved for the construction of the Jatigede dam in West Java, and the rest would be used to build a 517 kilometer-long double-track railway project in Central Kalimantan, the transportation of 2.6 metric tons of LNG (liquefied natural gas) from Papua to Fujian Province, and the building of thermal power plants and road construction (Abdussalam 2007).

Interests from Chinese firms to enhance economic relations with Indonesia are relatively high. It was reported by a local newspaper, that 400 Chinese entrepreneurs from Guangdong and Indonesian businessmen have signed in Jakarta on September 5, 2008, a memorandum of understanding to cooperate in 20 investment projects in Indonesia worth USD597 million. The joint projects will be in the sectors energy, electricity, plantation estates, agriculture, foodstuff, infrastructure development, and trade. (*Kompas* daily news, 5 September 2008). However, there are none in the manufacturing sector. Again in late August, 100 business representatives and 20 government officials, led by the governor of Henan Province were visiting Indonesia to set up business contacts (Kompas daily news, 25 August 2009).

A free trade area between China and the ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) has been established. The framework agreement for the ASEAN-China Free Trade Agreement (ACFTA) was signed on 4 November 2002 in Phnom Penh, Cambodia. In 2005 an agreement for trade in goods went into effect, in 2007 one for services, and in 2010 an agreement on investments. This implies that more investment opportunities will be opened and there will be more open and free flow of capital between the member countries in the region. The objective of the Agreement is to strengthen and enhance economic, trade and investment co-operation between both parties, and to create a transparent, liberal and facilitative investment regime.

The Investment Agreement implies that foreign investments from China to ASEAN countries will increase and vice versa. Though this is a positive development it is not certain yet that the outflow of Chinese investments will primarily go to Indonesia. Many sources predict that future Chinese outward foreign investments will increase significantly but this is also likely to be contingent on the extent to which Indonesia improves its investment and business environment. On the other hand, with the Trade in Goods Agreement in place, trade in goods will also increase as trade impediments are being abolished. As trade becomes more open, it will have an adverse effect on market-penetration oriented investments from China as most products are produced more cheaply in China itself.

THE FIRM-LEVEL SURVEY

The following section reports the findings from the firm-level survey of Chinese invested companies in Indonesia, which was conducted from February to August 2009. Among the 15 Chinese invested companies, which responded to the questionnaire, four are engaged in mining & quarrying activities, five in manufacturing industries, and two firms in each of the three other sectors: construction, transportation & storage, and financial & insurance services (see Table 5). I.e. well over half of the firms are in either mining & quarrying activities or in manufacturing industries.

Table 5 Sectoral distribution of firms in the sample (number and percent)

Sector	Firms	Percent
Mining & quarrying	4	27
Manufacturing	5	33
Construction	2	13
Transportation & storage	2	13
Financial & insurance activities	2	13
Total	15	100

Note: coded according to ISIC Rev.4

The location of the firms is spread out in many provinces in Indonesia but highly concentrated in the capital city, Jakarta. Six out of 13 firms reporting their location are located in Jakarta. The firms were inquired about the location of the main production facility. If this is outside Jakarta many firms will in addition have a central office in Jakarta.[viii]

With respect to the year of establishment of the 14 firms that answered the question they are almost equally distributed over the years from 1992 to 2007. The earliest year of establishment is 1992 reported by the China National Technical Import-Export Corporation. Air China Ltd. reports to have first invested in 1994. These two projects may, or may not, initially have been branch offices rather than FDI since according to the Indonesian Investment Coordinating Board (BKPM) data reported earlier, the first Chinese FDI entered Indonesia only in 1995. On the other hand BKPM data is often not accurate.

The size of the firms in terms of number of employees is very mixed, the smallest being 20 employees and the largest 1,500 employees (N=9). Most companies are SMEs with only three companies exceeding 150 employees.

In general the number of Chinese expatriates working in Chinese companies in Indonesia is modest with over half having less than 10 percent mainland Chinese among their employees (N=9). A single company has a share over 50 percent. The survey also reveals that mainland

Chinese employees are typically in management positions. Furthermore, all firms report the company's CEO in Indonesia to be mainland Chinese.

The majority of the firms (ten out of 14) are wholly owned Chinese foreign subsidiaries, while joint ventures are a minority group (four firms). As discussed earlier ownership structure is sector-dependent with automobiles and motorcycles having a high incidence of joint ventures. Greenfield investments are the most frequent (eight firms) but acquisitions are also important (six firms) (N=14).

The profits earned by most of the subsidiary firms surveyed are considered to be good (seven firms) to reasonable (three firms) (N=11). As to expectations about future profits two firms expect a high increase over the next three years, six firms expect an increase while the remaining seven do not give any opinion.

The survey confirmed that Chinese FDI is dominated by state-owned enterprises: nine firms are wholly state-owned enterprises (N=14, see Table 6).

Table 6 Company type of the parent company in China (number and percent)

Type	Firms	Percent
State-owned	9	60
Collective-owned	1	7
Private joint-stock	2	13
Public joint-stock	1	7
Regional-owned	0	0
Sino-foreign joint venture	0	0
Sino-foreign cooperative enterprise	0	0
Wholly-owned foreign enterprise	1	7
Unknown/blank	1	7
Total	15	100

The companies were inquired about the extent of parent company investment they expected in Indonesia over the next three years. Nine firms did not answer the question while the remaining six firms expect either 'very much' or 'some' investments
Investments appear overwhelmingly market seeking: for four firms the main purpose of investing in Indonesia is to manufacture the product for the local market, four other firms are for distributing and selling Chinese products in Indonesia, one firm exports resources for export, and six other firms did not give answers (see Table 7).

Table 7 Main purpose of establishing this subsidiary (number and percent)

Purpose	Firms	Percent
Manufacture for sales in Indonesia	4	27
Manufacture for export	0	0
Distribute and sell in Indonesia	4	27
Extract resources for export to China	0	0
Extract resources for export elsewhere	1	7
Other	0	0
Unknown/blank	6	40
Total	15	100

Market seeking is also evident from firms' investment motives. The motive of most firms to invest in Indonesia is to seek new markets (nine firms), the second most frequent answer is to take advantage of the Chinese government's 'go global' policy and related incentives (six

firms). But other motives are important as well, such as reducing production costs or taking advantage of business contacts in Indonesia (see Table 8).

Table 8 What were the motives for establishing the subsidiary (number and average rating)

	Firms	Average rating (1-5)
To seek new markets	9	4.9
To take advantage of Chinese govt. 'go global' policy and related incentives	6	3.5
To reduce production costs	4	3.3
To take advantage of our business contacts in Indonesia	4	3.3
To take advantage of Indonesian preferential investment policies	3	3.0
To secure access to energy, raw materials and natural resources	2	3.0
To follow suppliers and partners who have moved abroad	2	2.5
To avoid saturated demand condition in the home market	2	2.0
To avoid trade barriers in foreign markets	2	2.0
To reduce risks (related to production interruptions, currency realignments, sales fluctuations, etc.)	1	3.0
Other	0	

The most important market of Chinese companies in Indonesia is business-to-business: nearly two-thirds of the firms report B2B to be their most important market while a quarter of the firms sell primarily to private consumers, and a single firm primarily exports (N=8).

In addition to the postal survey, a small number of companies were visited and managers interviewed. A visit to PT Haier Sapporo Indonesia was particular interesting. Prior published case studies and research reports about Chinese Haier, the world's fourth largest whitegoods manufacturer, report that Haier's first investment abroad was in a factory in Indonesia in 1996 in cooperation with an Indonesian company. However, an interview with the owner of this company revealed that Haier had never invested in the factory. The Indonesian company imported, assembled and sold Haier's products on the local market but Haier never supplied any investment capital for the venture.

CONCLUSION

From an occasional trickle foreign direct investment from China to Indonesia has grown rapidly to make China the tenth largest investor in 2008. Not only have investment flows grown in size, they have also become more diversified, sectorally and in motives and operating modes. China's companies ventured abroad relatively late and came to Indonesia in the early 1990s, picking up in significance only after the year 2000.

The current study has provided a more comprehensive and precise overview over Chinese investments in Indonesia than previously available. It was necessary to establish such an overview since there were no systematic data material on Chinese investments in Indonesia to base the study on. Subsequently, the study established a number of important characteristics of these investments as detailed in the following.

Chinese investment is predominantly market seeking and resource seeking. Even though increasing labor costs have begun to induce Chinese companies to invest in countries such as Laos and Vietnam, efficiency seeking is not a prominent investment motive for Chinese investors in Indonesia. Chinese companies do not invest in Indonesia for strategic assets. Rather than invest, market seeking companies may also be present through a representative office (shipping, finance) or an agent. While investors from Japan, US and other advanced

economies are often attracted by low production costs and producing for exports, Chinese companies are not producing for exports in Indonesia but attracted by the market provided by Indonesia's 230 million citizens. Most of the projects in the manufacturing sector are highly concentrated on the island of Java while investments in extractive activities are located in the provinces home to the deposits.

Most Chinese FDI flows into the manufacturing sectors. The motorcycle industry for example has been a target for Chinese investments. During the years 1997 to 2000 there were over 100 brands in the motorcycle assembling industry in Indonesia. Most of the companies do not involve FDI but are alliances with companies owned by Indonesian Chinese, often established at the initiative of the Indonesian side. Other companies are joint ventures with Indonesian Chinese and only a few are wholly owned Chinese subsidiaries. The partners in Indonesia are not preexisting motorcycle assembling firms. This is contrary to the automobile assembling industry where local partners are already existing assembling companies run by Indonesian Chinese.

Looking more closely at Chinese invested companies in Indonesia reveals a broader variety of activities than one might initially expect. In addition to the straightforward presence in natural resources, automobile industries, electronics, and telecommunications there is also a large presence of Chinese companies in shipping & air transport, finance & insurance, and construction & engineering. The latter category of investment has increased significantly in recent years. Chinese construction and engineering firms which have built up capabilities in their home markets, submit cost-competitive bids on Indonesian tenders on infrastructure such as dams, bridges, railways, power plants etc., often with construction financed by loans from the Chinese government.

The increasing investments in sea and air transport and in finance and insurance reflect that Chinese investments are becoming part of a broader and more systemic drive of overseas expansion involving a set of complementary Chinese industries rather than isolated individual investment projects as was the case initially.

Unlike FDI from other developing countries, due to the past economic system many Chinese multinationals are big state or regional owned enterprises. The emergence of private enterprises is relatively recent, though some manage to become big enterprises also. China's foreign investments in Indonesia are by mixed entities, some are state- or regional government-owned enterprises and also some are private firms. In case of joint ventures, their local partners are mostly local Chinese, except in the infrastructure, mining and energy sector where their local partners are exclusively Indonesian state-owned enterprises.

As in most other domains of Indonesian economic life the ethnic issue is prominent in the operating modes of Chinese invested enterprises. The study confirmed an assumption that Chinese overseas investments are to a large extent channeled through Chinese overseas business networks and that mainland Chinese companies establish themselves in cooperation with local ethnic Chinese. The importance and roles of these networks vary between different types of investments projects. The study also revealed that a number of investment projects come about at the initiative of local Indonesian Chinese businessmen who travel to China with the purpose of finding suitable Chinese business partners, often in the region from which their family originates. In these cases the 'motives' for investment projects must be revealed as much on the Indonesian as on the Chinese side of the relationship.

In the automobile and motorcycle sectors Chinese investors often enter through alliances or joint ventures with Indonesian Chinese entrepreneurs. While the Chinese partner provides technology, brand and sometimes capital, the latter usually provides manufacturing facilities built up through previous production experience, ability to negotiate the local business environment, sales and distribution networks, and after-sales service and support. The choice of entry mode is also contingent on small production volume which does not support establishment of new dedicated production facilities. Often the relationship is initiated by the Indonesian company, which initially acts as importer/agent or produces on a license. Later on either the relationship is terminated or the Indonesian company gradually involves the Chinese company closer.

Without belittling the benefits brought by Chinese investments in terms of employment, foreign exchange and tax earnings, technological and industrial spillovers from the investments present themselves as modest. Due to the fact that they originate from a developing country themselves, are accustomed to navigating developing country institutional systems, and apply technologies and routines, which are attuned to the institutional environment in the host economy, it would be reasonable to hypothesize that Chinese investors could embed themselves more tightly into the Indonesian economic system and that more potential for virtuous spillovers could occur. However, considering the sectors, investment motives and operating modes of Chinese investors, the heritage of ethnic tension and segmentation of the economic system along ethnic lines in Indonesia, and that Chinese MNCs as latecomers tend to be more vertically integrated than their developed-country counterparts, a picture emerges where Chinese investments, at this early period of their internationalization, are give rise to a more modest extent of positive spillovers than investors from more economically advanced countries.[ix] However, since this can in part be ascribed to their latecomer status and limited international experience the developmental potential may well increase over time.

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Appendix 1: The 40 largest Chinese companies and ownership ranked by outward FDI stock, 2007

		Government owned
1	China National Petroleum Corporation	X
2	China Petrochemical Corporation	X
3	China National Offshore Oil Corporation	X
4	China Ocean Shipping (Group) Company	X
5	China Resources (Holdings) Co.,Ltd.	X
6	CITIC Group	X
7	China National Cereals,Oils & Foodstuffs Corp.	X
8	China Mobile Communications Corporation	X
9	Sinochem Corporation	X
10	China Merchants Group	X
11	Shum Yip Holdings Company Limited	X
12	China Shipping (Group) Company	X
13	China National Aviation Holding Corporation	X
14	China National Chemical Corporation	X
15	China State Construction Engineering Corporation	X
16	SinoSteel Corporation	X
17	China Network Communications Group Corporation	X
18	Aluminum Corporation of China	X
19	GDH Limited	X
20	China Minmetals Corporation	X
21	CITS Group Corporation	X
22	Shanghai Automotive Industry Corporation	X
23	Legend Holdings Ltd.	
24	China Power Investment Corporation	X
25	Haier Group	
26	China Metallurgical Group Corp.	X
27	Guangzhou Yuexiu Holdings Limited	X
28	China National Foreign Trade Transportation (Group) Corporation	X
29	Shanghai Baosteel Group Corporation	X
30	ZTE Corporation	
31	Shanghai Overseas United Investment Co., LTD	X
32	China Huaneng Group	X
33	China Unicom Corporation	X
34	China Nonferrous Metal Mining & Construction (group) Co.,Ltd.	X
35	Shougang Corporation	X
36	China Poly Group Corporation	X
37	TCL Corporation	
38	Guangdong Province Navigation Holdings Company Limited	X
39	Xinjiang Zhongxin Resources Co.,LTD	X
40	Shenzhen Investment Holdings Co,,LTD	X

Source: '2007 Statistical Bulletin of China's Outward Foreign Direct Investment', MOFCOM, for list of companies; ownership structure added from company websites and other sources

Note: almost all companies are publicly listed or have a considerably share of their assets in publicly listed subsidiaries

[i] This research was enabled by a grant from the Danish Social Science Research Council (FSE).
[ii] E.g. Thee Kian Wie, Hal Hill, Hadi Soesastro, Xiaobo Wu, Sadayuki Takii, Eric Ramstetter, and Henry Yeung.
[iii] Interview with Mr. Zhu Hanliang on 1 December 2008. Mr. Zhu is the Vice President of the Chinese Business Association in Indonesia and also Marketing Director of PT Ocean Global Shipping.
[iv] Statistics on FDI in Indonesia released by BKPM do not include the sectors oil and gas, banking, non-bank financial institutions, mining in terms of work contracts or agreements, investment agreements issued by individual Ministries, portfolio as well as household investments. The number of projects includes also expansion of existing projects and investment value includes also retained earnings. The data above is based on realized figures; the Indonesian Investment Coordinating Board is also releasing data on investment approvals.
[v] Interview with Mr. Zhu Hanliang, see note iii.
[vi] One should be careful in interpreting even these realized figures due to the weak reporting and monitoring system of the Investment Coordinating Board. Yet, it is useful as an overall indicator.
[vii] Interview with Dr. Gunadi Sindhuwinata, President Director of PT Indomobil, Jakarta, July 10, 2009.
[viii] Jakarta is likely to be somewhat overrepresented since more effort to persuade the companies to respond was done in Jakarta, including physical company visits.
[ix] Generally, Chinese MNCs are likely to be more vertically integrated than their counterparts from Europe, US and Japan for a number of reasons, including the fact that their home environment is institutionally and market-wise 'thinner' and their lesser experience with operating complex international production networks. A similar difference was found by early comparisons between US and Japanese MNCs.