

THE ECONOMIC RELATIONS BETWEEN CHINA AND INDONESIA AND MAINLAND CHINA'S INVESTMENTS IN INDONESIA

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I. Introduction

There are many literatures about the economic relation between China and ASEAN which included the economic relation between China and Indonesia, major ones of which are as follows: 'the political economy of China's changing relations with Southeast Asia' (Wong 1984), 'China-ASEAN economic relations: trades and patterns' (Cheng Bifan and Chia Siow-Yun 1988), 'China-ASEAN economic relations: development in China and ASEAN and their implications for China-ASEAN economic relations' (Cheng Bifan and Chia Siow-Yun 1989), 'China-ASEAN economic relations: in the context of Pacific economic development and cooperation' (Cheng Bifan and Chia Siow-Yun 1991), 'China-ASEAN economic relations: industrial restructuring in ASEAN and China' (Luo Zhaohong and Chen Renhe 1995). Besides books, some scholars had published papers on economic relation between China and Indonesia such as Hadi Soesastro (1986), Raymond Atje and Arya B Gaduh (1999), Jusuf Wanandi (2001), and so on.

'The economic relations between China and Indonesia' is old academic studying field on one hand, but it is always a new field attracting scholar's attention on the other hand. The economic relations between them have been in change with the change of politic and economy in these two countries and the change of regional and global relationship. So it is always imperative to study the economic relation between China and Indonesia in response to the change of respective economy and international relationships. This paper will focus on four areas: 1) China's economic relations with Indonesia since 1950s; 2) the complementarity and competitiveness of economic relations between China and Indonesia; 3) The impact of China's entry into WTO and establishment of China-ASEAN free trade area on economic relation between China and Indonesia; 4) Chinese investment in Indonesia.

II. China's economic relations with Indonesia since 1950s

China and Indonesia finally became nation state after World War II, but followed different social systems which put strong influence on economic relations between them. Together with the influence of international political regimes in the period of Cold War, the economic relations between China and Indonesia had not been smooth. Economic relations between Indonesia and China are closely related to the political relations between the two countries. As the political relations have been up and down, so have been the economic relations.

China and Indonesia established diplomatic relations on 13 April 1950 and signed first bilateral trade agreement in 1953. Afterward, the trade between them had been increased, the total trade value between them increased from US\$ 7.38 million in 1954 to US\$ 129 million in 1959. Even in 1965, China once became the second trade partner of Indonesia which Indonesian import and export value from China occupied 11 percent of the total value of Indonesian import and export. But following the ‘30 September’ incident in 1965, the diplomatic relations between two countries were suspended in 1967. This had a significant negative impact on the economic relations between Indonesia and China. Direct trade link between them therefore stopped and indirect trade had been taken through Hongkong and Singapore. Until 1980s, Relations between China and Indonesia began to ease. In July 1985, the Indonesian Chamber of Commerce and the China Council for the Promotion of International trade (CCPIT) signed a memorandum of understanding (MoU) for the reestablishment of a direct trade link between the two countries. Five years later, it was on 8 August 1990 while Premier Li Peng was visiting Indonesia, the Chinese and Indonesian foreign ministers signed the Memorandum of Understanding on Restoration of Diplomatic Relations on behalf of each of his own government, and declared Sino-Indonesian diplomatic relations was officially restored as of that day. After that, the political and economic relations between the two countries had been normalized, Sino-Indonesian relations have seen all-round progress and developed rapidly. Average annual growth rate of trade reached 14.7 percent during 1990-2000. Entering 21st century, the relations between the two countries have been in best time. In May 2000, Foreign Minister Tang Jiaxuan and Indonesian Foreign Minister Alwi Shihab signed in Beijing the Joint statement on the Course for Future Bilateral Cooperation between the People's Republic of China and the Republic of Indonesia, and Memorandum of Understanding on the Joint Committee of Bilateral Cooperation between the People's Republic of China and Republic of Indonesia, which was the guideline of developing the relations between two countries in 21st century. This showed that the two countries reached consensus on establishing and developing all-round cooperative relations based on long-term stability, mutual trust and good neighbourliness.

Overview the history of economic relations between China and Indonesia since the establishment of diplomatic relations in 1950, the development of economic relations between two countries may be divided into three stages:

1. Slowly development in the period of 1950-1966. The trade relations between them were characterised as small volume and simple structure of trade.

Table 1: Chinese trade with Indonesia during 1950-1966 (Unit: US\$ ten thousand)

| Year | 1950—1955 | 1956—1960 | 1961—1965 | 1966 |
|--------|-----------|-----------|-----------|-------|
| Export | 11.75 | 206.28 | 236.99 | 0.33 |
| Import | 22.56 | 191.98 | 225.20 | 16.39 |
| Total | 34.31 | 398.26 | 462.19 | 16.72 |

Source: Almanac of China's Foreign Economic Relations & Trade 1984. No official data of 1967-1976

2. Indirect trade through Hongkong and Singapore in the period of 1967-1984. The normal economic relations between China and Indonesia had been stopped for nearly 20 years because the diplomatic relations between two countries suspended in 1967. The trade between them took place in term of indirect trade through Hongkong and Singapore. In 1970s, about 30 percent of Indonesian import goods from Hongkong were made in China and 14 percent of Indonesian export goods to Hongkong had been transferred to China at same time.

Table 2: Chinese indirect trade with Indonesia via Hongkong during 1967-1984
(Unit: million US dollar)

| Year | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|--------|------|------|------|------|------|------|------|------|
| Import | 8 | 28 | 45 | 33 | 42 | 34 | — | — |
| Export | 94 | 134 | 203 | 238 | 256 | 227 | 195 | 165 |
| Total | 102 | 162 | 248 | 271 | 298 | 261 | 195 | 165 |

Source: Hongkong's Foreign Trade 1978, 1979, 1980, 1982, 1984, 1985.

3. Restoration and rapidly development since 1985. China and Indonesia finally restored direct trade which ever suspended for nearly 20 years since 1967. The economic relations between these two countries developed rapidly after the normalisation of diplomatic relation in 1990.

A. The economic relations between China and Indonesia in this period are characterized as follows:

- The trade value between them has been steadily increasing. We can see this trend from below table. The trade value between China and Indonesia goes up sharply since 1985 except in 1998 and 2001. According to the data of China, Indonesia's trade with China by value increased nearly 100 times from US\$ 108.7 million in 1985 to US\$10.2 billion in 2003 and is planed to reach US\$ 15 billion with Indonesia's trade surplus most of years.

Table 3: The trade balance between China and Indonesia during 1985-2003
(Unit: US\$ million)¹

| Years | Indonesian Statistics | | | Chinese Statistics | | |
|-------|-----------------------|---------|--------|--------------------|--------|---------|
| | Total | Export | Import | Total | Export | Import |
| 1985 | 333.1 | 84.2 | 248.9 | 108.7 | 69.0 | 39.7 |
| 1986 | 476.1 | 139.0 | 337.1 | 285.0 | 102.2 | 182.8 |
| 1987 | 751.0 | 343.0 | 408.0 | 432.2 | 142.1 | 290.1 |
| 1988 | 930.5 | 491.8 | 438.7 | 522.7 | 170.4 | 352.3 |
| 1989 | 1,095.9 | 568.5 | 527.4 | 441.9 | 141.9 | 300.0 |
| 1990 | 1,486.8 | 834.4 | 652.4 | 545.7 | 220.0 | 325.7 |
| 1991 | 2,025.9 | 1,190.9 | 835.0 | 1,884.5 | 481.1 | 1,403.4 |
| 1992 | 2,147.9 | 1,396.4 | 751.5 | 2,025.7 | 471.4 | 1,554.3 |
| 1993 | 2,114.0 | 1,250.0 | 864.0 | 2,160.3 | 691.7 | 1,468.6 |

¹ This table shows there is big gap between Indonesia statistics and Chinese statistics because smuggling exists in Indonesia side. So the figures of Indonesia are smaller than that of China.

| | | | | | | |
|------|---------|---------|---------|----------|---------|---------|
| 1994 | 2,690.7 | 1,321.7 | 1,369.0 | 2,640.1 | 1,051.7 | 1,588.4 |
| 1995 | 3,137.0 | 1,641.8 | 1,495.2 | 3,490.2 | 1,438.2 | 2,052.0 |
| 1996 | 3,655.1 | 2,057.5 | 1,597.6 | 3,708.4 | 1,428.0 | 2,280.4 |
| 1997 | 3,747.3 | 2,229.3 | 1,518.0 | 4,514.2 | 1,840.6 | 2,673.6 |
| 1998 | 2,738.2 | 1,832.0 | 906.2 | 3,627.9 | 1,171.2 | 2,456.7 |
| 1999 | 3,251.1 | 2,008.9 | 1,242.2 | 4,829.8 | 1,778.9 | 3,050.9 |
| 2000 | 4,789.6 | 2,767.7 | 2,021.9 | 7,463.9 | 3,061.9 | 4,402.0 |
| 2001 | 4,043.4 | 2,200.7 | 1,842.7 | 6,724.6 | 2,836.5 | 3,888.1 |
| 2002 | 5,330 | 2,903 | 2,427 | 7,928.3 | 3,426.9 | 4,501.4 |
| 2003 | 6,760 | 3,803 | 2,957 | 10,229.0 | 4,481.0 | 5,748.0 |

Source: Almanac of China's Foreign Economic Relations & Trade (Different Years), Statistics Indonesia (BPS)

- In terms of commodity structure, China's principal export commodities to Indonesia are industrial finished products and semi-manufactured goods and some agricultural goods such as electrical machinery and apparatus, chemical materials, tobacco, rice and maize, China's principal import commodities are resource-intensive goods like crude oil, plywood, wood and its products, pulp, rubber and chemical materials. Of China's total exports to Indonesia, primary commodities accounted for 23 percent and industrial finished products accounted for 77 percent in 2001; by contrary, primary commodities accounted for 51 percent and industrial finished products accounted for 49 percent of China's total imports from Indonesia at the same year (Xu 2002).
- In engineering projects and labour services aspects, development is quick, but value is still small. China and Indonesia began cooperation in this area in 1989 and signed contract value of US\$ 810 thousand in that year. Although contract value of engineering projects and labour services between them have increased and even reached over US\$ 100 million in some years, but most of years until now are below that level. According to China's data, the total contract numbers of engineering project and labour service between China and Indonesia added up 1074 units with the accumulative contract value of US\$ 988 million and the accumulative turnover of US\$ 579 million until the end of 2002.² As Indonesia estimated, the contract value of engineering projects for foreign countries is estimated about US\$ 10 billion one year, but China only accounts for small percentage of it. China's biggest engineering project was that Chinese ChengDa Engineering Corporation built 20×30 kilowatt Cilacap power station in central Jawa worth US\$ 510 million beginning on 29 December, 2003. At same year, CHEC (China Huadian Engineering Company), one of the largest general contractors in China's power sectors, signed an agreement on establishing about 30 power plants in java with Indonesia companies PT Dana Mulia Sukses and PT Radu Pratama.

² calculated according Almanac of China's Foreign Economic Relations & Trade (Different Years)

- The cooperation between two countries in energy has made great progress. The Energy Forum has been set up in November of 2001, which shows the two countries will deepen energy cooperation in future. In September of 2002, Indonesia signed a 25-year contract to supply US\$ 8.5 billion worth of liquefied natural gas (LNG) to China's Fujian province from the Tangguh LNG plant in Papua. CNOOC (China National Offshore Oil Corporation) will start building an LNG terminal in 2004, while the first LNG supply from Tangguh is expected to arrive in Fujian by 2007. The supply will amount to 2.6 million tons per year.
- China provided credit worth US\$ 0.4 billions for helping finance the construction of the cross-sea Suramadu bridge linking Java and the island of Madura, double-track railroad connecting Cirebon-Kroya and the construction of 200 Megawatt Labuhan Angin power plant in Sibolga in 2002 (Setiogi 2003). Moreover, China also provided Indonesia with export credit facility and grant for food and medicine in 1998 and 1999 respectively.

Besides cooperation above mentioned, China and Indonesia have developed cooperation in agriculture, forestry, fishing, mining, transportation, finance, tourism, and other areas. In 2001, agriculture, fishing, energy, resource exploration, infrastructure construction as well as tourism was set by both countries as key sectors for economic cooperation. Mutual investment also will be the important area to be developed by both sides in future and will be discussed in last part of this paper.

Generally speaking, the economic relations between China and Indonesia had been steadily and all-roundly developed in past decades.

B. The reasons why the economic relations between China and Indonesia had been steadily and all-roundly developed since 1985 are as follows.

First, international relations changed. In 1950-70s, the world was in the period of Cold War, conflict and rivalry are major terms of international relations. ASEAN countries treated China as a rival or threat in the middle of 1960 and the early of 1970. With the improvement of relations between China and America after American former president Nixon visiting China in 1972, ASEAN countries justified foreign policy toward China and tried to improve the relations with China. Especially, The Cold War lasting 40 years turned out to be over in the end of 1980s and the early of 1990s with the disintegration of former Soviet Union in 1991. Therefore, the international relationship greatly changed, peace and development as well as competition and cooperation replaced conflict and rivalry.

Second, the foreign and domestic policy in China and Indonesia began to change respectively with the background of international relations above mentioned. China began domestic economic reform (namely market economic reform) and carried out outward-looking economic policy from 1978. Establishing friendly relations with neighbour countries around China is included into China's import foreign policy. Indonesia as a big country in Southeast Asia was in the nature of things

considered by China as one of China's most import neighbours who should be normalized bilateral political and economic relations. During 1980s, Indonesia also undertook significant economic policy changes in terms of deregulation or liberalization. Indonesia pursued outward-looking and export substitution policy instead of inward-looking and import substitution policy in the period of 'oil prosperity'. Trade contributed more and more to GDP in these two countries. From Indonesian perspective, China was also considered as having a large economic potential and could no longer be ignored. As Atje and Gaduh (1999) wrote: 'it was in such political and economic environments in China as well as in Indonesia that the rapprochement between the two countries took place'. The process began at the time when both countries were entering new phases of their respective economic reforms. The establishment of a direct trade between the two countries in 1985 and the improvement in economic relations between the two countries afterwards might be regarded as parts of their efforts to integrate their economies with the emerging global economy.

Third, the two countries pay more attention to develop their bilateral relation by means of frequently leader visit each other since establishment of diplomatic relation in 1990.

Fourth, China's rapidly economic development provides the strength of economic relations between China and Indonesia with more opportunities. With China's high growth rate since 1980s, China enlarges demands for Indonesia products, resources, investment and economic cooperation on one hand, China's enterprises begin to invest in Indonesia under the 'going out' policy on the other hand.

III. The complementarity and competitiveness of economic relations between China and Indonesia

It is argued that the complementarity of economic relations between China and Indonesia is less than competitiveness of that (Atje and Gaduh 1999). They think Indonesia and China are developing economies, with more or less the same levels of development, and lack economic complementarity that is necessary for extensive trade between them to take place. So it is necessary to review this point from theoretically and practically.

A. Theoretical Analysis

From one view of traditional trade theory----Factor Proportion Theory, difference of factor endowment fundamentally results in international division and then international trade. Furthermore, the more difference of factor endowment, economic level and industrial structure between two countries, the more economic complementarity between them, and vice versa. So it is easy to conclude that China and Indonesia lack economic complementarity because Indonesia and China are developing economies with more or less the same levels of development. Nevertheless, Factor Proportion Theory only explains one of reasons why international trade happen, but not all. In fact, some new trends appear in the process of economic globalization. On one hand, production factors multiply. Technology, information and system as new production

factors contributes more to production as well as traditional production factors such as earth, capital and labour; on the other hand, international flow of production factors brings about transfer of comparative advantage internationally and intra-industry trade. Factor Proportion Theory only explains why inter-industry trade takes place, but Intra-Industry Trade Theory explains why intra-industry trade happens. Exchange of differentiated products and intermediate-products of same industry between two or more countries is called as intra-industry trade. From the view of Intra-Industry Trade Theory, product differentiae and economy of scale are at the bottom of intra-industry trade. Furthermore, international trade also happens in the two countries with similar factor endowment, similar industry structure and similar economy. Therefore, it is possible to strengthen the economic complementarity of two countries with similar factor endowment by means of enlarging intra-industry trade. Intra-Industry Trade Theory as dynamic trade theory brings to light possibility that the two countries with similar industry structure and factor endowment develop extensive trade, so do China and Indonesia.

B. Practical Analysis

Generally speaking, the economic complementarity of China and Indonesia are relative limited at present, but we can't conclude that they lack economic complementarity which is necessary for extensive trade between them to take place. In reality, there are intra-industry trades between them as well as inter-industry trade.

First, China and Indonesia have differences of factor endowment, so they have economic complementarity. China rich in population, resources and broad area of earth covering areas of tropics, subtropics, temperate zone and frigid zone. Indonesia is a big country in Southeast Asia and abounds with natural resources in agriculture, mineral, forestry and ocean. They possess of different comparative advantage. The indicator of revealed comparative advantage in below table shows China's comparative advantage is on labour-intensive commodities and Indonesia's comparative advantage focus on resource-intensive commodities.

Table 4: Revealed comparative advantage (RCA) of China's and Indonesia's export commodities 1988

| | Oil, mineral and metal | Agriculture | Processing Food | Manufacture |
|-----------|------------------------|-------------------|------------------|-------------------|
| China | 0.5229 | 0.7264 | 0.7015 | 1.0916 |
| Indonesia | 2.5299 | 1.4995 | 1.7842 | 0.756 |
| | Agriculture-intensive | Mineral-intensive | Labour-intensive | Capital-intensive |
| China | 0.7596 | 0.5906 | 3.4531 | 0.6736 |
| Indonesia | 1.8748 | 2.2167 | 1.2559 | 0.3705 |

Source: NAPES. <http://napes.anu.edu.au/nph/rcademo.html>

The revealed comparative advantage index of a country's given product category is defined as the quotient of two ratios. The numerator is the share of the product category's export in the country's total exports, while the denominator is the share of the world's total exports of the product category in the world's total exports of all products. An index

greater than unity in a particular product category 'reveals' that the country has a 'comparative advantage' in the production of that product category, whereas an index smaller than unity 'reveals' that the country has a 'comparative disadvantage'. As the magnitude of an index becomes larger, its comparative advantage increases or its comparative advantage decreases, whichever the case may be. Other things being equal, the larger is the index, the greater is the comparative advantage or the smaller is the comparative advantage.

We should caution the interpretation of the indices of revealed comparative advantage. They are calculated from actual export statistics of any given country and the corresponding export statistics for the world as a whole. As such they may reflect the underlying 'real' comparative advantages or disadvantages of the economy, but they may also reflect the success or failure to deploy its resources efficiently. Moreover, changes in the indices over time may reflect the economy's success or failure in upgrading its production technology and its accumulation of human capital. The upgrading of production technology depends not only on domestic research and development activities, but also on direct importation of technology and technology transfer via foreign direct investment and the ability to have skilled manpower from other part of the world working and contributing in the economy. A country may begin with absolutely zero level of export in electronic components. Yet, with a successful effort in attracting export-oriented direct foreign investments in the electronic sector may catapult an economy into a significant player in the international electronic components market.

APEC study (1999) on RCA of each country in this region during 1980-1995 also indicated China's and Indonesia had different comparative advantage. In the APEC (1999) study, commodity exports are aggregated into four product categories, namely, (a) natural resource intensive products; (b) unskilled labour intensive products; (c) technology intensive products, and (d) human capital intensive products.³ Indonesia had a comparative advantage in natural resource intensive products, and it had a comparative disadvantage in unskilled labour-intensive products, technology intensive products, and human capital-intensive products throughout the period. Comparing to Indonesia, China has obvious comparative advantage in the production of unskilled labour-intensive products, technology intensive products, and human capital-intensive products throughout the period of 1980-1995.

Second, intra-industry trade between China and Indonesia had taken place and will increase. Grubel-Lloyd Index is often used as a major indicator measuring intra-industry trade. Intra-industry trade between China and ASEAN tended to widen since 1990s, so did intra-industry trade between China and Indonesia (Wang Qin 2003). Table 5 shows the continually increase of intra-industry between China and ASEAN

³ Natural resource intensive products include food and live animals (chiefly for food); beverage and tobacco; crude materials, mineral fuels; animal and vegetable oils; manufactured goods classified by material such as leather, wood manufactures, pearls, precious stones, pig iron.

Unskilled labor-intensive products will include textile and textile products; manufactured goods like furniture, clothing, footwear, toy.

Technology intensive products include chemicals; machinery and transport equipment; telecommunication equipment; office machines; computers; aircraft; scientific instruments.

Human capital-intensive products include dyes and paints; steel; paper; non-electrical parts, tools; watches and clocks; printed matters; musical instruments.

(including Indonesia). Additionally, China's entry into WTO and establishment of China-ASEAN FTA will promote increasing intra-industry trade between China and Indonesia. It was proven by Balassa and Bauwens (1987) that intra-industry trade and joining regional economic organization like FTA are positive related. In other words, the establishment of regional economic organization will contribute more to increase intra-industry trade within this region.

Table 5: Grubel-Lloyd Indices between China and five ASEAN countries 1993-2001⁴

| | ASEAN-5 | Singapore | Philippine | Malaysia | Thailand | Indonesia |
|------|---------|-----------|------------|----------|----------|-----------|
| 1993 | 0.36 | 0.38 | 0.27 | 0.29 | --- | 0.28 |
| 1994 | 0.42 | 0.36 | 0.26 | 0.27 | --- | 0.24 |
| 1995 | 0.41 | 0.39 | 0.26 | 0.31 | --- | 0.25 |
| 1996 | 0.46 | 0.42 | 0.34 | 0.34 | 0.27 | 0.26 |
| 1997 | 0.47 | 0.40 | 0.26 | 0.37 | 0.35 | 0.24 |
| 1998 | 0.46 | 0.46 | 0.34 | 0.43 | 0.35 | 0.30 |
| 1999 | 0.57 | 0.54 | 0.44 | 0.60 | 0.51 | 0.47 |
| 2000 | 0.58 | 0.55 | 0.44 | 0.54 | 0.62 | 0.47 |
| 2001 | 0.55 | 0.53 | 0.51 | 0.46 | 0.40 | 0.49 |

Third, steadily increase of foreign trade between China and Indonesia since 1985 strongly proves that the economic complementarity lies between them.

Of course, we can't deny the China-Indonesia economic competitiveness, which is mainly on third country markets and attracting foreign investment.

IV. The impact of China's entry into WTO and establishment of China-ASEAN free trade area on economic relations between China and Indonesia

In an increasingly integrated world economy, it is utterly insufficient to analyze China-Indonesia economic relations in isolation from the two countries respective relations with the rest of the world. China's entry into WTO and establishment China-ASEAN FTA will affect the development of China-Indonesia economic relations.

A. The impact of China's entry into WTO on economic relations between China and Indonesia

One word is often used to assess the impact of China's accession to WTO on ASEAN and China that Challenges and opportunities coexist. The challenges for Indonesia from China's entry into WTO may be generalized as three dimensions: 1) China's products compete in Indonesia domestic market. As a WTO member, China is entitled to enjoy the same rights as other WTO members, and Indonesia should provide with same preference to China like open domestic market. 2) China's products compete with Indonesia's products in third country market such as USA, Japan and EU. USA,

⁴ Zhao (2004).

Japan and EU are the three major export markets of both China and Indonesia. China's products will enter these markets as other WTO members and compete with Indonesian products, especially those products which China has obvious comparative advantage such as unskilled labour-intensive products, technology intensive products, and human capital-intensive products. 3) China will compete with Indonesia in attracting FDI. As we seen, FDI that flows to Indonesia had decreased sharply after Asian financial crisis because of Indonesia's bad political and economic environment. Even until now, FDI outflow from Indonesia still happens. According to Economic Intelligence estimated, Indonesian domestic capital outflow reached about US\$ 660 million and FDI outflow reached about US\$ 57.9 billions during 2001-2003.⁵ Some of FDI outflow from Indonesia may turn to China, Vietnam, Cambodia and Myanmar.

China's accession to WTO provides opportunities for Indonesia at the same time. China is responsible to open its domestic market for WTO members and has mandate to liberalize regulations related to trade and investment as it enjoys the rights, which inevitably increase Indonesia exports and investment to China. First of all, China should cut import tariffs and eliminate non-tariff barriers. China promises average import tariff rate will be cut to 10 percent that is a little bit lower than average level of developing countries by 2005. From 1 January 2002, China began to cut average import tariff rate from 15.3 percent to 12 percent with covering 5300 products. Of them, import tariff rates of seafood, crude oil and petroleum products refined, wood, paper and articles of paper, chemical products, electronic products had been cut by 25 percent. Those products are Indonesia major exports to China. Without question, it would enlarge Indonesia exports to China. Secondly, the openness of all sectors, especially service sectors, and liberalization of economy will enlarge mutual investment and economic cooperation between China and Indonesia.

In addition, China's entry into WTO has one meaning beyond economy for Indonesia. It is that China's membership may improve their bargaining power as a developing country vis-à-vis developed countries (Atje and Guduh 1999) and struggle more benefits for developing countries.

In fact, China's entry into WTO provides challenges and opportunities not only for Indonesia, but also for China. In order to reduce challenges from China's entry into WTO for China and ASEAN and reinforce China's and ASEAN's competitive capacity in the process of globalization, China and ASEAN finally agreed to set up China-ASEAN FTA within 10 years in 2002.

B. The impact of establishment of China-ASEAN FTA on economic relations between China and Indonesia

Theoretically speaking, FTA will benefit member countries by means of two ways: static effect like trade creation and dynamic effect like enhancing labour productivity and accumulating capital. FTA between China-ASEAN not only includes liberalizing trade, but also includes the liberalization of technology and investment and economic cooperation. So China and ASEAN FTA will take positive effects on GDP and welfare

⁵ *Capital outflow will reach US\$ 368 million this year*, International Daily (Indonesia), 15 May 2004.

of China and Indonesia as well as their trade.

The simulations conducted by the ASEAN Secretariat using the Global Trade Analysis Project (GTAP version 4) suggest that an ASEAN-China FTA will increase ASEAN's exports to China by 48 percent and China's exports to ASEAN by 55.1 percent. Among the ASEAN countries, the biggest gainers in exports are Singapore, Malaysia, Thailand and Indonesia, whose export value rises by US\$ 36.39 billions, 32.07 billions, 29.07 billions and 26.56 billions respectively. The biggest gainers for ASEAN by sectors are textiles and apparel, electrical appliances and machinery and other manufactures. Indonesia's exports of other manufactures to China will rank first which rise by US\$ 1.3 billions. At same time, the biggest gainers for China are also textiles and apparel, electrical appliances and machinery and other manufactures. China's exports of other manufactures to Indonesia also rank first which rise by 528 million.

Table 6: Changes in exports and GDP with China-ASEAN FTA⁶

| | Exports (US\$ million) | GDP (US\$ million) | |
|-----------|---------------------------|--------------------|-------------------------|
| | | Absolute increase | Percentage (%) increase |
| China | 2656.09 | 2214.9 | 1.12 |
| Indonesia | 1371.60 | 2267.8 | 0.27 |

Another simulation conducted by Chinese Professor Zhang Bowei and Li kungwang (2003) using GTAP version 5 and Computable General Equilibrium (CGE) made same conclusion that all members countries including China and Indonesia can get positive benefit in trade, GDP and welfares.

The removal of trade and investment barriers will certainly lower transaction costs, raise economic efficiency, upgrade product quality, increase economies of scale and scope etc. All of these will help improve external competitiveness in third country market. The (net) trade creation effects could be substantial, and so are the bigger flows of trade-related investment

Productive activities and industries will have to upgrade and move on to a different level of comparative advantage – through comprehensive trade and investment liberalization and, on the other hand, through economic growth, social development and a rising standard of living over time. Such a movement will make room for others to fill up the vacant economic space.

In one words, China-ASEAN FTA is a win-win arrangement that will benefit China and Indonesia as a whole. One thing should be mentioned here that some sectors and enterprises will face big challenges and even suffer loses like textiles and shoes in short term, but this is just results of FTA. During the process of FTA, reasonable intra-industry division in those sectors after competing each other will form finally with torture.

⁶ ASEAN-China Export Group on Economic Cooperation (2001: 150–152).

China's entry into WTO and FTA between China and ASEAN are positive response for China and ASEAN to face the challenges from economic globalization. It will be helpful to develop economic relations between China and Indonesia in long run. As for China and Indonesia respectively, it is clear that they need to formulate a strategic response to challenges and find niches, complementary opportunities and benefit from China's entry into WTO and FTA between China and Indonesia.

V. Mainland China's investments in Indonesia

Although the economic relations between China and Indonesia had made big progresses comprehensively in last decades, bilateral trade had been occupied big portion and mutual investment remains relative small in the size of their economic relations, nay, developed non-symmetrical. Indonesia's investments in China are nearly 20 times more than China's investments in Indonesia. Indonesia began investing in China in 1984. According to Chinese government statistics, Indonesia's investments in China totalled up to 970 contract numbers with contract value of US\$ 2.024 billions till March of 2003. On the other hand, China has opened in Indonesia 60 non-trading joint ventures and enterprises under joint management, with their investment totalling US\$ 0.27 billions, which Chinese investments reach US\$ 0.163 billions till March 2003 including 18 service enterprises with value of US\$ 0.105 billions, 39 processing enterprises with value of US\$ 34.92 million, and 3 fishing enterprises with value of US\$ 23.31 million (Ministry of Commerce of the People's Republic of China 2004). Total Chinese investments this year is about US\$ 1.5 billion. Previously, it was only US\$ 300 million.⁷ In June of 1996, the Chinese People's Insurance Company opened a branch in Jakarta. In April of 2003, Bank of China reopened its branch and business in Jakarta.

China's investments in Indonesia are mainly resources-oriented and market-oriented investments.⁸ For China, Indonesia are natural resources supplier and big potential market because Indonesia is with 0.21 billion populations and abundant in natural resources such as oil and gas, mineral, wood, palm oil and so on which are badly needed by China. China is more and more shortage of natural resources with rapidly economic growth. Petroleum, in particular, is becoming a cause for concern. China's oil consumption last year hit 245 million tones, making it the world's second biggest consumer of oil after America. In 2020, it is expected to become the world's biggest oil importer, with foreign oil resources making up 60 per cent of its total consumption. To supplement its diminishing resources, China should look towards South-east Asia, a precious land where China can obtain rich resources. Indonesia, for instance, has rich mineral and forest resources, as well as oil reserves amounting to about 120 billion barrels. In resources-oriented investments aspect, there are huge mainland China's invests in oil and gas exploration. CNOOC Ltd is a state-owned China National Offshore Oil Corp., China's third largest oil producer after No.1 PetroChina and No.2 Sinopec. In January of 2002, CNOOC, which has been expanding aggressively outside China, inked its largest overseas deal worth \$585 million for the Indonesian oil

⁷ *Indonesia: Tempo*, no.46/IV/ 20-26 July 2004.

⁸ Zhan Xiaoning, a senior official in investment with UNCATD, classifies Chinese overseas investment as four types: :resource-oriented, market-oriented, efficiency-oriented and technology-oriented investment.

operations of Spain's Repsol-YPF. It makes CNOOC the largest offshore oil producer in Indonesia. In February of 2004, CNOOC succeeded in buying 20.77 percent of British BG's shares in Muturi Ltd at price of US\$ 9.81 million and CNOOC became the biggest stockholder of Muturi Ltd whose share in Mutri Ltd rose from 44.0 percent to 64.77 percent and whose share in Tangguh LNG plant in Papua rose from 12.5 percent to 16.96 percent.⁹ In April of 2002, China's largest oil company, PetroChina made its first overseas purchase in Indonesia worth \$216 million for American Devon Energy Corp.'s oil and gas operations in the country. So the increase in investment in recent years has taken place in the oil and gas sectors, valued at about US\$ 1 billion. In market-oriented investments aspect (in terms of processing manufacture), mainland China's light industry such as household electrical appliances and motorcycles faces big challenge of relative overcapacity of productivity, but has strong competitiveness in terms of price. These enterprises have to find foreign markets to satisfy their overcapacity and Indonesia is just suitable market. For instance, in electronic sector, many well-known brands in China, like Cang Hung, Kang Cia and TCL, are marketed and invest in Indonesia. Bicycle manufacturers have also opened spare parts plants in Indonesia, like Jia Ling, Lif Fan, Chen Zhen and Pian Ma.

Indonesian-Chinese businessmen welcome investments from China and want to play important role in the process of China's investment in Indonesia. Overseas ethnic Chinese who attended The Third Overseas Chinese Forum Worldwide¹⁰ held in Beijing on 15-18 July 2004 expressed their willing that they want to act as a good partner and play bridge role in establishment of China-ASEAN FTA and in the process of Chinese enterprises 'going out'. Famous Chinese-Indonesians like Mr. Lin Wenjing (president director of SALIM GROUP), Mr. The Ning King (Chairman of ARGO MANUNGGAL GROUP) and Mr. Alim Markus (president director of MASION GROUP) attended this forum. Mr. Lin Wenjing made a speech on Ethnic Chinese businessmen Advantages in the Process of Establishment of China-ASEAN FTA. He said that ethnic Chinese businessmen posses four advantages as follows: first, having strong economic capacity; second, having deep influence in local and internal; third, interested in taking part in FTA; fourth, having more experience in domestic and international investment. In fact, many overseas Chinese businessmen invest in mainland of China in one hand and act as cooperate partner of China's enterprises in Indonesia. For instance, MASION GROUP once built a plant in hometown Fujian province, and established three joint ventures that are Pt. Shanghai Masion Oleo Chemical Industry, PT. Shanghai Masion Tooth Paste Industry and PT. Shanghai Maspion Printing Ink Industry with Chinese enterprises. To succeed in overseas market, Mr. Oei Hong Leong suggested five steps for Chinese firms to take: establish a domestic presence first as a back-up; groom daring and visionary corporate leaders; seek overseas partners, cooperate with other Chinese firms instead of engaging in price wars; and integrate the efforts of overseas Chinese firms locally when China's investments go out abroad (Chan 2004).

Although Chinese investment in Indonesia is still small, it is tendency to increase. That

⁹ *Indonesia: International Daily*, 4 February 2004, C2.

¹⁰ The Third Overseas Chinese Forum was jointly organized by the Overseas Chinese Affairs Office of the State Council and the Chinese Overseas Exchanges Association.

is because: 1) apart from the need for resources, Chinese firms may promote cooperation with Indonesian counterparts in the areas of agriculture, technology, finance, communications, trade and services. As UNCTAD stated, China is not only a major receiver of foreign direct investment but also is gradually turning into an exporter of capital. Statistics from UNCTAD show that China's direct overseas investment exceeded US\$ 35 billion in 2003, covering more than 160 countries and regions. 2) China's openness enters a new stage that the model of capital flow changes from single-way inflow of capital to double-way flow of Capital. Moreover, China are upgrading its industrial structure and integrate its economy into globalization, more and more enterprises including state-owned and private enterprises go abroad to investment for seeking resources, market, efficiency. 3) The establishment of China-ASEAN FTA will be helpful to promote China's investment in Indonesia. FTA requires member countries to simplify FDI application and liberalize FDI system. It makes mutual investment between China and Indonesia easier and increase. 4) Indonesia begins to pay more attention to attract China's investments. Indonesia will host a trade fair in Beijing from 30 August to 3 September in 2004. The five-day event will focus on Indonesian enterprises that work in sectors including oil, gas, mining, tourism, agriculture, fishery and papermaking.

It is worth to note for China's investments that there are many obstacles in Indonesia that are political uncertainty, labour law, corruption, lagging infrastructure. Labour law and corruption, in particular, are be strongly blamed by Indonesia entrepreneurs and foreign entrepreneurs, which is one reason why FDI in Indonesia transfer to invest in other countries.

In addition, China should pay attention to the negative impact on Indonesian Chinese enterprises during the process of strengthening the economic relations between China and Indonesia and FTA between China and ASEAN. When Chinese products, mainly labour-intensive products like shoes, apparel and home appliance, pour into Indonesian market, it may make some enterprises close and workers loose their jobs. Now we can hear many voices from Indonesia that China's products have flooded in Indonesia and complain about their low quality.

Any way, mutual investment between China and Indonesia will be more and more import in the economic relations between two countries.

VI. Conclusion

The relation between China and Indonesia is always an up to date topic for scholars. The economic relations between China and Indonesia had not been smooth since diplomatic relation first set up in 1950. The economic relations between two countries experienced three stages, namely slowly development in the period of 1950-1966, indirect trade in the period of 1967-1984 and restoration and rapidly development from 1985 to up to now.

The trade between China and Indonesia includes not only inter-industry trade but also intra-industry, and intra-industry trade is tendency to increase. The trade value between two countries is rising rapidly since 1990. Moreover, mutual investment, engineering

project and labour service, tourism and economic cooperation in agriculture, energy, infrastructure and resource exploration between them have been increasing. There are large potency for China and Indonesia to develop bilateral economic relations.

China's access to WTO and the establishment of China-ASEAN FTA are two important events that exert big impact on China, Indonesia and their economic relations. The positive impact of these two events on China-Indonesia' economic relations is more than the negative impact of that in long term. Moreover, China's access to WTO and the establishment of China-ASEAN FTA bring about opportunities as well as challenges.

China's investment in Indonesia is so far lower than Indonesia's investment in China, but it appears rapidly developing trend. China's capital outflow is the result that Chinese economic development enters into a new stage and China integrates itself into economic globalization. China's investments in Indonesia are mainly resources-oriented and market-oriented investments. Chinese-Indonesian businessmen welcome investment from China and want to play important role in the process of China's investment in Indonesia.

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