

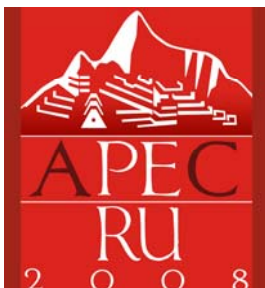


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The China Products Influence on Indonesian SMEs

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The China Products Influence on Indonesian SMEs

by

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Abstract

Globalization creates opportunities and challenges for a country, especially a developing country like Indonesia. Indonesia, which has just recovered from economic crisis, is experiencing many difficulties in the area of economics. The country is able to maintain economic stability, but the economic growth cannot attain the level of growth before the crisis. As a result, the unemployment and poverty level are still high until now, and the level of international competitiveness is still behind its neighbor countries. This makes the country has difficulties to boost its export especially in the area of manufactured sector, although its international trade is still surplus for Indonesia. The recent situation even shows that import products, especially the ones that come from China, have flooded the market. The China's products are very famous to Indonesians, especially electronics, motorcycles, and toys. The textile market in Indonesia is also flooded by many China's products, which come to Indonesia legally or illegally. Although the quality of China's products has been perceived as low quality, the lower price has attracted Indonesian consumers. That leads many producers in the country face serious difficulties, which lead some of them out of bussiness. Even many producers also find some advantages using China's products as input in their production (because the prices are lower). However, the country face serious problem since the deindustrialization phenomenon is becoming more serious in the country, because more industrialists are becoming distributors of China's products, and they cannot compete with China's products. If the trend were continued, it would hamper the ability of the country to develop its nation, especially to provide more employment and reduce poverty. Therefore, Indonesia needs to enhance its international competitiveness seriously, and revitalize its industrial sector.

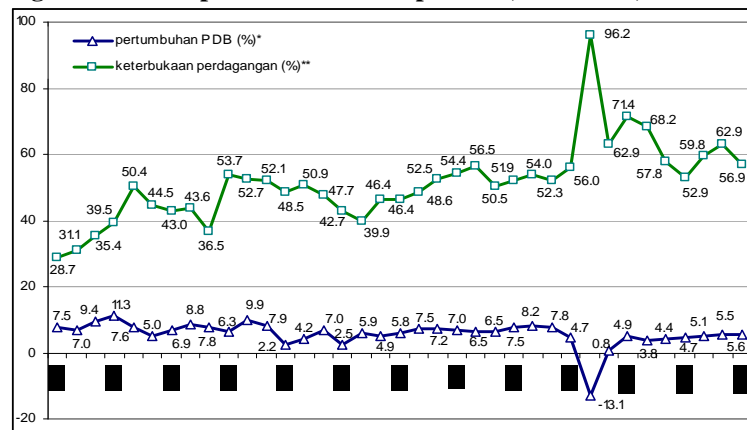
1. Introduction

Globalization has increased the intensity of economic activities and diversity of economic models. The global economy which was largely in form of international trade, today it is increasingly taking forms of intermediate goods flows and financial services which have strengthened globalization itself. National borders are disappearing overtime, creating a global market for practitioners. Globalization drivers are forcing nations to open their economies for international trade in output, input mobility, and for investment.

As far as Indonesia, is concerned, globalization is hardly a new thing, as the country has experienced it since VOC era, during Dutch colonialization. The phenomonon helped forment various social, economic, and political changes, therefore making Indonesia more open, especially in its economy. Indonesia has experined increasing openness overtime. Figure 1 depicts developments in trade openness Indonesia has experienced.

Figure 1 shows that Indonesian trade is increasingly become open over time. With effect from the elimination of trade obstacles in 1970s, trade has showing the upward trend in openness. During the 1960s, trade openness in Indonesia reached just 25 percent, and rose to 28.7 percent in 1970s. During 1971-1980 period, trade openness averaged 43,03 percent per year, and rose slightly to 47.56 percent and 53.24 percent, during 1981-1990 and 1991-1996 periods, respectively. Trade openness increased drastically to 96.2 percent during the 1997-1998 economic crisis, but decreased significantly in the wake of the economic crisis to 61.61 percent on average per year (1999-2006).

Figure 1. Developments in Trade Openness , Indonesia, 1970-2006



Cote: * GDP at 2000 constant prices, ** (X+M) / GDP
Source: Bank Indonesia & BPS, analyzed

Although openness of trade in Indonesia has registered significant progress during 1981-2006 period, the country's performance as regards still lags compares to other countries. Indonesia has the lowest level of trade openness of the ASEAN 5 nations : Thailand, Singapore, Malaysia and the Philippines.

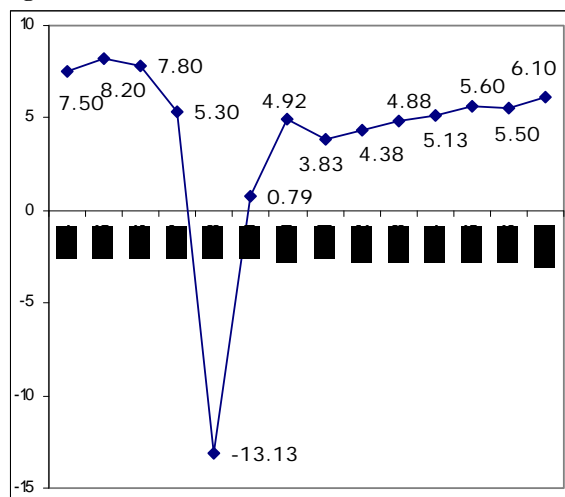
Economic globalization does not only increase globalization of the economy, but also alters the map of the world economy. China, which was closed market, communist state, today is one of key global players in the world economy. The influx of cheap Chinese products poses a serious threat to various products in many countries, including the United States and Indonesia (Park, 1993).

So far, economic openness has provided various benefits to Indonesia, like other countries in the region. The country has committed to open its market under ASEAN, APEC and WTO, and also EPA with Japan. The country's economy is widely open compared with any other countries, this would create opportunity and challenges for the country. Despite Indonesia has benefited from its openness policy for several decades, especially before the crisis period. But after the crisis although economic reform has been launched for almost a decade, and many economic policy packages have been delivered recently, the country still can not deliver a favorable and competitive business climate. There are still many structural obstacles such as unfavorable investment climate, low competitiveness, and low human resources quality. That lead to serious problem in the industrial sector, as deindustrialization is becoming a reality in the country. And the country is becoming more difficult to compete with product from efficient market like China.

2. Industrial Sector and International Competition

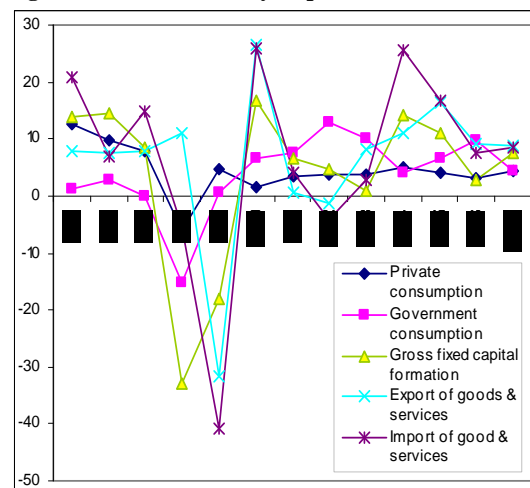
Indonesia GDP growth increases slowly after the crisis. In the same time investment and industrial sector grow slowly, especially compare before the crisis.

Figure 2. GDP Growth (%)



* 1st half 2007
Source: Central Bank of Indonesia

Figure 3. GDP Growth by Expenditure (%)

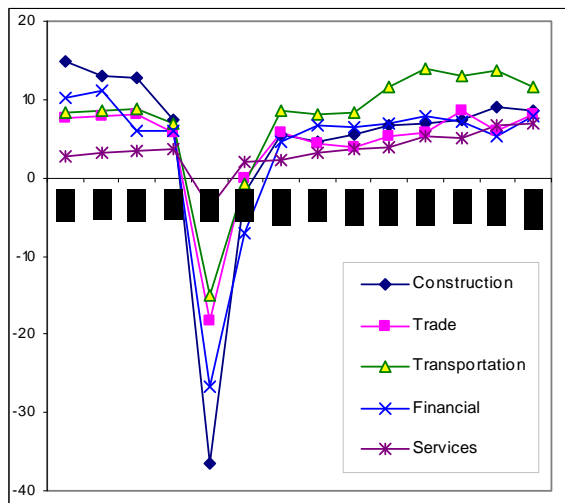


* 1st half 2007
Source: Central Bank of Indonesia

Low growth in manufacturing sector and investment have showed that the country still face serious problem in providing supported business environment. Even, recently there more signal

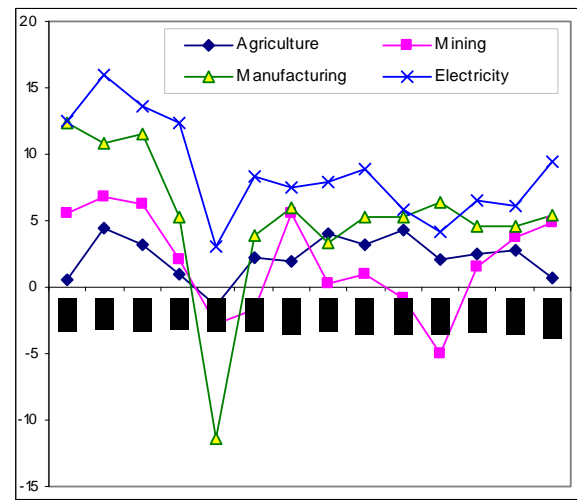
which indicates that the country is experiencing de-industrialization process: a decline in the processing industry. Many indicators of such tendency of a fall in industrial share to GDP growth after the crisis, and the reduction in employment generated by the industry. Therefore, closure of companies and relocation to others countries cannot be stop. This has largely been attributed to government failure to resolve a number of outstanding issues in the business and investment areas, which among others include, labor related issues, regulations that hamper business operations, taxation bureaucracy, especially the minimal transparency in executing tax returns; and rampant smuggling (Kuncoro, 2003).

Figure 4. GDP Growth by Sector (%)



* 1st half 2007
Source: Central Bank of Indonesia

Figure 5. GDP Growth by Sector (%)



* 1st half 2007
Source: Central Bank of Indonesia

Indonesia international competitiveness is decreasing since the crisis, and low compared to other ASEAN countries. Data released by two international organizations, which surveys on the competitiveness of countries in the world, Indonesia registers a very low rank. In the *World Economic Forum* report released in 2006, according to the *Global Competitiveness Index*, Indonesia shows an improvement in its ranking to 50th in 2006 out of 125 countries surveyed, which was higher than 69th in 2005. However, according to the survey conducted by Institute of Management Development (IMD), Indonesian competitiveness in 2007 was ranked 54th out of 55 countries surveyed. The ranking constituted a drop from the 52th position Indonesia registered in 2006 (IMD, 2006).

Table 1. Growth Competitiveness Index

Country	GCI 2006 rank	GCI 2006 score	GCI 2005 rank	GCI 2005 score	GCI 2004 rank	GCI 2003 rank
USA	6	5.61	2	5.81	2	2
Singapore	5	5.63	6	5.48	7	6
Japan	7	5.60	12	5.18	9	11
Korea	24	5.13	17	5.07	29	18
Malaysia	26	5.11	24	4.90	31	29
Thailand	35	4.58	36	4.50	34	32
China	54	4.24	49	4.07	46	44
Indonesia	50	4.26	74	3.53	69	72
Philippines	71	4.00	77	3.47	76	66
Vietnam	77	3.89	81	3.37	77	60

From 125 countries, Source: World Economic Forum

The investment climate in the country has not yet succeeded in attracting significant foreign and domestic capital into the Indonesian economy. Foreign direct investment and domestic capital formation levels prior to the crisis were higher than levels registered after. This is attributed to among other factors, investment climate that remains far from conducive, and the inability of government policies to promote investment (Central Bank of Indonesia, 2005).

The country actually realized the problems and the government has launched economic packages to increase investment and production, such as; Infrastructure, Investment, and Financial Sector Policies. The infrastructure policy package was issued on February 17, 2006, which covers overland transport, railway roads, sea transport, and air transport, and road tolls; electricity, oil and gas infrastructure, post and telecommunications, and clean water and housing. The key aspect in the infrastructure policy package entails the establishment of Public and Private Partnership (PPP) Center, charged with the task of formulating the working model for government-private sector collaboration in infrastructure development and the establishment of the financing agency responsible for funding infrastructure outside the government. Infrastructure policy package delineates the strategic steps within the policy, regulatory, and institutional framework of conducting infrastructure, which encompass: inter-sector strategic policy reforms; sector and corporate policy reforms tailored toward the promotion of fair competition in infrastructure procurement; regulation on the eradication of the exploitation of natural monopoly conditions and protection of the general public and investors during the infrastructure procurement process; and establishing a clear-cut separation between Ministers/Heads of institutions/regions, responsible for formulating policy and state owned enterprises/regional region owned enterprises as operators. (Coordinator Ministry of Economic Affairs RI, 2006). And the package on improving investment climate was embodied in presidential instruction (Inpres) No. 3, 2006, dated 27 February 2006. The policy was compiled by the National Export and Investment Enhancement Team, established by the President basing on Presidential Decree (Keppres) No.3, 2006. The investment policy

package covers general aspects relating to improving investment service delivery, and synchronization of regional and national government regulations; customs and excise programs; aspects of taxation entailing tax incentives for investment and revision of the value added tax tailored toward the promotion of exports; labor issues regarding industrial relations policy and creation of a flexible and productive labor market; and policies on the empowerment of SMEs and cooperatives (Coordinator Ministry of Economic Affairs RI, 2006). Meanwhile, the Financial Sector Package, is embodied in a joint ministerial policy statement issued by Coordinating Minister for the economy, Governor of Bank Indonesia, Minister of Finance, and Minister responsible for State owned enterprises on 5 July 2006. The policy package was underpinned by the need to enhance performance and efficiency of the financial sector, necessary for improving the investment climate (Ministry of Finance RI, 2006). The financial sector policy package covers such areas as financial system stability; bank financial institutions; non bank financial institutions; and the capital market.

With respect to financial system stability, the government implemented the policy that strengthens financial sector coordination mechanisms; and putting into effect the financial system stabilization forum. In the area of banking institutions, the government implemented the policy that strengthens banking institutions, by among other ways, adopting the Good Corporate Governance and risk management policy; and improving the performance of state owned enterprises through the state owned banks non-performing loans settlement program. As pertaining to non-bank financial institutions, the government implemented the policy that familiarizes the customer with non-bank financial institutions, strengthening of non-bank financial institutions through customer and investor protection and empowerment program; and strengthening the insurance industry, pension fund industry, and financial institutions industry. Policies implemented by the government in the capital market , include capital market development programs that entail , among others : enhancing the competitiveness of the stock exchange , improve the quality of supervision and regulation, developing the bond secondary market, and improving the legal framework to facilitate the development of syariah-based capital market. Other policies implemented in the capital market area, include developing the state bond market; and strengthening mutual funds industry (Coordinator Ministry of Economic Affairs RI, 2006).

However, the various policy packages so far issued by the government have not yielded significant results. This is largely due to ineffective implementation of the policies, as well as a host of other obstacles.

3. The Influx of Products of China

Although it is difficult to state the exact data when Chinese imports entered Indonesia economy, the undeniable fact is that for long, the economy has been experiencing an influx of

Chinese product. One of the most visible signs of the entry of Chinese products into the domestic economy took the form of Chinese motor bikes commonly known as "mocin". The motorbikes are sold at relatively low prices, providing the Indonesian public a higher variety of choice. The entry of Chinese motorcycles provided the public with another assortment of choice, and by so doing seemed to nibble away at the overwhelming dominance of Japanese motorbikes in the Indonesian market.

Subsequently, the influx of products from China into Indonesian economy intensified. This was especially the case for such products as electronics, textiles, and a wide variety of others. Thus, it is not surprising that Chinese imports dominate the Indonesia imports. Japan has for long been the country that has dominated Indonesian imports, a condition that has apparently been replaced by China. A detailed account of the contribution and growth of Chinese imports and those from other countries is shown in table 1 :

Tabel 2: Growth and Share of non-oil imports by country of origin to total Non-oil and gas imports, Indonesia (%)

	China		Japan		USA		Vietnam		India		Taiwan	
	<i>growth</i>	<i>share</i>	<i>growth</i>	<i>share</i>	<i>growth</i>	<i>share</i>	<i>Growth</i>	<i>share</i>	<i>growth</i>	<i>share</i>	<i>growth</i>	<i>share</i>
2000		7,84		19,14		11,77		0,39		1,69		4,63
2001	-12,65	7,81	-23,65	16,68	-6,50	12,56	-41,97	0,26	8,25	2,09	-14,51	4,52
2002	25,85	9,72	10,53	18,22	-13,95	10,68	166,31	0,67	23,20	2,55	-7,12	4,15
2003	13,04	10,11	13,62	19,06	5,54	10,38	11,98	0,69	9,77	2,58	-12,34	3,35
2004	50,77	10,97	25,98	17,28	26,89	9,48	-51,32	0,24	54,62	2,87	37,82	3,32
2005	62,84	10,80	69,67	17,73	28,81	7,38	44,68	0,21	6,73	1,85	58,22	3,18
2006	32,41	13,60	-11,45	14,92	5,62	7,41	109,94	0,42	32,74	2,33	1,18	3,06
2007*	48,25	14,98	0,31	13,89	7,11	7,40	238,73	1,07	26,75	2,70	11,93	2,93

* Latest data April 2007

Source : Bank Indonesia, analyzed

Another question that deserves posing regards as to why China is able to offer products at very low prices. According to research results on China, high productivity is in part responsible for its ability to offer products at lower prices than other countries' producers. As pertaining to productivity, many circles acknowledge the fact that China has a competitive edge in labor and capital productivity. As an example, shoes workers in China are able to produce 16 pairs of shoes, valued at US\$ 12-US\$14 per pair per day. On the contrary, under similar working conditions, shoe workers in Indonesia are able to produce just 10 pairs of shoes. Moreover, high labor and capital productivity of Chinese producers is coupled by the strategy adopted by China, which promotes the export of finished products and high valued added rather than raw commodities and intermediate products. That way, Chinese exports contribute substantially to the economy (Bisnis Indonesia, 2007).

Besides high labor productivity, high competitiveness of Chinese products imports also lies in the vertical relationship that exist at the distribution level and hierarchy among raw materials, intermediate goods, and finished products. Findings from several studies show that Chinese

products have a specific *supply chain* which constitutes an important source of competitive advantage in itself. The supply chain is intricately linked with the strong loyalty inherent in the culture of close friendships/ties (McGinness, at all, 1991).

On the issue of productivity, the influx of Chinese products to various countries has intensified market competition both in the domestic and international market. Undoubtedly, the condition has impacted on the business climate in Indonesia, for micro, small and medium size enterprises (SMEs). Nonetheless, the impact of Chinese imports on the character and condition in a certain industry and business climate, also depends on the type of products. In the backdrop of the foregoing, this article will present findings of the research on "the perception of businessmen about the penetration of Products from China on Small and medium size enterprises in Surakarta, Central Java ". This objective of this research was to evaluate the impact of the penetration of Chinese imports on businessmen, especially those SMEs in Surakarta, Central Java, and to assess the response and solutions they have developed to deal with such an influx.

4. Methodology

This research is exploratory, which is why the methods of analyses that were used constituted description of statistics in general and percentages in particular. Data that were observed were *hard data*, in the form secondary data (*existing data*) on the penetration of Chinese products and the impact they have had; and *soft data*, which represents businessmen perception about the impact caused by the penetration of Chinese products on their business operations. A questionnaire, which was designed to quantify qualitative variables, served as the instrument to collect the data.

The objective of the survey, which was carried out using a questionnaire, was to assess the opinions of top management executives (*top executive opinion survey*). The process entailed taking a sample of 55 respondents drawn from various groups of business groups. As regard to the type of products, the sample of businessmen was drawn from textile, garment, crafts, electronics sectors and so on. Respondents serve as producers, processors, exporters, importers, and retailers.

Besides, focussed group discussion (FGD) was also used in collecting the data collection, which was used in clarifying data obtained in the survey. FGD was conducted on 20 top management executives or middle level managers drawn from respondents who represented various SMEs.

In addition, an Interview with several businessmen, especially heads or managres of business associations such as textile association or the personnel responsible for managing the lokak chapter of the national chamber of commerce and industry. Collection of secondary data

involved literature review of various local, regional, national, and international publications issued by credible government and private research institutions.

Analysis of soft data was done by obtaining the perception of respondents in accordance with their position as regards products from China. In this analysis, selection of respondents was done on the basis of whether respondents use Chinese products as inputs, rivaling/ competing with their products, or as distributors of products from China. The selection was aimed at ensuring that during the analysis the different positions of traders as regards the influx of products from China is highlighted.

5. Advantages Associated with Products from China

5.1. World Perception about Products from China

Putting all manner of controversy concerning products from China, various publications, both in scientific and popular media confirm the notion that is increasingly becoming public knowledge that Chinese products have a high competitive edge over products from other countries, especially with respect to prices. Parkowski (2007) states that China is an important friend for US consumers, because of the cheap Chinese products available in the US market that range from tooth paste to DVD players. Furthermore, Parkowski states that US consumers have responded positively to the cheap prices offered for Chinese products by undertaking purchasing binge, causing a large deficit between US and China.

The same perception appears to abound among Asia and Pacific nations, which are hard pressed by the threat posed by imports of Chinese products. The prices of Chinese products which are very competitive have eaten up export share of many countries in developed country markets such as Japan, United States, and European Union (Park, 1993). As far as the garment market, China today dominates the Japanese Market, and 80 percent of the Japanese textile market.

Nonetheless, Chinese products continue to far short of standard or quality desired. The image of products from China still raises many question marks than answers. DeWoskin (2007) acknowledges that today American Consumers are experiencing a drastic change in their perception of the quality and safety of Chinese products. The bad reputation of products “*made in China*” does not only pose as erious threat to the economy of China, but also American companies dealing in importing Chinese products. Besides inadequate quality, according to Nailen (2004), Chinese products are infamous for being fakes or pirated, contravening all manner of licenses. It is noted that Chinese people are accustomed to communal property ownership, a feature that induces their disrespect for intellectual property rights. As regards quality, the deficiency in quality that has become to be associated with products from China, has created the perception that they are not safe, especially those products that are for direct consumption.

5.2. Openness of the Economy of China: History and Impact on Chinese products

The competitiveness of Chinese product, especially as regards the cheap prices at which such products are offered today, can be traced to reforms that were introduced in China. During 1949-1976 period, China followed the socialist, closed economy ideology, taught by Mao Zedong. All assets constituted the property of the state and decision making lay with the central government. With the death of Mao, his successor, Deng Xiao Ping instituted systematic change, by adopting a more flexible socialist system. Deng implemented reforms, by combining decentralization, providing incentives and economic openness. In the economy, reforms were implemented in all areas ranging from land in the agricultural sector, investment policy in the industrial sector, and other policies, which entailing enhancing the productivity of human resources in order to increase the efficiency of manpower, thereby boosting human capital (Vause, 1989).

The implementation of a system that emphasized reward for an individual, replacing communal reward system which has been in place since 1978, drastically increased productivity in Chinese agricultural sector. The new system characterized by individual reward/incentives in place of social/communal regards/incentives, helped to boost agricultural productivity during 1978-1984 period. A study carried out to examine change in productivity in the agricultural sector in China during 1978-1984 using the decomposition method, shows that institutional structural change constituted the main source of productivity in the sector (McMillan, et al., 1987).

The impact caused by ideological change on the Chinese economy is also confirmed by a study conducted by Park (1993), which examined the impact of openness in China on trade and investment in Asia Pacific region. According to Park, Chinese competitive edge begun when the country during Deng Xiaoping leadership said no to the “*self reliance mentality*”. Such awareness meant that China recognized the importance of international trade, foreign investment, and technological development, for country’s progress. In light of that, the policy of self reliance was transformed to become an *open economy*, with the main doctrines including: (1) meeting the *saving-investment gap* by attracting foreign investment, (2) inviting foreign managerial and technological knowhow from abroad, (3) increasing exports, and (4) increase productivity in the agricultural and industrial sectors. As regards the third doctrine, China did not rely all its hopes on its cheap labor, but the also made another step that involved the devaluation of the Yuan, which made Chinese products in foreign markets cheap and competitive. It is such policies that set the stage for Chinese manufactured products to dominate the international market.

Initially China produced labor intensive goods, by taking advantage of its immense labor resources. However, overtime China changed its orientation from relying on producing labor intensive products to high technology goods (Leininger, 2007).

Openness in China was bolstered by the country's entry into WTO. Some sources acknowledge, *China's WTO accession*, is responsible for the spectacular rise in productivity achieved by China (Ianchovichina and Terry Walmsley, 2005). By becoming a WTO member, China became a very efficient supplier thanks to the abolition of quotas and lowering of trade barriers among WTO member nations. This enabled the country to tap its cheap labor to derive benefits that WTO provided. In addition, becoming a WTO member, impacted positively on investment in China. Initially, China relied heavily on costly domestic investment to propel the its industrial development, and its accession to WTO made it possible for the country to tap cheap foreign investment funds from other WTO member nations. Such cheap investment funds enabled Chinese producers to lower the prices of their products. Another benefit that China derived from becoming a WTO member, was the agglomeration effect. . China, with its large population, was able to attract alot of investment which took advantage of the WTO large market. This promoted efficiency, as agglomeration induced economies of scale. Such a condition enabled China to carry out mass production , with attendant benefits in form of low prices.

China's shrewdness in taking advantage of globalization and economy openness, is as a result of a combination of political will, entrepreneurs, availability of natural resources and cheap labor. If compared withn England during the Industrial revolution, the competitive advantage China has lies in the political will. That said, China has been able to reap benefits that surpassed those achieved by England. This underscores the fact that political will constitutes the most important aspect responsible for causing the change that paved the way for achievements made by China (Heap, 2006).

5.3. Labor Advantage

It has been argued in earlier sections that cheap and productive labor is the main source of the competitive advantage that products from China have over those from other countries. Li (2001) shows that bassed on analysis of total faktor productivity (TFP), labor rather than technology, constitutes the main source of economic growth in China, as is the case with other developing countries. According to him, state owned enterprises dominate Industries in China. His analysis shows that technology has little influence on operations of state owned companies.

Closer analysis shows that labor productivty doesn't arise instantaneous, rather is a consequence of major changes in the system over time. In the context of state owned companies, according to Li (2001), competition has forced them to demand their workere to work even harder, thereby generating drastic achievements in production efficiency.

Besides, the government of China has implemented various policies tailored to promoting labor efficiency. One such policy entails the role of trade unions in supporting joint

venture companies. Trade union activities, among others included providing education to workers, on discipline and so on. Funds are allocated for workers' development to the tune of 2% of actual worker costs. The policy was based on the assumption that the success of joint ventures doesn't only rely on the macroenvironment but also management, including industrial relations. In light of that, the government of China, regulates trade unions to ensure that they focus on managing labor and labor relations (Nyaw, 1990).

Another policy implemented by the government of China, was on population, which indirectly impacts on the cost of labor and efficiency. Government of China imposes restrictions on the population movements/migration between regions, among cities, and between rural and urban areas (Henderson and, Chung-Chung Au,2002). Though, reasons for such a measure are not given explicitly, doubtless, such a policy undermines the efficiency generated by agglomeration. Various studies indicate that due to difficulties people in rural areas to move to other regions, surplus labor is common in rural areas. Surplus labor makes efficient agricultural production possible due to high labor productivity achieved during the 1980s. Employing an econometric analysis, Rozelle, et al. (1999) shows that rural to urban migration has significant negative influence on the productivity of the agricultural sector. Thus, if compensation in form of money transfer from urban to rural areas is made, rural-urban migration is found to lead to total labor productivity. In another study, Peng, et al (1997) shows that during 1990s, rural areas experiences a drastic increase in industrial productivity, which even outstripped national labor productivity. Such drastic labor productivity achievements was attributable to among other factors, rising capitalization in rural areas, higher education, and population migration policy playing a vital role.

In the backdrop of the foregoing, it is apparent that China has implemented various policies, which despite arousing criticism, have been able to promote labor productivity. At the industrial level, recent developments indicate inflation has depress the labor market due to the spate of incentives awarded to labor working in certain jobs/positions. Some of the jobs /positions that have received high incentives have included those working in fields of research and development (R&D), sales and marketing, and business development. Such an incentive system has been able to induce motivation from workers to increase the quality of their work , thereby product efficiency (Leininger, 2007).

At the macrolevel, worker productivity is also based on employee-company relations. Industrial relations in China, is different from that found in other countries in general, and developed nations in particular. Findings of a study conducted by Nelson and Reeder (1985) shows that employees in China have unique characteristics, among others include the fact that they are reluctant to move from one company to another as such a practice may be interpreted as inability of the respective employee to carry out his duties or in search on an easier job. Another important

thing is that Chinese workers show keen interest in carrying out their duties, concentrate on meticulous study of the tasks in question.

5.4. Investment policy and technological development

The efficiency achieved by Chinese products is not only attributable to labor competitiveness, but also investment policy. Investment policy in China supports and protects foreign investment. All systems such as worker remuneration, industrial relations, and workers' reward are tailored to promoting high productivity for the investor. The same applies to permission and bureaucracy, China has transformed then into such a way that they generate high efficiency for the benefit of efficient foreign investment. In the event of industrial disputes, resolution is often done through arbitration, which according to investors, is more efficient than using the court system/due process (Nyaw, 1990).

Investment policy is based on reforms that are tailored to attracting foreign investment in order to fill the savings-investment gap. Consequently, China the investment policy has brought substantial benefits to the economy (Whalley and Xin, 2006). In his elaboration, Whalley and Xin show that fantastic achievements in the area of economic growth in China are largely attributable to FDI. Besides, FDI has helped in boosting labor/worker productivity. During the last two years, FDI products contribute 20 percent of China's GDP.

Besides making significant contribution to the economy, FDI is responsible for providing a conducive investment environment that has attracted foreign investment in droves to China, as well as the mechanism through which technology transfer from abroad. One indicator that China has been successful in absorbing foreign technology through foreign investment, is the diversity of the products it produces (Brambilla, 2006). Using company level data drawn from the manufacturing sector, Brambilla shows that the performance of foreign companies in developing various products far surpasses that for domestic companies. The performance is measured by considering the reduction in average costs and increase in productivity over time, which attests to technological development. In theory, developments in the production of a diversity of products can be used as an indicator of technological development in a given country (Barro and Sala-i-Martin, 1995 p. 212).

Besides, foreign investment, another source of technology in China is the strong commitment of the Chinese government to that cause. As regards electronic products, China's electronics industry has become the strong foundation for the development of information technology. Electronics conglomerates have invested substantially in R&D in order to raise quality. For example "Great Wall Computer Group", which produces personal computers located in an outlying region, uses a variety of sources of funds which include company funds, central

government, regional government, and foreign investors, to develop its products (Simon, 1992). This example shows the strong commitment the Chinese government has to the development of industrial technology.

The government of China also shows strong commitment in promoting the saving culture among Chinese people. Recently, Chinese people on average save 40 percent of their incomes (Heap, 2006). If such strong saving culture is maintained, it is not surprising that in the foreseeable future China will no longer need foreign investment to bridge its savings-investment gap.

5.5. Prospects of Chinese products

Many sources raise doubts about the capacity of China to maintain its phenomenal economic development. Such doubts are based on possible political instability which poses a serious threat to China's political order, characterized by inconsistency and contradictions of decisions taken by top Chinese leadership. Besides, another source of worry is the structure of the Chinese economy which is dominated by state owned enterprises. The banking industry for instance, most banks in China are state enterprises. Management in such companies are by and large, representatives of political power interests who undoubtedly lack the requisite professionalism in bank management. In the event of high non performing loans, the government is compelled to undertake recapitalization, which is likely to undermine the banking system as well as send negative repercussions to the industrial sector (Whalley and Shunming Zhang, 2006).

The concern about the possibility of China staying the course Whalley points out are understandable. However, what must be taken into account are other factors that are likely to allay such fears which include transformation of the economy to a fully fledged market economy, advances made in government decentralization, advances in education, and continuous flow of investment and human capital development. Government commitment to elevate and boost the competitiveness of China, will undoubtedly guarantee that developments already achieved will be maintained in future (Fogel, 2006).

In study carried out by Ji Li et al. (2005) shows that ownership (between state and private) doesn't have any influence on the performance of a company. The finding strengthens the notion that state owned Chinese companies are moving towards professionalism. According to Ji Li, the findings have implications that there is need for caution as far as implementing reforms that entail increasing the role of the private sector since state ownership does not always lead to inefficiency.

Another source of doubt concerning the development of the economy of China are based on the rise in wages in China that averages 8 percent per year, higher than inflation which hovers

around 2 percent. This means that wage increase contributes significantly to inflation, which will undermine the competitiveness of labor in China in future. The argument seems to hold some water, however on closer observation it becomes apparent that not all wages/salaries experience high rises/increments. Wages that always are on the rise are those for certain jobs such as R&D, sales, and business development (Leininger, 2007). Such wage structure in China serve as sufficient incentives to ensure the sustainability of the competitive edge that Chinese products have as most human resources are attracted to R&D, sales and business development. This will also encourage employees to seek for higher education. Besides, some circles raises doubts as to whether wages in China today have already reached inefficiency levels. A study carried out by Parker (1999) shows that despite the fact that workers in China earn high wages, such wage levels are still within the efficient wage level limits because marginal product is higher than wages paid out to workers. In that light, if the scale of the company is increased, Chinese products have a high potential of achieving even higher efficiency levels.

A survey carried out by Tan and Richard Wellins (2006), confirms the notion that products from China will have even better prospects in future as they gain breakthroughs in competitiveness. The survey indicates that young managers in China, are more ambitious than young managers in the United States. They have strong ambition to make their country their best in the world through economic development. In light of that, products from China have high prospects of achieving ever greater inroads in competitiveness.

6. Study findings

The survey was conducted using a questionnaire. The questionnaire contains questions on the opinions/perception of 55 top executives of SMEs (top executive survey) drawn from various fields in Surakarta. Businesspersons who were included in the sample were drawn from textiles, garments, artisans, electronics, and so on. They comprise producer-processors, exporters, importers, and retailers. Besides the questionnaire, the survey also employed *focus group discussion* (FGD) and *interview* techniques to obtain perception and opinions of the business community. Those involved in FGDs and interviews included several businesspersons, especially association officials, such as the textile association, and chamber of commerce officials. In order to enhance the focus of the analysis, respondents were divided into three groups, which were those that use Chinese products as inputs (20), the category of competitors of Chinese products (21), and distributors of Chinese products (15).

6.1. Respondents Knowledge about China-made products

A survey of 54 respondents indicates that public knowledge about China-made products varies from one individual to another. According to respondents, a variety of China products is found in the Indonesian market, sold at cheap prices, but generally deficient in quality. The products are produced through process, on high demand, adequately innovative, and control a significant share of the market.

Compared with similar Indonesia-made products, 92 percent of respondents contend that products from China are sold at lower prices, and only 2 percent consider them more expensive. However, as regards quality, 51 percent of respondents contend that products from China are deficient in quality, and only 8 percent consider their quality better than Indonesian products. The same pattern is discernible with respect to reliability, with 62 percent of respondents perceiving products from China to be deficient as compared with Indonesia products, and only 2 percent considering them better. As regards the ease of servicing, 45 percent of respondents perceive products from China worse than those made in Indonesia, and 40 percent do not perceive any difference between the two types of products. Meanwhile, as pertains to availability, 58 percent of respondents do not perceive any difference between products from China and those made in Indonesia. In general, 73 percent of respondents perceive products from China to be cheap but deficient in quality, 20 percent consider them cheap and of good quality, and the remainder do not perceive any difference between products from China and Indonesia with respect to price and quality.

With the exception of price and quality, respondents in general perceive products from other countries to more or less the same as Indonesian products. Respondents' perception about the prices and quality of products from China borders on the extreme. However, no respondents' perceived products from China outshine products from other countries with respect to quality and reliability. As pertains ease of getting after sales services, 57 percent of respondents perceive products from China to fare poorly, 47 percent content they are more available, while 47 percent do not perceive any difference between products from China and those from other countries with regard to availability. In general, 83 percent of respondents perceive products from China to be cheaper but of poorer quality than those from other countries.

In accordance with type of products, 15 product types that are well known to the public which include vehicles, garments, textiles, electronics, child toys, work tools, construction materials, drugs and traditional medicine, cosmetics, foodstuffs, home appliances, artisans, an furniture. The main products that well known by the public include electronic products, automotives, and children toys. The products have become known post 1990s, though some

Chinese products such as traditional drugs and medicine have become household names since 1970s. Nonetheless, some Chinese products have become known only since early 2000s.

Survey results indicated that 36 percent of respondents have knowledge about products from China that are used as factors of production (inputs) in their enterprises, while 35 percent perceive them as competitor products, and 29 percent distributors.

6.2. China Products as Inputs

Survey results indicate that 45 percent of respondents who use Chinese products as inputs in production process consider them to be competitive in comparison with similar products (inputs), while 7.5 percent perceive them to have higher quality than similar products, and the remainder do not perceive any difference between China products used as inputs from other products used in inputs. Additionally, survey results show that 40 percent of respondents who perceive Chinese products that serve as inputs to better than inputs from other countries, give the cheap price as their main reason for such perception, 30 percent attribute the decision to availability, and the remainder cite quality, suitability with other equipments, and after sales services. In light of such findings, as pertaining to inputs, cheap prices constitute the underlying source of competitiveness of China products.

Businesspersons reap substantial earnings that are attributed to using Chinese inputs as opposed to other country inputs. Survey results indicate that 50 percent of respondents enjoy as high as 5-10 percent price difference, 40 percent cite price difference of 20 percent, and 5 percent of respondents suggest price difference of 30 percent and the remainder contend a price difference of 5 percent.

For businesspersons using Chinese inputs other than those from other countries, increases their profit margins. According to the survey, 68 percent of respondents acknowledge reaping a profit margin of as high as 5-10 percent, while 23 percent cited higher profits margins of 10 percent, and the remainder suggested profit margins to the tune of fewer than 5 percent. The above findings indicate that using cheap inputs from China enables businesspersons reap higher profit levels than would be the case if inputs from other countries were used. It is small wonder then that businesspersons decide to shift from using inputs produced in other countries to those made in China.

As regards compatibility, Chinese products are adequately compatible with other machinery/equipment. Survey of respondents shows that just 4 percent of respondents acknowledge the need for a total technology to use inputs from China, 8 percent suggest the need for a lot of modification/adjustment, and the remainder consider China inputs compatible, albeit with some little adjustments that are not fundamental. .

As pertaining to the distribution network of products, 50 percent of respondents acknowledge the fact that they buy such products from wholesalers, 32 percent from retailers, 9 percent from importers, and the remainder undertakes direct importing. With regard to the length of the distribution chain for China inputs, 50 percent perceive it to be just as the same as for inputs from other countries, 41 percent consider it shorter, and the remainder content it to be longer. These finding points to the short distribution chain as the factor that underlies the cheap price inputs from China cost compared with inputs from other countries. According to the survey, 73 percent of respondents perceive the short distribution chain associated with inputs from China to lower product price by 5-10 percent; 18 percent of respondents put the estimate to about 20 percent; 4 percent of respondents suggest 30 percent; and the remainder cite price difference of at most 5 percent.

Consequently, using inputs from China, enables 87 percent of respondents to predict expansion in the near future, while the remainder don't project any difference in growth in future relative to the rates they are able to achieve today. As regards the strategy to foster firm expansion, given the current level of revenues, 55 percent of respondents who use China inputs cite lowering prices, 18 percent suggest developing new production technology, and a similar percentage of respondents contend going for using the marketing strategy, while the remainder suggest enhancing their efficiency in distribution. Although respondents who are producers use inputs from China in their production processes, 32 percent perceive Chinese products to be a serious threat to selling them. According to the survey, 56 percent of producers opt for quality enhancement as the strategy to compete with Chinese products, and the remainder use marketing strategy, taking the form of lowering product prices as well as others. Competing on quality as strategy makes a lot of sense since the public perceives products from China to be deficient in quality.

6.3. China Product as Competitors

For respondents who are producers, for whom products from China constitute a threat to their products, 65 percent of them perceive products from China to be more competitive than their products, 30 percent perceive products from China as similar to others in the market, and the remainders consider such products to lack competitiveness. For respondents who perceive products from China as more competitive, which they attribute to three factors: quality, price, and ease of availability. Another factor that contributes to competitiveness is after sales service, suitability with complementary goods, and the design.

Some Chinese products are more competitive those similar product-types from other countries. An instance was given by a printed Batik textile businessperson, who acknowledged

that Imports from China have higher quality, cloth is broader , and the price offered is lower. One of the obstacles the above respondent has been facing is the difficult task of having to sew two pieces of cloth to make one bed sheet. Using cloth from China enables the tailors to avoid that problem since they are generally of larger breadth. Form just one dimension of breadth, China imported textiles adversely affect his output. According to him, there is host of other dimensions of Chinese textiles that affect severely on his output/revenue.

To respondents' reckoning, entrance of products from China commenced in 1997, picking up pace in 2003. The direct impact from the influx of Chinese products for 88 percent of respondents was a drop in the profit margin, while the remaining percentage of respondents did not experience any change. From the vantage point of production, 63 percent of respondents acknowledged experiencing lower production , while the rest registered no change. This effect is not only limited to the domestic market but also on the World market (destination of exports). Survey results indicate that 58 percent of respondents contend the reality that China products have intensified competition while the remainder contend having to deal with modest competition.

The influx of Chinese imports has led to a drastic decrease in output and revenues of the craft industry. This is due to the difficulties businesspersons in the industry face in competing with products from China in export markets. Consequently, sales revenues have dropped in the range of 20-30 percent. Factors responsible for low competitiveness of their products are many and complex, ranging from technology, to government policy, all of which point to efficiency related issues. According to the respondents, producers in China already producer the machines they use in production processes, enabling them to reduce production cost. On the contrary, Indonesian producers still import machines they use in their craftwork at 4 to 5 times as much . The same can be said to apply to attitude and policy of the government of Indonesia in fostering Indonesian products in export markets, which is in stark contrast to that pursued by the peoples Republic of China. According to experiences of respondents, Ambassadors and consulates of the Government of China in foreign countries often seek markets for export products of their nationals, which is not the case with Indonesian ambassadors and consulates in foreign countries.

Respondents adopt various strategies to remain competitive or survive in the markets. Three main strategies businesspersons use include enhancing internal efficiency, lower prices, and improve raw materials management, and production processes. The other strategy businesspersons often use is enhancing marketing, after sales services, packaging, improve distribution, increase production levels, and design development. Survey findings show that 84 percent of respondents improve production process and efficiency through technology development, while the rest use the same technology (do not institute any changes in technology they use).

As pertains to customers, 59 percent of respondents perceive their customer base to be sufficiently loyal, 18 percent consider it very loyal, while the rest regard it not that loyal. Survey findings show that 57 percent of producers who served as respondents in this survey, deliver their goods through a relatively long distribution network, 13 percent do so using a very long distribution chain, and the rest use a short one. Meanwhile, 46 percent of respondents consider products from China use a short distribution chain to reach customers, 42 percent perceive it as relatively long, and the rest use a long one. Thus, this finding unravels the possibility that difference between the distribution used by products from China and those employed by Indonesia products may be a key source of the higher competitiveness of the former over the latter. This is likely the case because the shorter the distribution chain, the lower the cost of production, hence lowers retail prices. As regards raw materials procurement, 58 percent of respondents (businesspersons) buy their material requirements directly from producers, and the rest obtain their materials from wholesalers. Concerning the procurements of the raw materials, 50 percent of respondents use short distribution chain, 33 percent employ a sufficiently long one, and the rest a very long distribution chain.

6.4. Distributors of Products from China.

Serving as distributors of products from China, respondents deal in a variety of products that include automotives/vehicles, electronics, textiles, garments, household appliances, foodstuffs, artisan work, furniture, steel, and children toys. Product distribution relatively follows a normal distribution. However, most producers deal in electronics and textiles. Survey findings show that 53 percent of respondents are retailers, 13 percent agents, and the rest distributors. They commenced their product distribution work after 2000.

Survey results show further that 20 percent of respondents were initially producers, who on failure to compete decided to become distributors. According to information obtained from one of the officials of the Surakarta chapter of the Indonesian textiles Association, it is hard for textile industry and products to compete with products from China. It is such condition that drives many businesspersons, especially small scale, who was initially producers to become distributors. In fact its is technical factors and moral responsibility to employees, are the two main factors that continue to keep many medium and large enterprises operating. For them, regardless of the obstacles, they have to continue operating, although it is hard to see how they can go on for long, under such circumstances. Hence, unless there is change in the prevailing conditions, there is no shadow of doubt that all businesspersons will exactly do what small scale producers have done.

As regards products they distribute, 92 percent contend that distribution chain they use in handing products from China is relatively short, while the rest perceive long. In distributing

products from China, businesspersons provide value added in the form of packaging, sorting, and after sales services. Survey results indicate that 82 percent of distributors, employ product standardization determined by principals in distributing products from China, while the rest contend that there is no product standardization.

From the perspective of profit level, 55 percent of respondents / distributors are pleased to be distributors of products from China because they are more profitable, and 45 percent do not perceive any difference in profitability related to their handling such products. According to 70 percent of distributors of products from China, competitiveness of such products is attributable to low prices, and the rest suggest many customers.

As pertaining the size of the profit margin at each distribution level, 50 percent of respondents state the figure of 5-10 percent, 40 percent cite the margin to be above 10 percent, the rest contend it to be under 5 percent. Meanwhile, concerning their involvement in after sales services, 30 percent of distributors perceive the role they play to be high, 50 percent consider it to low, and 20 percent state the fact that they do not play any such roles.

7. Conclusion and Advice

Observations and analysis made in earlier sections, lead to the following conclusion:

1. Basing on literature review competitiveness achieved by products from China is driven or strongly associated with the strong commitment and strategy adopted by the government of China in developing its economy. Such commitment is manifested in government of China policy on raising worker productivity through changing the reward system, and increasing the value of human investment; population policy; policy on facilitating foreign investment; policy on technology development, reforms and decentralization of the decision making system; reforms in state owned enterprises (SOEs); and bureaucratic reforms which have improved the competitiveness of Chinese products. Technological developments, high quality of employees and management, and investment, are likely to increase the prospects of Chinese products in the international market.
2. The perception of SME businessmen in Surakarta about the influx of Chinese products does not differ from that discernible in general public, which consider products from China to be cheap, but deficient in quality compared with products produced by producers in Indonesia as well as imported from other countries besides China. In light of that, producers of high quality goods are not at all bothered by the influx of Chinese products. However, textiles and textile products face very stiff competition from Chinese products both in the domestic and export markets.

3. SME businessmen have a good knowledge of various imports of Chinese products ranging from traditional drugs, child toys, electronics, textiles, to construction materials and tools. Businessmen are also aware of the fact that the variety of products from China imported into Indonesia will rise.
4. As inputs, products from China add substantially to profit margins earned by Businessmen, which is why many local producers have switched their input suppliers from domestic to Chinese imports. This is also coupled with the high compatibility of Chinese inputs with technology and equipment producers use in their production processes.
5. For businesspersons dealing in products that competing with Chinese products, they are not only hard pressed in the domestic market, but also in the foreign market. The pressure on such businessmen is attributed to falling profit margins, with some exporters facing stagnation and possible bankruptcy. Another impact caused by Chinese products, which is very vital, is the decision by some businessmen to change their roles from producers of products to distributors of Chinese imports. Such a change has been driven by their failure to compete with imports from China.
6. Distributors of products from China acknowledge the fact that dealing in Chinese imports entails a short distribution chain compared to channels followed by products produced in other countries. Distributors have keen interest in dealing in Chinese imports due to the high profit margins they earn on their sales compared with products produced in other countries.
7. For businessmen facing competition from products from China, they consider the competitive edge such products have in international markets, including Indonesia, to lie in the strong support the government of China gives to Chinese exporters, which involves, among other services, assistance by Chinese embassies abroad.

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