

# PERSPECTIVE

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## **Chinese Investment and Presence in the Riau Islands**

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### **EXECUTIVE SUMMARY**

- In recent years, the Riau Islands (*Kepulauan Riau* or Kepri) provincial government, the Batam Development Agency (BP Batam), and the Indonesian Investment Coordination Board (BKPM) have made concerted efforts to attract foreign investors following years of slowing investment rates.
- Provincial administrators have identified China as one of the priority countries for inbound investment into Kepri.
- There has been a marked increase in Chinese FDI since 2015.
- However, the volume of Chinese investments in Kepri still constitutes a very small proportion of total Chinese investment in Indonesia.
- There is the potential for negative public perception towards Chinese investments in the province, particularly following the 2016-17 naval and diplomatic tensions over Indonesia's portion of the South China Sea off Kepri's Natuna Islands.

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## **INTRODUCTION**

Riau Islands (Kepri) is one of Indonesia's youngest provinces, having separated from Riau province in 2004. Economically, it is distinctive because of its close proximity to Singapore and the Indonesian government's efforts to exploit its strategic position on maritime trading routes that cover Australia, Asia, Europe and the Middle East.

The province's major islands of Batam, Bintan, and Karimun (BBK) are the motor for economic growth in Kepri, owing to their special economic status and strategic location, and the availability of cheap labour. However, in recent times, a combination of factors that include global economic fluctuations, change of regimes in Indonesia, and uncertainties following regional decentralization in 1999 have severely decreased Kepri's attractiveness in the eyes of foreign investors. In order to boost growth, provincial administrators have felt the need to re-strategize and look for new sources of foreign investment.

Within this changing landscape, China has emerged as a source of foreign investment with big growth potentials in various industries, particularly in tourism, construction, oil/gas, and food processing/manufacturing. Indeed, the volume of realised Chinese investments has increased substantially since 2015, showing signs that the country might be a major provider of much-needed capital for Kepri in the future. There are also more Chinese tourists coming to Kepri every year, with large-scale tourism projects being planned to attract more investments.

However, as is the case with Chinese investments in Indonesia more generally, China's intentions and influence in the country are viewed negatively and suspiciously. This problem is particularly so in Kepri following 2016 naval tensions between Indonesia and China near the province's Natuna islands. This paper examines the current state of Chinese investments and presence in Kepri, and analyses China's potential as a source of foreign investment in the context of recent developments in Sino-Indonesian relations.

## **ATTRACTING FDI TO THE RIAU ISLANDS**

The Riau islands developed as an export-oriented industrial region began in 1971 after the Indonesian government under President Suharto launched an ambitious plan to transform the island of Batam into a major industrial zone. Batam was managed by the Jakarta-based Batam Industrial Development Authority (BIDA) that had control of land through presidential decree and operated outside of the local political institutions.

By December 2001, 750 foreign companies had established operations in Batam, with direct investments totalling US\$719 million.<sup>1</sup> Singapore was the largest stakeholder, with 279 companies in operation and direct investments of US\$453 million in total. However, after the nation-wide implementation of the regional autonomy scheme in 2002 where district/municipal/provincial governments took over the control of many areas formerly controlled by and for Jakarta.

In 2004, after years of negotiations, the BBK islands, along with three other island groups were detached from Riau Province to establish the new province of Riau Islands (Kepri).

Over the next few years, more resources and responsibilities were transferred to the newly created government in the new provincial capital of Tanjung Pinang. In order to allow for greater local input in decision-making, BIDA's head office was moved from Jakarta to Batam, and the agency's assets were later transferred to the provincial government. However, this new transfer of power resulted in overlapping interests and intense competition between BIDA and local authorities such as the Batam municipal government and the regional assembly.

This resulted in inconsistencies and contradictory policies, taxes, and levies implemented by different local authorities that confused, irritated, and dissuaded many potential investors. In 2001-2005, at least 95 foreign companies left the island for countries like Vietnam, and 35 others downsized operations or were considering pulling out. Between 2000 and 2004, non-oil exports declined by roughly 20 percent, and new foreign investments fell by 34 percent in 2005.<sup>2</sup>

To remedy this decline, Batam was designated in October 2005 as a "bonded zone plus," which meant that businesses were allowed to import goods duty-free into specified bonded zones. In 2006, Singapore and Indonesia signed the Framework Agreement on Cooperation concerning BBK islands, which includes joint marketing, taxation, financial issues, customs procedures, and capacity development.<sup>3</sup> Three years later in January 2009, Batam was officially launched as a Free Trade Zone (FTZ).

In September 2016, BP Batam became the first regional investment body to roll out the regional version of BKPM's 3-hour Investment Licensing Service (I23J) initiative that enables foreign investors with a planned investment value of at least Rp 50 billion (approx. US\$3.75 million) and/or plan to employ at least 300 local workers to obtain the eight key documents required to start investing in the province.<sup>4</sup> BP Batam's Head of Investment Services Ady Soegiharto said that this initiative was a conscious effort by the institution to expedite business licensing processes and minimise the bureaucratic red tape that have deterred potential foreign investors in the past.<sup>5</sup>

## **INCREASE OF CHINESE INVESTMENTS IN KEPRI**

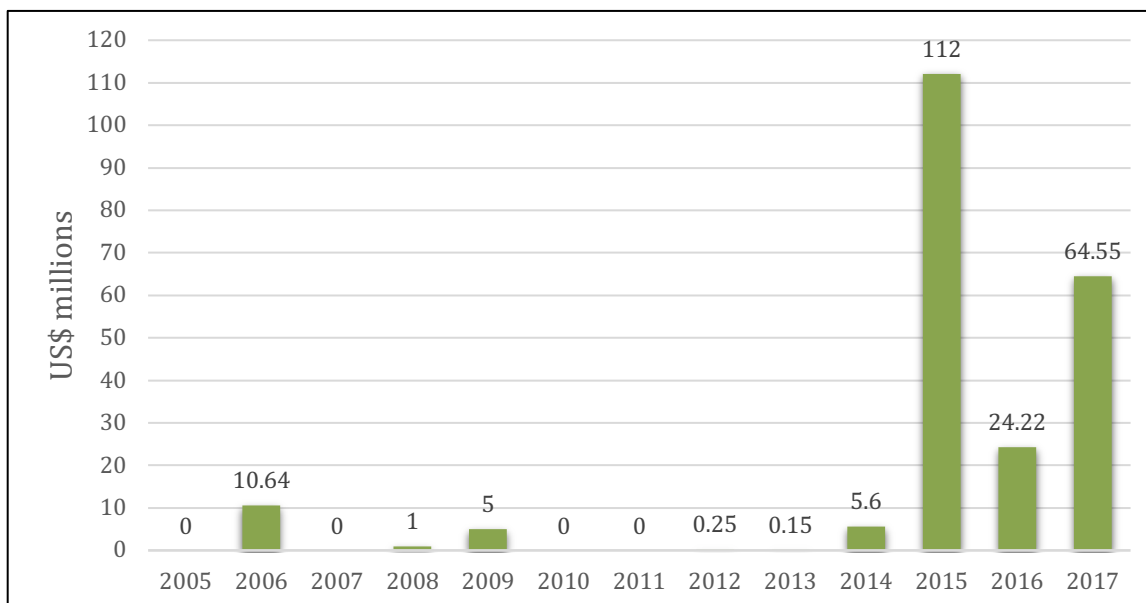
In addition to removing red tape, BP Batam and the Kepri provincial government also look to new potential sources of foreign investment. One of the most promising countries that provincial administrators are increasingly trying to lure is China.

According to Chairman of BP Batam Lukita Dinarsyah Tuwo, his team wants to convince Chinese investors of Kepri's attractiveness as a manufacturing site, especially amid rising labour and production costs in places like Shanghai, Shenzhen and Hong Kong.<sup>6</sup> Tuwo further elaborated that Kepri needs to take advantage of China's trade war with the US and market expansion into ASEAN.

Throughout the 1980s, 1990s, and early 2000s, Chinese investment in Riau islands was almost non-existent. Instead, up to 70 percent of FDI in Kepri was from countries like Malaysia, Japan, Germany, and in particular Singapore.<sup>7</sup> However, as seen in Figure 1, since 2015, China's investments in Kepri has increased substantially.<sup>8</sup>

The value of investments in 2015 was particularly large because of the initial funds injection of over US\$100 million for the building of Chinese oil refinery giant Sinopec’s US\$850 million West Point Terminal oil storage facility in the Janda Berhias island of Batam. Designed to be the largest oil storage facility in Southeast Asia capable of storing 16 million barrels of crude and refined fuels, the project has given Kepri’s petroleum trade industry a massive boost, which would also increase the province’s chances of competing with Singapore as the region’s petroleum hub.

**Figure 1: HK/China Investment Realisation in Kepri 2005-2017<sup>9</sup>**



*Source: Indonesian Investment Coordination Board (BKPM)*

Unfortunately, the West Point Terminal project has been halted since 2015 because of an internal legal dispute in which the Indonesian counterparts in the two-country consortium have accused the Chinese partners of embezzlement and nepotism in the appointment of project contractors. The case is on-going with international law enforcement institutions such as the Interpol involved. The project remains on-hold indefinitely.<sup>10</sup> However, despite setbacks in the oil and gas sector due to the stalled Sinopec oil terminal, Chinese FDI has also increased in sectors such as minerals processing, electronics, construction of industrial estates, fisheries and seafood products, transportation, and tourism.

With the recent increase of Chinese investments, China is quickly climbing up the ranks of the top foreign investors in Kepri. As seen in Figure 2 combining countries’ total investments in Kepri from 2004 to 2017, China is currently ranked at number 12, while Hong Kong (PRC) is high up at number 5.<sup>11</sup> China and Hong Kong are considered as one source of funds, the combined investment volume from the two would put China’s total investment value to date at over US\$232 million, which would place them as the 4<sup>th</sup> largest foreign investor in Kepri, surpassing Japan, South Korea, and Taiwan who have operated in the province for much longer. Over time, China may emerge as the number one investor in Kepri.

**Figure 2: Total sources of FDI in Kepri, 2004-2017**

| Rank      | Country                           | Number of projects | Investments (US\$ thousands) |
|-----------|-----------------------------------|--------------------|------------------------------|
| 1         | Singapore                         | 1,628              | 1,822,315.90                 |
| 2         | Consortium of countries           | 303                | 1,104,620.60                 |
| 3         | Malaysia                          | 218                | 230,104.50                   |
| 4         | Germany                           | 32                 | 213,176.80                   |
| <b>5</b>  | <b>Hong Kong (PRC)</b>            | <b>35</b>          | <b>170,671.50</b>            |
| 6         | Luxembourg                        | 18                 | 164,706.40                   |
| 7         | France                            | 13                 | 119,933.10                   |
| 8         | Japan                             | 52                 | 96,498                       |
| 9         | Cayman Islands                    | 9                  | 89,453.20                    |
| 10        | United Kingdom                    | 51                 | 82,722                       |
| 11        | Mauritius                         | 4                  | 73,089.50                    |
| <b>12</b> | <b>People's Republic of China</b> | <b>103</b>         | <b>52,754.50</b>             |
| 13        | Australia                         | 72                 | 50,690.70                    |
| 14        | The Netherlands                   | 42                 | 45,388.80                    |
| 15        | Switzerland                       | 6                  | 39,409.50                    |
| 16        | British Virgin Islands            | 50                 | 34,929.70                    |
| 17        | United States                     | 74                 | 31,152.20                    |
| 18        | Taiwan                            | 33                 | 21,541.70                    |
| 19        | South Korea                       | 26                 | 11,045.40                    |
| 20        | Thailand                          | 6                  | 4,730.90                     |

*Source: Indonesian Investment Coordination Board (BKPM)*

Tourism is one area of potential growth, with both central and provincial governments promising to improve infrastructures to support tourism projects, such as with the building of two new international airports in the Anambas Islands and in Natuna Regency. In 2015, Kepri received almost US\$7.5 million to develop tourism infrastructure, and in 2017 alone, the Ministry of Tourism budgeted US\$1.1 million to promote tourism in the province.<sup>12</sup>

During trade exhibitions and investment road shows to China, tourism is one of the main industries advertised, and this promotional strategy seems to be working so far. For example, China-based resort operator Sun Resorts is reported to currently be in the process of investing US\$30 billion over 15 years (starting in 2014) in building the ambitious Indonesian Street City integrated resort project in the Batu Licin area of Bintan Island. The Indonesian Street City will be a resort area, a wholesale shopping hub for Chinese products, as well as a satellite city where both local and foreign investors can purchase freehold apartments and marina spaces.<sup>13</sup>

To increase connectivity with Chinese cities, Indonesian national carrier Garuda Indonesia's low-cost subsidiary airline Citilink plans to have daily direct flights from Raja Haji Fisibilillah Airport in Tanjung Pinang to seven cities in central and south China.<sup>14</sup> Gradually, the airline plans to expand its routes to 19 cities in China and start direct flights from Batam to Chongqing in Szechuan province.

## **PRC INVESTORS IN KEPRI**

In the last few years, Kepri's government officials have been putting in effort to forge closer ties with the PRC Consulate General in Medan in North Sumatra through trade fairs and organised visits. For instance, in September 2017, Kepri Governor Nurdin Basirun invited the Medan-based PRC Consul Sun Ang to visit the Kota Piring Palace tourism site in Bintan in order to give the Consul a tour of Bintan's tourism potential.<sup>15</sup> During the visit, Governor Basirun showcased a number of proposed infrastructure projects such as the Batam-Bintan Bridge, as well as a number of ports that he hoped Chinese investors would be keen to invest in. Governor Basirun told Consul Sun, "Please tell Chinese investors that there are many advantages of investing in Kepri, we need investments in infrastructure, tourism, and maritime industries."<sup>16</sup> Governor Basirun added that Kepri's advantages as an investment destination included its abundant maritime natural resources, security, as well as the cultural similarities between China and Kepri because of the province's large ethnic Chinese population.

Along with the establishment of new Chinese companies, a growing number of entrepreneurs from China (and their families) have come to settle in Kepri, particularly in Batam. The community of Chinese entrepreneurs and companies based in Kepri is now sizeable enough for an association to be set up. Established in September 2015 as a support network for PRC Chinese entrepreneurs in Kepri, *Asosiasi Pengusaha Tiongkok Kepri Indonesia* (Association of Chinese Entrepreneurs in Kepri Indonesia, or APTKI) provides its members with investment tips, information on consular protection, social support, as well as networking opportunities. Supported by the PRC Consulate General in Medan, ICBC (Industrial and Commercial Bank of China) Indonesia, China Construction Bank Indonesia, Kepri Provincial government and Batam City administrators, APTKI members enjoy good access to local government officials as well as local business networks.

Indeed, at 14% of the total population (this percentage is much higher than Chinese populations in other parts of Indonesia), Kepri has large ethnic Chinese communities that over the centuries have heavily influenced the local culture, cuisine, and commercial landscape.<sup>17</sup> The majority of the ethnic Chinese in Kepri are fluent in Chinese languages such as Hokkien, Teochew, Hakka, and Mandarin, and these languages are often used as the lingua franca for local commercial activities. As evident in Governor Basirun's presentation to Consul Sun, the existence of a local Chinese-speaking community, as well as the abundance of Chinese restaurants and a relatively Chinese-friendly and safe society in Kepri is trumpeted as one of the province's advantages. According to one of APTKI's committee members Mr Ke Zongxian, most Chinese entrepreneurs have found it quite easy to set up businesses and settle in Kepri. This is partly due to the fact that the local government is keen to help, but also because language is not a big barrier in Kepri since there are many Chinese-speaking local ethnic Chinese.<sup>18</sup>

## **CHINESE INVESTMENTS IN KEPRI: OPPORTUNITIES AND CHALLENGES**

Despite the increase of Chinese FDI into Kepri in the last three years, at only 1.18% of the total amount of realised Chinese investments in Indonesia in 2017, China's investments into

the province are still proportionally miniscule and there is much room for growth. Furthermore, there are still many problems that need to be addressed.

For one thing, bureaucratic red tape, labour and wage problems, as well as structural issues to do with access to the Indonesian domestic market are discouraging for potential foreign investors. As Francis Hutchinson pointed out, relative to other locations such as Vietnam and Cambodia, wage levels for manufacturing workers in Indonesia are higher, and the minimum wage level in Kepri generally is higher still than the national average.<sup>19</sup> Furthermore, while Batam's FTZ status has given it an advantage in terms of the import and export of goods, it effectively prevents Batam-based manufacturers from accessing the local Indonesian market. If manufacturers want to sell their goods domestically, then they would need to pay a duty of 20%, and this is a huge deterrent for potential foreign investors since many would like to also have access to the Indonesian market.

A more specific problem for Chinese investors in Indonesia is the issue of negative public sentiments, particularly over imported labour from the PRC and China's increasing influence in the region being perceived as a threat to Indonesia's sovereignty.

Since President Joko Widodo took office in 2014, an issue that keeps surfacing in the media is the alleged 'flood' of low-skilled Chinese labourers into Indonesia along with Chinese investment projects with unsubstantiated rumours of 10 million Chinese workers being imported into Indonesia.<sup>20</sup> Such rumours, particularly at times of heightened public antagonism towards Chinese Indonesians – like during mass protests against former Jakarta Governor Basuki "Ahok" Tjahaja Purnama last year can be politically sensitive.<sup>21</sup>

The waters off Kepri's Natuna Islands were also the site of naval tensions between Indonesia and China in 2016 following maritime incursions by Chinese fishing boats and the Chinese Coast Guard. As the two issues have largely circulated at the national level, they have not affected daily life, investment activities, or inter-ethnic relationship in the province very much. However, the provincial government's efforts to attract more Chinese FDI, and the increasing number of Chinese entrepreneurs and new migrants that have settled in Kepri could cause a backlash in the future, particularly if ethno-nationalist sentiments rise, such as during contentious local elections.

China is certainly an important and promising source of FDI for Kepri, and it is safe to project that its investment volume will only increase in the future. However, attracting Chinese investments into the province will need careful management from the side of investment policy instruments and the provision of investment services, as well as in inter-ethnic and multicultural management.



- <sup>1</sup> Choi, N. (2009). 'Batam's 2006 Mayoral Election: Weakened Political Parties and Intensified Power Struggle in Local Indonesia,' in Erb, M. & Sulistiyanto, P. (eds.), *Deepening Democracy in Indonesia?: Direct Elections for Local Leaders (Pilkada)*, Singapore: Institute of Southeast Asian Studies, p. 77.
- <sup>2</sup> Choi, N. (2011). *Local Politics in Indonesia: Pathways to Power*. London: Routledge, p. 53.
- <sup>3</sup> For more on this agreement, see Wong, P. K. & Ng, K. K. (2009). *Batam, Bintan and Karimun: Past History and Current Development Towards Being a SEZ*. Singapore: National University of Singapore, Asia Competitiveness Institute.
- <sup>4</sup> 'I23J investment service putting Batam back on the map as an investment destination', <http://www.thejakartapost.com/adv/2016/08/31/i23j-investment-service-putting-batam-back-on-the-map-as-an-investment-destination.html>, accessed 13 February 2018.
- <sup>5</sup> Interview conducted on 30 March 2017.
- <sup>6</sup> 'BP Batam Roadshow Investasi ke China' ('BP Batam Takes Investment Roadshow to China'), <http://sumatra.bisnis.com/read/20180417/533/785357/bp-batam-roadshow-investasi-ke-china>, accessed 17 April 2018.
- <sup>7</sup> Singapore is also Indonesia's number one source of FDI.
- <sup>8</sup> In data sets from Indonesian government institutions such as BKPM, China and Hong Kong are classified as two different sources of FDI, with a note that Hong Kong is regarded as part of the PRC. In this paper, Hong Kong and China are grouped together under 'China' as they are considered to be one country.
- <sup>9</sup> Please note that '0' investments in the chart do not necessarily mean that there were no investments from China/Hong Kong in that year. Investment data from BKPM are unavailable for certain years, and unavailable data have been marked as '0' in the chart. In any case, from secondary data such as BP Batam's and the provincial government's records, it is safe to assume that pre-2015 Chinese investment levels are much lower than post-2015 levels.
- <sup>10</sup> For more on the case, see: 'Indonesia police say Interpol issues red notices for 3 Sinopec execs over Batam project', <http://www.straitstimes.com/business/companies-markets/indonesia-police-say-interpol-issues-red-notices-for-3-sinopec-execs-over>
- <sup>11</sup> It is interesting to note that, as seen in Figure 2, investments listed as coming from the PRC comprise of smaller investments spread over many projects, while those listed as coming from Hong Kong (PRC) are larger investments concentrated in fewer large-scale projects such as the Sinopec oil storage facility in Batam.
- <sup>12</sup> 'Investasi Wisata di Bintan Tembus Rp1,8 Triliun' ('Tourism Investment in Bintan Reaches 1.8 Billion Rupiah'). <https://economy.okezone.com/read/2018/03/29/320/1879563/investasi-wisata-di-bintan-tembus-rp1-8-triliun>, accessed 17 April 2018
- <sup>13</sup> 'Indonesian Street City', <http://www.isc22.com/isc.html?t=717>, accessed 13 February 2017.
- <sup>14</sup> 'Penerbangan Citilink ke Tiongkok Disambut Baik Wisatawan' ('Citilink Flights to China Met With Enthusiasm From Tourists'), <http://www.antarakepri.com/berita/39845/penerbangan-citilink-ke-tiongkok-disambut-baik-wisatawan>, accessed 9 March 2017.
- <sup>15</sup> 'Lewat Konjen China, Gubernur Nurdin Undang Para Pengusaha China Sejumlah Investasi Besar' ('Through the Chinese Consul, Governor Nurdin Invites Chinese Entrepreneurs To Make Large Investments') <http://batam.tribunnews.com/2017/09/20/lewat-konjen-china-gubernur-nurdin-undang-para-pengusaha-china-sejumlah-investasi-besar?page=all>, accessed 28 February 2018.
- <sup>16</sup> Ibid.
- <sup>17</sup> For a brief history of the ethnic Chinese in Kepri, see Ananta, A. & Arifin, E. N. (2008) 'Chinese Indonesians in Indonesia and the Province of Riau Archipelago: A Demographic Analysis' in Suryadinata, L. (ed), *Ethnic Chinese in Contemporary Indonesia*, Singapore: ISEAS Publications, pp. 17-47.
- <sup>18</sup> Interview conducted on 17 January 2017.
- <sup>19</sup> Hutchinson, F. (2017) 'Rowing Against the Tide? Batam's Economic Fortunes in Today's Indonesia.' *Trends in Southeast Asia*, 8.



<sup>20</sup> 'Jokowi dismisses concerns over Chinese workers in Indonesia', <http://www.thejakartapost.com/news/2016/12/23/jokowi-dismisses-concerns-over-chinese-workers-in-indonesia.html>, accessed 28 February 2018.

<sup>21</sup> Setijadi, C. (2016) 'Ethnic Chinese in Contemporary Indonesia: Changing Identity Politics and the Paradox of Sinification.' *ISEAS Perspective*, 12.

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