

# CHALLENGE FOR ASEAN-CHINA FREE TRADE AGREEMENT ON INDONESIA EMPLOYMENT

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## Abstract

This research analyzes the challenges for Indonesian economy towards the implementation of ASEAN-China Free Trade Area (ACFTA) especially on employment opportunity in Indonesia. Using regression technique, the labour cost and change in fix capital are statistically significant in influencing the employment opportunity. This result implies that ACFTA will challenge the Indonesian competitiveness due to increasing labour cost, while ACFTA also potentially increases capital flow from China which has ambiguous impacts on labour absorption. The SWOT (Strength, Weakness, Opportunity and Threat) analysis recommends for Indonesian government to improve comprehensive strategy of national industry to be more competitive to China products.

**Keywords:** ACFTA, employment opportunity, structural equation model

**JEL classification numbers:** F13, F14, F15, F42

## INTRODUCTION

The economic world has been moving towards higher economic relations across nations. It is characterized, among others, by the presence of various free trade agreements across countries both regionally and internationally. All seek to create more intensive international and regional trades. The economic conditions of the open and free world will open business opportunities and a wider range of exports. This will stimulate the direction of regular trading towards globalization of trade.

Various forms of international cooperation are undertaken to respond to such globalization in increasing market penetration capability. The establishment of free trade zone (Free Trade Agreement - FTA) is often seen as an effort to improve mutual market access among participants. The trend of cooperation reflects the desire of each country to manage national resources and regional affairs collectively. One form

of free trade agreements are the ASEAN China Free Trade Agreement or abbreviated ACFTA.

The spirit of ACFTA agreement is to develop the expansion of economic and political relations between the two parties. Objective conditions indicate that there has been a lot of estrangement occurred between ASEAN countries and China in the affairs of the economy lately. Even before the implementation of the initial phase of ACFTA, business in Southeast Asia will likely complain of agricultural and industrial flood of cheaper products from China to this region. ASEAN's competitiveness is being challenged by China's ability to produce cheaper manufactured products to the world market. There is no doubt that ASEAN needs to get closer to China. A closer partnership between the two parties will certainly bring prosperity and greater stability in East Asia.

ASEAN-China economic cooperation is expected to improve the welfare of

the people in their respective countries. In order to realize that it was agreed to reduce trade barriers so as to create lower-cost trading. In addition, it was also agreed to increase intraregional trade and investment and improve economic efficiency. One step to achieve is by the progressive elimination of tariff and non-tariff barriers to trade in all goods. Liberalization of trade in goods and services will progressively cover all substantial sectors.

The purpose of these agreements according to article ACFTA 1(b) of the Framework Agreement, is not only to strengthen and expand economic cooperation, trade and investment, but it also progressively liberalize and promote trade in goods and services, as well as create a transparent investment regime, liberal, and facilitative. Article 1(c) of the agreement also states that both parties exploit new areas and develop appropriate measures to strengthen economic cooperation. It certainly is an issue that needs to be monitored on a sustainable basis.

The process of tariff reduction under these agreements can be divided into three categories: (1) Early Harvest Programme (EHP), (2) normal path, and (3) Sensitive Track. Under the EHP, each ASEAN country are given the freedom to do the initial bilateral trade with China in five areas, such as agriculture, information technology, human resource development, investment and development of the Mekong region, if they can afford. One unique feature of EHP is China agreed to give unilateral concessions on 130 agricultural products and manufacturing to ASEAN member countries that fail to benefit from this mechanism. ASEAN countries are subsequently allowed to export their products with a lower tariff rates in order to obtain benefit from EHP (CSIS, 1997).

Instead of ASEAN agreed to provide tariff concessions on 600 products that enter the category code Harmonised System (HS), Chapter 01-08 (including live

animals, meat, vegetables, fruits and nuts), are mostly agricultural products that have been liberalization of China's target. However, a number of other agricultural products such as rice, is not included in the scheme because of its sensitivity EHP products in ASEAN countries. A number of provisions under this scheme also provides an opportunity for ASEAN countries to accelerate their tariff reduction process with China, although it should be done in bilateral such as the Agreement on Accelerating the Elimination of Tariffs between China and Thailand which determines the two countries to remove tariff for all products of vegetables and fruits to 0 percent beginning January 1, 2006.

Meanwhile, products that do not enter into the scheme EHP should be incorporated into the normal path. For ASEAN-6 and China, tariff rates will gradually be reduced or eliminated between January 1, 2005 and 2010, while for the new member countries of ASEAN are given the opportunity until 2015. In 2009, all products with initial rates between 10 to above 20 percent should be lowered to 5 percent, while products with initial tariff below 10 percent should be lowered to 0 percent. In 2010, all products in this category should be fully exempted from tariff. Furthermore, products that fall into categories of sensitive tariffs can be lowered in accordance with the extent and time frame agreed upon between both parties.

For Indonesia, the implementation of EHP is an initial phase arranged in two official documents. First is the Minister of Finance Decree No. 355/KMK.01/2004 on Import Tariff Provisions of the EHP-ACFTA, and second, the Minister of Finance Decree. 356/KMK.01/2004 on tariff provisions under the EHP-ACFTA. The EHP Agreement of Indonesia-China determines that the tariff reduction measures should be enforced starting January 1, 2004 to 2006, when all the products that fall into the category EHP will be reduced to 0 per-

cent. In general, a total of 530 listed products into the ASEAN-China EHP and 47 registered products are included into the Indonesia-China EHP.

It is difficult for Indonesia to reject the free trade agreement. Denial will only make Indonesia isolated from the stage of regional trade. On the other hands, rejected ACFTA will not automatically create a strong domestic economy. Without receiving any ACFTA, Indonesia would be flooded by imported products from China, which enter through the other ASEAN countries, which previously had been tied to regional cooperation.

ACFTA is an opportunity for Indonesia to expand export markets for Indonesian products that have a competitive edge. This is indicated by the value of Indonesian exports to China in 2009 experienced an increase that is exceeded 30 million U.S. dollars. While the value of Indonesian exports to the U.S. and Japan decreased.

Meanwhile, when Indonesia was involved in ACFTA, it is also not without problems. Indonesia, with 230 million inhabitants, is a huge market for Chinese commodities and products. Before ACFTA were implemented, various products from China have flooded the domestic market in Indonesia. Many Indonesian commodities and products are difficult to compete with products imported from China.

However, the government had declared that the government was ready to face free trade ACFTA. The Government considers that Indonesia will get a big advantage in free trade. This confidence will provide benefits based on Indonesia's position as a major player in the free trade in the ASEAN region and supported by the election of Indonesia as a member of the G21. When Indonesia withdrew from the ACFTA, the opportunity will be taken to other ASEAN member countries, especially Malaysia and Singapore. Moreover, when the global financial crisis hit the world,

there were only three countries that experienced positive growth, namely Indonesia, China, and India.

Scepticism is shown by instalments parties and widespread demonstrations against the implementation of the agreement ACFTA. The main themes raised is that Indonesian business that is the majority of SMEs (Small Medium Micro Enterprises) is not yet ready for a fight with China. Without it, products of China, both legal and illegal have been flooding the Indonesian market. Indonesia-China trade balance was deficit since 2008, although in previous years was always a surplus. Indonesia's export to China was amounted to USD 11.6 billion, while Imports from China to Indonesia reached USD 15.2 billion in 2008. Data from January to September 2009, the Indonesia-China trade deficit reached USD 1.7 billion due to Indonesia's exports was lower than imports from China. This is just proof that Indonesian products dropped because invasion of Chinese products which are cheaper prices and huge quantities.

The full implementation of ACFTA in 2010 it is disastrous for industries that have been relying on the domestic market for their products. Industry in particular micro, small and medium enterprises (MSMEs) in the country which rely on the local market will not compete with products from China flooding the Indonesia market.

Indonesia's international trade has been increasing in recent years, both in terms of exports and imports. Export growth continues to increase, because the government has been clean for international trade issues. An increase in exports this can be construed as an indication of the readiness of Indonesia in the face of free trade. Based on data from BPS (2009) Indonesia's trade balance from 2004 until 2008 in both import and export value had an increase, but from the side of the balance of trade balance from 2006 to 2008 has decreased.

**Table 1:** Outstanding Balance of Trade of Indonesia and ASEAN Countries and China (USDm million)

Year	Position	Indonesia	Philippines	Thailand	Vietnam	China
2004	M	46,525.0	42,345.0	94,410.0	31,969.0	561,229.0
	X	71,585.0	39,680.0	96,248.0	26,485.0	593,326.0
	B	25,060.0	(2,664.0)	1,838.0	(5,484.0)	32,097.0
2005	M	57,701.0	46,963.0	118,158.0	36,978.0	659,953.0
	X	85,660.0	39,879.0	110,178.0	32,442.0	761,953.0
	B	27,959.0	(7,084.0)	(7,980.0)	(4,536.0)	102,000.0
2006	M	61,066.0	54,077.0	128,654.0	44,410.0	791,605.0
	X	100,799.0	47,413.0	130,795.0	39,605.0	969,380.0
	B	39,733.0	(6,665.0)	2,142.0	(4,805.0)	177,775.0
2007	M	74,473.0	57,708.0	140,812.0	60,869.0	956,284.0
	X	114,101.0	50,270.0	153,092.0	48,302.0	1,217,815.0
	B	39,628.0	(7,438.0)	12,680.0	12,567.0	261,531.0
2008	M	129,197.0	42,699.0	167,447.0	73,893.0	984,789.0
	X	137,020.0	34,396.0	161,261.0	56,038.0	1,202,617.0
	B	7,823.0	(8,304.0)	(6,183.0)	(17,855.0)	217,828.0

Source: Bureau of Statistics Centre, Jakarta, 2009.

**Table 2:** Ranking of International Competitiveness and Position Statements based on Asia World Economic Forum (WEF)

Rankings - Global Competitiveness Index 2008-2009		
Country/Economy	Rank	Score
<a href="#">Singapore</a>	5	5.53
<a href="#">Japan</a>	9	5.38
<a href="#">Hong Kong SAR</a>	11	5.33
<a href="#">Korea, Rep.</a>	13	5.28
<a href="#">Taiwan, China</a>	17	5.22
<a href="#">Australia</a>	18	5.20
<a href="#">Malaysia</a>	21	5.04
<a href="#">New Zealand</a>	24	4.93
<a href="#">China</a>	30	4.70
<a href="#">Thailand</a>	34	4.60
<a href="#">Brunei Darussalam</a>	39	4.54
<a href="#">India</a>	50	4.33
<a href="#">Indonesia</a>	55	4.25
<a href="#">Vietnam</a>	70	4.10
<a href="#">Philippines</a>	71	4.09
<a href="#">Sri Lanka</a>	77	4.02
<a href="#">Mongolia</a>	100	3.65
<a href="#">Pakistan</a>	101	3.65
<a href="#">Cambodia</a>	109	3.53
<a href="#">Bangladesh</a>	111	3.51
<a href="#">Nepal</a>	126	3.37
<a href="#">Timor-Leste</a>	129	3.15

Source: World Competitiveness Yearbook, 2009.

Based on Table 1 it can be seen the Outstanding Balance of Trade of Indonesia compared to China and three other ASEAN countries from the years 2004-2008. Compared to China, the position of Indonesia's trade balance is still far behind. However compared to the Philippines, Thailand and Vietnam, Indonesia's trade balance position is still better. Furthermore, the level of readiness can be seen from the international competitiveness of Indonesia's economy in the ranking of economic competitiveness report issued by the World Economic Forum. The rank was number 55 of 117 countries in the world (Table 2).

Based on the assessment of the Global Competitiveness Index 2008, Indonesia is ranked 55th of 131 countries, while better positions are held by Singapore (5), Japan (9), Malaysia (21) and Thailand (34). The assessment is also decreased when compared with the position in 2007 which was ranked 54th. Indonesia's economic competitiveness also shows the competitiveness of Indonesian export products in international markets, which became a key measure of the readiness of Indonesian products to compete with other countries. The low ranking of global competitiveness Indonesia reflects the low capacity of Indonesian industry in global competition as well as lack of confidence in the international market of quality products from Indonesia. For example, America with the highest global competitiveness penetrates markets in almost all the world. So far there are several factors that pointed to factors that affect the poor competitiveness of Indonesia, such as political instability and the law, distorting the market (monopoly power and corruption), unfair business practices, quality human resources, bureaucracy, infrastructure and technology.

In terms of employment, labour productivity levels Indonesia is still lower compared with Singapore, Malaysia, Thailand and China. Based on the ILO report in 2007 the average growth ratio of output per worker

from the year 1995-2005, for Indonesia was only 1%, while Singapore 2.1%, Malaysia 1.8%, Thailand 1.6%, and China at 6, 6%.

The conditions of import, export, investment and labour productivity will affect the position of economic growth in every country that depends on ACFTA. Indonesia's economic growth in 2007 was 5.7%, Malaysia 6.3%, Thailand 4.9%, Singapore 7.8%, and China 13%. The existence of a global crisis of 2008 resulted in lower economic growth in those countries in the world. Based on the average economic growth per quarter in 2008, Indonesia's economic growth was at 6.0%, Malaysia 4.55%, Thailand 2.75%, Singapore 1.08% and China amounted to 9.13% (Bank Indonesia, 2009). This condition means that in a stable global economic conditions Indonesia economic growth is still lower compared with Singapore, Malaysia and China.

Nevertheless, Indonesia's economy was relatively able to withstand the global economic crisis hit the world compared to countries other ASEAN, but it is still far behind to China. China, viewed from several economic indicators experienced a positive development compared to ASEAN countries. Therefore, the presence of non-tariff free trade agreement between ASEAN countries and China, which became effective this year 2010, the countries of ASEAN countries including Indonesia, should prepare their competitiveness capability for such agreements so that have a positive impact on economic growth and welfare.

The low competitiveness of Indonesian products compared to China led to the sale of Indonesian products is lower than China. This has implications for workforce reductions in Indonesia or in other words, the unemployment rate in Indonesia is experiencing increase. Based on this phenomenon, it is urgently to evaluate the challenge of CAFTA implementation on the employment opportunity in Indonesia. What employment policies are undertaken

by governments in the anticipated implementation of the ACFTA agreement?

## METHODS

The methods used in this analysis are statistical inferences, linear multiple regressions, and SWOT analysis. The first method is to observe the pattern of employment growth prior to the implementation of CAFTA in January 2010. While the second method is to evaluate the government policy to anticipate the ACFTA impact for Indonesian economy.

As mentioned, growth of manpower absorption is denoted by  $Y$ . As explanatory variables are labour costs, changes in stock of capital, total cost, inflation, exchange rate (USD/IDR), exchange rate (Yuan/IDR), GDP at market price, trade accounts between Indonesia and China which are denoted by  $X_1$ ,  $X_2$ ,  $X_3$ ,  $X_4$ ,  $X_5$ ,  $X_6$ ,  $X_7$ , and  $X_8$ , respectively. The regression equation can be written as

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + e \quad (1)$$

where:

$Y$  is growth of manpower absorption,

$X_1$  is labour cost,

$X_2$  is changes in fixed capital,

$X_3$  is total cost,

$X_4$  is inflation,

$X_5$  is exchange rate (USD/IDR),

$X_6$  is exchange rate (Yuan/IDR),

$X_7$  is GDP at market price,

$X_8$  is trade account,

$e$  is error terms,

$\beta_0$  is constant,

$\beta_{1-8}$  are regression coefficients.

The OLS method is based on classical linear assumptions (Ananta, 1987, pp. 11). The assumptions are as follows zero mean of errors, homoscedasticity or constant variance of errors, no autocorrelation across errors, no multicollinearity or no correlation among independent variables, and normal distribution of errors.

## RESULTS DISCUSSION

The regression estimation result is presented as below:

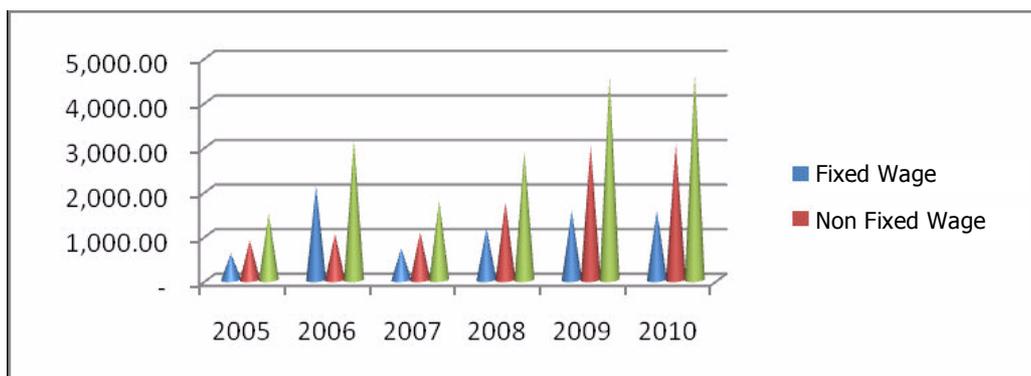
$$Y = 685531.198 - 2.474 X_1 + 15.266 X_2 \\ \quad \quad \quad (-2.41)^* \quad (2.93)^* \\ + 0.977 X_3 - 1995.241 X_4 + 38.904 X_5 \\ \quad \quad \quad (1.13) \quad (-1.60) \quad (0.32) \\ -560.682 X_6 - 581 X_7 - 0.00004727 X_8 \\ \quad \quad \quad (-0.51) \quad (0.60) \quad (-0.011)$$

where \* denotes significant at 5% level.

Based on the joint test of hypothesis it is known that independent variables- labour costs, changes in fixed capital, input costs, inflation, exchange rate USD/INR, the rates Yuan/USD, GDP at market price, and trade accounts are jointly significant in influencing the simultaneous employment growth. The value of F statistics is 2.590 which is significant at 5% level.

Partially, labour costs have a significant impact on employment growth. One unit increase on labour costs will reduce on employment opportunity by 2.47 units. This condition indicates that the higher labour costs in manufacturing industry will lead to decreasing employment growth.

That condition is dilemmatic. In order to compete with Chinese imported product it is necessary for the labour for having competence, skill or speciality with higher standards. However, this requirement will highly likely to increase labour costs because labour is more specialized (Robocka and Simmond, 1998). In fact, the current Indonesian labour cost is increasing (Figure 1). To some extent, this trend will have its own problem to the competitiveness of Indonesian products. On the other hands, it is very well known that very cheap labour in China contributes their competitiveness significantly. The challenge for government of Indonesia is how to maintain the competitiveness while still keep the welfare of the workers.



Source: Bureau of Statistics Centre, various years.

**Figure 1:** Labour Cost Year 2005-2010

The higher competition from China products would threaten local industries due to cheaper prices. The next impact will trigger a rising wave of layoffs. Industry, particularly small and medium enterprises (SMEs) in the country relying on the local market will be unable to compete with products from China are flooding the market in Indonesia. On the other hands, the infrastructure and government support is still very minimal as frequently blackouts and expensive tariff of electricity. Government does not seriously maintain and improve the real sectors which are dominated by SMEs.

The textile industry is one sector that is threatened because the local producers occupy only 22 percent of the textile market, while 78 percent is imported textile. The threat of layoffs from textile is as many as 1.2 million people. In total economy, the number of laid-off is expected to reach 7.5 million people.

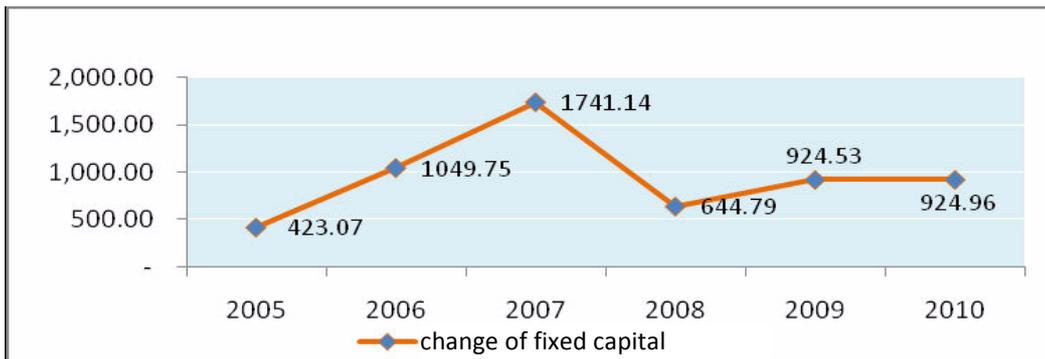
The Manpower and Transmigration Office of East Java recorded until late March 2010, as many as 872 workers were laid off due to impact of implementation of the China-ASEAN Free Trade Agreement (CAFTA) as of January 1, 2010. This number comes from 29 companies in East Java. While the employment opportunities was not significantly growing during five years prior to ACFTA (Figure 2), then the implementation of this agreement will seriously threaten the Indonesian workers.

Change in fixed capital also has a significant impact on employment growth where a unit increase on change of fixed capital will raise in employment growth amounted to 15.266 units. This condition indicates that the change in capital is conducive for industrial grow. The growth of capital will be accompanied by the employment opportunity because of higher production capacity.



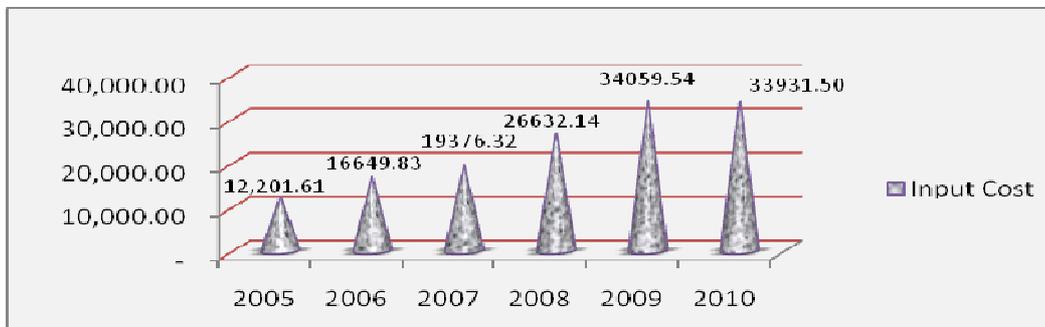
Source: Bureau of Statistics Centre, various years.

**Figure 2:** Employment Opportunities



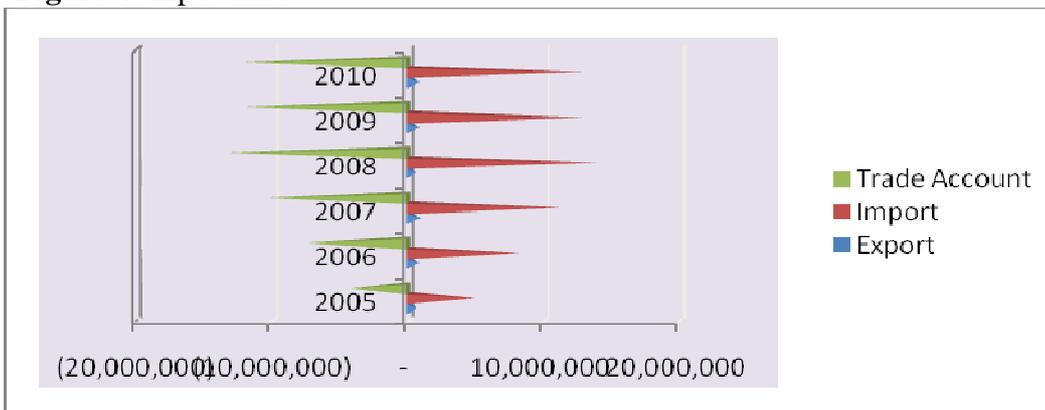
Source: Bureau of Statistics Centre, various years.

**Figure 3:** Changes in Fixed Capital



Source: Bureau of Statistics Centre, various years.

**Figure 4:** Input Cost



Source: Bureau of Statistics Centre, various years.

**Figure 5:** Trade Accounts Indonesia China Year 2005-2010

The ACFTA has already opened the crane of import from China including the import of much cheaper capital goods. There is a positive trend of the change of fixed capital prior to ACFTA (Figure 3). This has two possibility impact for job op-

portunity. If the fixed capital import is considered as new investment, then it can generate more labours. In contrast, the further impact of increasing fixed capital is leading to capital intensive industry that might require fewer labours. Due to an increase of

imports from China, the demand of the Yuan is greater than supply so that resulted in appreciation of Yuan and an increase in inflation which in turn decreasing purchasing power. It might cause workers demand for higher wages so the labour cost probably rises (Mankiw, 2004). The trend of total cost of production is increasing (Figure 4), so the ACFTA will potentially contribute to this increase. For this reason, the government must improve the industrial competitiveness to enhance national production that will increase the GDP for providing more opportunity of employment.

On the other hands, total cost of production factors does not have a significant impact on employment growth prior to ACFTA. The impact is very small which is only 0.99. The positive direction explains that any increase in the cost of production might indicate the expanding production activities. This in turn would create job opportunities of this industry. Meanwhile the inflation has also no significant effect on employment growth.

Exchange Rate (USD/IDR) is not significant in influencing the employment growth but has a positive direction. This means that if rupiah is depreciating then that the market will reduce imports and encourage exports. The rise in export can promote domestic industry which in turn it will provide new jobs in the economy. Similar to USD/IDR, the Yuan/IDR, GDP at market prices, and Trade Account also do not have significant effect on employment growth. Trade Account has negative direction which means that Indonesia has been long time as net importer of China product. The higher the net imports, the smaller employment growth will be.

Indonesia's trade account to China from 2005 until April 2010 was deficit. In the early ACFTA in January 2010, Indonesia deficit was US\$ 451.46 thousand (Figure 5). It shows that Indonesia import was getting increase while the export was relatively constant. The implementation of the

ASEAN-China Free Trade Agreement (ACFTA) will threat the sustainability of domestic market-based industries due to the final tariff from China to ASEAN become to zero percent.

### SWOT Analysis

The Indonesian government believes that the ACFTA will bring benefits, based on Indonesia's position as a major player in the free trade in the ASEAN region. The government has tried to accommodate all interests in the ASEAN-China discussion table and helped to overcome the difficulties number of products which can not compete with Chinese products. The government also provide some policies to improve the competitiveness of the industries like lowering bank interest which is currently considered to be very high, 15 percent. In addition, the enactment of tax rate for business people also need to be considered so as not to incriminate them in exporting their products (Moerjono, 1997).

Improving competitiveness is not only important for the sustainability of export, but it will also be able to maintain employment, moreover for the SMEs who become a buffer in the national economy (Rosser and Rosser, 1997). In the industrialization, it needs a comprehensive strategy to tackle unemployment through the creation of small and medium industries. Trade liberalization would only benefit the people of Indonesia, if large, medium, and small industries are able to compete in domestic and international market. In fact, the government have not been has a clear strategy and direction to protect domestic industries.

The government had negotiated to postpone some sectors from the implementation of free trade. The national industries proposed government to renegotiate 228 tariffs in ASEAN-China Free Trade. They really concerned about competitiveness impact of ACFTA fully implemented since January 1, 2010. Even though the negotiation was fail, at least there were numerous

efforts by the government to follow up the national industries concerns.

Asean-China Free Trade Agreement (ACFTA) has begun gradually since the year 2004 and enforced in a total of 1 January 2010. What about the readiness of Indonesia to face these conditions, can be seen from the following factors:

### **External (Opportunity, Threat)**

#### ***Chance***

The main reason for doing free trade agreement with China is China's population reaches 1.2 billion people, compared with the population of ASEAN countries which only reached 500 million people. The Indonesian government saw a big opportunity by the cooperation with China. Indonesia is rich in natural resources which potentially it will be a large increase for national income.

In the agreement China promised to accelerate is more balanced and mutually beneficial the growth of trade, but it also agreed to improve competitiveness, such as encourage investment, infrastructure development, credit facilities and other cooperation. This is the opportunities that are expected to benefit for Indonesia.

#### ***Threat***

After ACFTA was applied in total since January 1, 2010, invasion of low-cost Chinese products began to worry for employers Indonesia. One of the competadvantages of China is capable of producing goods and services that consumers demand cheap and Indonesia. We can see over the last invasion of Chinese products which are successful in Indonesia because it has many good choices of price, quality or quantity. However it brings competition to the local producer. The impact can potentially be serious unless Indonesia can cope the competitiveness problem.

China has the advantages resulting from government policies seeking to gain a

big advantage in trade with ASEAN countries bounded in ACFTA. In addition, the Chinese Government tried to place China as provider or producer of all the necessary input of industry. It is ranging from easy and quick business permits, supporting infrastructure, and availability of electric power. In 2007, China had opened new road which totals is 3.57 million kilometres. As for the port, China has at least 3800 freight ports, 300 of them to receive the ship capacity up to 10,000 megatons. To solve the electricity problem, China was reportedly going to operate the world's largest hydro power plant that can produce electricity at 84.7 trillion Kwh.

China government also persuade scholars who are abroad as well as professionals, especially those who worked in research centres of technology throughout the world, to go home. They are offered to open a new company in China. Of course, the persuasion is done by the lure of convenience and facility to start a business, such as tax incentives, ease of licensing, and capital injections. The China labour market reform started in 1980s resulted more efficient labour market (Santoso, 2010)

Research conducted by the Institute of Management Faculty of Economics, University of Indonesia shows that exports of small and medium enterprises (SMEs) is carried out without the branding. This makes the SMEs simply as units of production, while the labelling is done in other countries and to be sold more expensive. The Indonesian SMEs have lost large potential benefits due to unprepared for branding. Positioning of Indonesia's export products can no longer as a producer of low-cost and low-priced products. The existence of ACFTA makes that positioning was taken by China's products. There should be a grand-national strategy to re-map and analyze the competitiveness of each national export products.

## **Internal (Weakness and Strength)**

### ***Excellence Indonesia***

One of reasons why Indonesian government made an agreement of cooperation with China is the consideration that Indonesia is rich in natural raw materials that could be one source of Indonesian competitiveness. One example is batik. When compared with Chinese batik, Indonesian batik has its own advantages and higher quality of material as well as representing rich cultural diversity of Indonesia. It makes batik Indonesia remains an option although slightly more expensive price.

### ***Weakness***

The low quality of human resources must be supported by technology and human resource development. It is required to support the creation of value chains or linkages both backward and forward, and inter-linkages between the domestic industries.

Indonesia still faces a number of fundamental problems, both at macro and micro industries level, as well as poor infrastructure. It threatens the economic integration process in the country that could not be achieved efficiently. In terms of production and economic integration, there are fundamental weaknesses in the production capacity of final goods, semi-final and component indicating the fragility of the domestic industry structure.

### **Government Challenges**

The government saw long term opportunity generated from China's huge population. However, Indonesia is still facing the threat of Chinese superiority that can produce goods at lower cost. In order for Indonesia to win the competition with China after ACFTA, government must work to improve the competitiveness of national industries. The government should utilize the advantages owned by Indonesia, and process them into one superior product that can

compete both in the domestic market as well as in China, or the market that can not be met by China. Beside batik, one example is coal. China is an Indonesian coal consumer. If the coal is handled and processed properly before they are sold, this will give a big advantage for Indonesia.

Improving competitiveness is not only important for the sustainability of export, but it will be able to maintain employment level. Moreover for the SMEs buffering the national economic system, it requires a comprehensive strategy to tackle unemployment through the creation of small and medium industries.

Against the weaknesses that exist, it should be given serious treatment, so that weaknesses can be overcome. For example, the condition of human resources that have less ability, it is necessary given the intensive and continuous guidance for improving human resource capabilities since human resources are the most important factor in the implementation of the industry and the economy.

While the Training Centre in Indonesia need to be given a greater role. Other similar institutions have to provide skill and expertise for labour force periodically and continuously. Higher quality of human capital in fact yields higher return on investment (Riswati, 2009). Many executives recognize that training and development is a basic requirement when a company is growing rapidly or when it must face the growing competition. In this case the training and development can provide new skills required by employees and organizations to face the competition. Training and development is also important if the company is doing structural improvement and face challenges that requires employees to learn new skills and abilities quickly.

Most executives knowing the importance of training and development can intuitively feel that there is value acquired such as higher productivity, cost reduction and time savings. They also believe train-

ing and development can increase the level of satisfaction (customer satisfaction), improved morale, and build teamwork. However this awareness has not already existed in national industry as a whole that requires government to improve this awareness and promotion for doing more intensive training and development as well as innovative researches.

## CONCLUSION

The research suggests that one of the potential threats of ACFTA is in increasing labour cost of national industry. It potentially threatens the competitiveness Indonesian export in ASEAN and China markets. Beside that the ACFTA also open the crane of cheaper imported fixed capital from China. This has both negative and positive impact for labour absorption in Indonesia. Gov-

ernment has to make sure that positive impact exceeds the negative one.

The only one way for government to maintain national level of employment is to improve the competitiveness of national industry and securing domestic markets from flooding of China products. In the same time, government should guarantee that the implementation of ACFTA will have optimum benefit more efficient Indonesian economy. Intensive surveillance at ports and borders by increasing import and export control regulations in the implementation of the FTA can improve the quality of free trade. Government can also promote the use of domestic products. The last but not least is the continuous improvement of human resource capacity, because human resources are the most important factor in the implementation of industry and the economy.

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