THE EMERGENCE OF CHINA: SOME ECONOMIC CHALLENGES TO INDONESIA

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INTRODUCTION[1]

The constant rapid growth of development in China accompanied by more liberal political system during the past 25 years have brought the country to be a more decisive economic giant in the world. China's trade volume increased extraordinarily in comparison to the period of the late 1970s. In the context of world trade competitiveness measured by shares in world export, China was the leader in gaining market share from 1985 to 2000.[2] Moreover, China has also been able to invite foreign capital as reflected by the continuous increase of FDI inflows. The latest figures show that China not only was the second highest recipient of FDI during the past two decades, but also in 2002 it even bypassed United States as the top recipient of FDI in the world for the first time. China is no longer living in isolation or as a "sleeping giant". On the contrary, at the present time the country has surprised the world by flooding markets with its competitively priced products. The favorable condition of China's economic development has been highly supported by various important reforms directed towards an open economy, which also included the opening up of the country to foreign investors. The development of special economic and development zones, as well as opening up many coastal cities with favorable facilities and attractions, is among many significant efforts in the modernized and internationalized China.

For most ASEAN countries, the immediate effects of the economic reformation in China are the intensified efforts to increase their competitiveness in trade, in attracting foreign capital and advancing their technology. Basically, the economy of China is quite different from the ASEAN economies, particularly in developing and acquiring the basic and foundation of technology. In the latter case, China is leading far ahead of other ASEAN countries. The strong base of technology has been the important stimulating factor, which enabled China, within two decades, not only to increase significantly its market share but also to reveal its ability to keep up with the changing technologies

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2 *World Investment Report* 2002: "Transnational Corporations and Export Competitiveness," Chapter VI.

and trade patterns. China, for example, is reported as the export winner in technology-based products. The country was the top winner of non-resource based, high-technology, medium-technology, and low-technology products. In contrast, China ranked only third in the world in exporting resource-based products (WIR 2002). However, as the emergence of such a big and solid economy has been delayed due to the past economic and political isolation, China had been frequently regarded as a developing country because of its factor endowment and stage of economic development.

The similarities between China and ASEAN countries are: its richness in natural resources and presently promoting an export-oriented strategy, containing many competitive products compared to complementary ones. Even though China has a large domestic market for its products, the country which has an advantage in production due to cheap labor is now also intensifying its efforts to have a more diversified market. ASEAN countries are expected to be an important destination for many of the traditional goods from China. Consequently, many ASEAN countries will not only face challenges in their businesses with existing trading partners, but also will have to protect their domestic markets from the flood of China's cheap and competitive products. The China-ASEAN economic relationship is somewhat affected by the crisis of 1997, particularly as Indonesia, which stand as a big market in ASEAN, is experiencing prolonged economic and political instability. At least, ASEAN as a group has lost its important momentum, as its position as a market and favorable destination for foreign direct investments was disrupted. Although China was also affected by the crisis, the continuous reforms and efforts have been implemented in promoting trade and investment. Finally, China's success to become the 143rd member of the WTO has provided an alternative for many foreign investors who faced difficulties in dealing with various problems in some ASEAN countries.

Despite the commitment and responsibility of China's leaders to gradually and flexibly transform the country, challenges have emerged in this process due to the fast-changing society. Moreover, as a new member of WTO, the country must abide by the rules of this organization, which is not easily implemented as many internal judgments have to be considered. How well the government can overcome the problems that arise as a consequence of the political liberalization and of maintaining rapid economic development for a long period of time would be seen in the next few years.

On the other hand, the increasing attractiveness of China in one way or another will affect the growth of investment and export-import activities in some countries in the region that are unable to provide competitive offers. With respect to these challenges the following study will focus its analysis on the direct impact of China's emergence on the SWOT (strengths, weaknesses, opportunities, threats) of Indonesian manufacturing industries and investment.

BILATERAL TRADE AND THIRD MARKETS

Since the resumption of direct trade in the 1980s followed by the restoration of diplomatic relations in 1990, the economic relations between Indonesia and China grew significantly. Various MOUs in investment, trade, and technological cooperation have been signed, and exchanges and cooperation in cultural and scientific fields have been developed. Exchange visits between leaders of the two countries have been carried out intensively and extensively. Moreover, the Indonesian Chamber of Commerce (KADIN) has established a China Chapter in order to improve understanding and to create networks between businessmen of the two countries. This effort was followed by signing of an MOU for counter trade in November 1998. All measures were directed to attain a better relationship and cooperation between the two countries to overcome the increasing problems faced by Indonesia due to the relatively rapid growth of bilateral trade, as well as the strong competition of Chinese products in third markets against various superior Indonesian products. The future balance of trade between the two countries is crucial, especially for Indonesia.

The Growing Importance of Trading with China

The opening of China has gradually affected Indonesia. In the early 1980s, Indonesia's exports to China amounted to only US$8 million—far behind Indonesia's exports to Malaysia, Thailand, or the Philippines (Table 1). Since then, the trend has gone up very rapidly and the trade with China has grown in importance in the Indonesian trade balance. As a result, in comparison with Indonesia's other trading partners, at the present time, China occupies the fifth rank both in export and import, or the third among developing countries. China had surpassed Taiwan, which was previously Indonesia's fifth major trading partner until the end of the 1980s. (The first four are Japan, United States, Singapore and Korea.) It is predicted that the continuous growth of trade volume between Indonesia and China will possibly put China in the fourth position among Indonesia's major trading partners very soon. It also implies that Chinese commodities can compete with similar products of other countries in the Indonesian domestic market as they can accommodate the need and fulfill the demand of various consumer segments. Accordingly, China has joined the major trading partners of Indonesia where the balance still yields a high surplus.

Table 1: Value of Indonesia's Exports and Imports from Selected Countries

(Millions of US$)

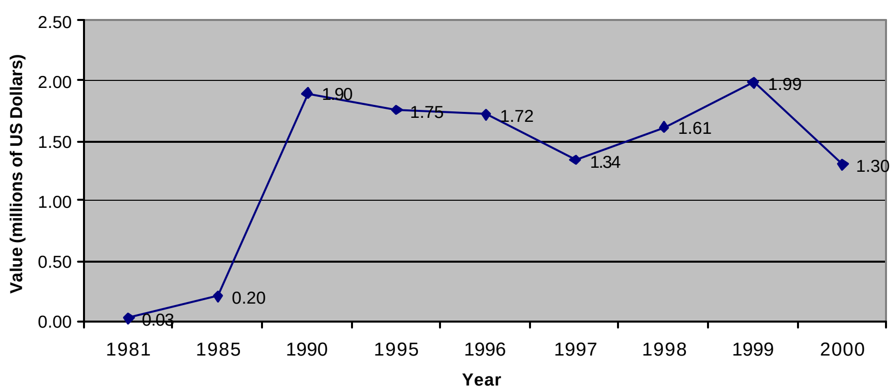
	China	Malaysia	Singapore	Thailand	Philippines	US	Japan	Korea	UE	Total
					Exports from Indonesia					
1981	8	47	2,320	37	439	4,360	11,416	295	1,158	23,810
1985	84	77	1,626	81	199	4,040	8,594	656	1,159	18,597
1990	834	253	1,902	188	161	3,365	10,923	1,363	3,029	25,675
1995	1,742	987	3,767	703	590	6,322	12,288	2,917	6,760	45,428
1996	2,057	1,110	4,565	823	688	6,795	12,885	3,281	7,723	48,973
1997	2,229	1,357	5,468	848	794	7,154	12,485	3,462	8,100	53,439
1998	1,832	1,358	5,718	943	707	7,046	9,116	2,568	7,774	48,843
1999	2,009	1,336	4,931	813	695	6,908	10,397	3,320	7,096	48,654
2000	2,768	1,972	6,562	1,026	820	8,489	14,415	4,318	8,681	62,102
2001	2,200	1,778	5,364	1,064	815	7,761	13,010	3,772	6,272	56,321*
					Imports to Indonesia					
1981	254	60	1,243	146	253	1,795	3,989	489	2,275	13,270
1985	249	52	839	48	23	1,721	2,644	205	1,802	10,275
1990	653	290	1,283	184	55	1,482	5,455	992	4,138	21,931
1995	1,495	2,595	2,367	737	81	4,756	9,217	2,451	8,175	40,629
1996	1,598	823	2,875	1,095	90	5,060	8,504	2,411	9,169	42,902
1997	1,518	865	3,411	867	127	5,444	8,252	2,322	8,336	41,650
1998	906	627	2,543	842	65	3,523	4,292	1,528	5,866	27,337
1999	1,242	606	2,526	933	55	2,841	2,913	1,330	3,801	24,002
2000	2,022	1,131	3,789	1,109	115	3,393	5,397	2,083	4,166	33,511
2001	1,843	1,005	3,147	987	94	3,210	4,689	2,209	3,715	30,962*

Source: Direction of Trade Statistics, *IMF Yearbook*, 1987, 1991, 2001, 2002* Indonesian Foreign Trade Statistics, 2001.

Before the crisis Indonesian exports to China had increased steadily, reaching US$2.7 billion in 1997. Not surprisingly many businessmen by that time predicted that exports to China would reach four to five billion within five to ten years time. Unfortunately, such an expectation was obstructed by the prolonged, multifaceted crisis since mid-1997. Indonesian exports to China during the crisis period were erratic. In 1998, the export volume was less than US$2 billion, in 2000 it reached US$2.7 billion, while in 2001 it decreased to only US$2.2 billion. This disruption affected the amount of trade surplus with China. The largest trade surplus was recorded in 1998 and amounted to US$925 million. However this achievement was not due to success in increasing export, as the amount of export to as well as import from China dropped. It was the compression of import that produced a high trade surplus in 1998. In the next year, 1999, the surplus decreased to US$766 million, slightly decreased to US$745 million in 2000, and dropped to only US$357 million in 2001. The decreasing trend of trade surplus with China will jeopardize Indonesia trading balance, because at the present time Indonesia is dependent on trade surplus in order to protect its current accounts position. Serious actions and strategic policies need to be carried out sooner in order to bring back higher trade surplus with China. Otherwise, Indonesia will fail to derive maximum benefits from China although that country is an important and big trading partner as well as a source of trade revenue. There is a possibility that the result will only be to open Indonesia as a big market for Chinese products.

Despite the growing efforts to promote the volume of trade between the two countries, Indonesia and China have not become major trading partners yet. The bilateral trade only reached around 2-4% of each country's total trade. In 2001, for example, the share of Indonesia's exports to China was 4% of its total exports; meanwhile China supplied around 6% of Indonesia's total imports. On China's side, the shares of export to Indonesia and import from Indonesia were only 2.4% and 1.2% of the total, respectively. Various detailed analyses by Laurenceson (2003) also showed specifically lower trade integration between China and Indonesia compared with China and other ASEAN member countries such as Singapore, Malaysia, and Thailand. The study also concluded that China and ASEAN-5 already have strong linkages with respect to goods and services. Calculation of the intensity index of trade between China and Indonesia proved that the bilateral trade increased in importance since 1990 (Figure 1).[3] Since that time the trend has fluctuated and disrupted, partly due to the crisis.

Figure 1
Intensity of Trade, Indonesia and China, 1981 - 2000



3 Intensity index examines the relative importance of a bilateral trading relationship. An index value above one indicates that the trade relationship between the two countries is more important than trade with the rest of the world.

Those studies imply the positive tendencies of bilateral trade between the two countries. It is highly likely that the trade liberalization processes which are being implemented seriously in both countries are the main reasons for the increasing trade relationship. Even the benefit of liberalization has somewhat detriment to Indonesia as the crisis and internal problems arose since 1997. Apart from some current internal problems in Indonesia, China is a promising destination of exports and important trading partner of Indonesia. Moreover, the relationship of the two countries is enabled by their relative propinquity compared with America or Europe, while trade networking and cultural relationships already exist.[4]

Commodity Composition

The composition of commodity trade between Indonesia and China is relatively fragile for Indonesia. China's exports to Indonesia range from primary products to low-, medium-, and high-technology products in relatively equal proportions. In contrast, Indonesian exports to China are mainly dominated by primary and low-technology manufactured products. Most Indonesian exports to China are natural resource-based products (Figure 2).

The 20 top commodity exports of Indonesia to China can be grouped into four major categories: i) primary products such as crude petroleum, petroleum products, natural gas, liquefied propane and butane, vegetables oil (SITC 3-4); ii) agricultural products, including natural rubber, wood, fish, cocoa (SITC 2); iii) relatively more labor-intensive manufacturers—textile, yarn, plywood, paper and paperboard, fabrics (SITC 6); and iv) relatively less labor-intensive manufactures, such as carboxylic acids, hydrocarbon, alcohols, polymers and telecommunication equipments (SITC 5 and 7). Those top 20 commodities comprised almost 84% of Indonesia's US$2.2 billion total export to China in 2001 (Table 2). Accordingly, Indonesian export commodities to China are relatively limited and subject to

4 The present trend and information on the amount of trade between China and Indonesia is surprising. In 2002, the Central Bureau of Statistics (CBS) stated that the volume of trade of the two countries reached around US$4.5 billion and still some surplus for Indonesia. The Indonesian Chamber of Commerce (KADIN) claimed about US$7.4 billion for the same year (*BPEN*, 21 August 2003). In 2003, the honorary advisor for economy and trade from the China Embassy told that the volume of trade between the two countries has surpassed US$10 billion. The value of Indonesian exports to China was US$4.4 billion and the import value was US$5.8 billion. This means that Indonesia started to experience negative surplus in its trade with China. Therefore, the Embassy advisor eagerly pushed Indonesian traders to increase their exports to China (*Bisnis Indonesia*, 16 January 2004).

international price fluctuations. However, in the short run there is still a possibility for Indonesia to increase its exports to China, particularly for some major export commodities (primary products) where Indonesia traditionally has relatively high competitive level. The rapid growth of China's economy based on much foreign investment is expected to lead to the import of more primary products particularly from Indonesia. Another opportunity will come from the greater openness of China's markets as a result of its accession in WTO, including the lifting of non-tariff measures.

Figure 2: Composition of trade between Indonesia and China

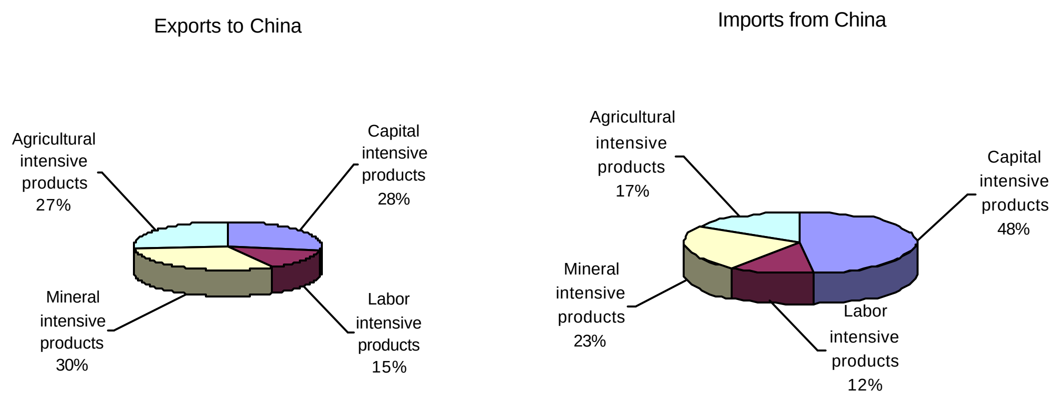


Table 2: Bilateral Trade between Indonesia and China, 1991 and 2001

SITC	Commodities	Value in US$ 1991	Value in US$ 2001	Percent of total 1991	Percent of total 2001
	Total Exports	1,190,896,671	2,200,670,560	100.00	100.00
0	Food and live animals	9,208,774	49,221,088	0.77	2.24
1	Beverages and tobacco	0	237,492	0.00	0.01
2	Crude material, inedible, except fuels	30,428,776	449,915,290	2.56	20.44
3	Mineral fuels, lubricants and related materials	519,956,539	629,997,789	43.66	28.63
4	Animal and vegetable oils, fat and waxes	48,882,288	119,168,672	4.10	5.42
5	Chemical and related products	83,326,385	328,824,747	7.00	14.94
6	Manufactured goods classified chiefly by material	457,273,548	499,886,375	38.40	22.72
7	Machinery and transport equipment	41,731,604	105,453,795	3.50	4.79
8	Miscellaneous manufactured articles	88,757	17,948,583	0.01	0.82
9	Commodities and transactions n.e.c in the SITC	0	16,729	0.00	0.00
	Total Imports	834,997,877	1,842,680,214	100.00	100.00
0	Food and live animals	99,038,982	193,066,229	11.86	10.48
1	Beverages and tobacco	14,404,362	75,718,034	1.73	4.11
2	Crude material, inedible, except fuels	204,916,342	82,963,266	24.54	4.50
3	Mineral fuels, lubricants and related materials	25,660,450	322,083,532	3.07	17.48
4	Animal and vegetable oils, fat and waxes	521,987	1,081,005	0.06	0.06
5	Chemical and related products	120,796,541	345,317,271	14.47	18.74
6	Manufactured goods classified chiefly by material	147,896,703	345,247,625	17.71	18.74
7	Machinery and transport equipment	203,487,870	388,187,507	24.37	21.07
8	Miscellaneous manufactured articles	18,274,640	89,015,745	2.19	4.83
9	Commodities and transactions n.e.c in the SITC	0	0	0.00	0.00

Source: Indonesia Foreign Trade Statistics, CBS, 2002

Indonesian imports from China vary from food and live animals commodities (SITC 0) to machinery and transport equipment (SITC 7). The top 20 import commodities from China amounted only to about 56% of total imports in 2001. This means that Indonesia's market is perfectly open to a wide variety of products from China, even for similar commodity groups which are also exported by Indonesia to China, in which Indonesia claims to be relatively strong, such as in agriculture and primary products. Crude petroleum and petroleum products show a high share (17%) of total imports by value, followed by some agricultural commodities (15%) in which Indonesia is also an important producer. The rest of import commodities with a high share consist of a variety of medium- and high-technology products. In the latter case, Indonesian producers cannot compete or even produce due to technological backwardness and dependency. Some of those commodities which are now pouring into the Indonesian market are motorcycles, electrical machinery and apparatus, telecommunication equipment and parts, and, last but not least, textile products.[5]

In the case of textiles, China's competitors are becoming more and more threatened. In 2001 the value of China's textile exports to Indonesia almost equaled Indonesia's exports to China, about US$100 million. Even though at the three-digit SITC level, the competition is claimed to be not so strong as clothing (except fur clothing) dominates Indonesian textile export while this category is not China's major export. The real condition of Indonesian textile industries cannot guarantee that business in textile and apparel will not be won by China. This is indicated by the level of technology and machinery operated by textile manufacturers in this country that can not keep up with the advancement of technology in the industry. Restructuring steps are not carried out yet due to the lack of capital supply.

The relatively similar trade commodities in SITC groups 0 to 4 between China and Indonesia unquestionably are due to the richness of natural resources in both countries. Consequently, the two

5 Some electronics traders in Jakarta's famous trade Center (*Glodok*) told how the center was flooded by cheaper electronic products from China during 2003. For example, video compact discs (VCDs) from China with a brand name "Sieko" were priced at only Rp200,000, while other brands were about Rp360,000. The average price of a digital video disc (DVD) from China is around Rp450,000. The brand names are Aiko, Mitoshiba, Antek, and Imitsu. The price of other brands is over Rp800,000. Televisions from China (i.e., Avanse, Viar, GMC, Ichiko, and Sieko) cost about Rp800,000 to Rp900,000, while other TV brands (21") cost more than Rp1.5 million (*Kompas*, 2 January 2004).

countries also specialize in the production of primary based and labor-intensive commodities. In other terms these groups are considered as raw material products. How far businessmen of the two countries can infiltrate the respective markets depends on the degree of openness as well as product competitiveness. China's traders have the advantage of a strong worldwide network that enables them to sell their products at competitive prices, making it easy to find markets for their exports. The profile of Indonesian traders is also dominated by many people of Chinese descent. However, not many are able to speak Mandarin let alone adopt Chinese business culture and behavior, not to mention those traders who are native Malays. Therefore, even though China has opened to foreign traders, it is not an easy matter in reality. The unbalanced capability (in terms of business culture) put Indonesia in a quite weak position in order to push higher exports volume in the future. Without restructuring the manufacturing industries to a more competitive level, it is highly likely that the trade volume surplus will continue to decrease.

The limited variation of Indonesia's export to China brought about many challenges from other countries which also actively promote trade with China. In case of CPO and plywood, Malaysia seems to have relatively stronger effort than Indonesia and is able to offer cheaper prices. While in textiles, the emergence of low-cost producers from Pakistan, Bangladesh, and Vietnam will directly attack textiles from Indonesia. Particularly when the MFA is no longer accommodating many bilateral trade interests, and the textile trade will be implemented without quota starting from January 2005. Therefore, the traditional strength of Indonesian commodities will be under strong challenges if the government can not come up with strategies and policies to anticipate them.

Competition in Third Markets

Naturally, Indonesia and China compete strongly in some major products on which both countries still very much depend. There is a limited trade complementarity between China and Indonesia because their stages of development and factor endowments are similar. The two countries are rich in resources and at the present time are also promoting export-led growth, particularly in some traditional products. However, in terms of technology, labor cost and on-going process of industrial restructuring, Indonesia lags behind. There are many cases in which Indonesia's export-oriented manufacturing industries, such as in textile industries, face difficulties due to their obsolete technology. Moreover, cheap labor which usually attracts foreign investors is no longer competitive because at the present time Indonesia is experiencing strong pressure from labor unions to increase salaries. Consequently, many foreign factories close down and start to move their investment from Indonesia. In addition, the process of industrial reformation and restructuring in general seems to be very slow and rather unorganized. Without serious measures, Indonesia will find it difficult to face stronger competition from China in third markets.

Revealed Comparative Advantage (RCA)[6] can give a clear picture of the comparative advantage of products from Indonesia and China in the world market. Table 3 indicates that China has comparative advantage in 7 broad-category products, such as basic manufactures, textile, leather products, clothing, IT and consumer electronics, electronic components, and miscellaneous manufacturing. In other words, China's strengths range from low-medium to high-technology industries. No Asian countries are able to challenge China in trading textiles and leather products. On the other hand, Indonesia has comparative advantage in seven broad-category products, covering mostly resource based industries or primary products. More specifically, Indonesia's strength is limited only to natural resource related industries, namely wood products and minerals. It is important to stress that, while Indonesia is still concentrating its comparative advantages on traditional products, other developing ASEAN countries (Thailand, Malaysia, and the Philippines) have joined competition in the world markets on medium and high technology products. Accordingly, within the Asian region Indonesia has to face stronger challenges not only from China but also from its neighboring countries.

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6 The RCA index compares the share of a given products in total exports with the share of this products in world exports. A country has RCA more than unity in certain products means that this country has comparative advantage in those products.

Table 3: Revealed Comparative Advantage (RCA) in selected East Asian Countries

		China	Indonesia	Japan	Korea	Singapore	Hong Kong	Thailand	Philippines	Malaysia
1	Fresh food	0.83	**1.42**	0.00	0.22	0.22	0.00	**2.36**	0.63	0.36
2	Processed food	0.60	**1.11**	0.10	0.22	0.44	0.44	**2.00**	0.77	**1.26**
3	Minerals	0.27	**2.43**	0.00	0.46	0.71	0.13	0.27	0.09	0.82
4	Chemicals	0.50	0.52	0.85	0.91	0.77	0.30	0.68	0.11	0.43
5	Basic mfg	**1.03**	0.63	0.96	**1.01**	0.32	0.22	0.65	0.29	0.46
6	Wood products	**0.46**	**3.43**	0.18	0.37	0.19	0.44	0.67	0.27	**1.16**
7	Textiles	**2.48**	**2.25**	0.62	**2.85**	0.24	**2.08**	**1.18**	0.31	0.47
8	Leather products	**4.53**	**2.50**	0.00	**1.14**	0.00	0.00	**2.07**	0.85	0.00
9	Clothing	**4.16**	**2.45**	0.00	0.86	0.42	**14.16**	**1.72**	**2.24**	0.71
10	Non-elect mach.	0.49	0.15	**1.65**	0.65	0.58	0.21	0.61	0.14	0.32
11	IT & consumer elect.	**1.72**	0.94	**1.31**	**1.89**	**2.84**	0.58	**1.78**	**2.46**	**3.19**
12	Elect. components.	**1.05**	0.45	**1.75**	**1.59**	**3.27**	**1.46**	**1.61**	**4.94**	**2.64**
13	Transport equip.	0.27	0.08	**1.86**	**1.34**	0.15	0.00	0.35	0.21	0.06
14	Misc. mfg	**1.73**	0.69	**1.14**	0.50	0.95	**1.97**	**1.01**	0.56	0.80

Source: Table. Specialization Index Some Selected Countries ITC, 2002

The strength of China's international trade can be drawn by comparing the composition and export volumes of some Asian countries with the United States. Considering the United States as an important market for countries in Asia, the position of China's exports is relatively secure (Table 4). Of the top 20 commodities the US imports from China and other Asian countries, only a few face China with strong competition particularly from Japan, Korea, Taiwan, and Malaysia, in automatic data processing machines, telecommunication equipment, parts of office machines & ADP machines, Sound Recorders and TV Recorders, and electrical machinery and apparatus. China's RCA is also high in medium- and high-technology based products, while the value of trade with the United States is also higher in most other products.

Even in the few commodities where the challenge seems strong, China exports to the United States relatively the same or even a little bit more than the competitor. For example, automatic data processing machines rank third in the top 20 US imports from China with a value of US$5,961 million, while the value of imports from Japan, Taiwan, and Malaysia, which are strong competitors in the same product, was US$5,924 million, US$5,748 millions, and US$4,824 millions respectively. This means that the appearance of many competitors penetrating US markets does not necessarily lower the value of China's trade. China is likely able to challenge them in the markets through various ways.

Table 4: Top 20 US imports from China and their substitution from other Asian countries, 2001

(millions of dollars)

SITC	Commodity	China	Japan	Korea	Taiwan	Hong Kong	Singapore	Malaysia	Philippines	Indonesia	Thailand	Viet Nam
894	Toys and sporting goods	12,672	3,468	-	721	230	-	171	109	184	299	-
851	Footwear	9,758	-	-	-	-	-	-	-	726	314	132
752	Automatic Data Process Machines	5,961	5,924	3,150	5,748	114	2,192	4,824	1,951	442	1,806	-
821	Furniture & bedding accessories	5,018	-	-	766	-	-	431	239	496	302	13
764	Telecommunication equipment	4,690	3,442	4,830	2,003	160	399	2,294	310	-	468	-
759	Parts for office machines & ADP machines	4,052	4,813	1,433	2,923	131	2,192	2,510	414	210	318	-
763	Sound recorders and TV recorders	3,065	3,588	767	-	-	65	1,180	-	626	263	-
775	Household electric & non-electric equipment	2,802	-	573	-	-	-	-	-	-	-	-
893	Articles of plastics	2,653	-	-	576	128	-	-	-	-	-	-
848	Apparel & accessories except textiles; headgear	2,437	-	-	-	107	-	472	-	141	312	-
842	Woman/girls coat, not knit	2,403	-	459	-	1,151	-	-	665	788	369	6
845	Articles of apparel of textile fabrics	2,362	-	727	688	1,862	135	238	585	664	915	13
813	Lighting fixtures and fittings	2,340	-	-	-	-	-	-	-	-	-	-
778	Electrical machinery and apparatus	2,295	3,553	398	918	133	84	187	90	-	-	-
899	Miscellaneous manufactures articles	2,177	-	-	-	113	133	-	-	-	-	-
831	Trunks, suitcases, vanity cases, & briefcases	2,172	-	-	-	-	-	-	283	185	349	-
762	Radiobroadcast receivers	2,105	-	-	-	-	233	832	-	322	-	-
771	Electric power machinery & parts	1,507	-	-	381	-	-	124	239	-	265	-
697	Household equipment of base metal	1,398	-	-	-	-	-	-	-	-	196	-
699	Manufactures of base metal	1,331	-	-	718	-	-	-	-	-	-	-

Source: Table. US Trade by Commodity with Some Selected Countries (http://www.ita.doc.gov).

Moreover, China's exported US$102.2 billion to the United States in 2001, the second largest exporter from Asia after Japan, with US$126.6 billion. China's exports to the United States were far bigger than those of other Asian countries (Table 5). China's exports to the United States also increased very fast, almost doubling in the past few years. Therefore, it will be hard to challenge the appearance of many Chinese products in every commodity category in United States, particularly as many commodities have relatively higher competitive level.

Table 5: U.S. Trade with Selected Asian Countries

(Millions of dollars)

	U.S. Imports from			**U. S. Exports to**		
	1997	**2001**	**% increase**	**1997**	**2001**	**% increase**
Japan	121,359	126,602	4.32	65,673	57,639	-12.23
Korea	23,159	35,185	51.93	25,067	22,197	-11.45
Taiwan	32,624	33,391	2.35	20,388	18,152	-10.97
Hong Kong	10,297	9,650	-6.28	15,115	12,923	-14.50
Singapore	20,067	14,979	-25.36	17,727	17,692	-0.20
Malaysia	18,017	22,336	23.97	10,828	9,380	-13.37
Philippines	10,436	11,331	8.58	7,427	7,665	3.20
Indonesia	9,190	10,105	9.96	4,532	2,499	-44.86
Thailand	12,595	14,729	16.94	7,357	5,995	-18.51
China	62,552	102,280	63.51	12,805	19,235	50.21
Vietnam	388	1,053	171.39	278	461	65.83

Source: Table. US Trade by Commodity with Some Selected Countries (http://www.ita.doc.gov).

Comparing the 20 major Indonesian exports to the United States (Table 6) and the 20 top U.S. imports from Asian countries (Table 4), shows that Indonesian products have a relatively small share in US imports. In total, Indonesian exports to US were only about one-tenth of China's. Therefore, the variety of commodities exported to the US has been limited and the value of Indonesia's exports was low compared to China's. Indonesia is represented by only 11 kinds of products on the list of the top 20 US imports from China, including Indonesia's three largest exports to the US in 2001, women's and girls' coats (US$788 millions), footwear (US$726 millions), and articles of apparel of textile fabrics (US$664 millions). For women's and girls' coats, the highest ranking export commodity from Indonesia to the United States, the total value exported by Indonesia was only one-third the amount exported by China. Moreover, China's RCA in footwear from China is much higher than Indonesia's, 4.53 compared to 2.50 (Indonesia's RCA in leather products). Accordingly, it is very hard for Indonesia to challenge China in U.S. markets, particularly in the manufacturing industries where China operates with more advanced technology. For China, the networking for businesses is already secured as its trade is more widely varied and higher in value than Indonesia's.

Table 6: Top 20 Commodities Exported by Indonesia to United States, 1997 and 2001

(Millions of dollars)

SITC	Commodity	1997	2001
842	Women/Girls Coats, not knit	545	788
851	Footwear	1,083	726
845	Articles of Apparel of Textile Fabrics	393	664
763	Sound Recorders and TV Recorders	457	626
841	Men's or Boy's Coat, Jackets etc, not knit	459	560
821	Furniture & Bedding Accessories	280	496
752	Automatic Data Process Machines	256	442
333	Crude oil	369	376
231	Natural Rubber in Primary Form	735	331
762	Radiobroadcast Receivers	229	322
759	Parts for Office Machines & ADP Machines	63	210
776	Thermionic, Cold Cathode and Photocathode Valves	211	201
634	Veneers, Plywood, and Particle Board	355	199
831	Trunks, Suitcases, Vanity Cases, and Briefcases	72	185
894	Toys and Sporting Goods	175	184
072	Cocoa	253	174
334	Oil (not crude)	97	160
036	Crustacean	152	155
037	Fish, Crustaceans and Mollusks	58	142
848	Apparel & Accessories Except Textile ; Headgear	133	141

Note: Top 20 commodities are sorted by 2001 value.
Source: Table. US Trade by Commodity with Indonesia (http://www.ita.doc.gov).

The ability of China to penetrate the US. markets has been amazing. The growth of market domination started immediately after China normalized diplomatic relations with United States in 1979 and thereafter became a member of MFA in 1983.[7] For example, while other Asian countries were experiencing difficult economic situation between 1997 and 2001, China was able to increase its exports to the United States as much as 65 percent, from US$62 to US$102 billion. Meanwhile, for specific products such as textiles and apparel, China appeared as an export champion. It is worth noting that China exported more than US$50 billion of textile and apparel products to the world in 2001, controlling 11.4% of world textile exports and 18.8% of apparel exports. This domination is the result of its competitive price and quality, as well as an extremely solid worldwide marketing network.

On the other hand, the textile and apparel industries in Indonesia are still in the process of improving technology, increasing efficiency, and finding more markets. In 2001, the value of textile and apparel exports ranked first in manufactured exports amounting to around 20% of Indonesia's total

7 With regard to competition for export share in the U.S. market a study by Thomas J. Voon and Wei Xiang-Dong from the Department of Economics, Lingnan College, Hong Kong stated: "The emergence of the Chinese market since 1979 was considered to be the major force contributing to the competition. China was observed to be gaining export share in the US market at the expense of all the other ASEAN-4 competitors. This is attributed to not only its low wage rate vis-à-vis Singapore and Malaysia, but also the fact that China has succeeded in lowering its artificially high exchange rate since 1979." The study also suggested that strong competition occurred among China, Malaysia and Singapore, while the level of competition with Indonesia was small.

exports. The composition of Indonesian exports to United States also supported the important role of Indonesian textile exports as it mobilized almost US$1.4 billion in 2001. This amount is much lower than for China, however, which mobilized about US$4.7 billion for similar products from the US market. Consequently, Indonesia must improve or at least maintain its current position in textile export, otherwise the slightest decrease in revenues from textile and apparel export will greatly damage the balance of Indonesia's trade.

Indonesia is experiencing serious challenges from other countries, in a lot of commodities, particularly during the six years since the beginning of the financial crisis. Competition against In various commodities competition not only with China but also with neighboring countries such as Malaysia, Thailand, Singapore, the Philippines, and also Vietnam, was getting stronger even before the crisis. Indonesia's failure to sustain the rapid growth of export industries that occurred between 1985 and 1997 reflects the fragile foundation of this sector. The manufacturing industries are not responding to the increasingly competitive environment in the global market.

INVESTMENT GROWTH AND TRENDS

In promoting economic development and keeping the present favorable growth tempo, China depends heavily on foreign investment, as also does Indonesia. The fast growth of foreign direct investment (FDI) has been continuing in China for almost a decade and reached the critical momentum in 2002when the country surpassed the United States as the single highest FDI recipient. According to the World Bank report China received US$52.7 billion, or 37 %, of developing countries' total FDI in 2002. Basically, this trend is also expected to stimulate the growth of investment in the region so that both China and the surrounding countries can derive maximal benefits as the resources and the markets are scattered.

Investments Flow in East Asia

In the regional context, the attraction of China as an important destination for foreign direct investment continues until the present time. The high-speed economic growth accompanied by the vast domestic market and improving investment environment have invited many trans-national corporations to establish businesses or even move from troubled areas. The flow of FDI to China has increased rapidly during the past decade. Investment in China in 2002 was more than twelve times the amount in 1991 (Table 7). This is an amazing and rational growth as a result of the extraordinary and consistent efforts and strategies of China's government. Within eleven years, the world's business eyes were directed towards China as an open and interesting place to invest so that foreign capital poured into China, jumping to more than US$52 billion. It seems that not only the radical changes of the investment regime but also the superior policies in China compared to its neighboring competitors have affected the attractiveness of the country as a major destination for investors.

Table 7: Foreign Direct Investment to Selected Developing Countries in East Asia, 1991 - 2001

(US$ billion)

	China	Hong Kong	Korea	Taipei	Indonesia	Malaysia	Philippines	Singapore	Thailand
1991	4.3	…	1.1	1.2	1.4	4.0	0.5	4.9	2.0
1992	11.1	…	0.8	0.9	1.8	5.1	0.2	2.2	2.1
1993	27.5	…	0.6	0.9	2.0	5.0	1.2	4.7	1.9
1994	33.8	…	0.9	1.3	2.1	4.3	1.6	8.6	1.3
1995	35.9	…	1.8	1.6	4.3	4.1	1.4	8.8	2.0
1996	40.1	…	2.3	1.9	6.1	5.0	1.5	8.7	2.3
1997	44.2	…	2.9	2.2	4.7	5.1	1.2	10.8	3.9
1998	43.8	14.8	5.4	0.2	-0.4	2.1	2.2	6.3	7.3
1999	38.8	24.6	9.3	2.9	-2.8	3.9	0.6	11.9	6.2
2000	38.3	61.9	9.2	4.9	-4.6	3.8	1.2	5.4	3.9
2001	52.3	22.9	8.9	4.1	-1.4	3.5	1.7	8.7	5.8

Source: Table 24, Foreign Direct Investment (US$ million), http://www.adb.org

In contrast to China, within a similar period, investment in ASEAN countries (represented by ASEAN-5) was static, if not decreasing as was the case with Indonesia. The changes were insignificant for pushing development in the region. The total value of FDI in the ASEAN-5 amounted to only one-third that of China in 2001 with no stable and continuous increasing trend as in China. During this period there has was strong competition among ASEAN countries in inviting FDI.

What is interesting in comparing the flows of FDI between ASEAN and China is the fact that the traditional sources of investment to China mainly come from ten East Asian countries led by Hong Kong, followed by Taiwan, Japan, South Korea, Singapore (ASEAN member), and Macao, while the other sources of investment come from four developing South-East Asian countries, namely Malaysia, Thailand, Indonesia, and the Philippines (Table 8). The outflow of capital from ASEAN-5 to China is contradictory to the difficulties experienced by many ASEAN countries in the race inviting FDI. The networks of TNCs as well as the preferences of many investors in ASEAN-5 to obtain business opportunities in China have been the crucial point of capital outflows to China. The financial crisis that hit many Asian countries has reduced the proportion of FDI to China particularly from ASEAN countries. Such decline however does not affect the increasing attractiveness of China as a FDI destination.

Table 8: FDI in China from the World and Ten Asian Countries, 2000 - 2002

(billion US $)

	2000	2001	2002
Hong Kong	16.21	16.72	17.86
Macao	0.35	0.32	0.47
Taiwan Province	2.38	2.98	3.97
Japan	3.24	4.35	4.19
Philippines	0.11	0.21	0.19
Thailand	0.20	0.19	0.19
Malaysia	0.19	0.26	0.37
Singapore	2.09	2.14	2.34
Indonesia	0.18	0.16	0.12
Korea	1.51	2.15	2.72
Total 10 Asian Countries	26.46	29.49	32.41
Total FDI in China	40.77	46.88	52.74

Note: Realized FDI value.
Source: Statistics on FDI by Countries/Regions for 2002/2001/2000, http://www.chinafdi.org.cn.

On the other hand, China's investment in ASEAN-5 is quite insignificant. With a cumulative investment for 1995-2000 of US$632 millions, 47% of which was invested in Singapore and 35% in the Philippines, China is among the lowest investors in ASEAN (Table 9).[8] This amount is very low compared to the US$5.6 billions, US$3.1 billions and US$4.5 billions offered to ASEAN during the same period by Hong Kong, South Korea, and Taiwan, respectively. Moreover, during the crisis many Chinese investors withdrew their investments from a number of ASEAN countries, particularly from Indonesia. There is a possibility that these disinvestments can easily be channeled to other members since the amount of capital invested is low and the investment types are flexible and mobile.

Table 9: FDI in ASEAN by Source, 1995-2000

(US $ million)

Source	1995	1996	1997	1998	1999	2000	1995-2000
ASEAN	3,187.7	2,651.7	5,377.9	1,861.9	1,404.5	869.1	15,452.8
Asian NIEs	2,385.2	2,382.4	3,035.0	2,407.0	1,363.8	1,592.6	13,166.0
China	113.7	100.7	-3.7	2753	89.6	57.1	632.6
All Others	15,225.5	20,809.4	188,892.3	14,894.7	13,789.0	7,889.6	91,839.6
Total	21,062.8	26,238.0	27,301.5	19,438.9	16,646.9	10,408.4	121,091.4

Note: Asian NIEs include Hong Kong, South Korea, Taiwan.
Source: ASEAN Secretariat, ASEAN FDI Database (BOP basis).

Contrary to the very low contribution of FDI from China, ASEAN countries brought more capital

8 ASEAN Secretariat, ASEAN FDI Database, Table VI.2.

to China. In the year 2002, for example, ASEAN had invested around US$4.3 billion in China. Certainly, the decision to bring capital to China is based on business judgments, as China offers superior facilities, better business networking, as well as the fact that many conglomerates owned by Chinese descendents in ASEAN countries prefer to go there. However, the imbalance in the flow of capital to the two regions brings forth a serious concern in promoting a harmonious relationship. For the longer term, the flux of investment to China along with relatively decreasing amount of investment in ASEAN will not create a relatively balanced development of East Asia.

The main problem relating to the competition among individual countries to attract FDI is pressing for all ASEAN countries except Singapore. It seems that ASEAN countries have to adjust their policies and strategies in order to equalize the trend and growth of FDI to China so that the interests of the region are also protected. It could be that only Thailand and Malaysia are able to establish active two-way flows of FDI with China on the basis of complementarities. Such a situation does not occur with respect to the development of Indonesia-China FDI. Moreover, an important source of investment for ASEAN from its member countries was also decreasing from US$3.2 billion in 1995 to only US$869 million in the year 2000. This situation reflects the tough competition among members as well as individual members' need to mobilize capital following the crisis. With regard to China's economic strength, importance, and continuing reforms it is quite reasonable that many ASEAN countries experience strong competition from China in inviting FDI from other regions and other developed countries.

With respect to Japan's investment in ASEAN and China during 1951-2001, some interesting figures appear. During the period, ASEAN as a whole received 10.1% of Japan's investment in the world, while China constituted only 2.3% (Table 10). Indonesia was in a relatively better position than China, as it received 3.9% of Japan's investment in the region. However, the trend of Japan's investment seems to have changed direction. Comparing Japan's total cumulative investment for 1992-2001 with the cumulative total for 1951-2001 shows that China has become an important destination for Japan's investment. About 80% of Japan's total investment in China came in the past ten years. Such trends also occurred in the Philippines and Thailand, which acquired 61% and 60%, respectively, of their total investment from Japan during the last decade.

Table 10: Destination of Japan's Direct Investment, 1951-2001

(¥100 million)

	Cumulative 1992-2001 (A)	Cumulative 1951-2001 (B)	Share of 1951-2001 total (%)	A/B (%)
ASEAN (10)	52,619	112,371	10.1	46.8
Indonesia	15,690	43,537	3.9	36.0
Malaysia	6,573	13,714	1.2	47.9
Philippines	5,718	9,355	0.8	61.1
Singapore	10,927	23,387	2.1	46.7
Thailand	12,142	20,405	1.8	59.5
China, Mainland	20,705	25,969	2.3	79.7
World	518,323	1,116,241	100	46.4

Source: http://www.asean.or.jp

On the contrary, Japan's investment in Indonesia dropped significantly. Since the crisis, Japanese investment has been steadily decreasing, finally reaching only US$576 million in 2001. Even so, Indonesia was an important destination of investors from Japan, which is reflected not only in the country's the relatively high percentage of Japanese investment, but also in the fact that almost two-thirds of Japanese investments in the country were allocated during the 1951-1991 period. So Indonesia was an early receiver of capital from Japan. The decreasing investment in Indonesia by this important traditional source of capital has very much affected the process of development and industrialization.

Table 11: Japan's Direct Investment to ASEAN, China and the World, Fiscal Years 1992-2001

(¥100 million)

	ASEAN	China	World
1992	5,012	1,381	44,313
1993	3,548	1,954	41,514
1994	5,306	2,683	42,808
1995	5,363	4,319	49,568
1996	7,201	2,828	54,094
1997	9,613	2,438	66,229
1998	5,159	1,363	52,169
1999	4,404	838	74,390
2000	2,751	1,099	53,690
2001	4,264	1,802	39,548
Cumulative 1951-2001	112,371	25,969	1,116,241

Source: Table 21, Distribution of Japan's Foreign Direct Investment Abroad in Selected Regions and Countries, http://www.asean.or.jp.

Indonesia-China Investment Growth

Unlike the favorable situation in China, the growth and trend of FDI in Indonesia are gloomy. The increase of FDI in the early nineties peaked in 1997 at around US$4.5 billion. Since then, due to the financial crisis, FDI was not just decreasing but it was negative, meaning Indonesia was experiencing disinvestment (Table 12). Many investors brought back or removed their investment from Indonesia.

Other countries such as Malaysia, Thailand, and Singapore although in a similar situation, still retained their FDI, albeit with a relatively lower amount than the period before crisis. For Indonesia the unfavorable condition has been aggravated by the prolonged upheaval of politics, law, and security reforms within a very short period.

Table 12: FDI in Indonesia by Source, 1995-2000

(US $ million)

	1995	1996	1997	1998	1999	2000	1995-2000
ASEAN	608.0	193.3	272.2	-37.1	-427.8	-232.6	376.9
Rest of the World	3,737.1	6,000.7	4,405.5	-318.1	-2,317.2	-4,317.4	7,190.5
Asian NIEs	255.2	424.5	477.6	-171.3	-100.7	-70.7	814.6
Hong Kong	106.8	94.5	232.3	13.3	-143.9	-122.2	180.7
South Korea	162.5	310.5	237.6	-177.7	63.7	56.4	653.1
Taiwan	-14.1	19.5	7.7	-6.9	-20.5	-4.9	-19.2
China	5.7	0.0	8.0	-44.0	-1.2	-2.8	-34.3
Total	4,346.0	6,194.0	4,677.7	-355.2	-2745.1	-4,550.0	7,567.5

Note: Negative sign means disinvestment.
Source: ASEAN Secretariat : ASEAN FDI Database (BoP Basis).

In 1999, the cumulative value of investment from China to Indonesia amounted to only US$230 million which was spread among 58 projects.[9] Thus, China is not an important source of investment, ranking only 27th among Indonesia's sources of FDI. This could be consistent with China's investment strategy of adopting policies to utilize domestic funds to foster economic development and concentrate on bringing more and more FDI in order to maintain the country's high rate of growth. Although China's investment in Indonesia is relatively insignificant and low on average, the specific sectors involved are important bases for Indonesia's industrialization, since they include the basic metals, chemical products, and non-metal mineral industries. Actually, for the process of industrialization, those industries should best supported by domestic investors.

Unfortunately, during the crisis period from 1998 to 2000 a number of investors from China withdrew from Indonesia, with disinvestment amounting to about US$48 million.[10] This situation could be related to the unfavorable environment of investment in the country. Many ethnic Chinese in Indonesia also moved their capital to Mainland China or other neighboring countries where the business climate is more stable. Actually, the amount of disinvestment by China was rather low compared to disinvestment by other countries. In fact, should the withdrawal of Chinese investment

9 Trade and Management Development Institute (TMDI). *Overview of Indonesian Trade in 1999*. Jakarta. p. 49.
10 ASEAN Secretariat: ASEAN FDI Database. Table VI.4.

continue from its already low level of less than US$10 million per annum, China could eventually cease to be a contributor to Indonesia's development. Besides, the outflow was not offset by an inflow of additional capital. Flooding Indonesia with cheap products from China cannot compensate, as the implications are not always parallel.

In contrast to the meager inflow of capital from China to Indonesia, FDI from Indonesia to China reached a cumulative total of more than US$5 billion for the years 1979 through 1998.[11] This contradicts the fact that Indonesia is in extreme need of foreign investment from China in the form of either capital or technology. The unbalanced flows of investment between the two countries is a big loss for Indonesia as Indonesia's private sector has little capacity to promote industrial growth, even before the crisis. It is possible that before the crisis, many conglomerates owned by overseas Chinese residents in Indonesia invested their capital in China. Naturally, the investment environment in China, which is very promising as the deregulation continues to offer more benefits for foreign investors, attracted their business expectations.

INTERNAL CONDITIONS IN FACING CHALLENGES AND ANTICIPATING OPPORTUNITIES FROM CHINA

Although Indonesia experienced rapid development growth before 1997, with respect to the structural economic changes and the development of manufacturing industries the country is still in the early stage of industrialization. When the change in political power erupted in 1998 in the middle of the financial crisis, Indonesia recognized that previous regimes had not constructed strong foundations and systems in many aspects (economic, politic, laws) so that recovery from prolonged multi-dimensional crisis could hardly be achieved. At the same time, during that difficult period Indonesia moved from a strong centralized power to less decisive intervention by lower levels of government. The central government handed over more political, economic and development power to local governments. Accordingly, the dynamic of development as well as efforts to anticipate impact of the rise of China as an economic giant on Indonesia's economy are not on the primary agenda of the

11 As recorded by Indonesian Embassy in Beijing. TMDI 1999, p. 50.

government.

Problems in the Trade Sector[12]

Lots of problems challenge Indonesia's trade sector, particularly as a consequence of the prolonged crisis. In regard to the volume of trade, for example, Indonesian performance is relatively weaker than that of Malaysia and Thailand, and it is very low in comparison to China. Moreover, Malaysia and Thailand are among the countries that are able to achieve a substantial trade surplus with China.[13] On the other hand, not only is Indonesia's trade surplus with China decreasing, but the prospects for promoting exports are not so bright as well. The combination of internal weakness in the manufacturing industries and external developments requires a substantial transformation in Indonesian trade policy. Otherwise, as the most open economy Indonesia could become simply an interesting market place for foreign products rather than becoming a significant source of competition in the global markets for various products.

Dependence on primary products such as oil, gas, and wood retarded efforts to promote diversity in the development of manufactured export commodities. In the mid nineteen eighties, due to plummeting oil prices, the government seriously encouraged the non-oil export oriented industries. As a result, the value of manufactured exports increased rapidly, and even started to dominate the composition of exports. However, the effort was concentrated in only three major products, namely plywood, textiles, and footwear, which constituted about 50% of the total export of manufactured goods. Indeed, about 80% of Indonesia's revenues from manufactured exports were derived from only ten products. Many of these commodities are sensitive to external demand, prices, quotas (such as the MFA for textiles), and can easily be in competition with products of better quality and more efficient production process.

In textiles, Indonesia has to challenge China's quality and competitive prices, while in rubber, plywood, and CPO, stronger competition comes from Thailand and Malaysia. Moreover, Indonesia relies too heavily on a limited number of market destinations namely, the United States, Japan and

12 Some analysis and figures in this section are derived from UNIDO's study in August 2000.
13 "China's Economy", http://www.economist.com .

Singapore. Any problems relating to export to these countries significantly hurt Indonesia's exporters. Dynamic changes in the region during the past five years enabled international businesses to promote products and compete for new markets. Unfortunately Indonesia, which has not yet completely recovered from its prolonged multi-dimensioned crisis, is not ready to challenge the stiffer competition.

Another weakness of the manufacturing industries is their dependence on imports. Many export oriented FDI plants in Indonesia, which operate medium- and high-technology processes need raw materials, components and parts from their home countries or other countries where their companies also operate. Many foreign-invested companies do not run a full manufacturing process; rather they operate as assembling, packing, or joining units. In 1977, for example, the value of raw materials, parts, components, and other inputs comprised 45% in chemical industries, 53% in machine industries, 56% for transportation, and 70% in electronic industries. Similar conditions were faced by labor-intensive industries such as the textile (40-43%) and footwear industries (56%). Consequently, the manufacturing sector always suffers a deficit, as the value of imports is higher than the value of the final export products.

The large depreciation of the Indonesian rupiah during the crisis should have created an export boom or brought more export revenues because it made the prices of Indonesia's exports very inexpensive for foreign importers. Unfortunately, export industries could not realize this opportunity because they relied too heavily on imported materials. Imported materials became very expensive for domestic industries that depended on them, such as footwear, textiles, and electronics. In fact, those industries were among the highest revenue creators of Indonesian manufacturing trade. The decline of exports was also related to the lack of trade financing. During the crisis, many domestic banks collapsed, making many traders unable to run their businesses due to unavailability of trade financing.

Although FDI usually provides new technology, managerial know-how, and marketing networks and systems, the business community seems unable to exploit such opportunities, due to weak capacity for technology absorption and development. The lack of highly trained and better educated manpower could be the main reason for the slow dissemination of foreign expertise, because the present systems of education and training cannot accommodate the need of industries. On the other hand, many investments in Indonesia tended to exploit and enjoy the large, protected domestic market and abundant natural resources. Some others perceived Indonesia simply as a location for exports. Consequently, foreign investors played a minor role in developing and promoting Indonesian manufactured exports. Moreover, there is no serious effort from the government or business community to utilize FDI expertise to increase the efficiency and competitiveness of the manufacturing industry. In the previous period, there was no competitive economic environment in the private sector because it lacked effective competition policy, and as a result Indonesia could not derive significant benefits from the presence of foreign firms in the country.

Added to the above problems is the lack of or slow growth of medium-technology industries. The contribution of plastic, rubber, cement, basic and simple metal industries to Indonesia's manufacturing sector gradually decreased from 1985 to 1997. This is unique because in all other countries the role of industries in this category kept on increasing. Instead, the rapid growth was experienced by low-technology manufacturing industries, such as wood, textiles, food, and footwear. In short, the trade sector in Indonesia needs immediate reform because the structural and organizational weaknesses are serious, as stated by UNIDO (2000) in its study on strategies for manufacturing competitiveness in Indonesia (Table 13).

Table 13: Structural and Organizational Weaknesses of Indonesian Manufacturing Sector

Structural weaknesses	Organizational weaknesses
• Narrow export base and markets	• Underdeveloped small- and medium scale industries
• Limited domestic production of intermediate industries inputs and components	• Significant market concentration by a few large firms in many segments of manufacturing
• Weak capital goods industry	• Weak capacity to absorb, adapt, and develop process and product technology
• Declining share of medium -technology industries and increasing share of low-technology industries	• Weak human resources
• Limited net revenue generated in oil/gas sector	• Fragmented responsibility for industrial policy and promotion
• Concentration of manufacturing production in Java, and Jabotabek in particular	• Weak industry associations

Note: Jabotabek is an abbreviation of Jakarta, Bogor, Tangerang and Bekasi (Jakarta and surrounding areas)
Source: UNIDO, 2000. Box 2 page 2.

Stagnation in Investment

During the nineteen nineties, competition to invite foreign investors to developing countries in East Asia was intense As mentioned, China is in an extreme case where FDI increased more than ten times in the 12 years after 1990. On the contrary, Indonesia which tried hard in the first half of the nineties, attaining FDI of about US$6,194 million in 1996, has to accept the painful reality of not only decreasing FDI but also disinvestment during the past five years. A similar trend occurred also in domestic investment. The prolonged, multi-dimensional crisis is responsible for the bad image of the country's investment environment. Consecutive regimes tried hard to overcome this difficult situation, but too many unprecedented political, social, legal, and security problems emerged simultaneously. At the same time that it must execute new rules and laws in the middle of a cynical community in order to address demands for reform, the government has to contend with various security and terrorist attacks and demonstrations of political and economic nuances. Those are the reasons for capital outflows from Indonesia.

As of 2002, the investment climate had not yet recovered, as shown by the facts that the realization of approved investment this year was very low (about 20%). Disinvestment is still continuing. In 2002, UNCTAD recorded minus US$1.52 billion for Indonesia, much better than the previous year's figure of minus US$3.27 billion. It is the return of portfolio investment that contributes a little hope for FDI increase. The worsening climate of investment has caused the exodus of many foreign-owned businesses. The security and legal aspects are still uncertain and the increase of labor conflicts has discouraged investors from coming to Indonesia. In 2002, many Korean and Japanese firms relocated their plants to other countries (between 40 and 50 firms, mostly Korean). The case of PT Sony Electronics, for example, which relocated from Indonesia, was a hard blow to the business climate regarding the momentum of the intention. Even though the relocation is part of the company's global strategy, the implication for Indonesia is the addition of more unemployed people (about 50,000) in the middle of a rising rate of unemployment.

Relocation and removing of businesses also happened in the toy industries. In 2003, at least 12 toy firms relocated to other countries; two were foreign investments while the rest were domestic investments. Actually, there were 110 toy businesses in Indonesia in 1998, and at the moment only about 30 still produce there.[14] Some sources mentioned that those firms prefer to locate t in China, Vietnam, Kampuchea, Bangladesh and Myanmar because these countries are more conducive for foreign investments. Accordingly, these cases will influence other multinationals and investors to reconsider their operations in Indonesia, especially in light of additional problems, such as illegal imports that compete with the products of foreign-owned firms and the emergence fees imposed by local administrations as a result of decentralization. With the initiation of local autonomy in 2001, local governments instituted numerous taxes and charges in order to increase their revenues. This policy has eventually affected and distorted economic activities.

In response to the deteriorating investment climate, the government designated the year 2003 as an "Investment Year." A new investment bill was submitted to parliament in early 2003 to replace the prevailing laws on foreign and domestic investment. A national investment team was also created in order to identify and solve various problems by expediting investment approvals, simplifying procedures and improving coordination among various agencies, and providing incentives for foreign investors. Transparency in approving investment applications has been carried out, and the discriminatory practices that occurred under the previous regime because the President personally signed approvals have been stopped.

These important measures, however, could only be effective in attracting foreign companies if economic growth were relatively high and increasing and if the country were still popular and competitive as a low-cost environment. In a period of tough competition, a large store of natural resources is only one factor in attracting FDI and it has to be accompanied by other supporting sources and facilities. The lower level of education and skill of Indonesia's human resources will always be a constraint, impeding the transfer of technology, management know-how, and skill from investors. Moreover, the condition of the physical infrastructure in the country is also apprehensive; high level public utilities and services are available only on Java Island, particularly in Jakarta, Surabaya, and their surrounding areas. Physical infrastructure is the difficulty in promoting investment in the outer islands. The most important thing to consider is that almost all countries in the world, and particularly those in the region, are also working hard to invite FDI. While Indonesia still has to reform its fundamentals of good governance, political and legal certainty, and security systems in order to be

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14 *Bisnis Indonesia* (Newspaper), 21 August 2003, page 18.

able to invite foreign investors, most countries are already making their utmost efforts to improve their attractiveness for FDI.

Responses to China's Emergence

Actually, the government has never made specific policies or strategies anticipating the emergence of China as an economic giant in the region. Typically, any efforts towards challenges from China will only be addressed in an ad hoc or special committee, but they usually do not result in any real action. Those traders or exporters whose businesses are affected raise many complaints and reactions, but they usually are concerned only with particular issues and they have no power to implement any direct measures to overcome the problems they face. Bureaucracy, connections, corruption, and nepotism are practically diseases that cannot be cured, and many leaders in Indonesia find it very difficult to carry out any good policies or strategies due to strong opposition of those interest groups. In the six years since the crisis began, the governments in power spent almost all their energies anticipating internal disturbances, which are highly political, so that the economic recovery is proceeding very slowly.

At the present time, an influx of products from China can be found in many types of trading commodities. The sectors that generate the largest share of manufacturing output in Indonesia are all affected by competition from Chinese commodities, not only in foreign markets but also in domestic markets. In the domestic market, the challenge of similar products from China is becoming more pressing although many Indonesian manufacturing industries consist of foreign investors including TNCs. In the automotive market, for example, motorcycles produced by primary agents in Indonesia such as Honda, Suzuki, Kawasaki, and Yamaha, are no longer as dominant. Chinese motorcycles can offer prices about 25%-30% cheaper, accompanied by availability of components and parts availability and satisfactory after sales service. The process of assembling is relatively easy, although some people point out the possibility of more completely knocked down units brought to this country illegally. It is quite probable that in a couple of years few types of commercial cars will also join the domestic car markets. China's efforts to enter the automotive market have surprised the old players in Indonesia who believed the high investment required to establish assembling units, marketing networks, and most importantly the develop workshops and repair units for after-sales services would make it difficult for a new player to enter the market.

China's electronic products are among the strong competitors, as many types of color TVs, radio-cassettes, VCD, and other household appliances such as washing machines, refrigerators, irons, and blenders can easily be found in the market. Those products that are similar to Japanese products are cheaper, more innovative, and improved from time to time. Therefore Chinese products can capture a special segment of consumers, particularly, lower income consumers. Traders of electronic and household appliances produced by Japan, South Korea, United States, and Italy started to be quite concerned about such an invasion from China. Similar challenges are also happening in footwear products, which are sold at low prices and can easily be found in traditional markets and small shops. Many people now state "we want to buy shoes not a brand". This awareness will adversely affect specialty shops that sell expensive, popular brand shoes. Other products which are now pouring into Indonesia's markets and selling well are capital goods, such as agricultural machines, chemical industry machinery, and tools for carpentry, handicrafts, and craftsmanship. Surprisingly, Indonesian markets now are even flooded by furniture and ceramics from China. These two products can be found almost everywhere, from ordinary shops to supermarkets, even though Indonesia is an important produce of such products itself. The above examples illustrate the difficulties faced by Indonesian producers even in the domestic market.

In response to such challenges, Indonesian businessmen took the initiative to form a business council with their partners from China, in order to strengthen trade ties and create trade balance between the two countries. The Indonesia-China Business Council (ICBC), which was formed with the objective of becoming a bridge between businessmen from the two countries, is the first of its kind in the region. The council will be also directed to balance trade between Indonesia and China, because hundreds of items have been imported from China, but only a few commodities exported to China.[15] Basically, China's Prime Minister, Zhu Rongji, proposed the council during a meeting with Indonesian

15 This statement was expressed by Ministerial Councilor at the Chinese Embassy as the honorary adviser of the council.

President at the Asia-Pacific Economic Cooperation (APEC) meeting in Shanghai. The council itself is an expansion of the China committee of the Indonesian Chambers of Commerce (KADIN).

On the other hand, some important industries in Indonesia are also undertaking efforts to create a harmonious relationship with China and to develop an important source of investment. The Indonesian State coal mining industry (PTBA), for example, has discussed a joint cooperation with China National Technology Import Export Corporation (CNTIEC) to bring new technology to Indonesia, particularly for deep mining. Meanwhile, in accordance with the increasing demand for electricity, the Indonesian National Electricity Company (PLN) has signed an MOU with a Chinese contractor to construct some regional electricity projects.

Efforts to establish economic relationships are also carried out by some local governments (provinces and regencies/cities). Some are seriously discussing various projects in their own regions with their counterparts in China in order to invite Chinese investors. In fact, 42 regency leaders planned to follow up the cooperation with a visit to Beijing, Shanghai, and Guangzhou. Moreover, some provinces are also establishing ICBC branches, such as the Indonesia-China Business Council in the Province of South Sumatra. The measures illustrated above are among steps that are realistic for Indonesia at the present time. It seems Indonesia prefers to create better, more harmonious relationship to protect its markets as well as to increase opportunities to enter China in order to promote Indonesia's exports and to invite Chinese investors.

CONCLUSIONS AND FUTURE TRENDS

Complementarity of trade between China and Indonesia is of limited scope because the stage of development and factor endowments of the two countries are similar. Both countries are rich in resources and at the present time they are also promoting export-led growth particularly in some traditional products. However in terms of technology, labor cost and on-going process of industrial restructuring, Indonesia is lagging behind. There are many cases, such as in textile industries, where Indonesian export-oriented manufacturing industries face difficulties due to obsolete technology. Moreover, cheap labor cost, which usually attracts foreign investors, is no longer competitive due to increasing labor salaries. The process of industrial reformation and restructuring in general seems to proceed slowly and be rather unorganized. Therefore, Indonesia needs immediate, realistic trade and investment policies and extra efforts to face stronger competition from other countries, particularly from China.

The crisis put Indonesia's economy and trade in a very difficult situation, while the government continues to maintain Indonesia's position as the most open economy. Reform policies have been carried out and have increasingly brought trading partners to penetrate various market segments of the country. The reflection of such an open domestic markets can be seen in the flooding of China's products into Indonesian domestic markets. Given its present condition, Indonesia's best opportunity to benefit from bilateral trade with China is by maintaining its position as an important source of food products and basic materials (natural resource-based products) for China.

The emergence of China's big economy has provoked surrounding countries to restructure their economic relationship with China, since both regions have implemented similar approaches to develop their economies. Although China open its domestic market to its trading partners and also open the country to FDI, it is not easy for traditional foreign businessmen to enter China as they are not used to Chinese culture and traditional behavior. On the contrary the infiltration and growth of China trade in ASEAN countries seems to be very smooth and to increase dramatically. It is likely that China can enjoy such benefit due to the business networks established by ethnic Chinese in the region. In this respect, China also got an advantage from the FDI inflows from ASEAN countries. It seems that many ASEAN countries have to maneuver in order to get more benefits challenged by such a big economy.[16]

The experience of reformation and liberalization in China has an important meaning for many surrounding countries. Individual countries reacted to China's dramatic economic growth differently, depending on the degree of economic, strategic and cultural relationship as well as the level of economic development and political situation. However, it is certain that—while undergoing quite dramatic reformation in various sectors—all countries in the region are expecting the continuance of a

16 In this regard, the Vice President for East Asia and the Pacific Region at The World Bank mentioned that it would be important for ASEAN countries to integrate their systems and the economic structures in order to be more competitive, especially as China is able to offer favorable and an attractive facilities. The ASEAN region's share in the world trade volume is relatively high and still has potential to increase so that the bargaining position of the region can be improved.

stable economic and political situation in China. As a solid economic giant in the near future, many countries have to create efforts in order to gain the most from their relation with China. Although, at the present time challenges and competition from China have put many developing countries in the region in a quite difficult situation, harmonious cooperation has to be built for the economic development of both parties in the future.

Many lessons can be derived from China's experiences, particularly for the developing countries in the area. Among others is the ability of ruling elites to adopt strategic policy measures in transforming a socialistic and centralized economic and political system a more liberal and market-oriented economy. Those changes, which can be called a great success, were achieved in a relatively stable condition. Therefore, it is not surprising to consider that China would reach a level of a strong middle income economy within a couple of decades as the economic development also reaches areas in the inner parts of China.

Basically, the rapid progress of development in China has long-term positive impacts on East Asia. China, where the income level of the population in the dynamic eastern region is now increasing, can provide a huge market for the region. The stable and continuous growth of China will open a new dimension of development and cooperation especially with Japan and the NIEs. It seems that a region of prosperity will cover the area of the Korea peninsula, eastern part of China, Japan, and Taiwan as a center of high demand and high-tech networks. This area will be supported by its developing neighbors in ASEAN. Strong cooperation among these countries will accelerate the growth of developing members and can create a more complementary basis for trade. At least the extreme success of China in this area will stimulate industries in the region, particularly in respect to the promotion of intra-industry trade. Competition will take a new format as the local TNC's utilize the strengths and weaknesses of individual countries. In ASEAN, Thailand and Malaysia are experiencing a solid improvement in their manufacturing industries and investment sectors. Indonesia, in its process of reformation and recovery has to work hard to move from dependence on primary-based industries to more technologically-based activities. Indonesia could provide some products in which it has greater competitive advantage and it could become the second most important market in eastern Asia.

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