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Palm Oil Plantation

Aerial footage of palm plantation and the forest in Sentabai Village, West Kalimantan.
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Chinese Capital's Move into Upstream Oil Palm Plantations: Navigating Competing Sustainability Norms and Regulations in Indonesia

Trissia WIJAYA,
Shofwan Al Banna CHOIRUZZAD

Chinese overseas direct investment in Southeast Asia is often seen as extending the reach of Beijing's influence. What this overlooks, however, is the diversity of structural power of Chinese economic actors across different sectors, as well as the agency of actors in the host country. Looking at Chinese capital in the controversial palm oil sector in Indonesia, the world's largest producer, this essay argues that multiple actors leverage their interests by developing local regulatory projects. This constitutes a set of redefined sustainability standards and policy innovations that align Chinese companies more closely with local interests rather than local interests being reshaped by Chinese economic actors.

Increasing demand from China has been one of the most important drivers of the global palm oil industry's rapid growth in recent years. In 2021, China became the second largest importer of crude palm oil, only slightly below India, and above the European Union. A rise in domestic demand for palm oil has sent China in search of crude palm oil overseas, prompting investments in plantations and mills in producing countries, including Indonesia and Malaysia (Shigetomi et al. 2020). While Chinese overseas investment is not a new topic for scholarly or policy discussion, the controversial nature of the palm oil industry and the development of global standards for its sustainable production warrant our attention to better understand the relationship between Chinese investment, global norms, and local interests.

As a rising global power, China has been increasingly active in expanding its economic presence through foreign aid and overseas investment. While many developing countries have welcomed this as an opportunity for their own economic development, there is a persistent suspicion—especially, but not exclusively, in the West—that the global expansion of Chinese capital will inevitably result in a broad range of actors in host countries becoming susceptible to Chinese influence. Likewise, observers have long

warned of China's use of economic instruments to create economic dependency, discussing China pulling nations into its 'economic orbit' and 'carving out an empire' (Harchaoui et al. 2021), and in the 2000s, there was talk of a 'new scramble for Africa', with China a key protagonist (Lee 2006; Chan-Fishel and Lawson 2007).

This essay contends that such perceptions overlook the diversity of Chinese economic actors and their relative positions in different sectors. At the same time, observers often underappreciate the agency of actors in the host country in relation to Chinese actors, in part due to the often asymmetric economic and geopolitical power between the two. This essay departs from the simplistic argument and reveals the complexity of power relations among Chinese companies and local actors, particularly in an industry in which China is a relatively new player. To support this argument, we look at Chinese investment in the palm oil sector in Indonesia. We found that multiple actors in the country that is the world's largest producer of palm oil leverage their interests by developing 'local regulatory projects', which constitute a set of redefined sustainability standards and policy innovations that pull Chinese companies closer to local interests, rather than vice versa. Amid mounting pressures on companies to comply with global sustainability standards, these projects have evidently enabled Chinese companies to claim they are complying with local regulations, adding a layer of complex interactions between global norms, Chinese capital, and competing local interests. One salient political dynamic is the increasing dependency of Chinese companies on Indonesian local political elites to protect their interests against opposition from the national government and local communities.

China and Palm Oil: Reframing the Discussion

The explosive expansion of the oil palm plantation sector has led to mounting pressure from a range of major stakeholders such as European downstream buyers and nongovernmental organisations (NGOs) for global sustainability regulatory frameworks to hold companies in the upstream sector accountable. This has led to the establishment of multiple such frameworks, especially in Europe, like the EU Renewable Energy Directives (RED) I and II (Nesadurai 2018) and transnational private governance, such as the Roundtable on Sustainable Palm Oil (RSPO) and the No Deforestation, No Peat, and No Exploitation (NDPE) commitments. These regulatory frameworks provide a market-driven mechanism to address social and environmental issues and promote sustainable practices. Governments in the Global South often view these frameworks as part of a 'trade war' waged against their economies by rival vegetable oil producers in the Global North to facilitate the internationalisation of the multinational corporations tied to them (Choiruzzad 2019).

Despite the differences between these governance frameworks, several governments in the Global South see the RED, RSPO, and NDPE as means to make their palm oil products less competitive than other vegetable oils, harming their production (Wijaya and Glasbergen 2016). Critics also claim that these frameworks do not sufficiently represent smallholders and offer only a procedural solution without developing proper goals and metrics to assess 'sustainable practices' (McCarthy 2012). This has led to the emergence of some experiments in South-led governance. For instance, after the Indonesian Palm Oil Association cancelled its membership of the RSPO in 2011, the Indonesian Government introduced alternative sustainability standards, such as Indonesia Sustainable Palm Oil (ISPO). Similarly, the Malaysian Government introduced the Malaysia Sustainable Palm Oil (MSPO). While on paper many elements of the ISPO and the MSPO are similar to the RSPO's principles and criteria (Suharto et al. 2015), these alternative standards have been developed by the governments of the producing countries and tend to be more flexible and lenient towards the producers (Choiruzzad et al. 2021).

While the academic literature has been paying increasing attention to the trajectory of Chinese businesses in oil palm plantations, the perspectives of the West and of global palm oil production networks remain dominant (see Schleifer and Sun 2018; Coenen et al. 2020). Likewise, the discussion often leads to a set of binary questions like: Will the internationalisation of Chinese capital in the palm oil sector push China to act more responsibly and uphold Eurocentric global sustainability norms, such as the RSPO and NDPE policies? Or will China challenge or even undermine these norms (Nikoloyuk et al. 2010: 62)? In this sense, the internationalisation of Chinese capital is seen to create either the 'Shanghai effect' (Adolph et al. 2017), in which Chinese capital undermines the social and environmental conditions in the producing country, or the 'California effect' (Vogel 1997), when higher regulatory standards are enacted by companies and the government to ensure producers can continue selling to more highly regulated markets. Such criticisms have been increasingly apparent in the many reports of NGOs and the international media naming and shaming companies that have been actively involved in deforestation, loss of biodiversity, and other environmental crimes, raising concerns that Chinese expansion in the upstream sector has nullified the impact of initiatives driven by transnational private governance and prevented the production of sustainable palm oil (see, for instance, Coca 2021; Kuepper et al. 2021; Segi Enam 2020).

We suggest that the trajectory of Chinese investments in the upstream sector must be recontextualised by considering the complex relationships with multiple actors in the host country and how they leverage their interests. Rather than focusing on the impact of Chinese investment on global sustainability standards, we delve into institutional regulatory contexts within which Chinese companies are embedded. As Polanyi posited, all economies are embedded and enmeshed in institutions (Polanyi et al. 1957). Expanding Polanyi's concept of embeddedness and focusing on Chinese

investment in Indonesia, we argue that these investments in oil palm plantations are entangled with competing local interests from which varying standards of sustainable palm oil production ensue. Simultaneously, as shown in the following case studies, local authorities establish compromises with Chinese companies in what we term 'local regulatory projects', which constitute renewed sustainability standards that might deviate from the national standards that strengthen the instrumental power of local authorities. In this context, Chinese companies become increasingly dependent on local authorities, especially in reaching negotiated compromises with any opposition and reducing the cost of compliance with global sustainability standards.

Internationalisation of Chinese Capital in the Upstream Sector

The internationalisation of Chinese enterprises in the palm oil industry did not occur in a regulatory vacuum but is embedded in various state strategic plans as well as voluntary guidelines that have emerged during both China's 'Going Out' policy of the late 1990s and the more recent Belt and Road Initiative (BRI). After the inception of the agricultural Going Out policy in 2006, China's Chamber of Commerce for Foodstuffs and Native Produce (CFNA) and the World Wide Fund for Nature (WWF) jointly established the China Sustainable Palm Oil Network, in 2009, to promote production of sustainable palm oil by Chinese enterprises (CFNA 2015). In 2013, CFNA partnered with a program called China–UK Collaboration on International Forest Investment and Trade to produce the *Guide for Overseas Investment and Production of Sustainable Palm Oil by Chinese Enterprises* (中国可持续棕榈油指南). The guide specifies the legal requirements and procedures for overseas investment by Chinese enterprises that are linked to both global standards like the RSPO and national standards applied in the host country—for example, it stipulates that 'Chinese enterprises shall not sacrifice the host countries' interests when they are engaged in overseas palm oil investment and production. They shall search for the win-win strategy to achieve sustainable development' (CNFA 2015: 9). A draft of the guide was opened for comment in 2015, but it is unclear whether it was adopted. However, this was not the CNFA's final foray into the regulatory realm, and it is reportedly in the process of developing another guide for the sustainable procurement of palm oil by Chinese enterprises (Jiang 2021).

As the BRI has developed, policy documents from a range of state entities and industry bodies have paid closer attention to environmental considerations in overseas investment and finance. For instance, in 2015, the People's Bank of China (PBC) and the National Development and Reform Commission (NDRC) set up the 'Green Bond Endorsed Project Catalogue', the first green bond standard in China that encourages the issuers of corporate bonds to invest in 12 key green projects without explicitly excluding palm

oil industries (Chen 2020). In 2021, the China Securities Regulatory Commission, the NDRC, and the PBC jointly issued a new '2021 Green Bond Endorsed Project Catalogue' to clarify the definition of 'green bonds' (绿色债券) as well as harmonising Chinese with international standards (Nedopil et al. 2021). The 2021 catalogue recognises trade activities related to 'green organic agriculture', including palm oil products that have received international sustainability certification such as the RSPO (PBC 2021).

The development of this multi-scalar regulatory framework gives the impression that Chinese companies in the upstream sector encourage internationally accepted sustainability standards like the RSPO and seek to harmonise them with Chinese standards. However, what has been largely neglected thus far is that the harmonisation of sustainability standards occurs at varying scales and paves the way for operational flexibility within a system of localised governance in the host country. In this setting, such harmonisation efforts are deeply embedded in power relations whereby local authorities leverage their power to reproduce sustainability standards, resulting in local regulatory projects. It is through these local regulatory projects that Chinese companies navigate competing interests, dissent, and the increasing demand for compliance with global standards.

The two largest Chinese companies active in the palm oil industry in Indonesia are powerful cases in point. The first, Julong Group, is a private company strongly backed by the Tianjin Municipal Government and headquartered in the Tianjin Binhai New Area. When the Chinese Government launched the agricultural Going Out policy in 2006 to encourage Chinese companies to strengthen their foothold in overseas markets, the palm oil industry was one of the sectors that companies, including Julong, targeted (Schleifer and Sun 2018). In that year, Julong started to develop its oil palm plantations in Indonesia and, in 2013, it built the China–Indonesia Julong Agricultural Industry Cooperation Zone to promote a more sustainable supply chain (see Julong Indonesia 2015). By 2019, Julong had nearly 200,000 hectares of oil palm plantations in Indonesia, with eight subsidiaries in Kalimantan and Sumatra (Sawit Watch 2020). The second-largest Chinese oil palm plantation in Indonesia, after Julong, is that of ZTE (Zonergy) Agribusiness. In 2021, ZTE had 30,321 hectares of oil palm concessions in Central Kalimantan (Segi Enam 2019).

Neither Julong nor ZTE is a member of the RSPO or the ISPO (Kuepper et al. 2021). Their investments in palm oil have involved different policy innovations across various regulatory contexts. As we will elaborate below, Chinese investments in areas rich in oil palm in Indonesia can involve Chinese enterprises that do not comply with established policymaking and the local regulatory institutions that have their roots in an earlier phase of liberalisation in the upstream sector. Thanks to this liberalisation, local states, with support from key political-economic elites, established new localised regulatory projects. As Paul (2002: 472) has noted, 'sub-national states are also sites of regulation for political-economic processes identified at diverse scales. They are sites

of regulation for processes which are simultaneously global and local.' This has led to a constant tension between different enterprises, including Chinese companies, and local elites who underpin the regulatory projects.

Case Studies: Chinese Oil Palm Plantations and Local Regulatory Projects in Indonesia

One of Julong's largest subsidiaries in Central Kalimantan, PT Rezeki Kencana (RK), tapped into the upstream sector via the internationalisation of subnational governments. RK owns 7,620 hectares of plantations in Kampung Baru Village, Kubu Raya District, and is included in the memorandum of understanding on 21 cooperation projects between companies and regional governments in Indonesia and China that was signed by the central authorities of both countries in 2013 (Hadrian 2017). Although its presence in Indonesia long pre-dates the BRI, the Julong Group now views its expansion as an embodiment of the initiative. As the group's supply chain director pointed out in a media interview: 'The initiative has provided various opportunities for our local investment and expansion. We are confident of making greater achievement and serve the two countries' (cited in Hanifah 2018). However, in its expansion, the company has faced ongoing tensions with social groups. According to the records of a local NGO, RK failed to provide fair compensation for 2,600 hectares of land that a local community group, Serikat Tani Darat Jaya (Darat Jaya Farmers' Union), used to produce food (ELSAM 2017).

As well as this indigenous community, Javanese from the early 1980s phase of Suharto-led transmigration to Central Kalimantan were greatly affected. Given that transmigration is a government policy, they have greater legal protection for their landownership than the indigenous Dayak community. This is especially so because these migrants received individual land certificates from the central government. Like many locals, they grew a mixture of corn, timber, and bananas on their land; however, their cultivation rights have been transferred to RK to make way for oil palm plantations (Interview with local representative, May 2021). The initial arrangement made by the government should have required the participation of communities under the scheme of *kemitraan plasma* ('plasma partnership')—a concept developed in Indonesia since the late 1980s according to which the plantation company (which is metaphorically conceptualised as the 'nucleus' or core) must allocate parts of its concession to be owned and managed by local smallholders (the 'plasma' that surrounds the 'nucleus'). Smallholders receive regular payments as well as loans for cultivation from the plantation company for supplying their produce (see Potter 2016). Unfortunately, RK reneged on its promise of a shareholding arrangement with local farmers under the *kemitraan* scheme.

Palm Oil Worker

Soil fertilisation process. Source: Icaro Cooke Vieira/ CIFOR (CC), cifor.org.

As argued in the previous section, accelerated liberalisation since the late 1990s has led to the rise of the local regulatory state in Indonesia, with provincial and local governments given more licensing powers and enacting regulations that define how businesses operate. After the fall of President Suharto in 1998, there were massive structural reforms characterised by economic liberalisation and democratisation (that is, general and regional elections, and decentralisation of political authority). This had significant repercussions on the palm oil regulatory regime, leading subnational actors, such as district and provincial governments, to play a more crucial role in the governance and sustainability policymaking for the sector. These subnational actors have since been trying to develop regulatory projects that allow them to capture the benefit of economic activities, both for local development purposes and for their own interests. This is evident in the enforcement of *Hak Guna Usaha* (HGU; 'Land Use Rights'). To operate in Indonesia, plantation companies must obtain HGU in accordance with the Basic Agrarian Law No. 5/1960. To encourage the production of sustainable palm oil, the national government restricts palm oil expansion in peatlands and food-production areas under the Food Area Preservation Law No. 41/2009 (Pramudya et al. 2018). Nevertheless, subnational governments have been granted more power to coordinate

plantation-related issues, including licensing, forestry management, and spatial planning. The reorganisation of power has not been accompanied by incentives for regional governments to promote sustainable palm oil practices, so states produce their own regulations to determine local production networks, development decisions, and forest destruction patterns (McCarthy et al. 2012).

In the case of Kubu Raya Regency, where RK is located, the district government produced the Local Government Regulation (*Peraturan Daerah* or '*Perda*') No. 4 of 2016 on Corporate Social and Environmental Responsibility (CSER), which incorporates into its regional development planning the United Nations' Sustainable Development Goals (SDGs) rather than the RSPO and other relevant global standards (Jari Borneo 2020). This has created new benchmarks for identifying performance gaps between Chinese and other market participants, such as those who are official members of the RSPO. The CSER program adopted by RK has so far failed to protect food-producing land from conversion or to provide fair compensation for affected farmers. This is relatively unsurprising, as regulatory governance at the local level refers to SDGs that only comprise 17 interlinked global goals that do not identify legal and institutional mechanisms for the sustainable production of palm oil. This largely mirrors a form of governmentality in which the CSER is 'imbued with aspirations for the shaping of conduct in the hope of producing certain desired effects and averting certain undesired ones' (Rose 1999: 52). Ultimately, in RK's view, it has done nothing wrong; it has complied with local regulations and implemented CSER programs that are seen to promote social inclusion and community engagement. In a media interview, a Julong representative claimed the company's plantations have recruited nearly 10,000 locals (as cited in Hanifah 2018), however, many of these people work as wage labourers and do not benefit from the plasma mechanism (Interview with a local activist, May 2021). Under the plasma mechanism, smallholders supply farm produce to the company but still own the land; as wage labourers, they do not own the land.

Meanwhile, Julong's South Kalimantan subsidiary, PT Palmina Utama (Palmina), in Barito Kuala (Batola) district, has faced similar issues. Conflict on the Palmina plantation emerged as Batola authorities were committing to a massive expansion of palm oil production through partnership agreements between private companies and smallholders (see also Tan and Yeremia 2022). Since the expansion decision was made in 2013, Palmina has failed to address land-sharing issues. This led to a long stand-off during which roads into the estate were often closed as local farmers demonstrated against the company (Interview with a local activist, May 2021). In 2019, the Batola Regent, Noormiliyani AS, implemented a regulatory project for the governance of the oil palm plantation based on *Perda* No. 5 of 2016. The rules redefined how plantation boundaries are determined and how plasma is allocated. More importantly, they have also reshaped the nature of regional agencies, such as the Regional Investment Monitoring Board. Under this regulation, Palmina is required to set aside 20 per cent of its concession for smallholders, while the board is now in charge of overseeing the company's performance,

with only limited monitoring and control from the national government. Palmina has been obliged to report in detail its operations and meet routinely with the district government and the board (see Arianto 2019). However, this has narrowed the scope for sustainability in the plantation sector, as here, Palmina's performance is measured not in accordance with how it adopts sustainability practices, but rather by the extent to which its established plantations have allocated 20 per cent of their land to the plasma mechanism. The gap between local regulations and the RSPO indicates a new form of regulatory arbitrage that enables the company to reduce its compliance costs in Batola while expanding its plantation area, including the allocated plasma land.

Local Authorities and Power over Chinese Capital

These local regulatory interventions have burdened commercial plantations with additional operating costs (Tanjung 2020; Wiangga 2011). It is important to note, however, that such projects have secured an 'enabling' environment for plantations to counterbalance national regulations that might harm their long-term interests. As local governments gain enormous discretionary power to review regional spatial plans and make changes to land use, officials have rushed to reallocate land to investors. With districts competing to attract oil palm investments, local governments often do not consider allegations of irregularities in the licensing process or the environmental and social impacts the plantations will have (Setiawan et al. 2016). This negligence is in part due to the Indonesian fiscal system, which provides few incentives for companies in the upstream sector to adopt sustainable practices. Although palm oil production generates large revenues for the central government, especially from income and export taxes, local governments do not receive a direct share of such taxes (McCarthy 2012). Nor is national revenue from the production of palm oil used to support major producing districts to enforce sustainable practices.

The significant implication of this situation is that some local governments issue additional oil palm levies (*retribusi kelapa sawit*) to companies for their activities. This contradicts the national Law No. 28 of 2009 on Local Tax and Local Levies, which does not allow such levies, and thus forces the central government to cancel the local regulations. In attempts to seek an alternative to local levies (*retribusi daerah*), local governments mandate companies to pay various other fees, such as 'disturbance permits' (*izin gangguan*) and for the use of public roads, among others. Although the national government revoked more than 3,143 such local regulations in 2016 (Cabinet Secretariat of the Government of the Republic of Indonesia 2016), this did not deter local governments from issuing more similar regulations or alternative mechanisms to extract funds from oil palm plantations, such as through the Third Party Support (*TPS, Sumbangan Pihak Ketiga*) mechanism that provides a versatile nonbinding framework

to receive funds or goods from nongovernmental entities. Apart from taxes (managed by central and local governments) and levies (managed by local governments), local governments are allowed to accept financial support for their budgets from other entities, usually in the private sector, falling under the TPS mechanism. Unlike the mandatory and fixed taxes and levies, the TPS is voluntary, nonbinding, and flexible; it is, however, frequently used to pressure plantations or companies to provide funds or other forms of support for local government programs. These mechanisms have provided the resources for local governments to implement development programs, but have also made them dependent on oil palm plantations. Their limited budget capacity requires them to find regular and reliable sources of funds, which companies will provide if the local government allows them to operate smoothly. Thus, it is difficult for local governments to revoke plantation permits or punish companies conducting illegal activities or failing to adhere to sustainable cultivation policies (Setiawan et al. 2016: 475).

This dynamic is highlighted by the case of PT Sebaung Sawit Plantations (a subsidiary of Shanghai Xinjiu Chemical Company) and PT Palem Segar Lestari (a subsidiary of Henan Jiujiu Chemical Company) in Sembakung, Nunukan Regency, North Kalimantan. As with other foreign and domestic companies operating in the district, these two have been accommodated by the district governments and surrounding communities through localised regulatory projects. According to audits conducted in 2021 by think tank Chain Reaction Research, from 2019 to the first half of 2020, Sebaung Sawit Plantations developed 2,077 hectares of plantations on peatland identified as conservation areas—a category that legally cannot be used for oil palm development (Kuepper et al. 2021). Meanwhile, the local community accused Palem Segar Lestari's director, Tjia Ke Seng, a Chinese citizen who also serves as the president of PT Sebaung Sawit Plantations, of misuse of the HGU in 2016. As well as failing to fulfill its commitments to reallocate plasma land to farmers in Sembakung, the company sought to use the HGU for other purposes, including illegal logging (Radar Kaltara 2016).

In 2018, Indonesian President Joko Widodo issued a moratorium on oil palm plantation permits that remained in force for three years, regulated under Presidential Instruction No. 8 of 2018 concerning the Postponing and Evaluation of Oil Palm Plantation Licensing and the Increasing of the Productivity of Oil Palm Plantation (Jong 2018). In 2021, the government ended the temporary freeze but claimed it was committed to not approving any new permits until a new omnibus law came into force. The moratorium mandated local governments to review existing licences as many were known to have been issued in violation of procedures. The Nunukan District Government, however, went back on its commitment to the moratorium and produced its own regulations to negotiate the terms of 'smallholder inclusion' and sustainable practices with companies operating in the district, including those from China. Rather than reassessing concessions with overlapping permits and in violation of sustainable practices, the district government produced regulations that subsumed sustainable practices under

the TPS mechanism mentioned above. Nunukan Regency enforces the *Perda* No. 33 of 2001, which requires commercial plantations to donate 5,000–10,000 IDR for every tonne of palm oil produced, claiming the TPS will contribute to local development (see Ruru 2016). Likewise, as one of the authors observed during fieldwork, local authorities leverage their interests over Chinese companies through the TPS and CSER programs, which are supposed to be voluntary. While this has added to the operating expenses of Chinese companies, the renewed sustainability standards potentially reduce their compliance costs. Likewise, commitment towards the TPS and CSER programs, like building roads, establishing vocational schools, and distributing plasma land, are seen by local governments as sustainable practices adhering to the standards set by the ISPO (Reza 2019). While Sebaung might not comply with nationally imposed sustainability standards, the normative judgement of local government about the performance of Sebaung Sawit Plantations and Palem Segar Lestari is in fact more critical and decisive for their business sustainability. As Murdiyarso et al. (2011) have argued, the presidential instruction including the moratorium on oil palm plantation permits is non-binding, which means there are no legal consequences if its instructions are not implemented.

Conclusion

Cheung et al. (2012: 202) observed that 'China's overseas investment activity has reached a level that could challenge international investment norms and affect international relations'. Likewise, the prevailing analysis of Chinese investment in the upstream palm oil industry has been reduced to the binary question of whether China-led South–South governance will challenge European Union–driven sustainability policies or transform markets to make sustainable palm oil the norm. Drawing from our research in Indonesia, our analysis has shown how this dichotomy erases the complexities and contingencies of resource and power distribution in the producing countries. Situating the internationalisation of Chinese capital in the context of power relations, this essay has set out to assess how Chinese companies have been navigating Indonesia's complex terrain of local institutions while being embedded within established global and national regulatory projects. Put simply, the trajectory of Chinese capital—be it in the form of smallholding or large plantations—is embedded within competing regulatory projects, and the performance of companies is indeed contingent on territorial politics. ●