



# THE OUTCOME OF CHINA'S INVESTMENT IN INDONESIA: LESSONS FROM THE NICKEL INDUSTRY

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## Introduction

As the largest country in Southeast Asia, Indonesia is among the top destinations for Chinese investment. Several researchers, including Priyandita (2018) and Damuri et al. (2019), have tried to analyze the impact of Chinese investment in Indonesia, but these studies have tended to focus only on investment in the infrastructure sector. In addition, the aforementioned reports do not adequately assess the positive and negative side effects of Chinese investment in Indonesia. For example, Damuri et al. provide evidence for benefits from Chinese investment in Indonesia, but include limited

commentary on the social, economic and environmental impacts of such investments.

In light of the scant critical analysis on the impact of Chinese investment in Indonesia, the Paramadina Public Policy Institute (PPPI) provides a more comprehensive analysis of the nature and characteristics of China's investment in the country. This paper explores the complexities of Chinese FDI through a case study on nickel mining and the midstream operations industry in Sulawesi.

China's economic growth and industrial policy have fed a growing, aggressive demand for nickel in recent years. The PRC established a policy framework and

committed financial assistance to develop its electric vehicle (EV) industry in the early 2000s. What was once a nascent sector has become a booming industry which demands increasing quantities of nickel to produce EV batteries. This demand is a driver of China's rapidly growing presence in the mining sector of Indonesia, which holds the largest laterite nickel deposits in the world according to the U.S. Geological Survey. While there is evidence that such Chinese investments have harmed Indonesian national interests, especially with regards to the local economy, environmental sustainability, technological advancement, and absorption of local workers, the complex impacts on the Indonesian economy remain poorly understood.

This study examines these impacts in greater depth in order to generate policy recommendations that will help Indonesian government officials better manage the threats and opportunities related to Chinese investment and foster Indonesia's sustainable economic development.

This report is based on data collected through document analysis and in-depth interviews with 22 stakeholders from both government and non-government agencies. Between February and June 2019, researchers interviewed representatives from the Ministry of Industry, state-owned enterprises (namely, GAG Nikel subsidiary

of PT Antam), the Corruption Eradication Commission (KPK), and the China Chamber of Commerce in Indonesia. From the non-government sector, researchers conducted field interviews with business stakeholders at the national and local Sulawesi levels, including representatives from companies such as PT Vale Indonesia (Ex-Inco), PT Sulawesi Mining Investment (SMI-IMIP), PT Virtue Dragon Nickel Indonesia, Cipta Smelter Indonesia, and the Indonesian Nickel Mining Association.

This research aims to deliver both theoretical and practical lessons that can subsequently be applied in other Southeast Asian countries. In theoretical terms, this research seeks a realistic perspective, one balanced between the optimistic and pessimistic views about the outcomes of China's investment for Indonesian social, political and economic contexts. Meanwhile, the practical contribution of this research will be to drive policy debates pertaining to foreign direct investment (FDI). This research will serve two significant roles in this regard. First, this study will conclude with policy recommendations for the design and implementation of constructive and productive investment at local and national levels. Second, the research will encourage a more neutral, fact-based national debate on the impact of Chinese investment. These findings will be informative for many citizens of newly

economically-liberalized societies that are pursuing economic development requiring financing from abroad. They will learn that non-transparent financing from authoritarian states is particularly risky.

## Chinese FDI in Indonesia

In 2005, Indonesian President Susilo Bambang Yudhoyono (SBY) and Chinese President Hu Jintao signed a joint declaration for a “strategic partnership” (Qin, 2005). The declaration included agreements on visa exemption for diplomatic and service visits, maritime co-operation, infrastructure and natural resources, economic and technological assistance, finance, preferential buyer’s credit, and earthquake and tsunami relief. In 2013, the relationship was upgraded again to a “comprehensive strategic partnership,” with a focus on infrastructure construction, manufacturing, agriculture, investment and finance (Xinhua, 2005). It is worth noting that Indonesia was the first country in Southeast Asia that President Xi Jinping visited after taking office. It was during his inaugural trip to Indonesia that President Xi announced his plans for the Asian Infrastructure Investment Bank (AIIB). More recently, President Joko Widodo (“Jokowi”) agreed to establish a “new level of bilateral and global partnership” under China’s Belt and Road Initiative (BRI).

Against this bilateral policy backdrop, Chinese FDI in Indonesia grew from USD 300 million in 2012 to 3.36 billion in 2017. This exponential annual growth makes China the third largest foreign investor in Indonesia, up from 12th just five years before.

## Composition

This section presents data on annual Chinese FDI transactions and cumulative FDI inflows to Indonesia based on 2019 research by the Rhodium Group (hereafter RG). Foreign direct investment is classified into various types, namely acquisition (buying shares of an existing firm) and greenfield (newly established) projects. For an acquisition to qualify as FDI, the investing party must purchase more than ten percent of the target firm’s shares. For greenfield projects, investment funds are frequently used to buy factories, offices or subsidiaries, or to fund research and development.

From 2000 to 2017, the cumulative gross value of Chinese acquisition and greenfield FDI transactions amounted to USD20 billion in top sectors, the majority of which was invested in basic materials, transport, utilities, infrastructure and energy. Nickel mining, the industry highlighted as a case study in this report, is classified as a “basic materials” industry.

Based on RG 2019, there were 27 mergers and acquisitions completed from 2002 to 2018, 30% of which targeted the basic materials sector. In addition to that, Rhodium has documented 49 greenfield projects initiated from 2000 to 2018, with 27% of this total targeting basic materials. Among the investors covered in these statistics is the Jinchuan Group, which had invested USD500 million in the WP&RKA nickel project on Nov 25, 2016. Jinchuan is a Chinese state-owned enterprise (SOE). Construction of the WP&RKA laterite nickel mine officially began on Obi Island on November 25, 2016 (China Metal News, 2019).

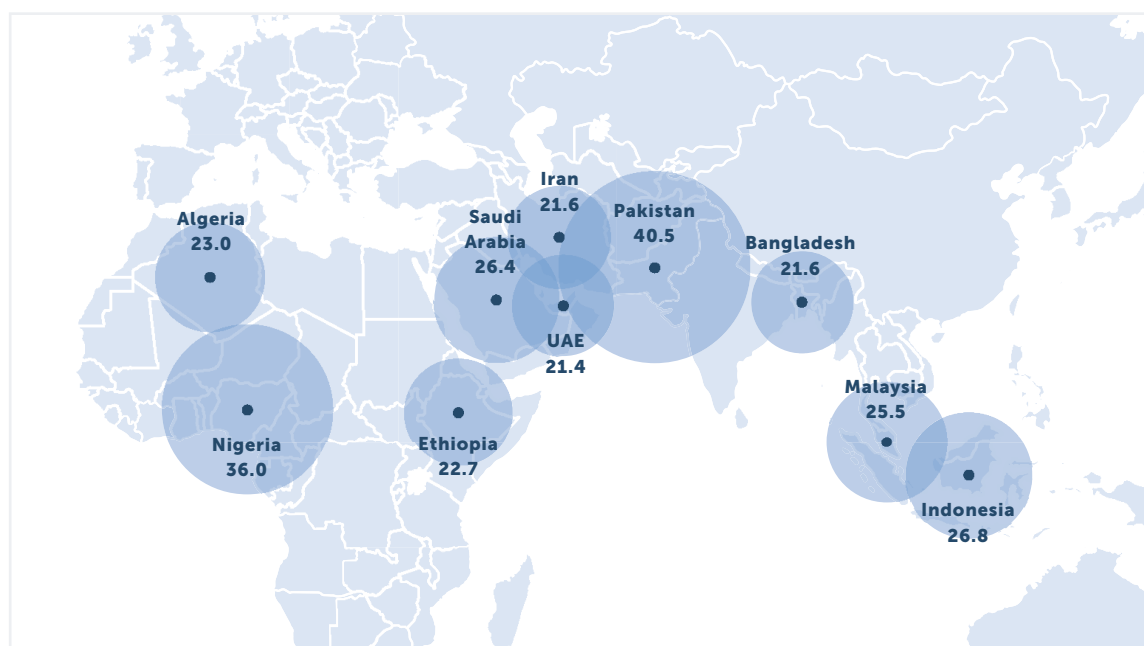
Construction contracts refer to work completed in a target country under a contracted agreement. Besides merger and acquisition and greenfield projects, Chinese FDI also takes the form of construction

contracts. In fact, in 2019, Indonesia has been one of top target countries for Chinese construction activity, as shown in Figure 1 (PG. 147), taken from a China Global Investment Tracker (CGIT) map produced by the American Enterprise Institute in collaboration with The Heritage Foundation.

## Types of Industries

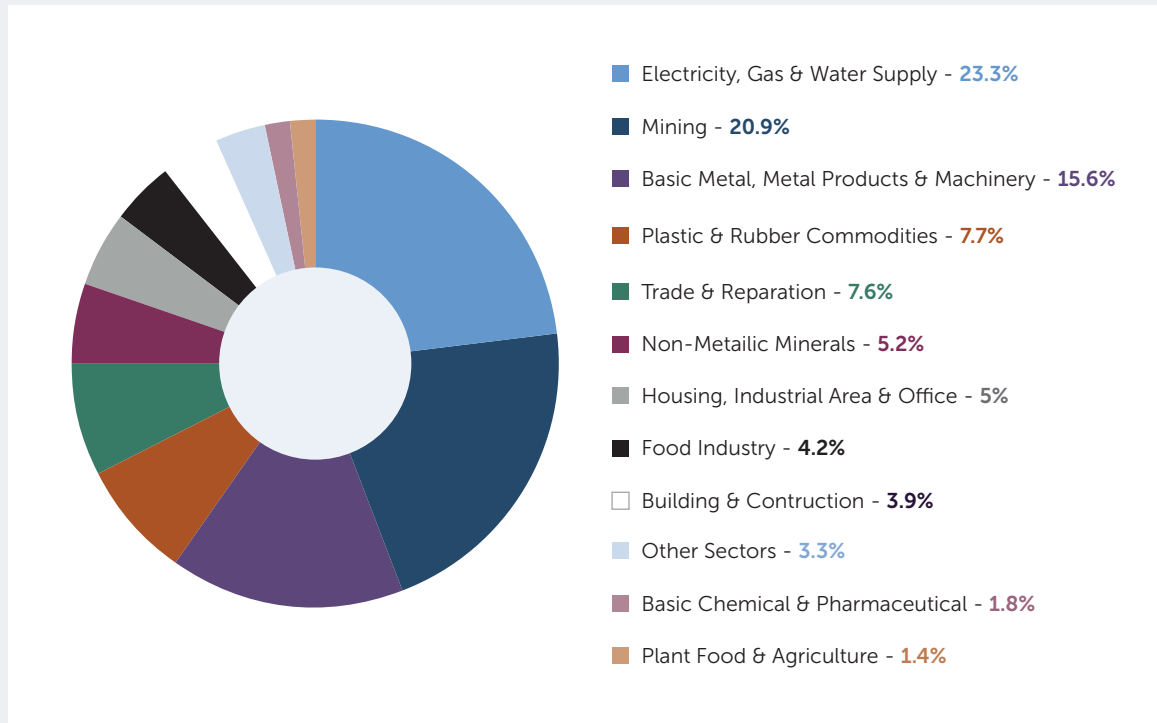
Based on recent official data from the Indonesia Investment Coordinating Board for years 2017 and 2018, Chinese investment in the form of inward FDI focused on several sectors and industries, including mining, electronics, chemicals, pharmaceuticals, electric and gas utilities, water supplies and others. Figure 2 (PG. 148), depicts the proportion Chinese FDI in these sectors over the period 2010-2015 (Table 1, PG. 148-149).

**FIGURE 1: China Global Investment Tracker**



**SOURCE:** Scissors (2019)

**FIGURE 2: Chinese Investment in Indonesia by Sector (2010-2015)**



SOURCE: CSIS (2019)

**TABLE 1: Chinese FDI in the Mining Sector 2011-2018**

YEAR	MONTH	CHINESE ENTITY	QUANTITY (USD MILLION)	SHARE	TRANSACTION PARTY
2011	July	Jilin Nonferrous	930	100%	
2011	October	China Nickel Resources	270	80%	PT Yiwang Mining
2012	Juni	China Nickel Resources	1,260	61%	PT Jhonlinto
2012	July	Beijing Shenwu	420	N/A	Titan Mineral
2012	July	Beijing Shenwu	180	N/A	Balinton Resources

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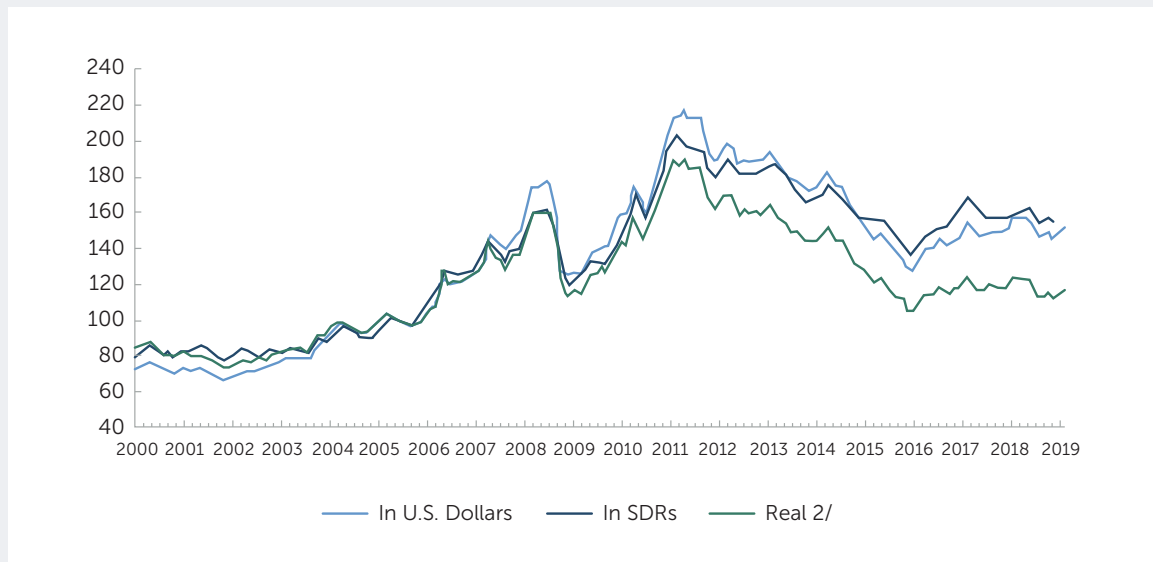
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YEAR	MONTH	CHINESE ENTITY	QUANTITY (USD MILLION)	SHARE	TRANSACTION PARTY
2013	May	Fosun	100	N/A	Gunung Gahapi
2013	July	Tsingshan Steel	320	50%	Bintang Delapan
2013	December	MCC	180	N/A	SMI
2014	July	CIC	1,360	19%	Bumi Resources
2014	August	Hongqiao	840	56%	Well Harvest
2015	May	Sinosteel	120	N/A	DBM
2015	July	Tsingshan Steel	510	50%	Bintang Delapan
2015	November	MCC	110	N/A	Tsingshan

**SOURCE:** American Enterprise Institute (2018), All fourteen separate Chinese firms listed here are owned or controlled by the Chinese government.

China's economic growth during the first decade of the 21st century was the fastest and most resource-intensive economic expansion in history..(Garnaut, 2015). This rapid development led to extraordinary rates of growth in demand for almost all commodities. This effect was strongest in the market for energy and metal commodities, which the Chinese required in unprecedented amounts.

Nickel was one of the basic metal commodities impacted by the global resource boom between 2000 and 2011. Indices for non-fuel primary commodities prices increased gradually from 2000 to 2011, with a brief falling period during the 2008 global financial crisis. Figure 3 (PG. 150) depicts these movements.

**FIGURE 3: Non-Fuel Primary Commodities Indices from IMF Primary Commodities Prices**

**SOURCE:** IMF Primary Commodities Prices (from Garnaut, Ross, 2015)

## Indonesia's Nickel Mining Industry—Background

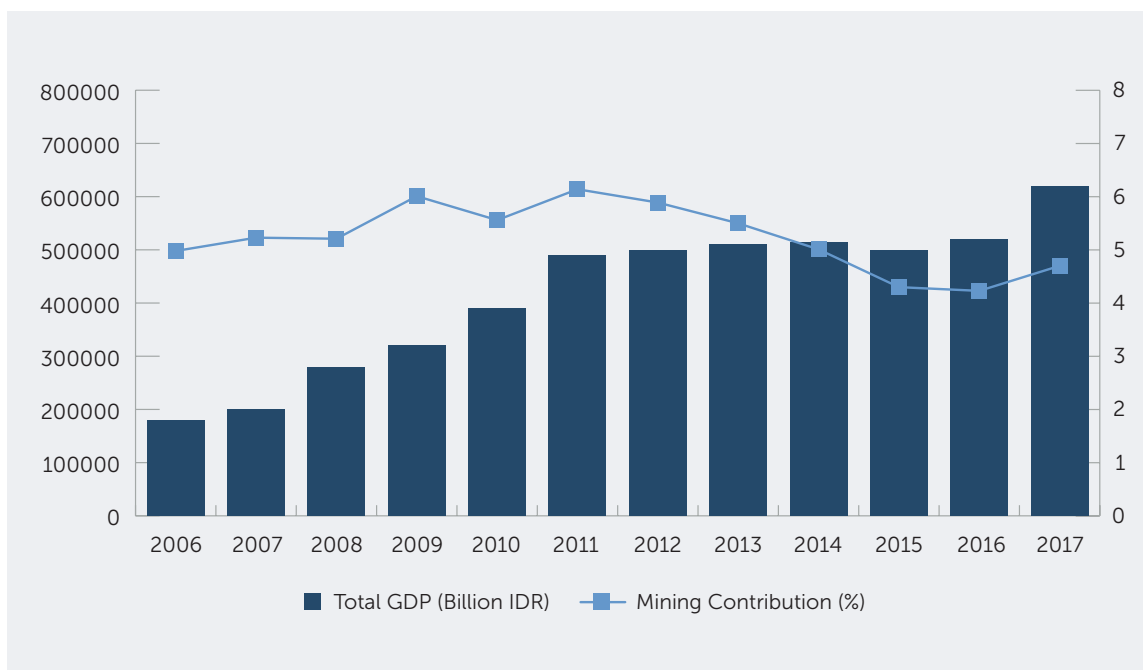
The mining sector has been critical to Indonesia's economic growth for several decades. Mining contributes to Indonesia's gross domestic product (GDP) through exports, government revenue, worker salaries, and perhaps most importantly, through associated development projects in many remote regions of Indonesia. Mining companies are often the largest employers in these remote areas (Figure 4 & 5, PG. 151).

This paper focuses on the development of nickel processing at the national level and the Indonesia Morowali Industrial Park (IMIP) provides an illustrative case study.

IMIP was established in the nickel-rich Central Sulawesi Province of Eastern Indonesia, and it is owned by a holding company called Sulawesi, which is two-thirds owned by a Chinese SOE. The Indonesian partner owns only 33.75%. Morowali's holding company, Sulawesi Mining Investment (SMI), is jointly owned by China-based Shanghai Decent Investment (66.25% shareholders) and Indonesian mining company Bintang Delapan Group (33.75% shareholders) (See Box 1: Indonesia Morowali Industrial Park) (Figure 6, PG. 152).

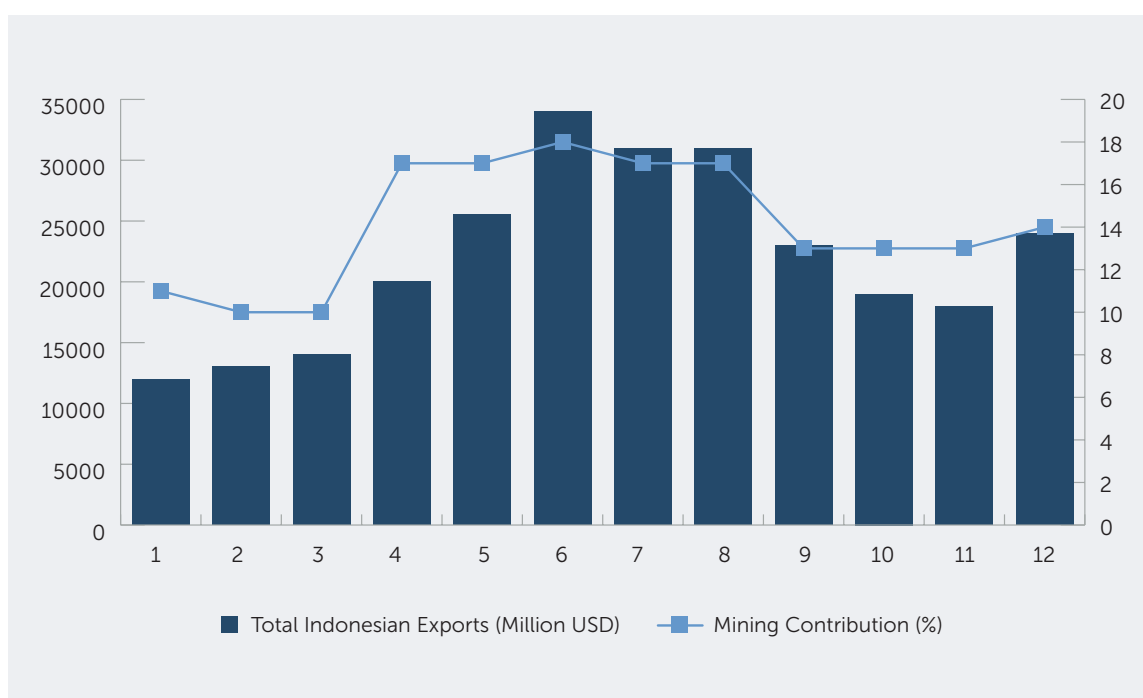
The natural resources sector, particularly mining, has been a backbone of Indonesia's economy for a several decades. Owing to the country's vast mineral resources,

**FIGURE 4: Mining Industry Contribution to Indonesian GDP**



**SOURCE:** PriceWaterhouseCoopers (2019)

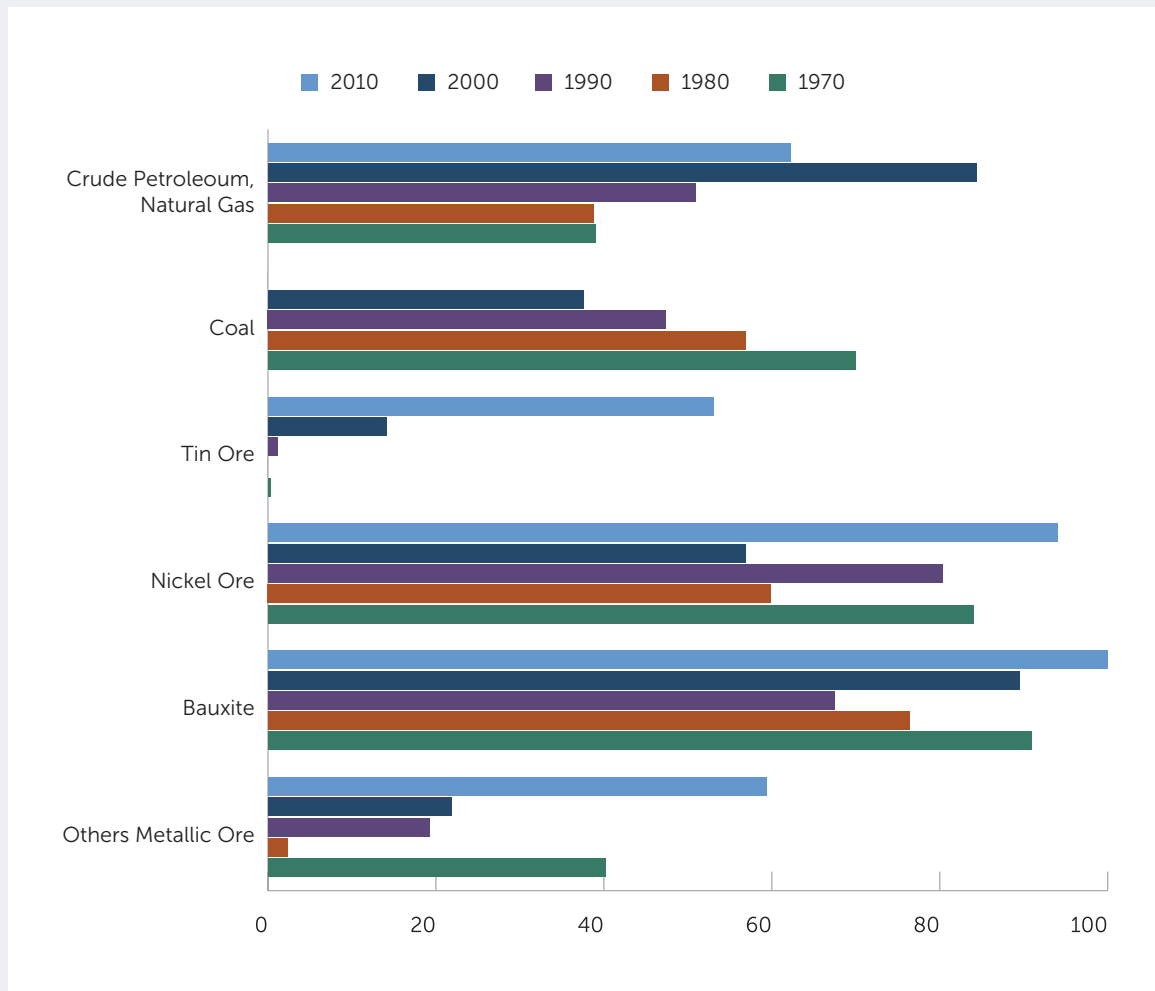
**FIGURE 5: Mining Industry Contribution to Indonesian Exports**



**SOURCE:** PriceWaterhouseCoopers (2019)



**FIGURE 6: Time Series Oil & Gas and Mining Contribution**



**SOURCE:** Pierre van der Eng (2014)

Indonesia has made significant contributions to the global mining industry. Up to early 2000, a number of global mining companies had their operations in Indonesia. In addition to Canada’s International Nickel Company mentioned above, other multinational mining companies including Freeport, Newmont, Barrick Gold, Rio Tinto and BHP have all been very active in Indonesia.

While the presence of giant exploration companies is good for upstream mining sectors, turning latent mineral deposits into exploitable resources and reserves, the country’s downstream sector was barely developed. For decades, Indonesia’s mining sector was an export-oriented industry, with commodities sent to advanced industrial countries such as Japan, South Korea and

European states. Indonesia enjoyed the status quo of being a commodity exporter, although it was generally recognized that exporting processed materials rather than raw commodities would be a better strategy for the country (Maulia, 2018). Not only is the price of processed materials less susceptible to global price fluctuation, but developing a domestic mineral processing sector would also support industrial growth, providing additional income for the state and creating new jobs.

The golden years of mining eventually came to an end when changes in the national political landscape slowed industrial growth. As part of the democratic transition that occurred after the 1998 economic crisis and reform, Indonesia decentralized political power, ceding autonomous economic control to regions that formerly had been left behind by Jakarta under the Suharto regime. Under Suharto, economic development had focused on Java, Bali and some parts of Sumatra, neglecting other areas. Those neglected areas were now granted authority over certain industries, including mining.

Unfortunately, abuses of power by heads of government regencies<sup>1</sup> (including over-regulation, corruption, nepotism, and arbitrary fees levied against companies), have driven

many mining companies to pack up and leave Indonesia, driving the mining sector into decline (Hamidi, 2015). Excessive demands by authorities on mining companies have also harmed the industry (Devi & Prayogo, 2013). In 2017, the Fraser Institute recognized Indonesia as one of the least attractive jurisdictions for mining investment, along with Venezuela, Democratic Republic of Congo, China, the Philippines, Bolivia and Ecuador. Indeed, political factors account for some 40% of the reasons investors decide to put money into a country' (Stedman & Green, 2018).

After the departure of the larger mining companies, local miners took over the sector. Local government officials began lavishing mining licenses, known locally as IUPs (Ijin Usaha Pertambangan or Mining Business License), upon designated recipients. It was not unusual for IUPs to be concentrated in the hands of local kingpins, relatives of high-ranking government officials, or even government officials themselves (JPNN.com, 2012). Mineral exports increased sharply, and the central government soon realized it was time to address the issue of exporting raw materials.

In 2009, Indonesian mining policy underwent a major shift. The government mandated that mining companies must build smelters or processing facilities or face revocation of their

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1 Regencies are administrative subdivisions of Indonesian provinces.

export licenses. Companies were granted a five-year grace period to comply, and targeted companies were expected to have their smelters ready by 2014. This decision was supported in particular by the Ministry of Industry, which had multiple reasons for supporting the ban of raw ore exports.

Based on this decision, it seems that the state failed in its objective to strengthen regional autonomy and increase freedom for regions to manage their own economies. High levels of corruption and abuse of power have left investors reluctant to invest outside the more developed areas of Java, Sumatra and Bali. Supported by more advanced infrastructure, these three regions have remained more attractive destinations for investment, and the gap between them and Indonesia's remote areas only grew larger during this period. While mining resources are also plentiful in areas outside of Java and Bali, the mandate to build processing facilities is projected to spur development (United Nations, 2017).

The new regulation on smelter construction sent shockwaves through Indonesian mining communities, which usually operate locally on a small-to-medium scale. Even large corporations like Freeport and Newmont ended up in protracted negotiations over the new policy. Scraping nickel from the ground and refining the nickel ore are two different things, and smelter construction requires

sizable investment. Smelters are so expensive that even mining giant Freeport McMoran found smelters very challenging to finance and build (Bisara, 2019).

Nickel smelter construction requires an estimated USD5-7 million before commission fees (Adjie, 2019), a difficult financing target for Indonesian miners. In fact, many smelter projects failed to achieve their target completion date, forcing the government to extend the deadline to 2022 because the target would not be achieved by 2019. Even the government has admitted that smelter construction is not easy (Hukumonline.com, 2017). The export ban was also relaxed because the government needed the revenue from mineral export.

## China Nickel Investment in Eastern Indonesia

Other than nickel mining giant Brazilian Vale, which was already operating smelters (under contract with Japanese investors since the 1970s), no Indonesian nickel miners had thought to build smelters until the government forced them to do so. At the time of Indonesia's smelter push, Chinese firms were already involved in Indonesia's nickel mining sector through capital injection or other partnerships. One of the first Chinese companies to get into the smelter business was Tsingshan Group, a company headquartered in Zhejiang Province.

Tsingshan, the largest stainless steel producer in China, with a record of 9 million tons of crude stainless steel produced in 2018, and one of the world's major stainless steel producers, had actually been partnered with the Bintang Delapan Group in the nickel mining business long before the government imposed its smelter policy.

The idea for Bintang Delapan to build an industrial complex instead of just a smelter may have come from the Ministry of Industry, which said that Tsingshan Group's participation in the deal could draw additional investment. The Ministry of Industry took a "mall approach" in this project, hoping that one large, central brand would attract other tenants (Suryawirawan, personal communication, 2019). The Tsingshan Group–Bintang Delapan Group joint venture has now developed the Indonesia Morowali Industrial Park, or IMIP, in Morowali Regency, Central Sulawesi Province. IMIP was completed in only five years and now hosts 16 tenants, including an Australian nickel mining company and producers of stainless steel and other steel products. The latest addition to the industrial park is PT QMB New Energy Materials, a joint venture between Chinese and Japanese companies that produces the material for electric vehicle batteries (Asmarini, 2018). Backed by strong capital, IMIP is an impressive industrial park with its own hotel, ports of 100,000 tons deadweight,

and 1,830-megawatt steam power plants. Currently, IMIP operates 20 smelters with possible expansion in the future. The industrial park employs 32,000 people, including workers not only from the Morowali area, but also from other regions in Indonesia, as well as workers from Mainland China. As of April 2019, an airport with an 1,800-meter runway was under construction. One interviewee said of the project,

*When Tsingshan and the Bintang Delapan Group said they wanted to build a smelter, we told them, "why not build an industrial complex instead?" They are big investors, and as owners of the industrial park, they can invite and select companies that fit with the park (Suryawirawan, personal communication, 2019).*

Tsingshan is also reported to be cooperating with French company Eramet to develop the nickel concession in Weda Bay of Eastern Indonesia. The plan is to build another industrial park worth USD5.5 billion that will also produce materials for electric vehicle batteries (Silaen, 2018).

Another noteworthy Chinese investment project in Indonesia's nickel sector is Virtue Dragon Nickel Industry (VDNI) in Morosi–Konawe, South East Sulawesi Province, eight hours' driving distance from Morowali. With a plan to build a total of 45 smelters, VDNI

is projected to be bigger than IMIP. VDNI is a subsidiary of DeLong Nickel Co. Ltd., headquartered in Jiangsu Province, China. Like IMIP, VDNI also exports its intermediary products, ferronickel, to China.

China's appetite is not limited to large-scale projects. Most of the sources interviewed for this research said there are traces of China's investment and Chinese components in every new smelter facility in Sulawesi and Eastern Indonesia. Currently there are more than 15 smelters across Sulawesi and Eastern Indonesia.

The Chinese smelters, through trading companies, finance miners' operational expenses. The lending is made on one condition: the nickel ore mined must be sold to the traders. When the miners fail to repay their loans, they are forced to sell the nickel at a very cheap price. In some cases, indebted miners are forced to give up their mining concession. This demonstrates China's weaponization of debt. China has monopolized these companies, becoming the only buyer. Such constraints limit these companies' abilities to diversify partnerships and scale their businesses. Many local miners operate as small or medium enterprises and often suffer from low cash flow. Due to the opaque terms of financing agreements, these miners often go into default and are seized by their Chinese creditors.

## China's Dominance in the Nickel Industry

Chinese nickel mining business practices reflect customary Chinese investment behavior where the promise of quick funding is made at the expense of domestic and international law. There has been a debate over the extent of Chinese investment in both the upstream and downstream sectors of Indonesia's nickel industry.

The biggest controversy over Chinese investment in the nickel industry centers on IMIP. PT Sulawesi Mining Investment (SMI), the managing company of the industrial park, has been accused of employing illegal workers from Mainland China. Illegal workers are the most controversial issue in regard to Chinese investment, and IMIP management has repeatedly denied the use of illegal Chinese workers in the park. In response to these allegations, then-Minister of Manpower Hanif Dhakiri visited the site to check on the issue; he later released a statement claiming that no illegal manpower was being used at the site (Dwinanda, 2018). Another debate has focused on the park's patronage by military generals. Both of these issues will be covered in a later section of this report.

The strong presence of Chinese investment in Indonesia, of course, cannot be separated from China's ambition to control the global market. China knows exactly how to make

itself welcome in a resource-rich country like Indonesia. For example, Chinese investors are known to be very flexible when doing business. In one anecdote, a major local nickel producer made a purchasing agreement worth USD32 million over text message after only hours of negotiation; the legal contract was ready the next day. The Chinese also understand when their counterparts are facing difficulties, and the Chinese investors are willing to make exceptions and to compromise. A mining company was recently obliged to pay a USD24,000 penalty due to high moisture content in a quantity of ore delivered to a purchaser. When the mining company that sold the ore came to the Chinese buyer saying it actually needed the money used to pay the penalty, the buyer returned the USD24,000. However, winning the trust of a Chinese counterpart is not easy. Despite the general perception that it is easy to do business with Chinese investors, just like any other investors, Chinese investors require assurance of the security of their investment (personal communication, 2019).

China's competitive technology also makes partnerships with Chinese firms attractive. The pioneer in Indonesia's nickel mining and processing, PT Vale Indonesia, has announced a joint venture with a Chinese company to improve its undeveloped Bohodopi concession, also in Central

Sulawesi. PT Vale's current smelter in Sorowako is linked to a hydropower plant; competitive technology is needed to help the company develop its other concession in Bohodopi.

*We need competitive technology that can help us manage the costs in our Bohodopi site. We have carefully selected a potential partner who will not dent our reputation. I tell you, there are some excellent Chinese companies. If we're conducting the Feasibility Study with any western companies, it would cost us \$70 billion compared to a maximum \$15 billion with the Chinese, not to mention the time needed to complete the project. Working with the Chinese partner would also reduce the necessary capital expenditure by 30%. We recognized differences between the two companies. There are things that we can change and can't change, practices that we can and can't adopt. But it is certain that we won't sacrifice our good reputation by carelessly selecting a partner (Superiadi, personal communication, 2019).*

These comments suggest the Chinese company has a superior product at a lower price, validating the decision to partner with Chinese firms. Yet in truth, Chinese start-up costs are so low because they are subsidized

by the Chinese government, and projects are completed at an unmatched speed because the Chinese firms ignore local laws that would inevitably slow project development.

China also has in-depth knowledge of Indonesian nickel resources. The president-director of a local nickel mining company shared his company's experience in conducting open tenders for smelter projects:

*Of the nine companies submitting tenders, six are Chinese; one is Finnish; one Korean; and one Filipino. The Finnish had the technology, but they didn't have people to do the project due to other engagements in other countries, while the Koreans didn't have the right technology. Eventually, it's the Chinese who won the tender. They have all the technology and expertise on Indonesia. But I have to admit that Chinese technology is still inferior to the Japanese (personal communication, 2019).*

One of the controversies involved in accepting Chinese investment is the "all China technology" requirement of many projects, leaving Indonesian vendors a very tiny piece of the cake. Because Indonesia continues to lag behind in smelter technology, Chinese investors must ship in all the technology from China (Sen, personal communication, 2019).

And of course, China offers the cheapest technology in the world. A source at the Indonesian Nickel Mining Association provided rough comparisons of smelter technologies available on the market:

*A US machine would cost you \$15 million, while a China-made machine will cost you only \$7 million. This excludes the commissioning cost. The cost of electricity is also higher for non-China technology. An electric furnace needs at least 33 megawatts per line. The cost of electricity per megawatt would be \$900 thousand using Chinese technology, \$1.5 million using Japanese technology, and \$1.7 million using German or US technology (Adjie, personal communication, 2019).*

China also has the speed-of-work Indonesia needs. In its ambition to dominate the world's steel and battery markets, China has been very quick in building processing facilities, at the expense of upholding environmental protection laws. By contrast, Freeport and Newmont had engaged in long and tiring negotiations with the Indonesian government regarding smelter building. China and Indonesia are complementing each other in the case of the nickel industry. While Indonesia is hoping to build a national downstream industry, China needs the nickel to feed its home industry and to fulfill its global ambition. This has helped

the two countries to accomplish their joint smelter projects. China's lavish funding is also a driver. Finally, the Indonesian Ministry of Finance has provided special zero-tariff conditions for machinery imported for industrial development for all investors (Minister of Finance, 2015). This has also helped the growth of China's investment in Indonesia.

While China seems to find Indonesia a rewarding place to invest, Chinese businesses may still find Indonesia a challenging place to do business. Indonesian counterparts need to ensure that Chinese investors feel confident. According to one interviewee, Mr. Suryawirawan, "...it was really not an easy job, but we need big investors to attract even more investors to come to the area."

PT Bintang Delapan, the Indonesian partner of Tsingshan Group at IMIP, feels heavy pressure to ensure the security of its Chinese counterpart's investment. It seems that IMIP enjoys high favor from the central government, as evidenced by countless visits from high-ranking government officials, an inauguration event hosted by President Jokowi, and special attention from the Coordinating Minister of Maritime Affairs. Nevertheless, a senior officer, Irsan Wijaya, still believes that IMIP lacks necessary attention from the central government:

*We want the government to pay more attention to our operation. It is not easy to secure such a big project.*

*We have had to deal with worker demonstrations over some wages and other issues as well as inter-ethnic tensions between the natives and people of other ethnicities. This project has benefited the country. It brings revenue and opens up employment. I think we deserve extra attention from government. The extra cost we have to bear in this operation is huge (Wijaya, personal communication, 2019).*

Mr. Bai Sen of VDNI told of challenges he has faced in managing a plant with a diverse labor force:

*Infrastructure in this area [Konawe Utara] is so bad that we can't go anywhere. The working culture is also different. The Indonesians have never worked in a plant before. Indonesian workers have a rest day, but the Chinese workers don't. We work 12 hours per day, every day. I envy the Indonesian workers. But the Indonesian workers are getting better now. Their reputation is better than before. Their conceptions are changing, too, and they really needed to change. Our plant is producing 24 hours a day, 7 days a week. If the workers are always absent and late, we definitely don't want them.*



*We respect Indonesia's laws as well. The workers can rest during their days off. On working days, they have to follow the company's rules and regulations.*

## Costs vs. Benefits of Chinese Investment in the Nickel Mining Industry

The massive influx of Chinese investment has undoubtedly created economic opportunities that Indonesia desperately needs. Indonesia's economy relies heavily on Chinese investment both for capital injection and technological know-how, and the liquid capital and speedy execution typical of Chinese investment have supported China's rapid growth and market dominance in Indonesian nickel mining. These assets have already established China as Indonesia's top investor in the mining industry. Chinese investment in Indonesia has been flexible, involving the acquisition of raw materials as well as establishment of new markets for Chinese products. In the case of the mining industry, it is clear that the primary investment motive was to obtain raw materials to meet industrial demand back in China. Nevertheless, Chinese investment has also involved development of target markets, as exemplified by the chemical, pharmaceutical and electronic industries.

The speed of project execution by Chinese companies is second to none. The

consortium of Tsingshan–Bintang Delapan built the IMIP in less than five years. The industrial park has 20 smelters with its own ports, power plants and other infrastructure, and it is projected to be Indonesia's largest integrated nickel-based industrial complex. Delong Group, the owner of VDNI, has also set up a large plant and delivered its first export only three years after breaking ground. This has made China a favored investor for Indonesia, which has seen many projects stalled or failed for numerous reasons. China's ability to execute large projects in a blink of an eye is also a result of its flexibility. However, this rapid execution in nickel mining increases environmental risks. The ease with which Indonesian environmental and labor regulations can be ignored reveals a widely exploited governance gap through which Chinese money can easily flow.

Although China's government actively supports state-owned enterprises (SOEs) and private companies investing abroad, there are ample examples of business-to-business cooperation between China and Indonesia. A study from Gammeltoft and Tarmidi found that nearly two-thirds of companies report business-to-business to be their most important market, while a quarter of companies sell primarily to private consumers and the remaining 10% primarily export their products (Gammeltoft & Tarmidi, 2013).

While acknowledging the benefits of Chinese investment, it is important to also highlight some potential risks. In recent months, Chinese FDI has spurred debate over issues of imported labor and small and medium-sized enterprises (SMEs) losing out to monopolistic Chinese firms. This research will analyze these issues and explore solutions to mitigate associated risks.

## Exploitation of Illegal Workers

As in most places where Chinese investment exists, use of illegal workers is a major issue in China's nickel projects in Sulawesi. During field research, we observed Chinese workers in all work sites funded by Chinese nickel investment. While we did not obtain proof of the legal status of these workers or ascertain whether they held working permits from the local Ministry of Manpower office, a simple analysis can help to answer this question. Chinese FDI-funded projects are implemented very rapidly and require thousands of workers, both high- and low-skilled. If one worker quits, the replacement worker from China arrives and begins work only a few days later (PT VDNI staff, personal communication, 2019). Due to the notoriously slow Indonesian bureaucracy, it is unlikely that workers from Mainland China could receive working permits this quickly, even if their employers have the

intention of obtaining proper authorization from the relevant authorities. Because of the lack of workers possessing skills and knowledge of nickel processing in the Indonesian market, Chinese investors must fly these workers into Indonesia from China (Sen, personal communication, 2019). It is very easy for Chinese visitors to enter and leave Indonesia, because Indonesia provides a visa on arrival for Chinese tourists in an effort to boost Indonesia's tourism sector. Monitoring from the Office of Manpower might be insufficient, however, because the closest office is often located hundreds of kilometers away from a project site (*Jakarta Post*, 2017). Thus, we believe the presence of illegal Chinese workers is very likely in China-funded projects.

## Control of the Price of Nickel

Vast Chinese investment has opened up the possibility of price control by smelters. Although the government's Mineral Purchasing Price Reference (Harga Patokan Mineral, HPM) regulates the price of nickel ore, smelters rarely comply with the HPM. In reality, nickel's sale price is very low due to an oversupply of nickel ore in the domestic market. The selling price thus could be as much as 50% lower than the regulated market price (Mulyana, 2019). The miners themselves have no option but to sell the ore to the China-controlled smelters at

the offered price. The Indonesian Nickel Association (APNI) says miners do not receive a fair profit due to the low buying price of the smelters. The APNI is currently working to establish an Indonesian Nickel Index (INI), an initiative that has gained support from government authorities who have admitted that the sale price of nickel ore in the domestic market remains an issue. However, the smelter association denies the APNI's statement, saying that the purchasing price is in accordance with the international market price.

Low nickel prices could harm the environment. Small profits may induce miners to disregard expensive environmental protections at mining sites. The cost of environmental protection often constitutes a significant portion of the total production cost for miners (Superiadi, personal communication, 2019). Thus, a depressed sale price for nickel ore can also lead to environmental consequences if miners lack sufficient funds to repair environmental damage caused by mining. Chinese enterprises customarily ignore environmental protection laws. Indonesia has laws mandating environmental protection for precisely this reason—miners cannot choose when to obey them and when to ignore them. To best address this governance gap, CIPE launched a project with Paramadina under the premise that when there is

compliance with environmental laws, there is an increase in transparency, a legitimization of rule of law, and a reduction in environmental damage.

## Lack of Health, Safety, and Environment Assessments

Because Chinese FDI-funded projects tend to operate quickly and cheaply, health, safety, and environment (HSE) issues remain a concern. We made a comparison of HSE treatment between PT Vale Indonesia, IMIP and VDNI. Although we do understand the methodological concerns in directly comparing two industrial parks with a standalone company, we did note that PT Vale has the best safety procedures in place, while IMIP and VDNI need improvement on HSE. Company budgets do not yet place high priority on HSE items (PT VDNI staff, personal communication, 2019).

## Military Connection

The Indonesian military is known for its long history of running businesses in Indonesia, both institutionally and personally. Some retired army generals who are currently serving civilian roles in government are said to be involved in IMIP's operation through local partner PT Bintang Delapan. These individuals were involved with the company long before IMIP was constructed (Wijaya, personal communication, 2019).

It is not hard to make the case that military connections help to “grease the wheels” of economic growth. Therefore, it is noteworthy to look at the number of capital investments related to the industrial park. Transaction-based data from AEI presents 21 transactions from 2011 to 2018 related to the metal and mining sectors and the steel subsector, illustrated in Table 2 above. From this list, we have identified five transactions that directly relate to the Indonesia Morowali Industrial Park:

- In July 2013, Tsingshan Steel took a 50% share in a new firm with Bintang Delapan Group with an investment of USD 320 million.
- In July 2015, Tsingshan Steel took a 50% share in a new firm with Bintang Delapan Group with an investment of USD 510 Million.
- In December 2013, MCC group invested USD 180 million in a project with Sulawesi Mining Investment.
- In November 2015, MCC group invested USD 110 million in a project with Tsingshan.
- In June 2017, Tsingshan Steel engaged in a joint investment in IMIP with Delong Holding, with an investment of USD 150 million.

Together, these five transactions amount

to USD1.27 billion. This is a huge investment considering the challenging business environment and the number of environmental permits that must be obtained. The necessary condition for businesses to operate is to obtain political support from the military and local authorities. By securing support from military and political elites, businesses are able to operate securely and smoothly without impediment.

## Prone to Potential Corruption

In a country where corruption is still a major issue, investment from China may open the possibility of corrupt practices. Laode M. Syarif, the chief of the Corruption Eradication Body (KPK), even warned state-owned companies to be careful in their selection of investment from China (Adharsyah, 2019).

## Lack of Good Corporate Governance

To end the practice of companies offering bribes to authorities, it is necessary to establish a system of values, principles, and implementation of good corporate governance. Namely, companies need to embrace the concepts of transparency, accountability, responsibility, independence and fairness in their daily operations and policies. Many foreign companies are forbidden under their home country’s

law to pay bribes and are thus limited in their capacity to engage in corruption. To our limited knowledge, many companies engaged with Chinese FDI lack good corporate governance principles and practices. Another issue related to corporate governance is the troubled implementation of corporate social responsibility, because many Chinese companies have no experience with this concept.

## Conclusion and Recommendations

Based on various information obtained through document analysis, in-depth interviews, and field observation in the nickel-rich region of Sulawesi, we conclude that China's investment in Indonesia's nickel industry has produced mixed results. As a developing country, Indonesia needs productive foreign investment to boost its economic power. China has seized on this need and established itself as a primary investor in Indonesia, and in doing so has also secured a supply of natural resources, particularly nickel and other metals, for sustaining and developing its own industry. For decades, Indonesia's mining sector was an export-oriented industry, while most of the giant exploration companies did their business in the upstream sector. As a consequence, Indonesia lost its potential to generate the higher revenues available in

downstream sectors. Subsequently, China arrived in Indonesia with large amounts of cash to develop Indonesia's first downstream industry and support generation of bigger revenues from selling processed materials, compared to those from selling raw materials mined for export.

Even though the downstream industry developed with Chinese investment has increased the competitiveness of Indonesian export commodities, China's investment has also created opportunities for mid-stream market power, under which the sale price of the nickel ore falls below market price, while local miners have no option but to sell their ore to China-controlled smelters. In the long term, these minimal profits will be insufficient to manage the environmental damage caused by the mining industry.

Indonesia's Corruption Eradication Commission (KPK) has warned the government and business communities about Chinese investors failing to meet their obligations for environmental sustainability. The rise of vibrant new economic sectors has the potential to increase the misuse of power by state officials, who may be offered incentives to provide official assistance, such as concessions involving more flexible application of regulations, to business actors intent on maintaining their successful positions in the new, openly competitive market system.

This situation incentivizes business groups to seek political patronage and support from government leaders by providing funds and other forms of support to policy makers in the circle of power. The interaction of these groups can create a powerful coalition of vested interests, which in turn may foster technocratic incompetence, hindering reforms via both legal and illegal channels and endangering good governance efforts in the newly democratic Indonesia.

In light of these concerns, KPK commissioners have warned state-owned companies to be careful in their selection of Chinese investment partners. However, China's companies face limited checks on their activities due to political support from those in Indonesia's circle of power, including high-ranking members of political, economic and military networks. Many retired army officials allegedly benefit from this business process. While the presence or involvement of military persons is unconfirmed, given the fact that big projects in Indonesia are generally difficult to execute due to bureaucratic delays, China's ability to efficiently navigate business obstacles in Indonesia may indicate that these investors are receiving support from military networks. Due to this support, Chinese companies investing in Indonesia enjoy certain benefits and flexibility.

Given the concerns identified in this research and analysis, we propose four

policy recommendations. If the concerns behind these recommendations are addressed, Chinese investment in Indonesia can proceed in a way that is beneficial for both countries.

1. Improving the system of working permits and business licenses for foreign investors. In a related case study, when an issue concerning a project using illegal Chinese workers emerged, the government acted swiftly to address the problem. However, there is still room for improvement in the availability of up-to-date data about the exact number of foreign workers involved in projects. Without improvement to the systems providing and tracking work permits and business licenses, the problem of illegal foreign workers will persist in any region that gets large amounts of foreign investment.
2. Establishing a fair and transparent nickel trading system. This will involve preparing and implementing a nickel price index to set benchmark prices for all market participants. The proposed Nickel Price Index will ensure that local mining companies and foreign buyers pay the same price for nickel. As of the publication of this report, Indonesia still does not have a Nickel Price Index. As a result, the price of nickel can occasionally fluctuate widely.

3. Becoming more selective in welcoming Chinese investment. In January 2020, Indonesia banned nickel ore exports. The implication of this is a further increase in Chinese investment.
4. Inviting more international competitors to invest in downstream industry and nickel refinement. The case of IMIP provides a great example of how business-to-business schemes can fulfill downstream policy and comply with the current regulatory framework, while at the same time provide quality investment and new job opportunities for the local economy.

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