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**A Critical Evaluation of Indonesia's Special Economic Zones
using
New Institutional Economics approach**

By

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A dissertation submitted to the University of Bristol in accordance with the requirements for award of the degree of Doctor of Philosophy in the Faculty of Social Science and Law.

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Abstract

This thesis investigates how institutions influence political institutions and economic agents' in making SEZ policy decision and why do these institutions affect the decision. Most existing literature tended to study SEZs economic outcomes, the advantages and disadvantages, and some have emphasised on the political nature of the SEZ development process. While the study on the institutions that influence the policymaking process by key policy actors and why is rare especially in Indonesia.

By developing an analytical framework that combines NIE institutional concepts and Williamson's institutional constraints model, this study examines what have up until now been separately used to study their influence in SEZ policy reform. The combination enabled an analysis on the interplay between Indonesia's political institutions, policymaking process under economic reform strategies, and policy outcome with regards to SEZ. The empirical case studies presented here show traces of policy interventions and is well-suited to highlight the role that institutions play in determining behaviour. They put more stress on revealing actors' decision in SEZ policymaking. This study found a causal logic whereby some institutional determinants constrain the state (political actors and economic agents) into making the market well-functioning thereby increasing the risk of SEZ policy change. The actors' boundedness to their own rationalities has complicated the process of SEZ policy formulation which resulted in SEZ mixed performance. It promotes further questions on the policy appropriateness and the actors' logic in their policy choice.

The study argues that institutions matter in SEZ policy process and its relevant policies. It further argues that SEZ policymaking relevant constraints involve behavioural assumptions, formal and informal rules, human actors, and modes of interaction between various economic agents and political institutions. Findings indicate that policy and institutions have been mutually influencing each other, entailing change or continuity of the *status quo* and contributing to the institutional arrangement where the government's current policy decisions affect what options become available in the future. Furthermore, the choice of policies and institutions and their implementation depend on the relevant political landscape and its importance is, in general, undisputed. This study also shows that despite the success of implementing economic development policies and programmes that have managed to restore macroeconomic stability for economic revival, institutional problems in the economic reform process remain.

The thesis reveals that the SEZ policymaking process in the following regimes has been potentially affected by the bureaucratic legacy of previous authoritarian rulers. SEZ policy debates and controversies by different regime periods lead to the continual intra-elite rivalry and interjurisdictional competition which still seemed to colour the access to state power while inter-factional tension emerged with higher intensity in the RDO era, often reflected in elite polarisation and thus lead to higher uncertainty, higher transaction costs, and stagnant growth. Therefore, this study suggests that future SEZ policy formulation process should take institutional study into consideration.

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Author's Declaration

I declare that the work in this dissertation was carried out in accordance with the requirements of the University's Regulations and Code of Practice for Research Degree Programmes and that it has not been submitted for any other academic award. Except where indicated by specific reference in the text, the work is the candidate's own work. Work done in collaboration with, or with the assistance of, others, is indicated as such. Any views expressed in the dissertation are those of the author.

Signed: Date: June 11, 2018

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List of Abbreviations and Acronyms

ABT	Additional Budget (<i>Anggaran Belanja Tambahan</i>)
ADB	Asian Development Bank
AEC	ASEAN Economic Community
AFC	Asian Financial Crisis
AFTA	ASEAN Free Trade Area
ANU	Australian National University
APBN	State Budget (<i>Anggaran Pendapatan dan Belanja Negara</i>)
ASEAN	Association of Southeast Asian Nations
AusAID	Australian Agency for International Development
Balitbang	Research and Development Agency (<i>Badan Penelitian dan Pengembangan</i>)
BAPPENAS	State Ministry of National Development Planning (<i>Badan Perencanaan Pembangunan Nasional</i>)
BI	Indonesian Central Bank (<i>Bank Indonesia</i>)
BIDA	Batam Industrial Development Authority
BIFZA	Batam Industrial Free Zone Authority/Batam Zone Management Agency (<i>BP Batam/Badan Pengusahaan Kawasan Batam</i>)
BKPM	Investment Coordinating Board (<i>Badan Koordinasi Penanaman Modal</i>)
BPK	Supreme Audit Board (<i>Badan Pemeriksa Keuangan</i>)
BPKP	Financial and Development Supervisory Agency (<i>Badan Pengawasan Keuangan dan Pembangunan</i>)
BPS	Statistics Indonesia (<i>Badan Pusat Statistik</i>)
BZ	Bonded Zone
CEO	Chief Executive Officer
CMEA	Coordinating Minister for the Economy (<i>Kementerian Koordinator Bidang Perekonomian</i>)
CNN	Cable News Network
CORE	Centre for Reform on Economics
CPI	Corruption Perception Index
CPO	Crude Palm Oil
DFID	Department for International Development
DGCE	Directorate General of Customs and Excise
DKI	Special Territory (DKI) (<i>Daerah Khusus Ibukota</i>)
DPD	Regional Representatives Council (<i>Dewan Perwakilan Daerah</i>)
DPR	The House of Representatives, National Parliament (<i>Dewan Perwakilan Rakyat</i>)
DPRD	Regional/Local Parliament (<i>Dewan Perwakilan Rakyat Daerah</i>)
EA	East Asian
EIU	Economist Intelligence Unit
EOI	Export Oriented Industrialisation

EPTÉ	Export-Processing Entrepôt (Entrepôt Produksi Tujuan Ekspor)
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
FGD	Focus Group Discussion
FIAS	Facility for investment climate advisory services
FTZ	Free Trade Zone
GAFEKSI	Forwarder and Expedition Association of Indonesia (<i>Gabungan Forwarder Penyedia Jasa Logistik & Ekspedisi Indonesia</i>)
GDP	Gross Domestic Product
Gerindra	Indonesia Movement Party (<i>Partai Gerakan Indonesia Raya</i>)
GOLKAR	Party of the Functional Groups (<i>Partai Golongan Karya</i>)
GOI	Government of Indonesia
GCG	Good Corporate Governance
HKI	Indonesian Industrial Estate Association (<i>Himpunan Kawasan Industri</i>)
IDE JETRO	Institute of Developing Economies Japan External Trade Organization
IFI	International Financial Institution
ILO	International Labour Organization
IMF	International Monetary Fund
IMS-GT	Indonesia Malaysia Singapore-Growth Triangle
IPO	Initial Public Offering
IRDA	Indonesia Rapid Development Appraisal
ISEAS	Institute for South East Asian Studies
ISI	Import Substitution Industrialisation
IZ	Industrial Zone (<i>Kawasan Industri</i>)
JICA	Japan International Cooperation Agency
KADIN	Indonesian Chamber of Commerce and Industry (<i>Kamar Dagang dan Industri Indonesia</i>)
KBN	Nusantara Bonded Zone (<i>Kawasan Berikat Nusantara</i>)
KCN	<i>Karya Citra Nusantara</i>
Kepri	Riau Islands (<i>Kepulauan Riau</i>)
KKN	Corruption, Collusion and Nepotism (<i>Korupsi, Kolusi dan Nepotisme</i>)
KPK	Corruption Eradication Commission (<i>Komisi Pemberantasan Korupsi</i>)
KPPOD	Regional Autonomy Watch (<i>Komite Pemantauan Pelaksanaan Otonomi Daerah</i>)
KSOP	Harbour Master and Port Authority (<i>Kesyahbandaran Dan Otoritas Pelabuhan</i>)
KTU	<i>Karya Teknik Utama</i>
KWTE	Exclusive Tourism Area (<i>Kawasan Wisata Terpadu Exclusive</i>)
LA	Latin America
LPI	Logistics Performance Index
MFA	Multi-Fibre Arrangement
MNCs	Multinational Corporations
MoF	Ministry of Finance (<i>Kementerian Keuangan</i>)

MoT	Ministry of Trade (<i>Kementerian Perdagangan</i>)
MP3EI	Masterplan for Acceleration and Expansion of Economic Development
MPR	People's Consultative Assembly (<i>Majelis Permusyawaratan Rakyat</i>)
NCE	Neoclassical Economics
NGOs	Non-Governmental Organisations
NIE	New Institutional Economics
NO	New Order (<i>Orde Baru</i>)
NU	<i>Nahdlatul Ulama</i>
OECD	Organisation for Economic Co-operation and Development
PAD	Locally Generated Revenue (<i>Pendapatan Asli Daerah</i>)
PAN	National Mandate Party (<i>Partai Amanat Nasional</i>)
PDIP	Indonesian Democracy Party of Struggle (<i>Partai Demokrasi Indonesia–Perjuangan</i>)
Pelindo	Indonesian Port Authority (<i>Pelabuhan Indonesia</i>)
Pemda	Regional/Provincial Government (<i>Pemerintah Daerah</i>)
Pemkot	Municipal/City Government (<i>Pemerintah Kota</i>)
PERTAMINA	National Oil and Mining Company (<i>Perusahaan Pertambangan dan Minyak Nasional</i>)
Pilkada	Regional election (<i>Pemilihan Kepala Daerah</i>)
PKB	National Awakening Party (<i>Partai Kebangkitan Bangsa</i>)
PKS	Prosperous Justice Party (<i>Partai Keadilan Sejahtera</i>)
PMP	Government Capital Share Ownership (<i>Penyertaan Modal Pemerintah</i>)
PP	Government Regulation (<i>Peraturan Pemerintah</i>)
PPN	Value Added Tax (<i>Pajak Pertambahan Nilai</i>)
PPnBM	Luxury Sales Tax (<i>Pajak Penjualan Barang Mewah</i>)
PPP	United Development Party (<i>Partai Persatuan Pembangunan</i>)
PSDA	Natural Resource Management Law (<i>Pengelolaan Sumber Daya Alam</i>)
PT	Limited Company (<i>Perseroan Terbatas</i>)
RAPBN	State Budget Draft (<i>Rancangan Anggaran Pendapatan dan Belanja Negara</i>)
RDO	Reform and Democratic Order (<i>Orde Reformasi dan Demokrasi</i>)
SBY	Susilo Bambang Yudhoyono
SEZ	Special Economic Zones
SIJORI	Singapore Johor Riau
SMEs	Small and Medium Enterprises
SOE	State-owned Enterprise
TCE	Transaction Cost Economics
TGUPP	Governor Team for Development Acceleration (<i>Tim Gubernur Untuk Percepatan Pembangunan</i>)
UKP4	Presidential Working Unit for Supervision and Control (<i>Unit Kerja Presiden Bidang Pengawasan dan Pengendalian Pembangunan</i>)
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development

USAID	US Agency for International Development
UU	Law (<i>Undang-Undang</i>)
UUPM	Investment Law (<i>Undang-Undang Penanaman Modal</i>)
VAL	Value Added obtained from Logistic activity centre
VAT	Value-Added Tax
WALHI	The Indonesian Forum for Environment (<i>Wahana Lingkungan Hidup Indonesia</i>)
WB	World Bank
WCO	World Customs Organisation
WTO	World Trade Organisation
YoY	year-on-year

Chapter 1

Introduction

1.1. Background

This study was initially motivated by the interesting outcomes of Special Economic Zone (SEZ) policy which triggered some debates. The debates are mostly about why and how the SEZ policy implementation and performance are different not only between countries who adopt it but within a country in different periods such as in Indonesia. The issue has become a topic of further discussion that despite all efforts the policy always appears unsuccessful. This motivated the author in writing this thesis when the author was first assigned to conduct a joint SEZ policy observation with other government bodies in 2008.

Further discussions on that matter have concluded some problems related to the policymaking process and the factors behind them which include history, culture, procedures, legislation, attitudes, norms, beliefs, etc. However, there have been challenges in determining what the reasons affect the differences, how and where to start the investigation. The first step in finding the answers was to search the relevant literature.

Preliminary Review of the Literature

The initial search for the suitable literature was to explore the contemporary international literature on SEZ. SEZ represents a more contemporary form of economic zone and has gained popularity since the 1980s. After long, SEZ is supposed to have made its way to become one of the most important mechanisms in attracting investment both domestic and international. But, in relation to its performance, there has been differing levels of performance outcome between one developing country to another as well as from one period to another in only one developing country such as Indonesia. Therefore, the institutional analysis of this thesis will be based upon and discussed in a later section.

SEZ policies that are successful in countries like the Dominican Republic and China may result in weak, unintended, and negative effects in Indonesia or other developing regions such as in Latin America (the case of *maquilas* in Argentina, Colombia, Ecuador, Uruguay and Venezuela) where the impacts of these policy reforms are highly dependent on circumstances (Hausmann *et al.* 2005: 23), such as political and economic. In political term, Indonesia's changing political system from authoritarian to democratic has changed some abstract and general SEZ institutional principles, i.e. the rules of the game (rulers, legislations or property rights) and play of the game (the organisation) at the national and subnational levels which resulted in a larger span of bureaucratic system in a decentralised

government. Moreover, in economic term, despite sharing similar Asian values and being more interventionist, Indonesia and China are incomparable in terms of 1) creating own supporting industries to empower domestic business sector and ensure the availability of cheap raw materials as the country's new sources of competitiveness other than cheap labour; 2) enhancing their Foreign Direct Investment (FDI) framework and establishing their own source of bank loan to finance the SEZ infrastructure rather than being overly reliant on the International Financial Institutions (IFIs) (Knoth 2000; Das 2013). The experience of the world's most successful SEZs, especially in terms of the experience of subnational government's policy processes particularly post-decentralisation, is still sought by the government of Indonesia (GOI).

Is SEZ policy in accordance with the expectation of theory?

SEZs are all about FDI (Carter and Harding 2011: xv). There is a substantial source of literature concerning the nature and extent of SEZ policies that support FDI strategy for economic growth. Using different measurements, the robustness of the findings varies. Ge (1999) finds that compared with foreign portfolio investment and commercial lending, FDI is the primary driver of capital, technology and knowledge transfers from developed to developing countries under multinational activities as they are motivated by long-term goals and fewer volatility perspectives. Evidence suggests that SEZ establishment is an effective vehicle to attract foreign multinationals and Ge (1999) further claims SEZ has a role in promoting economic transition and liberalisation (*Ibid*: 20-1). Carter and Harding (2011) further reaffirm the claim that through SEZs, FDI and trade liberalisation still result in economic development and poverty alleviation, particularly in Asia. Other FDI studies suggest that FDI contribution is beneficial for growth even though the host countries have limited human capital stock under the condition that adequate absorptive capabilities are available to accept the advanced technologies (Borensztein *et al.* 1998). Most responses to criticism do note, however, that their results are not necessarily generalizable to SEZs throughout the world (Madani 1999; Glick and Roubaud 2006; Aggarwal 2007). This will depend on the host government policy strategy in terms of efficiency.

Moreover, there are varying results on the performance of SEZs. Their success and failure often derive from aspects concerning location (Pradeep and Pradeep 2008), near national borders, urban areas, skilled labour, and infrastructure quality (Moberg 2012). Others allude to other recipes for success, i.e. zones areal size (Farole and Akinci 2011: 221) and perfect timing (Yuan and Eden 1992). SEZ success stories also mainly involve providing a sound and clear legal and regulatory framework (e.g. SEZs in Malaysia and Singapore). Another aspect depends on the developing countries' geographical position, either land-locked/hinterland area or coastal regions (e.g. countries such as India, Sri Lanka, Japan, and the Philippines located near an international trading lane along a coastal region are more

advantageous than if located in a hinterland as it will be in isolation to the trade wave). Moreover, the SEZs are even more successful if well-connected to the domestic market (Moberg 2012) whereby local sources are drawn by zone investors as factors of production (Farole and Akinci 2011: 217). Other aspects concern the host countries' political underpinning (e.g. democratic governance such as South Korea and Malaysia tend to have more chance of success than socialist governance aside from China and Vietnam such as North Korea). In addition, evidence suggests that the successful SEZ is simply due to the policymakers' decision in choosing the right industry for the respected countries. For instance, some industries may contribute to a country's growth geared towards high technology businesses such as Taiwan, China, and India, while some countries like Bangladesh may not benefit from the industry unless garment producers can invest in its zones to attract significant investment (Farole and Akinci 2011: 41). Therefore, these controversial facts that SEZ as a policy instrument yield mixed results related to this study.

Institutions matter in SEZ policy process

The different outcomes¹ of the SEZ policy have drawn the author to review the work of North (1990) on the influence of institutions on actors' behaviour and choice in policy. The author further adopts the New Institutional Economics (NIE) as this approach is conceptualised through delineating (1) 'Institution matters' to determine the success or failure of economic reform policymaking towards growth, due to market failure. It further underlines the empirical analysis by attempting to understand the role of institutions to SEZ policy process which lacks consistency in the policy's performance especially in a system of transition by delineating the concept of institutional change. The fundamental concern of this thesis is *how much* institutions matter and *which* ones, not just *how* institutions matter (North 1990 in Slater 2011: 1, *emphasis added*).

Additionally, North (1990) asserts that institutional economics produces answers through interpretations of formal and informal rules and the understanding of human cognition (perception or intuition) to reduce uncertainty in human interaction (*ibid*: 6). The cognitive factors refer to the development of meaningful beliefs and habits (rules). In North's (2005b: 163-4) words,

“the importance of understanding how evolving mental models (ideologies or religions) constrain the choice set of the players engaged in the process of institutional change not only through a clear understanding of the belief structure underlying the existing institutions but also margins at which the belief system may be amenable to changes”.

Based on North's interpretations, this study intends to explore the institutional challenges as constraints to the policymaking dynamics of key policy actors which draws upon Williamson's (2000) framework of institutional constraints or known as social analysis theory and discover why it produces

¹The outcomes is discussed further in chapter 2.

mixed results. Williamson's study will serve as the study's main theoretical guidance on the interaction of human actors and their modes of interaction. Further details will be elaborated in chapter 2 that synthesises existing NIE literature.

(2) In a policy context, drawing upon the work of Spiller *et al.* (2003) on Latin American development policy, this study pays more attention to the connection between political institutions and policymaking and uses the concepts to describe the structure of authoritative policymaking—formal and informal institutions along with governance structure and resource allocation—concerning the practice of authoritative governance in a polity. This study provides valuable insights into the politics of policymaking (specifically the process of SEZ restructuring) (Joskow 2008 in Lieberherr 2009:1).

(3) In mapping the political context, this study supports March and Olsen's (1990, 2004) proposition on the 'logic of appropriateness' that: "*Action, policymaking included, is driven by rules of appropriate or exemplary behaviour, organised into institutions*". The logic is viewed on to what extent the human action is construed while the importance of rules includes normative and cognitive levels in an SEZ structure and society.

1.2. The Indonesian Context

Nearly two decades since the Asian Financial Crisis (AFC) 1997-8, the Indonesian politics has experienced a profound transformation from an authoritarian regime with a highly-centralised polity to a democratic regime with a more evolving, pluralistic, and diffused system with an increasingly vigorous parliament (through the *Reformasi*).

This transformation has also led to a far more liberal development policy. Albeit neoliberal policymaking has always been an object of dispute, the dominant theme in Indonesian politics since independence has been the quest for growth and maintaining the *status quo*. The world's largest archipelagic state began investment (FDI) and export-oriented policies essential to the formation of Special Economic Zones (SEZs) in the 1970s. Internal and external pressures such as political turbulence after AFC, ethnic conflicts, corruption, the International Financial Institutions (IFIs) and free trade agreements (FTAs) have influenced SEZ formulation as an integral part of the neoliberal policy and economic reform, where the government's primary motive has been to bring investment into the country and hold legitimate power by any means possible².

Over the last four decades, Indonesian SEZ has undergone an evolution in which the terminology, period, and locations vary (See Table 1.1). At first, the objective of the SEZ scheme during new order (NO) in the early 1970s was to alleviate poverty by reducing unemployment then the SEZ strategies

²The empirical chapters 5 and 6 provide the evidence

were further diversified based on the focus of development and institutional environments underlying the flexible diversification strategy. However, these characteristics will play a part in the scope of this thesis to explain the different context underlying their policy formulation specifically the FTZ, EPZ, and the SEZ (new form) types.

Table 1.1

Typologies of Special Economic Zones in Indonesia								
No.	Type of Zone	Year Established	Political Institutions Line/Ministry (latest)	(Political Institutions) Regime (commenced and restructured)	(Governance Structure) Zone Developer	(Resource Allocation) Focus	Number of Zones	(Formal Institutions) Basic Policy (Statute)
1	FTZ (KPSKB)	1970s	B/OA and BP Sabang report directly to the President (through Ministries of Home Affairs, SOEs, Environment and Forestry, Industry, and Trade)	Soeharto, Habibie, Wahid, Megawati, and SBY**	1. National Council chaired by the Coordinating Minister of Economy Affairs. 2. Zone Council comes from the government. 3. Zone Facilitator.	improving trade sector development and export competitiveness.	2	<ul style="list-style-type: none"> Presidential Decree No. 74/1971 Batu Ampar region was chosen to bring industrial activities to the region through an Entrepôt Particulier Government Regulation No. 20/1972 on Bonded Warehouses as amended by Government Regulation No. 31/1977 Presidential Decree No. 41/1973, Batam Island was designated an industrial estate Law No. 36/2000 (latest)
2	EPZ (KB)	1972	Ministries of SOEs, Industry	Soeharto and SBY	State-owned Corporation	Encouraging high competitive exports, especially manufacturing, due to lower input costs.	1550	<ul style="list-style-type: none"> Government Regulation No. 20/1972 on Bonded Warehouse as amended by Government Regulation No. 31/1977 Government Regulation No. 32/2009 (latest)
3	Industrial Estate	1989	Ministry of Industry	Soeharto and SBY	Local Corporations	improving growth and regional industrial competitiveness for export and domestic purposes.	96	<ul style="list-style-type: none"> Law No. 5/1984 on industry Government Regulation No. 24/2009 on Industrial Estate (latest)
4	Integrated Economic Development Zone (KAPET)	1996	Ministry of Villages, Rural Development, and Transmigration	Soeharto and SBY	1. Development Agency chaired by the Coordinating Minister of Economic Affairs. 2. Management Board chaired by the Governor. 3. Technical Team headed by regional settlements and infrastructure minister.	Becoming the centre of regional economic growth for equitable development.	13	<ul style="list-style-type: none"> Presidential Decree No. 89/1996 on KAPET (Kawasan Pengembangan Ekspor Terpadu) as amended by Presidential Decree No. 9/1998 Presidential Decree No. 150/2000 (latest).
5	SEZ (KEK)	2009	Coordinating Ministry of Economic Affairs	SBY	1. National Council chaired by the Coordinating Minister of Economic Affairs. 2. Zone Council chaired by the Governor. 3. Administrator 4. Enterprises	A combination of other initiatives such as to enhance growth and export competitiveness, encourage the regional development and promote equitable development.	9**	Law No. 39/2008 on SEZ

Source: Author's adaptation from various sources (HKT 2012; Indonesian Customs 2012; Widjonarko 2013; CSIS 2015; SEZ National Council 2016)
 Note: *) The transformation process of Batam Zone Management body is still underway in the present regime of President Jokowi. **) So far until January 2016.

From the outset, the state dominated the rules of the game (*dirigiste*) with protectionist and strong interventionist measures. Despite SEZ proliferation marked by the launching of the Batam Bonded Warehouse³ in the 1970s (Wahyuni 2009), there was no significant improvement in FDI inflows taken by the NO regime other than the low-end labour-intensive industry. Moreover, the overall development of these zones⁴ has not provided optimal results and there are many obstacles to their implementation.

In the 1980s and 1990s, the country subsequently emerged economically strong; the SEZ policy has encouraged more investments into the country, however, severe contradictions underlie the process. After a series of economic reforms to make room for a more *laissez-faire* system, marked by minimal state intervention, the government adopted an export-led growth (EOI) strategy and intense FDI-oriented approach after 1986⁵. For example, export processing zones (EPZs) within Indonesia's industrial estates on the outskirts of Indonesia's major cities were concentrated mainly in Java in 1989,

³Subsequently initiated the mushrooming of the EPZ-type mainly in Java Island in 1980s (Warr 1989).

⁴Under import-substitution industrialisation (ISI) strategies by imposing higher tax and other barriers for infant industry protection

⁵Further details in chapter 2

continued by Integrated Economic Development Zones (KAPET) located in rural and underdeveloped regions in 1996, then by Batam Free Trade Zone (FTZ) which officially opened in 2000. During the reform and democratic order (RDO), KAPET was strengthened to focus on reducing regional inequality especially to eastern regions; and during the SBY period, a new SEZ scheme based on the region's resource potential arose in 2009 under Law No. 39/2009 via the economic corridors platform⁶. Subsequently, SEZs became market-driven and resource-based and aimed at serving various sectors and markets. Looking below the surface, SEZ's fundamental institutions were weak—increased by the devastation of the AFC. The RDO in 1998 to 2014 sought to encourage the revival of the SEZ policy after it had stalled. This caused serious political economic challenges for not only the RDO where four contradictory leaders⁷ after Soeharto offered erratic economic policy direction but until the changing democratic regime of Joko Widodo (Jokowi). This study investigates how SEZ policy transformed (from Habibie until Jokowi period) and why.

1.3. Statement of Research Problem

SEZ being widely accepted throughout the world (WEPZA; Farole and Akinci 2011) is displayed when the Indonesian government (GOI) since the 1970s designed several reform strategies including SEZ to improve the growth and competitiveness of exports through domestic and foreign investment (Daeng 2008; Maramis 2012). However, despite SEZ policy implementation applying different investment policies with different incentive provisions, the outcome has shown insignificant results and controversy.

Furthermore, aggravated by the first AFC, Indonesia's tradable and non-tradable sectors started losing their spark, continuing even after the recent global financial crisis (GFC) in 2008 (Table 4.4 in chapter 4). Although the economic performance has been largely unsatisfactory (Warr 1983, 1989; Jayanthakumaran 2002, 2003; Halim 2007) with exports decreasing and industrial growth stagnating, the RDO insist on continuing the economic marathon into a deeper neoliberal ideology by adopting a more liberalised SEZ concept for FDI purposes. They were compelled to take advantage of the trade liberalisation policy and encourage FDI through SEZs, leaving many to question whether SEZs are good for economic reform (Daeng 2008: 64). Therefore, it remains a subject of scholarly debate as to why this scheme has always emerged; how institutions are responsible for these economic performances and why? Hence, the nature and pattern of this contradiction—the political economy of SEZ and its institutional intricacies—will be critically examined. And corollary questions are; how do institutions

⁶Will be elaborated in more detail in chapter 3

⁷BJ Habibie (21st May 1998—20th October 1999), Abdurrahman Wahid (20th October 1999—23rd July 2001), Megawati Sukarnoputri (23rd July 2001—20th October 2004), and Susilo Bambang Yudhoyono or SBY (20th October 2004—20th October 2014).

affect actors' behaviour and which kind of institutions? What do actors consider to take in the SEZ formulation decision?

They chose to develop SEZ policy through a sequence of formal legislation and other institutional methods aimed to enhance the control of government concerning the management and SEZ localities during the SEZ policy implementation due to the ongoing conflicts of interest among the relevant authorities. These are the cardinal reasons for the thesis topic where these results dispel the popular view that SEZ policy has a 'multiplier' effect on economic growth; instead, it only increases the liberalisation level in every regime government. But, why did Indonesia show incapable to extract benefit from the SEZ scheme? This will be explored in the empirical chapters 4, 5, and 6 where chapter 4 constitutes the historical context of Indonesia's institutional framework.

The significance of institutional analysis is that it allows the author to apply practical knowledge in an inclusive range of political economic settings in Indonesia with its democratic dynamism. According to Harriss *et al.* (2003: 10), "*the state is always a reflection of the holdover power within a society, representative of the dominant economic interest groups*". This study also contributes to the understanding of the role of the state in policy formation, its implementation, economic outcomes, and political agenda. The author particularly focuses on information on the SEZ policy action by the successive regimes in a complex set of institutional contexts that include the normative, regulative, and cognitive features (Scott 1995 in Hazakis 2014 where Hazakis changed normative feature to organizational) that shape and transform SEZ policies where there is an acknowledged lack of research. Characteristically, SEZ studies are highly segmented. Given this idiosyncratic nature, most studies focus on specific segments of the SEZ which analyse the static economic effects⁸ of neoclassical assumptions (Aswicahyono and Maidir 2003; Robertson *et al.* 2004; Wu 2007; Adam and Tisdell 2008; Seshadri 2011; Vickers 2012), giving little consideration to the institutional economic approach. This thesis is a narrow study analysis that tries to avoid common drawbacks that other broader studies produce. It marks a departure from earlier studies that: first, focus mainly on the economic dimensions in a global context (map more comprehensive research trends across transitional developing countries that have over-generalised in macroeconomic terms⁹) or favour cross-country regression studies (Knoth 2000; Nicola 2009; Rossi 2011; Nyangu 2012). Instead of studying institutions from purely economic and quantitative positivist approaches (such as cross-sectional and time-series analyses¹⁰), this study

⁸Studies on the SEZ programme's formal institutions mostly capture the static economic measures: investment, contributions through taxes, employment, exports, indirect employment, and other short-term mechanisms.

⁹Among the most popular studies: the World Bank/IMF (1980s), Lal (1983, 1992), and Krueger (1992).

¹⁰Focussing on economic growth and trade liberalisation, cross-country and time-series analysis are often the case in economic research (Grossman and Helpman 1991; Devereux and Lapham 1994; Edwards 1998; Rodriguez and Rodrik 1999; Greenaway *et al.* 2002; Redding 2002). The research outcomes describe that on aggregate the

contributes to the contemporary debates on how political regimes and processes impact policy formulations (enriching the debate proposed by Przeworski and Limongi 1993; Lavigne 1999) and affect the socioeconomic dimensions in Indonesia through broadening the scope of knowledge in a qualitative case study design, hitherto unexplored by positivist approaches. Furthermore, this single country study may yield greater proceeds than further cross-country analysis.

Second, the inherent relation between SEZ policy and policymaking has not been wholly discussed and looks like two separate political economic phenomena without linkages (Daeng 2008; Hadi *et al.* 2011), which is not the case. Moreover, the 40-year history of economic zones,¹¹ its resultant evolution, and economic importance was documented as separate studies. Those studies have not clarified the political-economic dynamism with respect to SEZ policy and policymaking as two interrelated areas and how political-economic transition (as restructuring or change) has influenced SEZs policies in Indonesia.

Third, NIE study in Indonesia is still at an emergent stage given the dominance of NCE thought¹² and the analytical or methodological vulnerabilities involved in displaying and assessing cognitive-related procedures. It was only after the publication of Yustika (2005) with his study of the socio-economic and institutional conditions of sugar cane farmers in East Java, which institutional economic studies in Indonesia began to have some scientific research. Among the most notable ones also include Purbayu (2010) through the aspects of Indonesian economy analyses the failure of the neoclassical economy (NCE) and the relevance to the contemporary institutional economic study. To avoid the sensitive issue of institutional analysis, the theme of the precarious connection between policy and institutions or cognition (individual perception) has been overlooked and appeared unpopular among the Indonesian studies on good governance, policy, and development. This is due to the political sensitivity of the subject during Soeharto's tenure (Mas'ood and Savirani 2011: 75)¹³.

confident yet low impact of trade liberalisation on growth over-generalised the significance toward individual countries where there is growth heterogeneity across countries that should be explained (see Morgan and Kanchanahatakij 2008). The common drawbacks stems from the empirical analysis that a one-size-fits-all to a large extent more effective in broader economic studies, but scepticism over the validity, generality, hypothesis that links growth to openness, calculation to openness, and how a country changes its trade openness level are inconsistent and the growth heterogeneity is undetermined (Bhagwati and Srinivasan 2002).

¹¹Contributors on the history of SEZ see for example Easterling (2007) and Neveling (2014a, 2014b)

¹²Neoclassical economics became dominant in universities in the second half of the 1970s (Bresser-Pereira 2012: 347).

¹³The sensitive nature of NIE study was to a certain extent associated with the empirical evidence in Mas'ood and Savirani's (2011) political and sociological research on 'financing politics' which was revealed in a twenty-year span (1990-2010). 256 post-graduate students' theses were assessed. 13% were written during the Soeharto era with a significant increase in interest on the theme to an unprecedented 87% during the post-Soeharto era. It relates to the more controlled political system by the NO government; studies on political parties were limited, and elections were held with expected results. Meanwhile in the post-Soeharto era there were vibrant political parties with a relaxed and open political life.

Fourth, until today, there has been no comprehensive research ever been carried out on the politics of Indonesia's SEZ policy especially in the policymaking process employing an eclectic institutional economic approach by any Indonesian or western scholars. Research on SEZ in Indonesia, up to 2000s still limited to studies with topics specifically on the SEZ feasibility issues, its impact to national economy, and development planning policies (Wahyuni and Ng 2008; Darmawan 2008; Wahyuni *et al.* 2010; Wahyuni and Astuti 2011; Vickers 2012; Hertanti and Chaturvedi 2012, CSIS 2015). Most studies on Indonesian politics lay more emphasis on the NO authoritarian or the NO continuing influence on the contemporary political structure (Percaya 2000, Tahyar 2012, Korte 2013, Choi 2011, and Raffiudin 2015). They either discuss the good governance context (Korte 2013; Choi 2013), state or politico-business relations (Fukuoka 2012; Raffiudin 2015), Sino-Indonesian relations (Percaya 2000), state-society relations (Buehler 2014), or state-religion relations (Metera 2012). Hence, drawing upon Harold Crouch's argument (1979), the claim is still that several aspects of the NO patrimonialism persist (Korte 2014; Mackie 2010 in Raffiudin 2015: 6; Tahyar 2012). Moreover, many Indonesian democracy scholars were mostly influenced by the oligarchy thesis¹⁴ (Buehler 2014: 157). While other democracy scholars, such as Robison and Hadiz (2004), Webber (2006), and Case (2009, 2015) point out other perspectives that the new forms of political patronage between the old and new political institutions, economic agents, and their clients have impeded the democratisation process.

Therefore, this thesis attempts to fill the gap by assessing political intrigues of the SEZ policymaking and by adopting Williamson's theory as a guide. This study posits that institutions do matter in SEZ policymaking and that one institution affects other institutions in the action taken by policymakers resulted in mixed policy outcome under different presidential periods, thus how it happens and why will be the focus.

1.4. The focus of the study

Grounded by empirical case study, under the NIE approach, this study scrutinises the interplay between institutions and the politics of policymaking. Scholarship on the relationship between institutions and political influences tended to view authoritarian countries as inconsistent to the relationship between institutions and attracting investment (Jensen *et al.* 2011: 2), believing that access to factors of endowment is more influential to the nature of institutional intervention devised by the state (Combarrous and Rougier 2010: 4). This thesis provides insights into the political channels through which institutions affect the SEZ policymaking in Indonesia.

The specific context of this thesis starts when the regional autonomy or decentralisation legislation was enacted in 1999 followed by the constitutional reform in 2000. Following Soeharto's state and

¹⁴See Robison and Hadiz (2004, 2005), Hadiz (2010), and Winters (2011)

populist government prior to 1997, the RDO regime not only changed the bureaucratic structure of the governance but they also changed the structural legislation related to investment promotion and other neoliberal policies, i.e. labour standards, land acquisition, and spatial planning entitlements to help smooth the SEZ policy process on the pretext of curbing poverty and inequality under the economic reform and development. These policies were found to have adverse effects (as will be elaborated in chapter 4) as the well-placed were the main beneficiaries of a highly patronage-based and rent-seeking system, such as the oligarchs and bourgeois, hereafter cronies (Abonyi 2005; Aspinall and Mietzner 2010; Datta *et al.* 2011). However, the other neoliberal policies above are not considered in this thesis instead they serve only as impetuses for policymakers to design the appropriate SEZ scheme.

Evidently, the overall empirical evidence on the outcomes of SEZ policies in Indonesia shows mixed results. First, despite strong belief among scholars¹⁵, Indonesia's continuous efforts of constantly changing the facade of SEZ policy to effectively balance GDP growth or strengthen the industrialisation capacity or prosperity of the nation, boosting country competitiveness and seeking significant influence on the flow of investment, have largely failed¹⁶ (Daeng 2008: 127-261). Second, Indonesia's continued ill-advised economic policies at the expense of society's best interests have resulted in a widening economic inequality. It has provoked controversy for a number of reasons: 1) activists have protested about the likely impact of the neoliberal ideology, i.e. SEZ and investment policy running against The Indonesian economic ideology— '*Pancasila*'; in particular, with regard to the importance of and realising the ideals of economic justice and 'nationalism' (*Ibid*: 178-185). 2) The government is challenged on whether they are a hindrance, or a facilitator of economic growth and prosperity as will be presented in chapter 4.

The study focuses on the SEZ policymaking from the RDO period of 1997-2014 until the beginning of Jokowi's presidency (2015 until early 2016) when SEZ has been a key policy instrument for economic reform specifically investment promotion. The study not only have an interest in the new resource-based term SEZ¹⁷ that many provinces and districts in Indonesia have been enthusiastic¹⁸ to embrace with varying degrees of intensity, the interest also lies with two traditional forms of the zone as empirical case studies, possibly unique in their own right: the EPZ in the greater Jakarta area and FTZ in Batam. While Indonesia's SEZ policies and economic growth explain much about local SEZ policy outcome, regional responses in neoliberal promotion from external (IFIs) to internal forces (developed

¹⁵For example, Mallampally and Sauvart 1999; Sun 2002; OECD 2002; Wignaraja 2003; Dahlman 2007; Pitelis 2008, 2014; Delgado *et al.* 2012.

¹⁶ See Figures and Tables in chapter 4.

¹⁷The SEZ's basic concept is elaborated in the following chapter.

¹⁸Since the government released SEZ Law No. 39/2009, more than 62 municipalities and districts have proposed to promote their areas into either natural resources-based or tourism-based SEZs and until today (as per January 2016), nine regions have been approved and designated into SEZs (SEZ National Council 2014).

since the NO and originated from the influential neoliberalist role of multiple key state and non-state actors) inevitably vary. Jakarta EPZ and Batam FTZ briefly illustrate this. They are considered the most important SEZs which over the years have attracted a significant amount of investment, especially prior to the AFC, and contributed to the success of the resource-based industrialisation strategy in Indonesia (Sivananthiran 2009).

Moreover, the significance of Jakarta EPZ also resides in its role as a prototype for further zones of this kind and other SEZ forms, while Batam FTZ has a geopolitical and geostrategic significance since its location is adjacent to Singapore. The Jakarta and Batam municipal governments have been just as enthusiastic as other provinces and districts in converting the already established EPZs and FTZ into an SEZ under political elites' interference but through the hands of their respective zone management bodies, PT Kawasan Berikat Nusantara (KBN) and Batam Industrial Development Authority or BIDA. They introduce numerous additional incentives and benefits to facilitate investment and accommodate large public and privately-owned domestic and foreign corporations as Indonesia continues to compete with other countries such as Vietnam and China in a national 'race to the bottom.'

The empirical case studies narrate the complex institutional dilemma and offer an investigation of a unique period in the era of economic and political reforms in Indonesia. Through these cases, this study shows the intricate SEZ policymaking between and within key policy actors (national and sub-national elites) and their related bodies. It further analyses the institutional nature, scope and dimension of the challenges confronting the ruling elites' circle of power regarding policy intervention amidst the political repercussions and economic difficulties. The study also analyses modes of economic coordination. It refers to how political institutions (the 'rules of the game') defining the procedures through which public policy is made, i.e. authoritarian or democratic government) mitigate or reduce uncertainty (the degree of trustworthiness) included in transaction costs or administrative costs.

The study uses NIE theory and Williamson's social analysis model as guidance where each layer of the institutional constraints are explained in chapter 2, while the analytical framework derived from the theory is discussed in chapter 3.

The study tries to analyse problems associated to the influence of institutions in policy formulation through SEZ arrangements where existing literature has not adequately made contribution particularly linking Williamson's institutional constraints and SEZ policy process into an integrated analytical framework. Voluminous literature mainly focused on the nature and extent of the SEZ political economy in recent years and its empirical arguments but the institutional dynamics, formal (policy and regulatory framework) and informal context (socio-political culture) have not been emphasised or fully

analysed in relation to SEZ's significance to the policymaking process. Although so far, political economic studies on SEZ have shown a balance between macro-level (institutional environment) and micro-level (institutional arrangement) studies, however, studies conducted tend to use quantitative rather than qualitative approach not focused on the institutional theory and political factors but rather on the economic factors. Moreover, they are still largely contributed by Western scholars i.e. Knoth (2000), Seshadri (2011), and Moberg (2012). Therefore, the study tries to fill the void in knowledge of SEZ policymaking in Indonesia and contributes to the theoretical discussions on its institutional dimension.

1.5. Research Questions, Aims, Central Proposition, and Hypotheses

Guided by three research questions, this thesis intends to answer:

1. What are the institutional intricacies surrounding the process of SEZ policymaking?
2. How and why do institutions influence the behaviour of actors in SEZ policy decision?
3. Which institutions affect the SEZ policy decision and why?

The aims of this study are 1) to examine the intricacies behind the process of making the SEZ policy, 2) to investigate how institutions influenced political institutions and economic agents' decision and why do these institutions affect the decision, 3) to analyse the type of institutions generally affect the decision.

Based on my research questions, this study will work on the following central proposition and hypotheses:

The proposition and hypotheses started from the personal experience and literatures on the progress and setbacks of SEZ programme in Indonesia while working in the Ministry of Finance followed by the literature review on new institutional economics and its relevant theories and concepts including Williamson's social analysis (this study uses the term 'institutional constraints' rather than social analysis as it is better suited to the study of institutions at hand). Using Indonesia as the case, the author connects the proposition and hypotheses with the research questions as follows:

The central proposition based on the first research question:

The institutional intricacies that surround the SEZ policymaking process concern with the interaction of one institution to another that influence actors' behaviour and policy decision in a dynamic and complicated set of policy formulation strategies which caused higher uncertainties and transaction costs.

To elaborate the proposition into more clarity in the case of Indonesia 1) informal institutions, both productive and non-productive, have not been compatible in support of formal institutions and vice versa, 2) property rights are not yet optimal in the bureaucratic level of SEZ policymaking process during transitional period of centralist paradigm shift towards decentralisation, 3) continuous and

discontinuous SEZ bureaucratic policies have shifted the pattern of abuse of power by a handful of people in public institutions hindering the clarity of contractual relation of the SEZ relevant authority, 4) lack of clarity of the principal-agent relationships lead to moral hazard, adverse selection problems, and uncertain structural incentives.

Hypothesis 1

Informal institutions have a very strong influence on the functionalities of formal institutions in the SEZ policy process and actors' institutional preference tends to use informal practices more than formal practices during the SEZ implementation level rather than the formulation level due to the policy has been established and running and the actors' cultural and ideological beliefs are developed at the implementation level.

Hypothesis 2

Bounded rationality and opportunistic behaviours emanate when actors unable to settle conflicts occurred in the policy process and principal-agent, moral hazard, and adverse selection problems in SEZ governance structure at the central government level render contractual relationships to be unclear at the local government level.

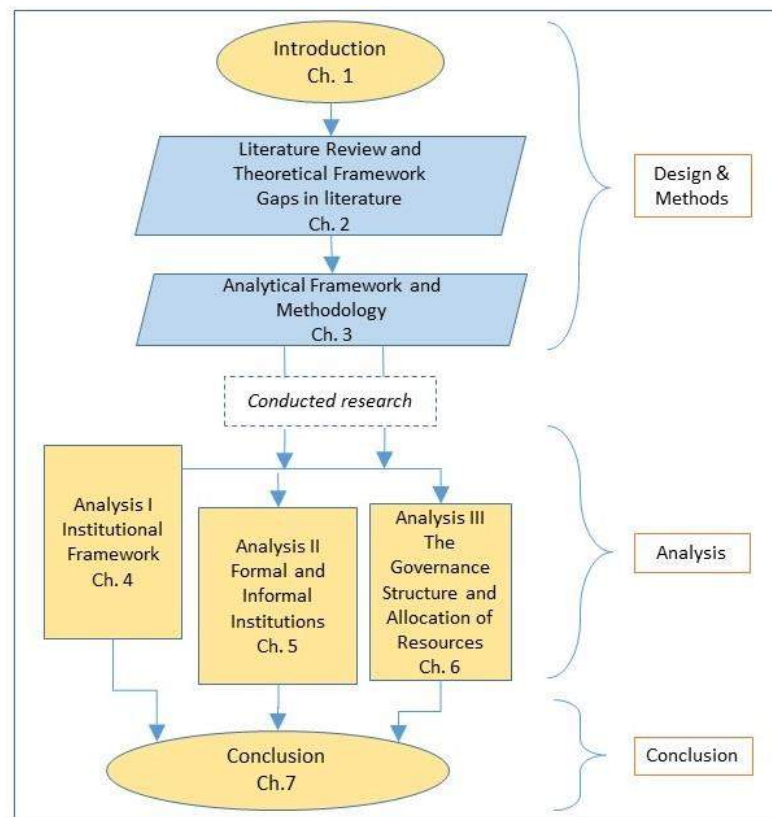
1.6. The Study Significance

This study contributes to the issue and current literature on SEZ policymaking, the policy implementation and policy outcome. The study sheds more light on the EPZ and FTZ type in regional level rather than the SEZ in general. It contributes to the theoretical knowledge of SEZ policy process under the reform and democratic regimes by employing institutional analysis for both theoretical as well as analytical frameworks depart from conventional views of SEZ as a simple reform policy tool. This study develops a more dynamic analysis and more nuanced, empirically viable and politically grounded theories of human behaviour to policy choice. It does not take technology as the defining factor of policy and institutional change as inferred by institutionalists, Hodgson and Stoelhorst (2014), however, this study adopts knowledge factor as one of the significant aspects for actors in using information they possess in the SEZ or economic reform policymaking process as suggested by independent scholars, i.e. Moberg (2012) and Datta *et al.* (2011).

1.7. The Thesis Organisation

This thesis consists of seven chapters. Following this introduction, chapter 2 sets the baseline for the research and conceptualises the NIE theoretical framework and related concepts and relate them to Williamson's hierarchy of institutional constraints. It also explains the relevant SEZ policy literature and develops the gaps in knowledge. This chapter delivers the interplay between political institutions, policymaking process under economic reform strategies, and policy outcome with regards to SEZ. The chapter argues that institutions matter in economic reform policy and its relevant activities. It further argues that SEZ policymaking relevant constraints involve behavioural assumptions, formal and

informal rules, human actors, and modes of interaction between various economic agents and political institutions. The interplay between institutions and SEZ policymaking is an empirical question.



Chapter 3 explores the analytical framework and methodology to provide direction of how the study is conducted. The chapter adopts Williamson’s (2000) theory to guide the analytical process. It also describes why the methodologies used in the study are the appropriate approaches by rationalising the use of qualitative approach by employing case study design. The chapter also highlights the research protocols and limitation of the research methodology.

Chapter 4 examines Indonesia as a case study by utilising the evidence found from the field, literature review, document, and media analysis. This chapter touches Indonesia’s historical context in policymaking including SEZ trajectories by different ruling elites. It spells out the institutional framework that influences policy process and prevailed both before and during the years of reform. It further analyses the structure of the emerging democratic reconfiguration and the evolution of Indonesia’s SEZ related policies, i.e. investment policies, its derivatives, and implementation under different ruling elites that ultimately points to how the trajectory of SEZ policymaking actually appears in the future. This chapter validates the central proposition in chapter 1. It demonstrates the mandate of the highest leadership in Jakarta being executed, interpreted, and disputed by diverse actors at the central, regional and parliamentary levels. It leads to how SEZ policymaking being implemented at different time and space. This chapter also elucidates the standard features from other countries’ SEZ

as measures of success. From those indicators (criteria) what are all the features more common in the selected countries in their success and compare them to Indonesia. This process is to find which country has more factors of success compare to others and which country has less common factors.

Chapter 5 highlights the first thematic series of institutional intricacies represented by the role of informal institutions in human motivations and social structure and its effect on formal institutions. The chapter will provide evidence to test the first hypothesis. It shows how localised political variables in the Jakarta EPZ in the KBN (*Kawasan Berikat Nusantara*) industrial zone can thwart institutional change initiatives. This chapter argues that the downsizing role of the state between 2009 and 2014 points to something more than an upsurge of collective displeasure generated from state-owned enterprises' (SOEs) mishandling of the port management and the Jakarta Bay SEZ reclamation episodes. This chapter reveals that the inclusive informal institutions that were strongly influenced by the prevailing norms of behaviour, ideologies, and values of the new order under political economic complexity coexist with formal 'rules of the game' resulted in both durable and fragile institutional change in distinct contextual bases during the Susilo Bambang Yudhoyono (SBY) period which at times the nature of formal rules tend to provide weak incentives for policymakers to make SEZ policies and reveals that more informal processes govern SEZ policymaking and shape the incentives that policymakers might have in requesting SEZ policy change in the implementation level.

Chapter 6 demonstrates the second thematic series of institutional intricacies represented by political negotiations that took place within the local political institutions and economic agents on the topic of Batam FTZ transformation, and a specific step of political wisdom displayed by the reform and democratic order period. The chapter answers whether the second hypothesis can be justified. It plots, first, the regular FTZ policy change (and subsequent ambiguities) that happened within the economic reform policy where the zone managers (represented by BIDA) and local authority (*Pemkot* Batam) tried to negotiate with the unstable formal legislation of the bureaucratic order, and to validate the inevitability behind the SEZ policy formulation in its own hypothetical terms. It is the mixture of these aspects that clarify to what extent the incumbent presidents take on SEZ policy reform proposals in the first place. The chapter draws from the last two layers of the institutional constraint rationale by Williamson (2000) which considers aligning regulatory intervention with the allocation of resources issues related to understanding the ways in which actors try to minimise transaction costs under principal-agent, moral hazard, and adverse selection problems. It involves balancing the incentive structures and compliance rule among the different stakeholders under the SEZ policy perspective in the SEZ system of rules, policy setting or regulation formulation and its enforcement (directed and monitored). This chapter also depicts that patrimonial relations, entrenched in the NO, still emerge in the local polity as a result of the devolving power structure noteworthy in the *Reformasi* period. This

chapter argues that SEZ initiatives in Batam became politicised not only, borrowing Das (2012), in *intent* and *meaning* but also in the execution process. The BIDA-*Pemkot* Batam conflicts in the NO are the peak of sequences of inherent paradoxes rooted in the way the BIDA and *Pemkot* Batam went about managing the Batam FTZ under transformation. They are not impartial episodes. The BIDA and *Pemkot* conflict show that their channel in policy execution initiatives was translated into exercises in maximising political benefits. The chapter founds the importance of policy negotiation in supporting any effort at SEZ policy reform.

Chapter 7 will state the results of my study. It presents significant findings directly and precisely includes some discussion around the institutional factors which both encourage and discourage SEZ policymakers. The author will state whether my hypotheses can be accepted. The author does not profess the hypotheses or the evaluation and conclusions to be definitive. What the author will show in the findings is that the author hopes to discover most aspects of the category based on usability theory. The chapter states the contribution of this study to knowledge, draws some shortcomings of the study, and provide suggestions for further research. This study generally acknowledged that studying institutions which have touched the course of a policy process in Indonesia is highly sensitive as it involves studying the actors behind it. Therefore, this study contributes to the understanding of institutions as constraints to policy formulation and they influence actors' behaviour in decision making.

Chapter 2

Literature Review and Conceptual Framework

Introduction

After laying out the introductory material and the study objective, this chapter aims, first, to review the existing literature on institutions as the study's main theoretical guidance explaining why and how institutions influence the actors' behaviour and action toward economic reform policy decision making. Second, this chapter aims to highlight the gaps from the current institutional economics and SEZ literature which this study tries to fill in.

The new institutional economics (NIE) will be employed to understand the institutional settings of the Indonesian government's SEZ policy orientation as their economic reform strategy. This study will explore these challenges through a unified conceptual framework which synthesises existing NIE literature.

After the introduction, before discussing the theoretical literature the chapter turns to the concept of 'actors' responsible for the SEZ policy transformation. The chapter consists of two subchapters. The first subchapter introduces the institutional framework as the theoretical foundation and the second subchapter discusses the literature on SEZ. The first subchapter is divided into three sections. The first section introduces the NIE by unravelling it from the neoclassical economics (NCE) to explain that institutions matter in economic reform policy. The second section elaborates Williamson's hierarchy of institutional constraint framework as a guide to the analytical approach which underpins the various practical and epistemological elements. It stems from the institutional characteristics of the Indonesian SEZ policy to show how the NIE and interrelated concepts can be applied in practice. This section includes the manifestation of NIE theory and literature to the political context through evidence from other countries' experience East Asian Tigers, India, and the Indonesian authoritarian New Order as special cases. The third section outlines the conceptualisation of 'institutions' and related concepts, and explicitly states the causal links between history, path dependency, and 'institutional change' context and its main characteristics that inform and underpin the key actors' behaviour. It incorporates concepts related to the political economy context i.e. asymmetric information and collective action, bounded rationality and opportunistic behaviour, the logic of appropriateness, and the intertemporal and credible commitment framework by outlining the state intervention in the process of policymaking to present a cohesive and clear overview of the study's theoretical foundations. They represent the kind of political compulsions which underlies Indonesian SEZ policymaking development.

The second subchapter sets out more general forms of literature on the rationale of SEZ. This subchapter consists of three sections, the first section addresses SEZ definition, typologies, and characteristics. The second section presents SEZ importance from a global perspective. The third section explores the literature on SEZ outcome. Finally, the final part concludes the entire chapter.

- **Key Policy Actors**

Drawing from Hoffmann (2010), which derives from Henisz's (2000) 'institutional environment' approach and Tsebelis' (2003) 'veto players' approach, the key actors or elites discussed here are actors engaged in the SEZ policymaking process and known to have their vested interests or rights in a governance system. They are described as the two crucial political economic variables or operating stakeholders in the political-economic sphere: 1) *political institutions* or legislators or political actors and the parties. They are executives or policy implementers in North's (2005b) terms (the three main arms of government, the executive, legislative, and judiciary) and beneath these government, branch are state actors or bureaucrats in government agencies such as *Pemkot* Batam (Municipal government); 2) *economic agents* or economic institutions a. technocrats in the Indonesian context in Amir's (2007a, 2007b, 2008, 2013) terms, refer to two groups of leading scholars, b. the economists and the technologists/engineers chosen by the incumbent regime as advisers of the government in carrying out economic policy decision-making, such as BIDA (Batam Industrial Development Agency) and c. the zone developer and management: state-owned companies including KBN in Jakarta EPZ, an independent agency supervised by the central government. The use of economic agents and political institutions in this chapter, at times, are used interchangeably with policymakers or key actors.

Political institutions in the cases here also refer to the public authorities, voting or majority rules or proportional representation, the constitution, and the management of collective problems. This can be attributed to the hidden action performed by, for instance, Jusuf Kalla, the former vice president of the SBY regime. However, other actors also emerged during the SEZ policy processes. For example, non-state actors such as privately-owned companies, KCN and KTU (Their roles will be discussed in chapter 5). Since the presence of uncertainty necessitates that individuals anticipate future wants and needs, it is argued that non-state actors who have the skills to recognise and implement opportunities by making decisions in the face of uncertainty emerged, hence, organising by instructing others and paying wages (Coase 1937 in Lieberherr 2009: 5). The multiplicity of actors involved in the SEZ policy is part of the Indonesian strategy to involve actors of trade, industry, and investment in exercising trade liberalisation termed the free trade area with Indonesian SEZ characteristics. The subchapter turns the discussion to explain the institutional theoretical framework and related concepts to inform the importance of institutions to actors' behaviour.

A. Institutional Framework

1. Understanding NIE

NIE has gained prominence in analysing institutions within the sub-disciplines of political economy and public policy and is one of the most important innovations in the contemporary study of politics (Bates 2007: 174). By employing NIE, it is crucial to analyse the ways in which economic agents and political institutions deal with uncertainties and informs the overall orientation and approaches of this study. This perspective has been known to obtain better results than other frameworks in development studies. In particular, the author stresses the understanding of institutional change in the economic reform strategy to SEZ policy (the empirical terms of this study in chapter 4 refer to the decentralisation and SEZ related policies, i.e. investment laws, labour laws) especially the policymaking process and the outcomes (ramifications) by policymakers.

NIE theory can open the black box¹⁹ of the weak application of neoclassical economics (NCE) theory by key actors in solving economic issues in developing countries. NIE theory is a reaction of dissatisfaction toward 'market failure' in NCE theory and an enrichment and continuation of the NCE view by offering answers to enhance and develop NCE. NIE was important for economic policy during the 1990s as it was against market domination and offered encouraging strategies for policy interferences unnoticed by orthodox economists (Harriss *et al.* 2003: 7).

The process of restructuring from the failure of market liberalisation has made NIE a well-known subject in social science literature. "*NIE is a body of ideas which is essentially dynamic or at least seeks to introduce an element of dynamism into the static stereotype of NCE*" (Harriss *et al.* 2003: 9). NIE gained global attention as it analyses modes of economic coordination. It is particularly suited to those interested in studying the political economies of countries that have yet to reach—so often depicted as the 'ultimate goal'—full industrialisation (Finger *et al.* 2005; Joskow 2008).

The interplay between institutions, transaction costs and NCE and the bargaining and negotiation of the transactions at the lowest cost possible puts more emphasis on the role of actors (economic agents and political institutions) as asserted by North:

"It was Ronald Coase who made the crucial connection between institutions, transaction costs, and neoclassical theory (Coase 1960). The neoclassical result of efficient markets only obtains when it is costless to transact. Only under the conditions of costless bargaining will the actors reach the solution that maximises aggregate income, regardless of the institutional arrangements.....Efficient markets are created in the real world when competition is strong enough via arbitrage and efficient information feedback to

¹⁹This concept draws on Williamson's (2000: 602) 'firms and bureaus' concept.

approximate the Coase zero-transaction-cost conditions and the parties can realise the gains from trade inherent in the neoclassical argument” (North 1993: 344).

In addition, the institution is important for establishing long-term economic growth since institutions form an incentive structure (rules) to run the economy and the actors.

NIE presents the study of the serious relationship between cognition and institutions in the good governance context. Good institutions encourage transactions to be carried out effectively and efficiently to reduce transaction costs by improving access/allocation to resources and quality of information and encourage the establishment of rules. NIE is important because institutions can organise and eliminate friction and uncertainty in policy, reduce transaction cost and strengthen the governance²⁰ to increase economic growth (*Ibid*: 8). NIE contributes by adding discussion on the institutional failures as the cause of underdevelopment in many countries (Bardhan 2007; Purbayu 2011). The institutional failure according to Bardhan (2007) refers to the weak structure of the contract and the law (such as SEZ policy framework), and the weak rules of third-party enforcement (in Indonesia, this entity belongs to the High Court as shown in figure 4.6, however, the parliament as the legislature since the Indonesian constitutional change has the power to control the mechanism of law executed by the president as the executive), whereas it should be strengthened to carry out market transactions. In a policymaking context, Johnson (1999) measures the role of institutions in policymaking to avoid failure through specific approaches which resemble Bardhan in some respects, such as structure, conduct and performance²¹ (political institutions) to compare original intentions (policymaking process) and actual management performance (policy outcome). For the purpose of the study, however, these measures will be synchronised with the study by Spiller *et al.* (2003) in a later subchapter with regard to political institutions (structure), policymaking process (conduct) and policy outcome (performance).

The characteristics of NIE according to some experts are constantly trying to explain the importance of institutions (institutions matter), as a reference model for firms or states against the rational individual behaviour to prevent the possibility of unacceptable human interaction. NIE is attributed as the foundation by development planners and policymakers trying to adopt an institutional economic approach to explore political economic issues (Toye 2003: 64). Moreover, a more empirical work by

²⁰‘Governance’ in a more contemporary context, according to the World Bank (2010) cited in Hoffmann (2010: 53) is defined “as the traditions and institutions by which authority in a country is exercised for the common good. This includes, (i) the process by which those authorities are selected, monitored and replaced, (ii) the capacity of the government to effectively manage its resources and implement sound policies, and (iii) the respect of citizens and the state for the institutions that govern economic and social interactions among them”.

²¹“Structure is used to identify what was originally set out in any legislation including design of policy instruments; conduct is used to identify how the legislative programme was interpreted and managed in practice; and performance is used to assess how well the policy system met the original objectives of the programme in terms of delivering the scheduled benefits to the targeted recipients” (Johnson 1999: 1).

Lim (2012) suggests the role that institutional quality plays in a market transaction is important and complements the already robust literature, i.e. Rodrik and Subramanian (2003) and Rodrik *et al.* (2004) such as to increase capital accumulation or investment. However, enhancing economic growth also requires a well-structured financial sector. Therefore, NIE is employed to delve into the role of institutions as vital determinants of economic reform, in this study is attributed to the policymaking.

NIE builds its ideas that institution and the structure and functions of an organisation seeking to achieve a level of *efficiency* (DiMaggio and Powell 1983) to minimise overall costs. In NCE, competitive market conditions can be a natural selection, where only the efficient firms or states will benefit; but it should also be noted that the real-world is an open-ended and unstable environment, evidenced by the unexpected 1997 and 2008 crises. In order to overcome the unstable world, NIE functions at two levels: macro-level environment or institutional environment and micro-level environment or institutional arrangements.

The institutional environment contains political, social and legal structural rules characterised, among others, by individual organisations through elaborating rules and requirements in order to receive legitimacy and support regarding the voting arrangements, for example, in the executive, legislative, and judiciary levels. These arms of government or 'political institutions' throughout history engage in stabilising economic activities and the budget allocation procedures to create order and reduce uncertainty (North 1990, 1991). It can be referred to as reaching the level of *equity*. These arms define the set of options and therefore determine which economic transactions have more economic value (*effectiveness*).

The institutional arrangement is an arrangement between economic units to address and discover a way in which the relationship between units takes place, either by way of cooperation or competition. The institutional arrangement according to Williamson is analogous to the term 'institution' (Kirsten 2009: 57). Institutional arrangements could also be a way to address transactions, either through the traditional free market, the quasi-market or a contract model that uses hierarchy in a state or firm. It can be related to the governance structure and to understanding the importance of defining and enforcing contract laws to achieve a perfectly functioning legal system (*enforceability*).

To illustrate both levels, when giant multinational firms (MNCs) or investors are desperate to enter SEZ in Indonesia or other host country markets due to facing international competition, they tend to change the environment to favour their interest rather than modify the internal structures in response to the environment. For instance, the choice they took to economise the transaction cost, instead of trying to make the established policy more efficient, they often put pressure rather than negotiate with the host government to call for reducing import tariffs (Katz and Kahn 1978 in Harriss *et al.* 2003:

89). Moreover, they craft a favourable labour policy without labour unions threatening to derail the effort through opening new job opportunities and keep the minimum wage at the lowest level possible. Easterling (2007: 76) reminds us that the maquiladoras in Latin America also “*organise a form of labour exploitation that is stable and within the law.*”

These negotiating attempts are attributed to the choice taken by the government who created various SEZ policies (for growth and infrastructure development) in different political settings in Indonesia, which underscores the phenomena on the influence of political hazards. According to Henisz (2000):

“.....where multinational firms have a varied choice of market entry mode based on the extent to which they face expropriation hazards from their potential joint-venture partners in the host country (the level of contractual hazards). As political hazards increase, the multinational faces an increasing threat of opportunistic expropriation by the government. Partnering with host-country firms that possess a comparative advantage in interactions with the host-country government can safeguard against this hazard. However, as contractual hazards increase, the potential benefit to the joint-venture partner of manipulating the political system for its own benefit at the expense of the multinational increases as well, thereby diminishing the hazard-mitigating benefit of forming a joint venture”. (*Ibid*: 334)

The next section elaborates a framework by Williamson (2000) to elucidate the hierarchy of institutional constraints and their relations to actor’s institutional preference to grasp the institutional intricacies surrounding their decisions, why and how institutions affect their decisions, and which institutions affect their decisions.

2. The ‘Hierarchy of Institutional Constraints’

This section presents Williamson’s framework on the hierarchy of institutional constraints (known as social analysis theory) as the theoretical guidance used in this study. It is a basis for understanding causal relations (or causal mechanism in Gerring 2004) to explain how and why they have an influence on actors’ behaviour especially in the cases presented in this study.

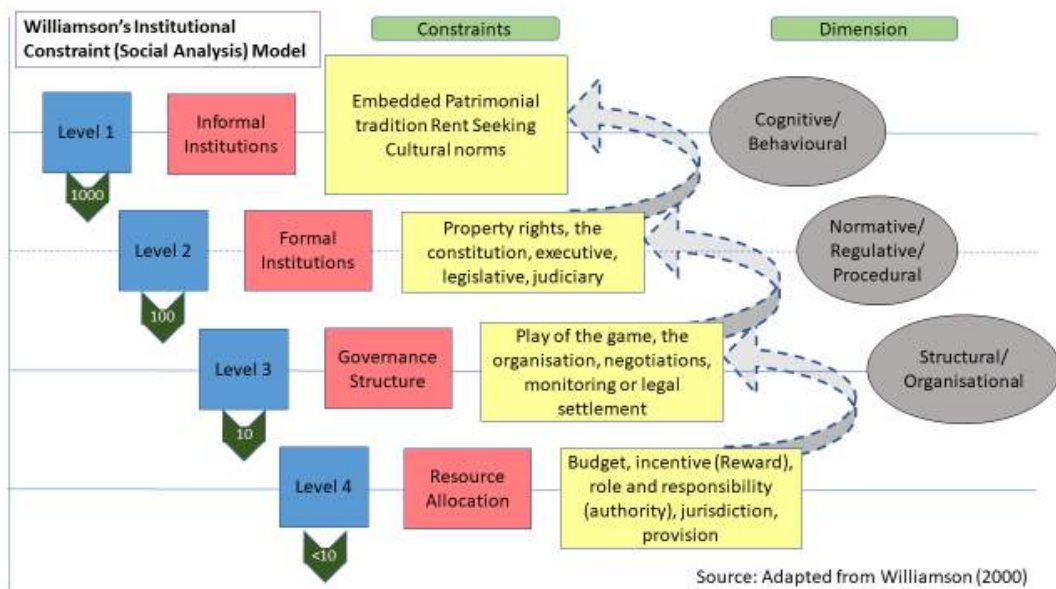
Williamson distinguishes institutions into four interrelated levels of constraints or ‘reciprocity’²²: informal rules, formal rules, governance structure, and resource allocation. Institutions in each higher level impose constraints and will have long-term effects on the level below it (Künneke 2007; Beckman and Padmanabhan 2009). Figure 1 shows the relationship of each level in the hierarchy (model) followed by the explanation of what constitutes each level. The blue square box represents the four levels where each level consists of the institutions that influence actors’ behaviour and imposes constraints from the topmost level of informal rules affecting the course of formal rules immediately

²²The term ‘reciprocity’ was coined by Putnam *et al.* (1993)

below it, then formal rules that have an influence on governance structure, and lastly governance structure that affect the allocation of resources as the lowest level.

The yellow rectangle constitutes each institutional barrier while the grey oval represents the dimensions of each institution. The full green down arrow shows the relationship between higher and lower levels where higher level determines the constraints on the level below. It also describes the general maximum duration of each level in years. The reversed dashed grey arrow shows the opposite relationship that connects the lower and higher levels which indicates feedbacks. In a complete SEZ policy process, the system is interconnected as described in chapter 4, but for the purpose of this study, the author adopts this framework by dividing the hierarchy into two parts to separate the SEZ policymaking episodes to illustrate the focus on the dimensions. The separation does not mean the institutional context in Williamson’s model not well-connected, it basically intends to show the different aspects of institutional constraints through the lens of different levels. The empirical chapters in chapters 5 and 6 outlines in detail the applications of the first and second episodes where the first and second levels in chapter 5 affect each other, while the third level affects the fourth level and vice versa in chapter 6.

Figure 2.1



The author found this framework particularly relevant for this study as Williamson’s hierarchy is useful for understanding the complex institutional dilemma in Indonesia and the subsequent effect on economic reform strategy. Institutions are dynamic and they adapt to changes in a society. Therefore, this concept is used to distinguish different categories of institutional constraints which have an impact on the policymaking process.

The *first* level as the most fundamental and highest level is *informal rules* inherent and embedded in society. It serves as a symbol of social institutions, social structure and human motivations that take centuries to evolve to influence the economy (Azfar 2006: 967). Based upon the work by Helmke and Levitsky (2004) "*informal institutions are socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels*"²³ (Ibid: 727). Informal rules are enforced by groups within society, and underpinned by: ethics, informal agreements and conventions, unwritten prevailing norms and values, ideologies/ beliefs, conventions, sanctions, attitudes, traditions or cultures, customs, and various implicit codes of conduct with a variety of names and designations (North 1991: 97). The form of enforcement system in this level lies in its self-enforcement mechanisms which vary on the degree of impact it has to the society, such as reciprocity expectation, obligation, adherence to internalised norm (standard operating procedures), boycotting, use of violence or threats, ostracism, shunning, gossip, and shaming (Jütting and De Soysa 2005: 5; Jütting *et al.* 2007: 31).

They usually extend, elaborate, and modify formal rules outside the official framework. For example 1) Trust, the tendency to cooperate among individuals who meet occasionally since individuals usually have the same assessment about what type of behaviour would make mutually beneficial cooperation; 2) Ethics and values, tend to restrict the behaviour of individuals to establish norms; 3) Political norms, usually implicit and typically restrict the behaviour of politicians and civil servants. In the context of this thesis, as in Helmke and Levitsky (2004), we treat informal institutions and norms synonymously.

The frequency at this level changes gradually. It is culturally and socially rooted in many generations and economists do not consider this level as variables of institutional analysis that affect economic performance. However, this level is particularly relevant in Indonesia, as culture and ideology are the two most relevant characteristics that can affect formal institutions and are deeply inherent in the society for many years. Despite excluding the cultural approach, this study incorporates the intricate cultural behaviour as informal rules. Moreover, Indonesian nationalism is the predominant ideology since the Old Order and 'small kings' are also entrenched in the political culture of every ruling elite. They play a large part and have a persistent impact upon the national character in the long-run (North 1991: 111).

The *second* level emphasises the 'institutional environment' (*formal rules*) that takes decades to gel (Helmke and Levitsky 2004: 970). It constitutes the legal rules such as 'property rights' (rules of the game), public organisations or 'bureaucracies'. In contrast to informal institutions, "*formal institutions are rules and procedures that are created, communicated, and enforced through channels widely*

²³See also North 1990; Lauth 2000; and Brinks 2003.

accepted as an official" (Ibid: 727). These types of constraints generally include designed and defined constitutions (North 1991: 97) and written rules enforced by the state such as statutes, legislation, agreements, contracts, legal constitutions, property rights, and common law. These rules constitute political, economic, and business agreements which are valid from the local, regional, national, and international levels. For example, 1) Statute, legal documents or formal legislation, regulate the incentive structure and influence actors' behaviour (individual or private organisations), i.e. companies in the market; 2) Civil servants contract, affects incentives in public organisations and other forms of contract between individuals or private organisations, personnel, budget, procurement, reporting and auditing procedures; 3) Constitutional Law, affects the incentives for politicians at various governance levels. It defines responsibilities, fiscal and political relationships. *"These formal rules are generally thought to be codified entities that officials (rulers) ostensibly apply through regularised enforcement mechanisms"* (Jütting and De Soysa 2005: 5; Jütting *et al.* 2007: 31). The enforcement mechanism includes official sanctions, such as fines, incarceration, criminal punishment, etc.

The structure of this level is constrained by the shadow of the past, a history that repeats itself to uphold the right order. The frequency of change at this level is estimated at between ten and a hundred years (Williamson 2000 in Kunneke 2008: 12-13). *"The definition and enforcement of property rights and of contract laws are important features.... that are difficult to change"* (Ibid).

This level includes political institutions or separation of powers/shared authority. It includes how powers are assigned to federal and local governments; for example, in a decentralisation or regional autonomy system in Indonesia or federal system in India, the extent to which citizens can directly participate in the rulemaking through referenda or the existence of a free press. Regional autonomy is one manifestation of the democratic process because it is characterized by the sharing of power. The division of power can be either vertical or horizontal. Vertical embodied by the authority delegation from the national to the subnational government, while horizontally by way of empowerment of parliament and the involvement of civil society in the public policy making and implementing the process. *Interjurisdictional competition* in Jakarta SEZ in chapter 5 best describe the category at this level when inter ministries compete over SEZ budget approval and project proposals. While *Inter-factional tension* emerged between the executive and legislative parties in chapter 6 constitutes conflicts over legislative and constitutional procedures. Thus, through regional autonomy, the process of interaction, interrelation and interdependence among numerous actors are likely to occur based on their respective power and function.

The *third* level emphasises the 'governance', 'contracts' in this respect 'policy', and 'transaction cost economics'. All of which cannot be separated from 'the agency' or legal institutions, the laws and their enforcement that take years to legislate. This level considers aligning governance structures

(regulatory intervention, vertical and horizontal accountability) with the cost of transaction consisting of execution of the contract, policy formulation and its enforcement. The idea is to use democratic procedures to improve the applicable institutional arrangements (Ensch NA). This level focuses on the 'play of the game' or the organisation associated with transaction costs incurred due to actors' action on negotiations, monitoring or legal settlement and related to the perspective of actors on the allocation of economic resources (Kunneke 2008: 13). Thus, it relates to institutions of governance. Property rights deals (national laws and regulations) are institutional arrangements because they allocate property rights to individuals, groups or governments. *Intra-elite rivalry* in chapter 6 best describes this level where property rights deals were not explicitly determined in the contract agreement or law.

According to an earlier study by John R. Commons, a transaction in governance encompasses three values: conflict, mutuality, and order (1932: 4). "*Not only does transaction cost economics subscribe to the idea that the transaction is the basic unit of analysis, but governance is an effort to craft order, thereby to mitigate conflict and realise mutual gains*" (Williamson 2000: 599). It refers to aligning multiple contractual, complex and incomplete institutional arrangements, and whether adaptation is the main issue of economic organisation (Hayek 1945 as cited in Williamson 2000: 600) seeking the suitable instruments to minimise transaction costs and carry out an exchange (Brousseau and Glachant 2008). The government will always change towards more efficient governance that can minimise transaction costs which have an impact on the allocation of resources. The frequency of change takes place relatively quickly between one to ten years. Williamson (2000) considered this a central issue of institutional economics and assumes the enforcement of governance is not costless. Equally important, the emergence of a good governance structure that ensures the certainty of interaction and transaction between actors or stakeholders requires money (i.e. the existence of conflict resolution, the certainty of the contract system, etc.) (Mayers 2005: 3).

The *fourth* level refers to the level at which neoclassical (NCE) analysis works, especially dealing with 'resource efficiency and incentive structures'. It is a continuous level or the use of law by private parties can be established over much shorter periods (*Ibid*: 973-6).

Constantinides (1986: 35) concludes that the cost of transaction reduces the volume and frequency of trade after including transaction costs in an investment equilibrium study. Other studies framed by NCE theory demonstrates the importance of transaction costs that reduce risk in investments (Musole 2007: 36). Institutional constraint at this level takes place continuously (all the time) following the change in economic incentives, the price of resources and manpower allocation. In other words, institutions change following the changes in the price of transaction inputs and vice versa (Williamson 2000: 600). The most interesting advances when adding behavioural aspects within the institutional

change and economic reform model have been on understanding the ways in which actors try to minimise transaction costs. There are problems that may increase transaction costs at this level: the 'principal-agent problem', 'moral hazard problem', and the 'adverse selection problem'.

Principal-agent problems occur if there are conflicting objectives between a principal—a person who delegates responsibility—and an agent—who accepts responsibility, at which time imperfect information occurs that affects a collective outcome (Chhotray and Stoker 2009). This type of situation has engendered *moral hazard*, a term generally used by economists, in which the agent bears little consequence for his actions. For instance, a president must motivate his ministers, who may have different goals, to accomplish the president's objectives such as sanctioning a law in his favour. Moral hazard will display a broader principal-agent problem with the tendency for asymmetric information where the agents' action cannot be observed by the principal or referred to as 'hidden action' problems (*Ibid*). Principal-agent problems and moral hazard can be reduced by institutions that establish effective monitoring or feedback mechanisms which can make performance and results more transparent and measurable. Ideally, the monitoring mechanism should be accompanied by an enforcement mechanism where the management provides effective punishment or exerts control over exchanges. The acceptance, compliance (voluntarily or under coercive practice), and enforcement mechanism of formal and informal rules may have been well established under the society's prevalent conditions, but at the same time are rendered ineffective if their acceptance and enforcement are weak (Azis 2008). However, it is difficult to distinguish which problems are associated with the principal and the agent if the role of each individual is unclear. To illustrate, in the Indonesian case, Pepinsky (2012: 8) argues that the accountability structure in the RDO has shifted from the strict bureaucracy of the NO. Therefore, it is unlikely to identify a specific principal-agent relationship because accountability is a dynamic process that moves either up or down the government level.

In combination, these four levels of analysis are intended to provide a comprehensive overview of how policymaking practices concretely function. This model is used to investigate how and why institutions hinder each other and which types of institutional subjects are assumed and encouraged and what forms of institutional rationality make policy outcomes possible. It captures the reasoning that institutional constraints may lead to risks of higher uncertainty and transaction costs through conflicts between actors such as *intra-elite rivalry*, *inter-factional tension*, and *interjurisdictional competition*.

Before turning to the next section, the following subsection explains the concepts of *intra-elite rivalry*, *inter-factional tension*, and *interjurisdictional competition* used to describe the conflicts between actors or government bodies in a different time (period of government) and space (situation) that occurred in the empirical case studies as some of the study's key findings.

- **The *intra-elite rivalry, inter-factional tension, and interjurisdictional competition* thesis**

This study adopts three terms above generally used in political and intergovernmental competition studies to represent the situation of conflicts between two contending bodies or within an institution to win the rights to power. The *intra-elite rivalry* as the term literally suggest is a form of political or non-political elite competition in a governance structure and is derived from Dick and Mulholland (2011: 65-85) in their study on Indonesia and elites' behaviour where the state is the arena of contestation. While *inter-factional tension* generally means tensions in the faction of legislative bodies and is derived from many sources, for instance, Ramet (1995) on social currents on Eastern Europe's great transformation, Bengio and Ben-Dor (1999) on the political chaos in the Arab world, and Van der Biji (2014) on the history of Great Britain's military operation in Turkey, Egypt and Yemen during British colony. The *interjurisdictional competition* on the other hand based on the study by Kenyon (1997: 14) is defined as "*the manner in which the free movement of goods, services, people and capital constraints the actions of independent governments in a federal system*" (ACIR 1991: 10). These terms describe the conflicts of interests between actors, political institutions or independent bodies represented by economic agents or other stakeholders. The terms are used in chapters 5 and 6 as part of the key findings.

3. Institutions, Institutional Change and Related Concepts

This section points out the general understanding of institutions and their related concepts in order to understand how institutions influence SEZ policymaking.

i. Conceptualising 'institutions'

North (1990: 4-16) describes 'institutions' as "*humanly devised constraints (formal rules and informal rules) that structure political, economic, and social interaction*". By virtue of its form, this study applies NIE as it highlights North's (1990) two types of institutions which interact among societies: informal or unwritten rules (norms and conventions) and formal or written rules (laws and regulations). Therefore, organisations and individuals attempt to reach their goals and interests within an institutional structure in the form of 'formal rules' and 'informal rules' that depend on the levels of acceptance in the enforcement standards and practices by the society either legally (formally) or through their social norms and cultures (informally). It is important to distinguish these rules and to know how they are enforced (North 1990, 2003). The fundamental concern is *how much* institutions matter and *which* ones, not just *how* institutions matter (North 1990 in Slater 2011: 1, *emphasis added*). Following North, this study defines rules as institutions and societies' key institutions are its political 'rules of the game.'

This study investigates to what extent institutions channel politics of policymaking and understand the political patterns in a society when political rules change.

Institutions regulate public and private actors, their organisations, and the interrelated transaction between them and the society (Nabli and Nugent 1989). Institutions influence how people make decisions to improve wellbeing. The relationship between institutions and organisations has a significant impact that affects the outcome of economic performance (Azis 2000; North 2005a).

However, a phenomenon that has evolved across countries is that even though two countries or two or more presidential eras within a country may have comparable formal and informal institutional settings, they may create different outcomes and have very different economic performance. The rules agreed upon by different countries or presidential eras is something that must be adhered to (have the power of sanction) with the aim of perpetuating or creating order. However, since the power of sanction or enforcement mechanism is different between countries or regime periods, the outcome of their performance is also different. Moreover, institutions usually determine constraints on human behaviour as imposed by societal rules (Roland 2003: 5).

For the study at hand, studies by Jütting and De Soysa (2005: 3) and Jütting *et al.* (2007: 32) are of relevance on a general level. They divide the constraints into conditions which are permitted and prohibited to carry out activities by individuals. Henceforth, to solve collective dilemmas in human action, institutional constraints promote some individual behaviours (through incentive structure/frameworks) and prohibit other behaviours (through enforcement mechanisms) (North 1990, 2005a; Azis 2009).

“Institutions are among the tools that fallible humans use to change incentives to enable fallible humans to overcome social dilemmas” (Ostrom 2005:125).

By using the tools, whatever their forms, either formal or informal, institutions provide the ‘rules of the game’ that society facilitates for human connection, and reduce the uncertainty by establishing a stable structure or pattern (which is not necessarily efficient) that will regulate human/social interactions and behaviour in a society (the enforcement mechanism) (Williamson 1985; North 1990 in Shirley 2005; North 1992, 2003, 2005a, 2005b; 2006; Kasper and Streit 1998; Hodgson 2003). An effective enforcement mechanism is the kind of pattern that involves a predictable structure to everyday life (North 2005a), while interaction depends on the level of economic, political, and social activities. As North (1991) puts it:

“The degree to which they are effective is subject to varying circumstances, such as a government’s limited coercive force, a lack of organised state, or the presence of strong religious precept” (*Ibid*: 97).

Therefore, in explaining differences in economic performance, besides increasing social order through effective enforcement mechanisms, key policy actors are important elements and integral parts of the institutional framework (Azis 2009). The study's theoretical concern is that the institutional change or rules of the game in a governance system is much related to the change in the key policy actors. The possible explanation to this is discussed in detail in chapter 4, due to tensions arise in every aspect of society caused by bureaucratic chaos left by Soeharto and Habibie's personal political agenda for presidential election, the reform order in 1999 had no choice but to make extreme modifications in the political structure through the reform of the constitution and bureaucratic/institutional reform or decentralisation/regional autonomy law. Mayers (2005) asserts that these actors can exert emotional or behavioural impact by the success of their organisational goals. This may include the interest of political parties, communities, and social groups (*Ibid*: 3). Enforcement directs the behaviour of key actors towards the desired path of the interest groups to reduce the opportunistic behaviour; this term will be discussed in a later subsection. It also aims to distribute economic resources fairly and equitably (Williamson 2000: 601). In the end, all institutions ameliorate failures and bottlenecks that exist in the markets and among individuals to achieve expected economic growth, the kind of growth in favour of self-interest priorities. These priorities in most developing countries emphasise the will of the successive government.

ii. Institutions Matter

This economic phenomenon has created much controversy, for instance, in Glaeser's (2004: 12) words: *"The economic success of post-war East Asia has been a consequence of good-for-growth dictators, not of institutions constraining them"*. Does this statement apply to Indonesia? Or is it the other way around? Rodrik and Subramanian (2003: 31) concluded that: *"high-quality institutions are critical for growth, and that means the transition from a low-investment economy to a high-investment economy requires a hands-on government."* Djankov *et al.* (2003) further confer that to understand different prevailing *"alternative capitalist systems in different countries requires a renewal of the institutional economics studies"*. As underlined by Rodrik (2008), *"each one of the common economic ends (growth, stabilisation, equity) can be achieved in several ways..."* (i.e. government intervention, the rule of laws, and most importantly the variety of institutional forms) that succeed in advanced countries (Freeman 2000; Hall and Soskice 2001). *"What differs from one country to another lies in the institutional setting in which actors and organisations make their decision, act and interact"* (Rodrik 2008). Therefore, it not only depends on market mechanisms that drive the economy but institutions (non-economic factors) also determine the success in resolving the problems of growth stagnation and encouraging market mechanisms (North 1989, 1990; Rodrik 2003; Przeworski 2004; and Acemoglu *et al.* 2005). This will further underlie the empirical analysis of this study.

For North, institutional regulations and norms of behaviour repeatedly shape interaction between humans (Lieberherr 2009: 4-6). The organisations and the individual behaviour reflect the structure of incentive rooted in society (Cassing 2000). New ideas and institutions are ushered by the tolerated rivalry between interest groups with dissimilar worldviews. However, institutions will alter only very gradually over time, due to the intricacies of institutional interdependence (*Ibid*: 5). According to North, “*If the highest rate of return in an economy comes from piracy, the organisations will invest in skills and knowledge that will make them better pirates*”. However, in order to build a strong, stable and fair economy, developing countries such as Indonesia who are built from different economic structures and always laden with theory cannot use existing generic theory, for instance, Harrod-Domar’s growth model²⁴, Rostow’s growth theory²⁵, and Solow’s growth theory²⁶ proposed by the advanced countries, as the insights gained from these theories are built with general assumptions and tend to persuade developing countries to imitate other more developed countries. Therefore, a theory is a country-specific context where developing countries are encouraged to formulate economic policy strategy from their own national settings including Indonesia.

iii. Transaction Cost Economics

Transaction cost is an essential topic in the NIE and becomes a unit of analysis. Coase’s concept of transaction cost economics (TCE) basically delineates the firm-level institutional analysis. However, this study emphasised actor-centred and policy-based analysis somewhat inspired by the Weberian concept of transactional (bureaucratic) and transformational (charismatic) leadership (adapted from Nikezic *et al.* 2012: 285-296). Under Indonesian circumstances, the transacted policymaking process to a large degree persists²⁷ after New Order (NO) under the patrimonial feature. This means that this study applies the logic of TCE to the problem of policy and political change and intervention. Coase introduces the term transaction costs, but Williamson was the one who tried to make transaction cost analysis more operational (Beckmann 2002: 5)—in this case, the cost of running the economic system by key policy actors.

The varied interpretations of transaction costs originate from a few sources; for instance, Dorfman (1981) defines transaction cost as the cost to adapt to environmental changes including regime changes in carrying out economic reform. Moreover, the cost of seeking, gathering information and

²⁴This theory is known to be the forerunner of the exogenous growth model.

²⁵This theory is known as economic growth theory which occurs in five phases: Traditional society, Preconditions for take-off, Take-off, Drive to maturity, and Age of High mass consumption.

²⁶This theory is also known as the Theory of Economic Growth which postulates the increase in Q (output) caused by 1) an increase in L (labour), but due to diminishing returns to scale there would be a reduction in Q/L or output per worker. 2) An increase in K (capital) which also increase in output and Q/L if the stock of capital rises. 3) an increase in A or in multifactor productivity resulted in the rise of Q/L or output per worker.

²⁷As studied by Crouch (1979).

processing the necessary information so that governance can run properly and in order is also proposed by Furubotn and Richter (2005) and Mburu *et al.* (2003: 59-73) to complement the definition. Regarding the political and economic transformation, the definition gives different incentives from every regime government such as in Indonesia in response to the reform process. As suggested by Williamson (1996):

“...ex-ante transaction cost derived from attempts to prevent transaction failures due to asset specificity and opportunism, including devising or drafting, negotiating, and protecting or safeguarding, and enforcing a contract or rule...” and arising from weaknesses in the contractual situation, while “....ex-post transaction cost are the costs of altering contracts to correct ex-post misalignments, the costs of setting up and maintaining governance structures and the costs of bonding to guarantee contractual commitments.....” (*Ibid*: 379).

An institution is strongly influenced by the prevailing norms, values, and economic complexity so the institutional needs and forms will differ in time (one period of governance to another) and space (from one country to another). In a society that has high communal values such as Indonesia, practically there is no need for modern economic institutions such as those applied in countries in the West. Shared values in western society serve as part of the institution that automatically functions as self-regulation and ultimately can reduce transaction costs. Not until the end of the “*Pancasila past in 1998*” had Indonesia pursued “*a serious imitation of the Western economic model*” (Spranz *et al.* 2012: 464).

Indonesia as a nation already has the sublime cultural values that can be used to encourage the improvements of social and economic norms, such as those listed in the five precepts of Pancasila, Indonesia’s national ideology and philosophical foundation. However, because of the experience at the NO era, which is limited to only the Pancasila on the theoretical level, but not on its implementation, there is scepticism among the public on the importance of the sublime values embodied in Pancasila to boost economic growth. Indonesian public sees culture as a set of values (Spranz *et al.* 2012: 470) to solve problems they encountered to maintain the group’s social viability in their internal and external environment. The five precepts in Pancasila include belief in one God that represents religious tolerance, justice and humanity, a unity that represents nationalism, democracy, social justice and solidarity. In relation to this, Spranz *et al.* (2012: 470) address Indonesian cultural determinants that can reduce transaction costs, including Indonesia’s Javanese culture and religious beliefs. In Williamson’s social theory, religious beliefs play a major role in the institutional analysis (Williamson 2000: 596) as a pervasive influence on economic performance in the long run (North 1991: 111). This implies that if Pancasila can be enforced correctly, transaction costs occurring during the policymaking process can be reduced.

Simply put, similarly, by adopting North’s suggestion, transaction cost is a cost for specifying and enforcing contracts or policy in this study underlying the exchange that by itself covers the cost of the

political and economic organisation; thus, covers the costs of negotiating, calculating, and imposing exchange (North 1991 in Klein 2000: 464).

- ***Asymmetric information and Collective action***

NCE takes for granted zero 'transaction cost' and 'perfect information', whereas the main message is the need for rational agents to opt for a governance structure that minimises transaction cost borne by the political transaction. It relates to dealing with *asymmetric information* (imperfect information) that is plagued with *collective action problems* as the main variables in economic activity (Furubotn and Richter 2005:19).

Asymmetric information; Transaction cost being costless is elusive and irrelevant, as not all economic actors can freely decide whether to enter or exit the market (in this regard, the investment market) and the market will not function perfectly without economic or political actors having enough information about the political economy environment and the transacted goods or services (Priyanto *et al.* 2013:14-27). The more imperfect the information, the higher the transaction costs issued by economic actors. This study refers to how political institutions (by which is meant the 'rules of the game' who in each political system define the procedures and processes through which public policy is made, i.e. authoritarian or democratic government) mitigate or reduce uncertainty (the degree of trustworthiness) included in transaction or administrative costs (Azfar 2012: 966). The broadly defined literature on transaction cost (Arvanitidis 2003) has put it as a serious cause of economic performance (North 1991), and evidently, transaction cost represents about 50 to 60% of the net national product of modern market economies (North 1990; Furubotn and Richter 2000). Moreover, transaction cost contributes to a greater portion of the total GDP of less developed economies (see Hagel and Singer 1999). North (1990: 67) specifically emphasises that at times due to these high costs, no trade or exchange has taken place in third world economies compared to more advanced industrial economies (Similarly, see Williamson 1985 and Coase 1992). Therefore, some economists are convinced that transactions can go on if the required information exists and it needs the cost to collect it.

Collective action problem is one of the political barriers to reform along with distributive conflicts and payoffs/incentive structure from successful reform (Haggard and Kaufman (1995: 156). However, the collective action includes the size, homogeneity and purpose of the policy actors that can be construed as key determinants of success (Kherallah and Kirsten 2001). Therefore, as previously regarded as a useful tool (Mayers 2005; Ostrom 2005) especially for interest groups, Kherallah and Kirsten (2001: 11) suggests that institutions analyse how to overcome the free-rider issues and come up with cooperative solutions to reduce transaction costs. For instance, the management of natural resources and public

goods in Batam FTZ and Jakarta EPZ epitomise the logic of collective goods as asserted by Olson (1971) in the “The Logic of Collective Action” that:

“If there is some quantity of a collective good that can be obtained at a cost sufficiently low in relation to its benefit that some one person in the relevant group would gain from providing that good all by himself, then there is some presumption that the collective good will be provided. The total gain would then be so large in relation to the total cost that someone individual’s share would exceed the total cost” (*Ibid*: 22 and 33).

Therefore, such tools as suggested by Kherallah and Kirsten (2001) related to local institutional arrangements including customs and social conventions in, for example, the ‘Jakarta elites’ in chapter 5 were bound to share their political interest and negotiate the development strategies based on the same cultural background of just a few influential people. Moreover, Nabli and Nugent (1989) and Ostrom *et al.* (1993: 220) have shown that those local conventions can overcome the collective action difficulties and help achieve efficiency since they motivate all policy actors in infrastructure development to keep transformation, coordination, and information costs down. Central to such an exercise is how to identify, explicate and mitigate the contractual hazards as Williamson (1996: 3) has suggested in the *ex-ante* and *ex-post* transaction cost above.

iv. Path Dependence and Institutional Change

North uses economic history to learn how a person or group in society is able to reduce transaction costs and how pre-existing institutions have, to a certain extent, empowered these groups in order to solve their collective action problem (Roland 2003: 10). However, Roland also stresses that the persistence of inefficient institutions not only necessarily resulted from collective action problems but in view of Acemoglu and Robinson’s work (2000, 2001, and 2003), governments in general face commitment problems. There is a lack of *credible and intertemporal commitment* from the government [derived from Spiller *et al.* (2003)] due to the typical non-existence of third-party enforcement (Bardhan 2007) to control and maintain the contract agreement between various groups in society. The usual type that government in developing economies hold when they are in power is that they will use the power for their own best interest. Roland (2003) further asserts:

“Thus, ruling elites who have vested interests in maintaining their power in societies with inefficient institutions may not agree to give up that power because the winners of institutional change may not be able to commit to compensation schemes for the losers. Inefficient institutions may, therefore, persist because of the combined effect of social conflict and lack of commitment” (*Ibid*: 10-11).

Institutional transformation can be explained by tracing the institution’s incremental history and evolution. The study of the institutional evolution in history guides how the pre-existing institutions establish strong causal links and guide human activity in determining the possible significance of predictable patterns or only pure random historical events (Yeager 1999). Institutional change,

according to North (1990) and Ostrom (1990) is incremental and necessarily the consequence of pre-existing institutions; they argue that any change occurs within the parameters of prior or existing institutions (path-dependent). Due to the difficulty in achieving the expected reform, through subjective thought, actors are faced with alternatives to opt for self-reinforcing or maintaining the positive feedback or increasing returns of institutions from the previous positive and viable feedback, both political and economic (North 2005b; Kirsten *et al.* 2009). Other actors will perpetuate the system for their own gains whenever they benefit from existing institutional frameworks (North 1990). For instance, elites' capture in chapter 5 suggests that the NO's patrimonial and clientele feature persist and the common disadvantage of decentralisation was apparent through the appropriation and transfer of resources to interest groups in chapter 6 by Batam central and local elites.

In politics, in addition to Acemoglu and Robinson's (2006) assertion of 'economic backwardness', increasing returns of institutions are particularly strong due to the relatively short-sighted political institutions, the strong *status quo* bias built into political institutions (Henisz and Zelner 2004: 903), and the absence of competition as an efficiency-enhancing mechanism (Pierson 2004: 13). In effect, policy reversal becomes ever more difficult (*Ibid*: 21).

In order to secure national interests, political institutions (authoritarian and democracy) adopt a series of policies and occasionally carry out bureaucratic restructuring—a concept of institutional reform to accommodate the political, social as well as an economic institution to better answer the complex and dynamic phenomenon of international relations (Wesley 2007: 5). For example, the decentralisation phases in the history of Indonesian rulers, the presidents have always been accustomed to the bureaucratic restructuring and cabinet reshuffling²⁸ to support the regime's neoliberal motives. These motives were associated with the merit of trade liberalisation, privatisation, and the accumulation of physical and human capital as elixirs of growth construed as the solution to the development problems (Soesastro and Basri 2005).

Nevertheless, Indonesia's political structure does not seem to have created a warm environment for a desirable and high-quality open market system, especially for long-term prosperity and welfare. Despite the rapid expansion of transnational trade, Indonesia still lags behind other countries vis-à-vis institutional weaknesses that pose a great challenge to stimulating foreign investors in the region. Their recent efforts at institutional reforms such as anti-corruption campaigns are not able to deter corruption as political and corporate strategy blends together and deeply contaminates trade policy formulation, for example, the evidence in the Jakarta EPZ in KBN in chapter 5. This was aptly theorised by Lambsdorff (2007: 218) that the "*negative effects of, and extended opportunities for, unfettered*

²⁸Further detail elaborated in the next chapter.

competitive practices that lead to substantial increase in trade-related corruption". Moberg (2013:4) may argue that institutions channel the self-centred actors' behaviour to stimulate growth, but Glaeser *et al.* (2004) posit otherwise: "*economic growth and human capital accumulation cause institutional improvement, rather than the other way around.*" Thus, the Indonesian reforms provide a great challenge for standard political economic theories.

According to North, the fundamental cause of economic growth is the low transaction costs. Institutions' role in an economic transaction affects the behaviour of the related costs (North 1990). Some economists argue that economic growth could not be maintained in the long-run because it did not involve particular institutional factors (Burki and Perry 1997, 1998; Rodrik 2004; Acemoglu *et al.* 2005). Institutions, mindful of being the 'rules of the game' in a society, are highly elusive. Indonesia and other emerging market economies' underperformance was in part due to achieving economic growth by focusing their economic policy under mainstream NCE on production efficiency and price mechanism on one hand, while ignoring the behavioural assumptions, rules, and social norms on the other (Coase 2000; North 2000; Joskow 2008 as cited in Lieberherr 2009: 1 and Nhundu 2013: 61). Nevertheless, Rodrik (2000) argues that there are also potential risks of falling into a perpetual cycle of institutional change that entails no effect on growth if developing countries have embedded institutional norms (Rodrik 2000: 980).

As explained above, agency or institutional change may occur at any level in response to experience, such as the AFC in 1998, the constitutional change and decentralisation reform in 1999 Indonesia. It will always turn towards more efficient institutional arrangements. The institutional change will be explained in further detail by drawing upon earlier theory provided by Hanisch and Schlüter (1999a). According to them, institutional change has three theoretical underpinnings: *economic efficiency*, *distributional conflict theory*, and *public choice theory* (*Ibid*: 9-12), the author simply wants to capture the essential thoughts of their seminal works as they offer more relevance to the present study.

The institutional change based on *economic efficiency* has three main premises. The first premise was delivered by Hayek (1968), the main supporter of NCE who considers institutional change as 'unintended results of intentional action'. It is spontaneous, not accidental, and is the result of deliberate action. It stresses, in particular, the uncertainty within the process of change and the role of the cognitive limits of each interacting individual. Simply put, a person or group of people will not make an institution/rule when there is no impulse that demands such rules must exist. What Hayek meant by 'spontaneous institutional change' is that the *momentum* to create or modify institutions is spontaneous (unintentional). While the *activities* to make or to realise the institutions are deliberate (intentional) (Hanisch and Schlüter 1999a: 9-10, *emphasis added*). For example, the *formulation* of regional legislation on Jakarta reclamation or the legislature's proposal to upgrade Batam's status from

bonded zone to FTZ is a deliberate act, but the *emergence* of the need for those regulations to be issued was a spontaneous response to a developing situation. Chapter 5 and 6 will elaborate on Hanisch and Schluter's (1999) argument in a more pragmatic way.

The second premise conveyed among others by Demsetz and Alchian (1972) states that atomization and privatisation of property rights are directed to any institution changes in a system (*Ibid*: 9). "*The driving forces behind this are described as external phenomena like technological change which create new cost-benefit relations, where the gains from internalising external effects into the property rights system offset the involved setup and enforcement cost*" (Eggertson 1990 in Hanisch and Schlüter 1999a: 10). This premise is much related to the cases that represent ways to reduce transaction costs, i.e. in chapter 4, the privatisation of SOEs by Megawati to stabilise the economy as her response to external pressure. Meanwhile, chapter 6 the Batam FTZ case which is related to atomization, where President Habibie directed the region towards modernisation and becoming a technological-based production zone so as to compete with Singapore rather than to complement their more advanced industrial base.

The third premise is based on economic efficiency, among others, presented by Williamson (2000) with regards to dynamic movement of institutions in an effort to minimise transaction costs, and North (1990) concerning the changes in the transaction cost that affect the incentive structure or motivation of individuals in interacting with others, thus affect institutional change. For example, information, law enforcement, price, technology, etc. Changes in relative prices on factors of production would encourage parties involved in the transaction to negotiate in order to reach new agreements. Changes in the contractual agreement will be very difficult without modifying the rules of the game (*Ibid*). In addition, institutions are also not resistant to the changing tastes or preferences of the members of society or actors involved in the community. Such changes, as they are believed by North (1990), would threaten the existence of pre-existing institutions. If the actors felt that the existing institutions are no longer relevant to the existing development or environmental conditions, they would try to make institutional change more accommodating to the new environment. This is also related to Roland's (2003) view of government's lack of credible and intertemporal commitment. The loss of cultural values, norms, traditions, etc. of a community is an example of institutional change because of changes in environmental conditions, either through external influences of the socio-economic community or internal factors. For example, in the open market system, developing countries' high market demand for labour-intensive industries, adequate infrastructure, and job opportunities are incentives for investors to gain access to cheap labour and natural resources. Therefore, a regional minimum wage and mineral extraction regulations as applied in several countries are viewed as inhibiting factors by investors seeking economic gain. Thus, investors' practical institutional preferences will try to change,

repeal or ignore the regulation by way of informal or formal negotiation. As a recent study by Dick and Mulholland (2011) notes:

“The state may be construed not just as a transactional space but as a political marketplace, in which access to authority and property rights to economic resources are traded in the process of elite contestation. Trading occurs most obviously through negotiation over the relevant formal and informal rules”. (*Ibid* in Aspinall and Klinken 2011: 66)

Correspondingly, when the Indonesian Foreign Investment Law No. 1/1967 was issued it was considered no longer relevant to current conditions due to its ineffectiveness; therefore, a new investment law in 2007 was imposed. Another example of the actor’s institutional preference in the empirical case in Chapter 4 is the drastic change in the bureaucracy through the decentralisation or regional autonomy policy while chapter 5 discussed the Jakarta Governor’s idea for land reclamation through ambitiously expanding Jakarta EPZ into an SEZ to accommodate the growing population and economic activities. However, despite the ongoing conflicts, his ideas were justified to bring in subtle, yet far-reaching changes while disregarding the fishermen’s livelihoods. He deliberately undermined the legislative procedure and changed the regulation through bypassing the applicable law by informal means to favour big businesses.

Although the stability of institutions is essential for increasing the investment and spurring economic growth, institutional changes have the same indispensable quality. The change of institutions raises the question of how that change might happen, how it happens and how to deal with it. Political economic factors are often the cause that determines the environment and degree of institutional change in diverse times and spaces.

The second theory that explains the institutional change is *distributional conflict theory* presented by Knight (1992) and Levi (1988). This theory assumes that power asymmetries are visible in any social system. They have different interests and strengths and they are the source of conflict and responsible for the development of institutions. Every actor involved in the conflict will try to find a solution by harnessing their former power through changing the rules of the game (regulations). The main reason for the institutional change is to change the existing basic elements of ‘power structure’ and focus the attention on actors’ differences in ‘bargaining power’ (Knight 1992 in Hanisch and Schlüter 1999: 11). Actors who can control the power or have better power, for example, because they control the information, have political access, capital, etc. will control the changing process for the rules to favour their interests (*Ibid*).

“The institutional system is pictured as the equilibrium result of repeated bargaining games between relevant actors. The basic elements of this ‘power structure’ are the fixed expectations regarding distribution, which the players had developed in repeated bargains

in the past. A process of institutional change is started as soon as the present beneficiaries of the power structure (the winners of previous games) can no longer effectively control the payoffs of others. This gives rise to new distributional expectations in society, weakening the existing power structure and fuelling new negotiations. As a result, a new equilibrium of power with its respective formal and informal institutions is established".
(*Ibid*)

In this regard, institutional change is not to satisfy all the parties or to achieve the collective interests but the interests of those who have the power. The process of change can be intentional or a consequence of a strategy for the profit of actors who play it. Therefore, conflicts of interest are often found in the law-making process because of differences in the interests of each of the actors who play it, regardless of whether the new institutions are more efficient or not. As North suggests:

"NIE is a powerful body of theory that relates power to contestation for resources and property rights through formal and informal rules and their legitimating ideology". (North 1990, 2005a in Aspinall and Klinken 2011: 66)

For instance, the government's policy option by embracing nationalist credentials in chapter 5 and 6 clashes with interest groups who pursue rent for personal gain. What is important is how these new rules could benefit their group (*Ibid*: 12).

The third institutional change theory according to Hanisch and Schlüter (1999) is the *public choice theory* developed by William Riker and Itai Sened. The focus lies on the role of the ruling elite as the main actor. It puts more emphasis on efficient production and property rights allocation and the main driving force is the augmentation of the elite's potential utility. Therefore, this theory only regards the intentional change of institutions and formal institutions (constitution, legislation). The incentive structure for the elite and the objective is characterised by the hope of making tangible benefits by either maximising the state budget from the excess productivity through increased tax revenue (Levi 1988), by increasing the probability of re-election (Sened 1997), or enhanced political support (Riker and Sened 1991; Sened 1997). Chapter 5 illustrates how Jusuf Kalla's political alliance established a patron-client relationship with the masses. As a result, it reduced the costs of doing business for all members.

v. *Bounded rationality and Opportunistic behaviour*

Because of market failure, alternative 'market' forms such as government interventions in developing countries, as a form of hierarchy in Williamson's (1975) terms, must inevitably determine the appropriate growth frameworks or policies to reduce the income inequality and perpetuate welfare equality. Among the institutions that matter is 'hierarchies'. Hierarchies in this respect serve as organisations or in this regard 'the state' to allocate mechanisms, mediate and economise transaction costs, not only private firms but also state bureaucracies (Arvanitidis 2003). The most sensible

application of this theory is the decentralisation or regional autonomy given by the state. Indonesia has undergone the big-bang decentralisation in 1999 after the crisis as discussed in chapter 4.

Given the repercussions from opportunistic behaviour in market transactions, the state can eliminate risks of actors who subvert group goals for personal gain. It can also mediate differences and be monitored more easily than the market (Williamson 1975: 20-30). Opportunistic behaviour is a behaviour that seeks to achieve their own desires even by illegal means (Ostrom 1990). However, this theoretical judgement will be explored in detail in the empirical chapters. There was evidence of the state (principal) not able to control the opportunistic behaviour of the actors (agents) in chapters 5 and 6 that needs further investigation. Given the possibilities of such behaviour to occur, as Williamson (1985: 6) in Boston *et al.* (1996: 22-23a) suggests that a proposed policy dialogue, amidst an uncertain and complex environment, with government *ex-ante* action, might be a solution rather than place an immediate *ex-post* enforcement mechanism on the actual outcomes of transaction costs to settle conflicts occurred in the policy process; this will reduce the risks of a bounded rationality of actors in a governance structure that entails high transaction costs and large cognitive demands without resorting to the judicial system. Bounded rationality according to Herbert Simon (1947) denotes:

“...‘satisficing behaviour’...That is to say, the inherent limitations on decision-making encourage people to behave according to well-established routines, patterns and rules, to seek predictability and certainty in organised or structured environments, and to be highly selective in the range of information upon which they draw in making choices. As the complexity and uncertainty of a situation increase, the greater the limits imposed on individuals by their bounded rationality and the more likely it is that the transactions into which they enter will fail” (*Ibid*, quoted by Boston *et al.* 1996: 22-23).

These individuals or actors according to Simon, subject to the above premises of high transaction costs and large cognitive demands, generally play games and utilise resources through political lobbying (access and use their legitimate rights) to control decisions and make choices based on evolving trial and error (Brousseau and Glachant 2008).

There is always an incentive for individuals to behave divergently so the economic system cannot only be guided by the market. Therefore, it is imperative to use non-market institutions (the state) in order to protect the market from the endless ‘market-failure’ trap of the neoclassical paradigm by designing adequate ‘rules of the game’ in economic activity. Rules regulate how economic activity is organised, coordinated and implemented. Economic reform will only work effectively if the rules of the game are clearly defined and efficiently implemented. Without well-enforced rules, economic reform will result in chaos as was seen in the ex-Soviet Union. However, as is evident in Korea, state intervention was focused on the function of the state as a facilitator and regulator (Chibber in Ikhsan 2000: 10).

From the property rights aspect, first, state intervention is appropriate and justifiable if transaction cost can be reduced and reach the highest possible efficiency, under the condition of a large or unknown number of parties involved in a transaction. Consequently, the transaction cost will be high with the cost of negotiation or private arrangements. In effect, the entire transaction could be aborted and efficiency is only possible through interference from central government (Johnson 1994, 2000). As Chibber (2002) asserted, the Korean government built a successful coalition with the business class (*Ibid*: 29-32). Korean state sets formal rules as part of the institutional environment. Thus, the state is a unique organisation that develops and establishes formal rules through social and political processes and plays an important part in the transaction between state and business as part of the organisation.

Second, when the transaction costs by means of the 'market' are higher than the 'hierarchy', government intervention is inevitable. In effect, this failed private agreement generates higher transaction costs. If there are impractical conflict resolutions by the market, issues of complicated bargaining process arise, thus state intervention is required to enforce the contract agreement as requested by the bargaining parties (Goldberg 1976 and Williamson 1975). *"Transaction Costs are persistently so high that markets fail or do not exist, or where tendencies towards concentration, with resulting abuse of power ... in which government capacity to regulate monopoly is limited"* (DFID 2000: 5). Lai (1997: 201-202) remarks: *"In this situation, 'externalities', 'public goods' and 'monopolies' may pose real problems, and government intervention may be necessary"*. Coase (1959: 29) stated that as a practical matter, it may be preferable to impose government special regulation if the market becomes too costly to operate. The case in Batam FTZ will embody these environments despite central government's neoliberal motives and withdrawal during decentralisation.

vi. Logic of Appropriateness

The rules or logic of appropriateness proposed by March and Olsen (2004) are also to a lesser extent the focus of this study in the democratic political orders context with formally organised political institutions. In this regard, *"the role of rule-driven behaviour in life might illuminate thinking about political life"*.

"Democratic political system shapes and is shaped by the processing of information, institutional memories, and the codification of experience into rules.... Rules of appropriateness are followed because they are rightful, legitimate, expected, and natural. Actors seek to fulfil the obligations encapsulated in a role, an identity, a membership in a political community or group, and the ethos, practices and expectations of its institutions... Embedded in a social collectivism, they do what they see as appropriate for themselves in a specific type of situation" (March and Olsen 2004: 2 and 18).

Following the logic of appropriateness, March and Olsen suggest that the goal-oriented rational individuals and organisations have the main task in equating the right perspective on decision-making

and in synthesising the limits of rational decision. But their rational behaviour is oriented in avoiding inefficiency in a market competition where there is the assumption of self-interest individuals with differing rules, identity, situation, and action (*Ibid*).

Decision-making following the logic of appropriateness is highly contextual. Its pattern is changing based on its adaptation to a historical event that involves collective imagining taking the form of strategic planning, training, vision, and leaders' aspirations in the analysis, bargaining, patterns of imitation, and experience of trial-and-error in the institution (Scharm and Neisser 1977). It is informed by contextual rules and identity full of ambiguity, uncertainty, risk, limited attention, and essentially imperfect information. This manifested itself in Indonesia's attempt to imitate the East Asian (EA) Tiger economies to boost its withering production capacity in the 1980s as discussed in the later subsection.

vii. Political institutions, policymaking process and policy outcome

In view of the above decision-making process, this study draws on the theoretical and methodological framework derived from Spiller *et al.* (2003) on Latin America where the argument of political institutions, policymaking process and policy outcome (PMP) has also emerged as a viable theme in institutional economics studies.

This study analyses how political institutions influence policy outcomes. Thus, within the PMP, instead of being affected directly by institutions or rules of the game, policy outcomes are more susceptible to the key actors playing a fundamental role in the policymaking process—designing, approving, and implementing policies. The emphasis of this framework is on the way in which some characteristics of the political institutions prompt the country's process of policymaking toward nearly cooperative intertemporal political transactions (Spiller *et al.* 2003: 3). Ultimately, the PMP is grounded in each country's political process—including Indonesia's decentralisation, as Spiller *et al.* put it:

“...in turn, the political process is conditioned by the incentives and constraints faced by the key political actors. These, in turn, are shaped by the country's political institutions, that is, by the rules of its political game. This is the reason for this project's emphasis on understanding the way political institutions shape political incentives and behaviour, how political behaviour influences policymaking processes (and State capabilities), and how policymaking processes determine the properties of public policies”. (*Ibid*: 4-5).

Furthermore, key veto players (individual or collective actors) in a political system with a different ideology, different degree of internal cohesion, and a different number of actors must come to an agreement to the policy change proposal. It is the way in which a country ceases the moment to change the established system, it is the exception rather than the rule (Williamson 2000 598).

“These characteristics affect the set of outcomes that can replace the status quo (the ‘win set’ of the status quo). The size of that win set has specific consequences for policymaking: when it is very small, ‘policy stability’ obtains” (Spiller *et al.* 2003: 13).

Cox and McCubbins (2001) in Spiller *et al.* (2003) further suggest that:

“The most important trade-offs in policymaking is the ability to change policy (‘decisiveness’) and the ability to commit to a given policy once it is enacted (‘resoluteness’). Different institutions (electoral rules, the number of chambers, legislative procedures, etc.) would map, through ‘separation of powers’ and ‘separation of purpose,’ into an effective number of veto players (à la Tsebelis). Countries with more veto players will be located closer to the resoluteness end along a decisiveness-resoluteness continuum. The dual notion of separation of power and separation of purpose is one explicit ‘micro foundation,’ or intermediate module, towards empirical implementation of the counting and characterization of veto actors. The effective number of vetoes increases when a polity has both many institutional veto points (separation of power) and political actors with diverse interests controlling those veto points (separation of purpose)” (*Ibid*: 13)

It implies that more separation of powers greatly affect the rise of varied transactions with varied governance needs; specifically, in Williamson (1983:519), these will be expressly recognised through the governments’ credible commitments carried out in support of coalitions and to support exchange, or credible threats appearing in the conflict and rivalry contexts.

North, on the other hand, offers a more reasonable explanation that despite reaching a high-level credible commitment, transaction cost will also be much higher than mainstream NCE due to the higher cost of exchange in formulating institutional frameworks.

“It should be stressed that creating an institutional environment that induces credible commitment entails the complex institutional framework of formal rules, informal constraints, and enforcement that together make possible low-cost transacting. This argument states that the players may devise an institutional framework to improve measurement and enforcement and therefore make a possible exchange, but the resultant transaction costs raise the costs of exchange above the neoclassical level” (North 1990: 57).

The role of credible commitment has also been further argued by Engerman and Sokoloff (2008), in that policy is flexible and elites may change the policy depending on how much it gives more benefit to the group compared to the constituents.

“Credible commitment to acknowledge private property rights, whether in the interests of the elite or the majority of the population, is the classic example of the value of certainty about policy action. More generally, however, allowing some flexibility in institutions, such that they can be altered to allow private or public agents to take fuller advantage of new opportunities that arise as technology or the environment changes, would be expected to foster improved economic performance and more rapid growth” (*Ibid*: 125).

From this perspective, the institutional change process is inevitably affected by the country’s political sphere. Even though there are effective political processes which offer no assurance to suitable reforms, the initial institutional change and improvement conditions nonetheless exist. In the Indonesian case, Boediono (2013) admits that policy outcome that becomes more intricate to design

and rules are difficult to implement since for much of the time after independence, the rules of the game are less explicit and the political processes are less established.

To summarise the first part of the chapter, institutions do matter in economic reform and policy process especially SEZ as a policy instrument through varying nature, degree and intensity which explains the difference in the SEZ performance in a different time (period of governance) and space (country). Institutions influence actor's behaviour and policy preference in decision making.

The following subsection discusses the SEZ relevant literature and the possibilities of the influence of institutions to SEZ policymaking.

B. SEZ relevant literature 'the development rationale'

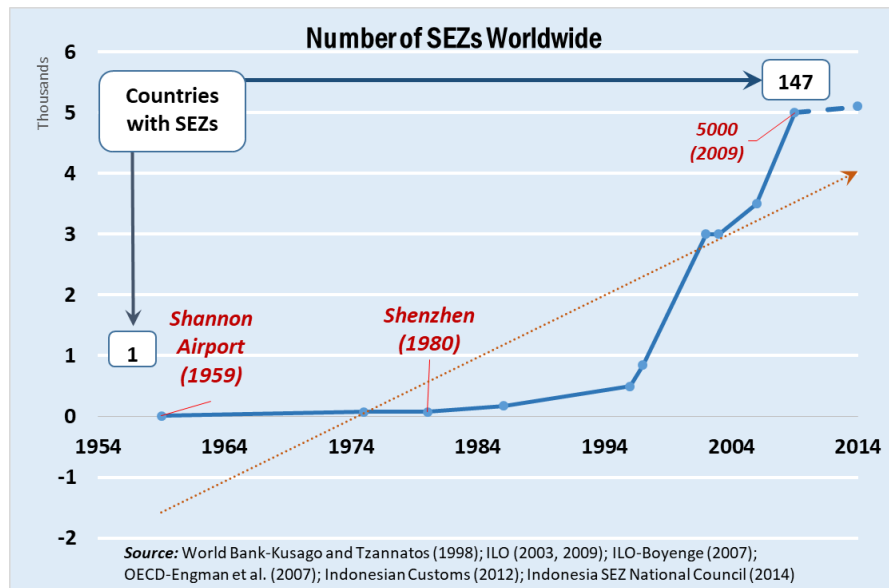
The previous subchapter focuses on why institutions matter in policymaking process, how the institutions have an effect on actors choice of policymaking and their actions toward the implementation process, and the effect of the institutions and actors behaviour on the policy outcome. The literature also highlighted how and why Williamson's (2000) framework of institutional constraints can modify the behaviour of key policy actors and therefore alter the effectiveness of the chosen policy.

This subchapter centres on the SEZ policy development process, how and what ways the rules of the game changed, and the organisation, the actors and the human resources that are playing it in order to explain that institutions matter in the policy formulation process on SEZ. The first part explains SEZ definition and types, the second devoted to the SEZ importance from global literature and why it has become the second-best policy, and the third shows where and what ways institutions matter in the SEZ policy process. The fourth part summarised the subchapter.

1. Understanding the definition and typologies of SEZ

The term 'Special Economic Zone' (SEZ) has a broad meaning because it can be used to describe various types of commercial zones. The factories in Maquiladora, Mexico, and the whole city of Shenzhen are SEZs, although they have differences in structure and size. The term SEZ in the world today varies greatly and is much intersected with many other terms with neither have a standardised definition nor model. The term is also widely known as the modern iteration of the free commercial zone, which was first established in 1959 in Shannon, Ireland. Currently, at least more than 147 countries in the world developed this modern economic zone based on the survey conducted by the World Bank, ILO, and OECD and the tendency of the number will increase is high although not a sharp one as shown in figure 2.2.

Figure 2.2



Although various types of free areas have existed in history for decades, it was only in 1970 that these areas were used as drivers of economic growth in developing countries. This policy develops especially in developing countries that change its policy of growth policy based on import substitution. In the 1970s and 1980s, countries in Asia and Latin America began to shape these areas. This establishment is aimed at attracting labour-intensive industries in coastal areas. Furthermore, the area is transformed into a pivot region of drivers of economic growth through exports. The movement of the formation of this region accelerated in the 1990s where other countries tried to replicate areas that proved successful, such as some areas in Asia and Latin America. Looking at the establishment of these areas is based on the same reasons, many of these regions have the same key characteristics. This area was formed in isolated enclaves given government incentives and privileges. This area is often located in remote areas but close to the transportation hub. The area is designed to attract labour-intensive industries, the industries that are concentrated in the region are mostly textile, clothing, and electronics industries (Cling and Letilly 2001).

The World Bank defines SEZs in all its forms comprises, at a minimum, as “geographically delimited areas administered by a single body, offering certain incentives to businesses which physically locate within the zone” (World Bank/Akinci and Crittle 2008: 2). In other words, SEZ is a zone where the government hopes to increase economic growth through increased exports and investment by providing various competitive advantages for entities that choose to be located within the zone. By this definition, some developing countries like Indonesia appointed a single body as a coordinating

agent²⁹ to oversee the implementation of SEZs. The key SEZ policy actors will be defined in the following section.

At least 66 different terms were discovered (World Bank 2008: 9) to describe what is generally known as SEZ around the world, including free trade zone (FTZ), bonded zone (BZ) or export processing zone (EPZ), maquiladora (known in Mexico, the Caribbean and most Latin American countries) etc. (Chen 1995; Kusago and Tzannatos 1998). All refer to the presence of defined locations for export-import and investment promotion activities.

Keep in mind that of the many kinds of literature that address this topic, the terms are used alternately with SEZ. Nevertheless, the names explain a slight difference that lies in the objectives as well as the expected outcomes of each zone. The Free Trade Zone, also known as the Free Commercial Zone, is the most widely located SEZ in the global port. This zone is designed to support trade, shipping and export by providing tax-free areas, and facilities such as storage, warehousing, etc. Singapore, for example, has six Free Trade Zones in its port area where goods can be stored and free of charge, and where customs procedures have been simplified for goods entering or passing through Singapore. The Export Processing Zone (EPZ), as the name suggests, is designed to promote and facilitate exports. In a typical EPZ, all zones are allocated to export-related companies. These zones may be referred to as Industrial Zones indicating that they are designed to promote industrial activities, both export and import. Lat Krabang Industrial Estate in Thailand is one of the new EPZ models. Finally, Freeport is a larger zone that accommodates all types of activities, contrary to the SEZ model that emphasizes only exports and other trade-related activities, or activities centred on manufacturing and production industries. Just like other SEZs, Freeport helps activities related to commerce or manufacturing activities, but Freeport can promote tourism, retail, allow people to stay permanently within the zone. The benefits and incentives provided in Freeport are more diverse. China is known for its success in creating multiple Freeport, such as Shenzhen SEZ. Meanwhile, Batam, located in Indonesia, a smaller SEZ compared to Shenzhen, has both FTZ and Freeport.

Some scholars and organisations, such as the World Bank (1998, 2008), Ge (1999), Aggarwal (2006), Ishida (2009), Yeung *et al.* (2009), Murray (2010), and Cheesman (2012) use 'Special Economic Zone' as a generic term. It is a general designation to encompass a variety of SEZ regimes as it can generalise the dominant characteristics of them. However, some policymakers either distinguish between these terms³⁰ (World Bank 2008: 9) or adopt the term EPZ as a common expression that covers all variations,

²⁹Indonesia appointed Coordinating Ministry of Economic Affairs as coordinator and the minister as chairman of SEZ National Council during the SBY administration in 2008 (Further discussion in chapter 5).

³⁰Many SEZs include EPZ industrial parks within them such as Shenzhen SEZ in China, the progress of information technology development centre in Bangalore, India, the progress of the port city of Pusan, the shipbuilding industry in Taegu as well as Industrial Zone in Masan Zone in the Republic of Korea and Kaohsiung SEZ in Taiwan.

remaining the most popular designation for this repeatable formula (Boyenge 2007). Nevertheless, these models are sufficiently different in the approach, investment requirements, and objectives. Regardless of the many differences, SEZs can be broadly defined as:

“Demarcated geographic areas contained within a country’s national boundaries where the rules of business are different from those that prevail in the national territory. These differential rules principally deal with investment conditions, international trade and customs, taxation, and the regulatory environment;...more liberal from a policy perspective and more effective from an administrative perspective than that of the national territory” (Farole 2011: 23).

2. SEZ importance from global literature

There has been much diversity in the reform experience and record of growth performance especially SEZ programme in most of the major developing countries since 1970. The aspects that have significant roles in the reform include the successes and failures of the incremental reforms and the major policy turns in the macroeconomics and the sectors, both globally and domestically. This diversity reflected in the development levels of the region and its political/institutional structures, which adds to the fruitfulness of the study.

In the NIE context, many agenda of reform phases are *ex-post* reactions to earlier reforms or existing unsolvable issues relating to further necessary steps. This should not be misunderstood as a reform blueprint already available at the beginning of the reforms, such as in China in 1970 (Knoth 2001: 39). In the last few decades, the emerging economies’ economic transition has generally been considered and discussed. However, the inward-looking industrial growth strategy (generally recognised as *dirigisme*) circa the 1970s to 1980s was greatly contested. After a prolonged phase of economic difficulties, Keynes productive capitalism³¹ was unable to resolve the simultaneous occurrence of economic stagnation marked by rising unemployment, persistent stagnation and rising inflation (stagflation), as well as the soaring global oil crisis of the 1970s.

Furthermore, the 1970s oil price shocks and the rise in domestic labour costs have contributed to the inevitability of firms from developed countries discovering new ways of minimising manufacturing costs abroad mainly to developing countries while developing countries gain the advantage of receiving much-needed capital from foreign investors (Das 2012: 23-30). Nicola (2009) states that a mixture of foreign investment and domestic labour is estimated to escalate the domestic production value and contribute to a country’s economic growth. More importantly, foreign investors are assumed to contribute to the management techniques, technology transfer, product competition and in so

³¹Keynesian economics gave a large portion for the government to intervene in the market through the fiscal and monetary instruments.

doing increase the modernisation speed and contribute to acquiring access to industrialised countries' markets.

In addition, with the rapid economic liberalisation in the globalisation era, the East Asian (EA) Tigers (World Bank refers to them as HPAEs/High-Performance Asian Economies) capture of export-led growth promotion (export-oriented industrialisation or EOI) poses challenges for developing economies wishing to use SEZs.

“The rising labour costs in China and other EA countries as early adopters of SEZs provides an opportunity for other economies to become viable locations for global manufacturing activity, provided such countries are able to market themselves as attractive investment destinations” (Woolfrey 2012-Trade Related Capacity).

Moreover, the driving forces for EA economies to favour export promotion increased international competition for FDI, fuelled by the desire to join global manufacturing, the end of the global trade for apparel products under the Multi-Fibre Arrangement (MFA), and lately, weaker demand in traditional export markets (Farole 2011). During this phase, the political actors' decision affect the process of reform in various ways. The pace of this transition varied but observing the past achievements and the optimistic effect of the EOI policy on the EA's economic development, emerging countries across the globe began to imitate EA's policy (Knoth 2000)³² as the EA became the benchmark of successful economic reform. Many emerging market economies including Indonesia have failed to imitate their success utilising the role of foreign investment to reduce poverty by providing jobs more effectively than what may have been created by the state or local firms. Indonesia ignored the fact that there are different institutional considerations behind successful economic reform between emerging market economies and the EA that should be considered (Stiglitz 2003: 113-121; Rodrik 2007: 153-183). Therefore, it is not “*whether a country should accept FDI, but how to put it to use*” (Latt 2007: 62). The discussion to follow explains the root of the institutional differences.

Many developing countries after their independence first attempted inclusive industrial development import substitution industrialisation (ISI) (for Indonesia it was the early 1970s) and infant industry protection programmes that substitute imported products with domestic products. ISI was considered costly and theoretically misguided (Khan 2000; Alauddin 2013). Furthermore, this strategy often created severe market distortions due to dependence on overvalued exchange rates, large bureaucracies to address international trade and rigorous import controls (Bruton 1998). Moreover, the economies of many newly independent developing countries were increasingly more centralised as various forms of state-led and socialist systems were embraced such as in India and Africa (Heilman

³²Knoth (2000) asserts that the controversy on the correlation between economic development and export promotion still occurred although it has become the new development policy paradigm.

and Lucas 1997; Paul Dana 2000), not to mention Indonesia in the Old Order (Sukarno period before 1967). This popular approach in the 1950s and 1960s also had restricted effect on these countries' growth and a very insignificant increase in living standards (*Economist Intelligence Unit* 1979: 1). Government measures include company nationalisation and increased taxation. Moreover, the soaring oil price has allowed the government to implement a trading strategy that is more inward-looking to help economically weak domestic businesses through a various subsidised credit on agriculture industries and power generation, and other highly protectionist and interventionist policy measures. These measures are based on the logic of self-sufficiency of the importing country through the local industrialised production (Soesastro and Basri 2005; Widodo 2008). However, negative externalities such as rent-seeking behaviour may complicate the process of infant industry protection. Business society or private entrepreneurs constantly search for opportunities to generate profit through protection, corruption, other incentives, or legal loopholes.

The so-called structuralist³³ development model (Clements 1980) initially emerged as a challenge to monetarist 'conventional wisdom'—the neoclassical model. The argument is that the state-led industrialisation in the neoclassical view has led to inflation through creating distortion in the market (Khan 2000; Alauddin 2013). However, this development model does not explain the extent to which many developing economies pursuing ISI strategy were unable to show any signs of catching up with the advanced economies; the prerequisite for catching-up are the levels of trade openness and protection to private property rights (Sachs and Warner 1995) and the "need for 'Social Capabilities', which is the ability to absorb new technology, attract capital and participate in global markets" (Abramovitz 1986). The developing economies, however, were unable to sustain the expected development in the long-run, i.e. Latin American countries (Argentina, Brazil, to a lesser extent Chile, Mexico, Uruguay, Venezuela, Peru and other poorer countries such as the Dominican Republic, Ecuador, and Honduras) (Krugman and Obstfeld 2009: 256).

Indonesia never determines or chooses any development strategy. Griffin (1999) implicitly expresses that Indonesia's economic development policies in the NO era were not based on a clear, deliberate, and chosen strategy (*ibid*). Along with Malaysia and Thailand, Indonesia implemented ISI strategy but its growth is more widely supported by the agricultural-led sector and the export of primary products—

³³Structuralist thought evolved in the 1940s to early 1960s and assumes that developing countries are characterised by cultural, social and institutional constraints that prevent change and their resources tend to stagnate (supply of goods and services is inelastic). It tends to be more concerned with the management of quantity than price of goods. It is generally marked by failure; sometimes they reached the target but often through poor implementation and achievement. For example, the World Bank gave its first loan to countries outside Europe in 1948. At that time, many developing countries were already busy in some form of centralised economic planning. Important also to note that the structuralist ideas dominating in the early 1950s were accepted by western academic scholars in the early 1960s.

the bread and butter of most developing countries. The small value added compared to the high technology manufacturing products of the more developed countries has led to criticism largely accepted by developing countries in the late 1980s, directed at the abandonment of protection policies towards trade liberalisation. This departs from the fact that the implementation of liberalisation policy has a faster growth rate than countries that implement protection (Krugman and Obstfeld 2009: 257). Liberalisation relates to the reduction in tariffs and eliminating the import quota and other trade restrictions while opening trade to the international community. In general, there are two major effects: an increase in the amount of merchandise and changes in the nature of trade (*Ibid*: 258). The embodiment of liberalisation is the export orientation policy whereby EA Tiger countries achieved significant change. However, controversy arose as:

“Trade liberalisation is sometimes illustrated as a two-edged sword since it can create opportunities as well as threats to the domestic economic development...The opening up of markets not only offers welcome opportunities for the development of exports but also provides a competitive environment for international and domestic markets. The benefits or losses from the opening up of the markets depend very much upon the readiness of all domestic economic agents (producers and consumers) as well as the government” (Widodo 2008: 162).

Furthermore, the pattern of ISI in Indonesia only provides specific industries with protective trade barriers, generates more assembly industries, and high dependence on imports (Gie 1999). Hence, ISI policy failure has reduced the developing countries’ prospects to emulate the EA Tigers’ success story. Narula (2002: 11; 2003:1) has aptly identified the main causes of the failures, i.e. *“the weakening role of the state; the unreasonable expectations for industrial development from the FDI liberalisation; unable to sustain the ability to efficiently absorb, internalise and utilise the knowledge potentially made available and developed elsewhere if they are to ‘catch-up’ (absorptive capacity); FDI and domestic capacity were not sequenced in tandem; unable to recognise the inertia of transition and coordination failures”*.

Some observers noted that EA countries’ outward-oriented policies and their potential for free trade were improving, but it was disputed since these countries are still implementing protection policies. Despite free trade policy often being heralded as a driver of growth and the positive connection between economic growth and the economic openness, evidence suggests that the policy had a low impact on the spectacular economic growth in these economies—i.e. export growth, FDI sector, and backward linkages to other parts of the domestic economy (Hirschman 1958; Edwards 1993). The key to the EA countries’ success was not only that they applied import restrictions, tariff policies, low-interest loans, export subsidies, and government support in terms of research and development but also their unique institutional characteristics (*Ibid*).

NIE has brought an important shift in the development discourse. *“....development should be redefined as economic growth plus appropriate institutional change; meaning institutional changes which facilitate further economic growth”* (Toye 2003: 61). The rapid development of the four EA Tigers and the phenomenon of slow growth of the developing countries (Africa and Latin America) in the 1970s and 80s, the disappointing performance of the post-Communist transition, followed by the AFC were all rooted in institutions and redefining the economic development strategy.

Indeed, there are some success stories in the history of economic integration of developing countries in regional and global markets. For example, the development of SEZs in China (Shenzhen, Guangzhou, Shanghai and Hong Kong), the information technology development centre in Bangalore-India, the port city of Pusan, and the shipbuilding industry in Taegu, South Korea. However, it should be highlighted that there are key explanatory factors behind the success story. First, the economic infrastructure can support and facilitate investment activities. Second, the government’s ideological value includes knowledge with a competent, corruption-free, and efficient bureaucracy. Third, the availability of skilled labour is high to support industrialisation. Fourth, the state’s persistent high intervention and economic readiness and ability to adopt technologies that produce high value-added goods are undisputed. Ironically, for Indonesia, those factors are still issues to be deciphered and colour the episodes of the economy.

Unfortunately, Indonesia’s economy is not yet in a condition to be able to maximise the benefits and advantages of the integration agenda. State involvement generally takes different forms from administrative/regulatory controls, taxation or subsidies, provision of goods and services, participation in investment, and/or direct ownership (see, for example Rodrik 2008; Chang 2009; Lin and Monga 2010; Capling and Low 2010; Wade 2012; Stiglitz and Greenwald 2014). Although the foregoing insights on the neoliberal paradigm under the NCE approach seem to underemphasise the role of the state, it is not essentially applied to the formation of SEZ and investment. Albeit current literature on Indonesian SEZs highlights problems with externalities and strategic competitiveness, some central issues persist regarding the role of the state to find the most efficient strategy to achieve success with the policy platform in promoting trade and investment. Since liberalisation usually implies significant institutional changes, our framework of economic reform is useful for analysing the implementation of liberalisation under political transformation. Successive governments over the years are challenged on striking the right balance between designating the right location for the zone to eliminate regional inequality and the public and private collaboration to develop these zones. Heavy state intervention is crucial in overcoming these overarching problems associated with FDI inflows into the SEZ localities. Furthermore, Schrank (2001: 223) suggests that EPZs act as a shield for domestic firms from

competition in order not to expose them to the world market, which in Indonesia case further entails unsuccessful fundamental structural reforms at the central and local level.

This raises another investigation as to how such a choice can be negotiated between the actors (political institutions, SEZ management, and business actors) while sustaining the successive government's outdated rhetoric and short-sighted character. How did the ruling elite consolidate political power to form SEZ and investment policies as part of the reform strategy or vice versa? In view of Indonesia's salient feature to maintain old institutions through patrimonialism and clientelism and by engaging in rent-seeking practices, these institutions neglect or constrain the capacity of democratic rulers to introduce the new SEZ policy. This is a unique experience in the intricacies of Indonesian political economy and has been under-researched.

Some SEZ classic works by scholars oppose the positive effect the SEZ has on economic growth, i.e. Hamada (1974), Rodriguez (1976), Hamilton and Svensson (1982), and Warr (1989). Other scholars support the SEZ idea due to its divergent positive externalities, i.e. Miyagiwa (1986), Young and Miyagiwa (1987), Chaudhuri and Adhikari (1993), and Din (1994). Their reasoning is explored below.

The most common macroeconomic theoretical perspective comes from wealth effects of SEZ in the context of the Heckscher-Ohlin Model by Hamada (1974). Hamada (1974) uses the standard two commodity model to affirm that in the absence of foreign direct investment (FDI), SEZs do not affect production if tariffs on final goods are removed; and the increase in FDI does not automatically improve the consumption but reduces national income in the developing country. He assumes that the host country's comparative advantage on full employment distorts the consequences of SEZs in developing countries (Hazakis 2014: 89).

Hamada's theory was developed further by NCE economists Rodriguez (1976), Hamilton and Svensson (1982). Their studies suggest that SEZs in developing countries not only distort efficient resource allocation through dispossession of key national resources (welfare decreasing) but also introduce unfair competition practices between domestic entrepreneurs and multinational firms inside SEZs and impose high infrastructure costs (Warr 1989).

“The conclusion of the aforementioned analysis is that in an internationalised trade environment the rationale in favour of special zones loses ground as the national economic conditions become favourable to entrepreneurship and the country fits its Hecksher-Ohlin comparative advantage” (*Ibid*).

Young (1987) also ascertains that distortions can be worse if tariff reduction on intermediate goods and taxes on foreign capital—that attract resources from the surrounding domestic zones— remain in the domestic zones and eventually decrease welfare and host countries' national income. To avoid such occurrence, Miyagiwa (1986) suggests the bigger role for the host government in formulating a

well-defined policy could mitigate economic distortions and promote welfare, i.e. through government subsidy that can promote industry diversification and export. Din (1994) however, does not assume any distortions from tariffs; instead, increases in FDI in the FTZ can generate higher national income under non-traded intermediate goods.

Young and Miyagiwa (1987) use Harris-Todaro's unemployment theory to postulate otherwise. They assert that FTZ unequivocally raises the value of national productivity in developing countries. It raises wealth and employment through tariff reductions on the sectoral basis that can *"raise the wage in the non-unionized sectors which reduce the gap between this and the unionized wage and hence reduces the unemployment required to equalise expected wages in the unionised and the non-unionized sectors. As a result, the increase in the wages exceeds the reduction in the return paid to domestic capital plus the loss of tariff revenue at the current volume of imports"* (Ibid: 403-4). However, the rigid wage structure in Indonesia creates another distortion. Moreover, in the context of high urban unemployment within SEZs, Chaudhuri and Adhikari (1993) state that it is not necessarily welfare improving despite the mobility of domestic capital that can expand FTZ between the rural and the urban sectors, and rural-urban migration is rational if it generates more income for urban than rural unemployment.

In addition, there are other more contemporary theoretical studies supplementary to the above classic works, for example, by Madani (1999), the World Bank (2001), Engman *et al.* (2007), and Akermany (2009). According to Madani (1999), in the medium term, if trade liberalisation is not politically viable, an SEZ could be useful as a tool to introduce economic reform, facilitate transitions from import substitutions to free trade regime and move away from state intervention. World Bank (2001) and Akermany (2009) further complement Madani's argument and posit that SEZs are touted as the second-best solution for trade policy after liberalising trade for the whole country. Engman *et al.* (2007: 35) also confirmed the World Bank and Akermany perceive SEZs as the second-best solution since SEZ's enclave nature only introduces extremely distortive political institutional environments compared to a countrywide liberalisation. It allows a country to maintain its existing economic policy in the general domestic environment on the one hand while there is no choice for regional competitiveness and as laboratories for experimentation on the other hand. It is regarded as part of economic reforms and a regional policy tool aimed at reducing unemployment in poor areas.

Based on the empirical works of Seshadri (2011) and Stein (2008), SEZ policy starts losing ground due to the negative externalities it sadly contributes to developing countries' economies. For example, the study on India by Seshadri (2011: 3) shows that there has been no obvious correlation between the establishment of EPZs and export growth, arguing that better explanation for export performance can be traced by a country's trade liberalisation since the mid-1980s and economic reforms since 1991.

Furthermore, Stein (2008) draws criticism over the orthodox liberalisation approach from his research on Africa. He argues that an EPZ should not be a panacea to solve the multifaceted economic issues. The evidence suggests that there was no accurate design or incentives within an industrial policy framework in Africa that could: offer a conducive environment to spur investment, employment, foreign exchange, and backward linkages (Hirschman 1958) while increasing the technological spillovers to enhance Africa's institutional transformation.

In addition, Yabuuchi (2003) affirms that if intermediate goods are internationally traded, then FDI decreases the production of the intermediate good and increases unemployment. However, Gestrin (2001), Carcovic and Levine (2002), Ancharaz (2003), and Graham (2004) postulate that despite higher growth, knowledge spillover, and spurring technological know-how, there are implications of industrial competition between countries in the use of incentives to lure FDI.

Correspondingly, Pouder and St. John (1996) illustrates that an SEZ is indicative of less innovation and a homogeneous macro culture. Consequently, instead of economic productivity, the economic agents have been exposed to an increasingly narrower variety of information resources and productive practices resulted in economic stagnation. Equally important, the incentive structure mechanisms to encourage industrial relocation constrains local entrepreneurs and accentuates unequal development progress within and between regions in developing countries such as Indonesia. This framework is later shown in chapter 5 of the KBN case in Jakarta as one of the weaknesses of SEZ policy when EPZ firms in KBN went bankrupt and were relocated to other more cost-efficient regions due to: first, the 2008 GFC which led to the decrease in global demands, in particular from the US and European markets; second, issues of the leasehold licence rigidity from KBN.

Although there are debates among practitioners, policymakers, and researchers as to whether SEZs can help escalate economic growth or to accelerate export-oriented investments in developing countries, SEZs have proliferated as major phenomenon particularly since the early 1980s (Madani 1999; World Bank 2008). SEZ not be understood as the first best policy and based on the approach of Lipsey and Lancaster (1956), there are the costs and benefits situation and welfare effect of reforms which depend on how individual countries perform their policy. For example, the considerations related to the host countries' race to the bottom strategy through tax privileges, lower levels of wages and other streamlined legislations and facilities, which differs in some respects between developing/host country economies.

SEZs in various countries usually offer preferential treatment not provided elsewhere in the country: simpler licensing procedures, better investor services, complete infrastructure, customs and tax treatment that are different from other parts in the country. SEZ also has its own authority which is

responsible for making decisions related to the area and the regional governing body responsible for the management of the area. In many countries, SEZ has a low-level legal foundation to provide legal certainty for an economic activity within the region. Many countries are successful in developing SEZ, but not a few also fail. China is among the most successful in SEZ development. Some of the reasons that led China to succeed in SEZ development include clear institutional framework, active involvement of local governments as key stakeholders, and the well-structured SEZ authority (governance structure).

It is imperative to examine the theoretical literature and discover the academic debates on SEZ expected results (policy outcome) which have touched practically every single facade of their motivation, rationale, and structure. For the study purpose, policy and regulation are treated equally and used interchangeably and are defined as *“ways and measures to overcome the specific development problems or to achieve specific development objectives by issuing a decision, strategy, planning and implementation in the field using specific instruments”* (Adopted from Pal 1992, Dunn 1994, and Hill 1997). The following subsections devoted to reviewing the SEZ policy literature.

3. SEZ outcome literature

Indonesia adopted an import substitution industrialisation (ISI) policy strategy in the 1980s. Indonesia has persisted in pursuing ill-advised economic policies, resulting in a widening economic inequality. During that period, Indonesia had been considered one of the eight Asian miracle countries from 1965 to 1990, due to its economic growth, with Malaysia taking the lead on low relative inequality (Page 1994: 239). Nevertheless, the Indonesian government has not been able to sustain long-term growth. Furthermore, amid Indonesia’s economic liberalisation in the 1980s with its export-oriented industrialisation (EOI) policy strategy, massive poverty alleviation was attributed in part to the implementation of the SEZ concept; the EOI policy with SEZ as an instrument showed vulnerability during the 1997AFC. The AFC quickly pulled Indonesia to a serious economic and monetary crisis and the Indonesian economy subsequently collapsed.

The rapid development of the four Asian Tigers and the slow growth of the developing countries redefine the economic development strategy. NIE has brought an important shift in the development discourse. *“.....development should be redefined as economic growth plus appropriate institutional change; meaning institutional changes which facilitate further economic growth”* (Toye 2003: 61).

SEZ policy being beneficial for development remains a subject of controversy. Its analytical rigour, pragmatic tenors and the flawed implementations of the SEZ scheme have led to the failure to achieve the SEZ objectives that mostly occur in developing economies, causing social and economic impacts.

Three major social issues were identified to cause detrimental effects, namely labour exploitation, forcible land acquisition, and environmental degradation. Meanwhile, despite SEZ proliferation, there is a significant economic loss from foreign investment and the export generation that contributes to the declining budget performance (state revenue) of the host country in general. In Indonesia, in Boediono's (Ex-Vice President in SBY administration) view, the real practice of policymaking such as SEZ is often ultimately converging on making policies that can work through obtaining at least fifty per cent of the initial objectives with minimum negative effects (Boediono 2011). But, it has reinforced a widespread debate from activists and civil society groups, academics, policymakers and politicians on the SEZ impact on the growth and development in the Global South today not to mention Indonesia (Daeng 2008). Despite high levels of FDI, the SEZ policy has not managed to overcome the legacy of unexpectedly lagging regions or backwardness as illustrated in Indonesia's rising inequality (see figure 4.1 and table 4.1). They have brought to the fore the impacts of an SEZ to a host country's socio-economic circumstance. For example, the study by Fröbel *et al.* (1978) expostulates that state's attempts to cut unemployment through supporting SEZs while preventing an extreme decline in living standards and working conditions are considered ineffective and only bring little chance of programme survival. Similarly, Aggarwal's (2004, 2005, 2006, 2007) study on the Indian SEZs argues that an SEZ has limited success in attracting investment and promoting exports and has critical and controversial elements of labour relations and employment. Indonesia's experience on its SEZ coincides with these empirical arguments (more details in chapters 5 and 6). Another more recent study by Pratap (2012) points out the land grabbing issue in Indian SEZs. This evidence also took place in some regions in Indonesia with new SEZs being established in Tanjung Lesung, Tanjung Api-Api, and Bitung. However, other than the land acquisition law, the details of the land grab issue will not be considered.

In the same vein, there are other studies such as Lang (2010) that stress the human rights violation in China, while Taguiwalo (2009) emphasises the resistance of women, land rights, resources, and livelihood struggles in India, Thailand, and the Philippines. Zhang (2008), Zeng and Eastin (2011), and He *et al.* (2013) assert the lack of environmental awareness among local governments and the deteriorating environmental quality in China. Despite changes in the environmental protection laws, China's investment addiction through the development of SEZs has brought an inevitable erroneous belief. They tried to spur economic progress but at the price of harming people's means of support (in terms of land grabbing and environmental deprivation). Ironically, as Knoth's (2000) study has ascertained, these SEZs are being touted as the most far-reaching economic reforms since China began opening up in the 1980s.

Furthermore, according to DeArmas and Sadni-Jallab (2002), even though there is an increase in FDI and export rates from SEZs, the employment rates were not significant in every developing country;

even jobs are only significant to small population countries i.e. Mauritius, Seychelles, and Jamaica not China, India or Indonesia. The availability of jobs in the zone cannot keep pace with the rapidly increasing population. Moreover, there is a tendency for an SEZ, being labour-intensive manufacturing, to be replaced with capital-intensive industry where the profit from return on investment (ROI) is much higher (Farole 2011). This will be determined by the role of host government in choosing the appropriate industry coupled with the political support surrounding the policy choice.

According to Aggarwal (2005), SEZs should not be the only growth policy to pursue the aforesaid objectives. Based on some inclusive work not only in recent times but also earlier times (Warr 1987; Madani 1999; Jayanthakumaran 2003; Aggarwal 2005; Farole 2011), it has always been a puzzle (Moberg 2012) that some SEZs, regardless of their potential, have become nuisances on the economy (e.g. India, the Philippines, China, or even Indonesia). The failures in many existing traditional EPZs in some countries and the general SEZ are mainly due to the high cost of doing business. The alleged problems associated with excessive bureaucracy, poor management and weak policy coordination (the EPZs in Dakar, Senegal, and most developing countries), poor infrastructure include dire transportation facilities, unreliable energy, power and water supplies with high electricity costs (including those more recent SEZs in Sei Mangkei, Indonesia), lack of sufficient cheap labour (this has become a global issue today where China, India, and Indonesia have frequently faced labour demands for wage raise), and spatial issues of poorly selected location, too distant from the port and inaccessible from main trading routes (problems in Dakar, Senegal) (Cling and Letilly 2001: 22 in Farole and Akinci 2011: 261). The inappropriate infrastructure will cause congestion and other social problems and entail a significant decline in the export sector (World Bank Survey Reports-Akinci and Crittle 2008; Farole and Akinci 2011). Other problems include unattractive tax incentives, unprofessional zone promotion, inadequate maintenance as well as excessive performance requirements (FIAS 2008: 5, 50).

One of the main concerns in most SEZ countries including Indonesia is that many low-income host countries are caught in a trap (Gareev 2013), when income rises, the labour-intensive production competitiveness will erode before the host country is prepared to move to a more advanced production. The private sector is small and weak, whereas local producers can hardly compete with global giants in open markets. It is important to note that this has been a global issue in most Asian middle-income countries. Khan *et al.* (2012) conclude that increased competition in the labour-intensive companies such as in Indonesia has not been effectively corresponding with the growing population (see chapter 4).

Moreover, despite SEZs as effective means to attract FDI and serve to promote economic transition and liberalisation (Ge 1999: 20), according to Jenkins (1999: 41) in his study on India, economic liberalisation is all about staying in power. SEZ is conventionally a transformation process of some form

of state economic activity and referring to a policy choice or an instrument in order to stabilise the economy by promoting exports, generating employment, and attracting FDI; but it is contemporarily, a mechanism to preserve the ruling elite's traditional rhetoric. Borrowing from Gellert (2010: 40), this study also incorporates the term 'investment regime' as a resilient political and economic regime of capital accumulation and growth that can withstand crises and last for years if not decades. In Indonesia, the SEZ platform is embedded in the investment regime which started when the Investment Law was issued in the new order and renewed in the reform and democratic order.

Given these diverse levels of achievement and disappointment, SEZs have contributed to economic growth through rising GDP and FDI in some countries, while being utterly ineffective in other countries. This is used as the relevant measure for this study to discover the institutional perspectives underlying the research question. This study attempts to understand the institutional core of economic agents and political institutions' interaction formulating new zone policy if some existing ones only succeed in the short term and fail in promoting positive contribution in the long-term. In this regard, it will entail analysing institutions and the political agenda. How do institutions affect SEZ key policy actors' decision? Which institutions affect their decision and why do they vary?

The relevant study that comes closest to our discussion is Knoth (2000) on Chinese SEZs. Despite Knoth's study as economic dominant rather than a political view, his work corresponds to the present study, suggesting it is an inadequate simplification for China that the political decision maker is characterised by one purpose; thereby SEZ development cannot be understood as straightforward proposal implementation. The outcome from policymaking is an alternative result of an intricate negotiating process between key policy powers where the dispersal of power (decentralisation) often shifts during the transformation process toward a free market economy (*ibid*: 8). However, rather than having a development policy transformed by the form of political structure, Knoth's research reveals that *"political arena is transformed by the development of new institutions (market economy policies) and the abolishment of old ones (command economy)"*. Lai (2006) in Das (2013: 37) also claims that the Chinese economic success was largely an effect of patient efforts to strongly shape administrative, authorised and economic institutions, actively promote market players that supported the market economy or most importantly steadily discontinuing deep-rooted mechanisms of the command economy. While in Indonesia, the old institutions are represented by its patronage political culture. The Indonesian experience (as will be discussed in the case analyses of chapters 4, 5, and 6) is that they did not abolish its patronage political culture as the old institutional variable; instead, it embraced the practice throughout the reform and democratic order (RDO) with substantially, not slightly, distinct nuances. Instead of preserving the positive cultural condition, Indonesians prefer to work on the basis of self-interest individuals for personal benefits rather than a group or national interest. Meanwhile,

the Chinese people and government prefer to support their Chinese investors more than the foreign investors based on kinship ties to develop their SEZs under a favourable institutional environment where legal framework is not necessarily a big issue. Cultural proximity as one of China's key success with the same language and culture made it possible for Chinese businessmen to overcome difficult times as experienced by Indonesia during the crisis and reform process (Knoth 2000).

These are examples of why institutions matter in policy process which relates to Williamson's first level on informal institutions that affect the success and failure of a policy due to actors' rational behaviour in their policy decision. Meanwhile, the following subsection presents the experiences from China and India in their SEZ policy developments and try to draw lessons that can be learned in SEZ development in Indonesia with respect to the other institutional aspects of Williamson's model (2000).

China SEZ

Beginning in 1978, China's central government began implementing a series of economic reforms aimed at developing the country's economy. The way in which the Chinese government pursues is to take bold action to 'open' its economy directly to foreign investment in order to raise the citizens' standard of living. Without the certainty of the outcome of economic reforms, the Chinese government decided not to open the entire economy at once, but for certain segments and regions. Therefore, the Chinese authorities established four coastal cities as SEZs pilot projects for economic reform and the development of other industrial estates. Based on Zeng (2010), thus, the initial motivation of SEZ development in China was an experiment in carrying out reform and opening up the economy. The arrangements aimed at attracting foreign investment and technology (through joint venture arrangements), providing employment, utilizing domestic resources and imports, and supporting capital formation. Most of the output was intended for export to overseas markets; this underscores the role of SEZ as part of an export-oriented strategy that has previously been widely pursued by other Asian countries - Japan as the first. In 1980, the Chinese government opened four SEZ areas - covering all areas of the cities of Shenzhen, Zhuhai, and Shantou in Guangdong Province; and fourth in Xiamen city in Fujian Province. They were coastal cities and chosen because of their proximity to major trading centres in East Asia, namely Hong Kong, Macao, and Taiwan. Four years later, the whole of Hainan province was designated as the fifth SEZ. Within these areas, industrial areas were also established which offered various facilities. This programme was considered quite effective in achieving the goals. The rapid developments for both export performance and the amount of investment especially were seen from Shenzhen SEZ as the main export area, while other areas look far below the performance of the city close to Hong Kong. This success prompted the Chinese government to open various other special areas on a smaller scale called the Economic and Technological Development Zones (ETDZs). At

first, the area was still built in coastal areas, but in the 1990s, the Chinese government began to open the ETDC in the hinterland, in the hope of developing other disadvantaged areas (Knoth 2000).

To make SEZ an oasis for economic reform, the Chinese government offers preferential policies for the development of these areas. These policies include tax incentives such as tax holidays, foreign exchange transparency and flexibility for overseas companies to send profits back to home countries. It is also complemented by other fiscal incentives such as exemption from import duties for raw materials in the framework of exports, exemption of export taxes, even granting limited licenses to sell as products receiving such facilities in the domestic market. In addition to fiscal incentives, SEZ managers are also given the autonomy of economic policy and more political authority. They are allowed, for example, to develop city laws and regulations, including tariffs and local tax structures, as well as to fully manage the development within these zones. They are also allowed to give special treatment to foreign companies by offering cheaper land prices or production facilities. One important point in the success of this programme is the policy for the formation of a currently unknown labour market within China's communist economic system. Companies operating within SEZ are permitted to make applicable employment contracts for certain term limits, as well as to terminate the employment of employees who do not achieve specified performance. The enforced labour policy also allows companies to set wages and salaries according to the labour market situation. Each special industrial zone, whether within the SEZ or stand-alone areas as ETDC is administered by a committee comprised of persons appointed by the provincial and local governments. The committee's tasks include managing land, developing infrastructure, and conducting regional planning. In addition, the committee is also responsible for various public services such as security and hygiene, as well as ensuring the creation of good and profitable industrial relations for workers and investors (Knoth 2000).

India SEZ

The SEZ in India has several different characteristics with SEZ in China. First, the SEZ was established at Kandla in 1965. In the period of three decades later six SEZs have been established in several regions. Unlike SEZ in many other Asian countries, SEZ in India is not intended to attract foreign investment, but rather as a means of providing facilities to domestic exporters from aggravating regulatory regimes in other regions and supporting import substitution programmes (Kundra 2000). After liberalizing the market in the early 1990s, the Government of India announced the launch of the SEZ programme in the country by modelling China SEZ in 2000 aimed at attracting foreign investment. After being ratified as a law in 2006, up to 2008 there were about 552 districts proposed as SEZ. As of March 2015, 416 applications have been formally approved for development, while there are 202 areas showing SEZ operations. The main motivation of SEZ establishment is to attract private investment not only in

productive activities, but also in SEZ creation. In the previous policy the Indian government intervened to form and prepare the Export Development Zone by investing the necessary funds to develop infrastructure. In the new SEZ policy, the central government will only be responsible for broad policy frameworks as well as monitoring performance and implementation. The role of SEZ also became more widespread to stimulate economic activity not only limited to increase exports. One of the attractions of SEZ in India is the application of a single window system to facilitate the licensing and operational processes of companies operating in the region. In addition there is direction for minimum infrastructure that should be provided by the developer. There are also fiscal incentive packages designed to attract private investment. This includes exemptions on various taxes and duties. Commercial financing facilities are also provided by banks and other financial institutions. These facilities and incentives are not just for investors which operates within the SEZ, but also for regional developers. Although the performance of the SEZs in India is still far below China, in some aspects there is considerable progress (Kundra 2000).

The lessons that can be learnt from the experiences of China and Indonesia can be drawn into a comparison of each aspect of the differences between them and Indonesia as listed in table 2.1.

Table 2.1

Comparison of SEZ between China, India, and Indonesia

Description	China	India	Indonesia
Location	Located in the coastal area, equipped with seaports, although some SEZ last reside in the hinterland	Locations can be anywhere. Coastal areas are not a criterion.	Location criteria are based more on things such as availability of resources and underdeveloped areas
Aerial Size	Shenzhen SEZ starts with an area of 493 km ²	Relatively smaller with few SEZs only have area of tens of hectares	SEZ that is being prepared has an area of thousands of hectares
Amount	<ul style="list-style-type: none"> In 2014, there were 6 SEZs, 14 open coastal cities, 4 pilot free trade areas and five financial reform pilot areas. There were also 31 bonded areas, 114 national high-tech development parks, 164 national agricultural technology parks, 85 national eco-industrial parks, 55 national ecological civilization demonstration areas, and 283 national modern agriculture demonstration areas. 	Until 2015 (10 years after launch) there are 202 areas gained SEZ status.	There are currently 9 SEZs, 2 FTZs, 1350 EPZs, 96 Industrial Estates, and 13 Integrated Economic Development Zones (KAPET) in operation.
Policy Regime	It is an experiment for economic reform with policies very different from other regions in China	No special economic policy for SEZ. The attractiveness of the region is more emphasized on fiscal, financing and infrastructure incentives	Specific policies tend to be limited. Currently only foreign investment policies are different from other regions.
Fiscal Incentives	Exemption of import duty and some goods tax. Including tax holidays and lower taxes.	Tax incentives are also provided but not as extensive and comprehensive in China	Fiscal incentives have not been fixed in detail and certain, even after five years of the program.
Employment Rules	The rules of employment are very different from the rest of China. Even the labour market was introduced in SEZ before being implemented elsewhere	There is no difference with other Indian territories	Currently there is still no difference. SEZ programs will be endeavored to provide greater flexibility for employment policies
Sources of Funding	SEZ development was initiated by the central government, but local governments with private assistance became the drivers of development.	SEZ development is done by the private sector fully. The central government also provides incentives for industrial estate developers.	The development is carried out by the cooperation of private parties, BUMN and local government. The central government assists in the development of supporting infrastructure
Development of Management and Authority	Management is carried out by a committee that is an extension of the local government	Management is undertaken by a commercial management body overseen by part of the local government	Management is undertaken by a commercial entity supervised by an administrator who is an extension of the local government

Table 2.1 shows some of the characteristic differences between SEZ policies residing in India, China and Indonesia. Site selection is the first quite different aspect of the SEZ policy in the three countries. SEZ in China has focused on logistic facilitation, agglomeration and industrial cluster formation, as well as proximity to international markets where the location of SEZ is selected in the coastal area and very

close to the international hubs, like Hong Kong. Therefore, their SEZs are more located in urban areas with several industrial areas within it. This makes the management of China SEZ directly carried out by the same party with the city government, complete with various existing instruments. The management of industrial estate shall be submitted to the governing body. While in Indonesia and India, due to the relatively small area, SEZ is directly managed by business entities and administrators under local government. India does not have a specific policy on location and the location can be anywhere. While Indonesia, due to the objectives of equality, they prioritised developing the disadvantaged areas. Currently, after 2009 SEZ Law was announced, Indonesia pays more attention to the availability of natural resources as their location targets.

In the prevailing policy issue, these countries also tend to apply different focus. SEZ in India emphasizes various fiscal incentives expected to attract investment. For SEZs in China, due to being an area for experimental reform of economic policy, the enforced regime of policy also differs from other regions in China, including employment, licensing, ownership, etc. (Ge 1999; Knoth 2000; Zeng 2010). In Indonesia, the focus of policy emphasised on fiscal and investment (non-fiscal) incentives. Different aspects can also be seen in policies for infrastructure development and territorial completeness. In China, the source of development financing is more determined by the government. Private participation is more a supporter of financing and implementing regional development, where the government plans and retains the authority. In India, SEZ development is left to the private sector for planning, financing and development, as well as in management. Indonesia plans to take a combination of both, where the development and management of the region are done by private or state-owned enterprises (BUMN/BUMD), while the central and regional governments develop supporting infrastructure. These differences also make a difference in performance and outcomes of their respective policies. As mentioned above, SEZ in China is very successful in inviting foreign investment, due to the nature of its policy facilitates the arrival of foreign investment, while SEZ in India, although not in terms of inviting foreign investors as their main concern, the ability to improve their export performance in accordance with the policy given by the government is worth taking into consideration. The discussion above points out that institutions do matter in which one institutions influence other institutions and not necessarily hinder each other. They can be linked to Williamson's other institutional aspects. Williamson's model can be applied with regard to the second until the fourth level. The second level considers formal institutions in the form of Chinese and Indian's clear SEZ legal framework and the government political will. The third level involves the governance structure of both countries with respect to their clear SEZ organisational structure who organises and manages the SEZ, and the fourth level in the form of undisputed distribution of resources which include the clarity of

roles and responsibilities of their respected management bodies to allocate certain resources and locations.

The final section concludes the chapter from the discussion of the two subchapters taking into account the institutional theory and SEZ literature studies.

Conclusion

This chapter has reviewed the literature on institutional economics, their related concepts, and Williamson's hierarchy of institutional constraints and argued that not only institutions matter on economic reform policy but on actor's behaviour and action in their policy decision. By adopting a modified NIE approach linked with Williamson's hierarchy of institutional constraint, this chapter demonstrates that NIE refers to studying the institutional change in the economic reform (SEZ policy) and extends the influence of institutions in the context of SEZ policymaking through Williamson's institutional constraints. This chapter conceptualises how SEZ policies devised by the state and which types of institutional subjects are assumed and encouraged for the policymaking practices to concretely function. It can be a challenging driving force capable of generating changes in the overall political system. NIE can be thought of as enriching the view of, and is more than simply turning away from, NCE thought while emphasising the efficiency of the market mechanism without interference from the state in neoliberal ideology. Despite the impossibility of establishing a well-functioning market mechanism without a well-functioning state, borrowing from Chang and Nolan (1995) and Stiglitz (1999) in Chang (2001: 13) that— "*market is a political construct*", this study perceived a causal logic that some institutional elements constrain the state (political actors and economic agents as SEZ policymakers) into making the market (SEZ policy) well-functioning causing the increased risk of frequent change in SEZ policy. Grounded in the NIE theory and literature and Williamson's model, conventional studies claim that economic policy and the policymakers, by their very nature as formal constraints, reflect how one set of institutions modifies or radically restructures another set of institutions. Thus, this study will explore that the key policy actors create change in the existing development systems by their influence on incentive structure and transaction.

From this perspective, the SEZs are conceived as an array of formal and informal institutions. They are administratively defined territories, conceptualised as dynamic entities, impacting relations and competitive and/or cooperative actions of economic agents, through vibrant and interconnected cognitive, regulative, and normative/organisational arrangements, based on a mixture of norms, practises, incentives, and procedures (North 2005a, Creskoff and Walkenhorst 2009, and Hazakis 2014). Undermining the SEZ path dependency and evolution is likely denying the relations among arrangements and economic agents, causing SEZ's low competitiveness and underperformance. This

marks the beginning of the leverage points to analyse how and why institutions affect SEZ policy process.

One aspect to be considered is SEZ as the driving force for economic reform and investment promotion. However, although currently there have been many SEZs being developed in many developing countries, the performance has not brought significant contributions to a national economy especially in terms of investment. Even in Indonesia, the enthusiasm in investment in many SEZ types is still not well developed. One of the issues that arise in the literature is the unclear incentives promised in the SEZ development plan. Until now, the specificity of a specific area cannot be elaborated with the appropriate legal framework. The scheme of institutional relationships in SEZ management in the global practice also has not provided a guarantee of full support to the business world and company operations in SEZ. Difficulties in infrastructure development are also important constraints in the success of this programme. Business investment, including foreign investment, is the most important factor in improving a country's economic performance. SEZ programme can be a catalyst to close the gap of economic policy that has not fully supported the business world.

Due to this vital status of an SEZ to the economic growth, the author feels the importance of studying the institutional aspects that affect the SEZ underperformance. Most existing literature tended to study SEZs economic outcomes, the advantages and disadvantages they have contributed to a country and some have emphasised on the political nature of the SEZ development process. While the study on the institutions that influence the policymaking process by key policy actors is rare especially in Indonesia. This is the gap from the literature that this study tries to fill in which is to focus on analysing the institutional frameworks of SEZ policymaking process in the national and subnational levels.

The next chapter elaborates the analytical framework built from the elements in the literature and explains the methodology being employed in the study to help answer how and why institutions affect SEZ policymaking on the case of Indonesia.

Chapter 3

Analytical Framework and Methodology

This chapter presents the analytical framework gathered from the literature and describes the research methodology adopted in the study in more detail. The aim of this chapter is to give a full understanding of what approach the author uses to start the research and how to develop the study into meaningful research contribution. Subchapter 3.1 is devoted to elaborate the analytical framework, subchapter 3.2 presents the methodology including the study design and protocols, while subchapter 3.3 spells out the limitations of conducting the empirical work. The last subchapter is the conclusion.

3.1. Analytical Framework

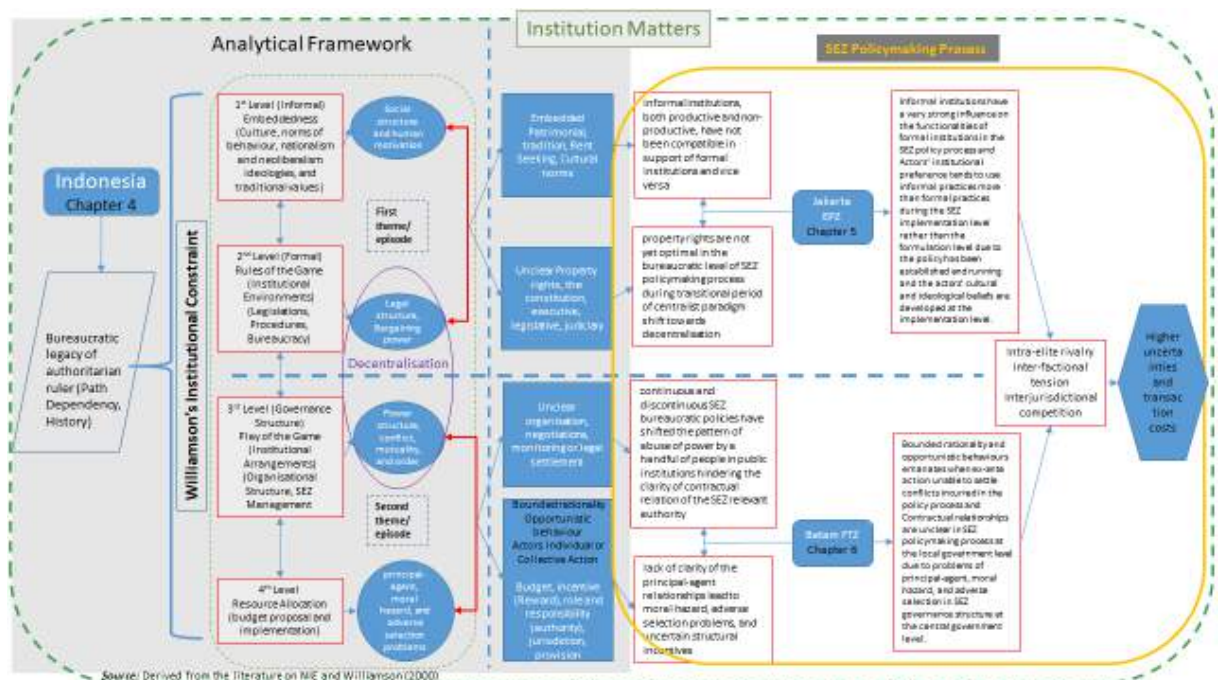
As discussed in the earlier chapter, institution matters in policymaking and actor's behaviour in making a decision. The relationship between institutions and policymaking, especially on SEZ policy, gleaned from the institutional theoretical literature is described in the analytical framework in figure 3.1 under the grey shaded area. The study tries to link NIE approach with the four levels of Williamson's 'hierarchy of institutional constraints' framework to analyse the SEZ policymaking by key policy actors in Indonesia.

Based on the figure, institutions matter is shown by the green rectangle dashed line. Throughout this study, the author used Williamson's (2000) as a guide to demonstrate the methods and insights of NIE and to guide the analytical process of this study. It involves elaborating the nature of each layer of the institutional hierarchy and their possible interrelation in influencing each other based on their co-evolution. This framework describes the case of SEZ policy change, the so-called catalyst of economic reform.

Williamson differentiates the constraints into four layers. The first layer focuses on 'informal constraints' or 'informal institutions/rules' where the existence has been integrated into a society. The second layer is 'formal institutions' focusing on the institutional environment regarding formal rules, bureaucracy etc. The third layer encompasses the governance structure, dealing with the system of rules and the actors who enforce, perform, and control the mechanism of rules, power relations, and transactions along the institutional structure. The fourth layer concerns how and why resources are allocated and optimised at, in this case, state and regional level. The purpose of combining different analytic layers is first, an attempt to study either structure or agency to control some of the obstacles in social science important for institutional development and economic performance. Secondly, it is an

attempt to ascribe causality from the first until the fourth layer of constraints to make clear sense of who are engaged in transactions either the executives or legislative (political institutions) that have an impact on other institutions (policies and their implementation) and how these institutions influence the way stakeholders use these policies. Third, it is an effort to ‘catch the logic’, commitments among and dynamic behaviour of the policy actors interrelating inside particular institutional situations, and thus being able to assess the future trends of SEZ policy to be credible and enforceable. Due to their nature as forms of coordination involving costs, the general challenge is dynamically interacting, both between and within, the four layers of analysis.

Figure 3.1 Analytical Framework



The institutional dynamics of the SEZ regime are explored in relation to political and economic contexts. The NIE approach as depicted in the literature applied to judge policymakers' potential efficacy in the long-run by exposing the reasons why each successive regime has so far rendered the pre-existing SEZ policy dysfunctional. The NIE approach is reflected by the sectoral focus of Indonesia and the two different zones as empirical case studies (Jakarta EPZ and Batam FTZ).

The study highlights SEZ policy as a fundamentally political issue as it regularly changed by the Indonesian incumbent regime not in terms of sustaining and developing the already established type of SEZ such as EPZ and FTZ (by raising the standards of industrial production)³⁴, but rather in insisting on keeping the import tariffs down for specific commodities. The motive is to attract investors and compete with other FDI-oriented countries (race to the bottom strategy). Needless to say, these

³⁴As will be discussed in the case studies presented in Chapter 5 and 6

uncertainties create high transaction costs. Generally, this prompted some economic agents to engage in rent-seeking activities with political institutions that manifest in various forms, i.e. corruption, collusion and nepotism (KKN in Indonesia) of the public officials entrusted with the responsibilities of policy approval to capture those valued returns or profits, and usually entails short-run economic growth instead of aiming at long-run economic outcomes. Rent-seeking activities in Indonesia emerged in the form of licensing through lobbying for politicians or government officials (Basri 1997). In addition, economic rents activity can also bring the implications of overinvestment in physical capital to justify licenses granted by government officials. For instance, the Masterplan for Acceleration and Expansion of Economic Development (abbreviated MP3EI) for the economic corridor has been known as the SBY government's ambitious project to accelerate growth. However, its long-term objectives were hampered by KKN practices. It raises the fear that Indonesia will enter an 'economic backwardness', a model constructed by Acemoglu and Robinson (2006). They assert:

“Government policies and institutions shape economic incentives, and via this channel, have a first-order impact on economic development. Why, then, do many societies adopt policies that discourage investment and maintain institutions that cause economic backwardness? Perhaps, politically powerful groups (elites) are not in favour of economic growth. But why? It would appear that economic growth would provide more resources for these groups to take over or tax, increasing their economic returns. So, why don't powerful groups always support economic development?” (*Ibid*: 115).

The cases here mostly circled around the study of political rules (styles) and the mechanisms of strong captivating ideologies such as neoliberalism and nationalism. Thus, they serve as important ways to analyse the influence of institutional constraints on actors behaviour in SEZ policymaking; firstly, the government's politics of economic reform policy, especially, how politics unfolds in SEZ policymaking circles, political connection between the successive regimes and internal pressures, and the wider political and external pressures; and secondly, the interaction of the regimes and the pressures towards their patterns of leadership, and the role and structure of external institutions which formed the process.

To simplify the interrelation of each layer, the study divides Williamson's framework into two thematic series with blue dashed horizontal line: first thematic series, informal institutions and formal institutions and second thematic series, the governance structure and resource allocation. The study then relates these layers with the interactions of the key policy actors in the policymaking process.

Firstly, the study explores how informal institutions i.e. with entrenched cultural values and ideologies, coexist with formal institutions. The study reiterates first how RDO's neoliberal choices reached the consensus in their respective ideologies to pursue a resource-based growth model such as an SEZ in chapter 4. The study then discusses how the polity gets the formal 'rules of the game' right in Jakarta

SEZ project in which the administration had to face challenges from political lobbies in Jakarta. The core argument put forward in chapter 5 has been that SEZ policymaking is potentially affected by the bureaucratic legacy of previous authoritarian rulers. This framework shows the inclusive informal institutions that were strongly influenced by the prevailing norms of behaviour, ideologies, and values of the new order (NO) under political economic complexity still coexist in the SEZ policymaking dynamics. Moreover, strong captivating ideologies such as neoliberalism and nationalism embedded in society since the old order continue to form the landscape of the state's political economy in the recent open political system (path-dependence). There are actors from the NO who create a political culture that embodies institutions and generate the set of payoff structures or incentives to which policymakers respond. Under the unexpected transition from authoritarian to democratic, Indonesia saw that the same principal actors and parties or at least have the same characters as in the NO have been influenced or may influence the successive government. It implies that unless there is an effect on incentive, where the key policy actors control the changing process so the rules favour their interests, the SEZ system will by and large be resistant to change. The framework provides the nature of formal rules that tend to provide weak incentives for policymakers to design SEZ policies and reveals that more informal processes govern SEZ policymaking and shape the incentives that policymakers might have in requesting SEZ policy change.

Secondly, regarding governance structure and resource allocation in chapter 6, the institutional change process focuses primarily on the role of the government; therefore, the efficient production and property rights allocation are emphasised with the augmentation of the government's potential utility as the main driving force (Hanisch and Schlüter 1999a. 1999b). This framework depicts the SEZ initiatives in Batam that raises the awareness that it contains political agenda due to its intent, meaning, and execution process. The framework founds the significance of policy negotiation in supporting any endeavour at SEZ policy reform. The governance structure analysis has shown significant issues in the 'play of the game', including disparities in the dispersal of authorities and serious enforcement problems. The central and local authorities' ability for collective action is one precondition to effective administration in Batam FTZ development. The policymaking in Batam's development trajectory also exhibits the entrenched new order's major political feature of patrimonialism, rent-seeking, and cultural norms. The resource allocation analysis has pointed out that principal-agent problems are related to the participation of internal members of the state as well as the performance of central government leaders and local officials in policy design. Though embracing government interventions as a dominant alternative to market failure, the framework shows that this theoretical judgement is inconclusive with the experience of Indonesia when the state (principal) was not able to control the opportunistic behaviour of the actors (agents) generating higher transaction

cost. Thus, rather than placing an immediate *ex-post* enforcement mechanism on the actual outcomes of transaction costs to settle conflicts occurred in the policy process, the government's *ex-ante* action is needed to reduce the risks of bounded rationality of actors (Williamson 1985). In the RDO as Mayers (2005) asserts, these actors can exert emotional or behavioural impact by the success of the organisational goals such as in BIDA. They distribute economic resources fairly and equitably but only by the will of the successive government through ameliorating failures and bottlenecks that exist in the markets and among self-interest individuals in order to achieve expected economic growth.

Thirdly, based on theoretical guidance, this framework reveals that the SEZ policymaking process and the political economy during the RDO regime are characterised by what might best be described as elite politics which produces conflicts causing higher uncertainties and transaction costs. It draws the individual threads together, explains how institutions in chapter 5 and 6 belong together and contrast each other.

The main proposition as mentioned in chapter 1 gleaned from the figure can be explained as follows which helps the author frame the hypotheses:

First, in SEZ policymaking, informal rules that constitute culture, norms of behaviour, nationalism and neoliberalism ideologies, patrimonial, rent-seeking, and traditional values of both productive and non-productive nature, are not yet compatible in favour of formal rules. The study tries to analyse Indonesia's cultural characteristics based on extant literature, i.e. culture of patrimonialism, patron-client, small kings, and rent-seeking that lead to corruption in the forms of tribute or illegal reward/incentive (i.e. bribery) as an embedded culture from the previous order as the behavioural mindset of current bureaucratic actors.

Countries in East and Southeast Asia have shown evidence of institutional and cultural importance in achieving progress and economic growth (Beeson 2004; UNDP 2004; Mubyarto 2005; Casson 2006; Streeten 2006). Theoretical (Casson 1993) and empirical studies (Gray 1996) suggest cultural characteristics generated from Hofstede's cultural indicators (in forty countries) inherent in a society, in a region or country that have a deep influence on the performance of the economy by incorporating policy variables as an intervening variable. The relationship between culture and policy, namely the degree of cultural and legal constraints exist to inhibit the government to establish specific policies. From the research, it was found that a similar conclusion with previous research, namely that the Confucian Dynamism variables in East Asian countries have an important effect on growth.

Indonesia is a perfect example of a multicultural country with diverse ethnicity and religion. Pre-existing cultural factors can either support or constrain the applicable formal institutions, and the ways policy and politics can transform culture (Spranz *et al.* 2012: 460-1). Therefore, it is important to

understand culture as a significant factor in economic outcomes. The success of an economy also comes from the interplay between formal and informal institutions and the adoption of economic policies that can avoid institutional traps and loss of popular support (*Ibid*: 461).

For example, informal practices put more emphasis on culture in the centralisation of power at the local village level as an effect of the decentralisation system. Besides nationalism, they are associated with the colonial legacy (La Porta *et al.*, 1997, 1998, 1999, 2008) and local traditions (embedded in society), such as the KKSS case in chapter 5 (the South Sulawesi kinship communion which was built during the Dutch colonialism). KKSS practice has vague social accountability as there was evidence of political allegiance in KBN management and KKSS. These cultures were the basic rules by an interest group to mitigate the main problems they encountered to maintain the groups' social viability in their internal and external environment (DiMaggio 1994: 596). The author further will examine whether transactional culture is still prominent in the policy process.

Second, in the new order, property rights were not optimal in the bureaucratic level of SEZ policymaking process, therefore this study attempts to discover what and how property rights have influence policymaking from the transitional period of a centralist paradigm shift towards decentralisation. The instances of this level are the separately elected and *de facto* independent executive (the polity), legislative, judicial and hierarchical system or the methods of selecting the government (authoritarian or democracy), the establishment of bureaucratic functions made by the legislature to enforce the political system (Williamson 2000: 598). The executive's power to impose formal rules on political, economic, and legal mechanisms including foreign investment facilitates institutional environment reforms (Joskow 2004: 10) — in this regard, SEZ and investment policy designs and practices. Although not in a deterministic manner, many cases of formal institutions are the evaluation result of informal institutions³⁵. They stress the importance of 'economics of property rights theories' where the state as the rule of the game is often the level of analysis. Transaction costs and incentives in enforcing the formal rules are their focus.

Due to the features of this level being partly the product of evolutionary processes, the purpose is to understand how the polity gets the formal 'rules of the game' right (*Ibid*). For example, relevant to the present study is the question of how the voting is arranged at the executive, legislative and judiciary level for SEZ and investment legislation and budget allocation procedures (Datta *et al.* 2011). Why and how the system of rules in the SEZ policymaking process has not yet given optimal function and why they lack clarity of functions. Since relationships between executive, legislative and judiciary

³⁵Important perceptions on the effect of formal institutions to economic behaviour are seen in De Alessi (1980) and Eggertsson (1990).

government in developing states are not well-defined compared to developed states, the relative performance of their relationships, such as in Indonesia, would seem in a state of considerable flux.

Third, this framework tries to validate that bounded rationality and opportunistic behaviours render contractual relationships to be unclear in SEZ policymaking process, resulting in increased transaction cost economics. It also tries to investigate the continuous and discontinuous SEZ bureaucratic policies that have shifted the pattern of abuse of power by a handful of people in public institutions. Not only does loyalty or political allegiance influence voicing dissatisfaction, but competition among institutions to some extent has a similar effect. In this level, a competition is not only in terms of competing for office and power among politicians and parties³⁶ but also in choosing the right policy. Legal and regulatory frameworks and organisational structure are assessed in the process of competition whether in need of institutional change through overall reform (e.g. decentralisation laws as analysed in chapter 4) or in need of abandonment (exit from the competition). The patron-client relationship is related to this scheme. This kind of atmosphere entails that societal factors i.e. reciprocity in a *quid pro quo* bargaining process, affect transactions. Economic theory and transactions commonly avoid the effects of interaction by the values they hold. Some organisations may reject certain modes of transaction. But, reciprocity may change the nature of the transactions (Williamson 1975: 20-30). Other significant examples refer to the role of the state on contracts with investors, fiscal incentives and other provision arrangements and with bilateral-regional relations (SIJORI Singapore Johor Baru, Riau Islands regional agreement in Batam FTZ) or international organisations (WTO, WCO/World Customs Organisation, and ASEAN) on trade-related aspects with other countries.

Fourth, this framework endeavours to uncover the complexity of problems (i.e. principal-agent problem', 'moral hazard problem', and the 'adverse selection problem') in the SEZ policymaking process in terms of unclear authority (institutional environment) and unclear governance structure (institutional arrangement), unclear authority contract relation or lack of clarity of the principal-agent relationships which lead to uncertain structural incentives. Meanwhile, there is a slight difference in defining adverse selection problems with the moral hazard concept (Azfar 2006). Moral hazard lays emphasis on the unobservable agent's action ('hidden action') whereas adverse selection refers to the circumstances where the value of the good or service being transacted cannot be observed by one party ('hidden value'). *"The classic example is the market for "lemons" (used cars) where the market may remain suboptimal because buyers do not trust sellers" (Ibid: 978)*. Chapter 5 and 6 illuminate both hidden action and hidden value problems. It is how in chapter 5 Jakarta governor cannot foresee the action behind Jakarta's city council employees' intention to oppose his pro-change policy nor in

³⁶Competition in appointments of high-ranking civil servants in Indonesia was made based on patronage rather than merit.

chapter 6 the president unable to anticipate the chairman of BIDA's involvement on a land dispute. Meanwhile, the hidden value of Jakarta Bay and land in Batam Island to be developed as an SEZ megaproject remains a controversy due to the agendas of both zone developer and management not being transparent.

From the above discussion by tracing institutional evolution to guide causal link, it can be said that the NIE concepts in chapter 2 and Williamson's model can be used to understand: (1) the complexity of sustainable management of SEZ policymaking process and at the same time the legal basis for issues that occur in the SEZ policymaking process in Indonesia, (2) the systematisation of rules which concerns issues of authority, organisation, administration, human resources, finance, hierarchical relations, supervision, planning and administration procedures. These understandings further trigger the *intra-elite rivalry*, *inter-factional tension*, and *interjurisdictional competition* to occur. They will be analysed whether they create high transaction costs and serve as the root cause of the SEZ policy problem.

3.2. Methodology

1. Qualitative approach—The rationale

The study adopts a largely qualitative research approach (Bogdan and Biklen 1998), characterised by a single country study, incorporating a case study design with multiple analysis strategies employing an interpretive method, analytic narrative methods, and content analysis. This study provides an in-depth understanding of socio-political phenomena (Yin 2014: 130) where policy debates and controversies by different regime periods lead to *intra-elite rivalry*, *interjurisdictional competition*, and *inter-factional tension*, and thus, higher uncertainty, higher transaction costs, and stagnant growth. The empirical case studies presented here show traces of process for policy interventions and well-suited to highlight the role that institutions play in determining behaviour. They put more stress on revealing the interactions and relations between Indonesia's political institutions, the economic elites, and their vested interests.

According to Creswell, case studies are qualitative research methods in which researchers explore and study a case or several cases that are bounded within a specific time span in detail, utilizing multiple sources of information and data collection method, such as observations, interviews, using sound recording and audio-visual materials, as well as research reports, and producing research reports based on selected topics (Creswell 2007: 73).

According to Yin (1996), case studies are the most appropriate strategy to use if the form of the research question is 'why' (descriptive) and 'how' (explanation). Given the control of the SEZ development and its relation to the policymaking process (in Indonesia especially Jakarta and Batam), containing the structural (political economy) and institutional (historical) dimensions simultaneously,

so that both dimensions are revealed. The choice of case study strategy to be performed should incorporate both approaches political economy and institutional (history). According to Kartodirdjo (1992), the first approach would explain 'why something happened' (the social context of events), while the second describes 'how the process occurs' (sequence of events).

Three types of the case study are known as follows: single-case study, collective or multiple case studies, and intrinsic case study. In the first type focuses on one case and then selects one other aspect as the issue. The second type focuses on one case but then takes some bounded cases to illustrate the issue of the research. There are times when variations are emphasized by the author in areas or topics in the same issue. Sometimes the author deliberately selects multiple cases in a single topic to show the varied perspective of the topic (Yin 2003). The third type focuses on the case study itself. This type is usually associated with the uniqueness of a case that is worth investigating. This study falls within the second type.

There is an obvious weakness of a single country study compared with a large-N based country-study in the extent to which a robust theory can be derived from the generalised results (Das 2013: 335). However, understanding the deeper questions embedded in the unique intangible cultural as well as ideological context in one country set in a wider theoretical works remains suitable for one researcher as compared to a team of researchers (*Ibid*: 335).

Additionally to the theoretical framework used in this study, in Ménard and Shirley's (2011: 42) view:

"NIE made substantial improvement using focused case studies and all the studies collected in Analytic Narratives (Bates *et al.* 1998). Despite the poor opinion that most mainstream economists have of case-studies, they have proven to be a valuable tool for understanding the rich details inherent in institutional analysis, especially when they are informed by theory and conducted with rigour".

Using the interpretive paradigm, I seek to uncover the phenomenon and explore the experience of the object of study. The interpretive approach departs from attempts to find an explanation of social or cultural events based on the perspective and experience of the person being studied. The interpretive approach is adopted from a practical orientation. In general, an interpretive approach is a social system that interprets actors' behaviour directly observe in detail (Neuman 2009). Interpretive method views facts as an essential context and meaning inherent in the system of meaning, unique, and liquid to understand the social meaning. The facts are specific and contextual actions, neutral, not unbiased, and objective. It depends on people's understanding in a social condition that encompasses ambiguities. Actors' statements and behaviour may contain various interpretations and be interpreted in many ways (Neuman 2009). The basic idea is to understand the social situation of actors' interaction with other stakeholders and their behaviour to make a decision. How political links between the central

and local government, the central, regional, and local parliaments, and other entities such as state-owned enterprises or civil society organizations embark upon formulating a policy from the initial process of negotiation and formation, the journey of escorting the policy proposal, to delivering the policy when it is in force. The author had assumed that there is a different pattern of political links between one policy product to another in different time and space. To understand the initial variations of SEZ formation, the policy process journey until the policy is successfully issued, it needs a comparison of political links in the policy process. Moreover, since the focus of this research is the institutional constraints, it relates the impact of institutions on actors' behaviour in policy decision.

To add depth in the analysis such as comprehensiveness, generality, and breadth and to answer the why and how questions, the author uses the interpretive method to explain the causal mechanism accountable for the institutions to have an influence on SEZ policymaking in Indonesia. Causal mechanism connects causes and effects and is considered as one way to explain the phenomenon in the study of politics. When compared with other research methods, this case study method has the strength in the causal mechanism as it emphasizes on specific cases intensively so that the background and causes of the observed phenomenon can be known (Gerring 2004: 341).

The case study is a thorough study of a unit that aims at generalizing larger units. Thus, case study methods are correctly understood as specific ways of determining cases, not just how to analyse cases or how to model causal relationships (*Ibid*). Given this method using case studies to examine a phenomenon, the resulting explanation must be more comprehensive (Gerring 2004: 346). Case studies can also be understood as a comprehensive data collection method, meaning that the data collected involves the whole chronology not to mention individual aspects. Examples can be seen in the scope of the politics which basically focuses more on historical evidence, including the actions and roles of the actors involved in the event or time period. The values and norms of those events can be used to predict the actions and perceptions of other actors over other time periods (Bennett and Elman 2007: 171-2).

To comprehend the connection between different layers of institutional constraints and policymaking process as well as uncover causality in social science, the author used analytic narratives as the empirical method. It is viewed to be the most powerful tools which refer to combining well-ordered theoretical assumptions (analytic) and dense historical picture (narrative). The author combined reviews of literature, documents, and archival materials with semi-structured and in-depth interviews with political and business actors, scholars, and independent entities. The author attempted to discover the *“actor’s preferences and perceptions, the information they possess and their evaluation of alternatives, their expectations and strategies they adopt as well as the constraints that limit their action”* (Bates et al. 1998).

In support of text-analysis in the analytic narratives approach, this study employs content analysis which adds knowledge through a thorough analysis of the content in media articles to gain more plausible information. Content analysis is usually used in qualitative research generally defined as a method that encompasses all analysis of the content text which refers to the conversation, writing, or drawing and used to define a specific logical method (Lasswell 1927). The content analysis is a technique to make meaningful and analytical conclusions by recognising the particular features of a message objectively, systematically, and generally (Holsti 1969). Objective means based on applicable procedures that produce similar conclusions if carried out by another researcher. Systematic means the content or category used is based on the consistently applied rules, including the selection process and coding of unbiased data. Generally means the discovery must include a theoretical reference. Information gained can be referred to other document attributes and has significant theoretical relevance. The author performs a 'reading' to discover the meaning embedded in the text. The author brings the subjective experience into the text. As it deepens the text, the author seeks to seep into the point of view that the text represents a whole context, and further develops a deep understanding of how parts of the text relate to the overall analysis. In other words, the true meaning is not easy or not noticeable; if you want to 'capture' the meaning, one has to do a detailed study of the text, ponder the various messages it carries, and look for relationships between the parts of the text.

In content analysis, what is dissected is the message which highlights language and neutrality. However, the weakness of a content analysis is the subjectivity of the author. The content analysis method is very time and cost-efficient (*Ibid*) and the author can use a reliable source of mass media that has been assessed as representative and can convey the contents comprehensively without the need of respondent's response which makes it a good methodological option. Coding sheets are used as a guide to the content analysis. There are a variety of data sources to be used in this method provided it has written text, but the main source is the mass media (*Ibid*). Within social science studies, content analysis is also used to examine the contents of the judicial opinions, statutory authority, or a specific policy (Bain 1983); how the statute/law or policy tends to take sides whether to be more pro-government or pro-community, etc.

2. Data Collection

- **Schedule and Research Stages**

Pre-research has been conducted since 2008 when the author came to Batam as a part of a team to observe and gather evidence on the inefficiency of customs procedures in the FTZ area. The official visit was intended to get an actual and comprehensive picture, as well as collect some up to date data related to the team survey plan. Using these pre-research data, a number of issues were addressed,

as well as the social and cultural profile and resources of the SEZ policy issue strongly support the preparation of research proposals, to the implementation of advanced research. There has been growing concern that Indonesia's SEZ stagnant development was due to the unclear institutional frameworks.

Based on the first visit, there were ongoing conflicts regarding the status of Batam Island. The conflict was mainly between the DPR (used interchangeably with parliament/legislative/House of Representative) and the President (central government) which then intrigued the author to embark on a planned research on the politics of general SEZ policy in the future. The opportunity to investigate these political dynamics as part of the issues of SEZ policymaking was opened when the author pursued the PhD degree to validate the conflict in Batam as one of the preliminary findings.

Following the approval of the PhD proposal, the author succeeded in obtaining a systematic and 'ideal' draft guide form, which is considered to be operational throughout the field. A more intensive follow-up study began in February 2013.

The first stage involves an extensive review of the literature as secondary materials from various related institutions and literature studies both from the results of previous research, historical documents, and other writings relevant to the study. The literature reviewed include NIE theories and methodologies and its application to the political economy, SEZ evolution and development, investment policy development, economic reform and political transformation research, policy formulation processes, both country and policy specific field.

The literature review was carried out after a systematic understanding of all the academic literature was available on the SEZ policymaking subject and the gathering of empirical evidence applies the political function of government based on the theoretical framework. The literature review was conducted after being accepted at the PhD programme but the topic and location of the study were the interest of the author since 2008 when having a series of observations on the FTZs in Batam.

Specifically, the review was undertaken amongst the following aspects: (1) aspects of the regulatory framework, in which the study looked at the coherence of the regulatory framework related to SEZ development within the context of national regulatory and development planning regimes and in the regional autonomy (decentralisation) perspective (2) institutional aspects related to cooperation and the role played by the institutions involved in SEZ development and management, both government and private sector, (3) aspects of development in SEZ, including funding and infrastructure development and lessons learned from the historical experience of SEZ development from other countries as well as from within Indonesia, and (4) aspects of SEZ implementation, related to policies on fiscal and non-fiscal incentives offered to business actors in the region.

The datasets were generated, adopted, and compiled from business and company websites and online international agencies' databases provided by the World Development Report-World Bank, IMF, OECD, ILO, UN-Comtrade database (UNCTAD), and Economist Intelligence Unit, as there is no better dataset with a unified methodology on economic performance in relation to SEZ and investment indicators and institutions available. The data covers the defined period under consideration according to its availability. Other vital documents and analysis were derived from local, national and international newspapers, archives, social media, and the national agencies database, i.e. Indonesia Statistics Agency (BPS); Indonesian Investment Coordinating Board (BKPM); the Indonesian Central Bank (Bank Indonesia/BI); Coordinating Ministry for Economic Affairs (CMEA); Ministry of Finance (MOF); Ministry of Trade (MOT); Ministry of Industry; Ministry of Public Works; Ministry of Transportation; National Development Planning Agency (*BAPPENAS*); PT KBN database; and BIFZA (previously known as BIDA).

At the second stage, primary materials (government and policy documents) as a substantial part of the research were obtained from local and international non-governmental organisations (NGOs) reports, relevant institutions and non-profit organisations such as independent research institutes dedicated to analysing policy impact or think-tanks with different areas of expertise, which are difficult to find in the UK [i.e. Centre for Strategic and International Studies (CSIS), Indonesia for Global Justice (IGJ)³⁷, SMERU Research Institute³⁸; Indonesia Rapid Development Appraisal (IRDA), and Centre for Reform on Economics (CORE)³⁹]. The author obtained supporting documents from state unions and research institutes under the University of Indonesia, Brawijaya University, and University of Gajah Mada as well as international academic institutions in the UK and elsewhere who research specifically the Indonesian political economy (Japan-based Research Institute for Economics Trade and Industry/RIETI; Singapore-based ISEAS; Australia-based ANU; and US-based Cornell University). The author also accessed minutes of meetings, handbooks, speeches, memos and statutes from MPR (People's Consultative Assembly) and DPR (House of Parliament) assemblies, conferences in Jakarta and Bali, and consultative meetings conducted by the SEZ National Council in Jakarta. They are a programmatic and qualitative feature and allow a more detailed institutional policy analysis of underlying concepts and activities. The author analysed official and legal documents from laws, government regulations, presidential decrees etc. that reflect more recent resource-based SEZ form and policy.

³⁷Mainly addresses the global trade liberalisation issues with areas such as: World Trade Organization (WTO), Free Trade Agreements (FTA), and trade and investment policies.

³⁸The main task is to monitor the impact of 2008/09 global financial crisis in Indonesia—i.e. impact on manufacturing industry until August 2009 (November 2009).

³⁹Its main contribution is in conducting research in public and economic policies especially for the economic commission in the parliament.

The third stage of primary data collection involves direct interaction conducted with observation technique which refers to the observation back in 2008 and fieldwork in two phases in 2014-2015. During fieldwork, Focus Group Discussion (FGD), informal discussion with several parties related to the implementation of SEZ in Indonesia, semi-structured and in-depth interviews as well as data gained from free interviews with politicians, officials, and other informants who were met unintentionally or by chance, such as in between meetings and plenary sessions, and study visits to several SEZs around Jakarta were carried out (Hussey and Hussey 1997; Darlington and Scott 2002; Creswell 2003).

The fieldwork in Jakarta was divided into two phases. The first phase was carried out in summer from July to August 2014 and the second phase from October 2014 to January 2015. I maintain a wide professional network as well as a number of potential hosts.

- **The fieldwork**

In the first phase facilitated by colleagues and the budget team from the Ministry of Finance (MOF), the author deliberately mapped informants through non-random (purposive and snowballing) techniques. The author visited the parliament building and a number of offices for preliminary observations, such as customs headquarters and branch offices in East and North Jakarta, Indonesian SEZ National Council (SESDENAS) head office and BKPM office. My professional ties at the MOF assisted me in the purposive sampling where a selection of potential informants in both case study areas was based on my professional judgment; for example, the competence they possess to represent the visions, policies, objectives and action plans of their organisation or institution. In addition, the snowballing technique was employed so that key gatekeepers from the CMEA, MOF, and BKPM who had actively promoted the new large-scale term of resource-based SEZ can help me identify the key informants at various government levels. Thus, the various aspects attempted to uncover this research require not only persistence and willingness in 'enjoying the rigours of academic adventure' while in the field which is very challenging and seemingly irregular, but also the academic sensitivity to observe the various behaviour of actors and a pile of documents and literature to be read.

Hoping to find a subjective reality, during my second visit to Indonesia at early October 2014 until late January 2015, the author visited not only government offices for the second time but other sites: the parliament building, think-tank offices, Industrial Estate Association (HKI) office, and the University of Indonesia Institute of Management. On several occasions the author have also visited five SEZ sites (scattered industrial clusters) while conducting interviews located around Jakarta such as at the eastern part of Jakarta in Pulo Gadung, as well as areas on the northern coast of Jakarta near Tanjung Priok Port (such as Cakung and Marunda), SEZs in the surrounding districts of Cikarang in Bekasi and Tangerang to deepen data analysis and accuracy. Often the author had to take a ride with the

respondents' vehicle or official vehicle from their respected offices to reach their office or EPZ locations, due to public transport did not serve the route or traffic was so jammed. As a result, more than expected, the field visit for almost four months, not only managed to bring the author together with some new key informants who have information more than they could give, even save some historical data related to the SEZ policy formulation process (which later gave its own colour for the diversity of data in the dissertation). It also provides an opportunity for the author to access some time-series data related Jakarta and Batam SEZ activities (along with their production values).

Having built strong SEZ networking during the author's professional career and prior communication with the author's gatekeepers, the author conducted a mixture of focus group discussions (FGDs), face-to-face semi-structured, in-depth, and indirect interviews (through emails and short messages), conversations, and discussion with 83 interviewees (Appendix 1) in parallel with the aforementioned archive work (review of literature): they are Indonesian active-duty planners, policymakers, politicians, councillors, former and retired officials dealing with or involved in any of the SEZ-type policy developments in Indonesia, journalists, researchers, think-tank executive directors and officials, and members of the aggregates sector in Jakarta EPZ and Batam FTZ. When the main informants could not be reached, to ensure quality and reliability, other informants with knowledge i.e. lower echelons/ranking officials or staff, were interviewed. The author discussed with a number of key informants who have extensive experience and knowledge on SEZ policy dynamics and the history of the SEZ in Indonesia, as well as visiting some sectoral institutions at the district and provincial levels concerned with the proposed study.

Even though the interview questions were highly situational and adjusted slightly depending on the circumstance and response of the interviewee, the general scope of inquiry was focused on a number of areas based on the preliminary propositions and SEZ evolution. They were oriented towards answering questions on why and to what extent institutional change (SEZ policies embraced) and resistance to change (SEZ policies rejected) occurred by particular individuals and/or groups including the dynamics and tensions between all key policy actors and stakeholders. Interviewee responses complemented and enriched the secondary materials. The author used the prepared list of guided questions which particularly link the questions with their response to the key actors' behaviour and policy preferences. The author links their responses to the theoretical framework and concepts built from NIE literature and uses Williamson's institutional constraints model as a guide on how institutions have influenced their decisions.

For nearly five months of field visits, the author managed to get a more up to date data on various problems related to the SEZ policy process and its institutional intricacies, to the collation of secondary data from various agencies and individuals who can support the research activities. The author also

collected various research details from field notes and interviews as well as media citations, which were very important in making data interpretation to deepening analysis, adding to the historical background of the emergence and continuity of the SEZ policymaking dynamics with quite deep and accurate analysis. Nevertheless, it must be admitted that the dynamics of the field often 'force' the author not to use a drafted question guideline which was academically considered 'ideal', since it seems formal, 'less flowing' and does not make the respondent comfortable. Often, researchers also get communication barriers in conducting interviews, because not all respondents able to address the specific issue in a clear straight to the point way as most of the respondents come from Java who culturally has slower character than any other ethnics in the country. However, the author felt fortunate to have been born and being raised in a Javanese traditional family so as to 'get a bit' to grasp the meaning of body language and some simple phrases they say in the Javanese language so as to gain adequate understanding in a non-formal situation. Although it must be admitted, often the revealed meaning becomes biased because it loses its context.

Guided by the circumstances in the field, researchers also began to understand, why at the time asking for interview becomes impossible due to lack of time, place, or opportunity. Not enough just to understand, the author was required to be adaptive and not easily let down, rushed to set an interview strategy or discussion with key informants directly in unusual places. The result is sometimes unexpected, can get rejected or received well and obtain greater opportunity to 'catch the reality'. Such unexpected empirical realities often provide different aspects for micro-research like this.

The data collection process continued during analysis and writing, and in particular regarding updating most relevant data from secondary sources through accessing media coverage of new legislation pertaining to the case studies until 2016.

3. Data Processing

Recording and transcribing an entire interview is important, as it provides a substantial text for detailed analysis. The interview records and notes were transcribed and translated into textual and digital data. Transcribing and translating interviews were managed in conjunction with other research methods. Not only it was costly, but also due to the nature of the topic being complex and sensitive, the author did not hire a transcriber or translator. After each interview, the author recorded all significant insights, read over the transcripts and wrote a summary of themes after three or four interviews to summarize the reflections (Bogdan and Biklin 1998).

- **Interpretive Phase**

After transcribing is completed the major step in analysing qualitative data was by performing classification, where the data speech obtained was then selected and coded according to the

phenomenon under study into meaningful categories. The author examined and generated the important data and information obtained through categories before generating keywords. This enabled the author to organise the *“large numbers of textual speech and determine patterns that would be hard to perceive by just listening to an audio recording or reading a transcript”* (Bogdan and Biklen 1998). This category was made as my starting point before going further into investigating the sensitive nature of other institutional constraints under different settings.

During the coding process, the author carried out the editing process which is the process of examining the data and information obtained so errors and biases in research can be avoided, thus the validity of the data can be obtained. The author arranged all interview transcripts in chronological order based on date, respondents' related affiliation and areas of concern. During undisturbed periods, the author read over all the data carefully. The author generated initial coding based on identified categories as the author read responses without worrying about different categories. The coding process works with regard to one of the study's themes from the perspectives of the informant towards the SEZ policy formulation process. This technique guided the author to understand the problem underlying the mechanism of designing a policy and the final decision made by each regime government. The author labelled the related data and used *“focused coding to eliminate, combine, or subdivide coding categories and look for repeating ideas and larger themes that connect codes. Repeating ideas are the same idea expressed by different respondents, while a theme is a larger topic that organizes or connects a group of repeating ideas”* (Bogdan and Biklin 1998). The author creates final codes to between 30 and 50 as suggested by Berkowitz (1997). After developing the coding category, the author creates a coding table based on the abbreviations and descriptions of each code. After the coding process, the author generated visual devices to guide the study such as diagrams, flowcharts, concept maps or matrices to illustrate themes or relationships (Berkowitz 1997). This step supported the analysis conjunctively with other secondary data collected by other means from literature and official documents, to support the confirmation of themes and stimulate the critical thinking on consideration of new relationships or explanations. To answer the research questions:

1. What are the institutional intricacies surrounding the process of SEZ policymaking?
2. How and why do institutions influence the behaviour of actors in SEZ policy decision?
3. Which institutions affect the SEZ policy decision and why?

The categories used in this study are: (1) the role of political institutions and economic agents in policymaking; (2) recovery from the AFC; (3) global trade competition; (4) the international investment campaign; (5) power relations in the SEZ institutional structure; (6) issues arising from the implementation of regional autonomy; (7) lobbying for economic reform; (8) lack of government incentives; (9) lobbying for the project sanctioned (approved project) and payoff or fiscal incentive

structures; (10) government policy inconsistency; and (11) the role of stakeholders in influencing government policymaking. Based on these identified categories, the author simplified the data by way of binding concepts into appropriate keywords of research problems, thus, the validity of the data can be obtained: role and function, institutional structure, reform process, the reason for the change, effectiveness, the significance of the change, autonomy, and programme implementation. These keywords symbolise the political landscape in which economic reforms take place or are being gridlocked and determine what obstructions and consequences these processes entail.

Using Williamson's (2000) framework as a guide, the author categorised the keywords into four themes: first, the entrenched values from the NO characterised by the patrimonial networks in the recent open political system; second, the economic reform policymaking process as a consequence of the AFC and Soeharto's demise and the reform post open market system and diffusion of power; third, the systems of rules and legal framework and the actors who run the system and enforced the mechanism; fourth, policy outcome as a result of the failure of the governance structure. These four themes imprint the discussion in the analysis and findings chapters (see chapters 4, 5, and 6 for detail).

4. Data analysis

Given this research is done with a subjective approach, it takes the accountability mechanism of data validity or credibility to determine whether the research findings can be trusted or not on the issue of SEZ policy dynamics in Indonesia. The author attempts to achieve credibility since the author is an outsider who is not the same as the respondents⁴⁰ who mostly were or still are engaged in the formulation and procedural context of SEZ policy. Fortunately, the author is quite familiar with the SEZ policy issue, which since 2008 has been involved in an observation for a number of professional and official duties although not in a research context. These circumstances have at least provided a fairly solid 'access space' for the author to approach a number of key informants, thus facilitating a more credible research.

Initial analysis of the results of the literature studies, on academic texts that have a significant influence on SEZ policy practice with the results of primary data analysis, to become a simple draft, started in February 2013 until July 2014. While initial analysis of the results of the observation and documentation results are conducted directly during leisure when filling in spare time during summer in July-August 2014.

The author performed the process of qualitative data analysis based on empirical findings and categorization of data conducted according to the formulation of research questions. The research

⁴⁰The respondents only serve as data sources and do not have the authority to actualize all the potential that lies behind the phenomenon or reality being studied.

findings contain broad statements on the relationship between the numerous categories of data used to develop a conceptual understanding of reality thus facilitating various interpretation into meaningful explanation in the form of analytical descriptions.

- **Testing the Validity of Data**

The triangulation method was carried out by clarifying the data and information to enable cross-referencing data derived from various information and sources and different ways of collecting data and following-up after fieldwork. The author re-assessed data sources through the same method to find links between the research results and the theory used in the research. These allowed the insights gained in the analysis to be tested for validity, reliability, completeness, and objectivity through a various degree of validity of the data source and data collection techniques. The method was done by comparing and/or contrasting observation with interview results, as well as the individual environment and perspectives with other peoples' opinions and views (Cohen and Manion 2000).

5. Ethical Issues

The main ethical issues associated with conducting the qualitative elite interviews (Whiting 2008) during the fieldwork were informed consent and confidentiality. Therefore, the author played a neutral role by building a rapport with the informants. In the case of anonymity, interviewees were not named but only identified by their institutional affiliation (Rubin and Rubin 1995: 262). Only data acquired on record (during the interview itself) used in the thesis. Due to most informants refusing to be specifically mentioned, their informed consent is highly respected. Therefore, based on the author's own professional judgment, their responses are quoted with full identity only when requested, otherwise anonymous.

The author travelled to Indonesia as a researcher and initially avoided acting as a government official to avoid information bias. However, the author's position as a researcher and government official forced the author to fully disclose the author's identity to gain such access and address the author's intention and study purpose to provide comfortability for the respondents as their wellbeing is the top priority (Hammick 1996, Beauchamp and Childress 2001). Details on the problems and limitations are elaborated in the final part of this chapter. Moreover, key gatekeepers who controlled access and made the final decision were willing to vouch for the author and the value of the research. They also acted as the author's sponsors, i.e. deputy directors at CMEA, second line echelons in my agency, MOF directorates (of which one was promoted to lead the agency in 2015) and other contacts, i.e. friends and colleagues. Awareness of sensitive issues and potential conflicts of interest from elite and professional interviews were taken into consideration. In the event that access to Indonesia was not possible during the data gathering period, efforts were made via email communication with

informants. A greater focus was developed on the informants who have good knowledge and are directly engaged in the SEZ policymaking process.

Even if the author was allowed to approach those people, there were still difficulties in gaining the practical information the author wishes to use in the research because of the sensitive nature of the topic whereby the author was questioning the policies the government undertook. To make up for the limitations of the interview the author used (auto)-biography, extant literature through media articles, and their personal information shown in official documents. Networks are important for extending the field for data gathering.

Following Lilleker's (2003) guidelines for elite interviews, from the first moment of contact, potential interviewees receive a succinct letter (via email) explaining the thesis (including details of the author's supervisors and the funding body), why the author wish to interview them, the format of the interview, and how the data from the interview were used and stored.

In the course of interviews except for informal discussion, informed consent was obtained from respondents. The informed consent document was prepared in English and Indonesian includes details about the research, how the interviews would be conducted and how the data would be used. Informants were allowed to withdraw their participation at any time.

Data recording was undertaken through simultaneous note-taking where possible during the elite semi-structured and in-depth interview settings, informal discussions, and during the shorter, one-off interviews, where sensitive subjects are unlikely to arise by using interview devices, i.e. a tape-recorder, camera, and field-notes, in addition to gaining additional documents from the respondents. The author asked whether the interviewee allows the author to record the interview (using the software on the laptop/netbook).

Interviewees were allowed to view transcripts upon request and the author asked if they are happy for direct quotations to appear in the thesis. With regard to confidentiality, the name and any other personal details of the interviewee did not appear on any notes or transcripts (Polit and Beck 2006). Without the consent of the respondents, the author will not share the given information (Levine (1981).

All data were coded. Each interviewee and their organisation were assigned an alias, making it difficult to identify individuals from the interview data. Therefore, the third parties that might be referred to in the interview remained anonymous and their identities and information encrypted (converted to a format that is password protected and unreadable to unauthorised users) and kept in a separate, secure location.

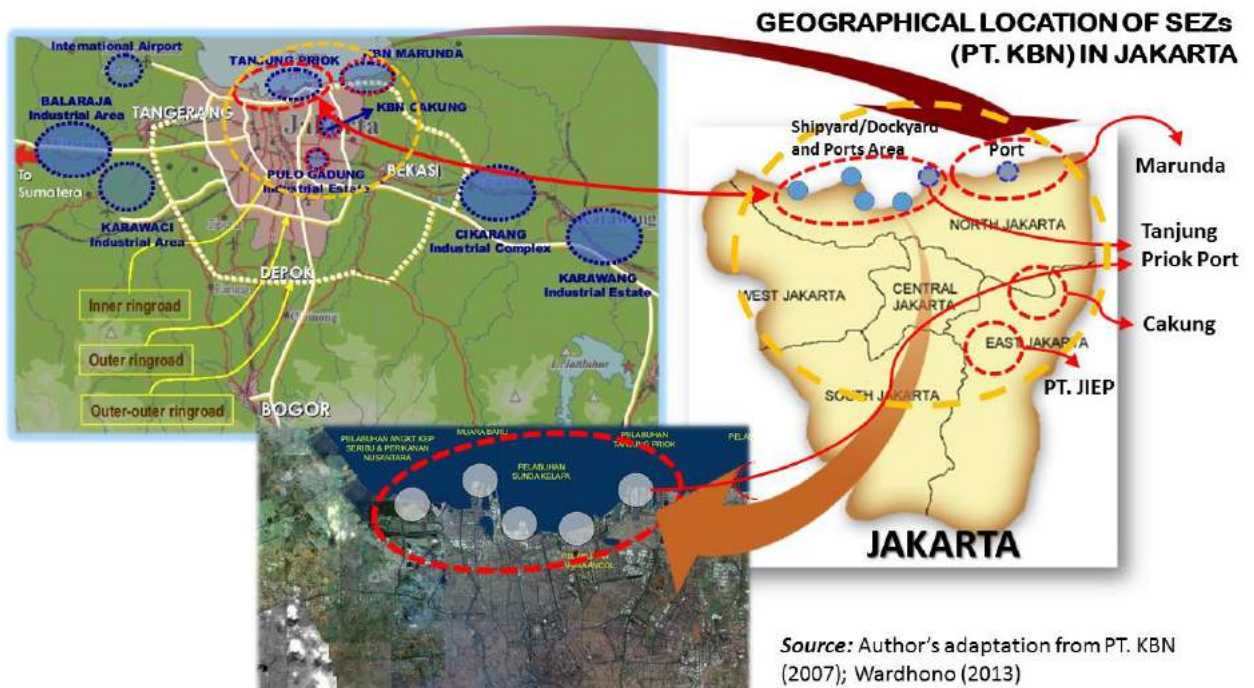
The final part, the author gave the respondent the option of allowing to be contacted if some questions need further information. This contact was made through text messages and personal email. Upon returning from fieldwork, the data was transferred to a University of Bristol computer. The data on the author's laptop/netbook and encrypted USB stick was overwritten.

6. Research Sites

The study's empirical design is informed by theory and secondary sources, but due to the scarcity of Indonesian SEZ academic research and published materials, the study relies on the primary sources analysis to clarify the findings carried out in the city of Jakarta and the surrounding districts (Figure 3.2). Apart from funding, research manageability, and logistical limitations of time, Jakarta has been selected because of having lived and worked in the city for almost the author's entire life. In addition, it is the location of the earliest and most progressive SEZ projects in Indonesia going back to the 1970s. It is also where the entire policymaking scheme of the empirical case studies (Jakarta EPZ and Batam FTZ) was decided and where the executive, legislative and judicial levels interact with other relevant bureaucratic units and stakeholders. Jakarta contains a significant central-regional-parliamentary connection. It is also where most international agencies operating in Indonesia are based (the World Bank and UN) as well as a number of Indonesian think-tanks, experts, and scholars.

- **Jakarta At a Glance: The Region's National and International Linkages**

Figure 3.2

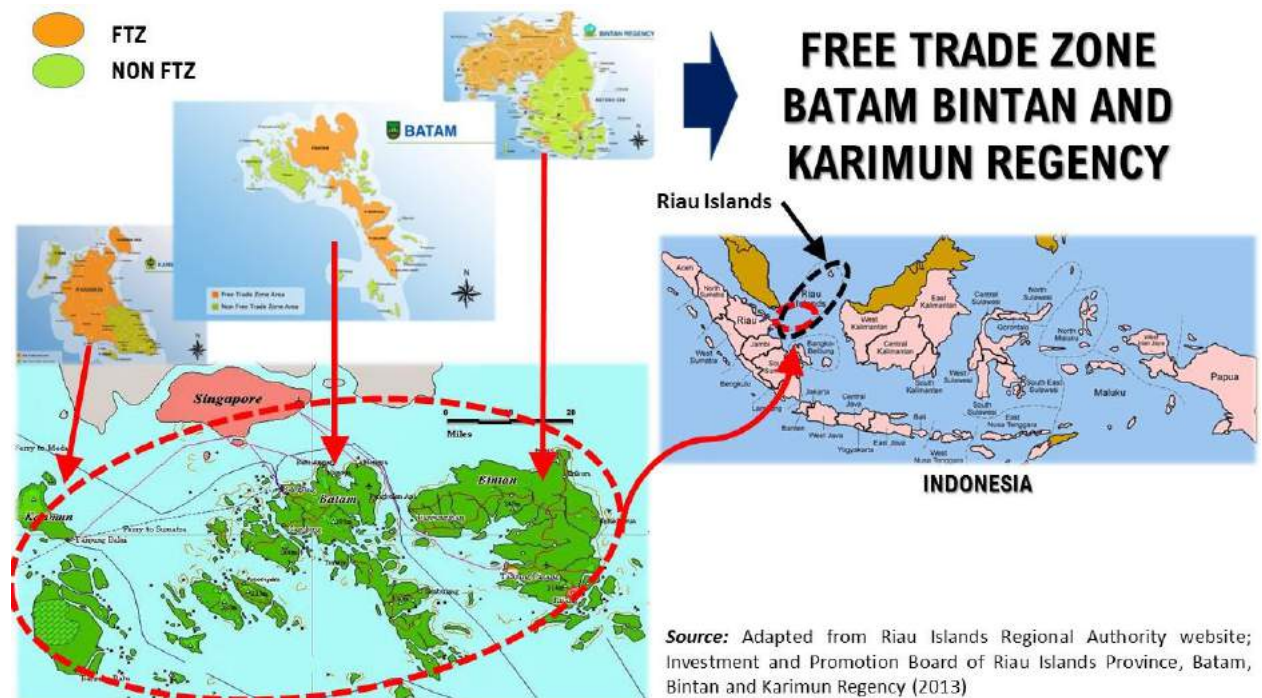


Jakarta, the capital city of Indonesia, resides along the northern side of West Java (in Java Island). It spreads over an area of more than 650km² and has a population of over ten million (Statistics Indonesia 2014). During the past 20 years it has played a significant role as 1) one of the major business and industrial centres in the Asia-Pacific developing region; 2) a centre of distribution for almost all parts of the country and has grown into the main gateway to Indonesia as it has been recognised as a trading partner for many cities worldwide; 3) a centre of national and multinational companies (MNCs), banks, and business services' head and branch offices; 4) a centre of international connection and trading activities in Tanjung Priok Port due to being equipped with supporting infrastructure and facilities and accommodating other trading partners in the world market (UNU 1996). It is designated as a special territory (DKI), which means that it enjoys the same status as a province and is administered by a governor.

By emphasizing the characteristics of policymaking of the political institutions such as the executive and legislative bodies at the central and local level (Jakarta and Batam) assumed to be the driving force for the operation of the SEZ policymaking, the author chose Jakarta as the location is the main key to the SEZ operation, which also serves as the node for the SEZ development of the entire economy, as well as the liaison between central and local government in the investment related events. This study focuses on SEZ policy and its policymaking dynamics.

- **Batam**

Figure 3.3



Batam, Bintan and Karimun regencies (BBK) are parts of Riau archipelago province of Indonesia (hereafter *Kepri* or *Kepulauan Riau* or Riau archipelago)⁴¹ located south of the South China Sea and bordering Riau, Singapore, Malaysia, South Sumatera, Jambi and West Kalimantan provinces with an area of 25,181.071ha. In this study, the case analysis mainly focuses on Batam Island as its long historical relevance⁴² provides a fertile ground for FTZ development in Indonesia.

Batam is a coastal area inhabited by 6,000 people, mostly fishermen, and geographically situated in the Malacca Strait—known to be one of the busiest for trade traffic in the world—adjacent to Singapore, and relatively in the middle of the Southeast Asia region. It is part of AFTA (ASEAN Free Trade Area) and the Indonesia-Malaysia-Singapore growth triangle (IMS-GT). Batam Island has an area of 415km² and is only 20km from Singapore (Figure 3.3) which makes the island an attractive site for Singaporean investors and Singapore-based multinational corporations (MNCs) (Colombijn 2003; Heng 2006).

7. Problems and Limitations

Semi-structured and in-depth interviews were conducted on politicians (executive and legislative levels), business actors (represented by SOE managers and industrial association), academics (university and independent think tanks), SEZ management, and economic agents under direct president supervision) to provide a comprehensive picture of the dynamics of policymaking especially on SEZ and relevant policies from time to time. However, gaining access to undertake social research is often problematic. Slight difficulties arise when accessing the interviewees involved in SEZ policymaking as the research includes high-ranking officials, former politicians, and professionals.

Although the author has repeatedly made initial observations over a considerable length of time around Batam in 2008, it must be admitted that conducting interviews directly on respondents is not an easy task. On various occasions, the author often gets a rejection, though a decent refusal and not a rough one, from a number of politicians and economic agents who are the target of the interview. According to one of the key informants who was also the guide on the visit, it seems that the person who refused subtly suspected the author as a 'government apparatus' (*aparatur pemerintah*) who wants to extract information about his involvement with some of the policy formulation. While a number of other key informants answered a number of questions as necessary and did not necessarily refuse but not enthusiastically accept the presence of the author, making it inadequate for the preparation of a comprehensive study. These conditions have at least forced the author to undertake a number of

⁴¹Riau Archipelago province is a newly created province and the result of the Riau province disintegration established by Law No. 25/2002 on 25th October 2002 comprises the cities of Tanjung Pinang and Batam, the regencies of Bintan, Karimun, Natuna, Anambas Islands, and Lingga.

⁴²See Smith (1996) for further details.

unplanned approaches (i.e. informal networks) and adapt to situations and conditions on the field, often even willingly “waiting” to gain the right momentum.

Gaining access to the parliament building was not easy but not too difficult as the author has a close connection with the budget planning team of the Ministry of Finance (trade sector) who attends a budget meeting at the parliament on a weekly basis. The team had encouraged the author to join and observe the situation for almost a month during summer before conducting fieldwork and approached the members of parliament (MPs) as the target of gathering information. However, after gaining access, to approach an MP the author have to wait in the hallway of the parliament building for a week and sometimes more.

Various ways have been taken by the author to gather data and information from informants, but sometimes even though official letters or emails to the informants have been delivered and received, they did not respond. Other occasion occurred when even if succeeded in interviewing the informant, the information needed was not adequate.

The author was very honoured and had the privilege to conduct an in-depth interview to a former Vice Chairman of the People’s Consultative Assembly (MPR) from GOLKAR faction, as he has more than forty years’ experience as a politician and parliament member since Soeharto. Through a lightly warm discussion, he was not only willing to share information related to the history and political intrigues of the parliamentary sessions in devising legislation but was also convinced to arrange the time for the author to interview him directly. Finally the next day the author had an opportunity to interview him at his big private house; a research stage that not only drains energy but also requires immense patience. The respondent was also willing to suggest some people be interviewed and connect the author to them unofficially.

In addition to conducting in-depth interviews, the author also conducted FGD with a number of informants mostly government figures who have a close connection to the policy formulation, some are still active and others have retired. FGDs were not conducted with rigorous techniques but are adapted to situations and conditions, which in this fieldwork two FGDs were in between meetings where more than one government institutions gathered without prior plans.

In addition, the authors also conducted semi-structured interviews with key informants that have extensive and credible information related to the SEZ and economic reform programme. Discussion topics often do not focus on one thing, sometimes the topic is about culture and society, sometimes also about the history and personal life of the informants. While observation was done by following the production until export activities in Jakarta EPZs and the activities of formal and informal trade activities in Batam FTZs which was a manifestation of FTZ policy peculiarities in Batam Island.

Although it must be admitted, it is not easy for the author to be able to perform the total academic examination in the midst of 'tight schedule' between family and office jobs especially after the result of the oral examination was not successful. However, there are times when juggling between writing, office jobs, and family have created maturity in writing. The difficulties in the first writing attempt were trying to make an 80,000-words thesis as clear and coherent manner as possible which apparently did not touch the detailed context, while in the second attempt, the author had the opportunity to express the analysis result in more detail with a chance of writing up to the 100,000-words thesis.

The obstacle of writing the revised thesis version which the author considers it as the crucial one was that being a government official in an around-the-clock office environment provides no room to develop in research writing instead the writing focused more on meeting and evaluation report materials and calculations of macroeconomic fundamentals with no opportunity to engage in a real research experience as in academic environment.

3.3. Conclusion

This chapter brings together the literature review and outlines it to analyse the case study by employing the NIE theory and Williamson's institutional constraints model. These theories comprehend the dimensions behind actors' behaviour and policy preferences in making decisions under different circumstances for policymaking such as SEZ policy in Indonesia. The analytical framework offers Williamson's model into effective purpose enabling the author to answer the research questions.

This chapter also elaborates the methods used in the research using case study design as the most appropriate design capable to answer the complex and dynamic phenomenon given the simultaneous dimensions contained in the cases presented to be discovered, the political economy dimension (structural) and institutional dimension (historical) of the SEZ development and its relation to the policymaking process. This chapter presents the data gathering and research protocols to help address the research questions and test the hypotheses.

The next chapter explores the style and mechanism of the successive regime's policymaking by diagnosing the institutional framework based on Indonesian political economy historical context. The ways in which economic reform practice are planned and operated both meet the political institutions' desired outcome which will be explored. The author aims to classify diverse levels of policy formulation constraints grounded by similar defining elements as Williamson's institutional constraints model, i.e. purpose or initiatives, the frequency, and the types of constraints that make the SEZ policy development insignificant.

Chapter 4

The Indonesian Institutional Framework Diagnosing the Policymaking Process: Evidence from the Field

4.1. Introduction

This chapter focuses on the policymaking dynamics of Indonesia's enduring economic and bureaucratic reform by the reform and democratic regimes (RDO). This chapter embodies the approaches used in the previous chapter: a case study, an analytical narrative, interpretive qualitative approach, and content analysis. Therefore, it seeks to explain the causal mechanisms generated by institutional influences on Indonesia's policy formulation procedures.

This chapter and the next two empirical chapters involve a mixture of primary and secondary data from reliable sources, i.e. personal observation and formal visits, semi-structured and in-depth interviews, FGDs, and the literature review from relevant periodicals, publications, official documents, reports/surveys, to media coverages. These methods guide me to answer the research questions and help me validate the hypotheses. Based on the first research question: What are the institutional intricacies surrounding the process of SEZ policymaking? This chapter analyses Indonesian institutional framework, especially how policy process has changed over time that yields to SEZ policy scheme. This chapter assesses the nature of political rulers that might shape SEZ development policy by relying primarily on the historical context of Indonesia's rules and regulations. It marks the start of the key findings. This chapter is not merely descriptive in nature which describes the intricate policy development but it treats the SEZ phenomena in the case studies and the context of Indonesia institutional framework as intertwined (Yin 2004).

This chapter examines the central proposition of this study based on the research questions in chapter 1: *The tendencies of institutional intricacies to occur within SEZ policymaking process are that: 1) informal institutions, both productive and non-productive, have not been compatible in support of formal institutions, 2) property rights are not yet optimal in the bureaucratic level of SEZ policymaking process during transitional period of centralist paradigm shift towards decentralisation, 3) continuous and discontinuous SEZ bureaucratic policies have shifted the pattern of abuse of power by a handful of people in public institutions hindering the clarity of contractual relation of the SEZ relevant authority, 4) lack of clarity of the principal-agent relationships lead to uncertain structural incentives.*

The argument put forth in this chapter reveals that policy and institutions have been mutually influencing each other, entailing change or continuity of the *status quo* and contributing to the institutional arrangement where the government's current policy decisions affect what options

become available in the future. Furthermore, the choice of policies and institutions and their implementation depend on the relevant political landscape and its importance is, in general, undisputed. This chapter also shows that despite the success of implementing economic development policies and programmes that have managed to restore macroeconomic stability for economic revival, institutional problems in the economic reform process remain.

The chapter begins by analysing some of the salient features of Indonesia’s institutional environment and its macroeconomic fundamentals outlining the decentralisation and formal legislation process under different regime government that yields SEZ policy process since the Soeharto era. The subchapter to follow examines the changing face of the SEZ evolution, its complexities and challenges in the democratic order. Last subchapter summarized the results and findings.

4.2. Institutional environment in Indonesia

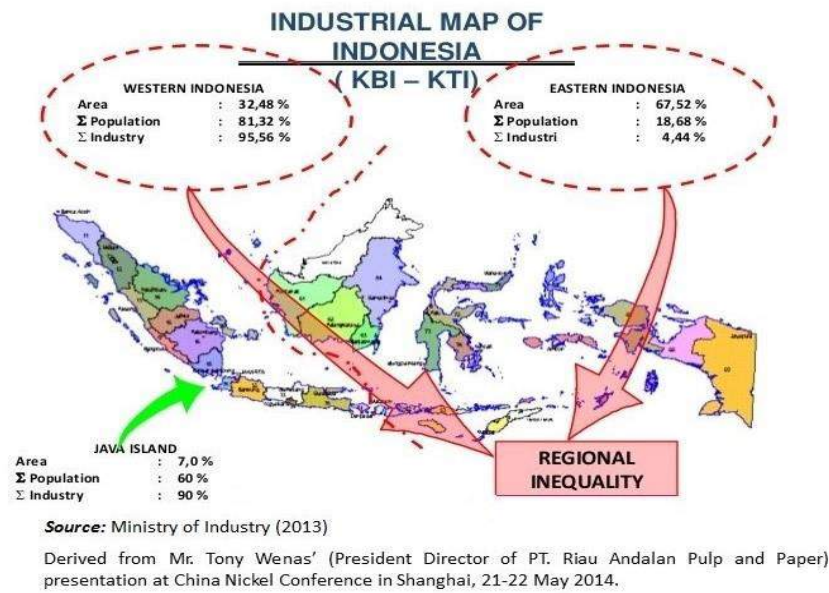
Indonesia, the former Dutch colony and the largest archipelagic state in the world consisting of 17,504 islands, is rich in natural resources. Indonesia is a maritime country with an area of 93 thousand km² and the fourth longest coastline measuring a total length of 95,181 km (World Resource Institute 2001 cited in Momaf 2007a). However, economic reform sixteen years after AFC and the important industry sectors operating at around 70% capacity (Chowdhury and Islam 2011:269) has not resulted in any breakthrough efforts in government policy to reduce the regional inequality. The apparent regional development disparities and stagnation of underdeveloped regions evident in Table 4.1 and Figure 4.1 are the main reasons for the RDO’s intention to embrace FDI-oriented SEZs as vital development policy to mitigate rising inequality. Table 4.1 presents the share of Gross Regional Domestic Product (GRDP) in six major islands in Indonesia since 1982. Figure 4.1 shows the industrial map of Indonesia in 2013 between the western region (known as *Kawasan Barat Indonesia* or KBI) of Java and Sumatera islands compared to other major islands in the eastern region (known as *Kawasan Timur Indonesia* or KTI comprising of Kalimantan, Sulawesi, Bali and Nusa Tenggara, and Maluku and Papua Islands). Regional inequality has not declined even though the regional autonomy (1999) has been running for more than a decade. These occurrences have shaped Indonesia’s institutions and character. The next section provides the fundamentals of the economy.

Table 4.1 Share of GRDP of major islands 1982-2013 (31 years)

ISLAND	1982	1987	1992	1997	2002	2007	2012	2013
Sumatera	29.3	26.7	23.9	21.5	22.3	22.7	23.8	19.3
Java	51.0	56.0	58.2	60.1	59.9	59.0	57.6	62.7
Kalimantan	9.8	8.7	8.9	8.9	8.9	9.4	9.3	8.3
Sulawesi	4.7	4.0	4.0	4.1	4.1	4.1	4.7	5.2
Bali and Nusa Tenggara	2.9	3.0	3.1	3.2	2.9	2.7	2.5	2.7
Maluku and Papua	2.3	1.7	2.0	2.1	1.9	2.1	2.1	1.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Statistics Indonesia (BPS) as cited in Bappenas (2014)

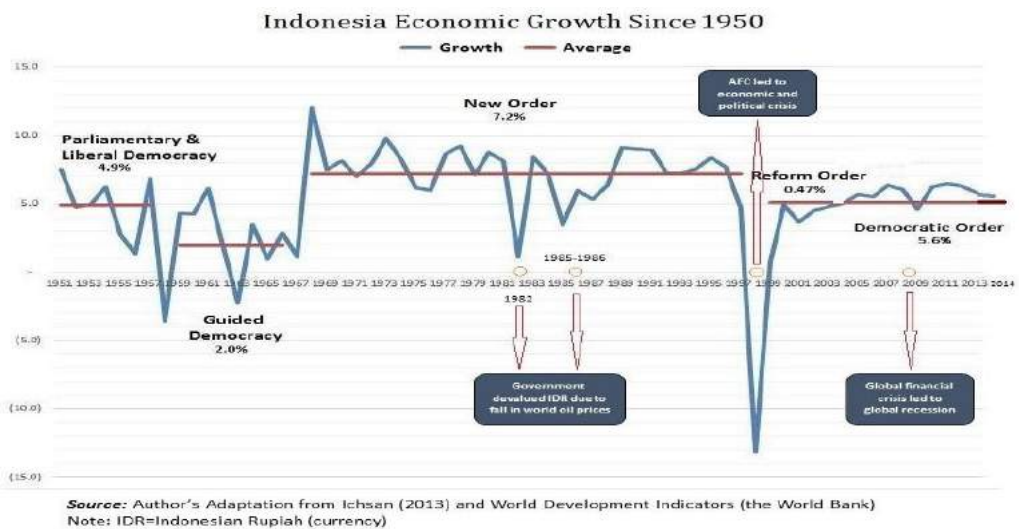
Figure 4.1



4.2.1. Socio-economic fundamentals shaping the Indonesian institutions

Demographically, Indonesia is the fourth most populous country at 253.60 million. It is expected to rise to 306 million in 2030 and is, currently, the fifth largest labour force in the world (Statistics Indonesia/BPS 2014). Corresponding to the political-economic phases described in the following section, Indonesian GDP growth has been relatively strong over the past fifteen years since AFC. The annual growth performance year-on-year (YoY) since the Old Order in the 1950s until *Reformasi* era and Democratic order (RDO) is shown in Figure 4.2. However, the robust growth level will not support the country's booming population (Swastoyo 2013-*the Jakarta Globe*) and for that reason, in the late 2020s the growth level will slowly decline (Hall and Stone 2010; Khan *et al.* 2012).

Figure 4.2



Even though SEZ under the FDI industrial sectors has generated employment in recent years, Indonesia still had average unemployment rates of 6.14%⁴³ from 1982 until 2015. The reduction in the unemployment rate has not had a significant impact on overall economic performance as it still hovered around 5.81% in the first quarter of 2015 from 5.94% in the third quarter of 2014 (BKPM 2015).

Moreover, Indonesia is still among the world's most corrupt nations, ranked 107 out of 175 countries in the Corruption Perception Index (CPI) (Transparency International 2014).⁴⁴ The young Indonesian democracy after Soeharto's authoritarian rule is still susceptible to political turbulence. The democratic consolidation until the reign of Soesilo Bambang Yudhoyono (SBY) was strongly depend on Indonesia's economic development and performance.

Culture and ideology play an important role in Indonesia's economic performance (Casing 2000). Indonesia has a high level of heterogeneity and cultural differences. To address the issue of cohesion, the government has devised '*Pancasila*' as its national philosophy and ideological base to stress universal justice and to standardise the language through a national motto '*Bhinneka Tunggal Ika*' or 'Unity in Diversity'. Further to maintaining cohesion, in terms of ideological differences there is a debate that accesses to resources would be difficult for key policy actors in the great pluralist society if not properly accommodating both national and personal interest especially if the power of the executive has not been set clearly in Indonesia's constitution (Percaya 2000: 5). This debate was driven by the need for a strong leader able to overcome the diversity which continues today.

Although throughout Indonesian political history, the 1945 Constitution⁴⁵ has granted the president head of the executive branch and emphasised that the executive always plays a central role as the most powerful and influential part of the state compared to other main arms of government (*Ibid*), Indonesian NO's style and mechanisms portrayed more power than in the RDO period. Therefore, after the reform in 2001, *Pancasila* was strengthened and served as Indonesia's enforcement mechanism not merely as an ideological term to oversee the course of power to be in sync with the guidelines of the constitution, one of which is realising the ideals of economic justice vis-à-vis reducing inequality. *Pancasila* is also at the top of Indonesia's formal legislation and thus is used as the ground norm for the overall legal product and legislation procedure (Figure 4.3). However, the high pluralist society has caused higher transaction costs borne by society. To address this issue in view of North (1991) and Williamson (2000), *Pancasila* offers a pervasive influence on economic performance in the long run

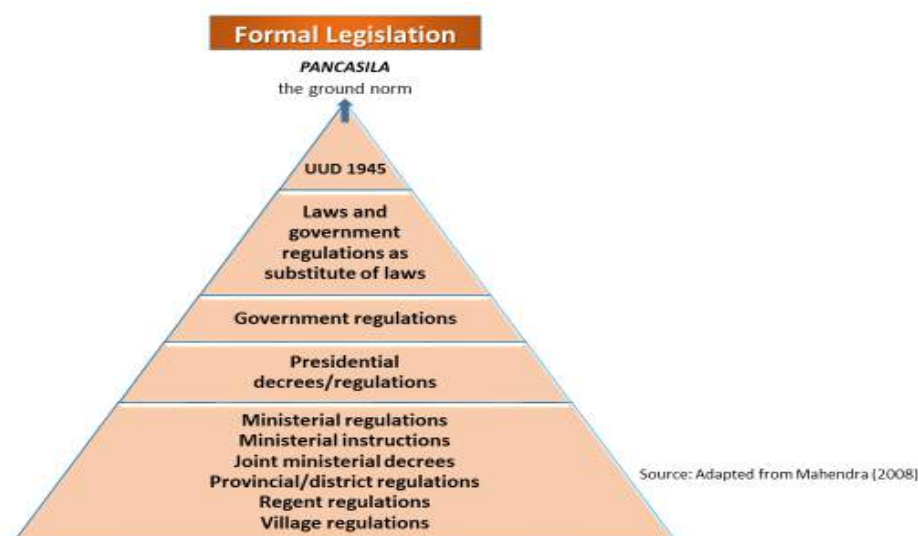
⁴³Unemployment rates in 2005 reached a high record of 11.24% while in 1983 reached the lowest record of 2%.

⁴⁴For further reading Indonesia's economic indicators, see Lloyd and Smith (2001), Bird (2001), and Dick (2003), as well as more recently Molnar and Leshner (2008), Chowdhury and Islam (2011), and van den Eng (2013).

⁴⁵Chapter 3 of the Constitution defines the authority of the President.

where it can reduce transaction costs during the policymaking process if enforced correctly. This will further be elaborated in the next section.

Figure 4.3



4.2.2. Indonesia SEZ Policy Political Economy in the New Order (NO)

This section diagnoses the synoptic background of Indonesian political culture towards economic policy vis-à-vis SEZ and investment. Despite Indonesia’s long history of foreign occupation⁴⁶ replacing the lengthy authority of Javanese Hinduism-Buddhism, feudalist dynasties, and Islamic kingdoms’, the institutional legacies (see Schwarz 1994; Ramage 1995 in Cassing 2000: 161) were incomparable to what was inherited by Soeharto and his cronies. However, under different institutional arrangements, the legacies of those historical events persist and to a certain degree are entrenched in today’s political and social spheres.

Moreover, closer scrutiny, as Hadiz (2005) and Razo (2008) would suggest, reveals that growth under Soeharto as grounded on the special privileges and protection or market power he translated into rents awarded to the selected few elites around him. The privileges are the driving force of the regime’s success (*Ibid*). Under this predicament, informal institutions in the NO era and prevailing social norms were equally un-conducive and would have been difficult to develop otherwise, especially if the economic actors and NO government rely heavily on business greatly affecting the continuation of their political power. If a very high-profile business case was at stake, Soeharto himself or his inner-circle was, by and large, the ultimate decision maker. Both find it in their best interest to fabricate development policies including but not limited to SEZ policy for rents with greater discretion and

⁴⁶The longest was the Dutch colonialism in 1605 until 1942 when the Japanese arrived.

credibility. Soeharto was the apex of Indonesia's policymaking and political structure (Crouch 1979 in Smith 1996: 9; Pepinsky 2012: 3).

A former Vice Chairman of People's Consultative Assembly (MPR) also a retired GOLKAR Party official during the NO and SBY era noted of how Soeharto have managed to adjust the governance structure (the arms of the executive power) at district level in order to pave the way for his allocation of resources at the local level if they do not follow Soeharto's terms.

"Society through local rulers such as sub-district heads and heads of villages were obliged to mobilise their funds and forces to succeed the course of Soeharto administration's plan, such as providing the tools of transportation, energy, and willingness to always attend giant meetings, speeches/indoctrination and so on. In some occasions, there are many leaders of the regional administration tried to resist and emphasized violence and power more than law-based policies. At that time a governor could be replaced if he could not carry out the task of controlling his subordinates to fulfil the needs of the ruler or submit by the rule, then the regent could also be replaced."

The statement implies that during the authoritarian regime of NO when public demand for goods and services was complicated, Soeharto automatically functions as rule governing institutions, providing incentives to run the rules of the game and punish the violators of the rules.

Hadiz (2005) aptly characterises the NO in at least three categories: first, a capitalist oligarchy able to dominate and, 'instrumentally' not just structurally, utilise the power of the state and its institutions along with their coercive strengths for their own benefit; second, the relation between the state and society characterised by systematic disorganisation of the civil society groups; thirdly, an extensive and complex system of patronage personified by Soeharto himself with the axis centred around Cendana⁴⁷.

This patronage system spreads and penetrates all levels of society from Jakarta, provincial, district, down to the village levels (*Ibid*: 253). To overcome the foregoing situation, Soeharto's adoption of a *laissez-faire* approach, as Capling and Low (2010: 126-127) suggest, marked the beginning of the economic reform in the 1980s which greatly reduced the state's role in the economy and increased the private sector's scope.

During the NO era, oil windfall allowed the government to transact a trading strategy that is more inward-looking (ISI strategy) and helps economically weak businesses through various subsidised credit. However, these reforms simply changed the monopoly of state-owned to private companies overseen by Soeharto and his cronies, for example using PERTAMINA, the only SOE in the oil and gas field, as the sole entity to develop Batam in the 1970s.

⁴⁷Cendana is the road name of Soeharto's residential address.

Further explanation from the former Vice Chairman of People's Consultative Assembly (MPR) with more than thirty years' experience serving as GOLKAR MP noted,

“Speaking of Batam...well, the development of Batam city was strongly influenced by the dominant bureaucratic culture at the time, the new order bureaucratic culture was laden with corrupt, collusion and nepotism practices. The conglomerates and rulers of the Batam Authority should be the closest persons to Soeharto. An entrepreneur like Liem Sioe Liong could be said to be the most important business person...he was the principal initiator you know....”

The respondent recounted that when Batam was still or under the previous body of Batam authority (it was known as BIDA now BIFZA) was chaired by different influential people and always changing. They were appointed by the president himself, such as Ibnu Sutowo, Sumarlin, Habibie and lastly Ismeth Abdullah.

The study by World Bank reveals the intricate scheme that has affected Indonesia's SEZ development budget (resource allocation for funding scheme) including the zone development programme for Batam; more than 30% according to estimates in two decades of NO rule disappeared which ultimately was appropriated for the benefit of individuals (World Bank 1998). Moreover, according to the respondent most of the output is then distributed to the devotees to sustain the regime's political legitimacy.

These events imply that during the NO period political patronage entrenched in the governance structure in order to secure the distribution of resources which according to the World Bank was much related to the budget allocation procedure. It also served to secure the power structure.

The relationship between the government's interventionist microeconomic policies and stable macroeconomic condition was not as distant as some scholars claimed; the latter facilitated the growth of the few oligarchs and conglomerates (capitalist class or business elites)—who were close to power—that in turn provide resources to the political elites. In effect, the capitalist class' dependence on the political elites helped guarantee their acceptance of the government's policies which were not only interventionist but arguably inward-looking (Rock 1999 in Tijaja and Faisal 2014: 8).

For example, researchers from CSIS (Center for Strategic Indonesian Studies) and IGJ (Institute for Global Justice) confirmed at length that:

“The various preconditions of 'economics' of the New Order political economy are motivated by the following theses; first, giving top priority to the achievement of high economic growth targets, which in its interpretation and implementation are left to a number of special economic teams (Widjojo, CSIS, Sumarlin, and Habibie teams), technocratically placing the flow of Western and Japanese capital into the import substitution industrialization (ISI) and export promotion (EOS). Second, build a political setting that places the president, ABRI, bureaucracy and GOLKAR, as the creator of monolithic political stability to support the at-all-cost success of economic programmes.

Third, it placed a specific target of rice self-sufficiency by utilizing the wave of 'green revolution', as a basic buffer for the creation of political economic stability. Fourth, provide tariff and non-tariff facilities and protection to the big-business (conglomeration) group which is assumed to be the locomotive of economic growth. And fifth, choose rare political and military repression in the face of any obstacles, distractions and threats to all the economic and political instruments created".

These characteristics amplified when the key actors in Soeharto era changed in the course of his presidency, but the format of the change in developing Batam Island has never changed that much. As a former military and Commissioner of PERTAMINA, Ibnu Sutowo was the longest to be appointed the head of Batam Industrial Development Authority (BIDA). Other key actors have performed accordingly to serve Soeharto's interest. However, their policy choices have induced susceptible economic foundation.

The literature pointed out that, when Soeharto developed SEZs in the form of EPZs, FTZs, and KAPETs (the Integrated Economic Development Zone), the growing SEZs contribute very little to the transfer of technology because the ongoing industry is dominated by the non-manufacturing sector (mainly oil and gas), not to mention the other low value-added manufacturing garment and textile industries in most of the EPZs in the country, and natural resource extraction manufacturing investment in KAPET which started in 1996 (Sjöberg and Sjöholm 2002; Aswicahyono and Maidir 2003; Wu 2007; Adam and Tisdell 2008; Widodo 2008; Vickers 2012). This means foreign investors dredge more raw material resources than developing a manufacturing industry. An increase in exports of primary products and exploitation of natural resources were also matters of concern.

In terms of Jakarta EPZ as one of the case study to be investigated, the structure of the governing bodies is not the same as Batam FTZ. Jakarta EPZ is governed by SOEs appointed by the central government but reports only to the Minister of SOE. The central government at the time had positioned itself as the largest investor (SOEs) followed by non-indigenous entrepreneurs (Chinese ethnics) and indigenous entrepreneurs (SMEs) in third place (Berry and Levy 1994, 1999), while Batam FTZ is governed by an independent body appointed by the central government and reports directly to the president. PT Jakarta Industrial Estate Pulo Gadung (JIEP) was chosen as a pilot project for EPZ development in Indonesia located in North Jakarta. It further became an experimental basis to evaluate whether similar industrial zones should be built in other regions (Ministry of Trade).

There has been a lack of quality support and resources from the public institutions and lack of accountability and professionalism from the industry associations for the SMEs to gain confidence. Meanwhile, the lack of flexibility and commitment has also led to the ineffectiveness of the SOEs in many respects. As suggested by Basri (2013), the GOI has been misguided by the thought that SOEs

are able to compete internationally when history suggests only a few crony conglomerates are able to withstand competition.

As confirmed by the PT. KBN (the Jakarta EPZ governing body) managers that,

“Policymakers in Jakarta at the time led by the Minister of Trade responded to international pressures on trade liberalisation and vigorously followed a trend of developing economic enclaves or industrial clusters to promote labour-intensive garment, textile, and footwear exports and inflows of foreign direct investment (FDI)”.

Under the control of an SOE—PT (*Persero*) Bonded Warehouse Indonesia (BWI), simultaneously, an industrial zone (IZ) site was formed at the port sub-district of Jakarta nearby Tanjung Priok⁴⁸ port (Warr 1983: 29). Garment, textile, and footwear industries grew rapidly but mainly concentrated along the northern coast and East Jakarta. Despite growth promises uttered in the NO economic reform, the EPZ developments did not present grounds for optimism due to administrative problems. BWI, who supposedly was the sole agent for overseeing EPZs in Jakarta at the time and was expected to cover its administrative costs from direct charges, lacked the authority to negotiate between EPZ firms and the various government agencies. Instead, EPZ firms were required to deal directly not only with the Investment Coordination Board (BKPM) and other relevant ministries⁴⁹ in addition to BWI but also with the port and customs authorities which caused higher transaction costs (Warr 1983: 35-6). Since then, the administrative cost has become essential in EPZ policymaking.

Warr (1979, 1983, 1989) viewed EPZ as an enclave—despite not being entirely correct for some of the firms—as the most appropriate assumption for this thesis, but EPZ in Indonesia is viewed as a tenant of fully foreign-owned or domestic-owned firms, while PT. Kawasan Berikat Nusantara (KBN) as the main SOE actor in the case study Chapter 5 is treated as the enclave or, in this case, industrial zone (IZ). Figure 4.4 illustrates the enclave approach according to Warr (1989).

Figure 4.4



Source: Corden (1974 and 1985) in Warr (1989: 76)

⁴⁸The main and largest seaport in Indonesia

⁴⁹Ministries of Trade, Finance, Industry, and Labour

Our attention thus focuses on the institutional elements that shape rulers and policymakers into deciding more SEZs be established under a variety of policy platforms.

Warr (1983) sheds light on the externalities brought by the existing EPZs in the new order (NO) regime and suggested that the transaction costs incurred during their establishment, e.g. administration costs including unofficial levies accrued to only a handful of people led to unscrupulous trade and decreasing state revenue. This evidence has outweighed the benefits sought in the economic study, e.g. employment generation, foreign exchange earnings, and technology transfer (*Ibid*: 36).

As a result, there have been large discrepancies in manufacturing and non-manufacturing foreign investment (FDI) in Indonesia and China and some ASEAN countries. Table 4.2 discloses the evidence where Japan and the United States (US) were the two most dominant FDI origins in 1997, prior to the AFC (Thomsen 1999). This situation is different from the neighbouring Asian countries (China, Malaysia, the Philippines, and Thailand) which were dominated by manufacturing investment, especially electronics (Thomsen 1999).

Table 4.2 FDI in China and four ASEAN Countries by US and Japanese firms (Total stock, end 1997; US\$ millions)

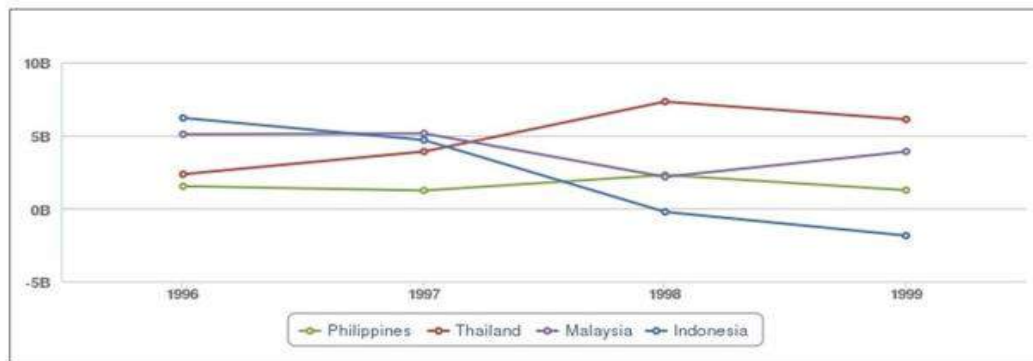
	China	Indonesia	Malaysia	Philippines	Thailand	Total
Japan						
Manufacturing	10 822	12 380	7104	3 176	8 914	42 396
Non-manufacturing	5 917	20 662	2 695	2 328	3 420	35 023
Total	16 739	33 042	9 800	5 504	12 334	77 418
USA						
Manufacturing	2 696	358	3 222	1 616	1090	8 982
Non-manufacturing	2 317	7 037	2 401	1 787	2 447	15 989
Total	5 013	7 395	5 623	3 403	3 537	24 971
Total (US, Japan)						
Manufacturing	13 518	12 738	10 326	4 792	10 004	51 378
Non-manufacturing	8 234	27 699	5 096	4115	5 867	51 012
Total	21 752	40 437	15 423	8 907	15 871	102 389

Source: Thomsen (1999)

Evidently, from Figure 4.5 after the AFC, Indonesia experienced a drastic decline in the value of investments (FDI net inflows) while other ASEAN countries such as Thailand, the Philippines, and Malaysia were not so affected but did not experience economic improvement either (Thomsen 1999). It should be emphasised that Indonesia is not the only country for which a change in investor attitude can be seen, but it may be one of the most extreme. Investment in Indonesia has been discouraged by the high transaction cost as mentioned above and the unstable political climate causing Indonesia's unhealthy economy.

Figure 4.5

Comparison of FDI Net Inflows 1996-1999 in Indonesia, Malaysia, the Philippines, and Thailand (BOP, US\$ billions)



Source: Author's Compilation from World Development Indicators database

Jensen's (2006) work coincides with the existing episode especially in the aftermath of the AFC. He suggests that approaching a more neoliberal ideology, the Indonesian government's (GOI) agreement with the International Monetary Fund (IMF) provides capital and conditions on future economic policies to help spur higher levels of policy stability to attract more FDI. The nature of the agreements becomes counterproductive when the arrangements to promote policy stability also promote policies that do not attract foreign investors or MNCs. The IMF conditions, by prescribing fiscal austerity and loans for Indonesian economic and bureaucratic reforms, have led to the decrease in public spending especially education and infrastructure, both of which are highly needed by the MNCs. IMF requirements increased unstable political and social conflict due to austerity policy prescriptions. It led to mounting levels of protest and unstable election process as Soeharto's regime was ousted from office. The loans from the IMF and their conditionality increased policy stability but also instability as perceived by the MNCs, due to the effects these policies have on the Indonesian political economy.

This study focused on the new developments of institutional constraints in two types of SEZ in the GOI's effort to spur growth by attracting more FDI. First, the Jakarta EPZ policy process after the formal institutions were established where informal institution plays an important role in the process of policy implementation. Second, Batam FTZ policy process related to the governance structure that influences the allocation of resources vis-à-vis budget allocation and jurisdictions rather than investigating the initial process of both Jakarta EPZ and Batam FTZ formal policies. It focused on episodes of SEZ policy process at the subnational level to justify whether the hypothesis that institutions have influenced SEZ policymaking process at the subnational level can be accepted. Before moving to that direction, the next section elucidates the political economy of SEZ policy in the RDO to gain more understanding on

the context to which SEZ related formal institutions have evolved but have not yielded significant economic benefit.

4.2.3. Indonesia SEZ Policy Political Economy in the Reform and Democratic Order (RDO)

- **the Habibie Period—The Beginning of Reform**

The Constitutional Reform

This section elucidates what made constitutional amendment in the RDO so important that it put the parliamentary approval as the core element of the entire SEZ policy process. 1998 was the toughest year for Indonesian economic development as a result of the AFC. Marked by a political transition from authoritarian NO to democratic rule, known as the reform period, it was also known as the economic recovery phase from the AFC characterised by regular changes in the presidency in a relatively short time from B.J. Habibie, Abdurrahman Wahid, then Megawati Sukarnoputri.

“The three presidencies each brought in some major reforms while attempting to balance opposing forces and maintain central political control” (Aspinall and Fealy 2003: 1-3).

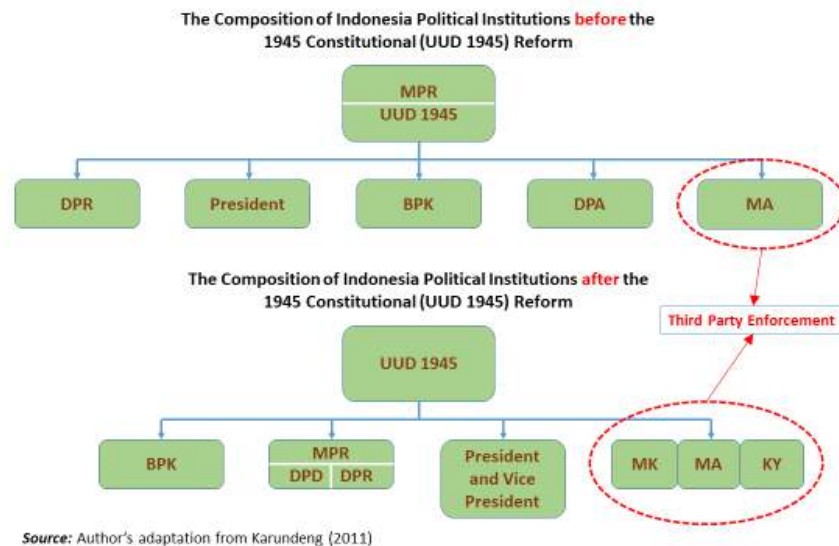
Within this period, on the governance front, the decentralisation and regional autonomy emerged on such a grand scale. Further impact of new decentralised regions or autonomy governance on SEZ is developed in the next chapters as two varied episodes of conflicts of interest between actors in the formulation of SEZ policies in Jakarta and Batam.

After Soeharto’s demise in 1998, there was an amendment towards the UUD 1945, the Indonesian Constitution which was considered a fundamental change to anticipate misconduct in the practice of state administration. The practice of change itself was in accordance with the wishes of the founding fathers as articulated in Article 37 of the constitution that they refused to be trapped in the state administration unable to be used for the paradigm of checks and balances or horizontal accountability in creating good governance.

This change also affects the relationship between the legislature (parliament/DPR) and the executive (president), i.e. in the process as well as the formation mechanism of the Law (Figure 4.6 and 4.8). In addition, the 1945 amendment also reinforces the functions of DPR, both fiscal and regulatory functions, as a control mechanism among state institutions. The reason for the reinforcement was that DPR as the people’s representative body ought to be the formal body to oversee the government in running the country. The legislative (DPR) and judicial oversight bodies (the Supreme Court/MA, Judicial Commission/KY, and Constitutional Commission/MK) have significant roles in assessing the effectiveness of the implementation of established regulations. If the established rules are not in accordance with the public interests, then it will be revised with a new adapted and pro-people rule.

In the Weberian notion of bureaucratic ideals, the formalised systems of control and surveillance by DPR and its elements over the executive or bureaucracies existed within an intricate context of checks and balances during the RDO. The amendment was to improve the existing institutional arrangements with the use of democratic procedures.

Figure 4.6



Source: Author's adaptation from Karundeng (2011)

A remark by a former MP from Gerindra Party observed,

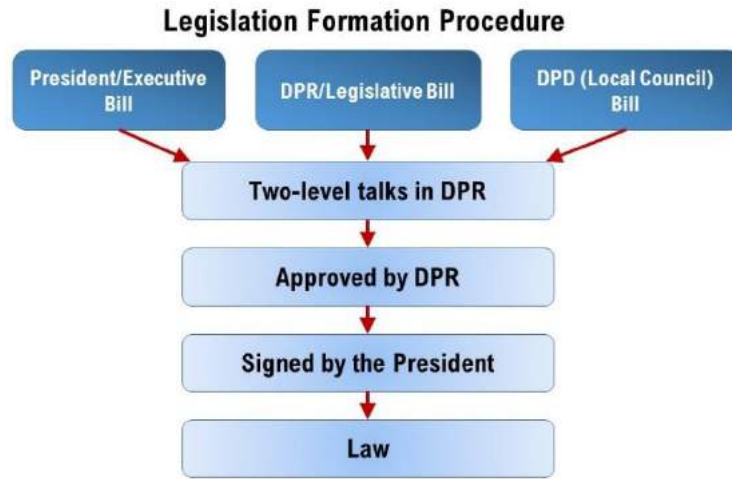
“In the NO period, the 1945 Constitution has become a powerful political instrument for the development of authoritarianism and fosters collusion, corruption and nepotism (KKN) practices around the President’s power. Therefore, during the reform period following the end of Soeharto’s rule, the agenda for the amendment of the 1945 Constitution becomes necessary. It is understandable that it is impossible to carry out political and economic reform without reforming the law. Legal reform is not possible without changing the constitution. The impact of the amendment (Article 20A of paragraph (1)) greatly affected the position and authority of the President and DPR as the legislative body; for instance, DPR has been given the righteous power to both establish and approve laws”

Figure 4.6 illustrates which part of the change has affected the President and DPR’s position as the legislative bodies.

After Soeharto’s resignation, political power was fragmented and opened up new authorities. At the central government level, the executive no longer has the exclusive power. Parliament became more dominant after they received Soeharto’s resignation. Despite DPR being the elected representative, the President holds the power of the executive in addition to holding the power to make laws as seen in Figure 4.7 which resulted in unequal relations between the President and DPR. The President can ignore the bill approved by both DPR and the President in the House of Representatives by not signing

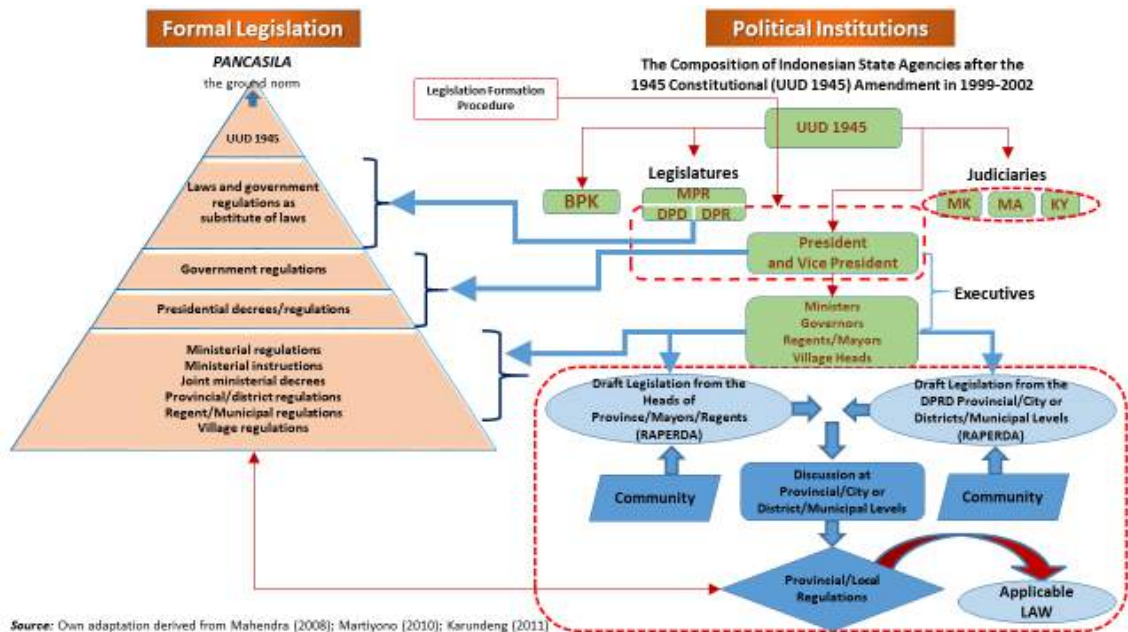
the formal legislation, and the bill can be repealed. This has had implications in the SEZ policymaking practices as elaborated in the empirical chapter 6 on the changing status of Batam FTZ.

Figure 4.7



Source: Law No. 27/2009 on the MPR, DPR, DPD and DPRD and Law No. 10/2004 which sets the formation of legislation to be divided into several stages

Figure 4.8



Source: Own adaptation derived from Mahendra (2008); Martiyono (2010); Karundeng (2011)

Despite these formal institutional and constitutional reforms, there are no limits on the extent to which any political system, authoritarian or democratic state, can bind its successors. By way of informal practices such as lobbying to speed up the legitimate supremacy of the ruling powers, in the actual policymaking processes under different regimes, the next two empirical chapters consider the constitutional powers which refer to the power to pass a legislative agenda to the successive regime; and unsophisticated partisan powers refers to the president’s ability to influence the legislature through their party with regards to the share of seats of the ruling party.

Albeit fiscal decentralisation had been implemented since the early 1970s, the basic elements were never executed, and the fiscal policy has not attuned to local needs and preferences. This condition has inhibited the industrial development planning and policy consistency which is still inherently carried out through a top-down approach. Therefore, the strengthening of domestic business actors also appeared to be stagnant. According to Rodrik (1997, 2004), the changes in policy and rules have not led to changes in the quality of institutions and the institutional changes have affected the ability of private entrepreneurs to utilise political connections to obtain rent-seeking opportunities.

In an interview, an official from the Regional Autonomy Watch (KPPOD) noted,

“There were massive discursive practices in early 2000 through decentralisation which created unclear property rights (national laws and regulations). Indonesia experienced weakening capacity to perform its functions while government policies were running partially and overlapping in various dimensions”.

This includes the case of changing the governance structure of FTZ in Batam in Chapter 6 which resulted in territorial or jurisdictional complexity. *Interjurisdictional competition* arose due to the unclear distribution of roles and responsibilities between Batam authority (BIDA) and Batam City government (*Pemkot Batam*).

On the economic front, economic development was stumbling, greeted by great political euphoria where during the NO era Indonesians were deprived of their freedom. There was also an enormous increase of nationalism euphoria built up by Sukarno. On taking office, Habibie faced the challenges of economic freefall as GDP fell by 20% per year. The rupiah exchange rate against the dollar rose two-fold from Rp8,000.00 in May of 1998 to Rp16,000.00 in mid-June with inflation close to 100%. Indonesian state debt had matured at the time while private debt was paid by the state as a condition of the loan from the IMF. It has been reported that the Indonesian debt increased to US\$70.9 billion (US\$20 billion alone was from private commercial debt).

However, domestic risks that were increasingly posing threats to the Indonesian economy post AFC with the persistent legal uncertainty and unclear authority to stabilise the economic policy deterred investors from returning to Indonesia. Domestic economies were territorially fragmented, managed individually, not integrated, and economic stagnation gradually and steadily took place. This condition was compounded by the fact that no political party has any firm direction related to the implementation of the economic nationalism they are keen to support. Corruption scandals and violence in East Timor further hampered the recovery process. This indicates Habibie's one-year seven-month term brought minor progress in the withering economy. There were no signs of FDI increasing at the beginning of the transition period as investors were expecting strong financial security and institutional capacity associated with a stable political, macroeconomic, and pro-investor policy

climate. The political situation was still erratic and uncondusive although Habibie had slightly improved the economic chaos left by the NO regime (Anwar 2003 in Soesastro *et al.* 2003: 75). Not until 2001 after the democratisation process began to show signs of certainty did the FDI situation in Indonesia begin to improve when the GOI convinced the financiers that FDI would be advantageous as it offers adequate facilities and support for the implementation of good governance (*Ibid*).

The expiration of the NO regime in 1998 did not mean the end of economic liberalisation in Indonesia. Prior to his demise, in order to attract investors and increase exports, Soeharto decreed Batam Bonded Zone to be released from any types of taxes. In its 1997 letter of intent (LOI) to the IMF, the GOI (government of Indonesia) promised to liberalise the investment regime by phasing out tariffs, but Habibie's brief presidency was overly preoccupied in dealing with urgent matters such as the efforts in stabilising the economic performance, especially in terms of macroeconomic indicators in order to restore foreign investor confidence (Hill *et al.* 2008). However, the IMF and Indonesia's post-crisis recovery programme was meaningless in strengthening the national industry and overall economic importance. Indonesia was more exposed to capital flight than China, Vietnam, and Bangladesh where most FDI companies moved away to these three Asian economies due to improved FDI attraction competitiveness. Then, the GOI made a more powerful gesture in their liberalisation agenda and took some measures to increase FDI inflows. These measures embodied the comprehensive legal and regulatory framework colouring their discordant effect on state sovereignty. In 1999 the government issued rules that allow foreign shareholding up to 99% in the banking sector and in October, the rupiah managed to strengthen to around 8,000 against the US dollar and inflation fell dramatically. In addition, some key non-oil exports began to show signs of recovery (*Ibid*: 471).

Habibie's sudden rise to power was considered a bittersweet victory for the pro-democracy movement due to the assumption that Habibie is the right hand of the former regime. His tenure in the early *Reformasi* had yet to perform any strong economic manoeuvres. His policies were prioritised to control the political stability while during the NO, Habibie was not too vocal in supporting his political views except his support for the NO (Jan Luiten 2012: 401). The middle-income population were unable to afford all the basic needs and this led to the poverty rate soaring to 27% (Hofman *et al.* 2004: 54). Nevertheless, Habibie succeeded in conducting a parliamentary election in mid-1999. He realised that restoring the country's economy offers greater opportunity for him to win the public's trust to be re-elected in the coming election (Boediono 2002: 387).

The Institutional Reform

Upon assuming the presidency, political development began to unfold and Habibie was also grappled with economic challenges. On the political front, two important issues were raised: 1) the

institutionalisation of democratisation as previously discussed through the constitutional reform, and 2) decentralisation (Robison and Hadiz 2004: 197-200). The democratisation process induced various institutional changes raised at the national level and a system of power dispersed and shared by the president, political parties, and parliament. The democratisation aimed at an open and transparent governance system with strong rule of law.

Moreover, according to Pratikno (1999), these decentralisation laws as formal institutions are used mainly for two purposes, first, to satisfy all regions by providing a high-level political participation at the regionals. This is manifested by 'political decentralisation' from the central government to the regional government and provides political opportunity and satisfaction to local society to enjoy the main symbols of local democracy (e.g. election of regional heads); second, to satisfy the 'rebellion' resource-rich areas by providing greater access to the pleasure of natural resources in their respective areas.

Evidence from the literature suggests that between the divisions of authority with the division of affairs, there is clearly a fundamental difference. In juridical context, authority is defined as the right and power of the government to determine or make policy in the framework of governance, while the meaning of government affairs is the content of the authority itself. The pattern developed by Law No. 22/1999 is the division of authority between the government and the regions (provincial authority) determined by the government authority. Meanwhile, the authority of the Regency/municipality is an authority that does not include the government authority and the provincial authority. In this context, Law No. 22/1999 does not allow the central government to intervene in matters which have been the authority of provinces, regencies and municipalities. The province may not interfere in the affairs of the Regency/city.

In this period, the KPPOD official explicated that:

"Indonesia's democratic infancy was very costly due to its search for an effort to implement real democratic identity. In this regard, political groups were given a greater role in contributing ideas in policymaking in ways that every citizen is assumed to be more involved in the political decision-making. These changes include the formulation and issuance of new legal frameworks (laws and regulations to be in accordance to the new corrected UUD 1945 constitution) and institutions in all spheres".

Habibie's team was also confronted with a greater challenge in the drastic institutional shift known as the 'big bang decentralisation' (The World Bank 2008). Law No. 22/1999 on Regional Government and Law No. 25/1999 on Financial Balance between the Central and Regional Government were enacted to replace the previous decentralisation law created by the authoritarian regime Soeharto the Law No.

5/1974. The new policies were defined as the transfer of administrative and budgetary authority⁵⁰ from central to provincial government (Inada in Shimomura 2003: 158). Some experts mentioned this stage as the first phase of a major institutional reform (Mungkasa 2013).

However, over time, these laws have created new issues related to, for example, the coordination between the province and district level autonomous regions, and the difficulty of monitoring the autonomous region. The economic power after the decentralisation programme was changing the locus of patron-client to regions. The Habibie administration was hampered by the intertwined politics at the time leaving only some of the oligarchs to survive. The path-dependent nature which considered something as not new to the regional autonomy system in contemporary Indonesia also arose in two aspects. First, it recalled concerns of 'small-kings' to emerge as a substitute for one king (a local leader) in an area that tends to ignore the value of ethics in politics. It is the new form of political democratisation in Indonesia, where the presence of new actors such as regional parliament, a multi-party system (as opposed to only three political parties in the Soeharto era), and second, the interest groups have shaped the face of Indonesian politics to become very fluid and difficult to predict (Rohdehwold 1995; Hill *et al.* 2008).

It is fair to consider two aspects of the rise of these 'small-kings' as very similar to the behaviour of the NO regime by having an affair with businessmen as well as playing a central development project. Clientelism and rent-seeking practices are rampant when the election event occurs, where the campaign fund of the candidates of regional heads' pair is supported by the businessmen, and if they win, all development projects will be controlled by the businessmen. Chapter 6 describes this situation.

As Umam (2011) points out that:

“The existence of an economic monopoly supported by the oligarchic regime means that the design of our regional autonomy is still weak”

Although the phenomenon cannot be used to generalise the regional autonomy situation in Indonesia, because there are also many other areas that excel because of regional autonomy such as Kutai Timur and Tangerang regions (only 10% of the autonomy regions show signs of improvement based on the Annual Evaluation Result by the Ministry of Home Affairs since 2001). Findings suggest corruption in Indonesia is much more regional than central. The fact that there are 57 heads of regions who become suspects of corruption in the period 2008-2012 is real which suggest that the democracy that prospers as the paradigm of regional autonomy has failed (Jati 2012: 769).

⁵⁰Regulatory and fiscal accountability in Pepinsky's (2012) term.

A literature by Hidayat (2003) revealed the high transaction cost from the decentralisation policy. This is also supported by the result from a focus group discussion with KPPOD, the National Development Planning Agency (BAPPENAS), and an official from Coordinating Ministry of Economic Affairs (CMEA) which is relevant to the proposed SEZ policy in Jakarta and Batam. The result sums up as follows:

“At least there were two aspects that encourage the need for revision of Law No. 22/1999 and Law No. 25/1999, namely,

First, the central government never seriously gave autonomy rights to the local government. The lack of seriousness could be seen from the central government’s neglect of old legislation that was not in line with the new autonomy law. In fact, there were hundreds of Government Regulations, Presidential Decrees and various other regulations must be adapted to the new regional autonomy framework. The absence of a new implementation rule that supports democratic regional autonomy made the two laws concerning regional autonomy sterile and ineffective. While at the local level, its absence had generated confusion.

Secondly, decentralisation had inflated uncontrollable spirits among some of the elite in the region, gave rise to very strong regional sentiments. The term ‘sons of the soil’ arose everywhere representing regional sentiments manifested through a kind of necessity that the top seat of government in the region must be occupied by the original figures of the region concerned. This was certainly not something to be desired let alone be the goal of implementing regional autonomy. However, the phenomenon of ‘sons of the soil’ was so burdensome in various regions including Batam Island.

In addition, there were potential problems, such as (i) the occurrence of conflicts of authority such as Ports⁵¹, Forestry, Investment, Batam Authority⁵², and many others; (ii) Regional Institutions augmented, groupings of improper task, high organisational costs, operating costs and neglected infrastructure; (iii) recruitment, coaching and personnel dispatched and promotion not based on competence and professionalism but kinship or cultural similarities, regional approaches were prioritised; (iv) neglected organisational facilities and infrastructure, unoptimized information technology; (v) development and service management have not undergone fundamental reform; (vi) in exploring local revenue sources (PAD) there have also been excesses, among others, the increase in PAD which has resulted in high economic costs, regional dependence to the general budget

⁵¹ Chapter 5 mentions this issue on the Jakarta provincial government’s proposal to build Jakarta port SEZ.

⁵² This issue is related to chapter 6

allocation (DAU) that kill local creativity and other unoptimized legal revenues; (vii) minimum standards of service that have not been formulated properly; and (viii) the DPRD in the (new) representative system became very powerful, the Regional Head (executive) was held hostage by the Responsibility Report”.

Meanwhile supported by Kausar (2000) and Tamin (2012) in relations to how the local governments attempt to reduce transaction costs through their decision to develop a location into an SEZ which was much related to their fiscal capacity.

“Fiscal capacity is an important and strategic issue because in the future local governments are expected to reduce and even release their dependency over the central government’s DAU. It should be understood that due to the level of financial dependence has an inverse relation with the level of PAD, so to reduce the financial dependence the local government must design and establish various schemes of increasing PAD. In general, PAD improvement schemes include:

- Intensification and extension of local levies in the form of taxes or user charges.
- Exploration of natural resources
- Scheme of capital formation or regional investment through fundraising or attracting investors.

Of the three options of this policy, it seems that the scheme of attracting investors is the most sustainable option and has a useful multiplier effect, i.e. job creation, one of which is seen in the SEZ policy. The first choice, intensification and extensification of local levies, either directly or indirectly, will result in a high-cost economy that leads to inflationary pressure, while the second option, especially if the available resources are non-renewable, will be hit on the issue of sustainability”.

Findings suggest from the document and literature review that the improvement of Law No. 5/1974 into Law No. 22/1999 was mere, 1) adjustment of the provisions in the Law No. 22/1999 with the 1945 Constitution, the Legislative Assembly (DPR) Decree, and the Decree of the People’s Consultative Assembly (MPR), and 2) the harmonization of laws and regulations in political field and other laws. Moreover, these improvements to the provisions in the Law No. 22/1999 caused some problems of incomplete substance and double interpretations as analysed in detail below.

Although these legislations were new, there has been a criticism of the Law No. 22 and 25/1999, among others, on the one hand according to Haris (2001), (i) the ambivalence of the province as an autonomous region and administrative area; (ii) natural resource-rich bias; (iii) there is no constitutional mechanism for the community to participate in overseeing the course of local

government so that opportunities for the re-emergence of widespread misuse of power in the region are wide open. On the other hand, Hoessein (2002) and Suwandi (2001) describe the inconsistency between chapters in the legislation (Hardjosoekarto, 2008).

BAPPENAS official with respect to the study by Hoessein (2002) on the fundamental changes of the decentralisation or regional autonomy legislation explained at length:

“It was a radical or drastic change and not a gradual change that yields to emerging conflicts, crisis, and shocks that accompany the reforms but outweigh the previous series of reforms.

Classified as big bang approach, these types of bureaucratic reform can be seen from the shift of a number of local government models and paradigms that occur as follows:

(i) Structural efficiency models emphasized at the efficiency and uniformity of local governance are abandoned and embraced by local democracy models emphasized at the value of democracy and diversity in local governance;

(ii) Along with the shift in the model there has also been a shift from primarily deconcentration to the pre-eminence of decentralisation;

(iii) There has been pruning and slimming of the organizational structure in order to shift the hierarchical and swollen organizational model to a flat and slim organizational model;

(iv) The relationship between Dati II (Regency) and Dati I (Province) develops from being formerly dependent and subordinate and currently being independent and coordinate. The relationship pattern is created as a consequence of the change from the integrated prefectural system which is only partially at the provincial level. The embodiment of the integrated prefectural system in the province with the dual role of the Governor as Head of Province (KDH) and the Government Representative is intended to reintegrate autonomous regions that basically has the characteristics of separation;

(v) the distribution of government affairs to the autonomous regions originally embraced by ultra-vires doctrine⁵³ by detailing the affairs of the autonomous regional government shall be replaced by a general competence or open end arrangement detailing the functions of governance that are the competence of the Government and Province;

(vi) The government control over autonomous regions initially inclined to coercive shifts to persuasive in order for discretion and the initiatives of autonomous regions to be more channelled. Consequently, the Government’s preventive and repressive control over Local policy is now only repressively;

(vii) In the autonomous region finances, there was a shift from prioritizing specific grants to block grants;

(viii) The concept of Regional Government originally covers KDH and DPRD according to Law no. 5/1974 now the concept refers only to the KDH and the Regional subordinates, while the DPRD is outside the Regional Government. KDH which was initially unaccountable to DPRD is now created accountable;

(ix) The relationship between the Government and the autonomous regions during Law no. 5/1974 is unidirectional from top to bottom replaced with a reciprocal relationship model”.

⁵³A term defined as ‘beyond the powers’ or without any authority.

A former MP from the GOLKAR faction during Habibie administration recounted that:

“Decentralisation during Habibie’s tenure had the main goal of preventing any centralised power to a handful of people believed to always embark on corruptive practices. Additionally, through decentralisation as a major component of democratisation reform, the regional autonomy laws as the epitome of institutional change at the sub-national level changed the landscape of the decision-making process and gave more power to governors (KDH/Dati I), heads of districts/regions (*Bupati/Dati II*) and mayors (*Walikota/Dati II*)”.

On the other hand, negative impacts also occur among others (i) a lot of leakages (corruption) and inefficient and effective budgetary usage; (ii) exposure to potential uproar caused by regional unpreparedness and incompleteness of regulatory design to implement the decentralisation process, in the form of decentralisation of corruption, collusion and nepotism (KKN) which contradicts the spirit of regional autonomy. If the previous character of KKN is more vertical with the above institutions take the largest part, then since the era of autonomy KKN character is more horizontal with every line of government (regional) organizers take the same part. This then led to the autonomy of the region itself and is actually a double-edged knife that encourages the occurrence of political oligarchic by the local elite which also encourages the occurrence of political clientelism practices and the re-emergence of regional rebellion against the central government (Umam 2011).

Another example, local governments try to increase local revenue due to their over-oriented PAD. The problem was, the increase in PAD coupled with duplicative policies was very burdensome to society and economic actors in particular. Most of the local regulations were considered to be the cause of the high-cost economy so as not to support efforts to improve the business climate in Indonesia, whether in the form of taxes, levies and non-fiscal charges. In this case, of course, the local government has acted as rent-seeker (Sari *et al.* 2012).

Regardless of the debate about the positive and negative impacts of regional autonomy, at least various groups believe that there are many positive aspects of the implementation of the concept of regional autonomy in Indonesia, including (i) the increasing level of independence and regional capacity in managing regional economic development, areas that are more concerned with bottom-up planning, enhancing partnerships with various stakeholders; (ii) significant economic developments, marked by increases in Gross Regional Domestic Product (GRDP), per capita income, economic growth, and improved intermediary function of commercial banks.

While the results of the Indonesia Rapid Development Appraisal (IRDA) in 2002 study show that decentralisation has succeeded in promoting three important conditions, namely (i) increasing

awareness and respect for community participation in the political process at the local level; (ii) local government apparatuses have a stronger commitment to service delivery and feel the pressure of the community to improve the quality of public services; and (iii) local governments work together and share information to solve the problems they face together. Nevertheless, SMERU (2002) revealed the fact that many areas impose new levies that have the potential to hamper the investment climate and the passion of local businesses (Utomo 2010).

Several governments around the world including Indonesia have adopted decentralisation and regional autonomy policies. Empirical results indicate that the success of decentralisation has increased the efficacies of bureaucratic institutions, and has successfully accommodated from the pressure of political forces. In contrast, the lack of decentralisation and regional autonomy have threatened economic and political stability and disrupted the provision of public services (Bird and Vaillancourt, 1998, Ter-Minassian, 1997; World Bank, 2000; Shah, 2003).

Based on this opinion, this study analyses the impact of the decentralisation and regional autonomy to the SEZ policy success and failure in Indonesia and the way it unfolds. Since the decentralisation law was enacted, there was the development of a new conflict represented by the presence of regional arrogance (in the name of autonomy or decentralisation dealing with the central government on behalf of centralization). The possible implications of this institutional constraint represented by the series of conflicts are reflected in the empirical chapters 5 and 6. For example, the drama between two FTZ governing bodies in Batam, one who gained full autonomy to oversee the region after decentralisation and one who represents the central government. It is characterised by the uncertainty of the rules of the game that resulted in a high-cost economy in particular in the provision of public services and regional economic development through the FTZ concept.

- **Wahid Period**

Continuing the leadership baton, Abdurrahman Wahid, chairman of Nahdlatul Ulama (NU), the country's largest Islam organisation, and Chairman of the Advisory Board of the Islamic National Awakening Party (PKB), was elected as the fourth president in October 1999. At the start of his leadership, with the holding of democratic elections, the situation stabilised. Despite having a deft political touch and gaining a likely stable social condition, the economic aspect at the time was under scrutiny. The Wahid administration could not ensure a firmer grasp of the economy. It happened due to instability in the cabinet (McLeod 2000: 5 in Jan Luiten 2012: 419). Wahid failed to manage the cabinet and the economy, both of which are indicators of a successful leader for their political compromise. This can be understood from the frequent reshuffles in the cabinet during his reign and

assigning a family member as a minister. Nepotism once again was practised in his period as stated by *The Economist*:

“Some suspect their dismissals formed part of a deal to shore up political support for Mr Wahid in the diffuse coalition he heads. It has not helped that he has appointed his unqualified brother to a job in an important bank-restructuring agency” (18 May 2000).

When it came to policymaking, Wahid used the same manipulative tactics. He not only brought societal figures such as civic leaders and academics to his cabinet, to create a system of checks and balances among the various factions in Wahid’s ‘rainbow coalition’, but he also appointed empowered group of ministers that came from military offices and members of political parties (Bresnan 2005: 173). Unfortunately, it did not seem to work as expected with investors due to his narrow political and economic base (Chew 2000-*Japan Times*). In effect, due to few reformers, there was a lack of cohesion within the cabinet and instability in the economic condition. Investors’ legitimate concerns were that not only was Wahid lacking the knowledge of economic management ...” *his economic ministers were at loggerheads with each other and with him, adding to the policy disharmony; and that his political aims are interfering with economic policymaking”* (*The Economist*-18 May 2000; Kellerman 2004).

Nevertheless, to gain full control, Wahid managed to reduce the military’s political role. But it led to the loss of military support and incapability of his administration to survive the leadership role. Furthermore, he was unable to address issues of regional conflicts plagued by violence such as continued social unrest nuanced by the disintegration and racist movements⁵⁴. This led to military withdrawal from efforts to help settle or resolve the outbursts, resulting in the undermining of his presidency (Gorjão in Soesastro *et al.* 2003: 13).

Wahid’s political exercise was regarded as signifying a dramatic shift to nationalist ideals by investors. However, the real performance of Wahid’s regime—i.e. prioritising his frequent and eclectic overseas travels to as many countries as possible within each trip—have been largely contrary to Sukarno’s nationalism he so highly inspired. For example, with regards to the development of SEZ, Wahid had been delaying the fiscal incentives (VAT and Luxury Sales Tax) for investors in Batam in early 2000 and re-establishing the Law on FTZ No. 1/2000 in order to solve the lack of political will on the side of the legislative body (DPR) at the time as discussed in Chapter 6.

However, a year later, on 23 July 2001, he managed to freeze the legislative authority of the People’s Consultative Assembly (MPR) and House of Representatives (DPR) by issuing a decree to counter the allegation from the members of parliament (MPs). He also decreed to freeze GOLKAR as he feared

⁵⁴For example, Aceh insurgency, Maluku conflict, and Central Kalimantan ethnic strife, not to mention the more frequent labour demonstrations that reflect their increasing dissatisfaction of the domestic economic condition, as well as greater political elite contention.

GOLKAR's political influence would threaten to overturn his position (*Liputan 6 News—24th July 2001*). He returned the legitimate role of the MPR/DPR to the people as the highest sovereign power.

This conflict of authority not only showed his lack of credible commitment to the people but was construed as illegitimate and a sign of his authoritative rule. However, while ineffective in stabilising both the politics and the economy, he was replaced by Megawati Sukarnoputri (the daughter of Sukarno) who had previously served as his popular Vice President.

- **Megawati Period**

In 2001, the MPR held a special session to address the freezing of MPR/DPR and GOLKAR'S role by Wahid. Subsequently, Megawati officially led Indonesia despite her long engagement in the political arena when she served as an MP, chairman of the Indonesian Democratic Struggle Party (PDI-P), and long before, a student activist in Indonesian National Student Movement or GMNI⁵⁵ (*Gerakan Mahasiswa Nasional Indonesia*).

Unlike Wahid, Megawati did not show her sense of nationalism that her late father had proudly displayed due to public and international pressures for urgent economic recovery. Her emphasis on development led her to reiterate her commitment to fulfilling the constitutional mandate in the Preamble of the 1945 Constitution where it clearly states that the Indonesian government should contribute to the shaping of “*a world order based on freedom, abiding peace and social justice, and equitably shared prosperity*” (Anwar 2003: 77). In doing so, she put pragmatic economic needs over her nationalist pride and prestige—contrary to Sukarno's belief—and further tried to secure support for territorial integrity and forge closer regional cooperation with ASEAN counterparts by her travels to those countries. She aimed at convincing the ASEAN leaders of her ability to overcome the deep-rooted common problems such as terrorist threats, secessionist movements, and continuing economic crisis. It was understood as a necessary action for the continuing viability of the organisation and it signalled the regional association's centrality in her foreign policy approach (*Ibid*: 81). Shortly after assuming the presidency, in August 2001, Megawati fulfilled a promise she had with her constituencies at Aceh and Papua provinces through Laws which granted Aceh and Papua special privileges and became Special Autonomy provinces by consecutively issued Laws No. 18/2001 on Special Autonomy of Nangroe Aceh Darussalam Province and No. 21/2001 on Special Autonomy of Papua Province. Subsequently the regional autonomy snowball rolled and entered the second phase (the first phase was the first decentralisation law No. 22/1999) marked by passing a new Labour Law No. 13/2003 as

⁵⁵GMNI was born with intrinsic identity as an organisation of cadres and struggles based on the teachings of Sukarno to realise the Socio Nationalism, Socio Democracy, and belief in the one and only God to build Indonesia Nation and Character Building (<http://www.gmni.or.id/>).

a further form of assurance and incentive to foreign investors that Indonesia was committed to maintaining the low wage levels⁵⁶ and thus would provide greater profit margins for private companies in their production cost (Daeng 2008: 89). Three other attributable laws were created relating to the State finance namely, Law No. 17/2003 on State Finance, Law No. 1/2004 on State Treasury, and Law No. 15/2004 regarding Audit of State Financial Management and Accountability.

She did not stop there, Hertzmark (2007) stated that:

“In November 2001, Megawati immediately launched Law No. 22/2001 regarding Oil and Gas giving more concern to the domination of foreign oil companies over state-owned PERTAMINA by facilitating more extensive exploitation. The foreign companies also dominated the upstream to the downstream (retail trade) end of the production chain”.

In addition, Megawati made some concrete yet controversial steps in the context of rebuilding Indonesia’s economy which had collapsed after AFC hit most countries in Southeast Asia. The first step shortly after taking office was to embark upon relatively expansive macroeconomic policies to recover the state budget deficit that was falling apart post-crisis and had an impact on the people’s basic needs. She further aimed at improving the regional autonomy and growth of per capita income. Like the growing paradigms in the current administration, the measure to rescue the state budget deficit was by cutting subsidies as the fastest option due to the state revenue not being maximised. The Megawati government was also opting for short-term policies that were expected to quickly stabilise the economic situation that was undergoing a process of rebuilding, such as the reduction of subsidies to strategic sectors like fuel, electricity, telecommunications, etc.

In the political context, most people are aware that the government’s actions do not provide any impact other than a form of state failure in fulfilling the basic needs of society. As conferred by former GOLKAR party official,

“The logic used by Megawati’s government at the time...even today...in the economic context was considered very irrational. Arguably, it was a modest attempt to create a wider gap. Their systemic impact led to more fundamental problems with society’s purchasing power, as well as affecting the psychology of the people longing for a leader who truly embodied the mandate that they offer to the state”.

A literature by Kawamura in Kasuya 2013: 174-186 supported these comments by referring Megawati’s action with her strategic policy decision which drove public sentiments, as follows:

“The increased tariff rates on energy (fuel and electricity) and telecommunications would represent a fatal decision for the long-term economy, especially for the domestic-scale economy. Public sentiments emerged based on the result of an actual analysis made by previous scholars that the increased tariff rates had eroded the microeconomic. Lacking careful consideration, this ill-advised policy was contrary to Megawati’s well-known

⁵⁶One of the ‘race to the bottom’ characteristics

“*wong cilik*” ideology—the pioneer of Indonesian grassroots society. The reduction of the public sectors subsidy had ultimately reduced the level of market demand of the lower-class society. Further, it generated a higher gap between macro entrepreneurs and the lower-class society whose everyday basic needs continued to skyrocket”.

Even more controversially, Megawati introduced SOE privatisation and trade liberalisation as her stabilisation measures. The policy was due to external pressures, particularly from the IMF and the World Bank when Megawati restored normal dealings with the IFIs and Asian Development Bank (ADB) and also lobbied to request Indonesia’s debt rescheduling of US\$5.8 billion at the 3rd Paris Club meeting in 2000 (Anwar in Soesastro *et al.* 2003: 74). Her LOI reaffirmed the GOI’s commitment to remove any remaining distortions in trade structure and circumvent any introduction of new trade barriers to maintain a neoliberal trade regime, which also refers to the ideological legitimacy set forth by Soeharto since the 1980s.

As remarked at length by a former official at the Ministry of Trade that:

“Many state-owned enterprises (SOEs) during the days of the NO until RDO were unprofitable even though market fundamentalism economists often occupied important posts in Indonesian economic policy, for example, Boediono, who created controversy. When Boediono was the Coordinating Minister for the Economy, the micro-climate in Indonesia was not growing due to the gap between the macro and micro sector, while leading the Central Bank (BI), he took extreme measures in response to the crisis. Extreme policies such as a free foreign exchange regime and allowing interest rates to determine market forces were taken which embodied patterns advocated by the market fundamentalists. These policies demonstrated a very destructive and mechanical model”.

Mechanical means that the market moved like a pendulum swing that was driven without the control (the principal) and without the perpetrator (the agent) of the state. The benchmarks of economic well-being according to the order of market fundamentalism are a foreign direct investment (FDI) and loans. Before providing loans, the loan agents monitor the macroeconomic policies of a country and should be investor-friendly which means running the liberalisation, privatisation, and deregulation policies while downsizing the role played by the state as a regulator in the market.

The media also expressed their concern and supported the view that:

“Megawati’s pragmatist policymaking was not much different from the NO not only in dealing with loans but on overall economic policy. The only excuse was that she simply continued the agreements made by the previous administration through the loan agreement ties. In addition, the consideration to privatise the SOEs was to seek funding by securing the loan and foreign investor support to cover the state budget deficit. Clearly, Megawati inherited a chaotic economic condition due to the AFC. In the period from 1991 to 2001, the GOI made fourteen ill-judged attempts to privatise

the SOEs and twelve SOEs were successfully privatised. Megawati expressed her reason that the programme was to prevent leakage of the state budget, the monopoly of certain business conglomerates, and that the programme was a continuation from the previous regime” (*Detik News*—31st May 2011).

For example, IMF exerted pressure to release INDOSAT (A State-Owned Telecommunication Company). Based on the LOI with the IMF in 1997, there was an obligation for INDOSAT to release its subsidiaries totalling approximately thirty firms. In this case, the state as the last gate to foreign intervention failed to carry out its political sovereignty. The political atmosphere heated up when SOEs’ high-rank officials were forced to confront the Chairman of the MPR. Harsh criticism came from various elements, in particular, by one of the reformists from the National Mandate Party (PAN), Mr Amien Rais and the National Awakening Party (PKB) faction that opposed the decision to sell assets belonging to the country. The analysis of the current political context was by no means simply repeating the political map in the NO regime. In the Megawati era, everything was seen as the result of the echoes of democracy—fairly new in the ears of the society. Thus, the democratic principles of accountability and transparency were being intensified at various administrative levels (Anwar in Soesastro *et al.* 2003: 83).

Although the Corruption Eradication Commission (KPK) as a form of third-party enforcement mechanism was established, there was no concrete breakthrough. Indonesian development was highly affected at the time by the circles of oligarchs and bourgeois who were involved specifically in shaping the KPK as a vehicle for their personal interest to secure their economic supremacy. Their perpetuation was a form of affirmation against the extensive anti-corruption campaign prevalent in a country in transition to a democracy (Klinken 2009, 2011).

In the final year of her rule in 2004, Megawati made another drastic move. First, she validated a regulation amending the Forestry Law of 1999⁵⁷, which gave mining companies—mostly overseen and owned by foreign affiliates—the right to exploit protected forest areas. This policy was broadly rejected by Indonesian civil society, in particular by social movement activists⁵⁸. Second, the various experiences and lessons encountered during the 5 years of implementation of regional autonomy in October 2004, her government issued a new policy on regional autonomy with the enactment of Law No. 32/2004 on Regional Governance and Law No. 33/2004 on Financial Balance between Central and Local Government. The spirit contained in the laws was intended to carry out one of the main agendas of reform in the national budgeting system under the decentralisation policy by reducing the negative

⁵⁷Government Regulation *in lieu* of Law (*Perpu*) No. 1/2004 concerning the amendment of Forestry Law

⁵⁸Approximately eleven non-governmental organisations (NGOs) and eighty individuals from various regions requested a judicial review to the Constitutional Court (MK) to annul the Law No. 19/2004 on the Stipulation of *Perpu* No. 1/2004 on the Amendment Law No. 41/1999 on Forestry became Law (Daeng 2010 13).

impacts of previous legislation. These laws were made to clarify the rules regarding the authority of monitoring local government performance and local budget approval by the central and regional parliaments that seemed to overlap under the 1945 Constitution (Lindsey 2008: 148). The law substantially changed some paradigms and is respectively revisions to improve the Law No. 22/1999 and Law No. 25/1999. This stage is referred to as the third phase (Mungkasa 2013). One of them is decentralisation and deconcentration is seen as something continuum (sequential) and not dichotomous (divided). In the formation of regions, Law No. 32/2004 also regulates administrative, technical, and physical requirements of the territory. It is intended that the formation of regions can ensure optimal service delivery.

Megawati's style of policymaking, therefore, entailed a more pragmatic and utilitarian approach over national sentiments and emphasised development over independence, more importantly from overdependence on foreign investors and loans.

The Perils of Stagnation

Ultimately, these events have influenced the economic performance, especially in the manufacturing industry and export sector. During the reform order, Indonesian industrial development tended to stagnate (Tomsa 2010; Fealy 2011).

An official from the Ministry of Industry observed,

“Industry is one of the indicators of progress in a country. A country will be more developed if a larger share of the industry contributes to the national economy. Currently, the world is in the globalization era, global economic activity has been restructuring which affected domestic economic activity including industry. Addressing such changes, the industry is required to adapt (cope), among others, to make flexible institutional changes. The interests of the industry in addition to being flexible should operate efficiently to create profit. With such advantages, the existence of the industry will be sustained”.

However, the fact that the industrial performance at the time did not meet the Ministry of Industry's expectation is revealed in Table 4.3. Indonesian exports did not change from being raw materials even up until the end of the SBY period. Compared to neighbouring countries in Southeast Asia, Indonesia still relied largely on exports of primary products with a share of 31.1%, compared to Malaysia with only 13.3% (which like Indonesia also has extensive natural resources). Poor conditions are also evident in the manufacturing industry, where the proportion of low-end technology products such as textiles, footwear, and low-end electronics or so-called 'footloose industry' SEZs were highest compared to other countries. Indonesia recorded a score of 18.1% for this component. Indonesia is far behind the industrialisation of Singapore which was able to record up to 96.2% in terms of manufacturing exports—largely contributed by the export of technology-intensive industries such as machinery and transport equipment (70.1% share of total exports) (Hausmann *et al.* 2006).

Theories suggest, SEZ should create a cluster of industrial production activities which help the economy boost economic growth performance, but this evidence tells otherwise.

Table 4.3

Indonesian Non-oil Export Performance by Major Commodity Category Compared to a number of ASEAN Countries (two years average) in the period of 2003-2004 (percent of total exports)

	Indonesia	Malaysia	Philippines	Singapore	Thailand
Primary Product	31.1	13.3	9.2	3.8	20.5
Manufacturing Industry	68.9	86.7	90.9	96.2	79.5
Chemicals and related products	7.6	6.2	1.2	13.4	7.5
Resource-based manufactures	21.5	7.5	2.5	3.3	11.8
Machinery and transport equipment	21.8	63.4	75.8	70.1	48.1
Parts and components	9.1	36.3	59.6	45.2	20.5
Miscellaneous manufacturing	18.1	9.6	11.4	9.4	12.6
Total	100.0	100.0	100.0	100.0	100.0

Source: Athukorala (2006) compiled from UN Comtrade (UNCTAD) database

Based on the above data, the evidence suggests that until 2004 Indonesia had not escaped from the structure of ‘peripheral capitalism’. The reliance on primary products to support manufacturing production as well as for exports trapped Indonesia in being more dependent on the international market where foreign multinationals as capital owners hold the global dominant economic power. Indonesia is vulnerable as a peripheral capitalist state due to its reassertion of the NO leadership as the colonial legacy was characterised by the damage caused by economic depression and war. Alavi (1982) suggested that this placed its leaders in a bizarre situation: *“their economic policies especially tended to delegitimize the regime, but to maintain a political structure in which they could pursue their economic interest required political legitimacy”*.

In the same year, on the back of Indonesia’s serious leadership credential issue, SBY won the presidential election. His administration proved itself enthusiastic about attracting foreign capital but the promotion was mostly hampered by the issues of inadequate infrastructure, land acquisition, labour issues as well as the completion of the Public-Private Partnership (PPP) regulations.

- **SBY First Term (2004-2009) – The Rise of The Democratic Order**

The next tenure led by SBY was construed as an *ex-post* governance to ‘get the institutional support right’ due to the lessons learned from previous administrations. He gained unprecedented popularity and defeated Megawati in the direct presidential elections in 2004. Despite the president enjoying the mandate as a popular independent leader, the parliament (DPR) was and still the only authorised entity to hold regulatory and fiscal accountability to approve the passage of legislation and budget. DPR acquired strong bargaining power on the lobbying for voting arrangements in the drafting of the budget and legislation as well as an enforcement mechanism for the questioning of public officials

(executive powers) over matters of public accountability. This was also evident in the formal independence of the judiciary. It only underlines the need for serious measures to finalise changes to the constitution. It represents how the polity gets the formal 'rules of the game' right.

“Christianto Wibisono argues that parliament has become ‘a monster’ that has no compunction about squeezing the executive, a view that is widely shared among Jakarta’s political elite” (Dick and Mulholland in Aspinall and Klinken 2011: 75).

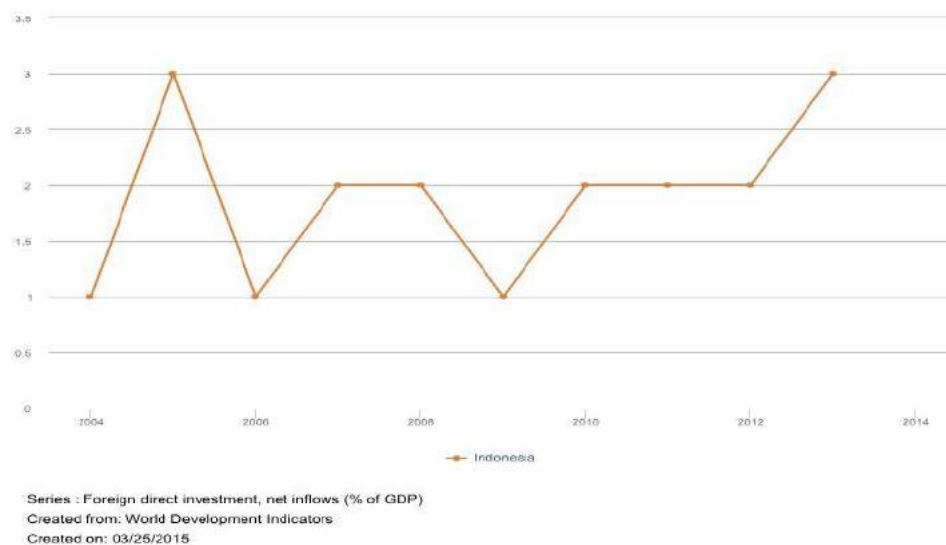
SBY’s presidency experienced both achievements and shortcomings. Compared to previous presidents, under his leadership, President SBY recorded the highest number of cabinet reshuffles⁵⁹. Moreover, in terms of community development, SBY later either formed or re-enforced several symbolic reform agencies under his direct supervision to assist him in an anti-corruption campaign, among others re-enforcing KPK’s task to eradicate corruption, the Inspectorate General, and the Supreme Audit Board (BPK), while the Financial and Development Supervisory Agency (BPKP) was divided into regions (Buehler: *The Diplomat*-5th February 2013).

Moreover, despite the administration was good at planning concealed under pro-poor rhetoric and unenthusiastic support, SBY was destroyed in the implementation and supervision. This was evident when corruption continued and the bureaucracy remained completely unreformed. Once again Indonesia’s elites, oligarchs, and bourgeois utilised their political influence to safeguard their individual interests to gain financial benefit and keep the judiciary in a shambles (*Ibid*) (*Kompas*—26th June 2008). In Stiglitz’s words (*Project Syndicate*—15th June 2015) “*financial markets tend to induce short-sighted politicians to loosen today’s budget constraints or to lend to flagrantly corrupt governments*”.

In SBY’s first period (2004-2009), Indonesia’s economic development began to improve with the gradual withdrawal of the budget subsidies of petroleum and gas which had been a burden to the government. Although FDI performance was unstable between 2004—2006 as shown in figure 4.9, the government handed over the price of goods to the market mechanism where the domestic economic interaction is international-minded and follows the international economic system.

⁵⁹There was no change of ministers in the Megawati era while when led by Wahid there were more than five ministers replaced (*Tempo*—11th April 2013).

Figure 4.9 FDI net inflows (2004-2014)



Economically it indicated an improvement, however, there were still many Indonesians who lived in poverty; with rising unemployment, the rupiah exchange rate still hovered around 9,000 per US\$1, purchasing power was relatively low, and the corruption level was still in the top five countries in the world (Corruption Perception Index from the Transparency International), etc.

Roots of the institutional intricacy in SEZ programme

Based on the interviews to some researchers conducted at the IGJ office, there are several relevant formal institutions to attract foreign investors which yield SEZ policy to be formulated, such as Natural Resource Management Law (PSDA), Energy Law, Minerals and Coal Law, Electricity Law, Investment Law (UUPM), and Land Acquisition Law. The culmination of the SBY government's pro-foreign capital measure was the new Investment Law they put before parliament in 2007.

IGJ researcher noted that:

“While the NO regime applied the economic liberalisation by opening foreign investment, the SBY-Jusuf Kalla (JK) regime enhanced it through the passing of the new Investment Law No. 25/2007. This policy put foreign investment, domestic investment, small-medium enterprises (SMEs), and the people's economic sector in the atmosphere of free competition in extracting resources and market share”.

The implication is obvious: huge foreign capital will dominate, while the domestic capital and small economy will gradually lose from external competition due to their lack of skills and industrial strength.

IGJ researcher further exclaimed,

“The adoption of this principle into Indonesian Investment Law is considered subversion to the 1945 Constitution, which mandates the state to protect Indonesians' welfare. The

equal treatment for domestic and foreign investment is to serve the interests of developed regions, especially the US, the European Union, and Japan”.

A literature by Daeng (2008) and (2010) supported this opinion.

“The government attempted to put investment issues into trade issues. The investment law superseded the long-standing legacy of investment policies from the new order, they are the Law No. 1/1967 on Foreign Direct Investment (FDI) and Law No. 6/1968 on Domestic Direct Investment (DDI). However, the new investment policy was valued as disadvantageous to the interests of the people and the country not only it weakened state accountability for meeting Indonesian basic needs, but all FDI-related economic sectors by encouraging more land grabbing and violence in civil societies”.

There was growing public disenchantment with the incumbent regime after public opinion polls. In effect, they showed at least 70 Civil Society Organisations (CSOs), mass organisations, and judicial reviews responses to the Constitutional Court that backed withdrawing the law. Moreover, the new Investment Law enshrined principles of equal treatment for foreigners into domestic law that consequently removed all obstacles for foreign-based transnational (TNC) and MNC to gain more control over natural and economic resources in Indonesia. These powerful TNCs and MNCs were given a free reign to crowd out smaller and weaker domestic companies (Daeng 2008: 216-263).

Through the Investment Law, which allotted a substantial amount of land to foreign investors, the democratic regime continued to expect more capital accumulation. According to SBY, every year Indonesia needs foreign investment amounting to US\$2,000 trillion, of which Japan is expected to fill half of the needs and the rest from other countries (*Seputar Indonesia News* 2009). The president’s statement marked further Indonesian openness to foreign investment that can play a leading role in boosting economic development and labour expansion. It contains a challenge for the Japanese—as the foreign entrepreneurs with the highest contribution of inward FDI since the NO—to take advantage of the investment opportunities provided by the government.

In support of the new Investment Law and the plan to set up an economic corridor prior to the upgrade of Batam’s status in becoming an FTZ, the SBY government through the parliament enacted the new Spatial Planning Law No. 26/2007 as a replacement for the earlier Law of 1992 in parallel with the decentralisation programme of RDO. This law authorised the local government to draft their own formal rules, especially in spatial arrangement and development plans accordingly.

The SBY-JK regime believed that the economic nationalism is not enough to boost economic development in the country. Foreign investment can lead to industrialisation and as a key driving force for economic growth based on exports, which is to encourage agro-processing industry for exports. Indonesia’s exports and the SEZ developments are still too dominated by labour-intensive industry, even though there were several initiatives have been taken to advance the industrialisation and

infrastructure. However, Indonesia overly relying on primary commodity exports shows that the industrial sector is stagnant.

As will be discussed in the subsequent chapters, this study will show that over time, Jakarta consolidated its authority over primary commodities, i.e. timber, coal mining and other minerals, and palm oil licences by moving against those district and provincial governments in commodity based-SEZ policies, which contradicts the earlier regional autonomy legislation (McCarthy in Aspinall and Klinken 2011: 103). The Jakarta government had been allowing the neoliberal system to flourish without deepening the industrial structure in the domestic market. There was a high dependence on foreign capital and exploitation within the 'forest zone'. Consequently, the foreign capital in these SEZs can easily move abroad, whereas almost no domestic entrepreneur is able to replace this position resulting in the termination or drastic decline in the flow of exports, foreign exchange, and employment.

The policy choice to place domestic and foreign investment under a single regime shows a complete lack of recognition of the more positive correlation between prosperity and domestic investment and development of nationally-owned industries. The failure to protect national interests was creating a distinct imbalance, which goes a long way to explaining why increases in investment are not reflected in a corresponding increase in the welfare of the people. If we look at the BI report in 2004, it showed that 80% of growth came from the consumer sector. Investment only accounted for 16% and the remaining 4% were exported. The development of national industry has not departed from the development of production bases. The lack of capacity of Indonesia's production base is reflected in new production capacity reaching 70% of the installed capacity. That is still 30% idle (idle-capacity). This is exacerbated by the increasing destruction of the corporate sector of the textile industry (Textile and Textile Products) as a result of the invasion of Chinese textile products and the elimination of the Multi-Fibre Association (MFA) system.

Another disturbing point is when a statement given by one of SBY-JK's well-known technocrats, former member of Center for Strategic and International Studies (CSIS) think tank, and former Minister of Trade, Mari Pangestu in the signing of Agreement on Trade in Goods between ASEAN members and China in November 2004⁶⁰, appeared to correlate with the issue of imported raw materials (Ministry of Trade website). Paradoxically, she looked positively on the Indonesia-China trade deficit, where the increase in Indonesian imports is mainly driven by the need for raw material components and

⁶⁰After two years of negotiations it was finally agreed upon.

supplementary materials rather than to fulfil the demand for consumer products (Booth 2009). Her statement raised some debate among most of the nationalist groups⁶¹.

Consequently, the GOI were faced with a dilemma whereby on the one hand the import of these components is necessary for the national industry, but on the other this fact also shows the weakness of the supporting industry structure and the inter-linkage industry in Indonesia which is not able to meet the backward linkage industry and should be met from other countries. Ironically, Indonesia has imported cheap raw material products from China which is actually a latecomer in terms of industrialisation. In just a short time, through its SEZs, China has created its own supporting industries that not only empower the domestic business sector but also ensure the availability of cheap raw materials and the country's new source of competitiveness other than cheap labour.

The SBY period was a watershed in modern democratic history (Aspinall *et al.* 2015). SBY *"was not only the first Indonesian president to be directly elected but also the first to be democratically re-elected"* (*Ibid*: 5). It generally meets the basic democratic procedural criteria (Mainwaring 1989) to provide protection for all citizens on the rights to vote and be voted, guarantee traditional civil liberties without any pressure, and guarantee their security. Political parties flourished with 42 participating in the 2004 presidential election which then increased competitive elections. The election system also embodies the principal route to political office (Aspinall *et al.* 2015: 3). Freedom of speech for all citizens to express their opinions either through mass media or demonstrations was framed by a more flexible applicable law. None of which applied to the NO regime. *"Moreover, the stability of those new rules suggests, in Higley's (2006) terminology, a new elite consensus that imposes limits on the extent of the conflict and allows for effective cooperation to mutual benefit"* (*Ibid*).

"Since the collapse of the New Order, the government has missed almost every opportunity to turn its economic boom into a positive force for all Indonesians. Serious and comprehensive reforms of Indonesia's political institutions have been anathema to the Susilo Bambang Yudhoyono government and most of the president's political appointees almost from day one in their decade-long reign" (Buehler: *The Diplomat*-5 February 2013).

The high incidence of corruption in the SBY period is not so different from in Soeharto's regime: corruption increasingly dispersed, no longer confined to the centre of power, because of governance problems remaining high. Thus, the issue of governance always coheres with the life of the nation, with merely a different nuance. To that end, it is necessary to refer to the pattern of business and politics today as a form of accumulation of corruption from the previous events in the NO. Hadiz (2005:

⁶¹President SBY's macroeconomic stabilisation programme from 2004 to 2009 was mainly driven by technocrat groups such as Finance Minister, Sri Mulyani and the Governor of the Indonesian Central Bank (BI), Boediono. Meanwhile, nationalist groups scarcely left a trace after Habibie's period in office.

244) suggests that the politico-business capitalist oligarchy within new political frameworks in the democratic order restructured their economic power to retain the deep-rooted state-business elite relations from the NO. The situation demonstrates that patrimonial relations, entrenched in the NO, were still noteworthy in the *Reformasi* period (Webber 2006: 2). It provides a general understanding of politics, economics and society of the transition effect from an authoritarian to a democratic regime (Robison 2012: 5-12).

SBY came to office after the much turbulent transition. His government managed to hold Indonesia's macroeconomic stability to a steady 5.6% annual growth rate and supporters view his presidency as a decade of remarkable political stability (*Ibid*). His period of democratic consolidation, against all odds, had succeeded amid the global financial crisis in 2008-09 (see Figure 3.2). He had impeccable credentials for the job of leading Indonesia toward a new egalitarian state. But critics view that other aspects of his rule have been the subject of controversy and a decade of missed opportunities and stagnation. Evidence suggests that political bargaining by clientelism persisted where political elites influenced the political process in the palace's governing circle to create policies in their favour (*Ibid*). This is something that has become a tradition of Indonesian rulers. The reason is none other than these actors are the legacy of previous orders. Rent-seeking by elites persists in manipulating state bureaucracy from the lowest governance level.

In the history of Indonesian politics, it appears that the roots of corruption have been the entrenched rent-seeking practice since the pre-independence era. The political elites in the parliament systematically used their power to influence the budget planning decision-making. Although it has been reconfigured, their behaviour remained. Moreover, the trend indicates a few MPs have business backgrounds and to illustrate this intricacy chapter 6 shows the power struggle of Batam's governing bodies between BIDA and *Pemkot* Batam which was backed by the intricate relations of politico-business. Such configuration became the state's 'parasite', especially in terms of public funds management; therefore, the initiative to society's welfare was just a mere expression. It implies that the big political issue is that the parliament has extensively transformed from an ideal form of House of Representatives to a House of Rent-seekers in buying their way to state power.

Before his first term ended, SBY enacted the SEZ Law No. 39/2009 in order to build a well-structured governance which able to overcome the industrial, investment, and export stagnation as well as the actors' partial network of coordination in the SEZ development trajectories. This marked for another institutional change in the face of SEZ structure of governance.

- **SBY's second term (2010-2014)**

As mentioned in chapter 1, this study focuses on the new form of SEZ developed in the RDO era. During SBY's second tenure, the GOI sought to resolve the formidable industrialisation stagnation, to increase investor confidence and to ensure an economically sustainable future, therefore, the GOI embarked on implementing its largest national economic development plan through a Master Plan for Acceleration and Expansion of Indonesia's Economic Development (MP3EI) for the period of 2011 to 2025. This long-term mega project was launched on 27th May 2011 with the spirit of 'Not Business as Usual' as the tagline.

SBY's administration convened a restricted cabinet meeting on 30th December 2010 attempting to address the increasingly challenging investment promotion. He instructed to further accelerate and expand the economy in order to propagate Indonesian competitiveness from the rest of the world so as to align with the developed countries. This form of economic reform was oriented to nurture labour-absorbing capacity of the manufacturing sector and increase FDI through debottlenecking, ailing infrastructures and other investment-related services that were lacking. Strategic zone development was his most primary attention to materialise his goals, one of which was the new form of SEZ.

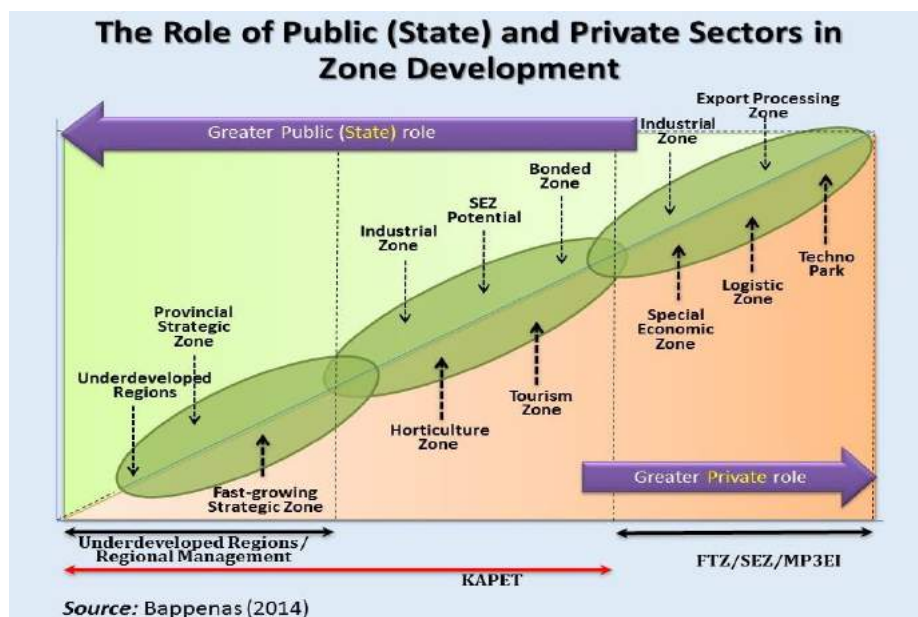
The Changing Face of SEZ

The new form of SEZ under the Law No. 39/2009 is a resource-based SEZ scheme highly dependent on extracting and exploiting Indonesia's natural resources which is desperately needed in the country, for instance Batam FTZ and Palu SEZ for minerals and coal mining, Tanjung Api-Api for rubber industry, Sei Mangkei and Maloy Batuta SEZ for the crude palm oil (CPO) processing industry. Therefore, the state's driving forces of Indonesian SEZ development are: taking the role to utilise regions which are not owned by the central or local government who more often work mechanistically, more project-oriented and short-term-oriented; to prevent a greater backwash of natural resources occurring with the introduction of economic corridors as doors to facilitate upstream product marketing; and to develop a logistics system to facilitate distribution of commodities in supporting the upstream-downstream development.

The leap towards Indonesian economic transformation requires collaboration from key actors and stakeholder involvement in the SEZ-MP3EI financing between the central and local government, state and local-owned enterprises, to foreign and private sectors. This takes place through numerous financial schemes for achieving Indonesia Incorporated (*BAPPENAS* 2014); for example, Public-Private Partnership (PPP) or joint venture scheme, state (APBN) and APBD budgetary (local budget) allocation, or loan schemes (from the World Bank and other financial institutions or foreign counterparts). The overall regional development is a division of a more dominant role in the development realisation. In

figure 4.10, the underdeveloped regions require greater financial injections from the government such as the KAPET, while FTZ and SEZ in MP3EI requires a greater private role to fund the construction of infrastructure and supporting facilities. While the GOI's role, in this case, is more on providing special incentives (fiscal and non-fiscal) that are attractive to the private sectors especially investors. The fiscal incentives include investment allowance, tax holiday, import and excise tax exemptions etc. While non-fiscal incentives include one-stop services on the bureaucratic formalities on land, labour, and licensing and other services required to increase investors confident.

Figure 4.10



The 210-page MP3EI document published by the Coordinating Ministry for Economic Affairs (CMEA) includes the principles of the MP3EI megaproject and its conceptual and technical explanations on how the project is run and tries to convince the community to support this gigantic project.

Taking the view of the Secretary of the SEZ National Council and his staffs in an interview at their head office explained with full confidence that:

“The MP3EI project tries to overcome all obstacles in national development planning and of course this mega project is to accelerate development with an obsession to achieve high, inclusive and sustainable growth rates. As President Yudhoyono constantly said in his speech that Indonesia as a country in the midst of increasingly tight global competition, its position is increasingly taken into account and geographically located in the new centre of world economic gravity. President Yudhoyono feels confident to ensure that Indonesia will no longer be a world economic power and enter the ranks of developed countries. And the MP3EI giant project is the right reason to pick Indonesia into a big player country

in the global economy. This can be seen from the activities of Indonesia in regional and global forums such as the ASEAN Economic Community (MEA) 2015, G-20, APEC, WTO, and so on”.

This optimism is relevant to Indonesia having the four basic capital i.e. demographic bonus which ensures Indonesia has a qualified human resources capacity, ability to manage natural resources that have added value, geographical formation of Indonesia in the epicentre of the world economy, and the world’s largest democracy. The MP3EI plan seems to reflect the idea of the Greater Mekong Corridor (Ishida 2009) and Kenya’s Master Plan Study for Kenyan Industrial Development (JICA 2007). The primary goal of MP3EI is to pave the way for an industrialised economy and to support the domestic economy to move up the global value chain. Through this master plan, government-led investment initiatives were said could deepen industries’ downstream connections by improving the infrastructure development to help industries become more competitive and trade more fluidly.

However, according to Daeng (2010) and Basri (2013), MP3EI has more than meets the eye as criticism arose from various dimensions. Despite the collective effort from every aspect of society, the MP3EI model is outdated and unrealistic as it has downplayed and excluded the role played by cooperatives, academic institutions, and society.

“It is very unfortunate that MP3EI has downplayed the participation of significant actors and limit the development involvement only to the bureaucratic and the business world. Cooperatives, universities and research institutions, non-governmental organisations and the community were excluded. It is no exaggeration to say that the society in the concept of MP3EI is an object of development, not the subject” (Basri 2013).

This view was supported by the authors from IGJ who commented at length,

“The awkwardness of this megaproject lies in the development policy formulation which does not involve every component of the nation. Stakeholders in this large MP3EI project do not involve civil society, and only involve the central government, local government, and SOEs (BUMN), local state companies (BUMD), and private sector (both domestic and foreign companies) to achieve Indonesia Incorporated. Likewise, the legislature is also responsible for rolling out the various legislation that paved the way for MP3EI and other investment flows.

The same applies to the application of SEZ as an integral part of the single MP3EI system. The main problem of SEZ as an agglomeration zone is reaping a number of cases of seizure of space and often the country is in a prolonged agrarian conflict, as well as the basic changes in the geospatial level of development and marginalization of the ecological rights of society, thus creating social exclusion. In addition, the issue of space makes the

movement more limited due to the privatization of space. The case is encountered in Merauke (Eastern part of Indonesia) and some other zoning. Instead of being integrated, the reality is the disintegration of social and cultural space. Not to mention the issue of population migration explosion which is a serious problem in every zone programme. The explosion of social migration adds to social problems such as the loss of employment, social vulnerability and radical impoverishment. In the case of automated employment, the outsourcing system becomes a prerequisite for the successful economic development of zoning. What is also important is the capital flow and loan scheme, public-private partnerships, and other financing sources that add to the debt burden of the state.

Open-ended regionalization makes the Indonesian government only distracted and outward-looking and ignores the essentials of development such as economic sovereignty based on independence and sovereign economic ethics appeared to be a constraining factor in the framework of open regionalization. The government is afraid of losing face abroad and is embarrassed if left behind and MP3EI is the justification for Indonesia's backwardness in development-especially the acceleration of economic growth. The growth determinism in the MP3EI megaproject requires the strengthening of Human Resources capacity to succeed smooth MP3EI roads with research findings, national innovation systems and national education systems prepared to generate productive human resources as drivers of economic growth--education by design--to create value-added and capitalization of science and technology leads to increased productivity and profitability of economic growth".

According to BAPPENAS (2014), public pressure and civil society in Indonesia since the demise of new order have forced some elements of government to make changes and adopt a new paradigm. The government can implement policies, but the process of designing and making policy should involve the public. The public in this respect covers a wide range of elements of the community, including the general public, indigenous peoples, non-governmental organizations, private sectors, higher education or academics, leading religious figures, and other community leaders. Ideally, all these parties should be involved in the policymaking process before it is formally approved by the government.

Therefore, in a discussion with a panel of scholars, government officials and members of the local legislative bodies (November 25th, 2014):

"There has been growing concerns that often the government considers that the representation of the general public has been facilitated in the people's representative body (the House of Representative of Parliament in the central and local region). But

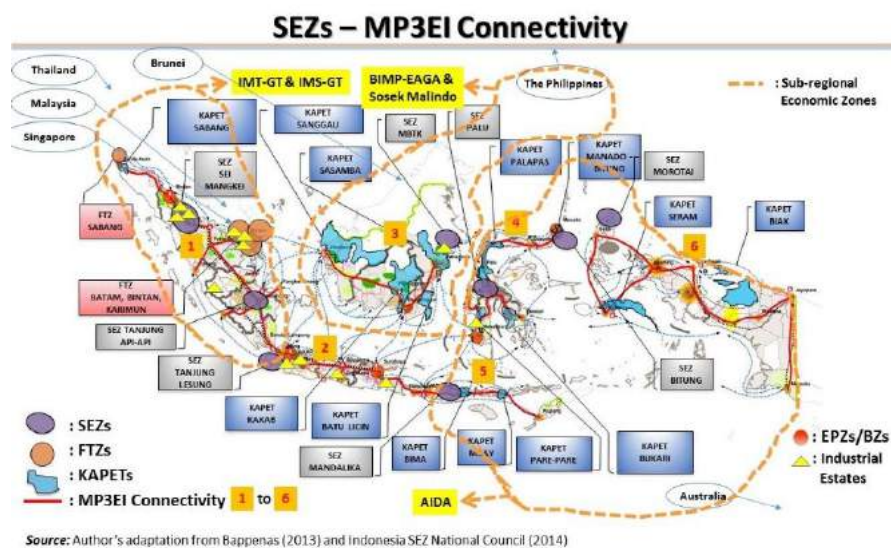
because of public dissatisfaction over the performance, morale and effectiveness of these legislative bodies, there is growing pressure to engage with the wider community where there is indeed more adequate representation and it does not have to be formal”.

In this respect, the possibility of this kind of actors’ behaviour is also seen in the next chapter where KKSS as a kinship-based organisation had influenced KBN leaders over the decision and political affiliation.

SEZ as one of MP3EI’s main products (See Figure 4.11) and the manifestation of the new Indonesian Investment Act No. 25/2007 also expected to increase investment or business by lowering production and transport costs in resource-based localities, foreign exchange earnings, and use of local resources, services, and capital to increase exports and spur economic growth. Therefore, other policies are needed to cover the principal criteria for selecting the SEZ area that meets the requirements. To approve policies required by the regions, the government provides institutions that have international standards for organising the investment services.

However, scepticism still came from Basri (2013) who argues that the tagline represented misguided thought after considering SOEs that joined the PPP scheme will gain much advantage. He also argues that throughout Indonesian history, SOEs have been unable to compete globally except for a few conglomerates run by pervasive crony capitalists⁶² from the NO period (*Ibid*: Survey and analytical report 2013).

Figure 4.11



In order to further strengthen the legal frameworks of the 2005 and 2006 Presidential Decrees on Land Procurement, the government enacted further powerful regulatory mechanisms for land acquisition

⁶²Kang (2002) and Krueger (2002)

in 2012. The new mechanism regulated the implementation of the law and support the Investment Law, not to mention to resolve the issues of compensation and justice while eliminating barriers to infrastructure development (Ponggawa 2012).

“These regulations will provide necessary, fair and better compensation, i.e. money and land, resettlement, stock ownership, and/or other forms as agreed with the affected parties. It gives legal certainty in the planning, preparation, and execution where the previous decrees failed to provide an adequate solution (*Ibid*).

As supported by the BAPPENAS and CMEA officials, the GOI claimed,

“The Investment Law, Spatial Planning Law, and Land Procurement Law would accelerate infrastructure development to achieve sustainable economic growth and equitable development”.

Moreover, they were expected to improve the ease of doing business and regain investor confidence (Wulandari 2012). Further literature suggests, these types of formal institutions ultimately enhance the Indonesian investment climate (Molnar and Leshar 2008) assisted by the decentralisation programme (Bird *et al.* 2008; Basri and Hill 2009).

However, based on the discussion carried out in the field with researchers from IGJ on the laws,

“those so-called legal frameworks are more likely to create an institutional environment that failed to deliver growth prospects particularly on the following grounds: it is increasingly difficult for the workers and peasants to gain access to capital and economic resources, it legitimises the accumulation by dispossession of people’s land to serve a handful of rich people and the interests of MNCs by providing greater opportunities for investors to take control”.

The finding suggests, the GOI has been attempting to sustain their neoliberal ideology through these legislations which show how the GOI embraced the decentralisation policy not as a mere formal rule to guide the state towards the context of good governance but under the pretext that these rules could accelerate the national economy.

Borrowing Rodrik’s (2000) argument, there are potential risks of falling into a perpetual cycle of institutional change, through new legislation, that entails no effect on growth if Indonesia has embedded institutional norms. The GOI has shown its weakness by only focusing their economic policy under mainstream NCE on production efficiency and price mechanism to achieve economic growth and ignore the social norms.

Furthermore, during SBY’s democratic government, Indonesia experienced symptoms of de-industrialisation (Gobel 2009). As shown in Table 4.4, the growth performance of the tradable sectors especially manufacturing sector was often very small and below the average national economic growth from 2005 to 2012 as compared to non-tradable sectors which grew more rapidly (Thee 2012: 129).

Indonesia's growth performance increased from 4.6% in 2005 to 5.73% in 2012 but plummeted significantly in 2009 against the backdrop of the SBY-Boediono administration and the second year of the global financial and economic crisis. On the one hand, other tradable sectors such as the mining sector unexpectedly declined and even had an opposite experience in 2009 when they achieved their highest performance. The primary sector, on the other hand, had a slight increase from the period. Meanwhile, the non-tradable sectors such as tertiary services sector (generally capital intensive, do not absorb much labour, and depend on domestic market) appear very dynamic with growth far above the average national economic growth. Nevertheless, trading, hotel and restaurant sectors as well as the financial, leasing and business sectors had a similar experience to the manufacturing sector during the 2009 occurrences and plunged to levels of great concern. Their growth performances had a slight increase or tended to stagnate in 2012 (Hill 2009: 9 in Thee 2012: 9).

Table 4.4

Data on Economic Growth per sector 2005-2012 (in percentage)

Sector	2005	2006	2007	2008	2009	2010	2011	2012
A. TRADABLE								
Agriculture, Farming, Forestry and Fishing	2.5	3.0	3.5	4.8	4.1	2.9	3.0	3.97
Mining and Drilling	1.6	2.2	2.0	0.5	4.4	3.5	1.4	1.49
Manufacturing	4.6	4.6	4.7	3.7	2.1	4.5	6.2	5.73
B. NON-TRADABLE								
Electricity, Gas, and Water Works	6.5	5.9	10.4	10.9	13.8	5.3	4.8	6.40
Construction (Housing and Building)	7.3	9.0	8.6	7.3	7.1	7.0	6.7	7.50
Trading, Hotel and Restaurant	8.6	6.1	8.5	7.2	1.1	8.7	9.2	8.11
Transport and Communication	13.0	13.6	14.4	16.7	15.5	13.5	10.7	9.98
Financial, Leasing and Business Services	7.1	5.7	8.0	8.2	5.0	5.7	6.8	7.15
Services	5.2	6.2	6.6	6.4	6.4	6.0	6.7	5.24
GDP	5.6	5.5	6.3	6.1	4.5	6.1	6.5	6.23

Source: Author's compilation from Basri (2009) and Statistics Indonesia (BPS) database

An official from BKPM with more than twenty years' experience remarked that:

“Attracting foreign investors is not limited to doing whatever it takes to ensure capital inflow. It requires appropriate investment policies that strike a balance between providing profitable business opportunities for foreign investors and devising restrictions and obligations for these investors to ensure sufficient returns to the nation. Appropriate laws must be established to ensure that investment growth goes hand in hand with increased prosperity. The Indonesian economy until the first quarter of 2013 has shown the ability to withstand external shocks although pressures to the economy increased from external and domestic factors. However, to keep the performance going will much depend on the national economic policy structure which to some extent includes the investment and SEZ policy”.

Domestically, political and social uncertainties and supply-side contraction may jeopardize Indonesia's development forecasts. SBY-Boediono, who have claimed to be pro-growth, pro-job, pro-poor, and pro-environment since 2004, drew world attention and compliments for their ability to bring Indonesia among the top twenty most preferred investment destinations for investors (reaching 17th in the ranking) and 4th prospective host economy for 2013-2015 (UNCTAD 2013 survey).

A former MP of PPP faction, now Secretary General in one of the SBY cabinet stated that:

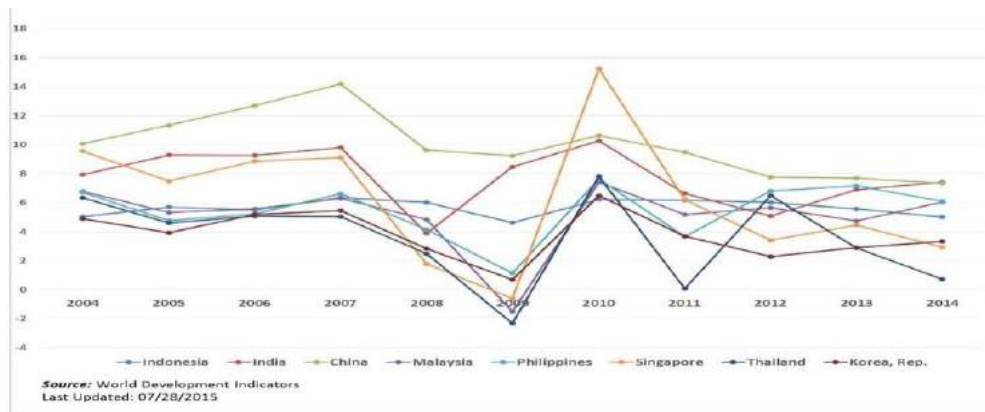
“Given that the Indonesian economy does not rely too much on exports to western countries, which had been first affected by the unexpected AFC calamity, it was not so affected by the 2008 global recession with the high-interest rates of the US. However, the Middle East amplified geopolitical conflict, in addition to the economic slowdown in China, the decreasing price of commodities, and the decrease in demand from the US and European market for garment industry products from the EPZs may affect Indonesia’s growth potential; therefore, the Indonesian government has promised higher return to foreign investors through varied scheme of SEZ policies”.

Jensen’s (2006) study, for example, has revealed the busy FDI traffic in developing countries is due to the host country policy being formulated according to the interests of MNCs and political elites. Jensen (2006) aptly discussed the inflows of foreign capital into the country by raising the question of why certain countries are attractive to foreign investors, i.e. China and Vietnam SEZs, and other countries are not, i.e. Bangladesh and Indonesian SEZs. In his opinion, the factors supporting the success of the competition in gaining foreign investment are not to lower taxes (race to the bottom) (Scherrer and Greven 2001; Kucera 2002; Jauch 2002; Jensen 2006; Jansen and Lee 2007), instead of dealing with the country’s political factors. The political factor is the political perception of the economic policies and conditions in the future.

A prevalence of extensive incentive schemes and special treatment for large investors, in particular, foreign actors, in the new Investment Law No. 25/2007 points to the predominance of supra-natural power intervention in its drafting. As noted in the NO period, MNCs are well-known for using developed countries’ governments (for example, Japan and the US) and international financial agencies (for example, IMF and the World Bank) to intervene in their interests. Several parties especially NGOs assess that the small target of economic growth by the SBY regime in 2010 of around 6% per annum will not address the unemployment and poverty issues significantly despite large inflows of foreign funds to Indonesia.

Despite Indonesian GDP annual growth performance until 2012 surpassing some major Asian ‘FDI-receiving’ countries such as South Korea, India, Singapore, Malaysia, and Thailand (excluding China and the Philippines) (Figure 4.12), the signs of vulnerability were occurring in 2010. Anwar Nasution, Professor of the Faculty of Economics, University of Indonesia (2010) warns that Indonesia’s debt performance and policy structure show signs of economic volatility and the GOI must take advantage of the globalisation opportunities for the benefit of the national economy. He asserts that one of the foreign dependency’s negative impacts after the AFC has been the 2008 global financial crisis (GFC) (Nasution 2010). Based on the survey by *Kompas News* in 2010, Indonesia’s economic growth in 2010 was the lowest among those Asian countries and the GDP growth of 6.2% in 2010 demonstrates less of an increase when compared to the economic growth of 5.6% in 2004.

Figure 4.12 GDP Annual Growth Performance until 2012



Source: Author's Compilation from World Bank, World Development Indicators

Therefore, following years of recording around 6% annual growth (Figure 4.12), Indonesia has no excuse for complacency and needs to organise and shape its policy transformation to resume the positive trajectory in the years ahead in the face of the looming economic slowdown (Nasution 2010). The rates between 2004 and 2014 were a 'blessing in disguise', as the *"inconvenient fact that Indonesia's economy is mainly driven by a commodity boom fuelled by China's appetite for raw materials and global demand for biofuels"* resulted in Indonesia's rising inflation rate and staggering imports (Buehler in *the Diplomat* 2013; *Kompas News* 2010).

Over the past decade, Indonesia's stable economy and respectable growth can be attributed to factors such as: first, the significant increase in foreign capital inflow especially the manufacturing sector by large MNCs with FDI surging to a record \$23 billion in 2012 (i.e. Japanese *Toyota* and *Nissan* and French cosmetics *L'oreal*) (Wignaraja in *the-East Asia Forum* 2013). Nevertheless, the amount of foreign capital inflow during the crisis in 2008-2010 was dominated by 'hot money' (speculative and short-term portfolio investment) (Ramli 2007). It raised fears of a 'bubble economy' (*Kompas News* 2010; *Reuters* 2010) and endangered the fragile economic growth if foreign investors had any reason such as political and security instability to take their capital abroad. According to Bosworth and Collins (1999), portfolio capital inflows appear to have no discernible impact on investment. They suggest FDI generates large increases in domestic savings with no negative implications for the external balance compared to loans. Although the programme to encourage investment is always a top priority, the implementation in the past was responded to with a very monetarist policy approach by creating stability in trying to bring down inflation, maintaining a stable exchange rate, and so forth (Ramli 2007). If there are other measures, such measures are simply associated with administrative and bureaucratic routines. Finally, the only realisation is an increase in the more speculative and short-term portfolio investment, while investment in the real sector decreases. Second, the high rate of thriving middle-class consumption (around 60 per cent of GDP), like China although not in terms of comprehensive

economic structure, which can be attributed to the buoyant domestic consumption of 120 million people. Third, there is high demand from China and India for coal, oil, and palm oil as Indonesia's main natural commodities (Wignaraja in *the East Asia Forum 2013*).

However, in relations to the SEZ policy development, findings suggest that another path-dependent nature had occurred in relation to the SEZ Law which overlapped into two governing sectors. The overlapping regulation occurred based on past experience in the previous administrations and order under the regional autonomy platform. The summary of various sources from document reviews to interviews conducted at BAPPENAS and KPPOD revealed that:

“Taking into account the experience of the implementation of regional autonomy can be categorized several major issues that need attention, such as the overlapping sectoral and decentralised regulations on the implementation of regional autonomy. Based on a study by the Directorate of Regional Autonomy for BAPPENAS (2011), there are 87 sectoral regulations governing 31 matters delegated to local governments. At least 29 areas of affairs are overlapping. Two sectors concerning the Spatial Planning and Investment govern the same regulation on SEZ (Law No. 39/2009)”

To describe some of the regulations delegated to local governments related to SEZ Law as shown in Table 4.5, it indicates that SEZ Law inside the red rectangle is delegated to local governments under two different sectors, the spatial planning as well as investment regulations.

Table 4.5

Sectoral Regulations	Delegated to Local Governments
1 Education	Undang-undang no. 20 tahun 2003 tentang Sistem Pendidikan Nasional;
2 Health	1. Undang-undang no. 36 tahun 2009 tentang Kesehatan; 2. Undang-undang no. 44 tahun 2009 tentang Rumah Sakit
3 Public Work	1. Undang-undang No 26 Tahun 2007 Tentang Penataan Ruang; 2. Undang-undang No 28 Tahun 2002 Tentang Bangunan Gedung; 3. Undang-undang No 38 Tahun 2004 Tentang Jalan; 4. Undang-undang No 7 Tahun 2004 Tentang Sumber Daya Air; 5. Undang-undang No 18 tahun 1999 Tentang Jasa konstruksi
4 Housing	Undang-undang No 4 Tahun 1992 Tentang Perumahan dan Pemukiman
5 Spatial Planning	1. Undang-undang no. 26 tahun 2007 tentang Penataan Ruang; 2. Undang-undang no. 39 tahun 2009 tentang Kawasan Ekonomi Khusus;
6 Development Planning	3. Undang-undang no. 44 tahun 2009 tentang Rumah Sakit 1. Undang-undang no. 25 tahun 2004 tentang Sistem Perencanaan Pembangunan Nasional; 2. UU No. 17 Tahun 2007 tentang Rencana Pembangunan Jangka Panjang Nasional Tahun 2005-2025 ; 3. UU No.1 Tahun 2004 tentang Perbendaharaan Negara; 4. UU No.15 Tahun 2004 tentang Pemeriksaan Pengelolaan dan Tanggung Jawab Keuangan Negara; 5. UU No.17 Tahun 2003 tentang Keuangan Negara
7 Transportation	1. Undang-undang no. 22 tahun 2009 tentang Lalu Lintas dan Angkutan Jalan; 2. Undang-undang No 1 Tahun 2009 Tentang Penerbangan; 3. Undang-undang No 17 Tahun 2008 Tentang Pelayaran; 4. Undang-undang No 23 tahun 2007 Tentang Perkeretaaplan;
8 Environment	1. Undang-undang no. 32 tahun 2009 tentang Perlindungan dan Pengelolaan Lingkungan Hidup; 2. Undang-undang no. 22 tahun 2009 tentang Lalu Lintas dan Angkutan Jalan; 3. Undang-undang no. 19 Tahun 2009 Tentang Pengesahan Stockholm Convention on Persistent Organic Pollutants; 4. Undang-undang no. 18 tahun 2008 tentang Pengelolaan Sampah; 5. Undang-Undang Republik Indonesia Nomor 19 Tahun 2004 Tentang Penetapan Peraturan Pemerintah Pengganti Undang-Undang Nomor 1 Tahun 2004 Tentang Perubahan Atas Undang-Undang Nomor 41 Tahun 1999 Tentang Kehutanan Menjadi Undang-Undang; 6. Undang-Undang Nomor 41 Tahun 1999 Tentang Kehutanan; 7. Undang-undang Nomor 23 Tahun 1997 Tentang Ketentuan Pokok Pengelolaan Lingkungan Hidup; 8. Undang-undang Nomor 11 Tahun 1974 Tentang Perairan
9 Land	1. Undang-undang no. 43 tahun 2008 tentang Wilayah Negara; 2. Undang-undang no. 27 tahun 2007 tentang Pengelolaan Wilayah Pesisir dan Pulau-pulau Kecil; 3. Undang-undang No 5 Tahun 1960 Tentang Pokok-Pokok Agraria
10 Population and Civil Registration	1. Undang-undang no. 12 tahun 2006 tentang Kewarganegaraan Republik Indonesia; 2. Undang-undang no. 23 tahun 2006 tentang Administrasi Kependudukan
11 Women's Empowerment and Child Protection	1. Undang-undang No 23 Tahun 2002 Tentang Perlindungan Anak; 2. Undang-undang No 21 Tahun 2007 Tentang Pemberantasan Tindak Pidana Perdagangan Orang; 3. Undang-undang No 23 Tahun 2004 Tentang Penghapusan Kekerasan Dalam Rumah Tangga; 4. Undang-undang No 44 Tahun 2008 Tentang Pornografi
12 Family Planning and Welfare	Undang-undang no. 52 tahun 2009 tentang Perkembangan Kependudukan dan Pembangunan Keluarga
13 Social	Undang-undang no. 11 tahun 2009 tentang Kesejahteraan Sosial
14 Employment and Transmigration	1. Undang-Undang No 13 Tahun 2003 Tentang Ketenagakerjaan; 2. Undang-Undang No 2 Tahun 2004 Tentang Penyelesaian Perselisihan Hubungan Industrial; 3. Undang - Undang Nomor 29 Tahun 2009 Tentang Perubahan Atas Undang - Undang Nomor 15 Tahun 1997 Tentang Ketransmigrasian; 4. Undang-Undang No. 21 Tahun 2007 Tentang Pemberantasan Tindak Pidana Perdagangan Orang; 5. Undang-Undang No. 40 Tahun 2004 Tentang Sistem Jaminan Sosial Nasional; 6. Undang-Undang No. 39 Tahun 2004 Tentang Penempatan dan Perlindungan Tenaga Kerja Indonesia di Luar Negeri; 7. Undang-Undang No.21 Tahun 2003 Tentang Pengawasan Ketenagakerjaan dalam Industri dan Perdagangan; 8. Undang-undang No. 21 Tahun 2000 Tentang Serikat Pekerja/Serikat Buruh;
15 Cooperation and SMEs	Undang-undang no. 20 tahun 2008 tentang Usaha Mikro, Kecil, dan Menengah
16 Investment	1. Undang-undang no. 25 tahun 2007 tentang Penanaman Modal; 2. Undang-undang no. 39 tahun 2009 tentang Kawasan Ekonomi Khusus;
17 Culture and Tourism	3. Undang-Undang Nomor 9 Tahun 2008 Tentang Penggunaan Bahan Kimia Dan Larangan Penggunaan Bahan Kimia Sebagai Senjata Kimia 1. Undang-undang no. 10 tahun 2009 tentang Kepariwisataaan; 2. Undang-undang no. 33 tahun 2009 tentang Perfilman.
18 Youth and Sports	Undang-undang no. 3 tahun 2005 tentang Sistem Keolahragaan Nasional
19 National Unity and Domestic Politics	1. Undang-undang no. 43 tahun 2008 tentang Wilayah Negara; 2. Undang-undang no. 27 tahun 2007 tentang Pengelolaan Wilayah Pesisir dan Pulau-pulau Kecil 3. Undang-undang No 32 Tahun 2004 Tentang Pemerintahan Daerah.

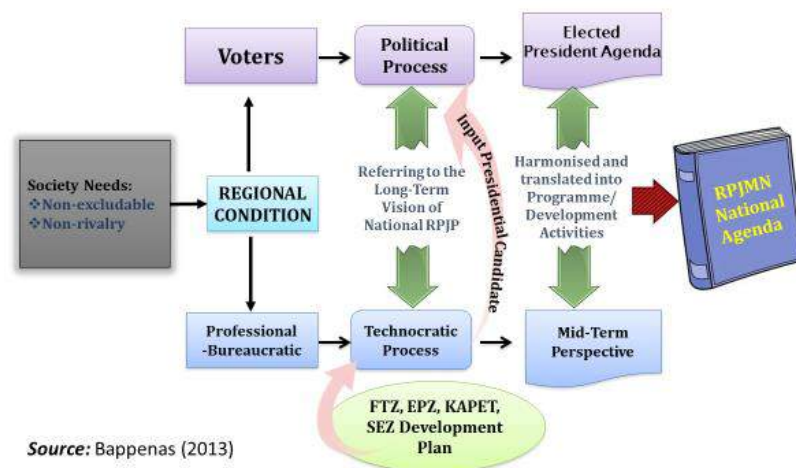
Law No. 39/2009 on SEZ

Source: Directorate of Regional Autonomy BAPPENAS (2011)

Some factors are suspected to be the cause of overlapping sectoral regulations, such as (i) disagreements between the law and its implementing regulations; (ii) conflicting central government policies; (iii) clashes between the authority of government agencies due to the non-systematic division of authority; (iv) the difference between legislation and jurisprudence and the Circular Letter of the Supreme Court (Directorate of Regional Autonomy, 2011).

Figure 4.13

FIVE YEARS POLITICAL AND TECHOCRATIC PROCESS



Source: Bappenas (2013)

From the figure 4.13 above, regional development policies such as the zone development programmes (FTZ, EPZ, KAPET, and SEZ) continue to use planning from the technocratic process of BAPPENAS to calculate sources and formulate development objectives and procedures to achieve the development process.

In view of the study by the Indonesia Institute of Science (LIPI) in 2012 that the inclusion of BAPPENAS in the process to address efforts to involve community participation in the development policymaking process. However, criticism of the lack of community participation in development planning has not yet been addressed with changes to existing social and institutional structures. There is indeed a change of actors and their roles in development planning. However, the participation of the community remains minimal due to the participation space has not been fully opened.

Findings from the view above and reviews of various literature suggest that limiting the role of BAPPENAS in development planning does not change the technocratic approach to participatory. The development plan, in fact, shifts even more to a political approach. This is mainly due to the strength of parliament, which is driven more by the political interests of the party. In implementing the budget function, for example, both the DPR and the DPRD are more guided by political logic than the

rationality of the policies or the aspirations of the people. The elites, with their transactional politics, have hijacked the agenda of increasing community participation in development. The development process itself is not always done formally when the local government implements various interconnected policies, programmes or projects. The most logical source of policy or monitoring strategy lies with the regional assemblies (DPRD) that set the guidelines for local governments in their implementation.

The Role of the Local legislature or Local Parliament (DPRD)

Some scholars characterise the legislative body (DPR including DPRD) with at least three functions: First, the legislative function, in which the DPRD as the representative of the people accommodates and seeks to realize the aspirations and interests of the people through local regulations and to create checks and balances. Secondly, the budgeting function of the DPRD has the authority to determine local budget (APBD). Third, the controlling function, which is obliged to assess executive performance in order to create a clean government administration from KKN practices (Hadna 2004 Jati 2012 Aritenang 2012 Mungkasa 2013).

According to the interview with a researcher from BAPPENAS,

“The relationship between the Regional Government (such as the Jakarta Provincial Government/Governor and Kepri Governor in Batam) and the Regional People’s Legislative Assembly (DPRD) is equal, stands in partnership. Equal means that among the local government institutions have the same position and parallel, meaning not mutually supervisory. The issue here is that DPRD being the third-party enforcement to create order in the political institutions is prone to political conflicts of interest as they perform not only has the role as the legislative but also as the judicative (to control the mechanism of government in a good governance context)”.

The judiciary branch in Indonesia is basically the duty of the Supreme Court (MA), Judicial Commission (KY), and Constitutional Court (MK), see Figures 4.5 and 4.7.

Based on these three functions, the dynamics of the relationship between the executive and the legislature since Law no. 22/1999 was enacted can be traced. During the NO regime, the stigma attached to the DPRD in the legislative function was only as a "stamp" of all policies made by the executive. The function of legislation here ought to be interpreted as the process of formulation of regional regulations since the planning, designing, forming and even post-establishment activities, namely implementation, enforcement, evaluation, and verification.

Furthermore, there are two fundamental findings of the legislative function of the DPRD that have implications for its relationship with the executive, as confirmed by KPPOD and BAPPENAS,

“Both are the capacity of DPRD members to make their policies and commitments to public issues in the output of the resulting policies. From all IRDA research areas, it was

found that the policy in the form of local regulations set by the DPRD was mostly on the initiative and made by the executive. The DPRD merely discusses and sets the proposed executive draft or bill (Rancangan Peraturan Daerah/Raperda) such as the case in chapter 5 on the Marunda port SEZ reclamation conflict. Even if there are proposals from the legislature, the proposal normally to regulate matters related to their own function, i.e. the DPRD Code of Conduct”.

During the study, no evidence has yet been found not even IRDA research where the DPRD is able to draft local regulations directly concerned with the people, for example, regional economic problems, as well as basic needs such as education and health, and poverty alleviation. The weakness of the DPRD’s capacity in drafting the Raperda made a great dependence on the executive role in drafting the draft regulation. This case embodied in the empirical chapter 5 when DPRD failed to pass the Raperda Zoning for the reclamation of Jakarta SEZ.

In many areas, the role of the executive is strongly supported by the strong leadership of the head of regions such as the Regent (*Bupati*) or Mayor (*Walikota*). Thus, the dominance of the executive role in the formulation of policy substance is still considerable and this pattern of relationships has not changed much since the previous centralized order.

In addition to capacity issues, linking the literature research and KPPOD’ statement, that:

“DPRDs are also faced with the issue of their low commitment to the public interest. This can be seen from the number of DPRD products in the form of local regulations are still more oriented to the interests of the government rather than the public interest⁶³. For example, the first scheme of Perda (local legislation) on the issuance of over 140 alcoholic beverage licences and the second scheme on Batam’s tourism sector to open the amusement and gaming centre with total disregard to the public’s dissatisfaction in chapter 5. This increase is indeed on the proposal of the executive”.

From this example, it can be concluded that there is a matter of commitment which is still low both from the executive and legislative in allocating budget for the public interest. To relate the study on SEZ policy formulation with DPRD’s role, findings suggest that DPRD’s play a more important role of bureaucracy than in voicing the aspirations of the community. The bureaucracy ultimately benefits from the weak DPRD commitment to the public interest.

There are arguments that could explain why a commitment to the public interest is low, especially as an example of a case in Jakarta and Batam SEZ cases. Local investment is one of the major contributors in PAD. Generally, within a year it was targeted to contribute a certain percentage to the local treasury. In the meantime, there is a central policy that regulates the operational cost of supporting the Head of Region and its representatives as well as DPRD activities which is determined based on the PAD

⁶³Similar findings were also obtained from the results of the 2002 Governance and Decentralisation Survey (GDS) which concluded that there are a number of different types of local regulations that are more oriented to the interests of the government (see Dwiyanto, Agus, *et al.*, 2003) in the book Reform of Governance and Regional Autonomy, PSKK UGM).

classification. The bigger the PAD, the budget for activities for head/regional representatives and DPRD is greater⁶⁴. This motivation is thought to be one of the driving forces of the DPRD and executives to conduct informal ways (informal lobbies, networks, negotiations, meeting) in an effort to raise as much PAD as possible. In addition, other reason which undermines DPRD's commitment such as the lack of a clear relationship between DPRD members as party representatives and their constituents. Meanwhile, not much different from the function of legislation, the budgeting function also still faces fundamental problems.

Former Vice Chairman of the MPR exposed at length that:

“The process of drafting the APBD as the output of this function is entirely the design of the executive. Not many DPRD members are knowledgeable and have sufficient knowledge about the systematics of APBD, the origins of income and how to allocate it in local expenditures. Knowledge about this is absolutely known by the executive because budgeting does require certain skills not necessarily owned by DPRD members who unfortunately this cannot be fulfilled by the council due to weak human resource capacity. What the DPRD has in this budgeting function is the will to question the size of the budget allocated for each planned project and activity.

Data in a number of areas indicates a serious effort by the DPRD to discuss the budget on any project and activity proposed by the executive. The general way is to call the relevant local government offices that have the project plan and the activities. Arguments sometimes occur between the two to indicate how important the project or activity should be funded by certain rupiah. Although in terms of domination, the executive is still the dominant institution. There is also the initiative of the board to propose a project plan and activities that in their view is very essential. The types of proposals that come from members of the council are generally partisan (biased) due to it carries the mission of a particular party. In such a position the executive is generally incapable of rejecting proposals coming from members of the council, especially proposals from the dominant party in the DPRD. But sometimes it raises debate among the factions within the DPRD itself, especially when the proposal is suspected of carrying a particular party mission.

There are a number of cases where this proposal is ultimately determined by voting. Important to observe in this budgeting function that this role is given to the Executive

⁶⁴As mentioned in the Government Regulation No.109/2000 on the Financial Position of Regional Head and Deputy Regional Head especially Article 9; and PP No.110/2000 on the Financial Position of the Regional People's Legislative Assembly especially article 14.

Budget Team and the Legislative Budget Committee. It is highly probable that so far these two institutions have been the final determinants of the size of the budget for each project and activities budgeted in APBD. Lobbies between the executive and legislative as well as from other stakeholder groups concerned with the budget are allegedly passed through these two institutions. Although there is a plenary session, it is suspected there has been a very strong screening process in both institutions”.

Findings in a number of areas indicate the existence of informal institutions have influenced the institutional arrangements (formal legislation of budget allocation) through non-transparent criteria for the reasoning of the size of the budget allocated to each project and activity, as revealed by IRDA (2003) and stated by KPPOD official,

“Let alone the people who want to know it, the local government agencies or agencies that receive budget allocations often do not know for sure why the DPRD and the bureaucratic elite budget projects and activities with a certain amount of rupiahs. The game to hide the board budget into the executive budget is another example of how non-transparent this budgeting process is. Thus, if traced the extent of the authority possessed by both institutions has actually cut off the chain of the participative budgeting process. One function of the board that is quite successful is the supervisory function. The success, among others, is shown when the process of preparation of APBD and the accountability report (LPJ) Head of Region. Although some cases still show a lack of transparency in APBD preparation, there are a number of facts in some other areas that show the courage of DPRD members to carry out supervisory functions. They dare to reveal the possibility of the practice of deviation from the budgeting process. Not only in APBD but the form of monitoring process often taken place during the LPJ Head of Region. LPJ is often used as an arena to bring down the regional head because it is considered unable to perform the mandate given by the people”.

A response from the former member of PDI party who resigned after Megawati was elected president remarked further explanation at length which is supported by Hadna (2004), a researcher for IRDA and the Center for Population and Policy Studies, Gadjah Mada University.

“Unfortunately the response to this oversight function is often negative because what happens then is the process of bargaining power in exchange for materials to smooth LPJ revenues. In spite of such bad practices, at least surveillance has forced the executives to do the job as well as possible. The method used in carrying out supervisory function are formal and informal. Formal methods are conducted through development coordination

meetings and also through meetings on performance evaluations for each local government agency. In addition to the two forms of the meeting, the DPRD also seeks to establish a hearing commission as part of the data collection process. This method is felt rather rigid, therefore informal methods are considered more effective and efficient in capturing the information that develops in the community. Informal methods commonly used by members of the council include dialogue and meetings with community members, making unannounced field visits, either separately or cooperatively by members of the parliament. Sometimes it is also done by some people from the political parties in which the council members come from, establishing good interaction with the people in the region, especially during the recess. Another informal method is to use mass media to collect various information or accommodate aspirations to obtain feedback about the implementation of a programme. Interactive programmes on radio and television are also used and all of these are effective arenas for conveying suggestions, criticisms, aspirations or complaints about various policies and specific project implementation like you said such as the SEZ policy”.

In the various IRDA research areas there is a tendency that recently evolved:

The DPRD has started to hold special sessions open to the general public both with regard to APBD and the making of local regulations. As society is increasingly enthusiastic to listen to executive performance accountability reports, the steps taken by the DPRD are to organize public hearings and conduct field visits directly to prove the contents of the accountability report (LPJ). Although the supervisory function has been quite positive, the IRDA’s results indicate a disagreement about the range or intensity of oversight that should be done by the DPRD. In addition, until now there has been no consistent policy that can be used as guidance by the DPRD in implementing this supervisory function. For the executive, the DPRD should only monitor the implementation of priority programmes at the policy level, and not to the technical level. However, the opinions of these bureaucrats are not acceptable to legislators, they require that their oversight should include both levels of policy, as well as on their technical implementation.

Another obvious disadvantage of this oversight function is that it is still partisan and not yet patterned as an effective form of institutional oversight. The partisan and unpredictable nature of this is not separated from the DPRD as a forum of meetings between political parties. This can be seen from the more functioning faction than the commission in carrying out supervisory functions. Each faction carries its own party mission so that supervision is done more on behalf of the party rather than the commission as a board fitting whose member cross-party.

The implications of this weakness often make it difficult for the executive because of the possibility of spontaneous reaction of faction members who may not necessarily be the official political stance of the council. *Inter-factional tensions* among council members (MPs) may occur during this event and despite all the inherent weaknesses in the oversight function of the board, at least this function has encouraged the executive to show the best performance. Now they are not only directly highlighted by the public but also by MPs who can at any time criticize the executive's performance. The magnitude of this oversight function is often understood as a form of superiority of the executive board and this is much different than the conditions under the NO regime.

4.3. The Development of New Special Economic Zones (SEZ)

4.3.1. Institutional Aspects: Inter-Related Cooperation Concept

The concept of SEZ development is thought-provoking, considering the development of this area is a breakthrough that can optimize geo-economics and geostrategic advantages owned by Indonesia as one of global production base. The development of SEZ which is focused on five main corridors namely Java Main Beach, East Coast of Sumatra, Kalimantan, Sulawesi and Papua is also expected to be the centre of economic activity that can encourage the market based on the specification of excellence of each region. Therefore, there must be a balance between central, provincial and district governments in the process of development. This means that the division of tasks and authorities between the three units of government should be clearly divided for efficient cooperation in order to solve problems associated to the SEZ formation.

The Secretary of the SEZ National Council and his Operations Manager gave their comments regarding the division of roles and responsibilities of the parties involved in the SEZ development as follows:

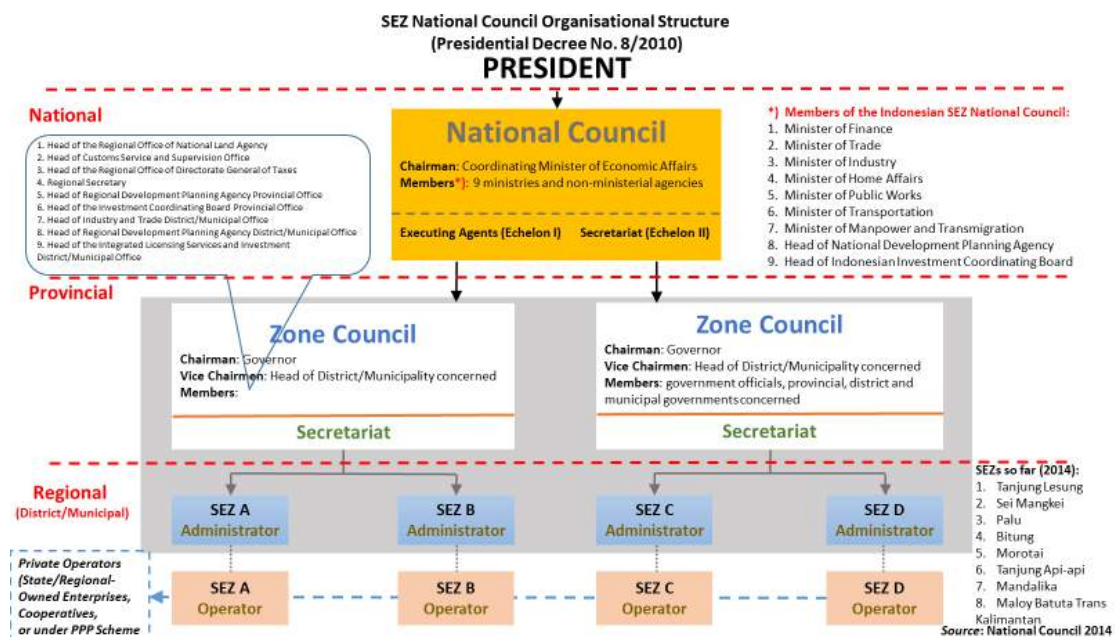
“In line with regional autonomy, the tasks and authorities of local governments are much greater, while the government is tasked to facilitate and support the development of SEZs in the regions. SEZ development efforts are the joint responsibility of central and local governments (provincial and district/city governments). The central government has a facilitative function in both regulation and financing issues, while local governments have the function of implementing SEZ development and development in their region. In addition to the facilities and facilities provided, the specificity of SEZ is also characterized by the large role of local government. The central government only establishes its norms, standards, guidelines and manuals (NSPM), while the region has a role to prepare the land and its infrastructure. Although the portion of government authority is much larger in SEZ development, the centre also still has a strategic role. The central government, through the relevant ministries, has the authority to regulate, coordinate and provide direction for regions whose territories are designated as SEZ. Therefore, it is necessary to balance the implementation of functions between the central,

provincial and district governments, so that SEZ development is not hampered. However, as a major project capable of significantly influencing regional and national development, the involvement of central, provincial and district governments makes the problems more complex.

As a result, the authority of both central and local governments often overlaps as shown in the next empirical chapters. Therefore, it needs an intensive communication between the parties involved to avoid the growth of their respective basic tasks. The synergy between stakeholders is needed, where cooperation relationships are not only prioritized in an effort to meet the requirements but also must be prioritized on solving problems that occur in the development of this area”.

There are four key institutions that have different duties and authorities at each level of government: the National Council, the Zone Council, the Administrator, and the SEZ Operators (Managing Enterprise Agency). Figure 4.14 shows the relationship between the four institutions.

Figure 4.14



At the national level, the SEZ development programme is under the responsibility of the SEZ National Council. The National Council of SEZ is chaired by the Coordinating Minister for Economic Affairs. The duties of the council are to set general policies and strategic measures for SEZ development at the national level. This includes reviewing and recommending SEZ status. This Council is also tasked with resolving strategic issues in SEZ implementation, management and development. To this end, the council reserves the right to seek the explanation of other institutions at the regional and regional levels. Meanwhile, at the provincial level, the key institution of SEZ is called the Zone Council, chaired by the Governor. The duties of the Zone (Regional) Council, among others, establish the SEZ Administrator, supervise, control, evaluate and coordinate the implementation of the tasks of the SEZ

Administrator in the case of One Stop Service (PTSP) and SEZ operations, and submit the SEZ management report to the National Council every year.

Furthermore, the specific management in each SEZ shall be run by the SEZ Administrator and the SEZ Operators (Managing Enterprise Agency). The tasks of the SEZ Administrator are to carry out the granting of business license and other permits required by the Business Actors operating in SEZ, supervising and controlling the operation of SEZ, and periodically and incidentally submitting the SEZ operationalization report to the Zone Council. The SEZ Administrator has obtained delegation or delegation of licensing authority from the central and local government, as well as related ministries/agencies at the central level. SEZ Administrator is appointed as the executor of PTSP in SEZ region.

Meanwhile, the conduct of business activities in SEZ shall be carried out by the SEZ Operators. If the SEZ Administrator focuses more on administrative matters and permits, the SEZ Operators focuses more on the development and commercial aspects of SEZ management. The SEZ Operator (in Batam, the managing body is called BIDA, while in Jakarta EPZ is managed by an SOE called KBN) is responsible for making the SEZ blueprint development plan, promoting to investors, distributing/selling lots in SEZ to investors, carrying out infrastructure development in the region as well as utility distribution, and managing SEZ for commercial aspects.

4.3.2. SEZ Formal Institutions

Through document reviews, there are at least 13 (thirteen) legal bases of SEZ have been in force. The details of the legal bases are:

- (1) Article 5 paragraph (1), Article 20, Article 27 paragraph (2), and Article 33 of the 1945 Constitution of the Republic of Indonesia;
- (2) Law No. 25/2007 regarding Investment (State Gazette of the Republic of Indonesia Year 2007 Number 67, Supplement to State Gazette of the Republic of Indonesia Number 4724);
- (3) Law No. 26/2007 on Spatial Planning;
- (4) Law No. 39/2009 on Special Economic Zones (SEZ);
- (5) Government Regulation No. 26/2008 concerning RTRWN;
- (6) Government Regulation No. 24/2009 on Industrial Estate;
- (7) Government Regulation (PP) No. 2/2011 concerning SEZ Operation; it is one of the two main platforms of the SEZ regulatory system besides the SEZ Law No. 39/2009. This PP contains a more detailed description, especially regarding the institutional and management aspects of SEZ
- (8) Presidential Regulation (Perpres) No. 28/2008 on National Industrial Policy;

- (9) Regulation of the President of the Republic of Indonesia (Perpres) No. 33/2010 Concerning the National Council and the Zone Council (National Council is a council established at the national level to organize SEZ);
- (10) Presidential Decree (Keppres) No. 8/2010 concerning the SEZ Council;
- (11) Regulation of the Coordinating Minister for Economic Affairs as the Chairman of the National Council for SEZs, No. PER-06/M.EKON/08/2010 on the disciplinary proceedings and procedures for the decision-making of the National Council of SEZs;
- (12) Regulation of the Coordinating Minister for Economic Affairs (CMEA) as the Chairman of the National Council for Special Economic Zones, No. PER-07/M.EKON/08/2010 on the Organization and Working Procedures of the Secretariat of the National Council for Special Economic Zones. One fundamental point of the SEZ programme initiative is the establishment of a special area given by the central government, but proposals must come from local authorities. In order to be granted the status of SEZ, a region must first be proposed to the National Council of SEZ, and;
- (13) Decree of the Coordinating Minister for Economic Affairs as Chairman of the National Council of SEZ No. Kep-10/M.Ekon/03/2011 on Amendment to Decree of the Coordinating Minister for Economic Affairs as Chairman of the National Council of Special Economic Zones No. Kep-40/M. Ekon/08/2010 on the Executing Team of the National Council for SEZs.

During the process of research, there are eight locations have been set as SEZs but only two have been in operation, they are Tanjung Lesung SEZ in Banten and Sei Mangkei SEZ in Medan, North Sumatera. Until now, the main legal foundation for the implementation of SEZ in Indonesia is Law No. 39/2009 and Government Regulation (PP) no. 100/2012 (as revised by Government Regulation No. 2/2011).

The Law No. 39/2009 on SEZ, among others, regulates the functions, forms of SEZ, SEZ proposing criteria, SEZ formation mechanism, institutional aspects of SEZ, and facilities offered in SEZ. Among the contents are: (1) Special Economic Zone, hereinafter referred to as SEZ, is a region with certain limits within the jurisdiction of the Unitary State of the Republic of Indonesia set to perform economic functions and obtain certain facilities; (2) affirmed the definition of Zone, National Council, Regional Council, Administrator, Business Entity, Business Actor; (3) SEZ shall be developed through the preparation of areas that have geo-economic and geostrategic advantages and serve to accommodate industrial activities, exports, imports and other economic activities that have high economic value and international competitiveness; (4) SEZ consists of one or more Zones: a. export processing; b. logistics; c. industry; d. technology development; e. tourism; f. energy; and/or g. other economies; (5) Inside an SEZ, support facilities and housing for workers can be built; (6) In each SEZ shall be provided location

for micro, small, medium enterprises (SMEs), and cooperatives, either as Business Actor or as a supporter of company activity within the SEZ;

The four criteria given by Law No. 39/2009 for the location to be proposed as an SEZ are: 1) in accordance to the Regional Spatial Plan (RTRW) and not use and interfere with the protected areas, 2) gain full support of the provincial government, as well as the relevant district/city government, 3) the position is close to an international trade or shipping lane or located in an area with natural resources potential, and 4) the proposal has clear territorial boundaries.

Giving SEZ status can be based on suggestions from various related parties, namely: Business Enterprise, both private and state-owned enterprises (BUMN) and regional-owned enterprises (BUMD), with the support from the local government concerned. The proposal may also be promoted by district/municipality governments. In addition, the provincial government may also be the main supporter of the proposal.

After all relevant documents are collected, the SEZ National Council will issue a decision within 45 days whether the region is designated as SEZ or not. The determination of a region as an SEZ is officially based on a Government Regulation. After an official region is designated as SEZ, the government provides a maximum of three years until the SEZ is ready to operate. To support all activities within the area, each SEZ consists of one or more of the following zones: (1) export processing, (2) logistics, (3) industry, (4) technology development, (5) tourism, (6) energy, (7) and other economies. The determination of the main zones in an SEZ will be adjusted to the potentials owned by the SEZ region. In addition, in the SEZ will also be provided support facilities and locations for SMEs (Secretariat of SEZ National Council document).

Evidence indicates that the separation of powers among key institutions determines the success of SEZ programme. Therefore, to support local government's commitment, both central and local government must delegate some of the SEZ development authority issues to the SEZ management body. The SEZ management body is associated with a one-stop-service organization to design and effectuate SEZ authority under one command. The challenge is that it opens up a new opportunity for rent-seeking between SEZ authority and local government as well as a local government with local businesses who represent local investors. For example, in chapter 5 where the Jakarta provincial government (JPG) as the sole authority who oversees the Jakarta EPZ collaborated with local private sectors represented by the appointed SOEs to bypass the bureaucratic formalities in order to reach their personal goals to be able to operate their businesses in the proposed SEZ.

4.3.3. New challenges and trends

Although a new type of SEZ continues to be introduced around the world, the recent SEZ type is quite different from the SEZs during the first major development waves. These changes have a significant impact on countries, such as Indonesia, planning to develop these new zones in the coming years. The number of countries implementing SEZ grew rapidly in the early 2000s, reaching 130 countries in 2006, up from just 112 countries in 2002 (Singa-Boyenge, 2007). Over the same period, China has doubled the number of people employed in its Export Processing Zone (EPZ). This success makes China has a large percentage of contribution to the growth of SEZ in the world. Another noteworthy difference regarding zones built over the past 15 years is that a large proportion of the SEZs is privately owned, developed, and operated. In 2008, 62% of SEZs located in developing countries were developed and operated by private parties (Akinchi and Crittle 2008). Public-Private Partnership (PPP) scheme is a method where the role of the state is significant in providing infrastructure to incentivize private parties to invest in SEZ development is also becoming increasingly popular. Both these trends have succeeded in significantly reducing the costs required by governments to create new zones.

Furthermore, in a study conducted in 2008, the World Bank found that privately operated zones have a higher success tendency than government-operated zones. The growth of SEZs in the world has reduced the additional benefits that arise as a result of the creation of new zones. The fact that many countries have a goal to increase their exports simultaneously has led to a phenomenon called 'fallacy of composition' which, first, the availability of world supply for exports exceeds the world demand for imports (especially since many countries try to become net exporters) and secondly, growth in export offerings has lowered the prices of exported goods that have been used by countries to improve their economic growth (Millberg and Amengual 2008).

Findings indicate that this change is exacerbated by the fact that, after the 2008 financial crisis, imports from the United States and Europe declined, indicating that these two markets could no longer be used as drivers of global demand. This is followed by several zones that apply the traditional SEZ model such as EPZ, which focuses specifically on exports, to move to the SEZ model that allows them to expand the types of activities undertaken within the zone while refining the high value-added activities in the global production chain. However, findings further suggest, it also often causes activities in the zone to become less labour-intensive and have an impact on job creation. Although SEZs established at the start of development can be designed to take advantage of the underutilization of a country's competitive advantage (such as relatively low labour costs) if they can offer greater competitive advantage than already been given elsewhere. Farole and Akinchi (2011) also said that location, effectiveness to the design programme, and sustainable management, are criteria of whether or not an SEZ development programme is relevant to the programme in the specific context.

4.4. Conclusion

This chapter examined the context that history has on policymaking and showed a prolonged institutional change since the NO era until the RDO era where the neoliberal ideology and practices through various institutional framework influence each other in various ways. It verifies the central proposition put forth in chapter 1 and brings together the verification of key findings as follows:

First, the choice of policies and institutions and their implementation depend on the relevant political landscape and its importance is, in general, undisputed. The contemporary SEZ policy platform as the key policy actor's choice of economic reform was generally a mechanism to preserve the ruling elite's traditional rhetoric. As opined by Jenkins (1999: 41) economic liberalisation is all about staying power. The SEZ policy practised by Indonesian rulers has deviated from its conventional objective to stabilise the economy by promoting exports, generating employment, and attracting FDI. SEZ policy platform is embedded in the investment regime to stay in the course of neoliberal ideology. It is argued that policy and institutions have been mutually influencing each other, entailing change or continuity of the *status quo* and contributing to the institutional arrangement where the government's current policy decisions affect what options become available in the future.

Second, findings indicate despite the success of implementing economic development policies and programmes that have managed to restore macroeconomic stability for economic revival, institutional problems in the economic reform process remain.

Third, the broad-spectrum of democratic political transitions and decentralisation in Indonesia have led to postponements in the economic recovery effort due to the wide-ranging transaction costs associated with the actor's adaptation to the decentralisation policy as a form of the new governance structure.

Did the RDO era as opposed to the new order, with more popular democratic practices and built-in checks and balances produce greater material prosperity? In answering this question, several points identified as follows:

First, the basic Indonesian economic structure was devoted to serving foreign capital. As stated by Dick *et al.* (2002), Brown (2003), and Wood (2005) the workings of the various inheritances from colonial regulations in Indonesia created a weak national economy. Economic performance is not an instantaneous event (North 1990). The history of Indonesia's legal system is a vital element affecting Indonesia's institutional environment and influence the varied performance of the economy. By impeding the emergence of institutions convenient for growth, Indonesia has imported institutions not adapted to local environments and cultures but adapted to extracting rent for their benefit. Under

these circumstances, the chapter argued that Indonesia's institutional features emanate from the long-term institutional change and have influenced actors' preferences and behaviour in making decisions. Second, changes in the political-economic system in Indonesia with the reform in 1998 has affected policymaking process in which key policy actors adjust to improving the state efficiency, capacity, and public accountability in order to align with the ongoing democratisation process. The Indonesian government has done its best to confront and overcome the AFC. One of their efforts is the design of economic reform policies. In the RDO, the information transaction on the resource allocation was given to the market. The changing political system becomes more intense and the economy becomes more integrated with the global economy, consequently, these changes affect SEZ policy and policymaking. Third, the chapter was able to trace the formal institutions relevant to the SEZ policy process from legal frameworks to the political institutions who run the system. It also traces the informal practices that influence the process as well as the legal framework and the chosen institutions to formulate the policy. However, the specific context of how informal institutions influence formal institutions and how governance structure influences the resource allocation of SEZ in a variety of ways was not specifically discussed which the next empirical chapters will delve into.

Fourth, the capacity to define and compete with new institutional rules such as the decentralisation policy in the era of economic reform yields new prospects for rent-seeking. Political actors will try to seek solutions to the conflict they are involved in by harnessing their power and changing the rules of the game (regulations). The main reasons for the institutional change in every ruling elite are changing the existing basic elements of the 'power structure' and focusing the attention on actor's differences for 'bargaining power'. Actors who are able to control power can control the process of institutional change for the rules to favour their interests.

The next chapter explores the first thematic series of Williamson's institutional constraints on how formal and informal institutions influence the SEZ policymaking in Indonesia. The political entity has an interesting link with the economic agents and their contested interests between informal rules and formal rules whereby informal rules have an influence in formulating formal rules, especially in the SEZ and investment policy context. Informal rules can be a useful vehicle for the ruling elite to strengthen their political power through the Export Processing Zone (EPZ) case but render SEZ programme to be unsuccessful and underperformed.

Chapter 5

The Interaction of Formal and Informal Institutions in Jakarta SEZ

5.1. Introduction

While chapter four mostly elucidate the institutional context where SEZ policy process sets out in Indonesia, this chapter analyses episodes from different sources of persistent problems caused by the first thematic series of Williamson's (2000) informal and formal institutions respectively. The chapter attempts to answer parts of the second and third research questions; How and why do institutions influence the behaviour of actors in SEZ policy decision? And, which institutions affect the SEZ policy decision and why?

In order to answer the research questions, the chapter attempts to verify whether the first research hypothesis actually occurs and can be applied to generalise the findings or otherwise annul the hypothesis; *Informal institutions have a very strong influence on the functionalities of formal institutions in the SEZ policy process and actors' institutional preference at the local government level tends to use informal practices more than formal practices during the SEZ implementation level rather than the formulation level due to the policy has been established and running and the actors' cultural and ideological beliefs are developed at the implementation level.*

The central argument of this chapter lies in the SEZ development initiatives under economic reform. The chapter argues that setting up new formal institution on SEZ or new legal framework posed risks whereby the interest groups were cautious and took informal measures to bring influence on the formal 'rules of the game'. New SEZ initiatives were introduced but the policy process by actors at the execution level contains different ideological interpretations, applications, and significant administrative discretion.

This chapter is divided into three subchapters: after the introduction, the second subchapter explores the characteristics of the industrial zone, in particular, the type of SEZ created under the management of SOEs. The third subchapter explores the chronology of more contemporary debates and dynamics of cases in the SEZ policy process under pro-market and diffusion of power where entrenched values from the NO characterised by the patrimonial networks still impede the formal rules of the game in the recent open political system. The last subchapter concludes the chapter by putting all the excerpts of the cases together.

5.2. The industrial zone and EPZ development-setting up the actors 'who' are affected by informal rules

The previous chapter argued that policy and institutions have been mutually influencing each other, entailing change or continuity of the status quo and contributing to the institutional arrangement where the government's current policy decisions affect what options become available in the future. The following section discusses the role of actors in the SEZ policymaking and at which point institutions influence their decision.

5.2.1. PT. KBN Profile and Role

PT (Persero) Nusantara Bonded Zone or KBN is a state-owned enterprise (SOE) and the sole government representative agency who accommodates the zone facilities in North Jakarta regarded as the administrator of the zone based on a presidential decree (see figure 3.1 in chapter 3). As an SOE, KBN was established as a result of merger and liquidation of some underperformed SOEs in the country. Under Government Regulation No. 23/1986, the merger was carried out between two small SOEs, PT Bonded Warehouse Indonesia and PT Sasana Bandha and was named KBN. In 1990 through Government Regulation No. 31/1990, PT. *Pusat Perakayuan Marunda* (Persero) or Marunda Timber Centre Corporations (MTC) was liquidated and merged with KBN. Subsequently, KBN shareholders consisted of 88.74% state ownership and 11.26% owned by the provincial government. In 1994 through Government Regulation No. 38/1994 the shareholders received other proceeds by liquidating underperforming SOEs, PT. *Pengelola Kawasan Berikat Indonesia* (PKBI) or Indonesia Corporation for Bonded Area Management into KBN (*Ibid*).

KBN's core business in managing the bonded zone status in the integrated industrial zone and accommodating EPZ firms and other general non-export and non-bonded zone industries offers attractive rates for business and investment (*KBN website 2014*). For example, logistics services include freight business, mechanical and documents (forwarding), warehousing services and their respective utilities (power and water supplies, communications and the internet, waste and security management).

The role of KBN as an independent entity

Based on KBN's record, prior to becoming the sole agent to accommodate the facilities, KBN had already managed to become a pilot project for export industry development. In the period of 1986 to 1996, when the neoliberal consensus began to unfold, the government set a variety of economic deregulation and reform packages (Appendix 3) including the merits of FDI and non-oil commodity exports. All agencies associated with KBN development policy delegated their authority to KBN management to play a major role as a Zone Incubator free from government intervention. All the

interests of the investors related to the government were held by KBN. This engendered an elevation of investors' confidence to invest in KBN and consequently the investors contributed to high average annual income (KBN Business Performance Record).

Nevertheless, post-1996, to protect domestic industry and ameliorate the export competitiveness in the global market, the government decided to improve trade efficiency by aligning a timely supply of raw materials from domestic industry and making available promotional tools to support the marketing. Hence, streamlined bureaucratic customs, excise and taxation procedures were required. The enactment of the Government Regulation (PP) No. 33/1996 that placed the EPZ as a financial instrument resulted in the enactment of a wide range of tax and import duties imposed and EPZ was simply a foreign exchange earner. Subsequently, the amount of investment led to a significant decline in KBN's annual income.

Due to the declining income, KBN was assigned to take part in the fight to obtain public funding. The central government passed on some challenging responsibilities to the provincial government who governed the SOE, by making KBN as a liaison for EPZ firms. The first issue here is that the trace of the informal institution in the form of rent-seeking between the central government and KBN can be seen from the way the president Soeharto chose his SOE minister in order to get the most financial benefit from KBN's profits.

Assigned responsibilities to KBN caused the Jakarta provincial government (JPG) through KBN to enter an *interjurisdictional competition* among line ministries where KBN managers not only fought to obtain public funding for IZ-related infrastructure, share expropriation, domestic and foreign private investment but also gained profit through their tenants (EPZs) who bought raw materials from their subsidiary firms without supporting a long-term national industry structure (one of the cause of Indonesia's weak economic and financial foundation).

PT KBN—in which the firm has an important part to play in Jakarta's economy—based on evidence from the regional autonomy watch (KPPOD) report (2000), is one of the most stagnant EPZ zone developers⁶⁵ where the local parliament (DPRD) has come to play a subordinate role after the executive branch.

A former GOLKAR MP recounted in an interview:

“On KBN's establishment, President Soeharto set the agenda for almost all legislation due to it wielding most of the political power. The majority of DPRD members were pro-Soeharto from GOLKAR party and had a powerful influence on the legislative ideas of the government”.

⁶⁵Others are PT JIEP, PT SIER and generally other SOEs in Java

Evidence from interviews (KPPOD, KADIN, and MP from PPP party faction) and media reviews (*Media Indonesia* and *Bisnis Indonesia*) indicates that not only during the new order (NO), even during the reform and democratic order (RDO) there has been structural changes at KBN and also other SOE such as the Jakarta Industrial Estate Pulo Gadung/JIEP. KBN and JIEP's corporate structure evolved significantly over the past decade changing the authorised and unauthorised elites which also paved the way for rent seekers. Other major elites also often experience reshuffling, especially both the executive (relevant cabinet ministers where KBN as an SOE is under their direct control) and local parliament (DPRD, which has had more political sway in SEZ policymaking since Habibie until the SBY presidency).

Until the early 2000s when the big bang decentralisation system was implemented, the elites' landscape in Indonesia had undergone another major shift especially when SBY came to power. The central government's elite role was strengthened. Since the direct elections in 2004, Jakarta governors and DPRD have become more influential in this regard. Basically, there were in practice two elites: first, the President who mostly bounded to the literal power he could place on SEZ policy; and second, which is manifested in this chapter, the Jakarta governors who held situational elite roles.

To confirm the evidence found during interviews and media reviews on the main obstacles of developing an EPZ, the author interviewed a couple more people, they are the former director of the Indonesian Customs office and former KBN administrator.

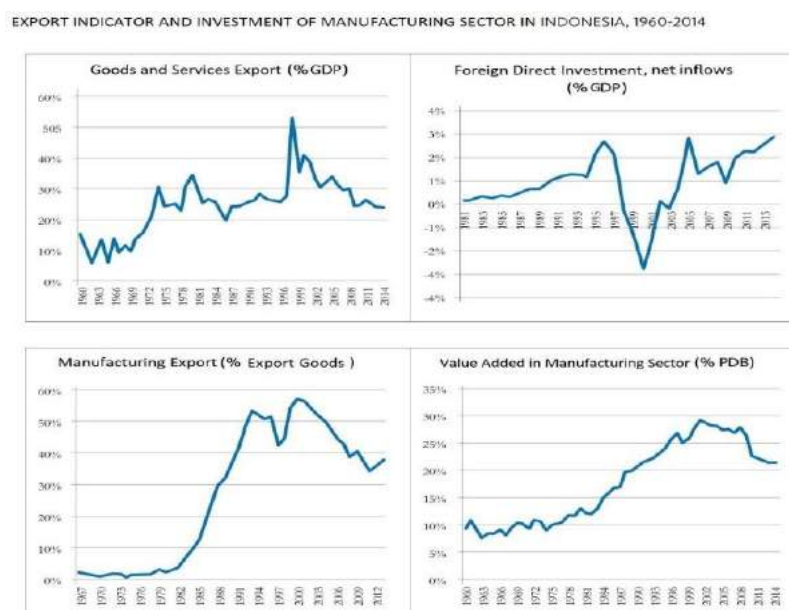
“As you know, we performed really well in the export sector especially manufacturing sector before the crisis, but then the AFC occurred and our economic and financial fundamentals were weak. This was because one of the obstacles during my time serving the customs office was instead of exporting goods overseas, some EPZ companies had chosen to sell their products locally in return for short-term profit margins which the bureaucracy and the actors involved are less complicated....of course as long as they maintain a good and a well-coordinated relationship with the right officials.”

To validate the response stated by the respondents, the author has taken the relevant data from the Centre for Strategic International Studies report (2015) derived from the World Development Indicators as shown in figure 5.1 below. The export-based promotion industrialisation strategy was quite successful in increasing the role of the manufacturing industry, attracting foreign investment, and increasing export revenues, at least before the 1997/98 AFC. The development policy of EPZ corresponds to a period of rapid growth in investment and exports in Indonesia, especially in the manufacturing sector. Figure 5.1 shows that this strategy succeeded in boosting the growth of Indonesia's manufacturing sector, reflected in the rapid increase in the value-added ratio of the manufacturing sector, from 11.94% in 1982 to 26.79% in 1997. In addition, the export structure also reflected something similar. The growth of the manufacturing sector is mainly due to a significant increase in investment, both domestic and foreign, in the export-oriented sectors, especially the export

of labour-intensive and resource intensives. The growth of manufacturing exports grew significantly, contributing more than 50% of Indonesia's total exports in 1996, compared to only 4% in 1965. Nationally, this policy encouraged Indonesian exports from contributing only 19.49% to GDP in 1986, up to 27.86% of GDP. Meanwhile, net inflows of foreign direct investment also experienced a significant increase since the turn of export promotion strategy, from 0.25% to GDP in 1984 to its pre-crisis peak of 2.72% to GDP in 1996.

Most of the imports in EPZ used to bring in goods that can support the process of producing export goods. These goods may be in the form of raw materials or capital goods/machinery or equipment supporting the production process. In 2008, the total value of imports in EPZ accounted for about 18% of total national imports, as well as 24% of total national non-oil and gas imports. This figure is quite large when considering the relatively small amount of industry and area of EPZ on a national scale. Nevertheless, in the last seven years, a steady and significant decrease in the contribution of EPZ imports occurred. By the end of 2014, imports in EPZ accounted for only 12% of total national imports and 18% of total national non-oil and gas imports. This indicates a decrease in the central role of EPZ in encouraging export production activities.

Figure 5.1



Such outcomes, however, are not surprising as Stiglitz (2002) notes trade liberalisation has been about cheap imports flooding the markets. These distortions in the domestic economy also destroyed domestic producers and resulted in stagnating industrial production and ultimately the perpetual lag of income behind inflation levels. Public finance for manufacturing industries also decreased when Susilo Bambang Yudhoyono (SBY) came to office and signs of the de-industrialisation tendency

emerged after the Soeharto regime. This study focuses on the new development of EPZ during the transition from the SBY regime to Joko Widodo. Meanwhile, to confirm the issue of informal connections that constraint the production of formal rules and cause EPZ performance to be ineffective are explained in the next section.

To provide policy certainty to investors, it was assumed that the basic idea of the previous legislation on EPZ (PP No. 22/1986) was more affluent and could be applied to the basic legislation to upgrade KBN status into an SEZ. According to KBN's Senior Manager,

“... policy certainty is a very important issue when it involves attracting investment. History has shown that KBN's performance was better when inflows of FDI was high. Central and local government as agents of change should have a common vision to designate KBN as an investment destination. Therefore, collaboration in its development and applying the right policies are highly needed”.

Even though there are not many EPZ firms currently in operation, KBN status has been a subject of controversy for many years as it has more political and economic value than any other zone developer and management in the country—not only because it is located in the capital city where its closeness to power has raised much attention, but also its status as an SOE has put more pressure on public accountability for high-quality performance.

Findings suggest that formal institutions were generally acknowledged until it was hampered by internal political interest coupled with the central government's chance to pit local government and SOEs—with prolonged tensions over state resources—against one another by opening profiteering, rent-seeking, and political patronage opportunities at the local level to prosper.

Informal institutions, in the SEZ policy dealings, are often overlooked as powerful tools for economic efficiency or distort resource allocation (Phelps 2007; Maramis 2012). This, in turn, leads to the effect of informal institutions as a complement to business transformation but not necessarily constrain the enactment of formal policy.

5.3. Informal Institutions in a New Alliance for Institutional Change: A Network of Connections

Like most industrial zones (IZs) in the world, IZ in Indonesia is a specific area in the customs jurisdiction and authorised by the state to support industrial infrastructure for EPZ firms (foreign or domestic investors) and to boost export-oriented processing industries. The government provides other facilities as special incentives such as exemption from import duties and other levies. Foreign investors in IZs are generally granted some rights for constructing production sites in these zones (WTO 2006: 57). GOI also provides incentives for foreign nationals including five years 100% foreign ownership and 95% ownership afterwards of their businesses. Other incentives include the duty exemption on

components and materials for manufacturing purposes, provided 100% of production is exported (*Ibid*).

To take advantage of business opportunities in the IZ, domestic and foreign investors must register with the Investment Coordination Board (BKPM) and offer to establish business projects in the IZs including the issuing an investment license. EPZ firms are obliged to export at least two-thirds of their production, excluding components. Components are allowed not more than 50% the value of export to enter the domestic market (WTO 2006: 57).

However, as pointed by the former director of the Indonesian Customs office and former KBN administrator in the previous section, evidence suggests that despite a number of entrepreneurs in EPZ have enjoyed various fiscal facilities provided by the government, there were some EPZ companies not export-oriented by using low export market demand as an excuse and used this scheme to gain instant earnings authorities with the intention of avoiding customs duties. Instead of export, they sold more of their products in the domestic market. The practice was not in accordance with the motivation of EPZ development and also harm the government and other industries in the country. As regulated by the Minister of Finance Regulation No. 255/2011, employers in the EPZ must export at least 75% of the production, and only a maximum of 25% may be sold in the domestic market (although this rule is relaxed in 2013 to be at least 50% production in EPZ that must be exported, due to weakening export market). As a consequence, there were more than 30% export earnings lost by the unscrupulous behaviour of the actors involved (the executives represented by the agencies under the Ministry of Finance i.e. customs office, the EPZ administrator (in this case KBN) as the representative of the Ministry of SOE, the legislative branch of DPRD, and the business actors represented by the EPZ firms.

Further confirmation on the evidence, through a focus group discussion (FGD) with KBN managers and their staffs, and the representatives of the EPZ firms, the author with prudence and no intention of judging or making the respondents feel accused of doing the same, asked the respondents the reasons for the possibility of some illegal practices, i.e. selling export products into the country without the permission of the relevant authorities have occurred in the past. The response was that the price of imported raw materials used in production has increased annually. As surveyed by the Economist Intelligence Unit (2008) *"A drawback on duties and surcharges is available on imports into the Indonesian customs territory that is subsequently shipped to EPZ firms for later export"*.

Additional comments from the respondents further noted,

"Therefore, when we raised the export prices of finished goods, export demand was decreasing, while operational costs including labour costs also increased. EPZ companies were unable to cover the costs incurred from production so they took other ways by

selling the goods into domestic market with more potential for substantial profit. Sometimes they coordinate with some officers in the field using informal means to achieve their goals (refers to the implementation level). These practices, in the end, have either one of the consequences such as first, the possibility of the number of investors in the industrial sites decreased due to the corruptive practices have forced them to deal with legal issues resulted in high transaction cost and second, the possibility of investors to increase due to they prefer to use informal methods to deal with the bureaucratic cumbersome and high production cost.”

These findings indicate that the possibility of higher transaction costs incurred due to the informal institutions (informal dealings and unofficial negotiations which led to unofficial levies) influence the formal institutions in the NO era to divert the applicable law during the implementation of SEZ still persist in the RDO. It suggests that the study by Warr (1983) on the externalities brought by the existing EPZs in NO regime still applies to today’s SEZ policy development.

5.3.1. The Insignificant Performance and The Decreasing role of the state—the rise of new actors

Based on the KBN’s document review, KBN has two main objectives as stated in the amendment in the company mission and none of their objectives or duties involves dealing with potential investors. Their objectives are: to strengthen the business position to increase the benefits to stakeholders and shareholders and to participate in supporting the national logistics system. Related to these objectives, KBN has embarked upon the provision of inclusive infrastructure facilities in the form of ready-made property for lease (standard factory building rental and land-lease systems), total logistics system (TLS) services—container depot into the integrated supply and value chain—, other port services and amenities such as health centre in all business units.

However, with the enactment of the Regional Autonomy Law Number 22/1999 as a manifestation of a one-stop service (OSS) scheme, the KBN Board of Directors (BODs) was given full authority to sign a Letter of Investment—a licencing approval by the Jakarta Governor through decree No. 800/2002. The delegation of authority means another decreasing role of government to intervene in the market, which was previously represented by BKPM.

Although there was a gradual decrease in the number of investors after the 1997/8 AFC and 2008/9 global financial crisis (GFC), since 2013, KBN has maintained stability in EPZ firms to 306 investors with a total employment of 640 foreigners and 100,000 Indonesian workers not affected by the overall EPZ performance to national export as drawn in the figure 5.2 below. In Cakung alone—one of the sub-districts in North Jakarta, there are 94 firms mostly foreign investment in the garment industry (KBN Annual Record). A total of 200 firms in KBN is in labour-intensive sectors, such as garments, shoes,

bags, and wigs (Ministry of Industry 2014). Of that number, 150 firms come from South Korea, Taiwan, and China. Currently, almost all EPZ firms in KBN class 80% of workers as outsourced and only 20% have permanent employee status (*Berita Satu News* 10th August 2015).

Figure 5.2



Institutional Change of the Corporate Strategy—A blessing in disguise

- **The Blessing**

In 2012, KBN performance under Sattar Taba leadership—the CEO who has cultural ties with the Vice President at the time, recorded Rp14 billion⁶⁶ profit and in 2013 managed to increase the profit to Rp267.14 billion, growing 1,808% after years of significant losses and development stagnation as seen in EPZs overall export performance in figure 5.3 where it tends to slope downwards over time. In addition, KBN successfully contributed Rp602.44 billion in revenue in 2013. The position of the balance sheet at the end of 2013 stood at Rp1.26 trillion (KBN Financial Record; *Indopos News*—23rd May 2015).

In 2014, the firm's business pattern was also transformed from previously a 70% lease and 30% management to portfolio management of 80% and lease of 20%. The prime characteristics of this restructuring were to change KBN as one of Indonesia's business clusters and its business pattern, as stated in the amendment of the firm's articles of association followed by the revised mission and vision. The transformation also changed the corporate's rules of the game as determined by the shareholders and administered by the KBN directors. Various new projects were introduced as will be elaborated in the next section. The changes in business patterns and the implementation of various projects were guided by the principles of good corporate governance (GCG).

⁶⁶Average exchange rate (2012-2015) US\$ 1.00 = Rp11,295.25

Throughout 2014, KBN achieved good performance. Assets of the company until the end of December 2014 amounted to Rp1.711 trillion, a rise of 20% over the previous year, with a net profit of Rp263.84 billion (*BUMN Track* 15th December 2014). Paradoxically, the corporate's high performance has not been able to contribute significantly to Jakarta's export performance⁶⁷. In addition, sentiments and expectations of the new SEZ and investment policies also affect the prospects of investment, notably from FDI, which requires certainty.

The increased foreign investment was expected to anticipate the ASEAN single market in 2015 (ASEAN Economic Community or AEC) to open investment opportunities as shown in figure 5.3, especially in the services sector. However, the data suggests insignificant results. Moreover, the strong inflows of foreign capital in the AEC which ideally support increased investment performance in Jakarta, but due to the insufficient production capacity in most of Jakarta's EPZ manufacturing industries has caused insignificant demand from the global market.

Figure 5.3



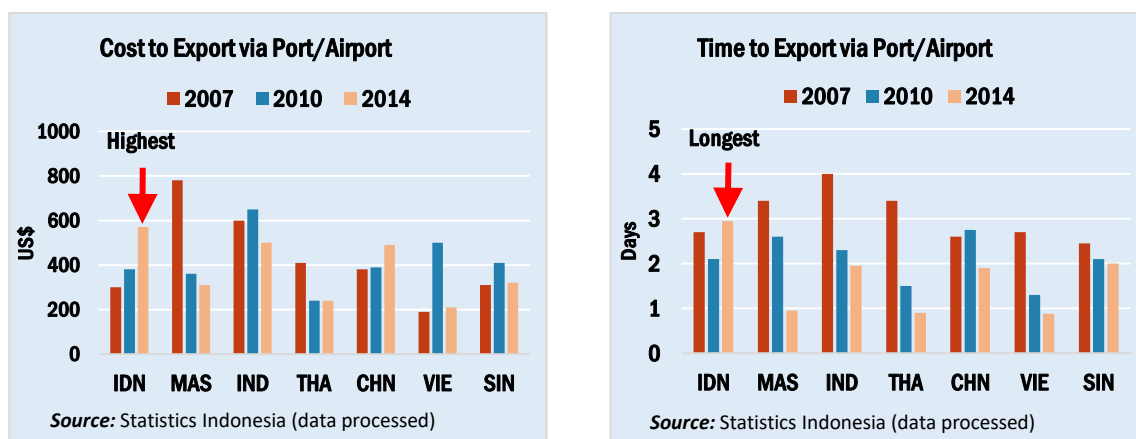
Furthermore, competitiveness between Jakarta and other regions requires the state to intervene in the acceleration of the industrial sector's structural transformation and strengthening of enablers⁶⁸. Other forms of state intervention include a fiscal incentive which also plays a vital role in supporting both FDI and domestic investment, especially for export-oriented and the global supply chain. Until recently, the state's initiatives and efforts to ameliorate competitiveness have not been able to align

⁶⁷In effect, national export also decreased, see Figure 4.7.

⁶⁸Enablers is the success supporting factors in Jakarta, such as individual, organisational, and technology towards knowledge sharing as instruments of change from resource-based competitiveness to knowledge-based competitiveness (Bank Indonesia analysis on Jakarta's Regional Economic and Financial performance 2014).

with competitors in the ASEAN region (Figure 5.3) and has been outperformed in terms of cost and time of export as displayed in figure 5.4. Particularly, the relatively low capacity of innovation and technology infrastructure to promote the industrial progress is still a problem today.

Figure 5.4



- **The Disguise—leading to the upsurge of actor’s informal institutional preference**

Nonetheless, Sattar Taba boasted about the fact that there is no firm like KBN that can raise nearly 2,000% profit in 2013 and improve corporate performance. He asserted that the improved performance was not limited to KBN as a firm but also an attempt to support government programmes especially those related to EPZ’s logistics flow as part of the supply chain (*Tribun Makassar*—27th September 2012; KBN Report 26th May 2015). But under close scrutiny, upon assuming the duty as CEO, Sattar had built trust in himself, the business, and the company’s shareholders rather than the government and the public at large.

Citing Warr (1983)⁶⁹,

“KBN’s goals adhered to the capitalist ideology of ‘maximising shareholder value’ by reaping the net gain from the existence of the firms; thus, apparently disregarding the interests of the firms themselves” (*Ibid*: 38).

In view of Acemoglu and Robinson’s (2006) ‘economic backwardness’, KBN is more likely to block development as the political stakes are higher.

Further evidence from KPPOD response noted,

“KBN did not cater for the EPZ investors’ needs and ignored the neoliberalist economic objectives. This was evident through scores of complaints and claim cases from the

⁶⁹Borrowing Warr (1983: 38), during the NO regime the condition at the time was not much different with what is evident in today’s contemporary EPZs even though they differ in some respects, notably, political and bureaucratic characters.

tenants with regard to the rigidity of time to lease the factory buildings and properties in the zone”.

Other instances of KBN’s setbacks as viewed from the media found:

“High court prosecutions on behalf of 100 EPZ firms against KBN must be dealt with in the past three years following KBN’s arbitrary action to reject the renewal of their factory leaseholds unless the new and higher lease rate is paid⁷⁰ and other conditions are met.” (*Sindo News*—12th June 2013; *Berita Satu News*—16th January 2016).

From Institute for Global Justice’s report (2011) also confirms,

“There has been evidence of land rent enjoyed by the elites. Other matter that has yet to be addressed by KBN and EPZ firms since the previous CEO is in relation to the escalation of labour movements that demand better labour prosperity. When the law of labour is deemed no longer appropriate, the government will resort to a new law that minimises transaction costs. Yet, the irony is that the law is deliberately changed to favour investors rather than Labour’s welfare”.

Additional information regarding Sattar Taba from an anonymous interview revealed,

“Sattar was and still is an active member of a civil society organisation called *Kerukunan Kekeluargaan Sulawesi Selatan* (KKSS)⁷¹—a communion of ‘Putra Daerah’ or ‘son of the soil’ from South Sulawesi province—where he and other South Sulawesi-born influential people⁷² are currently devoting. It was apparent that by his dedication to the communion, he has gained trust from business, politics, and government communities and further has the power to retain order. *It seems like his achievements were obtained through kinship with the group rather than meritocracy*”.

Through media reviews, interesting to note that:

“Allegiance and solidarity of KKSS members were in part due to a statement from one of the former leaders in the country and reiterated by the Ministry of Agriculture who explains that KKSS was understood as a national asset. The members have become potentially connected by political allegiance and business proposition” (*KBN editorial* 13th November 2014; *Fajar Daily*—28th March 2015)

Findings suggest that not only informal institutions matter (informal practices and political allegiance) but the presence of power (new actors i.e. KKSS members) greatly affect the established EPZ formal

⁷⁰It refers to the appraisal of the land rental value through the Tax Object Value (NJOP) in 2011 approximately Rp1.5 million/m².

⁷¹KKSS as a regional indigenous organisation goes a long way since colonial era when it was inspired by the growth of ethnic-based youth organisations such as *Jong Java* (the most popular and dominated the social order), *Jong Sumatera* and *Jong Kalimantan* that served as a training ground for future leaders of the nation based on love of the homeland since Dutch colonialism in early 1900. The youth organisation from Sulawesi was known as *Jong Celebes* that brought together young students from Celebes or Sulawesi. The purpose and goal were to strengthen the unity of the brotherhood (Hernanda 2013; *News Phinisi* website).

⁷²To name a few, former President Habibie, former Minister of SOEs in Habibie’s cabinet Tanri Abeng; Said Didu, former Secretary of SOE Minister in SBY cabinet (being professionally qualified in the mining sector, he held four vital positions as: Expert Staff for Minister of Energy and Mineral Resources (ESDM), Commissioner of two strategic SOEs in mining and plantation sectors (PT Bukit Asam and PTPN IV since 2008), and Chief of National Smelter Study Team. It has driven him to be a strong candidate for Director General of Mineral and Coal), and current Vice President Jusuf Kalla (known to be an influential businessman and politician).

institutions in its implementation level. What institutional factors exacerbate the informal-formal institution's influence the behaviour of actors? The next section elucidates the emerging issues.

5.4. The First Informal-Formal Institutional Complexity

The presence of new power also affects the city of Jakarta as a whole due to the status and position of Jakarta as the most developed city. Jakarta has a vital role as the centre for political, economic and territorial control. Ginsburg (1976) in Evers (2002: 5) argues that the concentration of various institutions in the Southeast Asian cities leads to the increased degree of the capital city's primacy. With its high population, large port, central government offices, business centres, social and cultural centre, and a prime location for industrial production, Jakarta and other capital cities often serve as independent trading cities (*éntrepot*), a node point of international trade routes (Chong 1976 in Evers 2002: 44-46). Jakarta meets the criteria and the requirements to have an SEZ, as has been mandated in Investment Law No. 25/2007 and SEZ Law No. 39/2009 where special provisions in customs, taxation, licencing, immigration and employment are enacted.

In mid-2010, as a form of state intervention to revitalise the economy which is part of the government's economic reform programme, Jakarta Provincial Government (JPG) has proposed Marunda sub-district in KBN (see figure 5.1) as the next SEZ and converted or upgraded the already built KBN industrial zone into an SEZ under one piece of legislation. The JPG planned to build a 500 metres long strategic land as an SEZ in the coastal areas of Tanjung Priok Port and reside along the shoreline of Marunda starting from Cakung Drain to Blencong River (Susanto 2012; Wardhono 2013) (see figure 5.1).

The JPG has insisted to intervene in order to improve KBN's performance in accordance with the plan for the SOE revitalisation from 2005 to 2009. The vision and mission of SOE were focused on developing corporate competitiveness and resilience in the global market and high innovation to meet the expectations of stakeholders. Therefore, to boost JPG's goal, a healthy and lucrative KBN in terms of generating a significant contribution to the state and the public at the time was highly needed (in the form of taxes, optimised income and other contributions).

Nevertheless, interesting information gathered from the field suggests that the proposed Marunda Port SEZ was a measure taken by the JPG to dictate the established SEZ formal rules (rules of the game) through informal practices. Based on the interview with former Staff of SEZ National Council as well as former director of BKPM, it was JPG's informal policy measure to boost public support for the upcoming regional election in 2009. Additional information, from the media reviews and IGI researcher, the scenarios launched by the JPG indicated strong determination to act and be appointed as the only institution who has the full rights to plan, carry out, and utilise the facility for their own

interest disregard the public interest. It was by their concerted effort through informal negotiations and lobbies the formal rules took effect.

According to World Bank survey (2000), the JPG's idea appeared to have performed a functionalist approach ensuring the institutions to systematically support JPG policy by assuring the public that the new formal institution will prioritise their needs to increase economic efficiency (Dutraive 2009).

In theory, based on Stiglitz's (2001) assertion, the evidence points to the institutions that help promote actor's status of power, their vested interests and rents rather than to promote efficiency. In support of the view, North's (2005) proposition also relates to the above issue that:

“Through ideological or cultural beliefs, political institutions dictate the rules of the game to define economic institutions”.

The Marunda SEZ proposal has been included in the international port map where imported goods can be transported directly to Jakarta without transit through Singapore. Marunda SEZ was set to remodel the existing labour-intensive comparative advantage into a competitive advantage. The government planned to facilitate a number of barges that serve to distribute containers to and from large vessels that were not able to dock at a depth of fewer than 18 metres⁷³. Marunda zone development was intended to also explore several infrastructure improvements, which include the availability of power supply, water and waste management. But the concept of zone development has yet to find the appropriate mode of capitalisation or funding.

Through document reviews and interviews with KBN managers, Bapennas official, former budget policy staff in the parliament, the following paragraphs elucidate further the background of the Marunda SEZ project.

KBN (state-owned private sector) was appointed to carry out a joint venture (Public-Private Partnership or PPP) with non-state private sectors to finance the zone development. JPG used the study by the Jakarta SEZ project team (2010) led by a political economist from the University of Indonesia, Dorojatun Koentjorojakti⁷⁴ joined by the Assistant Governor for the economic sector which the result stated that the SEZ development as a regional logistics centre will require approximate funding of US\$2 billion which did not include human resource development, IT improvement, and other supporting infrastructure, i.e. the construction of Cikarang—Tanjung Priok toll road.

⁷³As studied by ADB, Trace, Frielink and Hew (2009) in Tocchetto *et al.* (2014: 31) discover that in addition to the ailing infrastructure and poor management system, Indonesia has not been able to address the depth problem of its ports which bigger ships for trading purpose cannot pass.

⁷⁴Although he was graduated from Berkeley, but his economic approaches were more nationalistic in nature (Mallarangeng 2002 in Hadiz and Dhakidae 2005:47).

The first step the JPG did was to speed up the toll road construction and provide a number of residential flats used as port workers housing facilities estimated to employ 1 million people and expected to contribute revenue to the provincial government in two or three years. The JPG expected that the value of the provincial government's shares in KBN would reach 38% in 2010/2011 and in the next two years become the majority shareholder.

In 2011, the proposal was approved by the regional parliament (DPRD) and the governor (then Fauzi Bowo) and the port named after the previous governor Ali Sadikin Logistics Centre to be completed by 2015. The JPG hoped the regional development of Marunda as an SEZ with all the facilities, fiscal and non-fiscal incentives, the readiness of human resources, and adequate infrastructure will be able to accelerate the entry of investors on an ongoing basis and ultimately absorb labour in addition to improving the national economy.

With the two scenarios of KBN's pre-existing capital (budget) condition as well as mandate given by the JPG as justification to further develop an SEZ, KBN attempted to reposition the business into a Logistics Centre which not merely served as a special investment zone but other businesses that require cooperation and support from logistics and shipper firms to support the supply management network and third-party services in terms of inventory management, inspection, labelling, packaging, barcoding, and ordering. Therefore, the pressure of utilising the value added obtained from the logistic activity centre (VAL) was high as it can induce good attraction for investors. VAL services in the logistics chain encompass more of its existing roles and functions today and the opportunity to be pursued by KBN and continued in the future prompted the need for a better logistic centre behind the port area.

In a separate interview, KBN managers and BAPPENAS observed,

“The technical hitches at the time were that KBN had no port of its own to support the logistic centre. KBN's dependence on Tanjung Priok port was less lucrative due to severe congestion in Tanjung Priok and this condition was well known among shippers. On the other hand, the waterfront at Marunda could be developed into an SEZ port to answer the concept of SEZ logistic centre development. The target markets of Marunda Port SEZ will include domestic short distance (inter-island) as well as international trade”.

Findings suggest, the analysis result for Marunda Port SEZ to be developed as a dry port facility might reach a common understanding among all key actors including stakeholders involved (See Figure 5.5) given the high projection of trade traffic congestion and logistics performance index in the World Bank's survey (2014) in figure 5.6, as well as vessels characteristics and visits if such an SEZ failed to be built. Congestion and other social problems entail a significant decline in the export sector (World Bank Survey Reports-Akinci and Crittle 2008; Farole and Akinci 2011).

As Susanto (2008) and Wardhono (2013) further confirmed,

“Tanjung Priok port has exceeded the capacity to accommodate the logistics of exports and imports from a number of countries. Therefore, an international port SEZ development plan was put forth to be formulated and enforced inside Marunda to provide reliable services for investors and stakeholders”.

Figure 5.5

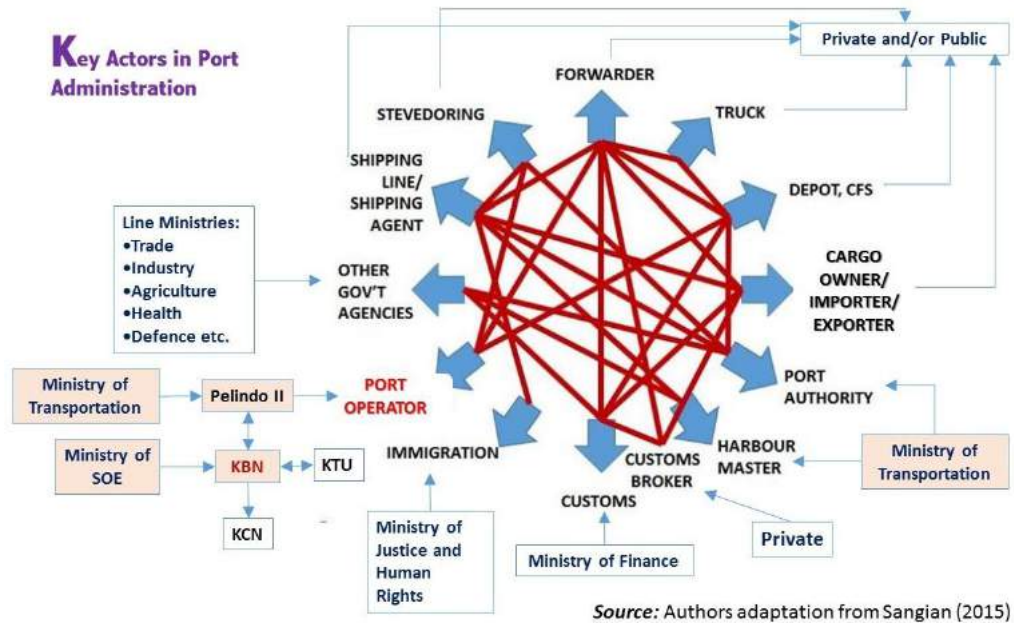
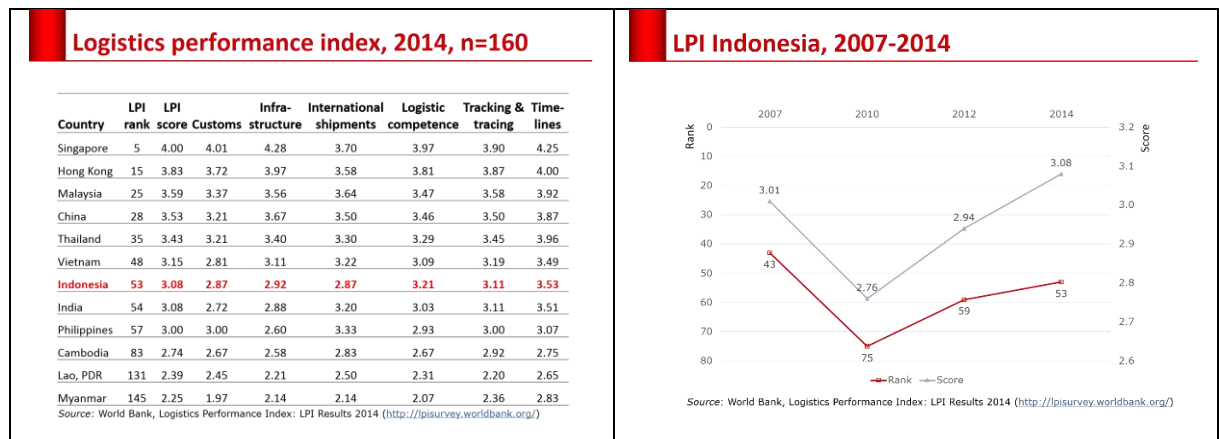


Figure 5.6



Marunda port SEZ was planned to be developed alongside Tanjung Priok on two accounts, first, their respective development plan, so that both ports are comparable in terms of service capacity; second, because of the growing industry in KBN not only for garment-textile-related but also waterfront-related industries or oil-based industries such as crude palm oil (CPO) processing and other follow-up industries (cooking oil industry), biodiesel industries, concrete industries, etc.

As remarked by one of the KBN Managers,

“The scenario for Marunda Port SEZ operation with the services capacity it provides and supported by an Industrial Zone at the rear is that it will be able to take over the market

share in the future, especially industries of raw material and industrial products both of which are in KBN Industrial Zone”.

The joint project between KBN, central and provincial government will change the rules for budgetary allocations to secure funds amounting to Rp400 billion from the Government Capital Share Ownership of Jakarta’s 2011 APBD budget (*Berita Satu News*—5th December 2012). KBN claimed that the governor responded positively to the project, but the plan did not materialise, instead, there were interruptions in the process. The following paragraphs further discuss the specific interruptions.

MP from a PDIP political party faction recounted,

“There was intense pressure from both sides when a PDIP politician and member of Jakarta DPRD at B Commission had asked Fauzi Bowo to urge the central government to continue this project and insisted that the project will be taken over by West Java province if not promptly given the official license.

According to various sources including the media and a former secretary of the Indonesian Industrial Estate Association (HKI):

“The delay in the construction of Marunda Port SEZ was due to the issues of interests in the central government. Fauzi Bowo was running for the second round for governor nominated by Democrat Party led by SBY. Ahead of the gubernatorial election in 2012, there was a conflict of various political interests between two sides, Fauzi Bowo from Democrat Party and Jokowi from Indonesian Democratic Party of Struggle (PDIP) that led to the postponement of the Marunda SEZ project”.

Azis’s (2000; 2008; 2009)⁷⁵ and Rosser’s (2004)⁷⁶ conjectures do much to present the circumstance that Indonesian economic liberalisation and decentralisation, particularly the case of Jakarta, has demonstrated an unsurprising, more continuous and radical quality of rulers to remain in power.

As pointed out in chapter 4, one of the DPRD’s main function is to determine the local budget, however, in relation to utilising the APBD budget funding, more information was gathered through the media that:

“Under intense compulsion from both sides, although financing for the SEZ had finally been approved and allocated from the Jakarta 2011 APBD, the budget was never spent as KBN did not gain an official license as a form of approval from the governor until the gubernatorial election in 2012” (the *Jakarta Globe* 2014)

The budgetary allocations for the SEZ project exhibited how sectoral spending priorities were evolving in the DPRD. It appeared the conflict between DPRD and the Governor arose when the Marunda port SEZ was first proposed by JPG through two scenarios, as previously discussed, was not formalised into formal rules.

⁷⁵See chapter 2 and 3.

⁷⁶See chapter 3 and 4.

There were rumours that the delay was due to a matter of naming the SEZ which back then was still up for deliberation at the provincial level and district level in North Jakarta in June 2011. This caused the proposed name to not be ratified by the DPRD. The most likely candidate was Ali Sadikin⁷⁷ Logistic Centre, named after a former Jakarta governor from 1966 to 1977, who was well-known for his heavy-handed urban reform.

During separate interviews, the authors from IGJ remarked,

“Naming was just an excuse to divert attention and stall the process until the upcoming election. A conflict of interest due to other proposed projects and change of leadership evolved at the state level”.

Even though the governor and DPRD had approved the Marunda Port to be set up as an SEZ in 2011, the process to build an SEZ by the Jakarta provincial government has taken longer than expected.

Divided Sovereignty in the Port and Logistics Management

The media coverage stated:

“The strategic coastal area for SEZ has largely been under the management of PT *Karya Citra Nusantara* (KCN), a subsidiary firm of KBN. KCN was built in 2005 as a joint venture (PPP) between KBN and PT *Karya Teknik Utama* (KTU), whose core business is in the harbour management and as a majority shareholder resulted in KBN’s trivial voting rights to be able to continue the SEZ project plan. KTU has 85% ownership shares in KCN while KBN only 15% as stipulated in the Notarial Deed on February 2006 (*Pelita editorial* 22nd December 2015). KCN port in Marunda is a public port as stipulated in the decree of the Minister of Transportation No. KP 401/2011 and is granted the licence to develop and manage the port area in Marunda. KCN is the deepest port in Marunda with 6 metres of low water spring (LWS) to 7 metres LWS with a 700-metre length and 15-metre width” (*Bisnis Indonesia*—9th April 2013).

KCN began its operation in September 2012, a month before Jokowi came to office as the next Jakarta governor. After seven months of operation, there were problems between KBN and KCN which impeded the plan to set up an SEZ. The problem was due to a plan to take over KTU’s shares by JPG. A leading figure in the United Development Party (PPP/*Partai Persatuan Pembangunan*) argues that this plan would have an adverse effect on the city’s investment image, therefore he suggested, it would be wise to cooperate or to purchase the shares in an open bidding.

According to the MP, he commented that:

“Jakarta provincial government to explore the possibility of cooperation with the private sector (KCN) who has control over the proposed SEZ land, by noting that Jakarta provincial government as the lead agency should have the majority of shares or purchase the shares” (during first meeting).

⁷⁷He was an ex-military economic nationalist along with other generals in Soeharto period, Ibnu Sutowo and Ali Murtopo, whose economic approaches were more nationalistic in nature. With the beginning of the oil boom in the mid-70s, they were the contending group against neoliberal technocrats from Berkeley.

While a former DPRD member in PDIP faction in a separate occasion recounted that:

“In the parliament (DPR) commission meeting, the KBN case was briefly mentioned. However, the executives (relevant ministries and the governor) have not been clear and transparent in disclosing the many problems facing the Jakarta provincial government in the plan to build an SEZ in Marunda. Consequently, it raised much controversy and augmented uncertainty for investors. The process became longer than expected since there was an alleged information concerning other business proposition that had already been premeditated involving some powerful people”.

To confirm, the author conducted an interview to search for other perspectives and information from KBN managers and Port Authority in a separate interview:

“The insoluble situation was that KCN who control most of the harbour land had carried out licence application procedure for port development to the provincial government and awaited approval of the Marunda Port development master plan. It was said that the official licence has not been issued by the provincial government, but what they defined as investment principle licence or ‘*ijin prinsip*’⁷⁸ has been issued to KCN. The issue was further complicated as the executives (governor office and relevant line ministries) have also not been transparent in providing in-depth information regarding KBN’s status to DPR and DPRD at the APBD meeting. Local governments should be open and not cover the issue because land is a sensitive issue”.

Further, the key parts of discussion which were briefly reviewed in the DPR meeting held in Senayan, Jakarta in 2013 were as follows:

“First, the council revealed that KBN has yet to disentangle the residential land acquisition issue and the budget of approximately Rp175 billion has not been allocated to KBN from the Government Capital Share Ownership of the provincial government. Second, the problem was that the port development projects in Marunda had a time limit. So if it is overdue, the project proposition will be nullified, as the provincial government has been delaying in issuing the licence”.

The media also commented a follows:

“The problem has not reached common ground, even though KCN has been in operation for over a year; KBN had committed to obstructing the activities of KCN port from 21st March until 4th April 2013 by means of blocking the access to the port by KBN security guards and fire engine units. In effect, to normalise and maintain the flow of trade commodities in accordance with the instruction of the Director General of Sea Transportation, Ministry of Transportation, as many as five vessels loaded with coal and CPO were forced to navigate their loading and unloading cargo activities to Tanjung Priok port and six other vessels to a number of other ports⁷⁹” (*Berita Trans News*—7th April 2013).

⁷⁸‘*Ijin prinsip*’ is a compulsory licensing required by any person or legal entity who wish to apply for the utilisation of public space for any large-scale businesses.

⁷⁹As many as eight public and private ports are currently in operation in North Jakarta including KCN Port and another port is set to be built as Marunda Centre. However, only four ports are recognised of having been engaged in loading/unloading activities: *Nusantara* Fishery and *Kepulauan Seribu* Transport Pier, *Muara Baru* Fishery Quay, *Sunda Kelapa* Wharf, and *Ancol* Marina Pier. But none of which has the adequate capacity to accommodate logistics shipping vessels in terms of depth, port or quay length, land area, and the vessel’s weight.

Rumours surfaced among the high-level elites that the closure of the port access road by KBN was due to the political tug of war and conflict of interest between the Ministry of Transportation and Ministry of SOEs, which was further denied by a former official of the Ministry of Transportation in an interview.

“Actually, it is not a conflict of interest between us and the SOE, but rather an issue of coordination which is not synchronised”.

Marunda Port at stake

Between the end of 2012 and mid-2014, there were a variety of management tactics and mechanisms in the face of voting hazards from KBN’s joint-venture partners (KTU and KCN) whereby KBN was highly unlikely to win all negotiation opportunities. As political hazards also augmented especially ahead of the presidential election in 2014, all SOEs encountered an increasing tension of opportunistic behaviour from the DPR and DPRD in the voting arrangement.

Instead of the legislative monitor the work of the executive as stated in the constitution, findings suggest that there is a reversed situation where the executive branch (the Minister of SOE) rebukes the legislative branch (the MPs in DPR/parliament and DPRD/local parliament). The story that unfolds was that high profile KTU and KCN controversy and political backroom negotiations of the budget and joint-ventures caught the Minister of SOE’s attention in the SBY cabinet, Dahlan Iskan, in late 2012.

Based on media coverage and document reviews,

“Individual MPs garnered for themselves a larger fraction of the strategic SOEs’ revenues. The political atmosphere heated up when the relationship between Parliamentary Commission VII and Dahlan Iskan was in a state of contention. The conflict stemmed from Dahlan forwarding the first circular letter issued by Cabinet Secretary, Dipo Alam, which in Dipo’s earlier letter requested state officials not to practise any collusion with the parliament (DPR), regional parliament (DPRD), and partners or related stakeholders regarding state budget (APBN)”.

As mentioned in chapter 4, the information gathered from the Former Vice Chairman of the MPR, the high possibility of the executive and legislative budget team to determine the size of the APBN budget. Lobbies between the executive and legislative as well as from other stakeholder groups concerned with the budget are allegedly passed through these two institutions, but evidence suggests the types of budget and joint venture proposals that come from the MPs appeared to have carried the mission of a particular party. In such a position the executive is generally incapable of rejecting proposals coming from MPs and to deal with ongoing conflicts, informal measures were used (collusion) as the last resort.

In the circular letter—that had copies submitted to the President, Vice President, Chief of UKP4⁸⁰ (Presidential Working Unit for Supervision and Control), and the Minister of Home Affairs—the Cabinet Secretary had revealed that an amount from the ‘unofficial’ state budget was transferred to regions from 2005 until 2013 to accelerate and expand the development projects throughout the archipelago. However, after the circular letter was issued, Dahlan complained to Dipo via a text message about the remaining MPs who still asked for shares from the SOEs’ approved projects and profits. Subsequently, Dahlan’s circular letter stated banning all subsidiaries of SOEs if any collusion was committed as it would induce policy interference on SOEs’ projects.

As stated in Tempo editorials 25th October 2012 Dahlan Iskan told the media the reason behind his action:

“This has something to do with the Cabinet Secretary Dipo Alam who issued the first circular letter to ministries including the Ministry of SOEs. The Circular Letter No. 542/Seskab/IX/2012 contains 2013-2014 budget escorting to prevent collusion practices, whose contents should not be any conspiracy with the parliament”.

Further document reviews find that Dahlan had issued twelve prohibitions contained in a copy of the Minister of SOE regulation No PER-04/MBU 2012 on the Administrative Code of Ethics dated 9th April 2012. The major prohibitions were: to be discriminating in duty; to be administrators and members of political parties; participate as an executor or attend the election campaign of the president and vice president and head of regional or members of legislative elections; misuse of authority; misuse of data or ministry information; eliminate state assets and state/ministry documents; misuse of assets and documents belonging to the state/ministry; use the ministry’s facilities other than in the interests of the ministry; receive and offer bribes; participate in the SOE Initial Public Offering (IPO) Buying in the IPO programme; and conduct any business propositions with SOEs.

A statement by Democrat Party politician in the media stated:

“Dahlan’s performance during the SBY era was fast, precise and yielded measurable results; among others, by breaking the gridlock of bureaucracy and streamlining the bloated management ranks where many directors and managers did not perform their duty properly and merely spent budget for their personal salaries. He streamlined budget endorsement, refreshed the target partners, and replaced the SOE Board of Directors (BODs) with competent professionals.

SOE is a jungle of bureaucracy, where politicians play. Do you still remember how the MPs were on fire with Dahlan’s action in replacing the BOD in the SOEs? Yes, it happens because the Directors were intertwined by political interests and that the SOE is the

⁸⁰UKP4 stands for *Unit Kerja Presiden Bidang Pengawasan dan Pengendalian Pembangunan*.

politicians' and political party's piggy bank for funding. Dahlan's duty seems to get heavier" (Sorot News—25th October 2012)

There were very strong political overtones in the SOEs and various political interests actively played, which ultimately led to SOE being exploited by politicians. The company elites and officials also tended to enjoy the acquired funds. Moreover, most of the existing SOEs became ill-managed and this fact persists throughout the history of SOEs in the country.

According to one of the former researcher in IGJ,

"SOEs generally feel the importance of the contribution to a political party for future benefits and 'political investment' they will gain as a reward in the form of business opportunities, ease of obtaining contracts, access to information on government projects, and share expropriation. Therefore, it is no exaggeration to say that political salesmanship through businessmen who approached DPR or DPRD was part of investment for benefits and was nurtured prior and at the time of the elections".

5.5. The Continued Informal-Formal Institutional Arrangement-Contradiction to KKSS ideology

This subchapter explains the problems of formal institutional change (in the KBN's business transformation), where informal institutions of privilege and power of the JPG (political allegiance and KKSS affiliation) have hampered the development of new formal institutions to support KBN's development in the implementation of the applicable law by setting up an SEZ.

In contradiction to the circular letter passed by the SOE Minister, Sattar's reputation (KBN CEO) is a vital instrument for KBN's businesses to make private deals through an informal method such as kinship-based systems. The path-dependent nature of reputation system is always changing to address the flaws of formal rules, while kinship systems, such as KKSS businessmen and politicians, are based on familial ties and cultural commonalities, i.e. ethnicity and religion. KKSS originated from a social democratic faction and an independent group with uncertain political affiliation. It can persuade MPs of a party to depart from its initial intention and accede to a commitment of working within the group's democratic setup.

Although Sattar and other influential members of KKSS were reported to take the initiative in practising the principle of public accountability to answer to the citizenry of their respective affiliations, the nature of it was far from eradicating rent-seeking opportunities as neoliberals expected. Rather, their seemingly pro-public attitudes and direct communication with the KKSS circles of power complemented their predacious practices.

Unlike in the democratic era of SBY, in the New Order era, *Pancasila* and UUD were taken into serious consideration as a useful mechanism for maintaining the existing social order through full government

control (Aspinall *et al.* 2015). They fashioned the *Pancasila* guidelines to favour their interest and maintain their political hegemony (*Ibid*: 13) so that no other kinship-based societal organisation would be able to flourish. The government instilled the teachings of unity through various systems such as education, government agencies, military training facilities, and SOEs to build new alliances entrenched in every facet of society. They were recruited to build connections whereby many informal institutions emerged within business communities devised in a frequently complex and multidimensional manner to reduce transaction costs such as writing business agreements, searching for trustworthy partners, and enforcing mutually beneficial exchange aimed at maintaining profitable relationships and standing among peers (*Ibid*: 111).

Much literature on post-Soeharto Indonesia has emphasised the 'continuity' of the politico-business alliance which is still evident today thus constitutes business societies that often not transparent to firms and individuals. They were identified and excluded for behaving poorly unless they had familial or kinship and business affiliation (Crouch 2010; Hadiz 2010; Aspinall and Klinken 2011; Aspinall and Mietzner 2014; Aspinall *et al.* 2015). However, in this case, KKSS or any other societal organisation in democratic order is granted the freedom to express their own ideologies and flourish. However, they cannot escape from parliamentary control as political institutions mobilise their presence for rent-seeking through vote-buying which tie the group members together. KBN objectives were aimed at consolidating Sattar's reputation and KKSS's frequent meetings with influencers which allowed Jusuf Kalla (JK), the former vice president (in the SBY administration) and current vice president (in the Jokowi administration) to establish a patron-client relationship with the masses. As a result, it reduced the costs of doing business for all members (*Ibid*: 110-1).

North uses economic history to learn how a person or group in society can reduce transaction costs and how pre-existing institutions have, to a certain extent, empowered these groups in order to unravel their collective action problem (Roland 2003: 10). To employ North's (1991: 111) theory of transaction costs, the gradual change in frequency of informal institutions such as culture in DiMaggio (1994) has a persistent impact upon the economic character in the long-run; the logic of appropriateness developed by March and Olsen (2004) will help to understand the influence of trade lobby emphasising bargaining power for instance from the South Sulawesi traditional concepts. KKSS has been promoting South Sulawesi's potential to foreign investors. This organisation recently organised a 2015 Bugis Makassar merchant (PSBM) meeting, which was centred on Takalar, Sulawesi to promote the investment potential of the region as an SEZ and integrated industrial zone (KAPET). Their informal approach perceptibly embodies the existence of informal institutions associated with the legacy and traditions (La Porta *et al.* 1997, 1998, 1999, 2008) of the founding fathers embedded in society that can impact on the applicable formal rules.

The KBN issue with KCN was further mediated by the head of Tanjung Priok Port Authority with the central government overseeing the situation. To clarify the responses, the author approached a source from the Ministry of SOEs and Indonesian Logistics and Forwarders Association (ALFI) who considered that:

“The KCN port was one of the most important ports. The closure of the port was problematized to gain attention from the central government that there was a problem between KBN, KCN, and KTU and should be resolved. The closure would not have happened if the central government had interfered in the PPP contract agreement between the three parties in the first place. The parties should rectify the situation internally without having to close the port”.

Tanjung Priok Port Authority has stated that the closure of access to KCN port by KBN was due to the unresolved land compensation issue; as the land (where the access road was located) was under KBN's ownership. The issue raised in the media was that KBN demanded a contribution from the port operational income for every vessel docked at the port oversaw by KCN to compensate the cost of road maintenance in Marunda engendered by the passing of trucks.

“The news on the closure of access road was an effort to gain public's attention that in order to keep the roads in good working order and protect the zone road environment from damage due to the passing through coal carrier and CPO trucks, every year we have to spend a huge amount of maintenance cost for roads and have absolutely no interest to continue blocking the flow of goods in KCN Port Marunda” as stated by KBN source (Pelindo Marine 12 April 2013).

KCN port maximising profits from the open market regime was the epitome of an opportunistic alliance (Williamson 1975, 1985) between the state-led development policies and the neoliberal agenda of less state intervention through the opening of business opportunities to the private sector in managing ports as regulated in the Sea Voyage Law. In addition, because of its readiness, KCN port became a stopover port for vessels that serve as coastal shipping or so-called short-sea shipping, a new government programme aimed at transporting goods and services by means of sea transport along the coastline of Java Island and other islands—a concept laid down by the Coordinating Ministry of Economic Affairs (CMEA) and regulated under the Ministry of Transportation.

However, the concept was not supported by KBN and the blockage of the KCN port was ongoing for two weeks and had an impact on the high-cost economy for logistics and transport activities; this prompted the officials from Directorate General of Sea Transportation under the supervision of Ministry of Transportation to authorise Marunda Harbour Master and Port Authority (KSOP) in coordination with Tanjung Priok Port Authority as mediator.

As stated by the official from Sea Transportation:

“The activity of closing and operating public ports was under the authority of Ministry of Transportation, so the blockage activity in Marunda Port violated the provisions of Law No. 17/2008”.

The media reported that:

“Former Secretary of the Ministry of SOEs, Said Didu at the time, assessed that the dispute between KBN and port operator KCN was due to the decisions agreed upon by old management not being approved by the new management. Said believed the government must be stringent on the contract enforcement mechanism against port management, especially the firm’s policy conformity. He considered the main aspect that needed to be moderated was the issue of shareholders who manage the KCN port in Marunda (*Bisnis News*).

Williamson’s approach (1995) is also found in the dispute when the project was highly politicised with Marunda port SEZ proposal as a leverage point. KBN has the advantage as an SOE under the Jakarta provincial government (JPG) and Jokowi as governor, whose CEO has built good connections as a member of KKSS (now chairman since 2014) with highly influential people, particularly, with the current vice president, JK (Jusuf Kalla). The KKSS organisation needs to leverage its key resources in order to deal with the port management situation without resorting to a legal framework in a judicial system as an enforcement mechanism (Williamson 1995: 6). This suggests that the KKSS and JK’s institutionalisation process is resorting to a type of informal means to strengthen their institutional capacity and achieve their organisation and national goals.

Based on reviews of literature, legal documents, as well as media reviews, evidence suggests that the relationship formed between JK and KBN CEO produced a very durable political base. Their social relations beyond the business and political sphere has also made every negotiation possible and was attributed to the 2014 presidential election of which JK was pairing with Jokowi. With the assumed authority of Jokowi as governor in 2012, with no ideological resemblance between JK from GOLKAR and Jokowi from PDIP, KBN elites and JK started approaching each other prior to the 2014 presidential election in order to achieve their personal agendas and seek personal favours such as unravel land ownership issues, guarantee projects in local government schemes, etc. The candidate elected to run the government (as in Jokowi’s exceptional promotion and JK’s second time as vice president), will always bear the burden of serving the elites and political parties (JK from GOLKAR and Jokowi’s coalition parties) that have helped them answer the problem. At the same time, businesses in the SOE and political elites in the parliament who have been ‘planted’ a ‘donation’ to the governor or president in return for ‘share’ will always collect a reward when they make important decisions.

Thus, in such situations, it is not surprising that the policy process was not able to answer the demands of the constituencies. According to Basri (2013), so far Indonesia adheres to a system where no one political party can propose its own candidate for president and vice president unless the potential

winning party, such as PDIP which gained the most votes, embraces other parties in order to nominate their strong candidate. It is a strategy, arguably, for a party as political ruling elite in a democracy to win the tickets of established parties to participate in the competition and aim to win the presidential election; all such manoeuvres of coalition or electoral alliance are legitimate for a greater good. It is, however, important to note that a critical part in the interest group's attempt for the legitimate statute is winning elections.

The media coverage further commented that:

“The election result was supposed to have been forged to support the election of JK to the vice presidency chair. JK had successfully forged electoral alliances with promoters in the Jokowi-JK constituency in Jakarta when KBN facilitated their electoral campaign attended by 37,400 workers from five labour unions⁸¹ (*Rakyat Merdeka*—27th June 2014). The declaration of support from the unions for candidate number two (as opposed to number one, Prabowo-Hatta) was taking place in the KBN yard in Cakung and it was in North Jakarta alone while other districts had far more constituents. In the campaigns, established parties succeeded in co-opting many labour activists who are pure opportunists and sincere ones as volunteers. However, when all attempts to build a network of support from the higher level failed and new laws not in support of the labour were made, good activists turned to their mainstream parties. This was the case with one labour union leader who turned to his labour companions to bring all labour groups and unions under the same roof by establishing an independent labour party opposing the new regime⁸² (*CNN Indonesia*—30th April 2015; *BBC Indonesia*—1st May 2015). The labour revolutionaries on behalf of the underprivileged proved to be impractical ideologues that had no idea how to fight for negotiation (*Rakyat Merdeka*—27th June 2014).

The comments suggest public interest was neglected through political misrepresentation and the government's poor accountability. The debates about SEZ that arose in the KBN as a strategic SOE in SBY's second term, as the clear views of Basri (2013)⁸³ and Daeng (2008)⁸⁴ were more than just an

⁸¹Regional Labour Alliance (ABK) declared itself to join the People's Freedom Alliance (ARM) in order to win the candidates of President and Vice-Presidential, Joko Widodo-Jusuf Kalla. As stated by the ABK coordinator, there are five unions that joined ARM: Indonesian Prosperity Labour Union (SBSI), the National Workers Union (SPN), Indonesian Labour Union Federation (FSBI), Highway Transportation Workers Union (SPTJR), and Graha Sarana Duta Workers Union (SPGSD).

⁸²In the 2014 presidential election, there were two groups who were indeed in an opposing position. The All Indonesian Workers Union Confederation (KSPSI) who supported Jokowi-Jusuf Kalla, while Confederation of Indonesian Labour Union (KSPI) raised their voices to vote Prabowo-Hatta Rajasa (*CNN Indonesia*—30th April 2015).

⁸³See chapter 3 subchapter 2.2.

⁸⁴In chapters 1 to 3

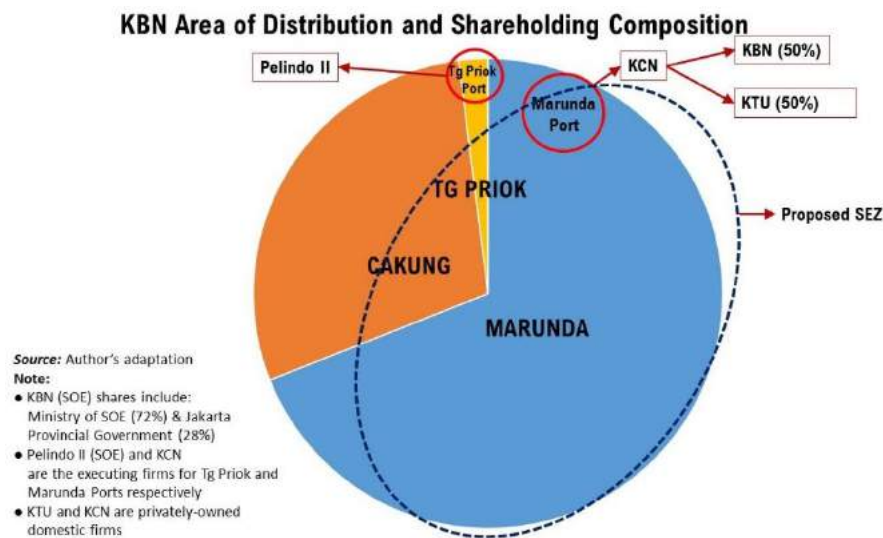
argument over the Jokowi party's covert objectives and JK's embedded societal mobilisation. Problems that occur in this case are not just corrupt political elite, but also the poor political representation. Nevertheless, political representation is not only a hallmark of politics and democracy in Indonesia. Other countries belonging to the category of new democratic states are also experiencing a common problem in terms of political representation. Generally, this problem occurs due to democracy only being understood as a ceremonial event instead of policy participation of the public that reflects the political activities of everyday life.

- **KBN-KTU at Peace—KCN Port Development Continued**

In a market economy, the role of the state is central to negotiating a failed private agreement, public and private interests, etc. (Goldberg 1976 and Williamson 1976). The issues of complicated bargaining process caused higher transaction costs. Thus, state intervention is needed to ensure the contract agreement is completed and enforced as requested by the bargaining parties (Goldberg 1976 and Williamson 1976) as seen in the JPG's effort to intervene in the KBN's company performance to spur local development. KCN port construction in Marunda continued after KBN, KTU, and KCN were set to negotiate and had collectively made a deal over infrastructure development. A peace agreement was signed by the CEO of KBN, Sattar Taba and CEO of KTU, Wardono Asnim in mid-2013 (*Bisnis News*—26th June 2013).

Some important points were built around the agenda of the agreement related to the synergy of two shareholders, the endorsement of changes in capital, and shares carried out by the public accounting firm to report the new composition of share ownership. Another original, more substantive policies as subjects of negotiation during the Extraordinary General Meeting of Shareholders (EGM) in KBN were to prioritise the corporate structure, specifically, the composition of BODs and commissioners. It was officially determined that KBN and KTU ownership shares in the PPP (joint venture) were disseminated respectively by 50% from the previous composition of 85% of KCN and 15% of KBN (See Figure 5.7). Sattar was optimistic that the firms will rise because there will be two major forces cooperating with each other to share in the development of the port (*BUMN magazine*—29th December 2014). “*We have reconciled and agreed at the EGM in the determination of share ownership between KBN and KTU in the port construction of the Karya Citra Nusantara (KCN) port,*” said Sattar in Jakarta, in a press release (*Ibid*).

Figure 5.7



In addition, in the KCN's General Meeting of Shareholders (or AGM), the changes in the firm's articles of association (AD/ART) and corporate structure were scheduled and confirmed. Of four directors in KCN, two directors came from KBN and from KTU respectively. Commissioners also consisted of two from KBN and two from KTU. These new adjustments accelerated once the top executive was passed from SBY-Boediono to Jokowi-JK in October 2014.

Findings suggest, prefigured as an icon of businessmen and politicians, JK took it upon himself to promote the changing face of North Jakarta port to gain more popular support while sustaining his business order in port management with the assistance of the kinship-based SOE, KBN. Only by virtue of JK's electoral victory instead of the coercive method that KBN claimed to represent the public interest.

There was a preliminary doubt concerning JK's capacity to such action, as stated in the publicised editorials, among others, *CNN Indonesia*, *Lensa Berita News*, and *Konfrontasi Daily*:

“Although not immediately after he succeeded Prabowo-Hatta, the news exhibits the trace of his business empire which has long been involved in the seaport management sector; in his first vice presidency duty back in 2009 he intervened in the decision made by SOE Minister, Sofyan Djalil, who is currently Head of National Development Planning Agency (*BAPPENAS*) in the appointment of the CEO of Pelindo II (a state-owned port authority under the Ministry of Transportation). Moreover, the CEO's business partner was the family of JK and a close friend since college while the son in law of the CEO owns almost half the share of the company that belongs to the vice president's family”.

The EGM and AD/ART documents generally stated that both parties—KBN and KTU—would remain to play an important part in the port development and management. This is rather superficial, mainly due to the unclear KBN intention whether they could attract investment while simultaneously lead a state-owned public firm. Consequently, they performed risky programme which caused uncertainty among

shareholders and prospective EPZ investors on the government's real objectives to either maximise shareholder value or procure EPZ investor satisfaction over their (KBN) services. This EGM announcement was perhaps the only plausible official clarification of the policy evolution that the KBN delivered throughout Sattar's leadership.

In a focus group discussion with KBN managers, EPZ firms, and KCN port operators—3rd December 2014

"KBN's managerial experience and KTU's great strategy have equally helped develop the port sector, warehousing sites, and logistics system to attract investors into doing business. The presence of the KCN port in Marunda was intended to help relieve congestion at Tanjung Priok Port managed by PT Pelindo II. As a fellow SOE, KBN and Pelindo II have worked together in improving services to the public. The port in Marunda supports Tanjung Priok Port in domestic shipping for raw materials from upstream industries in other regions in the archipelago and to reduce the vessel dwelling time and cost. KCN performance has continued to rise after KBN and KTU reached an agreement after the ongoing dispute since 2012".

Based on the company website and a media report:

"Despite the policy to build KBN Port as an SEZ not materialising, since the re-operation of KCN Port in Marunda, KCN Port has recorded a significant rise in performance with assets worth up to Rp1,078 trillion in December 2014; whereas, in the previous year, the assets of KCN were only Rp15.3 billion. There is an increase of 3,437% due to the completion of the port construction. KCN recorded a net profit of Rp27.8 billion in 2014, up from the previous year by Rp8.02 billion. The number of ships that docked along the 1,000-metre long port reached 1,200 vessels in 2013. Most of the vessels carried bulk cargo such as grain, wheat, maize, and fertiliser as well as sand, coal, and offshore vessels in cooperation with PT PERTAMINA" (KBN website; *Indonesia Shipping Line*).

Furthermore, the presence of the number of other ports along the northern coast and West Java has increased. The growing number of ports resulted in the significant decrease of port services in Tanjung Priok, especially the volume of dry bulk cargo, liquid bulk and general cargo (*BUMN website 21st April 2015*).

Indonesia Shipping Line journalist observed that:

"The density of Tanjung Priok port had started to decrease since the KCN Port had been in operation. A number of bulk cargos from coal and CPO have been regularly carrying out their loading and unloading in KCN port which has since its establishment declared itself a Tanjung Priok supporter. However, KCN Port today not only serves as a companion but it has become a competitor based on the fact that the cargo owners tend to choose KCN Port over Tanjung Priok Port. It was due to much easier and faster bureaucracy, resulting in swift import and export procedures as well as being congestion free. In terms of transaction cost, KCN Port is able to economise the operational and production costs".

Port management has long been a bone of contention among political and business elites. However, much remains to be seen concerning the provincial government's (JPG) ambition and motives to

deliver port services in the name of public or private interests by maximising value for shareholder's profit to sustain their group's *status quo*. This evidence will be revealed in the next section in a formal feasibility study from an independent consultant in the second formal-informal controversy.

After KBN reconciled the dispute with KCN, JPG was still searching for ways to formulate an SEZ concept and designate Marunda as the centre of economic activity and an international port. An alliance that includes the majority of SEZ port developers tends to exercise political force for establishing policies on port development which allow the supporters to anchor a greater portion of a higher company profit. Independent groups or civil society organisations (CSOs) and IGJ tend to condemn democracy and economic growth more than political parties in influencing policy due to their vague political affiliations.

To sum up, in an event of bureaucratic culture and political investment, in Sattar's case, informal institutions, in general, collide with formal institutions in the SEZ policymaking process and bureaucratic politics. This was evidently the case with Sattar's recruitment to hold the corporate position as CEO in KBN, having much to do with his personal affiliation to KKSS (intricate and well-insulated oligarchs) rather than his meritocratic recruitment. His meritocracy did not lead to organisational effectiveness but his loyalty and patrimonial relations did. Sattar's role shaped the relationship between effective bureaucratic forms of administration and economic goals, but his own distinct agenda setting of decision-making procedures complement the formal institutions (market-based institutions).

This initial conspiracy reveals the ways in which the public sector interacts with the private sector (KBN) and civil society (KKSS) to produce port services. These include issues such as accountability, the government's capacity to manage complex contract relationships and partnerships, financial transparency and in particular, the performance of non-state actors on the merits of port management service delivery arrangements involving KBN and KKSS actors.

In spite of the fact that the intricate relation between business and politics in the KBN case is not a new phenomenon, NIE practically differentiates formal and informal institutions (Williamson 1985: 519; North 1990) where informal institutions or norms of behaviour from the side of KBN along with their political connections with elites under the basis of KKSS influence the formulation and application of the applicable KBN formal rules.

5.6. The Second Formal-Informal Institutional Controversy

Following KBN's intention, the political holiness of a pro-neoliberal capitalist alternative economic model was recreated and the policy restructuring labelled as necessary instead of fundamental adjustments. KBN is an asset that able to contribute to local revenues and spur economic growth in

the surrounding areas, but its utilisation rate in 2013 was below 70%. Higher utilisation can be achieved if the zone's land and buildings are optimally used by investors for industrial activities not only for office administration, but the problem is that KBN management prefers to collect general tenancy rather than to make sufficient use of the lands and buildings in the bonded area for long-term investment.

KBN's financial record shows that between 2009-2014 industrial difficulties increased phenomenally. In an interview on a separate occasion, the policy advisors from Indonesian Chamber of Commerce (KADIN) and the former secretary of the Industrial Estate Association (HKI) explained:

“Many EPZ firms went bankrupt or were relocated to other more cost efficient regions due to: first, the 2008 GFC which led to the decrease in global demands, in particular from the US and European markets (Figure 5.2); second, issues of the leasehold licence rigidity from KBN. The decelerating rate of exports led to the industrial disputes between a labour union and EPZ firms concerning the inability of EPZ firms to pay the labour's minimum wage as decreed by the Minister of Manpower. The wage policy was subject to annual change as needed depending on the inflation rate. The firms were forced to take necessary measures for efficiencies such as labour discharge and upsurge labour outsourcing, whereas the rigidity of land and property lease meant the firms were unable to complete their production unless leasehold renewal had been made in advance. These issues also led to the KBN's undesirable performance of low-income and state revenue. Although there were investors who closed down or reduced the size of the leased property, there were other new EPZ investors/firms as tenants, but the income from the lease was insufficient to cover the maintenance of the KBN site. This was noticeably detrimental to KBN's financial structure considering property maintenance requires high costs. Without KBN revenue, it will only serve as a cost centre”.

While conducting on-site observation, the author witnessed some unexpected events i.e. labour movements on the streets inside the harbour area and its surroundings including KBN on a daily basis. These events have been going on for years prior to the GFC causing acute labour agitation demanding improved welfare and increased wages (outside the Ministry of Manpower North Jakarta office and North Jakarta DPRD office 8th-11th December 2014). The ailing infrastructures of KBN added to the unlikely performance. KBN is generally a quiet place, not many activities beyond the site's periphery; however, unlike Tanjung Priok and Cakung, KBN Marunda was not as the author had expected as there are several abandoned and unoccupied buildings, damaged roads and other inept facilities (general warehouses/storages).

Fragmented Political Power Emanating from Pervasive Coexistence of Informal and Formal Institutions

By 2012, an institutional change among Jakarta elites just started—that their previous political moves were not efficient and needed a change in the pattern of leadership. However, the pattern was unclear which caused severe ambiguity. Jokowi as governor of PDIP adheres to the traditional PDIP slogan that grassroots society's welfare is the prime concern while capitalists are the class enemies who need to be destroyed; and yet his vice governor at the time, Ahok (a Chinese Indonesian known by his Indonesian name Basuki Tjahaja Purnama) found an excuse for inviting them to the city. The argument that Jokowi-Ahok supposedly shared the same vision arose from the current conditions where they were bound to be contingent on private investors; however, in principle, they were in opposite directions. They consider that they no longer need private investors when they can reach a common vision to mobilise public support into gaining national power. The finding suggests that Jokowi-Ahok was unprepared to admit the importance of private investors in Jakarta's economy. Therefore, rather than they compete with the private sector, the pair ought to search for alternatives of revitalising their responsibilities and ideas for effective cooperation. Principally, they sought to make a situation which accommodates the revolutionary pro-poor party at the core (conforming to SBY's motto) and yet remains pro-industry. This reflects a total absence of ideological certainty (either neoliberalism or nationalism) and political sincerity.

- **The land reclamation episode**

After settling the dispute with KTU, various attempts were raised by KBN to continue the SEZ port project under different schemes, even though very few of these schemes were ever put into action due to a turf war between port management. By 21st August 2013, other schemes had been put in place. KBN under the authority of the Jakarta provincial government (JPG) planned a new project in Marunda by constructing an integrated logistics port to develop an industrial zone in the C4 block through land reclamation. It will cover an area of 600ha or three kilometres on the Marunda coastline to overcome port density. It will serve as an industrial centre, container storage area as well as other industrial facilities.

Operations Manager of KBN Marunda recounted the history of reclamation in North Jakarta area to have a clear picture that the idea of a reclamation on Marunda was not the first in the area:

“Reclamation in Jakarta Bay is not the first time. In the 1980s, PT Harapan Indah reclaimed about 400 meters of Pluit Beach area to build luxury housing Pantai Mutiara. In 1981, PT Pembangunan Jaya Ancol reclaimed north of the Ancol area for recreation and industry. In the 1990s, Kapok mangrove forest was converted to become a luxurious residential area of Pantai Indah Kapuk. While in 1995, reclamation in Jakarta Bay was done again to build an industry of Bonded Zone Area. This is the fourth reclamation plan which reaped

much debate.... some say this reclamation disrupt the Muara Karang power plant system. Only in those days, freedom of expression is not like now. No one dared to speak out loud (He was referring to the days of the new order)".

Editorials from Tempo magazine (2nd September 2014), stated that the estimated investment value for the reclamation project reached Rp10.9 trillion in 2013/14 to optimise the EPZ utilisation and implement the appropriate strategies in order to attract investors. In addition, to anticipate congestion outside the dock, a 5-kilometre bridge was planned to be built from Tanjung Priok port. The bridge will be in cooperation with Pelindo II and Jasamarga (two state-owned road and bridge facilitators under the Ministry of Transportation). KBN has invited Chinese contractors and Singapore consultants to do the job, but on the 1st September 2014, the scheme was cancelled due to reasons unspecified. Some say due to unqualified spatial planning, others say the provincial government had another initiative to build an airport off the coast of Jakarta Bay. In the end, the reclamation of Marunda port did not materialise and instead KBN will develop a new dock for coastal shipping. The dock will have an area of approximately 1,400 square metres with a budget of a Rp1.1 trillion. However, Ahok requested KBN to review the reclamation sketch. Ahok said the reassessment was necessary in order for the port construction project not to be halted due to conflicting projects.

Interesting evidence from the document review on one of the consultants hired to carry out a feasibility study on Marunda Port SEZ revealed that the JPG took upon themselves to be the only institution who carries the role and responsibility as well as the privilege to carry out business dealings with the third-party. Findings indicate that formal institutions in the form of statutes render SEZ project protocols to pose a great risk of offering the JPG some type of control points and opens up opportunities for rent-seeking. The statutes stated that the Marunda SEZ should follow procedures as stated below:

1. Being a part of the government policy in the arrangement of National Harbour System (SPN);
2. Being a part of the Integrated Ports Development Project at Jakarta Bay (JICA);
3. Implementing the Roles and Functions of the local governments according to the Trust it holds: a) Law no. 17/2008 on Shipping [Chapter VII]; b) Law no. 32/2004 on Regional Autonomy; c) Law no. 9/2007 on the Capital City; d) Law no. 39/2009 on Special Economic Zones; e) Law no. 26/2007 on Spatial Planning; f) Presidential Instruction no. 5/2005 on the Empowerment of the National Shipping Industry with emphasis on the implementation of the Cabotage⁸⁵ system; g) Government Regulation (PP) No. 61/2009 on Ports; h) Government Regulation (PP) no. 26/2008 concerning Spatial Planning in Jakarta, Bogor, Depok, Tangerang, and Bekasi areas;
4. Ministry of Transportation has launched the port authority (OP) of Tanjung Priok, which carries out the functions of regulating, controlling and supervising urbane commercial port activities;

⁸⁵"Carriage of cargo between two points within a country by a vessel or vehicle registered in another country" (*Business dictionary website*)

5. OP Tanjung Priok consists of 2 Technical Implementation Units: 1. Port Authority Office (OP), 2. Local port authority (Syahbandar) Office, and 3. Port Operator Unit Office.
6. Development of Marunda Port SEZ if done in an integrated manner will need to have a business entity in the seaport field within the scope of the Jakarta Provincial Government (JPG). This business entity will be integrated with PT (Persero) Pelindo II, as a business entity from the Ministry of Transportation.
7. Cooperation with shipping lines is clearly one of the keys that later cannot be negotiable for the success of the development of this port or Marunda Port SEZ.

Development of Legal Aspects - Scenario 1

Scenario 1: New Port (Marunda Port SEZ)

1. The SEZ will require further legal frameworks: a) the location of the port establishment is determined by the Governor; b) the maritime action of the Governor announced officially that the JPG will build a port for the benefit of the cooperation with all parties; c) The Minister of Transportation establishes the hierarchy and port functions. Approval will be determined by alignment with the National Harbour System;
2. The Governor (or JPG) is the Port Authority (based on Law No. 17/2008 on Shipping) and the Area Administrator (based Law No. 39/2009 on SEZ);
3. As the initiator, all legal authority is filed by and given to the Port Authority, via Tanjung Priok Port Authority;
4. As an initiator, the JPG obtains the 'privileges' in entering into concession cooperation with the Port Authority.

Development of Legal Aspects - Scenario 2

Scenario 2: Development of Marunda Port SEZ (existing)

1. Being part of a Special Port, Marunda has obtained a license issued by the Director General of Sea Transportation;
2. JPG's position as the initiator prepares a master plan which will be submitted and received by the port administrator of Marunda Port (as the representative office of Tanjung Priok Port Authority);
3. As the initiator, the JPG have the 'privileges' in entering into concession cooperation with the Port Authority.

Development of Legal Aspects - Scenario 3

Scenario 3: Development of Marunda Terminal at Tanjung Priok Port (Existing)

1. Being part of Tanjung Priok Port (existing). No need for location approval if the master plan already existed;
2. The position of DKI Provincial Government is the initiator, by preparing this master plan as the material to revised the existing master plan of Tanjung Priok port;
3. As the initiator, the JPG have the 'privileges' in entering into concession cooperation with the Port Authority.

Findings suggest, as can be seen by the three scenarios, the JPG have the 'privileges' in entering into concession cooperation with the Port Authority which means that JPG do have ambition and motives to deliver port services in the name of public or private interests by maximising value for shareholder's profit to sustain their group's *status quo*.

As predicted, from the media coverage which stated that:

“Ahok offered another scheme which was in parallel with the KBN’s aforesaid intention. He controversially announced to carry out land reclamation of seventeen islands off the coast of North Jakarta and proposed to set up an SEZ and airport on one of the islands, named O island at DPRD (city council) on 13th August 2013 (See Figure 5.8). The new project was also set to build utilities i.e. steam power plant and the logistics development to support Tanjung Priok port. The initial plan before the reclamation plan was to build an overpass from Kalibaru Port to Marunda Port at the end of 2014 at a cost estimated at Rp5 trillion” (*Berita Satu*—13th August 2013).

Rather than building an overpass, the provincial government (JPG) managed to instil a belief in the DPRD members and central government that the reclaimed islands will be built at low-cost and will attract profit and investors’ attention.

Figure 5.8



A document analysis revealed that of the seventeen islands, the provincial government will reclaim three islands to be used as an SEZ in North Jakarta owned by PT Pembangunan Jaya and PT Jakarta Propertindo (Jakpro) as Jakarta’s regional-owned enterprises (ROEs) to store logistics-related exports and imports. Detik News also reported that the reclamation of three islands for SEZ on 1500ha of land has been offered in collaboration with PT Pelindo II as its partner (7th April 2016).

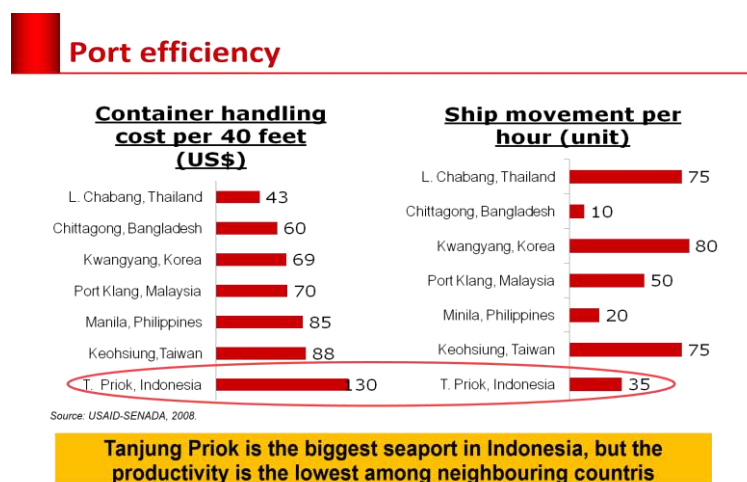
Based on Tempo News coverage (2nd September 2014), nonetheless, further discussion was needed between the provincial government and the Ministry of SOEs as the shareowner of PT Pelindo II to ensure the islands’ ownership portion. Ahok had suggested that if the port authority (Pelindo II) asks for some shares in the SEZ, the provincial government would also ask for shares in the port ownership. The underwater access road in between each island will shorten the logistics transport and develop a

new city on the northern coast. This ‘New Tanjung Priok’ was said to be a huge project with a water depth reaching 20 metres, much deeper than Singapore at only 16 metres. In addition to the three reclaimed islands, some parts around 400ha in front of Marunda coast will be reclaimed and be built as an SEZ. It will serve as a place where people can work with exceptional comfort.

Subsequently, not until 14th August 2014 was an MOU on Marunda dock signed between Jakarta Governor, Jokowi and Director General of Sea Transportation, Ministry of Transportation. This MoU aims to maximise synergy between the central and provincial government in order to improve the city master plan developed in accordance with North Jakarta’s spatial plan, but little did Jokowi know that this event would cause the opening of a ‘can of worms’ related to Jakarta’s northern coastal development project. Vested interests related to the strategic location of North Jakarta has turned public-oriented to profit-oriented as 40% of its territories are used as industrial areas and there are more than 5,000 listed companies domiciled in North Jakarta, which is hard to control (*Ibid*).

The new dock was highly needed by Jakarta, due to Tanjung Priok Port as the biggest seaport in Indonesia having the lowest productivity among neighbouring countries (Figure 5.9). It has exceeded its capacity often resulting in substantial inefficiency of dwelling time⁸⁶, loading and unloading time. The construction of the new dock would reduce the burden of Tanjung Priok port by 30 to 40% and decrease the dwelling time to three days. KBN was appointed as the executor of the 8 to 9-metre-deep dock construction project in the Marunda area in order for the provincial government as the leading shareholder to oversee the project (Indonesian Customs Marunda branch office).

Figure 5.9



⁸⁶To note, the dwelling time at Tanjung Priok Port is currently five days. Meanwhile, as a comparison, in Singapore only takes two days.

After long bureaucratic inefficiency, Ahok's SEZ reclamation proposal was finally made operational without the involvement of KBN. Instead, the project was implemented as a collaboration between PT Jakpro, PT Pelindo II, and other private-owned domestic companies.

Lack of an Ideological Consensus

Based on media coverage and comments from experts, politicians, and academics at the time, the speed and radical nature of Ahok's reforms brought Jakarta praise amongst observers and instilled public interest in SEZ and investment matters, but also evoked resistance among Indonesia's economic elites who felt that their vested interests were increasingly threatened. Ironically, while in the process of writing this thesis, Ahok's reclamation plan was being criticised by the public, within his coalition party PDIP, both inside and outside DPR and DPRD, by technocrats, policymakers, subaltern groups, at public meetings in the sub-districts and towns of Jakarta such as CSOs, the Indonesian Traditional Fishermen Union (*Kesatuan Nelayan Tradisional Indonesia*), and marine activists. There were multiple accusations from a moral disloyalty of the PDIP nationalist (which was not only built by PDIP's founders notably Megawati and her brother Guruh Sukarnoputra but also what Sukarno's principle stood for), the illegal phase of policymaking frameworks, until the emotional outbursts accusing Ahok of selling out Jakarta to capitalists and disregarding the people.

The discussion of each allegation as follows:

First, on assuming power as Jakarta Governor, Ahok must answer some accusations raised within his coalition party PDIP⁸⁷. One PDIP politician said Ahok was not in favour of the 'pro-wong cilik' grassroots society but pro-entrepreneurs. However, the advocates of the reclamation including Jokowi—as president-elect—claim that the project is a step to address the housing needs and land saturations. The new reclamation land will be able to form an engineered-island to prevent flooding, increase coastal area investment, develop an integrated residential area, overcome the problem of road congestion, and increase public space.

Jokowi refused to acknowledge that the new dock construction project was a part of his campaign in realising his vision and mission as president in the maritime sector as had been predetermined since mid-2013. Jokowi stated that the construction is necessary to improve Marunda's management, support national logistics distribution, increase the loading and unloading process, and ease the cost burden. It eventually will forestall the public's negative reaction on the impact of increased price

⁸⁷Due to ideological differences, Ahok's political affiliation had changed three times. After GOLKAR party (2008-2012), he was a member of *Gerindra* party (2012-2014) and coalesced with PDIP when he became governor, and finally decided to break away from any party influences and become an Independent party since September 2014 until present.

towards the overall national economy. The plan for setting up a port facility is to use the Build on Transfer (BOT) investment arrangement (*Ibid*).

As someone who is socially derived from the local capitalist class, Ahok has a primary interest in creating a local governance able to support the capital mobility in Jakarta. However, these efforts collided with and must encounter political realities dominated by local interests who plunder public resources for personal gain. The collision is then the basis of the conflict of interest between Ahok with the old political forces entrenched in Jakarta. Here then the conflict between Ahok versus DPRD is perceived in a way different from the way it is in reality because the displayed representation in a conflict of interest that seemed clear is that Ahok is pro-change and against corrupt MPs in DPRD. But we need to be more observant in seeing the conflict that gave rise to this illusion. Conflicts that arise were not only against the corrupt MPs in DPRD but rather towards Ahok's response upon failing to discipline his own government bureaucracy.

Second, a number of Ahok's controversial policies beg the question of the legality aspect as they were not in-sync with the existing regulations. It was feared that, according to a source, rules governing laws and higher regulations that were allegedly infringed by Ahok to carry out Jakarta development programmes could entail a bad precedent for local governance, especially for the heads of the other regions, that confiscates the power of legislation, MPR (People's Consultative Assembly) decrees, as well as presidential regulations (See Figure 4.7 in the previous chapter).

Based on interview through email with former DPRD member:

"They (the heads of regions and governors) will also search what rules could be violated as was carried out to accelerate development or what they think it's best for the region by ignoring the higher rules. According to the rules, a Head of the region should, of course, be creative by making policies for the region's economic growth. However, in principle, must not violate the rules or norms of laws above it. I admit that Ahok's performance was very good by his creativity, but if the ethics of a leader is unguarded it will be aimless. He was acting as if he was able to change the rules of the game and untouchable by things related to it".

Ahok's pro-capitalist intention was also challenged by allegations of bribery on the part of DPRD regarding the reclamation licence (*Tempo News*—3rd April 2016). The chairman of the *Gerindra* Party faction (Great Indonesia Movement Party) of Jakarta DPRD who refused to discuss the draft (bill) on the Zoning of Coastal Areas and Small Islands (*Raperda* Zoning) states that the spread of bribery allegations had been practised in the regulation plan.

"There are indications regional MPs were bribed. The alleged bribe perpetrator was the developers who received shares to develop one of the reclaimed islands. The money disbursed to the MPs was Rp5 billion".

However, the chairman of the DPRD Regional Legislation denied bribery had taken place in the discussion of the regulation plan. He argued that the issue of bribery was out of place if associated with the reclamation where the reclamation of seventeen islands was explicitly arranged in detail within the *Pantura* (north coast) Bill or *Raperda Pantura*, while the *Raperda Zoning* clearly regulates the designation of 110 islands north of Jakarta. His argument was confirmed by Head of Jakarta Regional Development Planning, that both bills serve as a legal basis of reclamation and are complementary and interrelated. Two such bills enhanced the previous regulation (the Governor Regulation No. 121/2012 concerning Spatial Arrangement on Reclamation).

Third, in spite of growth promises articulated in Ahok's alternative to pro-capitalist development addiction, Jakarta Bay development did not present grounds for optimism due to the reclamation licence issued by the governor having likewise drawn resistance from a number of non-governmental organisations (NGOs). A number of NGOs explained the harm it will cause to the ecosystem of mangrove and seagrass around the reclamation area eliminate the function of mangroves to withstand abrasion and intrusion of sea water and damage the coastal areas' ecosystem. The reclamation allegedly was wrapped with vested interests and only benefitted the investors, oligarchs, and middle-income class, while the environment feasibility study licencing issued by WALHI (an Indonesian environmental non-governmental organisation) was vulnerable to manipulation. The Minister of Maritime and Fisheries (KKP), Susi Pudjiastuti, who was among those opposing the plan, laments the research and development agency (*Balitbang*) study and argues that it could lead to environmental degradation (*Balitbang Study on Jakarta Bay Reclamation Project 2015; Bisnis Keuangan Kompas—16th September 2015*). Moreover, *CNN Indonesia* reported that the fishermen are the biggest victims and the reclamation scheme is said to increase marine environment degradation and ruin the upstream and downstream fisheries industries around Marunda. Consequently, the fishery sector of Jakarta Bay would never realise its full potential to meet the needs of Jakarta's fish consumption and food processing industries (*Ibid*).

The following figure illustrates how the reclamation procedure works in practice which opens up opportunities for informal means to develop, especially such as bribery to overcome the cumbersome bureaucracy as having been practised by Ahok before. There are a number of requirements must be fulfilled and documents to be submitted by the port operator in order to gain a licence. These requirements involve a number of relevant authorities in the process including the Minister, for reclamation in the main and subsidiary ports; The Provincial/Regional Government, for reclamation in the territorial waters of the Regional Feeder Port; and The Regent or Mayor (Bupati/Walikota), for reclamation in the Local Feeding Ports area. The technical requirements, include: the description of the purpose and objectives of the reclamation activities; the location and geographic coordinates of

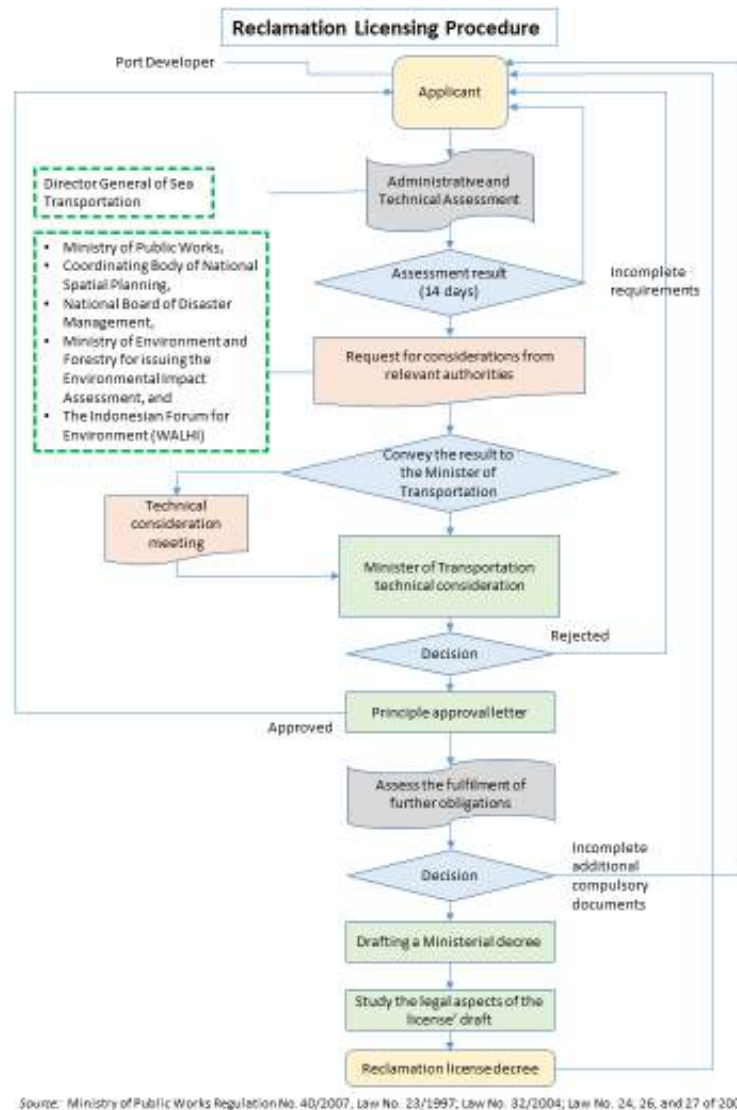
the area to be reclaimed; the initial depth measurement (pre-dredge sounding chart) of the location to be reclaimed; and the results of an environmental impact assessment study or in accordance with applicable regulations. The port operator also needs to submit some kind of assurance through a formal declaration that the reclamation work will be performed by a company that has a business license and has the ability and competence to undertake reclamation. Other documents related to recommendations from a number of authorities to be included in the application process, such as from the local Port Authority (*syahbandar*) to coordinate with the local Navigation District Office on the safety aspect of the voyage after receiving consideration from the Head of the local Navigation District Office; the Port Authority or Port Operator Unit from the local port to be in conformity with the Port Master Plan for reclamation work within the Work Area and the Port Environment Area or from a regent/mayor to be in conformity with the general spatial plan of the district/municipality concerned for reclamation work in the special terminal waters area.

Based on the application, the Director General of Sea Transportation shall conduct research on the requirements of the application for reclamation license within 14 (fourteen) working days from the receipt of the complete application. In the event that the requirements have been fulfilled, the Director-General shall convey the results of the research to the Minister. Based on the research results conducted by the Director-General, the Minister shall within a period of no more 7 (seven) days issue a reclamation license. The formal institutions used as legal bases are among others, Ministry of Transportation Regulation (*Permenhub*) No. 52 of 2011 on Excavation and Reclamation and Government Regulation No 61 of 2009 (PP).

A reclamation licence at the provincial/regional level was issued by the Minister of Transportation to the provincial government via SOEs. The staff of the Governor Team to Development Acceleration (TGUPP) stated that:

“Prior to the issuance, provincial government must undergo phases in which different bureaucratic agencies are involved in the process. The procedure not only involves Ministry of Transportation as the leading executing agency on the reclamation construction but other line ministries and governing bodies such as Ministry of Public Works who authorised the approval to be in accordance with the Spatial Planning Law of sea reclamation, Coordinating Body of National Spatial Planning, National Board of Disaster Management, and Ministry of Environment and Forestry” (see Figure 5.10 to illustrate the real condition)

Figure 5.10



The Politics of Duality

The SEZ port project has brought an inevitable erroneous belief of trying to increase Jakarta’s global competitiveness and economic resilience thus subjecting the fishermen to implicit pressure tactics (*Tempo News*—12th November 2015). Its upstream industry, the Muara Angke fish market is within 27km, whereas the industrial customers in Greater Jakarta are at a mean distance of 35km away.

An interview with IGJ researcher remarked,

“The old SEZ map has changed...The premises of out-dated SEZ sites were transferred to authorised developers to construct port facilities, theme parks, housing properties, roads and bridges etc. The government evicted fishermen’s fishing spots although through many resistance”.

Even so, a source in the DPRD office in an interview conferred that the SEZ project is being touted as the most far-reaching economic reform since Jakarta was led by Ali Sadikin in the 1960s and 70s. As a

former businessman, Ahok was too fearsome to be defied. As long as there is an ideologue like him controlling both sides of the aisle, legislative compromise is out of the question. Even Jokowi never had any objections to every step that Ahok and his ensemble made to secure Jakarta development financing from the private sectors including the SEZ reclamation project. To apply Tsebelis's (2002) argument in Spiller *et al.* (2003)⁸⁸ and Tsebelis (1995) in Henisz (2002) quoted in Hoffmann (2010)⁸⁹ on veto players that individual or collective actors in a political system with different ideology, degree of internal cohesion, and number of actors were forced to agree to the proposed change in order to change policies (Hoffmann 2010: 59),

“These characteristics affect the set of outcomes that can replace the status quo (the ‘win set’ of the status quo). The size of that win set has specific consequences for policymaking: when it is very small, ‘policy stability’ obtains” (Spiller *et al.* 2003: 13).

Jokowi's tacit support was due to Ahok's sincerity on not tolerating any forms of corruption in his governing circle. However, the opposition exposed it was an empty rhetoric⁹⁰. On the contrary, Ahok had apparently praised Jokowi as a slow decision maker as reported in a *Tempo News* exclusive interview with the Vice Governor. However, Ahok argued Jokowi's indecisiveness has a strategy and a reason. “*He believes it's the best way, that is his prerogative and he is entitled to do so. I accept it as his deputy*”. Ahok also assesses Jokowi as not so timely. Jokowi too often went ‘*blusukan*⁹¹’ therefore it was difficult to figure out his time correctly (*Tempo News*—13th January 2014). Jokowi and Ahok created power domination in every aspect through public networks and Jokowi gave Ahok's ensemble a new space to propagate.

Indonesia is seen as a country where business-government-bureaucracy connections are closely related to informal norms and embedded rent-seeking (Jütting *et al.* 2007: 122-3), including legislation under the Ministry of SOE and Ministry of Transportation. For example, a source from PDIP said, ministers who issue a policy for the sake of personal and group gains still persist, but take shelter under the Work Programme of SBY-Jusuf Kalla in 2004-2009 or SBY-Boediono in 2009-2014. According to the source, the politico-business relations of the MPs and cabinet ministers also persist in Jokowi's presidency, which threatens the failure of the *Nawacita* and *Trisakti*⁹² programme (*Interview*—12th November 2014).

⁸⁸See Chapter 2 section 2.4.3.

⁸⁹See Chapter 2 subchapter 2.2.

⁹⁰Rhetorical officials who are full of hypocrisy still entrenched in the provincial government office and DPRD until today.

⁹¹Known since 2012 for Jokowi's impromptu visits to observe field conditions directly prior to gubernatorial election as part of his campaign and prioritise field work rather than sitting in his office.

⁹²*Nawacita* and *Trisakti* are concepts initiated by the coalition parties supporting the present Jokowi government. The concept was created as a basis of performance monitoring and evaluation of the ministers.

These allegations of criminal or corrupt behaviour increase the quite heavy burden of the president to address the issue where they may not result in legal convictions; instead, the cabinet ministers are only censured for their unscrupulous performance and being unable to work in accordance with the *Nawacita* and *Trisakti* platforms (*Merdeka*—29th November 2015). Under the condition of no legal measures such as courts and impartial watchdogs, economic matter in Indonesia or any developing country rests largely on informal rules (Jütting *et al.* 2007: 114). As stated by Azis (2002), “*Rules and regulations may have been well established under the prevailing conditions of a society, but at the same time are rendered ineffective if their acceptance and enforcement are weak*” (*Ibid*: 4).

The last episode of this chapter lies in the action taken by Ahok which he, buoyed by an increasing popularity as an uncompromised governor, ambitiously trying to realise Jakarta’s reform trajectory as a tourism-business-art-culinary-based city to compete globally, especially ahead of the AEC 2015, by bypassing the bureaucratic formalities, which in his opinion was inefficient and costly,—though it is the correct policy procedure—and even placing under compulsion whoever stands in his way.

Theoretically, adopting North (1990, 2005a) and Azis (2009), Ahok used the informal method as a tool to reduce not only transaction cost but the uncertainty caused by bureaucratic inefficiencies through bypassing it for the success of the SEZ project. Moreover, borrowing Hadiz (2005), Ahok’s behaviour resembles the informal characteristics in the NO period where “a capitalist oligarchy able to dominate and, ‘instrumentally’ not just structurally, utilise the power of the state and its institutions along with their coercive strengths for their own benefit. Thus, institutional constraints (by this it means informally) influence Ahok’s behaviour in making decisions by denying the proper formal institution.

JPG’s commitment towards developing Marunda should be supported by all ranks of the local government or institutions to upgrade KBN’s status to an SEZ. However, according to a member of the management board of KBN, for the last ten years, there has been sectoral arrogance and overlapping authority as a result of central government intervention towards the implementation of the policy. It has resulted in bureaucratic inefficiencies contrary to the study by Di Maggio and Powell (1983: 147) who argued that the structure and functions of an organization are measured by its efficiency.

In short, illegitimacy turns out to be a problem for lobbying under an intricate relation of formal and informal institutions. The competition was also seen as a way informal institution serves to redistribute power, status and wealth. The stakes are context-specific which largely depend on the success or failure of each successive president. Their programmes are their political contract and mandate of the coalition parties that serve as indicators of targets to be imposed on each minister. It is the epitome of ‘credible commitment’ as argued by Spiller *et al.* (2003) among alliances of the legal system and access to financial markets. It also involves designing reciprocal actions for relationship safeguarding or

protecting from corrupt bureaucrats (Dick and Mulholland in Aspinall and Klinken 2011: 65). When the state is unable to enforce legislated sanction, Dick and Mulholland further suggest:

“A useful perspective on the state is, therefore, that of a transactional space in which the rules of the political system are constantly being tested and renegotiated. The state may not work in accordance with the constitutional and legislative façade but the informal rules of the game, however, inscrutable to outsiders, help to maintain and enrich the often fractious power elite” (*Ibid*: 65).

This also means monitoring and evaluation, as noted by a senior researcher in the Centre of Reform on Economics (CORE):

"Indonesian presidents in the reform era are viewed as walking among robbers and swimming with sharks. And all this time, mafia was allowed to survive while the presidents were only able to address the issues slowly. The burden for the political affiliations was in terms of ideology and made sure their work programme and strategy were enforced. We understand a lot of ministers who embraced the president's work programme as an argument, but we will be horrified when observing the debt on behalf of the government's programme".

The same can be said to be linked to the performance of the political parties (*Merdeka*—29th November 2015). Despite democratisation allowing political activists to found the party and thus expect they would serve constituents on a certain ideological basis, in the end, it was the interests of the politicians who are served.

A survey on the progress of democratisation in Indonesia presented that 81% of respondents considered that political parties have poor performance in carrying out their duty to grapple important issues concerning the interests of the people (Priyono *et al.* 2007: 68). Not only does the regional parliament (DPRD) pass local ordinances and vote to generally exert some control over appointments to administrative positions, but also Ahok's seemingly pro-people projects and circle of power are vulnerable to money politics and tend to abuse the loyalty of constituents to gain popular support.

Table 5.1

The Marunda Port SEZ Development Chronology until the end of SBY period

Date	Port Development Scheme (Jakarta Provincial Government ambitions)
19 th March 2010	Marunda Port SEZ was proposed
2011	The proposal was approved by the regional parliament (DPRD) and the governor (then Fauzi Bowo) but suspended due to the issues of interests in the central government. Fauzi Bowo was nominated by Democrat Party led by SBY to run another round as governor. Ahead of the gubernatorial election in 2012, there was a conflict of various political interests that led to the postponement of the Marunda SEZ project.
11 th July 2012 and 20 th September 2012	First and the second phase of gubernatorial election
15 th October 2012	Jokowi as Jakarta governor and Ahok as vice governor until 16 th October 2014
5 th December 2012	Jokowi expressed a positive signal to continue the SEZ construction in Marunda as an international port and set to be completed by 2014 KBN awaited the governor's official approval for reclamation.
22 nd February 2013	Still awaited Marunda Port SEZ reclamation licence from the governor and port business licence from Ministry of Transportation
21 st March—4 th April 2013	Internal dispute between corporate shareholders KBN and KTU, SEZ project again under suspension
9 th July 2014	Presidential election
14 th August 2014	MOU on Marunda SEZ was signed between Jakarta Governor and Director General of Sea Transportation, Ministry of Transportation, but little did Jokowi know that this event would lead to the opening of massive can of worms related to Jakarta's northern coastal development project
2 nd September 2014	The Marunda port SEZ plan was cancelled, but other strategic initiatives have been made by the provincial government, a SEZ reclamation programme of 17 Islands off the coast of north Jakarta.
20 th October 2014	Jokowi assumed the presidency, Jusuf Kalla as Vice President, and in November 2014 Ahok became the next Jakarta governor.

Source: Author's adaptation from various sources

5.7. Conclusion

This chapter examines the first thematic series of Williamson's institutional constraints that formal and informal institutions have influenced SEZ policymaking process, This chapter also highlights the daunting array of conflicts of interest among elites and relevant interest groups, their transactions, culture, and dynamics, in particular, the inadequate and often confused allocation of property rights from the state to the market in a democratised governance after decentralisation. However, there is a significant issue on incentive structure represented by the provincial government (bureaucratic world) and the market (business world) represented by public and private-owned domestic enterprises as well as an apparent concern of the state regarding market failure.

Through SEZ policy formulation schemes, findings indicate that informal institutions play an important role in the SEZ policy formulation through the intention of opposing parties and interest groups in SEZ port management and development procedures which vividly contain contrasting ideologies, with some tacit support from the state. Further findings suggest the political measures pursued by the business leaders enhanced by the additional dimension of informal rules that were useful tools for the business and ruling elites to gain control of Jakarta but render ineffective to support SEZ development. It was characterised by central and local political leaders who complement and constrain simultaneously the formal rules that govern the SEZ policy processes as it slowly occurred to business elites and relevant stakeholders to strengthen their *status quo*. In other words, these findings confirm the first hypothesis stated in chapter 1 and the introduction of this chapter.

Through micro-level dynamics, evidence shows that localised political variables can thwart institutional change initiatives, therefore, it argues that the downsizing role of the state between 2009 and 2014 directs to more than an upsurge of increasing dissatisfaction over state-owned enterprises' (SOEs) mishandling of the port management and the reclamation construction episodes. Further evidence indicates that the inclusive informal institutions that were strongly influenced by the prevailing norms of behaviour, nationalist ideologies, and traditional values under political economic complexity that coexist with formal 'rules of the game' have resulted in both durable (in the case of PT KBN or *Kawasan Berikat Nusantara* industrial zone) and fragile (in the case of Jakarta Bay SEZ reclamation project) institutional change in highly distinct contextual bases from one ruler under different political settings to another.

Chapter 6

The Governance Structure and Allocation of Resources: The Political Discretion of Batam Free Trade Zone

6.1. Introduction

The previous chapter succinctly revealed three institutional issues in the first thematic series that surfaced. First, it considered informal institutions to play significant roles in the implementation process of SEZ applicable formal regulations; second, it discovered that informal institutions in SEZ policymaking are critical elements of socio-political significances; third, the degree and method of influence varied at each political setting in the Jakarta SEZ projects.

In the context of institutional change, this chapter elaborates what the experiences of Batam Island development tell us about the SEZ policymaking processes and political economy and continues the investigation on two other institutional determinants in the second thematic series of Williamson's institutional constraint: the influence of governance structure to resource allocation and vice versa. This chapter aims to comprehend how different forms of power are transacted in the structure of governance. The central focus is mainly on the actors and their associating bodies who run the governance system—as a constraint to the enforcement of rules and legal frameworks—as well as the actors who control and enforce the policy process mechanisms (the play of the game). It also focuses on understanding the behavioural aspects of actors who set the allocation of resources to minimise transaction costs.

The analysis is framed by and answers parts of the second and third research questions: 1) how and why do institutions influence the behaviour of actors in SEZ policy decision? 2) Which institutions affect the SEZ policy decision and why? The analysis corresponds to the second hypothesis that *Bounded rationality and opportunistic behaviours emanates when actor's action unable to settle conflicts occurred in the policy process and the problems of principal-agent, moral hazard, and adverse selection in SEZ governance structure at the central government level render contractual relationships to be unclear in SEZ policymaking process at the local government level.*

The Batam FTZ policy formulation determines whether incumbent political and economic elites have designed and exerted the appropriate policies and budget they promised to the constituencies and the citizens at large. Batam's development trajectory has induced scholars⁹³ to examine its political

⁹³See for example, Smith—ANU/Australia 1996; Resosudarmo *et al.* 2002; O'Rourke 2003; Phelps 2004; Anas *et al.*—CSIS 2006; Latt 2007; Burmansyah-IGJ 2008; Kuroiwa—IDE JETRO/Japan 2009; Erb and Sulistiyanto—

economy; however, the literature on the deeper institutional approach has not been observed by the policy directive as well as institutional debates around SEZs in Indonesia. Nevertheless, their insights have enriched the author's views and understanding surrounding Batam FTZ's contemporary debate and the effects of change the institutional arrangements have on decentralised governance and vice versa, more importantly, policy delivery provision. As well as having visited the region in 2008 and 2011, references were gained along with interviews with officials in the database located agencies, collections of national archives and media coverage in Jakarta in parallel with the cases in the preceding chapter. This chapter, therefore, brings this underlying, yet continuous, conflict of interest in the FTZ project into the spotlight.

The chapter argues, first, that Batam FTZ institutional change with the new autonomy laws complemented by resumed industrialisation of and migration to Batam, the strongly controlled and enclaved-based of Batam development was slightly weakened by the two governing bodies of BIDA and Batam city government (Pemkot Batam) with functional overlaps and no single synchronised policy. Second, after the RDO and the above-protracted conflicts, the disputes concerning the executive and legislative bodies after Batam being designated an FTZ is a combination of various obstacles to an efficient and coordinated regulatory approach that have already taken place. Therefore, bounded rationality and opportunistic behaviours of the key policy actors render policy formulation to be unclear in SEZ policymaking process, resulting in increased transaction cost.

The chapter proceeds as follows. The first subchapter highlights the introductory part including the general features of Batam. The second subchapter revisits the FTZ policy development during NO in the pre-regional autonomy era of 1999. The third to fifth subchapters elucidate the governance reform post-regional autonomy policy, which contains three periodizations of FTZ policy formation. This is to understand the contemporary SEZ problems and discusses the argued impacts of regional autonomy on FTZ policy processes based on existing empirical evidence. For instance, regulations application with overlapping regulatory authorities, limited coordination between national and subnational governments, and inconsistent policy interpretation by government officials that led to confusion, delays, slow decision-making processes and, eventually rent-seeking and KKN. The sixth subchapter concludes the chapter.

6.2. Batam Free Trade Zone institutional capacity

When Indonesia had the means—though not the appetite—Batam FTZ was developed to transplant or replicate FTZ elements elsewhere under the auspices of the authoritarian Soeharto administration. FTZ

ISEAS/Singapore 2009; Wong and Ng 2009; Bunnell *et al.* 2011; Choi 2007, 2008 and 2011; Evaquarta 2012; and Damuri *et al.*—CSIS 2015.

and SEZ in Indonesia can be distinguished by their focus on exports; however, the regulations and investment incentives are equally applicable. Unlike SEZs, equipment, materials, and particularly fiscal incentives⁹⁴ within FTZ are exempted without a time limit⁹⁵ until the goods are exported or transported into the Indonesian market or customs territory (Indonesian Customs website; EU-Indonesia Business Network 2015). Further data concerning Batam FTZ's economic indicators and relative performance are presented in Appendix 4. According to the World Trade Organisation (2012), FTZs can be defined as:

“...geographically distinct areas located near seaports and airports, where imported goods may be stored, repacked or processed, free from the imposition of import duties, VAT, sales tax on luxury goods and excise tax. Import and export documentation is simpler than for regular imports....”

Viewed from the aspects of geopolitical and geostrategic advantage, the Indonesian government was not immediately aware of Batam's importance as one of the pillars of the national economy. Today, it is a seemingly thriving manufacturing, industrial and tourism area with several other islands in its vicinity—which have also become part of a special zone development. It was once a sparsely populated island of subsistence farmers and fishermen, but being in a relatively strategic location, the area of Batam developed quite rapidly before being officially chosen as an FTZ after its status as *Entrepôt Particulier*⁹⁶, Bonded Warehouse⁹⁷, Export Processing Zone (EPZ), and Bonded Zone Plus. For the case analysis, instead of EPZ, this chapter is devoted to analysing a similar term, Bonded Zone (BZ), as it was commonly the term used in Batam. Furthermore, Batam as an FDI enclave is considered unique, due to it being a product of a centrally-planned unitary postcolonial state and a hybrid experimental model of industrialisation strategy between Indonesia and Singapore's social order (Phelps 2004; Anas *et al.* 2006). Batam at the time had sufficient room for economic activities such as investment and industrial production consisting primarily of garments and electronics supported by the availability of labour, both from Batam Island and the surrounding islands in Riau and Sumatra. However, the benefit from significant employment absorption was not realised until 1977 when the new 10.5ha of the zone was

⁹⁴Import and export duties, income tax (PPh), value added tax (VAT or PPN), sales tax on luxury goods (PPnBM), and sales tax on imported capital goods (PPBM).

⁹⁵Although the fiscal incentives are without time limits, the FTZ service in Batam based on the law is set for a 70-year lease-time.

⁹⁶An export-orientated production *entrepôts* or EPTes consist of buildings or areas of manufacturing companies with fiscal incentives governed by Minister of Finance Regulation No. 855/1993 (as amended). Goods may be exempted from tariffs and VAT after entering EPTe to be re-exported. EPTes may divert their products up to 25% (by volume) to Indonesian customs territories, where they are subject to normal procedures and customs duties (*Indonesian Customs website* cited 22nd February 2015).

⁹⁷A customs-controlled building, warehouse or other secured area managed by either the state or private firm in which dutiable imported goods may be stored, manipulated, or undergo manufacturing operations for export without payment of duty or until the duty owed is paid for domestic market (*Indonesian Customs website* cited 22nd February 2015).

occupied by four firms and four standard factory buildings (WTO 2012). The GOI (in this case central and regional government) further developed areas for manufacturing industry entirely for exported products initially at Batam Island (in Riau Province) as the first FTZ. By virtue of Batam's potential natural resources, it has attracted many foreign investors mainly from Singapore. It was also Batam's commercial viability and spatial proximity to Singapore for why it was chosen to be an inclusive development rather than just a regional area development. Batam is separated from Singapore by a busy international shipping lane, one of the main international trade routes connecting East Asia, Western America, the Middle East, and Europe. The central government (CG) took advantage of this proximity to develop a labour-intensive manufacturing where Singapore started to lose its competitiveness (OECD 1999). Batam's strategic position in relation to Singapore's 'excessive growth' is one of the main motives the GOI singled out this area for development and Singapore's manufacturing base, where companies can lower manufacturing costs and access the infrastructure facilities; for example, air and sea transport and ports, logistics networks, and international financial centres (Yeoh *et al.* 2004; Wong and Ng 2009).

FTZ was proposed to help promote cross-border trade by reducing obstacles imposed by bureaucratic rules and formalities. Nevertheless, findings suggest that Batam has some selected institutional issues in its development concerning bureaucratic formalities and jurisdictional tension, centrally and locally with the government failing to convert its status to SEZ. Batam's key milestones are recorded in Table 6.1.

Table 6.1

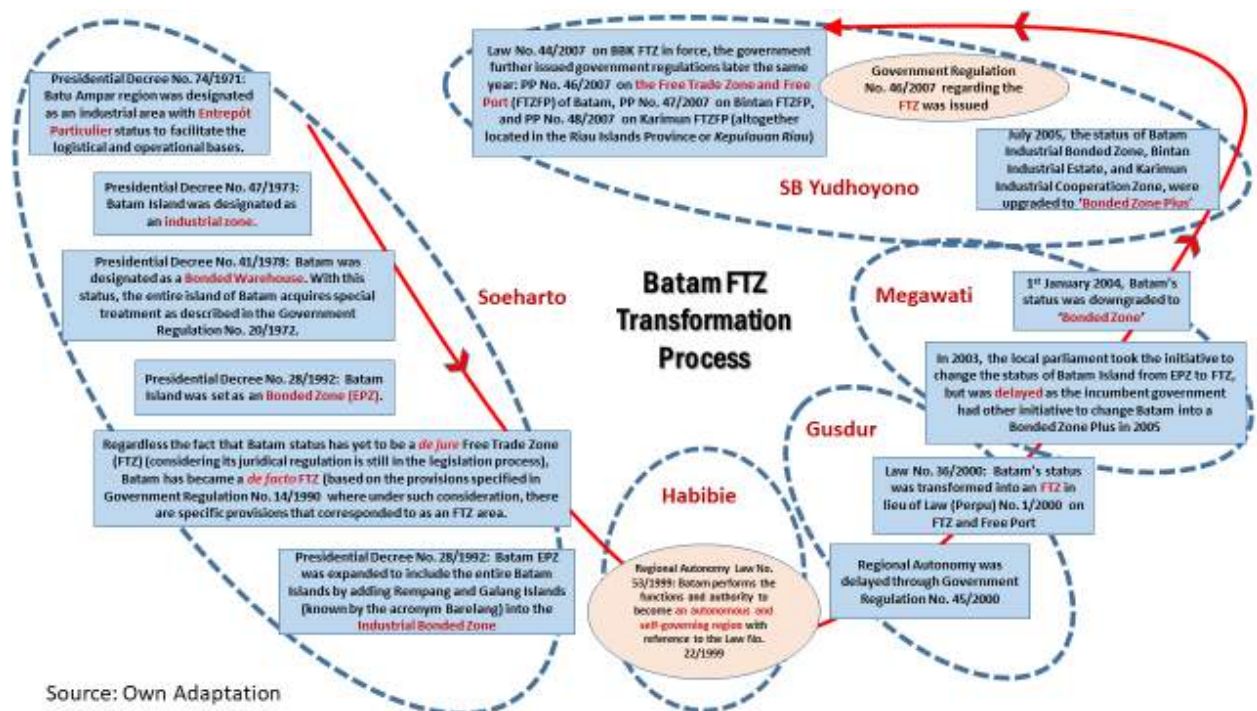
BATAM FTZ Key Milestones

1965	Batam Island to be considered as an important transit point for international trade.
1968	PERTAMINA state-owned oil company began using Batam Island as a logistics and operational base for the offshore natural gas and oil exploration and exploitation.
1970	The Presidential Decree No. 65/1970 was issued to officially designate Batam Island as the above purposes.
Early Development (1969—1978)	
1973	The construction of Batam was entrusted to the government agency called the Batam Industrial Development Authority (BIDA) or known as Batam Authority.
1971-76	The Preparative Period led by Dr. Ibnu Sutowo, an ex-military who served as Minister of Mines, Oil, and Natural Gas in President Soeharto's New Order (NO) emergency cabinet of 1966 and later became the CEO of PERTAMINA.
1976-78	The Consolidation Period led by Professor JB Sumarlin, an economist graduated from University of California, Berkley who served as Minister of State for Administrative Control-Head of Civil Service Orderly Operation (Opstib), concurrently Vice Chairman and Chairman of National Planning Board (Bappenas) in NO era.
The Infrastructure and Investment Development Period (1978—1998)	
1978-98	The period was led by Professor BJ Habibie as the Chairman of Batam Island Industrial Area Development Authority (BIDA). He was the State Minister for Research and Technology and as Chairman of the Agency for the Assessment and Application of Technology (BPPT) at the time
1978-92	Batam as Bonded Warehouse and was redevelop as a Bonded Zone
1989	Growth Triangle (GT) concept was introduced connecting three sub regions as an integrated economic region consists of Singapore, the Malaysian state of Johor, and nearby Indonesian province of Riau Islands (SIJORI) in Indonesia.
1990	The signing of the Framework Agreement on Regional Economic Cooperation on 28 th August 1990 also known as the Regional Economic Cooperation Agreement between the Government of Indonesia (GOI) and Singapore.
1992	Batam was expanded by Presidential Decree No. 28/1992 to include the whole of the Batam Islands by adding Rempang Island and Galang Island (known by the acronym Barelang) to the Industrial Bonded Zone.
1992-96	Batam as Bonded Zone period
1994	Mr Goh Cok Tong proposed to form a Growth Triangle between Singapore, Johor (Malaysia), and Riau (Indonesia). A partnership arrangement was formally constituted in a memorandum of understanding between the three states signed in Johor Bahru (Malaysia) on 17 th December 1994. It was later known as the Indonesia-Malaysia-Singapore Growth Triangle (IMS-GT).
1996-98	Uncertainty period
Government Reform under Polarsed Power Period (1998—2004)	
March-July 1998	The Infrastructure and Advanced Investment Development Period under the leadership of JE Habibie, another ex-military officer and the brother of BJ Habibie who served as the Chairman of Batam Island Industrial Area Development Authority (BIDA).
1998	The GOI revoked Batam's privilege through Government Regulation (PP) No. 39/1998 on the imposition of VAT and Sales Tax on Luxury Goods in Batam.
1999	The GOI enacted the Regional Autonomy Law No. 53/1999, Batam became an autonomous and self-governing region of which performs the functions and authority with reference to the Law No. 22/1999.
2000	The Government Regulation No. 45/2000 was issued and the Central Government subsequently issued the Law No. 36/2000 which was used as reference to the Law No. 37/2000 on the re-establishment of Sabang as a Free Trade Zone and Free Port (FTZFP). The Law No. 36/2000 was used as a legal basis to prepare the Batam, Bintan and Karimun (BBK) FTZ Law by the central and local government of Riau Islands Province.
2003	The Government Regulation No. 63/2003 was issued on the imposition of VAT and Sales Tax on Luxury Goods in Batam and annulled PP No. 39/1998.
Stagnation Period (2004-2007)	
2005	The status of Batam Industrial Bonded Zone, Bintan Industrial Estate, and Karimun Industrial Cooperation Zone were upgraded to 'Bonded Zone Plus' to offer more legal certainty for investors.
2006	On 25 th June 2006 at Turi Beach Resort Batam, President Susilo Bambang Yudhoyono (SBY) and Prime Minister of Singapore Lee Hsien Loong agreed to carry out an economic cooperation by organising and witnessed the signing of a Memorandum of Understanding (MoU) on the establishment of Special Economic Zones (SEZ) in Batam.
2007	The Law No. 25/2007 on Investment was issued in April 2007 The Law No. 44/2007 granted Batam, Bintan and Karimun (BBK) as FTZs for 70 years run by a new supervisory council and each zone by a separate management body.
Volatility Period (2008-onwards)	
2008	The government subsequently established the FTZ National Council based on Presidential Decree No. 30/2008 and the FTZ Zone Council through Presidential Decree No. 9, 10, and 11 Year 2008 for Batam, Bintan, and Karimun respectively. SEZ National Team was formed by Coordinating Minister of Economic Affairs decree No. 33/2008
2009	On 19 th January 2009, SBY officially inaugurated BBK as FTZs and on 17 th November 2009 the Minister of Industry Mr. MS. Hidayat stated that Batam's status which originally was as a Free Trade Zone will be transformed to SEZ in due course. This statement was later shown to correspond with the release of Law No. 39/2009 on Special Economic Zones.

Source: Authors adaptation and compilation from BIFZA, BAPPENAS, Toh and Ng (2009)

6.3. Revisiting Batam FTZ Policy Transformation in the New Order: Looking Back and Taking Stock

Figure 6.1



This subchapter discusses the background episode of Batam FTZ development during the new order (NO) to present a clear understanding of why and how Batam development always been a place of contention between key FTZ policy actors until recent.

Batam's ambitious project began in 1968 in the post-oil crisis when Soeharto undertook neoliberal reforms for the first time and singled out the exploitation of natural resources, in particular, oil and gas (Sari 1998: 4; Burmansyah in Daeng 2008: 216-263). An oil-based state-owned enterprise (SOE), PERTAMINA, used Batam as its base for logistics and operations and hence, it became Batam's source of funding for development. This subsection discusses the structure of governance who runs the system and control the mechanism of development in Batam.

Based on document and literature review on Batam's early development, three key players have been identified who served as economic advisers in Soeharto's highly centralised regime who were closely attached to him and competed for his favouritism in the Batam policy directives. First, the typical technocrats—*“who adopted liberal economic policies and promoted liberalisation of finance, trade and foreign investment while trying to be free from political intervention and from domestic political struggles”* (Inada in Shimomura 2003: 149). Second, nationalists (i.e. an ex-military and senior technologist, Ibnu Sutowo, and young technologist Habibie)—*“stemmed from the desire to transform the economy from one focusing on low-value-added industrial production to a technologically*

advanced industrial economy. To achieve this, the Indonesian government normally pursued strong intervention and trade protection policies in the country's domestic and international economic activities" (Chandra 2008 in Chandra 2011: 3). And third, his cronies or rent-seekers (the Chinese businessmen and kinship ties) that centred in a patronage network and had an influence on the decision making. This kind of patron-client relationship consistently supplemented the competition in the policymaking process.

Based on the identification of key players above, it can be inferred that competition between key players was present in devising a policy to be presented to Soeharto, but Smith (1996) suggests their competition in winning a project endorsement was relatively neutralised by Soeharto as the dominant institution and ultimate power during the 1980s (maybe until 1993) and thus, the political competition was very low and interference virtually non-existent. The policymaking processes were also generally insulated from other non-state actors apart from the cronies.

Other scholars such as McCulloch in Brömmelhörster and Paes 2003 supports other findings by Smith (1996) that there are several essential features which tell us about the political economy of FTZ policymaking during NO. However, it should be noted that Batam's developments were not identical to national developments although they were carried out in parallel. The first feature is the absence of key political economic structures. Instead of infiltrating Indonesian politics during NO, the role of the military was more prominent as an 'economic actor' when Ibnu Sutowo not only led the sole agency for Batam development known as BIDA (Batam Industrial Development Authority) but also led PERTAMINA—the leading SOE for oil exploration. He appeared politically confined and marginal, not merely dealing with Batam's internal security but significant business and investment matters with complete disregard for the presence of Batam city government (*Pemkot* Batam). BIDA served as the central government's professional representative with managers appointed based on their industrial and technical expertise (mostly technocrats), while *Pemkot* Batam as the industrial zone administrative body ideologically served as the government's executive branch.

The second feature, from before the 1970s until after 1993, were the conflicts between technocrats and the nationalists from military-dominant Ibnu Sutowo or technocrats and the technologist-dominant Habibie, or with other cronies in winning Soeharto's policy approval. However, despite basic power structure and balance shifting from technocrats, technologists, and the cronies (families and rent-seekers), the conflicts were less noticeable. The reasons were twofold: 1) Batam and *Kepri* were relatively isolated from the rest of the economy and unlikely to be disruptive as a source of conflict to the whole national policy issues and consideration; 2) There was an absence of established and powerful business and vested interests affected by technocratic policies. This was partly the cause of the less visible conflict between technocrats and the cronies.

The third feature, Batam's location on the Indonesian geographic periphery was more exposed to external pressure and foreign influence than other Indonesian regions. Despite foreign government presence in Batam—i.e. Kuwait which depended on oil refinery throughout Batam's development process, Japan who had influence in Batam's development plan, or the modest influence in knowledge and international practices from the US and European multinationals—, Singapore was the only country who played a major role in influencing Indonesia's policymakers in Batam's development and therefore, other foreign presence may not reflect Batam's true importance (Smith 1996).

Evidence from the features above and the key milestones in table 6.1 suggests, Batam FTZ policymaking, in general, was characterised as having a strong tendency of the NO political economy. Not until 1996—1998 did ambiguity and uncertainty become typical. Elite politics epitomised most of Batam's political economy as in Jakarta. Mainstream research findings were palpable with the features of *intra-elite political rivalries* and patronage networks combined with patrimonialism that persist in the absence of legislative power. The persistence and ascendancy of patrimonial politics suggest that the main features of policymaking were centralised, organised and systemic. Therefore, the concentration of power was very high.

The managers of Batam Authority in Jakarta representative office recounted,

“Those days...the low dispersion of political force and institutional capacity caused governance issues. Unsurprisingly, corruption was ingrained in the power elite. The effective governance still produced no adequate checks or balances, and this transformed into a crisis in 1998”.

In effect, the mechanisms that had once provided a credible commitment to the constituencies and the public disappeared with that breakdown, thereby convincing Indonesian local regions that secession was the only viable alternative as mentioned in chapter 4 during the days of decentralisation or regional autonomy. Further on this issue will be discussed in the next section.

Following years of institutional change marked by the enactment of the decentralisation law, the development of Batam into an FTZ was hampered not only by the *interjurisdictional competition* between BIDA and *Pemkot* Batam but *intra-elite rivalries* between neoliberals/technocrats and nationalists/technologists that have arisen since the establishment of BIDA in 1973. These tensions centred on Ibnu Sutowo who was both BIDA's chairman and technologist. The magnitude of the former conflict was overlooked when *Pemkot* Batam or more precisely the Riau subnational government had not been delegated to represent the CG in overseeing Batam's economic development. BIDA served as the CG's means to maintain power over Batam. This phenomenon is also associated to 'power structure' and 'bargaining power' where actors with more control over power will control the changing

process for the rules to favour their interests (Knight 1992 in Hanisch and Schlüter 1999). More on the issue of power and bargaining process is evident in the later subchapters.

Media coverage by Detik Finance (12th February 2014) reported:

“It was not until 1984 that the centralistic NO power took it upon themselves to provide a theoretical justification to delegate various functions of the autonomous government such as planning and implementation of local development projects to the regional government. Meanwhile, the latter tension stemmed from Ibnu Sutowo’s intention to change Batam into an industrialised region second to Singapore through PERTAMINA’s corporate agenda”.

However, based on Smith’s study (1996: 62-3), PERTAMINA’s activities received criticism from the technocrats in BAPPENAS and other economic ministers, because its plans were not in accordance with the technocrats’ development formula. Confusion arose within Soeharto’s Batam circle of power when the authority of BIDA as an autonomous body and PERTAMINA as an SOE shared the same leader, where PERTAMINA Board of Commissioners and BAPPENAS’s technocrats were the same people.

Moreover, Wong and Ng (2009: 4-5) reveal, the BIDA supremacy over *Pemkot* Batam continued through the leadership of a technocrat, JB Sumarlin (1976—1978) and a young technologist, BJ Habibie (1978—1998). BIDA’s leadership baton was passed to Habibie’s younger brother, an ex-navy captain, JE Habibie from March until July 1998. His short leadership was attributable to his concern over his brother’s KKN (corruption) involvement which could put BJ Habibie in the public spotlight after assuming vice presidency. Moreover, Indonesia was on the verge of economic collapse where the central and regional government including Batam experienced the worst investment climate. Despite the continuous efforts to develop Batam’s lacklustre economic growth, the area’s performance steadily worsened with the onset of the AFC. However, Batam’s importance and status were not diminished despite the fall of the NO regime. In fact, Batam became an icon for the congregation of ASEAN and gained international support for trade and investment to jumpstart the economic recovery after the crisis.

In support of the views above, more recent studies by Albintani *et al.* (2010), Evaquarta (2012), and CSIS (2015) confirmed that:

“Prior to the 1997-8 Asian financial crisis (AFC), Batam’s performance was growing rapidly and this period was also known as the ‘Advanced Infrastructure and Investment Development’ period. Habibie’s successful high-technology platform and infrastructure plans during his foothold as Minister of Research and Technology as well as chairman of BIDA⁹⁸, along with Soeharto’s strong faith in him, led Habibie to become

⁹⁸Notably, the position of Chief Executive of BIDA was filled by former Presidential assistants.

the next Vice President in March 1998. There were three reasons for the appointment: first, Soeharto felt a need to avow more influence on Batam and Indonesian development in general; second, it was an honour to his meritocratic achievements; and third, in many instances he had complete control over developments and as a technologist was largely unaffected by technocratic interference (apart from Berkeley-graduated economists like Radius Prawiro and Ginandjar Kartasmita who had closer politico-business connections with Soeharto and Habibie). Habibie continued to perpetuate strict control over the investment permitted and his involvement lasted twenty years until 1998”.

Habibie’s intentions raised some debates on the merits of challenging the wisdom of conventional development theory, in particular by initially exploiting the existing comparative advantage, namely labour-intensive manufactured goods in developing countries like Indonesia. Batam Island’s major irony is that neoliberal experience so far suggests that trade liberalisation and deregulation simply freed market forces to direct export-oriented industries more along the economic development route of Indonesia’s low-tech and cheap labour. Habibie was adamant to lead Batam and Indonesia, in general, to climb up the high-technology industry ladder by conditioning the regulations with the help of his team and family members. The doubt ascended as to whether there was a preordained role for Indonesia in the international division of labour and whether Habibie would be able to promote Indonesia’s position given that the success of his goals was being hindered by the continuation of selective resources (such as formal institutions, bureaucratic structures, and political representation).

More on the document review that after JE Habibie, the BIDA leadership was entrusted to Ismeth Abdullah, who was the Executing Administrator of Export Support Board—a national body established by the GOI and the World Bank—from October 1989 to July 1998, to provide technical assistance in production, marketing, and expertise to Small and Medium Enterprises (SMEs) for export commodities. He successfully brought the programme to benefit more than 1,000 SMEs. His most important contribution to several associations and Non-Governmental Organisations (NGOs) was to bring some balance to the leadership in the public and private sectors. After his appointment, he placed greater attention on the welfare of Batam residents and the improvement of the investment climate by augmenting Batam’s competitiveness as a prospective regional industrial centre. However, what remains as a controversy was Ismeth’s role as a CG representative in the following territorial game.

The fall of the NO and the implementation of decentralisation or regional autonomy laws have provided new opportunities for local elites such as Ismeth Abdullah to strengthen and consolidate the scope of their influence. For example, the context of a very complex power struggle and social and political restructuring were articulated through the language of ethnic and religious politics (van

Klinken 2007: 579). Finally, in September 2002, in an effort to empower the Malay identity, *Kepri* broke away from Riau mainland and became a separate province which stimulated the inclusion of Batam as part of *Kepri*. However, it took nearly two years to witness formal implementation.

Interview with one of BIFZA (was BIDA, used interchangeably) managers at Jakarta office remarked:

“The rapid development of Batam became one of the factors in the formation of Riau Islands Province (*Kepri*). Establishment of Riau Islands to make some areas of Riau Islands, especially around Batam Island into a grey area associated with the implementation of customs policies. To support and prevent the creation of the grey areas of the government through Law No. 44 of 2007 on the enactment of Government Regulation No. 1 of 2007 on the Amendment of Law No.36 of 2000 on Free Trade Zone and Free Ports into Law stipulates the criteria of specially treated areas. Through the legal basis, the government issued Government Regulation no. 46, 47 and 48 in 2007 that make Batam Island, Bintan and Karimun as free area and free port or in other words Riau Archipelago region specified as an area with the concept of free trade zone”.

After a heated debate and intense lobbying that went on for almost six years, a new province *Kepri* was officially created on 1st July 2004 when Ismeth, the chairman of BIDA, was appointed as acting governor (*Jakarta Post*—21st May 2003).

Further information from the BIFZA managers:

“After his success in creating a conducive business climate in Batam, President Megawati promoted Ismeth Abdullah as the first Acting Governor of Indonesia’s 32nd newly created province of *Kepri* (Riau Archipelago or *Kepulauan Riau*) on 1st July 2004. He developed a striking and grounded idea called “*Building Batam: For the People and With the People*”. This new social development concept provided the opportunity for non-economic sectors to grow, such as decent education, religion, culture, and security sectors”.

According to Smith (1996) and Albintani (2010) on Ismeth’s leadership background:

“Ismeth’s influence was apparent when he was awarded the Social and Cultural Award by the Malay community to indicate that *Kepri*’s social reality had undergone significant progress. His aim was not simply to build Batam’s resilience and steadfastness and prioritise the process of development by improving the welfare of its people but to gain trust from his constituency to maintain his *status quo* ahead of *Pilkada* (regional election) in 2005. Ismeth was selected as the first Governor of *Kepri* as part of his meritocratic achievement and his experience in leading BIDA. Further, he was also elected as a member of BIDA Advisory Board in 2005 by the Coordinating Minister for the Economy (CMEA) on behalf of President Susilo Bambang Yudhoyono (SBY). He became the outsider⁹⁹ who managed to establish his position over Batam’s power circle of *Putra Daerah* (sons of the soil)”.

Despite some countries succeeding in their SEZs under the decentralisation programme not to mention the cultural proximity in chapter 2 that plays a key role in the success of the SEZ platform, such as China

⁹⁹Ismeth Abdullah was not originally from Riau and has no Malay blood, instead he was born in West Java.

(Knoth 2000), compounded by a series of factors, Indonesia failed to reach the desired policy outcome (Bardhan and Mookherjee 1999; Azfar and McGuire 2002). These factors, to employ Williamson's (1996) analysis and Hayek's (1945) assertion, include information asymmetry. The more imperfect the information, the higher the transaction costs issued by economic actors.

A former BIDA representative in Jakarta recounted that

“When I was appointed to serve as the Secretary of the Head of BIDA, the members were ordered to regularly make frequent informal field visits to the villages due to the risk of losing the competition to gain community support from the Batam City government. The Head of BIDA admitted that their methods outperformed BIDA's in many ways as they mostly come from the rural areas”

In view of the above response and Williamson's analysis, the argument put forth is subnational governments in a decentralised regime are considered to have better information and are seen as close to local populations than the CG through their informal arrangements. Hence, Batam subnational governments are better informed to respond to the variations in public demand for goods and services in an FTZ area and tend to disintegrate from the core government control. Behind the façade, Ismeth's hidden action, in Azfar's (2006) term due to asymmetric information engendered a principal-agent, moral hazard, and adverse selection problems which also embodies the fourth layer of Williamson's institutional constraint. However, it is difficult to distinguish which problems are associated with the principal and the agent if the role of each individual is unclear. To illustrate, in the Indonesian case, Pepinsky (2012: 8) argues that the accountability structure in the RDO has shifted from the strict bureaucracy of the NO. Therefore, it is unlikely to identify a specific principal-agent relationship because accountability is a dynamic process that moves either up or down the government level.

Information gathered from the editorials sums up this point:

“He was found to have an early interest in making money. In 2004, during his temporary role in BIDA (2004-2005), he was allegedly involved in a procurement project by deploying the direct appointment of a private company in issuing public tenders for supply contracts which normally requires the procuring authority if the procurement value exceeds a certain threshold. He was accused of directing and ordering his subordinates to enter the project cost into the government's additional budget (ABT or *Anggaran Belanja Tambahan*) as it was not initially budgeted. However, not until the end of his mandate as *Kepri* Governor in August 2010 was he proven guilty and sentenced to two years in prison and a penalty of Rp100 million” (*Tempo and Viva News*—23rd August 2010).

This period accentuated Indonesian rulers who, under compulsion, aimed at minimising transaction costs borne by political transactions through regional autonomy policy. However, it is not the best way to conduct such reform, instead, it caused higher transaction cost and uncertainties despite most common theoretical arguments for decentralisation having justified its presence, for example, in Azfar

et al. (1999: 2), Ostrom *et al.* (1993), and Azis's (2000) term that decentralisation able to improve the efficiency of resource allocation as well as the best mechanism to retain order and reduce uncertainty. The events from the above and the following discussion are summarised in table 6.1 of Batam's key milestones and figure 6.1 of Batam's FTZ transformation. The next subchapter focuses attention on the institutional arrangements to integrate organizations and institutions. The institutional arrangement is the arrangement of relationships between actors governing the way these actors can work together and/or compete in a contract or transaction and the main purpose of the contract is to reduce transaction costs (Williamson, 1985). It is where the findings take place.

6.4. Looking Ahead to the Governance Reform under Polarised Power Period (1998—2004): Get the Formal Rules of the Game (Institutional Environment) Right but Governance Structures (Institutional Arrangement) Wrong

When Habibie¹⁰⁰ became president in the wake of AFC, political economic turbulence hit Indonesia; long-awaited freedom of expression and policy perspectives were the order of the day. Therefore, due to this unexpected event and his short rule, Habibie's policymaking over Batam FTZ development was regarded as inconclusive as he had left his position as the dominant policymaker on the island after being elected as Vice President. However, to probe some of the unexplored implications of Habibie's leadership set forth in chapter 4, this subchapter provides a clear vision of his policymaking style and mechanism and the key actors before turning to Wahid.

In view of the study by Inada in Shimomura (2003: 151), Habibie's period was challenged by the rise of nationalist social movements, who demanded devolution of power from central to local government and gained a firm foothold. Economic policy in general and the neoliberal policy in particular, i.e. Batam FTZ policy, fell into confusion. The first step for economic reform was filling the core economic ministerial posts previously were occupied by politicians and people with different backgrounds who were vulnerable to domestic pressure from interest groups. Habibie appointed some capable economists, Ginandjar Kartasasmita as a senior economic minister and Boediono as Minister of Finance. Old technocrats as economic advisers still existed. Habibie leveraged these men as they played a key role in negotiations with the IMF and had built very good connections with the leading international donor community (Schwarz 2008: 373). However, under the conditions required by the IMF, technocrats lacked the power and influence in domestic policymaking to promote radical economic reforms.

¹⁰⁰More detailed information on technologist versus technocrats concerns in Habibie period, see Amir (2007a, 2007b, and 2008)

Further Shiraishi (2006: 46) study suggests, the technocrats courted the support of other elites due to desperately needing to revive their political and economic effectiveness when the presidential trust was no longer enough. Technocrats were inevitably in touch with other key players—which were diffused into many political parties and interest groups in Indonesia’s political economy—but faced a lot of difficulties coordinating among these actors. However, the elusiveness arose when implementing their policy decisions conflicted with these actors and, in particular, through frequent meetings with leading politicians and various parliamentary commissions, Indonesian Chamber of Commerce (KADIN), influential businessmen and foreign investors’ representatives.

Inada in Shimomura (2003: 152) and Shiraishi (2006: 33) further explored, the technocrats also frequently met with the new generation of academics, leading economists and prominent intellectuals i.e. Sri Mulyani Indrawati, NGOs and the media as well as foreign governments and international agencies in order to gain public support for their proposed reforms. They began to increase their influence in the economic policy design.

According to Aspinall and Fealy (2003: 9), the rising social unrest and demands from local authorities prompted Habibie’s administration to issue a drastic constitutional shift known as ‘big-bang’ decentralisation policy. Law No. 22/1999 on regional autonomy and Law No. 25/1999 on fiscal arrangements between central and local government were issued. Subsequently, Law No. 53/1999 was promulgated, changing Batam from only a sub-district under *Kepri* district to an autonomous and self-governing region with functions and authority from the decentralisation policy (Wong and Ng 2009; Damuri *et al.* 2015). Accordingly, BAPPENAS lost its control over Batam’s development and budgetary power where prior to the regional autonomy policy, Batam had been totally controlled by Jakarta as their special project through the BIDA.

The devolution of authority through regional autonomy led to removing obstacles on Batam FTZ policy decision-making, and public acceptability of policy decisions. Moreover, it facilitated collective action and cooperation when in fact Indonesia had lost all policy cohesion and credibility of its economic policy decisions due to Habibie’s incapacity to provide strong leadership in coordinating the segmented policymakers and to produce coherent economic policies vis-à-vis FTZ policy.

The revival of the withering economic performance was coloured by the intricate institutional settlement that changed course detrimentally towards high levels of political disintegration and economic contestation. Not only intense but contrary to NO, the turf war emerged between political parties. The *inter-factional tension* between the executive and legislative appeared to colour the policy design to gain access to state power. Under low economic growth, patrons were unable to enforce

order over their various factions, especially when the low growth resulted in a low opportunity for payoffs.

This verifies other assumptions made by Knight (1992) and Levi (1988), that power asymmetries among actors are visible with different interests and strengths especially in times of crisis. The actors are the source of and involved in the conflict and responsible for the development of institutions, thus will try to find a solution by harnessing the power that they had by changing the formal regulations and changing the existing 'power structure' while focusing the attention on actor differences in 'bargaining power' (Knight 1992 in Hanisch and Schlüter 1999: 11). Actors who can control the power because they control the information or have political access, capital, etc., will control the changing process so the rules favour their interests (*ibid*).

6.4.1. 1999—2002: The First Series of the Conflicts of Interest, the first growing impact of governance structure towards resource allocation. The changing players of the game

After Habibie was forced to step down by DPR (the parliament) from the presidency, remembered as a time of chaos¹⁰¹, President Wahid continued the agonising and convoluted journey of drafting the rules of the game on Batam with the absolute bypassing and decreasing number of technocrats, except the old ones, and the outright disregard of institutional bulwark BAPPENAS (Shiraishi 2006: 46). One important aspect as an indicator of economic movements was that decentralised economic development turned optimism into pessimism when *inter-factional tension* among political institutions arose. This is what is meant by *ex-ante* expectations again not able to be proved *ex-post* which corresponds to decentralisation that spelt out the conditions for the devolution of political authority and posed problems rather than caused a positive outcome. Therefore, very few of the Batam FTZ policy plans were ever put into action.

On the one hand, the executives under the recommendation of what was left in Wahid's economic team published two important policy and bureaucratic initiatives to encourage Batam investment which contradicts each other in terms of political will. The most interesting example, one that aptly demonstrates Wahid's unstable commitment was the delay of the incentive structures i.e. VAT and Luxury Sales Tax in early 2000. Meanwhile, the other initiative was re-establishing the Law on FTZ No. 1/2000 in order to address the severe deficiency of political will particularly at the legislative level, which typically takes too long to officially pass FTZ formal rules.

When the author came to Batam in 2008 as a part of a team to observe and gather evidence on the inefficiency of customs procedures in the FTZ area, there has been growing concern that Batam's

¹⁰¹The period was known when the cabinet members were constantly dismissed or replaced, or chose to resign and his presidency lasted from October 1999 until his impeachment in July 2001.

stagnant development was due to the ongoing conflicts regarding the status of Batam Island. The conflict was mainly between the DPR and the President (central government) which then intrigued the author to embark on a planned research on the politics of FTZ status in the future. The opportunity to investigate these political dynamics as part of the issues of Batam FTZ policymaking was opened when the author pursued the PhD degree to validate the conflict as one of the preliminary findings.

Based on Detik Finance report (9 June 2005) and further confirmation from former BIDA representative in Jakarta, a comprehensive overview of the *inter-factional tension* in the Batam FTZ government's policy practices and sums up the points made above is explicated as follows:

“After three months, in order to anticipate the unconducive investment climate and frequent policy changes at the time, the central government launched Law No. 36/2000 to ratify Perppu No. 1/2000 as a valid and feasible law when, traditionally, it took a long time to produce FTZ Laws due to the governance gridlocks in the evaluation process and political intervention from the DPR.

One amendment warranted attention in Article 2 of Law No. 36/2000 which was used as a legal basis by the central and local executive branch to prepare FTZ legislations not only for Batam region but also Bintan and Karimun regions. The article states that:

“The borders of Free Trade Zone and Free Port of both lands and waters are defined by the Government Regulation on the Establishment of Free Trade Zones and Free Ports”.

In addition, the provision in Article 3 was also amended as follows:

“The Free Trade Zones and Free Ports as referred to in Article 2, are open to activities in the economic sphere, including to trade, maritime, industry, transportation, banking, tourism, and other sectors as specified in the Government Regulation on the Establishment of Free Trade Zones and Free Ports”.

On the other hand, following the FTZ legislation, on 1st May 2001, the DPR used their legislative power to propose an FTZ Bill to designate Batam as an official FTZ. Lacking trust and confidence, Wahid's administration did not immediately follow-up the initiative. Instead, the bill from the Batam commission in DPR was virtually negated by the central government who endeavoured to extend all of Batam Island to a Bonded Zone Plus in 2005¹⁰².

The outcome was an early gridlock or the phase of the political ambiguity of both executive and legislative power who recommended similar resource allocation that spilt over into the realm of policymaking and again met with a similar problem. The conflict broke out between the two powers (executive and legislative bodies) which manifested the political disharmony over FTZ policy formulation that marked the first *inter-factional tension* (*emphasis added*).

Although FTZ Law was ideologically approved at the 2000 legislative commission, what explains this duality in legislative attitude, one that often delays the legislation process and the other that is too ambitious to propose a bill? Moreover, what explains Wahid's policy confusion and the resultant

¹⁰²“Bonded Zone Plus in which businesses could import duty-free goods into specified bonded zone” (Choi 2011: 53).

gridlock on putting the incentive scheme on hold while undertaking a drastic liberalisation agenda for Batam?

In a separate interview, think tanks such as CSIS and IGJ view this as one of the institutional constraints causing collective action problems.

“It is necessary to recognise that the post-reform era brought significant challenges which are new to Wahid’s team. On one hand, although Wahid had a narrow political and economic base and lacked cohesion in his cabinet, his economic team preferred to be involved in a strategic economic development. The strategies only slightly came to fruition as he frequently disrupted his own cabinet (such as agreeing to frequent cabinet reshuffles). On the other hand, unlike the NO, the legislative body gained its constitutional supremacy to overpower the executive in policymaking. However, they still attempted to maintain old populists of NO that shift from the executive to legislative through mobilisation of alliances with the regional (DPRD) and local (DPD) legislative branch”.

This evidently creates bureaucratic inefficiency (governance structure in Williamson’s third layer of institutional constraint) in which Batam FTZ investment projects including those sponsored by the government, remain stagnant. In addition to the problem, Wahid’s active role in international fora by soliciting support for Indonesia’s territorial integrity and economic recovery through building strong ties with regions other than the West turns a blind eye towards not only Batam but Indonesia’s stagnating economy (see chapter 4 for details).

“The BIDA and *Pemkot* situation after NO barely improved over the next decade. During the period of decentralisation between 2000—2004, major interruptions had occurred in the execution of Batam’s status as an FTZ. After Batam’s transformation into an FTZ (based on Law No. 36/2000 in November 2000) until Megawati assumed office in 2001, the guideline or government regulation (PP) for the employment status of and the relationship between BIDA and *Pemkot* Batam had yet to be ratified. To recall the legitimate position of both agencies, *Pemkot* Batam was established by Law No. 53/1999 and BIDA was established by presidential decree No. 41/1973”.

Interesting to note that according to the hierarchy of Indonesian legislation (See Figure 4.3), a presidential decree is below a law. Therefore, the position of BIDA ought to be lower than *Pemkot* Batam in the bureaucratic function.

However, based on Hutchinson (2015: 107), under the regional autonomy measures, *Pemkot* Batam received additional tributary and land zoning authority in 2001. However, surprisingly, Law No. 53/1999 recognises that *Pemkot* Batam should ‘engage’ with BIDA in Batam development which means

Pemkot's position remained equal to that of BIDA despite being established by a law and the highest authority to oversee Batam after the regional autonomy.

This was one of the obstacles to the development of future Batam, the polarised power that remains today¹⁰³. See figure 6.2 the dualism of power.

Figure 6.2

Conflicts of Power Between BIDA and *Pemkot* Batam

Under Law No. 32/2004 on Regional Government in Article 14 paragraph (1), the authority of the Government of Batam (<i>Pemkot</i> Batam) is the mandatory affairs covering sixteen service deliveries. Based on the review of the scope of the authority, only six of the mandatory affairs have brought the actual problems of dualism of governance and functional overlaps in Batam which can be identified as follows:	
a. Development planning and controlling	Conflict in the development planning and controlling. Due to the Principle Permit for land use or urban design (<i>fatwa planologi</i>) is issued by BIDA while the Building Permit (IMB) is issued by the <i>Pemkot</i> Batam (Batam city government). These conditions resulted in <i>Pemkot</i> Batam can only control the order of the building and has no right to assign the function of land use in the area of Batam. This situation further complicates the synergy between these two separate institutions.
b. Spatial planning, utilization and supervision	Conflict in the spatial/layout planning, utilization, and supervision. As mandated by the Law No. 24/1992 on Spatial Planning, the City Government has an obligation to draft a Spatial Planning in their respective regions. <i>Pemkot</i> Batam has been carrying out its obligations in the preparation of the Spatial Plan (RTRW), but once again they has no authority in controlling the layout in the city area of Batam because it is associated with the authority to grant permission to use land that is still held by the BIDA. These conflicts of authority would interfere with the process and bring very serious impact for the balance of land use in Batam territory in the future which is indeed very limited.
c. Public infrastructure provision	Conflict in the provision of public facilities and infrastructure. The division of authority between <i>Pemkot</i> Batam and BIDA needs to be clearly established and detailed in determining which type of public facilities and infrastructure they are responsible with. This is to ensure the rights of the people who are entitled to such public facilities.
d. Environmental control	Conflict in control of the environment. Due to the regulation that contains investors' obligation to carry out the analysis of the environmental impacts (AMDAL) of planned development is attached to the Principle Permit of the urban design (<i>fatwa planologi</i>) issued by BIDA. Thus, <i>Pemkot</i> Batam has no authority to control the environment. This situation resulted in increasing number of cutting hills and reclamation activities without paying attention to environmental balance due to confusion in the AMDAL control.
e. Land service delivery	Conflict in Service land. One of the problems arising from this conflict is that there are two types of land tax charged to the community in the form of payment of Land and Building Tax (PBB) and Annual Mandatory Money Authority (UWTO). This certainly adds to the cost burden on society or the investor, resulting in increase of investment cost. This situation is one of the reasons for investors not too keen to invest in Batam.
f. Investment administrative service	Conflict in investment administration services. This is related to all investment licensing and levies for industry and other sectors. Currently, BIDA is the sole authority to carry out the services as it become an extension of the central government. That means, the economic impact on a wide range of investments in Batam are not enjoyed by local residents due to the small portion of income tax on investment as <i>Pemkot</i> Batam's rightful share.

Source: Ministry of Public Works 2014 Strategic Issues (<http://www.pu.go.id/isustrategis/view/7>) and Kompasiana online—6th January 2016 cited 25th January 2016

Further investigation on the expected 'engagement' setting through document and literature reviews, the roles and functions of BIDA and *Pemkot* Batam were not clearly stated to anticipate Batam FTZ becoming a Special Economic Zone (SEZ). Therefore, based on an interview with the former Batam Authority official,

“At the time... a guideline to differentiate both roles and responsibilities was highly needed which includes the rule settings and legal platform between BIDA and *Pemkot* Batam. But not until the next administration led by Megawati, was Batam's autonomous position redefined after Megawati's new regional autonomy (decentralisation) law was passed (No. 32/2004)¹⁰⁴.”

¹⁰³By the time of writing this thesis, the present Joko Widodo (Jokowi) administration has instructed to eliminate the dualism of authority to provide legal certainty for investors (*CNN Indonesia*—19th January 2016). Two options were offered whether to merge BIFZA (was BIDA) under one roof with Batam District administration (*Pemkot*) or to dissolve BIFZA and send its employees to join *Pemda*. “... I demand an acceleration on the policy review based on one policy map (in particular thematic maps) to avoid any overlap on possession and use of land and spatial utilization on Batam Region,” said Jokowi in closing his directives at a closed cabinet session (*Indonesia President website*—Press Release 5th January 2016).

¹⁰⁴Further discussion in section 6.3.2

In this phenomenon, Megawati as political institution not only determine policy outcomes but also the allocation of resources, the allocation offers power to the bodies (who have *de facto* power) who have the capability in influencing the CG and DPR as the political institutions (who have *de jure* power) in favour of the bodies' respected interests of being the dominant group through rents.

In support of the finding, the media had reported that:

“Chairman of the local legislative branch of Batam (DPRD) Commission III, repeatedly told the government to immediately issue a guideline to harmonise the relationship between the two contending bodies; not only was the guideline serving as the mandate of Law No. 53/1999 on Batam as an autonomous region, but the tense relationship between BIDA and *Pemkot* would spark further bureaucratic issues in the future” (*Jakarta Post*—23rd July 2005).

The relationship worsened in the 2000—2004 period when there were changes in the political leadership and uneasiness on the division of Batam's jurisdiction (See figure 6.2). This dispute over territorial control manifested *the first interjurisdictional competition of BIDA-Pemkot Batam (emphasis added)*.

Added to the dispute and similar to that of Wahid's administration, Megawati's policymaking style was full of conflict and lacked coordination.

Shiraishi (2006: 46: 1) has identified Megawati's three economic agents who always at loggerheads in drafting a policy, they are: the old and traditional technocrats who lost their influence as they adhered to maintaining state intervention in industrial policy; 2) another breed of economic advisers who became influential in an era of budgetary decentralisation and fiscal austerity; and 3) the younger generation economists and intellectuals (i.e. Boediono) who later joined the economic advisory team and increased their influence in economic policy design. The vital institutional reform for macroeconomic stability was by reforming the Ministry of Finance and appointing Mr Boediono as its minister to take the leading role in the investment policy. However, this form of service delivery not only gestured to the public and investors that the economic agents were divided at the expense of BAPPENAS and long-term national planning but strengthened Megawati's position.

Furthermore, added to the dispute, according to BAPPENAS official and KADIN policy advisor:

“When Megawati ruled, she knew there were unclear property rights going on in Batam which concerns BIDA and *Pemkot* Batam. However, rather than ratifying the guideline to discern the roles and functions of BIDA and *Pemkot* Batam, Megawati, through her economic advisers instigated a Memorandum of Understanding (MOU) to be signed by the two bodies in 2002 with the addition of DPRD Batam. The MOU encouraged them to

join forces in the development activities on the island's infrastructure after negotiating at central government level by local interests".

Despite the implementation of the regional autonomy (decentralisation) and MOU being signed to integrate roles and responsibilities of the interest groups, evidence suggests it also triggered emerging confusion and uncertainty among businesses as demonstrated in the following paragraphs.

First, in a media coverage, businesspersons and associations who strived to produce more to meet demand such as KADIN (Indonesian Chambers of Commerce) and APINDO (*Asosiasi Pengusaha Indonesia* or Indonesian Entrepreneurs Association) were also divided into two power centres, one that adhered to the executive power of *Pemkot* Batam and the other to BIDA's professionalism. The division forced them to collaborate with political elites in a joint negotiation and intervened in the structure of local politics (*Tribun Batam*—30th March 2001). This manifested itself through various policymaking schemes in section 6.3.2 and subchapter 6.4 by the business community's interference in the legitimate electoral procedure.

Second, based on three reliable sources, *Gatra News*—3rd March 2003, van Klinken (2007), and Evaquarta (2012) revealed:

"After the MOU took place, *Pemkot* Batam accrued a substantial amount of PAD (Own-Source Revenue) of more than Rp8.8 billion in 2002 some of which derived from *Perda* (local legislation) on the issuance of over 140 alcoholic beverage licences (first scheme) and Batam's tourism sector (or the second scheme from the amusement and gaming complex) with total disregard of public discontent. Initially, these legislations did not encounter any strong public opposition as the PAD was being used to help build Batam infrastructure and there was no interference or direct supervision from the *Kepri* (Riau Islands) provincial government. Despite the peculiarity of the project considering national regulations forbidding any gaming practices, controversially, the second scheme was legalised and pursued by *Pemkot* Batam with the support of GOLKAR (Functional Group Party) and the PDIP (Indonesian Democratic Party of Struggle) leaders in the DPRD. *Pemkot* Batam's justifications were: to use Batam's 'gateway for international commerce', boost PAD as part of a government policy on KWTE Exclusive Tourism Area (*Kawasan Wisata Terpadu Eksklusif*), enhance Batam's market price in competing with Malaysia and Singapore's popular business-amusement centres, and essentially localise and limit the industry already established on Rempang Island".

Evaquarta (2012: 9) further added that later, the first *Perda* as the first scheme was withdrawn by Minister of Home Affairs arguing that alcoholic beverage was the *Kepri* provincial government's

jurisdiction due to its effects on public health. The second scheme was challenged by various streams from the established clandestine gaming industry to protests from Malay/Moslem communities. These developments accordingly decreased *Pemkot* Batam's tax-based PAD significantly to Rp545 million in 2004. *Pemkot* Batam had to find other sources since their tax-based PAD showed signs of decreasing and they took advantage of regional autonomy provisions to generate more PAD.

The next period narrates the second episodes of conflict between BIDA and *Pemkot* Batam as well as the executive and legislative bodies but under the influence of non-state actors who played a key role in navigating Batam FTZ policy process.

6.4.2. 2003—2004: The Second Series of Conflicts of Interest

This section analyses the conflicts of interest between the Central Government (CG) representing the President and the House of Representatives (DPR/Parliament) to defend the Batam Authority (BIDA or BIFZA) through the implementation of the Free Trade Zone (FTZ). It shows how dominant the influence of actors or any groups in the conflict. Institutional reform became unimportant to the two political institutions as a reference in carrying out the ongoing principles of reformation, either economic, political or legal reform. How the conflict took place can be observed and started through the establishment of the Batam FTZ.

The study starts with the focus on the alarming rate of smuggling (Indonesian Customs database) which during this period has disrupted the national economy. The smuggling events based on the information gathered from former Indonesian Customs official triggered the old technocrats into influencing Megawati's administration to seek strong government intervention with a series of institutional changes in Batam.

In view of this contingency, further detail from the former Customs official recounted:

“There were multiple even in parallel meetings only to discuss Batam matter with other relevant ministries and agencies. Based on the results of the meetings, there were changes particularly in the status of Batam in early 2004 which was downgraded to ‘Bonded Zone’ and the imposition of the VAT and Luxury Sales Tax (PPnBM)¹⁰⁵. The taxes were imposed only on products sold domestically or shipped to other parts of Indonesia, not those that are exported, which include electronics, alcoholic beverages, cigarettes, and motorised vehicles. It was in part due to encouraging more exports as a national priority and there had been an unprecedented record of uncontrolled goods from and to Batam”.

¹⁰⁵Formerly, the reconsideration of Batam gaining its *de facto* special exemption from VAT and PPnBM was established since 1980s through central government's decision in Jakarta (tax haven period).

As confirmed by the Minister of Industry and Trade and the Central Statistics Agency (BPS) Annual Report (2004-2005), there had been differences in export and import data between Singapore and BPS which there was a strong indication of illegal trade occurred between those periods.

Furthermore, the former Chairman of the Batam Forwarder and Expedition Association of Indonesia (GAFEKSI) as reported in the media noted:

“Batam society had been lenient in allowing the circumstances of import and export leakages to get out of control without being fully aware that the incentives (tax-free haven) given to investors and business sectors were only enjoyed by certain interest groups (corrupt officials colluding with ‘black-list’ businessmen) and not the public. We have never tried to solve and minimise the smuggling problems and let the state and community bear the cost of losing a large number of revenues” (Kompas News—12th January 2004).

To confirm the statement by GAFEKSI Chairman above, based on CSIS study by Anas *et al.* (2006) and Hutchinson (2015) observed:

“The imposition of taxes, the downgrading of Batam, not to mention the high rate of smuggling had a substantial impact on the investment in the electronics sector, which has fallen year-on-year since 2003 with almost half of the firms folding or relocating. Furthermore, the new fiscal policy received mixed reactions, especially from business communities. The policy degraded the business climate in Batam and the surrounding areas. Local business groups felt disadvantaged as it indirectly increased labour wages and production costs”.

Based on the interview with the business association (HKI and KADIN) on separate occasions,

“The acceptance or rejection attitude of the implementing agency will greatly affect the success or failure of the formal regulatory mechanism of the Batam FTZ development. This is very possible because the policies implemented are not the result of formulation that involved local people who know the fundamental issues. But the policy which will be implemented properly is the ‘top-down’ policy. Very unlikely the decision makers realise the fundamental needs, desires, or problems that Batam residents or investors want to solve”.

This evidence suggests the persistent institutional changes in Batam’s status and policy forced the business community to work together with a solid agenda (e.g. public dialogues with the government) to ensure a definite legal base for Batam’s status and their businesses.

According to KADIN policy advisor, in many occasions, they influenced policymakers by rolling back the policy direction from government protectionist measures to a more liberal approach and had to reallocate ‘extra costs’ for possible graft in their budget plans. Evaquarta (2012) also argues that they financed Batam’s political bargaining on DPR as their manifesto in mobilising support and funds. This idea has received strong support from the Riau Islands Regional Government and the people of Batam Island as a whole. Given the enormous support and importance of the bill, DPR immediately put it into the National Legislation Programme (PROLEGNAS) in 2002.

Consequently, based on Anas *et al.* (2006: 5), DPR under intense pressure from the business community proposed an initiative to change the status of Batam Island from a bonded zone to FTZ in 2003, but Megawati's economic team disagreed, thus the plans were delayed. Evaquarta (2012: 10) further states that the major reason was that the CG intended to re-enact the Presidential Decree of 1974 on a bonded warehouse in Batam industrial areas based on the principle of fiscal equality for all regions for the implementation of regional autonomy, and more importantly to circumvent smuggling activities.

Choi (2008) in Erb and Sulistiyanto (2009) and Evaquarta (2012) further argue that despite *Pemkot* and BIDA's support, the on-going power struggle for Batam's status was instead a threat to the success of the bargain. However, with the involvement of influential businessmen and BIDA's 'infiltration' of the structure of *Pemkot* Batam, the battle was progressively resolved by 'harmonising' the power constellation through contributions to and winning the campaign of 2005-6 *Pilkada* (regional election) as the businessmen's grand strategy.

Through gathering information from studies and research on extant literature, in this period more importantly in September 2004, DPR unilaterally agreed on the FTZ bill recommended by inward-looking populist politicians who seemed to have a greater chance of promoting the development of democratisation. Moreover, the increasing power of DPR meant an increased risk of opportunistic pressures from DPD (local representatives in DPR or *Dewan Pimpinan Daerah*) for protectionism and governmental interventionism with the help of their business affiliates granting Batam FTZ status. However, the CG led by Megawati confronted the DPR and refused to ratify. The presidency and bureaucracy were weakened by pluralistic and vague power centres and configurations. Thus, this *executive-legislative dispute* over FTZ policy formulation marked *the first-factional tensions (emphasis added)*. The bill was automatically annulled after three months during the SBY presidency.

- **2004: The First Commission Meeting**

Zaenuddin (2013) and Choi (2007) study argue that the reluctance of President Megawati to sign the FTZ bill the DPR proposed, aggrieved the MPs since their position as public representatives was arbitrarily disregarded by the executive.

It appeared that there was political vengeance in not immediately approving the FTZ bill into a Law even though the structure of the MPs had undergone many changes.

Further, Choi (2007: 2) in her study argues, in the context of the FTZ bill, DPR's version seemed contrary to the bill proposed by the CG. When the CG began discussing the Batam FTZ bill in DPR, the discordant effect surfaced instantly. The status of Batam 'as a whole' FTZ put forward in the DPR version which stated that all the areas, excluding the hinterlands, in Batam, Bintan, and Karimun be developed as

FTZs, contradicted the status as an ‘enclave system’ proposed by the CG, which allows only certain industrial areas free trade status.

Media coverage also reported that the government was determined to make corrections to the idiosyncrasy that had taken place in Batam for years, with the attempt to restore Batam’s strategic position. The government was called to clarify provisions of their FTZ bill at a commission meeting held at DPR. The meeting had a subtle tone of disagreement. As alluded to by the Finance Minister, Boediono, Batam’s current position with its taxes and import duties amenities needed clarification as for its status and definition in the two opposing bills was not synchronised (*Bisnis Indonesia and Media Indonesia editorials—December 2007*).

Based on the document review, DPR’s version intended to convert the entire Batam region into an FTZ and become part of *Pemkot* Batam territorial responsibility in accordance with Law No. 53/1999—as embodied in the regional autonomy policy—and to be implemented gradually through PP (government regulations). The first phase would cover Batam, Rempang, Galang, and Belakang Padang regions.

The CG’s version included issuing a PP that states Batam will be divided into a number of FTZs: the so-called enclaves such as Rempang and Galang and certain zones in Batam region divided into seven FTZ areas (Figure 5.9): Batu Ampar in the district of Batu Ampar, Batam Centre and Kabil in Nongsa, Muka Kuning in Sei Bedug, as well as Sagulung, Tanjung Ugang, and Sekupang in the district of Sekupang. The government accentuated that seaports and airports are assets belonging to the CG.

Further remark from the former BIDA official in an interview as well as other supplementary documents and media reports (Bank Indonesia 2007; *Bisnis Indonesia—22nd August 2007*):

“Despite the differences, the executive and legislative bodies had settled an agreement that an independent management body should be established before Batam FTZ area is chosen in order to accelerate Batam investment development. On the one hand, in the transitional provisions of the bill, the legislature (DPR) requested all the assets and land management within the sovereignty of BIDA be transferred as the property of the new zone management body (a form of resource allocation on property rights). On the other hand, representing the executive, the State Secretary explained that based on one of the provisions in the PP, all the assets and employees of BIDA were to be transferred to the zone management body, except for the assets submitted to *Pemkot* Batam and the land management rights under the authority of BIDA; the authority of *Pemkot* Batam located in Batam FTZ should also be transferred to the zone management body”.

Added to the evidence on the dualism of power, a study by Siregar (2013) on the land management rights as mentioned by the sources above noted,

“The main problem is when the issuance of Government Regulation No. 46 of 2007 on FTZ where Batam area was established into an FTZ, it also regulated the transfer land management rights (HPL) (another example of allocation or resource on property rights) to BIDA through a Government Regulation as well as the rights transferred to *Pemkot* Batam, this caused the dualism of authority to be more visible.

In response to this issue, BIDA and *Pemkot* Batam may consult and settle the issue by prioritizing the interest of the community above any interest by making a joint decision agreed by both parties. The object of the land management rights is the rights to extract sea sand, in this case, the reclaimed land, while BIDA and *Pemkot* Batam are the subjects of the land management rights (HPL).

BIDA as HPL holder in Batam Island based on Presidential Decree Number 41/1973 *juncto* Presidential Decree Number 94/1998 while *Pemkot* Batam as HPL Subject based on Government Regulation number 8/1953. Furthermore, Article 67 of the Regulation of the Minister of Agrarian Affairs/Head of the National Land Agency Number 9/1999 also mentioned that one of the subjects of HPL is the government institution including the regional government (*Pemkot*) and the authority bodies (BIDA). Thus the two subjects of this HPL between BIDA and the *Pemkot* Batam can make a joint decision to solve this problem and can manage together the reclaimed land”.

In his work, Hasan (2007: 129-135) in Albintani (2010) explains that prior to the issuance, the law on Free Trade Zone and Free Ports Batam failed to be approved due to the different views between DPR and the Central Government (CG) on the concept of the zone. The seriousness of DPR to totally validate the island of Batam as a Free Trade Zone (not limited to certain areas) and the strength of the CG to maintain the concept of clusters (a part of an economic area) into a law remains a debate.

In terms of tax privileges, the government’s version did not regulate exemption of various types of Non-Tax State Revenue levies (PNBP), while VAT, PPnBM, import duty and excise remained imposed outside the FTZ.

Furthermore, information gathered from various sources from interviews on during DPR’s parliamentary sessions to the minutes of the plenary session revealed,

“On the plenary session held on September 14, 2004, from 18.30 to 21.00 West Indonesia Time (WIB) the agenda of ratification of the proposed (initiative) Bill on 'Free Trade Zone and Free Port of Batam' became a law coloured by a sharp debate. At the hearing, the Minister of Justice and Human Rights (MENKUMHAM) Yusril Ihza Mahendra, objected to the views of each faction in the House. This was due to no common views among each faction. Yusril who represented the CG questioned the DPR’s position on which areas will actually be used as Free Trade Zone. He suspected the DPR’s version could trigger misinterpretations with regard to the vague definition of FTZ. For instance, FTZ should be governed by a different authority based on *Perppu* No. 1/2000 which was finally confirmed by Law No. 36/2000. This law allows a region within Indonesia to establish an

FTZ and enjoy various exemptions, but they will be imposed 'in the customs territory. The faction's answer in the DPR, though agreed to legalize, is different from the argument'.

This reality was what causes 'anger' of the CG at the same time rejects the enforcement of Batam FTZ into a law (*Bisnis Indonesia*—16th August 2007).

Extant literature noted that the Minister of Trade and Industry was more stringent than DPR's definition was not applicable at the time and some of the elements in their version would be difficult to implement. If imposed, the provisions of the bill would lead to 'jealousy' between regions. Despite DPR having the right to approve major economic policies including FTZ bills, no single party has overall power in it. Therefore, DPR's version was not strong enough to persuade the government which prompted the Minister of Trade and Industry to explain the circumstance to DPR:

First, an area for FTZ should be demarcated because of the development of Batam now deviates from the initial thoughts [as an industrial area] ...Batam is now home to around 500,000 inhabitants and the industrial activity is only part of the region's activities. If the bill was enforced, other areas would ask for the same incentive treatment (*Bisnis Indonesia*—22nd August 2007).

Second, given the widespread smuggling activities coupled with a weak control mechanism, the law could not guarantee that smuggling would not occur; due to the huge price disparity between FTZ and its periphery region, the exposed tax-free based area would be flooded with cheap imported goods.

Despite the condition has been slightly dealt with through various joint ministerial-level security measures, smuggled goods by the residents are still ongoing and entering the FTZ then transported to other areas within Kepri province and other areas in the Indonesian territory that do not fit the category of an FTZ (*Ibid*).

Therefore, the CG emphasised that their position was clear, that the establishment of FTZ was only intended for the industrial area to spur national exports and, therefore, required legal protection for their activities. Natallis-Bank Indonesia (2010), Susanto (2009), and Burmansyah (2008) argue, the CG claimed that it was imperative to transform Batam into an FTZ as it already applied the rules and regulations as *de facto* FTZ characterized by a variety of fiscal incentives (tax incentives i.e. VAT and PPnBM exemption)—gradually abolished for certain commodities.

In October 2004, prior to Megawati's end of term, her administration launched Law No. 32/2004 as an amendment to Law No. 22/1999 on Regional Autonomy which reinstated the CG's withdrawal from superseding local policy structure (as opposed to technocratic arbitrary intervention in policy or legal drafting in NO due to the absence of established and more powerful vested interests).

Evidence from the conflict between CG and DPR suggests that based on Law No. 10/2004 on 'The Establishment of Legislation and Procedure of DPR, does not clarify the deadlock position, i.e. the DPR and the CG do not reach mutual agreement in the First Level Talks and Second Level Talks (See figure 4.7 of chapter 4). Finally, DPR runs with confidence, thus continuing to enact the Batam FTZ Law in the Second Level Talks. Meanwhile, the CG did the same which did not enforce the law passed in the State Gazette.

- **Budget Allocation as the second *interjurisdictional competition***

Ahead of the 2004 presidential election, due to the withdrawal of the CG's authority, the sensitivity of local budget (APBD) as a political commodity¹⁰⁶ triggered more intense involvement—compared with the previous regional autonomy policy—of the local executive and legislative bodies (*Pemkot* and DPRD) in the APBD formulation process. For the purpose of building power, APBD has been an open space for debate and seized by Batam authorities as well as bartered between the ruling elites.

A study by Evaquarta (2012: 8) noted, in order to participate in future projects, interest groups must follow 'the rules of the game'. Profiting and manipulating funds from APBD, BIDA and *Pemkot* Batam—who have the power to generate tax and manage local development—increasingly intensified competition and authoritatively promoted their important project plans according to their interests.

This dispute over projects and budget allocation marked *the second interjurisdictional competition of BIDA-Pemkot Batam (emphasis added)*.

Finding suggests, Megawati was widely regarded for her pragmatic leadership and yet seriously criticised for her policy indecisiveness when she was depending on economic advisers to overcome issues of Batam's budgetary autonomy arrangement. In hindsight, she was seen to be fully submissive to the PDIP party, as a *pro-wong cilik* (lower class society). Through her economic team's initiatives to attract investments, she managed to be appreciated despite clearly expressing their emphasis in generating instant funding through tax, loan, and privatisation on several occasions (see chapter 4).

6.5. Stagnation Period (2004—2007)

Learning from past mistakes, the SBY administration was cautious to fully rely on his economic team to determine economic policy. During the fuel crisis in 2003-2005, SBY had complete confidence in and appointed ex-reformist Sri Mulyani, the Chief of BAPPENAS and Boediono as his key players in prioritising macroeconomic stability. SBY's first term manifested by avowing his power from the

¹⁰⁶Currently (until 2016), the unstable combination between energy and politics remains, as energy has been one of the most volatile political commodities. Based on the analysis of this chapter, other political commodities significant to the study are land or territorial limit and budget.

domination of Vice President, Jusuf Kalla (JK) and Economic Coordinating Minister, Aburizal Bakrie, in economic policymaking. Both of which are influential GOLKAR leaders.

A study review by Shiraishi (2006: 48) suggested, once GOLKAR found itself as the sidekick of the ruling party Democrat in 2004, there was an explicit sentiment within GOLKAR, as well as Democrat, that this would not last.

Appear out of the crisis, many Democrat leaders embraced a profound scepticism of GOLKAR and thought that it will be very long before the GOLKAR dominated the government. This conviction strengthened after JK's influential role was revealed (see the previous chapter as it relates to JK's political aspiration) and remained. Based on an interview with a former and retired MP of GOLKAR faction supported by Shiraishi (2006), three factors sum up this point:

- 1) His control over GOLKAR as the dominant government coalition in DPR. He openly and deliberately persuaded SBY to fill the cabinet with GOLKAR people involving some of the nation's most promising political and corporate figures, i.e. Mr. Aburizal Bakrie, known to be one of Indonesia's business tycoons who was also appointed as Coordinating Minister for People's Welfare in SBY's cabinet reshuffle and Mr. Paskah Suzetta, known to have a construction business to be appointed as State Minister for Planning;
- 2) He has the mandate as directly elected vice president by coalition parties; and
- 3) He has a political contract to team up with SBY in winning the election. By interfering with the empowerment of BAPPENAS, JK recommended Mr Suzetta as BAPPENAS Chief after Sri Mulyani in 2004-2009 clearly shows technocracy was no longer shielded from 'political interest'. It was also evident, where JK was partly responsible for persuading SBY to further realise the SEZ plan in 2006 and immediately endorse the status of Batam, Bintan and Karimun regions as FTZs in 2007 (as elaborated later in this subchapter).

Furthermore, following democratisation, economic agents' influence on politics and bureaucracy had grown. Under such pressure and bound by political feasibility, SBY's reforms had to succumb to vested interests. It was an act that remained at disagreements due to peculiar tension between SBY and JK. The channels of the bureaucracy of both sides were mindful of not go beyond the acceptable political function but caused unclear policy directions concerning Batam's FTZ development or other policies. However, these policy directives as illustrated in the following paragraphs show signs of political tactics by accommodating the goals of the Democrat-GOLKAR coalition party to enhance their neoliberal stance to promote investment disregard the public interest.

During the first year of SBY in office in 2004–2005, the investment climate was unattractive (see figure 4.9) with closures and relocations of factories in the manufacturing sector as a consequence of the imposition of VAT and PPNBM and bureaucratic uncertainty ahead of the 2003 gubernatorial election (*Pilkada* in *Kepri* Province). *Pemkot* Batam and DPRD patronage network was significantly disrupted by the *Pilkada* following the defeat of the PDIP-backed former *Pemkot* Batam Mayor, Nyat Kadir and the victory of the GOLKAR-backed pro-BIDA group, Ismeth Abdullah as the *Kepri* Province Governor (Choi 2007; Evaquarta 2012). The networking establishment was short-lived. Furthermore, there was a change in the political constellation of local governance post-*Pilkada* in 2005–6 which ensured the abandonment of some projects including the KWTE project. From April 2005 to June 2006, Mustofa Widjaya¹⁰⁷ replaced Ismeth Abdullah as acting Chairman of BIDA and through a Presidential Decree of 2006; he was appointed BIDA definitive chairman (*Ibid*).

This unexpected institutional change was the culmination of a power struggle beginning in 2001 between *Pemkot* and BIDA with the addition of DPRD and it was regarded as the business elites' first success in their harmonising agenda. The second success of the business community's scheme was the victory of one of the BIDA's deputies and a Democrat Party politician, Ahmad Dahlan, as the next mayor of *Pemkot* Batam in the 2006 mayoral election which underscored BIDA's consolidation with the incumbent regime (Evaquarta 2012: 11). The business groups finally had accomplished the goal of better business consideration after BIDA had been transferring their staff gradually to *Pemkot* Batam's structure, which led to a more harmonious relationship. The new pro-BIDA and pro-central government leadership of *Kepri* provincial government and *Pemkot* Batam, embracing the neoliberal paradigm as its new ideology, subsequently decided to take the region in hand and redevelop it as a free trade zone (Yeung 2000; *Kompas News*—10th June 2005). As these local politicians and businessmen in their respective areas constantly enjoyed virtually unimpeded power due to the businessmen's influential role as patrons to mobilise support for the democratic election purposes, therefore the ruling Democrat party had no alternative to avoid them.

The diverse factional (legislative versus executive) and ideological (neoliberal and nationalism) pressures within interest groups, quite predictably, spilt over into the realm of SEZ policymaking. SBY was in a dilemmatic position between balancing his pro-growth initiatives to attract investment and to address the public criticism over his new investment policy.

Therefore, his first step was to restore Batam's status to 'Bonded Zone Plus' in July 2005 (*Economist Intelligence Unit*—2008; Wong and Ng 2009). The government offered investors more legal certainty, including enhanced incentives to investors, less bureaucracy, streamlined customs inspection

¹⁰⁷He was a technologist since 1979 and ex-BIDA Director of Planning from 1989 to 1992.

procedures and exemptions for import duties, VAT waivers for raw materials, and exemptions from retroactive taxation (*Jakarta Post editorials—June 2005*).

However, in an interview with former MP of GOLKAR faction decried,

“This policy was being politicised, and not too convincingly, as the central government acknowledged their interference and kept a stronghold on Batam’s future development by placing ‘their men’ in Batam’s strategic position and discreetly proposed a new national investment scheme”.

For instance, Finance Minister’s affirmed Batam’s status as a ‘Bonded Zone Plus’ during Mustofa Widjaya’s temporary leadership in BIDA. The status was followed by the issuance of various reform packages signed by SBY to improve the island as well as the overall national investment climate through a Presidential Instruction of 2006. SBY proposed to ease bureaucracy, which boded well for growth. However, the packages which aimed at customs bureaucratic formalities to be simplified, facilitating more raw material imports and export goods movement between zones, tax reduction, etc. (*Economist Intelligence Unit—2008; Wong and Ng 2009*) were also followed by the government’s schedule for submitting the forthcoming investment bill to DPR.

In a further development, on 25th June 2006 at Turi Beach Resort Batam, President SBY and Singapore Prime Minister (PM), Lee Hsien Loong, agreed on economic cooperation by organising the establishment of SEZs in Batam and the signing of an MoU by the Coordinating Minister for Economic Affairs, Mr. Boediono and Singapore’s Trade and Industry Minister, Lim Hng Kiang (Bako 2009; Pahlawan *et al.* 2009; Arafat 2010; Maramis 2014). Clearly, both parties were committed to making Batam a profitable centre of dynamic growth. The scope of cooperation between the two parties ensured the successful development of capital investment, finance and banking, taxation, customs, immigration, labour and capacity building. The SEZ was based on the development principles of an effective, clear, and reliable institutional and policy framework. It would simplify the investment procedures, provide adequate infrastructure, and offer a well-organised administrative management toward building an effective and efficient economic zone (Ministry of Foreign Affairs and Coordinating Ministry of Economic Affairs 2010 and 2014 database). However, Singapore’s dominant position as a rising high-tech industry country led some scholars to believe that Singapore was able to convince and subsequently put pressure on the GOI regarding the inevitability of the neoliberal policies with Singapore formally collaborating with Indonesia to develop Batam into a major SEZ capable of attracting foreign investors from Japan and other major industrialised countries (Phelps 2004; Latt 2007; Burmansyah 2008; Wulandari 2012).

This form of external pressure originated from Singapore’s Prime Minister, Lee Hsien Loong who once observed Batam as a place of high economic value, for both Indonesia and Singapore. The pattern of

cooperation applied in Indonesia was based on the successful SEZ development in China who also invited Singapore. Lee's rhetorical justification that Singapore has proven to be more knowledgeable in providing feedback and contributing ideas in a number of SEZs in China, Vietnam and India induced Indonesian policymakers to accept the SEZ model. The key policy actors also withdrew some of their former radical nationalist attitudes alongside private investment to comply with Singapore's terms and conditions of how to develop SEZs.

"We are close to the investors. We know what they need. We know the existing problems, and we will communicate this so that Indonesia's investment climate can be friendly to investors" (BIFZA online news—26th June 2006; Burmansyah-IGJ 2008).

The GOI at the time was intensely ambitious to prepare an SEZ, not as a shortcut for boosting investment, creating employment, increasing exports, earning foreign exchange, and improving competitiveness; the issue, in fact, had circulated since early 2006 when the Vice President, Jusuf Kalla (JK) visited Bojonegoro in the province of Banten and considered Bojonegoro as potentially an integrated industrial park to be developed as a highly competitive SEZ (*Ibid*).

In 2006, in an attempt to further realise the SEZ plan and address investors' concerns, the GOI had attempted to deal with confusion and overlaps of responsibilities between BIDA and *Pemkot* Batam through an MOU signed by both authorities who stipulated that *Pemkot* Batam would take charge of social issues and welfare, and BIDA would retain authority for investment coordination. However, this did not result in an appreciable difference (Choi 2011; Hutchinson 2015). Overlapping authority in Batam occurs not merely because of the unclear division of authority between BIDA and *Pemkot* Batam, but when referring to the laws on Regional Autonomy Law and Batam as an Autonomous Region, the CG should provide large executive authority to *Pemkot* Batam (City Government) to manage the region. On the one hand, it is realistic if today there are increased pressures that the various authorities held by BIDA be handed over entirely to *Pemkot*. On the other hand, BIDA rejected the requests for the dissolution of the institution or the transfer of a number of its authorities to *Pemkot* due to being the 'agent of change' and consider them more professionally responsible for Batam's development progress as a significant economic zone. These two vested interests were reviewed more closely because of the socio-cultural, political and economic circumstances had undergone many changes due to the FTZ status being implemented. Therefore, it becomes natural if the CG was prompted to carefully resolve the fundamental problems of Batam today.

The economic stagnation or quasi-growth rates experienced by Batam was a compelling reason to encourage SBY administration to immediately conduct a review and policy change in order to address the various problems. SBY was known to be the only Indonesian leader so far who established rules with vigilance. His strategy to balance domestic and foreign interest while preserving the euphoria of

his positive feedback from thriving national and international media and civil society was a clear sign of realising a good governance concept which was highly needed to create a conducive situation to achieve the objectives of FTZ implementation. However, given the situation at ground levels such as the persistent overlaps of authority between BIDA and *Pemkot*, it became considerably dissimilar from the pretence of an encouraging investment climate stemming from the highest authority. FTZ was difficult to implement and potentially caused confusion among investors and, therefore, contributed to the decline in foreign investment.

Although the SBY administration took various measures to eliminate the tension between the two bodies through implementing transparent regulations and good leadership (Wahyuni *et al.* 2010), the institutional structure with regard to their distinct roles and responsibilities had yet to be clearly identified. In addition, these two bodies have also been unsuccessful in efficiently communicating a better rule setting to enhance their cooperation in order to circumvent any confusion and uncertainty.

Furthermore, prior to the GOI's intention to upgrade Batam FTZ to an SEZ and the plan to set up economic corridors under the MP3EI master plan (Master Plan for Acceleration and Expansion of Indonesia's Economic Development) as cited in previous chapters, the SBY government ambitiously enacted two interrelated legislations, the new Investment Law No. 25/2007 and Spatial Planning Law No. 26/2007. The Investment Law was set to connect the deficiencies observed in the previous policies in overcoming the decreasing investment problem (Tambunan 2008, 2013), whereas the Spatial Planning Law replaced the previous law of 1992 and gave authority to local government (provincial, district together with DPD) to draft their own zoning, spatial arrangement, and development plans. These laws were expected to stimulate investors and regain their confidence (Wulandari 2012: 2).

For the second consecutive time in 2007, following the two legislations, SBY passed a Presidential Instruction to further increase the speed of real sector development and the micro, small and medium enterprises empowerment in order to boost national economic growth. It was also expected that based on the instruction, the government would schedule an SEZ bill to be submitted before DPR by November 2007 led by the Trade Minister and Chairman of BKPM (Investment Coordinating Board).

Since then, Bojonegoro has often been seen as Indonesia's selling point to various investment exhibitions in a number of countries. Despite still being in the preparation phase, the Chairman of the SEZ Executive Team in June 2007, on the sidelines of the World Economic Forum, offered the city of Kendal in the province of Central Java, as an automotive SEZ to the CEO of an automotive company, Renault-Nissan Carlos Ghosn. Kendal was also a strong selling point at fairs and investment seminars held by BKPM in South Korea in early August 2007. The offer was important since South Korea is one of the world's biggest automotive manufacturers (*Ibid*).

SEZs are not necessarily areas of new openings but could be the development and refinement of existing ones. According to former Deputy Chairman of the SEZ National Team, SEZs may be formed from new areas such as Bojonegoro or an upgrade of existing ones such as Marunda, but basically, depending on the local government proposal for the readiness and ability of the region until approved by the CG (*Ibid*).

6.5.1. Overstated Neoliberalism

- **Who benefited from Batam FTZ?**

Despite the SEZ bill being scheduled for submission in November 2007 as clearly stated in the Presidential Instruction of 2007, the plan to convert Batam, Bintan, and Karimun (BBK) into an SEZ had yet to materialise after a series of inter-ministerial coordination meetings in Jakarta from August to October 2007 failed to reach a consensus. Meanwhile, SEZ did not seem to be pinned down to the BBK but rather other potential areas in Indonesia. The new issue emerged when the government considered BBK as an FTZ instead of an SEZ (*Kompas*—27th February 2006). The government argued that the designation of Batam into an FTZ stemmed from the contingencies of a stagnating economy due to lack of investment promotion.

Given the articulated issue, the inter-ministerial coordination meeting heated up and the economy minister was split into two camps, the advocates of BBK as FTZ and the advocates of BBK as enclaves (Choi 2007: 2). The pro-enclave was led by the Coordinating Minister for Economy (CMEA) and Finance Minister assisted by the Trade Minister supported by PDIP leader, Megawati. Meanwhile, the opposing camp was guarded by the chairman of the BKPM (Investment Coordinating Board) and Minister of Industry supported by GOLKAR's Jusuf Kalla (JK). The debate ended with victory to BKPM's team. Following the FTZ legislation and advice from JK in a meeting on 28th June 2007, three government draft regulations (RPPs) were formulated as a legal basis for Batam, Bintan, and Karimun (BBK) to be transformed into FTZs (*Kontan*—15th August 2007). Irrespective of political parties, such dialectical oppositions are quite common in Indonesia and modestly expressed.

However, the story that unfolds is individuals as actors are assumed to possess a set of specific traits, including the presence of particular tastes or institutional preferences and the capacity to decide rationally in choosing alternatives to social economic and political choices.

After the victory of BKPM's team, the Secretary of the Indonesian SEZ National Team suggested the FTZ location in BBK will be determined in accordance with the RPPs and the BIDA still functioning as the temporary management body until the legitimate body is set by the Zone Council. Nevertheless, the transition process was not as simple as it might have seemed. The day after Batam was set as an FTZ, *Pemkot* Batam claimed to hold the position as Chairman of the management body. This dispute

over territorial chairmanship marked *the third interjurisdictional competition between BIDA-Pemkot Batam (emphasis added)*.

Despite the dispute, under intense dialogue, lobbying, and various considerations, the draft regulation was finally completed and handed over to the Ministry of Law and Human Rights to be officially legalised into a government regulation (PP). Thus, Batam was officially set as an FTZ for the entire Island plus Rempang and Galang with Bintan and Karimun as enclaves under three PP¹⁰⁸ and BBK FTZ was officially established on 20th August 2007. However, PP was not enough to formalise the legal procedure. It appeared that JK had urged the relevant ministers and local government officials of the SEZ national team to upgrade the legal foundation under a law. JK's advice was either ammunition or pressure to immediately formulate an FTZ bill and any necessary transformation procedures. The FTZ law refers to endorsing *Perppu* No. 1/2007 as FTZ's official and legal framework (*Bisnis Indonesia—Herbawati* 22nd August 2007). Such legal uncertainty contradicts what the businessmen and ground level authority especially *Kepri* government had expected. The behaviour caused issues of transaction cost and productivity levels to be disturbed. According to the interview results, high-level political interference and local interest continue to contradict and cause long delays in legal protection. Therefore, in order to speed up the upgrading process, the GOI at the time was compelled to endorse the previous FTZ law (Law No. 36/2000) rather than design a new FTZ law. Then, SBY signed a new *Perppu* No. 1/2007 to amend the content of Law No. 36/2000¹⁰⁹ (containing the endorsement of *Perppu* No. 1/2000 as an official FTZ Law and legally adopted on 4th June 2007) (*Ibid*). What the evidence above suggests is that, unlike the NO, technocracy was again proven not to be insulated from the pressure of JK's group.

Despite one regulation being formally endorsed in Law No. 36/2000 on FTZ, the changes in the articles of the law did not specifically regulate BBK. Meanwhile, changes to the *Perppu* No. 1/2007 only encompassed three unsubstantial articles. In the first attempt, the government addressed the situation by using the *Perppu* as a legal foundation for BBK as an SEZ instead of FTZ. In the second attempt, the government prepared the SEZ bill where it was expected that the national assembly will legislate the bill into a law on SEZs¹¹⁰ by November 2007, but it failed to materialise (*Bisnis Indonesia and Media Indonesia editorials—December 2007*). It raised questions on the extent to which *Perppu* on FTZ was being endorsed and highlighted the fading analyses and predictions of Batam from various elements of society. Reactions and pressures from the business world, as well as allegations toward

¹⁰⁸By the number 46, 47, and 48

¹⁰⁹Law No. 36/2000 was also used as reference to Law No. 37/2000 on the re-establishment of Sabang (in Aceh province) as an FTZ.

¹¹⁰The aforementioned SEZ bill was initially prepared in anticipation if the *Perppu* No. 1/2000 was not endorsed into a law.

the GOI, emerged. For example, Chairman of APINDO *Kepri* Province shows the unsettling and rampant political culture among the elites at high and ground political levels. He asserted that there were signs of unscrupulous bureaucrats who were trying to push the FTZ issues in the realm of central and local political elites. Further information based on media coverage and interviews pointed that the respondents mostly appeal to the unscrupulous bureaucrats to better promote the interests of the public rather than the groups' private interest.

Despite the passage of *Perppu* No. 1/2007 on general FTZ, both national and subnational government had a number of issues to resolve which prompted the government to prepare its provisions and to design another *Perppu* bill to promote Batam as an FTZ. The *Perppu* bill was scheduled to be proposed to DPR during a commission meeting in mid-August 2007 and further passed into a law, although today the reason for the emergency is still being debated among MPs (*Ibid*).

In a dialogue meeting between BIDA Chairman, Mustofa Widjaya and journalists of four notable national media (*Bisnis Indonesia, Kompas, Media Indonesia, and Antara News Agency* or LKBN) held on 22nd August 2007, the journalists expressed their concerns over potential territorial conflicts with *Pemkot* Batam, the future of BIDA and its assets, infrastructure development, and other rhetorical issues, including the content of the PP No. 46 on Batam FTZ. Mustofa denied any confusion would arise with regard to the fate of BIDA after the enactment of this government regulation, whether dissolved or integrated into a single body known as BIFZA (Batam Industrial Free Zone Authority).

Media coverage has succinctly posted Mustofa's statement that all of the assets and employees will be transferred to BIFZA. In other words, BIDA will not be dissolved but it will only be a name while the organisation has changed (*Bisnis Indonesia, Kompas, Media Indonesia, and Antara News Agency*—23rd August 2007). Mustofa was able to convince the journalists that institutional change was inevitable and BIFZA did not constitute an immediate threat to BIDA. It is from this perspective that Mustofa seemed to firmly defend the legitimate rights of BIDA employees.

The PP No. 46/2007 signed by the President was expected to provide more legal certainty not only for the island of Batam but also for the *Pemkot* Batam and its employees. It raised public debate in the local media keen to proclaim the dissolution of the BIDA and turned out to be a unilateral interpretation. The media, national scandals and acclaimed events involving public figures have divided public opinion and the government and MPs have been colouring Indonesian political economic history over nearly two decades post-*Reformasi*.

In Article 1 of PP No. 46, Batam FTZ service is designed to last 70 years from 20th August 2007. The general provision accompanying this regulation further elaborates on the status of BBK Islands. Not only will Batam become a development centre for technology-intensive industries that can provide

high value-added industrial development¹¹¹ (*Kepri FTZ website cited 15th May 2014*), but also a place for gathering and distributing products to and from the Indonesian regions and overseas (*BKPM official website cited 20th November 2014*). All these changes indicate that the basic motivation for assigning special status to the Batam region has been to accommodate foreign investors' demand for land, access to cheap labour, and an easy export base for natural resources.

Findings suggest that the status of Batam has been a source of controversy among the elites. From the beginning, the legal basis for the area to be built as an FTZ has never been properly discussed. This condition cannot be separated from the initial development plan of this area was not intended as an area for the industrial sector. Therefore, instead of establishing a law as the legal basis, Batam development was supported only under a presidential decree, ministerial decree, or local government regulations (See figure 4.3 of formal legislation). It caused problems when the reformation takes place. Moreover, in principle, the legal basis did not pay attention to two dimensions related to social welfare and land entitlement. These two dimensions are not formulated simultaneously and complementarily. Thus, the challenges of Batam Island development to find the perfect pattern or basic model to become an industrial cluster are always in terms of devising an appropriate legal framework followed by the interests of elites or certain groups.

- **2007: The Second Commission Meeting: FTZ Bill Constitutional Inaccuracy**

Nevertheless, another pressing issue escalated when it led to constitutional inaccuracy. Irmady Lubis, a member of DPR Commission VI of PDIP faction states that *"Not because we are of the PDIP as an opposition party, but such methods cannot be justified. The Constitution must be upheld."* The process of formulating an FTZ bill did not show any signs of improvement. The initial draft was first intended to transform Batam. However, the CG's measures undertaken to promote Batam as an FTZ were not without obstacles, MPs had been poised to reject the ratification of Government Regulation In lieu of Law (*Perppu*) No. 1/2007 concerning FTZ, which was signed by SBY (*DPR website—18th February 2007; Kontan—15th August 2007*). This marked *the third inter-factional tension* over inaccurate constitutional procedure between the executive and legislative bodies (*emphasis added*).

In accordance with the policy formulation mechanism, the enforcement of *Perppu* No. 1/2007 on general FTZ and the PP No. 46, 47, and 48 of 2007 on the designation of Batam, Bintan, and Karimun as FTZs respectively was jeopardised for allegedly violating the constitution. To represent the MPs, Irmady deplored the publication of this regulation because it would jeopardise the trust from potential investors due to the government's legal uncertainty on BBK.

¹¹¹Such as telecommunications, electronics and medical equipment, industrial assembly and fabrication, shipbuilding, textiles, oil and energy services, agribusiness, and tourism.

Irmady asserts that there are many ambiguities and violations of the constitutional system in the issuance of the decrees and its derivatives mainly on three counts. First, the publication of PP must be based on a Law, not *Perppu*. “How can the president endorse a legal product such as PP while the base legislation (*Perppu*) has yet to become a law? Article 22 of the Constitution (UUD 1945) states:

“(1) in cases of emergencies, the president has the authority to set a *Perppu*. (2) A government regulation must be approved by the parliament in the next parliamentary session (3) if no approval has been made, the government regulation and its derivatives should be annulled”.

A person or group of people will not make an institution/rule when there is no impulse that demands such rules must exist (Hayek 1968 in Hanisch and Schlüter 1999: 9-10). This meant, unless, in a state of emergency, *Perppu* may be produced as a Law, while DPR did not see any urgency to issue a *Perppu*. Institutional change is ‘unintended results of intentional action’. It is spontaneous, not accidental, but is the result of deliberate action (*Ibid*). It stresses, in particular, the uncertainty within the changing process and the role of the cognitive limits of each interacting individual. What Hayek meant by ‘spontaneous institutional change’ with regard to the case is that the momentum to create or modify the *Perppu* (the emergence of the need for regulation) is spontaneous (unintentional). The activities to make or to realise the *Perppu* based on a developing situation are deliberate (intentional).

Due to no emergency in the *Perppu* case, Irmady further states the PDIP faction will file a judicial review to the Constitutional Court upon ratification of *Perppu* No. 1/2007 for violating the constitution.

“This regulation is still likely to be cancelled and the parliament will not necessarily approve. If the parliament agrees to cancel then BBK FTZ’s legal status would be annulled” Irmady added (Bisnis Indonesia—23rd December 2007).

Second, since there was no urgent situation, the government could just amend the already established Law rather than issue a *Perppu* especially if it only requires minor changes in an article/s.

“The *Perppu* No. 1/2007 only made some changes to Articles 2, 3, 4, and the transitional provisions in which Article 4 mentions the establishment of FTZ is stipulated in a PP. If only to change an article, the government had to issue a *Perppu*, then it is not clear what the use of having any law discussion mechanism is? This issue can be solved by passing an amendment to the Law No. 36/2000 without stipulating an in lieu of law,” said Irmady (*Ibid*).

Third, it had conflicted with other legal products, namely Law No. 32/2004 on Regional Government and Law No. 25/2007 on Investment. The *Perppu* would seize the legitimate role of local authority by the presence of the SEZ management (*Ibid*).

There were indications that the president had been surrounded in a contentious situation and entered a vortex of intra-factional tension between the executive and legislative bodies. The uncertainty of the fate of *Perppu* No. 1/2007 was in fact already known by the Governor of *Kepri*, Ismeth Abdullah.

According to the Governor, this regulation has to be reviewed as a legitimate law in order to be implemented. On the one hand, BIDA was forced to merge into a new form of zone management body known today as BIFZA (*Badan Pengusahaan Kawasan* or Batam Zone Management Agency) as promulgated in the *Perppu* which was challenged by groups in the parliament. They have sought to defy the *Perppu* and to converse it by informal practices such as negotiation and lobbying. It was, therefore, needed for the interest group powers, which have a special interest in Batam's development and used BIDA as their instrument of control, to be cautious and so orientate their work to be able to overcome all possibilities, to any unforeseen events. On the other hand, there is *Pemkot* Batam who are backed by *Kepri* provincial government, the CG (the executives led by President SBY), and technocrats who thought that BIDA's presence was rendered ineffective in facilitating investment-related formalities (*Media Indonesia; Kompas News; Bisnis Indonesia; LKBN Antara media coverage 25th-29th August 2007*).

Findings indicate that the network of technocrats still exists to promote the advanced technology in BPPT and other institutions. Moreover, Habibie's network of engineer since two decades ago remains as shown in BPPT and BIFZA's persistent cooperation in 2013. The atomization approach which Demsetz and Alchian (1972) suggested is a utility maximising tool conjured to influence the distribution of jurisdiction between BIDA and *Pemkot* to further influence the use of valuable resources in Batam.

The effort to change inefficient institutions during the transformation from BIDA to BIFZA was in a state of complexity; not only did the GOI face collective action problems (Acemoglu and Robinson 2000, 2001, 2003) but owing to the typical non-existence of third party enforcement to control and maintain the contract agreement between various interest groups, GOI also lacked credible (Williamson 1983) and to borrow Spiller *et al's* (2003) term, 'intertemporal' commitment when some characteristics of the key actors evoked the policymaking process and affected certain features of the policy outcomes (*Ibid*: 4).

In response to the reform process in the governance of Batam FTZ, for the second time since 2004, the government had been oversimplifying the problem by ignoring the applicable constitutional procedures. At the time, the executive proposed a regulation that should become a law while the legislative assembly in DPR refused; the regulation was annulled. This meant that BBK being given FTZ status was indefinite.

Contrary to institutional change logic, taking the view of Williamson (1996):

".... ex-ante transaction cost derived from attempts to prevent transaction failures due to asset specificity and opportunism, including devising or drafting, negotiating, and protecting or safeguarding, and enforcing a contract or rule...." (*Ibid*: 379).

...and arising from weaknesses in the contractual situation, while:

“... ex-post transaction costs are the costs of altering contracts to correct ex-post misalignments, the costs of setting up and maintaining governance structures and the costs of bonding to guarantee contractual commitments...” (*Ibid*: 379).

In the case of Batam, despite SEZ institutional rules being built to have a triple role, such as to reduce uncertainty/transaction cost, to define incentive structures, and to act as anchors of reference for incoming investors, the existence of parallel SEZ policy or rules of the game muddled prospective investors and finally triggered higher transaction costs and raised the level of uncertainty (Farole 2011). The regulations indicate that the CG’s intention to withdraw from Batam’s development was simply rhetorical and to save some time and minimise transaction costs was dealt with by endorsing past legislation to designate Batam as an FTZ. Their presence represented by the zone management body (BIDA under a different name) remains to play an important role in Batam’s development to trade liberalisation.

The executive government was known to have filed a discussion meeting on *Perppu* No. 1/2007 into a law with DPR and subsequently, the Commission VI was assigned to discuss this regulation in their internal meetings. But the Commission VI of DPR also scheduled a discussion meeting on this matter along with government representatives. Hence, an overarching question was the legal basis of the FTZ. Undoubtedly, the draft law spawned a new polemic that national agencies and local officials have taken opposite directions. The draft recently initiated by local officials was widely supported by the business community after lobbying with DPR. The FTZ draft motion, tabled by DPR, was put forward before the parliamentary meeting to defy the CG’s draft (*Bisnis Indonesia and Media Indonesia editorials*—December 2007). This marked *the fourth inter-factional tension* over parliamentary approval between the executive and legislative body (*emphasis added*).

In November 2007, following the result of the 2006 MoU between BIDA and *Pemkot* Batam, and after going through several changes in its regulations, initiatives were taken by the CG. The joint negotiation between BIDA, *Pemkot* Batam and DPRD Batam successfully lobbied Jakarta’s political elites to ratify Law No. 44/2007 on FTZ on 1st November 2007 (a law endorsing *Perppu* No. 1/2007 to become an official law) and to make Law No. 36/2000 as reference for Law No. 44/2007 which hopefully will further integrate and expand Batam’s industrial ability and *Kepri* provinces at large.

Despite the polemic ending with the issuance of Law on FTZ, the debate on the matter has still not produced any final conclusion. The end of the debate is ultimately up to the wisdom of the government (executive) and members of parliament (MPs) in discussing any formal rules of the games. Whether both groups put national interests above the insistence of maximising the group’s political interest will depend on their shared commitment and collective action to develop Batam.

A businessperson who played a significant role in Batam and had close relations with local authorities and the parliament, on condition of anonymity, asserted: “the government should not make wrong decisions, [because] it will threaten the development of [economic] Batam in the future” (Interview—12th January 2015)

The final decision from the government seemed to be an interesting insight into the path-dependent nature or known as a *déjà vu* of the FTZ policymaking process during 2000-2004 in the first commission meeting when the CG had finally confronted the DPR who passed Batam FTZ Law unilaterally in September 2004. Some businessmen were still sceptical about the decision. Questions were raised among local leaders and entrepreneurs due to the common thread of the three issues of BBK SEZ, *Perppu* FTZ, and ultimately a comprehensive FTZ in Batam which boils down to inefficiency. Further concerns were expressed by a spokesperson in the Chamber of Commerce (KADIN) who stated:

“The momentum has passed because the government has been too long in providing legal certainty on the FTZ status for Batam. Agree or not, Batam already has an FTZ status and today people are still waiting for the next government’s breakthrough on government regulations that will strengthen the position of the FTZ”.

At the macro level, he further stated that *Kepri* encompasses six strategic sectors: manufacturing, shipyard, tourism, trade, property, and supporting oil and gas industry.

The respondent further argued:

“If we can overcome the obstacles experienced by the six major sectors then I am sure the *Kepri* economy can accelerate and exceed 8% growth this year, but of course, it’s not easy. Barriers to customs and FTZ regulation remain a constraint to the development of the leading sectors. Not enough for only the governor to solve it, but it must be addressed by a special minister who can coordinate all relevant agencies to offer serious attention to the development of BBK FTZ ahead. If all boils down to the vagueness and difficulty, then how can *Kepri* economy grow rapidly to reach 8-10%? Only a miracle can do. Yet, during this time, shipbuilding sector grows without local and central government interference (including BIFZA)”.

According to him, all industrial sectors develop on their own, such as trade flourishes and tourism grows because they support the existing industrial sector. Support for the oil and gas sector is growing because there are existing supporting industries. With lower promotion costs, the government hopes to attract investment— a strange strategy that is rarely applied anywhere in the world. Without clear incentives, how can investors get into this area? For example, because of the game played by land mafia in BIDA who intersected the legitimate process, ultimately investors worth US\$150 million withdrew their intention to enter Batam. Uncertainty regarding the status and charges of land on the island discouraged the investors (*Ibid*). Local and foreign investors have struggled to deal with inconsistencies and contradictions in local governments’ policies and regulations.

When BIDA transformed into BIFZA, there were not many changes; instead, most agency's operating budgets were absorbed in employees' substantial cost. Similarly, with a budget of nearly Rp1.2 trillion, *Pemkot* Batam was not able to present an attractive and orderly city. They failed to perform a reliable service delivery. People's tax money was disbursed only for compensating employees and officials' routine costs, rather than to increase public welfare.

6.6. Volatility Period (2008—onwards)

Following up the FTZ law, drawing upon Commons' governance structure terminology (Commons 1932 in Williamson 2000: 599), the SBY government crafted order, mitigated conflict and realised mutual gains among interest groups and stakeholders by establishing an SEZ National Council through Presidential Regulation No. 30/2008 and the Zone Council based on Presidential Decrees No. 9, 10, and 11 of 2008 for Batam, Bintan and Karimun respectively. Further emphasis was expressed by Boediono that after the establishment of the National Council and Zone Council, three-zone management bodies will also be established in three regions: Batam, Bintan, and Karimun. The zone management in Batam is known as BIFZA (Batam Industrial Free Zone Authority/BP Batam/*Badan Pengusahaan Kawasan Batam*/Batam Zone Management Agency). Moreover, he added that the Zone Council will only be an agency managing three FTZ regions centred on the provincial capital of Tanjung Pinang (*Ibid*) and in terms of funding; it will be allocated through local budget (APBD) and state budget (APBN).

Former BIDA Chairman and the then *Kepri* Governor, Ismeth Abdullah, emphasised the presence of BIDA would not interfere with the formation of BIFZA because both institutions have different duties and responsibilities. Ismeth said in the media that:

“BIDA's core competency lies in infrastructure planning and development and management of the region's critical assets such as airports, seaports, etc. while the BIFZA more specifically manages investment within FTZ. BIFZA should be established no later than 31st December 2008, while the same body for Bintan and Karimun no later than August 2007, following the issuance of three PPs of FTZ Batam, Bintan and Karimun” (Berita Sore—16th May 2008).

These policies were expected to accommodate the required needs of every element in society. Moreover, the Coordinating Minister for Economic Affairs at the time, Boediono, stated that the councils are set to centralise the management of SEZs including FTZ in order to further steer efforts to attract more investors and to formulate common policies for each of the free trade zones (*Ibid*).

The structure of the National Council consists of Coordinating Minister of Economic Affairs as the chairman and 16 other relevant ministries as members (Figure 4.14). The structure of the Zone Council of Batam, Bintan, and Karimun is chaired by the Governor of *Kepri*. Boediono further asserted that:

“The National Council and the Zone Council are effective since the launch of the policy on 7th May 2008. However, a Zone Council is not an independent agency. It will be overseen by a National Council as adviser and supervisor. National Council also formulates the general policy that applies to all the regions” (Berita Sore—16th May 2008).

Despite Batam FTZ being mixed with residential settlements governed by a self-governed authority (BIDA) and its own public administration (*Pemkot* Batam), the management will be authorised to BIFZA (*Jakarta Post*—13th October 2008). Interesting to note, perhaps there is no other single free trade area anywhere in the world all mixed together with the residential areas. Even Pudong district renowned in Shanghai is limited between the free trade zone and the residential zones as well as the daily activities of the population. Typically, an FTZ is free from settlements, so that it can curtail the occurrence of unofficial trade transactions, i.e. smuggling. Therefore, the FTZ is confined to a BZ area, in which there is no population or administration activity.

Furthermore, contrary to what most scholars would believe that insular societies tend to take measures to protect themselves against foreign values (Williamson 2000: 598), it was not happening in Batam. Instead, they welcomed the idea and can enjoy the benefits of Batam being an FTZ. The transformation offered immense pleasure to the Batam population who are mostly of Malay descent, some migrants, and labourers from Java and other parts of Indonesia, where foreign and migrant labour contributed one-third of the Batam population in 2014 (see details in Appendix 5).

6.6.1. The Birth of BIFZA

After a series of managerial controversies, in 2008, BIDA was dissolved and integrated into BIFZA—a new governing body—based on the Chairman of the Zone Council’s decrees¹¹². Low-level employees in the BIDA felt their fate was in the hands of BIFZA. Mustofa Widjaja continued his role as Batam authority’s Chairman under BIFZA. The new BIFZA period from 2008 emphasised the investment infrastructure and policy development given the facilities that the policy could accommodate for the benefit of investors, thus was expected to ultimately increase the investment rate (*Jakarta Post*—2nd September 2008).

After the birth of BIFZA, Batam region experienced a rapid development, more importantly in the economic sector. Perhaps, this was in part due to the right design and policy implementation in the short-run, as well as a conducive economic climate which put industry, trade, services, tourism, and transshipment as development priorities, involving a maximum role for the private sector (large-scale foreign and domestic investors). This period can be viewed as a public maturation growth stage. The development progress clearly provides a positive impact on business opportunities and hence social

¹¹²The decree amended three times with the latest on 2011

and employment aspects. Henceforward, before long, other issues continued to grow and gradually arose in both Jakarta and Batam until recently (end of 2015). The CG soon dissolved BIFZA due to the unattractive investment climate and the gradual loss of state revenue from tax receipts of up to Rp20 trillion (*Kompasiana*—5th January 2016).

Interesting to note, despite the loss, the government still endeavoured to develop Special Economic Zones (SEZ) at a national scale but tried to learn from the problems encountered in the past. Therefore, in October 2009, the government enacted Law No. 39/2009 on SEZ as a legal foundation for the establishment of SEZ in Indonesia, like those already running in China and other parts of the world (Hendrawan and Hidayat 2012). Subsequently, on 17th November 2009, the Minister of Industry, Mr MS. Hidayat stated that Batam's status which originally was an FTZ will be transformed to SEZ. Batam became the 'pilot project' of the new type of SEZ development in Indonesia. This statement was later shown to correspond with the launch of Law No. 39/2009. It is a manifestation of economic diplomacy between Indonesia and Singapore in accordance with the MoU on the establishment of Batam SEZ in 2006 of which Singapore will provide guidance based on their experience, developing and building several SEZs in China. However, there are some differences. In China, their FTZs were built after the SEZs were up and running and the FTZs are located inside their SEZs, such as in Shenzhen with Shatoujiao FTZ, Yantian FTZ, and Futian FTZ (*Ibid*). Meanwhile, in Indonesia especially in Batam, the SEZ platform was established after FTZ was formed and Batam will be transformed instead of built inside an SEZ once the legal framework has been set up.

After BBK was set as an FTZ, the investment climate in the region showed encouraging signs, partly due to Ismeth Abdullah (*Kepri* Governor) having more powerful vested interest in the private sector. He boasted that at least eight companies from Singapore invested in Batam and Bintan with an investment valued at US\$31.6 million with employment of 2,000 people (*Bisnis Indonesia*—24th July 2010). The influx of foreign investment back to Batam was expected to be a magnet for foreign investors, particularly in the BBK region.

Despite the FTZ being established, it has yet to accomplish the expected policy outcome as the will of the actors is still thwarted by political nuances that pervade the condition below government control in almost all policy initiatives in the Batam region, but these are beyond the scope of this study.

6.7. Conclusion

Batam has undergone significant physical, economic, and political transformation, thus, the contemporary debates on its free trade zone (FTZ) policymaking process has to acknowledge every phase of its historical dimension that set down the pathway of SEZ policy. The changing FTZ history and political settings have shaped the 'long and winding road' of governance and the central-local

relationship in Batam especially in Indonesia's Reform and Democratic order (hereafter RDO) from 1998 to 2014.

To employ Williamson's (2000) second thematic series of institutional constraints, the governance structure and resource allocation, the period of change in Batam's governance structure takes years to legislate while the 'resource efficiency and incentive structures' were established continuously (*Ibid*: 973-6) following the change of the regime. This chapter validates the second hypothesis that bounded rationality and opportunistic behaviours emanates when actor's action unable to settle conflicts occurred in the policy process and the problems of principal-agent, moral hazard, and adverse selection in SEZ governance structure at the central government level render contractual relationships to be unclear in SEZ policymaking process at the local government level.

In Batam, the evidence reveals the main features that help augment the commitment of the government to increase Batam development under imperfect governance structures even with the continued and persistent change to authorities and numerous actors in their development. Nevertheless, findings suggest that the government's (GOI) appeared to have manipulated Batam's governance structure in order to sustain power under the guise of economic reform and equal development.

In practice, before the decentralisation, only Batam Authority (BIDA) has the only governing capacity to engage in investment related and FTZ regulations in Batam island (centralisation of power) and in post-decentralisation (the institutional reform to local government) has created other entity (the Batam city government/*Pemkot* Batam) with legal capacity to enter institutional arrangements which were to oversee the administrative matters of Batam City. Batam FTZ has always been a well-known interplay and conflict of power between BIDA and *Pemkot* Batam from the NO to the RDO. The failure of these two forces to drive Batam into a leading SEZ structure has led to the unproductive development of Batam Island as a whole characterised by the territorial tug of war and the failure to reduce transaction cost presented by the failure to allocate resources (roles and functions of the governing bodies through the ratification of the FTZ bill which gave a part of the control authority to *Pemkot* Batam).

There were little or no significant improvements after decentralisation that specifically design the development of Batam Island as a strategic area located on the periphery, except only maintaining the existence of BIDA as the centralised institution representing the CG. However, BIDA and the CG during the thesis writing has yet to realise the upgrade status of Batam from FTZ to SEZ. The FTZ which sought to be a policy strategy for growth at the time was only a rhetoric: easy to pronounce but has never been implemented.

The formal institution from the decentralisation law has influenced the governance structure in Batam which yield to the constraint in distributing the territory and authority to the rightful entity (resource allocation). The discussion exhibited that the fundamental features of governance structures and design were fashioned by numerous actors (policymakers, bureaucrats, or other influential actors) through political means, but can never completely anticipate all future contingencies.

There were difficulties in ensuring all actors coordinate. Findings indicate that actors have influenced and deliberately bound governance structure and regulatory frameworks in order to pursue an overall reform such as restructuring a country's political authority (e.g. big-bang regional autonomy and revenue sharing policy), through smaller changes (e.g. BIDA restructuring and fiscal incentive policy), or through abandonment (exit from the competition), while the overall governance structure was subject to evolutionary change (Williamson 1975: 20-30).

Further evidence suggests, that the central government was unable to promote perfect policy solutions and adapt institutions to social, political, and economic fluctuations. The existence of policymakers was incapable of matching policies with institutions and vice versa. There was evidence that policymakers did not seize the moment to create a more conducive political environment and institutional foundation. Furthermore, because governance is a dynamic process, policymakers did not make a feasible policy choice under market-oriented reforms. Moreover, single events (such as Jusuf Kalla's visit to Bojonegoro which gave a new motivation for the FTZ transition in Batam) or the demise of authoritarian rule Soeharto and the AFC served as triggers or catalysts and crucially affected Batam's development trajectory, but cannot serve to determine an appropriate political leadership or institutions.

In the resource allocation aspect, this case displays the behavioural elements of actors in allocating resources under the economic reform model in order to minimise transaction costs. The principal-agent problem occurred when each president after Soeharto as persons with interests (principal) delegated the formal institution responsibilities of Batam's development to BIDA as the other party (the agent), thus bounded rationality factors occurred (Simon 1947 in Boston *et al.* 1996).

Given the evolutionary background, the informal institutions of patronage network are embraced and display a great deal of inertia. Despite each regime government set their own definition of responsibilities, two contending bodies such as BIDA and *Pemkot* have always been thought of as the administrators of Batam. Consequently, a well-designed structure of resource allocation that constitutes the distribution of benefits was ostensible, such as appointments and elections of high-ranking BIDA and *Pemkot* officials made based on patronage rather than merit. Others at times took the president's symbolic value in order to create an alliance as the essential aspect of strong rent-

seeking pervasiveness. This shows the deficiency of accountability of both central and local government leaders as well as bureaucrats.

BIDA plays an important role and was unaffected by the institutional change under different regimes and therefore was not immediately transformed or scheduled to be dissolved. The reasons can be synthesised as follows: first, BIDA not only as an old player in the business development of Batam but an instrument of CG control since Soeharto and further as a legislative control in post-New Order. Due to the strong power of the BIDA and CG and the weakness of the Regional Government law, BIDA was unprepared to surrender their duties, managerially or financially. Second, the capabilities of BIDA's appointed leaders and officials are not easily transferable, i.e. Ibnu Sutowo's strategic capability, Habibie's technological capability, Ismeth Abdullah's cultural approach, and Mustofa Widjaya's professionalism. They are appointed as capable of guarding CG's concerns and interest in their 'high-valued and subtle projects' in cooperation with Singapore. It is a highly-politicised project easily transferred to only the trusted and loyal individuals. This meant GOI's political legitimacy is a crucial precondition for CG's emerging societal consensus with Batam authorities in favour of Batam's distinct development strategies. Third, BIDA was recognised as an 'agent of change' for the astonishing development of Batam from an isolated island into a significant economic zone today. Therefore, the position of BIDA which was legitimised through only a Presidential Decree was maintained despite arguments on the status of the decree is weaker than a law.

Principals are rarely omniscient for instance; the president's rationality was constrained by multifaceted moral hazard problems such as asymmetric information where the hidden action of the agents such as Ismeth Abdullah's appointment as BIDA chairman cannot be observed by the president (Azfar 2006: 978). Other factors included the tractability of the decision problem, the cognitive limitations of each regime's mind, and the finite amount of time available to make the decision. Furthermore, the presidents' lack of capacity for conscious foresight caused adverse selection problems such as where the value of the land being transacted by BIDA (land mafia) cannot be observed by one party (or 'hidden value') while the BIDA chairman's unobservable action bears little consequence.

The chapter argues that SEZ initiatives in Batam were used as subjects for political interest both in the policymaking as well as in the execution process. BIDA-*Pemkot* Batam conflicts in the RDO are not separate events, but the peak of the inherent conflicts since NO. The BIDA and *Pemkot* conflict show that their policy execution initiatives were translated into exercises for maximising political benefits. Despite Batam's uniqueness in Indonesia, it could hardly be considered to embody archetypes of equitable and sustainable growth to be adopted more extensively in the decentralisation arena if multifaceted dilemmas concerning jurisdictional management and central-local industrialisation

strategy still occur. The chapter finds the significance of policy negotiation in supporting any attempt at SEZ policy reform.

Chapter 7

Conclusion

7.1. Introduction

Indonesian SEZ development often comes from the overreliance on the neoclassical paradigm (NCE) by employing macroeconomic investigations which often ignores the institutional perspectives as the basis of the entire development and policy formulation process.

NIE theory can be thought of as complementing and continuing the view of NCE, emphasising the efficiency of the market mechanism without interference from the state in neoliberal ideology, however, this study found a causal logic whereby some institutional determinants constrain the state (political actors and economic agents) into making the market well-functioning thereby increasing the risk of SEZ policy change. The actors' boundedness to their own rationalities has complicated the process of SEZ policy formulation which resulted in SEZ mixed performance. It promotes further questions on the policy appropriateness and the actors' logic in their policy choice. This chapter recaps the issues by reiterating the research questions and validating the hypothesis followed by presenting the findings and pointing out the contribution of the study to knowledge.

This chapter is divided into five subchapters: first, the introduction; second, reiterates the research questions and hypotheses and presents the key findings derived from the empirical chapters 4 to 6; third, concludes the chapter; fourth, provides the contribution to knowledge; and fifth, summaries of the limitations and suggestions for future study.

7.2. Main Findings

7.2.1. What are the institutional intricacies surrounding the process of SEZ policymaking?

This section brings up the first aim of the study which is to examine the institutional intricacies behind the process of making the SEZ policy. The findings based on the arguments that unfold in the study are as follows:

The central argument has been that SEZ policymaking is influenced by institutions. Findings suggest that SEZ policymaking was potentially affected by the bureaucratic legacy of previous authoritarian rulers (NO). The legacy of ideology and rent-seeking culture play a large part and have a pervasive influence upon Indonesian economic character and are entrenched in the political culture of every ruling elite. The informal institutions did not support formal institutions in reducing transaction cost, instead, they increase transaction cost as well as uncertainty in a variety of ways.

Indonesian policy and institutions have been mutually influencing each other, entailing change or continuity of the *status quo* and contributing to the institutional arrangement where the government's current economic reform policy decisions affect their SEZ policy decision as a form of neoliberal ideology in the future. Therefore, this study supports Jenkin's (1999) argument that economic liberalisation is all about preserving power.

The contemporary SEZ policy platform as the key policy actor's choice of economic reform is generally a mechanism to preserve the ruling elite's traditional rhetoric. The SEZ policy practised by Indonesian rulers has deviated from its conventional objective to stabilise the economy by promoting exports, generating employment, and attracting FDI. SEZ policy platform is embedded in the investment regime to stay in the course of neoliberal ideology. The Indonesian policy reform has not fulfilled the required set of institutions that can provide the right incentives for all economic actors. Since policies and institutions are difficult to separate like two sides of a coin, the Indonesian SEZ policy was established based on institutions which hinder the economic development process to achieve maximum results. It can be inferred that Indonesian actors' used the preferred inappropriate institution that restricts their action due to the institutions were created by a social system that has the power to control and direct actors' interaction and their decision where the entry into force depends on the existing social condition.

The Indonesian government (GOI) of the reform and democratic order (RDO) was burdened with a remarkably heavy economic and political reform agenda, with civil society and government institutions that do not function to handle the variety of policy issues and new inter-organizational relations. The SEZ policy actors have been unable to build an organized response to the changing environment. The result was that *intra-elite rivalry*, *inter-factional tension*, and *interjurisdictional competition* were inevitable due to loss of control over the policy agenda, weakening of the structure of coordination inter-ministries, a dramatic decline in the superiority of the formal rules, and the obscuring of the boundary between responsibility and authority.

The most serious impact from the influence of institutions was seen in the failure of the SEZ policy process which showed the inability of GOI to develop a clear SEZ policy vision and priority programme that can be communicated and supported by the public. The clarity of policy vision is of utmost importance, especially in times of systemic transition because it involves a major political shift, while in Indonesia the strength and economic excellence weaken and deteriorates. Particularly under circumstances of decentralisation, the important policy question at the time was not about technical matters, but about beliefs, value systems, and incentives that were subject to change. For example, efforts to promote investment policy did not succeed in attracting investment due to the policy was not well-defined to accommodate public aspiration and was not accepted due to issues of

unacceptable inequality or economic gaps. These evidence endorse the context of political institutions by Johnson (1999), Spiller *et al.* (2003), and Bardhan (2007) in some respect but go a step further where Indonesia might not be included in their use of variables on politico-institutions as SEZ policy uses country-specific context with regards to the complexity and patterns of SEZ policy outcome and the fundamental role the key actors play in the policymaking process besides the direct effect institutions or rules of the game have on the outcome.

The failure in establishing a strategic vision in Indonesia led to opportunist reform, the reform supposedly moves in an area that has a strong agent of change or where there is a window of opportunity with stable institutional structure and has a high political legitimacy, but in a systemic transition period in Indonesia this method is less practical. The key policy actors did not provide a clear strategic roadmap, which made them unable to determine which parts of the previous order should be preserved and which should be reformed. The actors' were unable to distinguish tactical issues and strategic questions. The change in the whole political culture was supposed to be a prerequisite for a consolidated democracy, and the actor's material for democratic transition was the construction of political legitimacy.

The findings above addressed the first research question and confirmed the central proposition that: 1) informal institutions, both productive and non-productive, have not been compatible in support of formal institutions and vice versa, 2) property rights are not yet optimal in the bureaucratic level of SEZ policymaking process during transitional period of centralist paradigm shift towards decentralisation, 3) continuous and discontinuous SEZ bureaucratic policies have shifted the pattern of abuse of power by a handful of people in public institutions hindering the clarity of contractual relation of the SEZ relevant authority, 4) lack of clarity of the principal-agent relationships lead to moral hazard, adverse selection problems, and uncertain structural incentives.

7.2.2. How and why do institutions influence the behaviour of actors in SEZ policy decision?

This section brings up the second aim of the study which is to investigate how institutions influenced political institutions and economic agents' decision and why do these institutions affect the decision. The findings based on the arguments that unfold in the empirical chapters 5 and 6 are as follows:

One of the factors that appeared to justify the GOI's course of policy choice and the making of such decision was the level of SEZ success and performance of the EA Tigers. Not only was the SEZ policymaking determined by the successful performance of the EA Tigers, but the idea to swiftly increase the country's development prompted each ruling power to adhere to the neoliberal principles propagated by market-oriented external forces such as the IMF, the World Bank and the WTO.

The study has also exposed the institutional core of why the government is so persistent in developing new zones if some zone schemes in Indonesia only succeed in the short term and fail in promoting positive contribution to long-term economic growth. That one-size-fits-all strategy to adopt and craft country-specific decentralisation and SEZ institutional structures are as significant to effective governance as the devising of efficient regulatory and SEZ policies. However, empirical evidence now suggests that effective governance is independent of the form of government. Best-practice governance for SEZs in China, Korea or even Singapore or transferring governance structures under authoritarian or democratic rulers from those countries to Indonesia cannot be fully embraced and will be doomed to fail; due to the extent to which institutions suitable for those countries are not applicable in Indonesia and the cases presented in the study, Jakarta or Batam SEZs, depend on the period of Indonesia's political and economic progress and the transfer cannot account for the enduring informal institutions. Moreover, adopting Chibber (1998; 2003), compared to the successful coalition between the state and business class in Korea in supporting the development model at the time, Indonesia ironically was unable to affect the performance of the economy or export-oriented industries through the establishment of SEZ Law and Investment Law in which both rules can oversee the behaviour of the relevant stakeholders. The dynamic movement of institutions in the Batam case is an effort to minimise transaction costs, and the changes in the transaction cost affect the incentive or motivation of individuals interacting with others (North 1990; Williamson 2000). However, the institutional framework of SEZ and investment policy is not optimal to form the 'incentive structures' as the maximum possible payoff. Therefore, it can be said that the SEZ and investment policy institutional framework has not produced any maximum results or outcomes. Another example: a regional minimum wage in Jakarta or mineral extraction regulations in Batam is viewed as inhibiting factors by businessmen and investors seeking economic gains. Thus, investors will try to change, repeal or ignore the regulation by way of negotiation. Other than political motives, some of the businessmen in Indonesia are none other than the politicians themselves who subvert public goals for their parties' or groups' intention. Having identified the potential outcomes to avoid conflicts and divergences, the legal and regulatory frameworks in Indonesia (contracts or organisational rules) are unable to set fair boundaries and regulate transactions (policy dialogue) between members, in this case, businessmen and politicians (Azfar 2006: 966).

In chapter 5 and 6, the author suggests the successive regime took upon themselves the task of engineering different types of SEZs as merely to sustain their legitimate power and not necessarily the best reform policy option for the open market system. Moreover, the half-hearted attitude of the officials in the SEZ policymaking process was the major factor behind the rather halted SEZ projects and stunted economic growth in Jakarta and Batam which based on the SEZ policy trajectory posed

significant risks in its future performance. It argued that the SEZ schemes represent the government's ill-suited model of a country's economic development strategy or a precondition to market-oriented reform due to political factors when the local government officials make strategic decisions. Empirical evidence suggests that the local government was unable to reform due to their inability to form a strong political coalition and expand their network of public support. Nevertheless, when there is a window of opportunity and the political coalition becomes ever more decisive, local officials instead tend to put more consideration to the constellation of political parties in the region.

Moreover, the interaction between executive, legislative, and political parties in the two regions has shown that democracy in Indonesia is still elitist. Because the public control of the executive in the post-election period is still weak, not only do most politicians not truly reflect the people's views, but also the SEZ policy is also exclusive. The phenomenon of serving the interests of political parties or, rather, the political elite means that there is still much to be done in Indonesia regarding a direct link between the platform of the party and its relevance to everyday public policy in local government.

7.2.3. Which institutions affect the SEZ policy decision and why?

This section brings up the third aim of the study, to examine the type of institutions generally affects actors' decision. The findings based on the arguments that unfold in the empirical chapters 5 and 6 are as follows:

Findings suggest that the formal institutions' importance was largely recognised until it was hampered by internal political interest coupled with the central government's chance to pit local government and SOEs control—with prolonged tensions over state resources—against one another by opening new prospects for profiteering and political patronage at the local level.

Informal institutions, in the SEZ policy dealings, are often overlooked as effective instruments in distorting the allocation of resources and in general, influencing economic efficiency (Phelps 2007; Maramis 2012). This, in turn, at times leads to the effect of informal institutions as a complement to business transformation but not necessarily constrain the enactment of formal policy.

This study reveals that the SEZ policymaking was influenced by the prevailing norms of behaviour, ideologies, and values of the NO under political economic complexity coexist with formal 'rules of the game' resulted in both durable and fragile institutional change in distinct contextual bases during the Susilo Bambang Yudhoyono (SBY) period which at times the nature of formal rules tend to provide weak incentives for policymakers to make SEZ policies and reveals that more informal processes govern SEZ policymaking and shape the incentives that policymakers might have in requesting SEZ policy change at the implementation level.

Informal institutions were applied by local elites to adjust to changes in the zone management when elites' were lacking in their ideological consensus, i.e. in Jakarta Bay reclamation which generated public disbelief. These institutions distort policy effectiveness. In exploring SEZ as a form of neoliberal policy in forty years, as Williamson (2000) also argues, culture (small kings, kinship-based organisation) and ideology (nationalism and neoliberalism) were the two most relevant characteristics that have affected SEZ development policy (formal institutions) as they are deeply inherent in the society. This study finds that there was a multifaceted cultural condition of political and economic behaviour as informal rules. As North (1991: 111) further asserts, they play a large part and have a prevalent effect on the key policy actors' character in the long-run to maintain the government's *status quo*. The elites not only adopted culture (informal) as an important determinant of economic outcomes but also adopted economic policies (formal) that helped avoid loss of popular support and prevent institutional traps (Spranz *et al.* 2012: 461). Both institutions influenced each other.

For instance, informal practices give more emphasis on culture in the centralisation of power at the local level as an effect of the decentralisation system. Besides nationalism, they are associated with the colonial legacy (La Porta *et al.* 1997, 1998, 1999, 2008) and local traditions (embedded in society), such as the KKSS role (kinship-based organisation) in chapter 5. To maintain the groups' social viability in their internal and external environment, these cultures were the basic rules by the interest groups to mitigate the main problems they encountered (DiMaggio 1994: 596), such as KKSS platform was used to influence trade lobby emphasising bargaining power. KKSS had been promoting South Sulawesi's potential to foreign investors and KKSS nationalist ideology and the influencers behind it, such as Jusuf Kalla and Sattar Tabá, had more political and capital access which enabled them to control more information and to take advantage of the local constituent and investment opportunity. In accordance with the concepts of Williamson (1985), North (1990) in Shirley (2005), North (2006), and Azis (2008), rather than settling disputes by means of legal framework (courts or other third-party enforcement), the informal approach in share appropriation policy can significantly reduce the cost of exchange (transaction). Over time, the informal institution is more efficient from legalistic to more negotiated methods in conflict settlement. The kind of negotiation used by both sides evolved out of previous 'significant other' relationships.

The finding on the influence of formal institutions is in partial agreement with Williamson (1996) that formal institutions are built to reduce uncertainty and transaction cost, but in full agreement with Farole (2011) that in the case of Batam, SEZ institutional rules which were supposed to 'act as anchors of reference for potential investors' (Hazakis 2014) triggered the existence of higher uncertainty through parallel rules of the game or programmes with regard to fiscal incentives which raised transaction costs and finally confused incoming investors.

To illustrate the ideological characteristic that coexists with formal rules in Jakarta Bay reclamation, this involves the local elites challenge against the additional SEZ policy-change dilemma. Ahok, the Jakarta governor (the agent) tried to change the president's (the principal) ideological stance toward developing SEZ for economic reform without jeopardizing his own public and political support. The dilemma was addressed through a democratic agenda of party coalition between the Democrat and PDIP parties where they may have to accept unless they are willing to be electorally penalised for not supporting the reclamation which was regarded as a pro-poor policy and supporting the earlier nationalist ideological commitments (from the PDIP and Ahok side). In addition to this dilemma, there were issues of credibility of the party which continued to haunt SEZ development prospects and extensive public and investors' disbelief and uncertainties on Ahok's political objectives which made promoting his coalition party exceptionally hard. Therefore, even after the 2009 SEZ Law, it was not clear how the state would support the radical nature of Ahok's reforms which, on the one hand, earned Jakarta praise amongst observers and instilled interest from the general public in SEZ and investment matters, but on the other hand evoked resistance among Indonesia's key policy actors who felt that their vested interests were being increasingly threatened.

The larger debate was Ahok's land reclamation idea, which ironically mounted well-constructed critique and public disbelief. The allegations constitute the fragmented political power emanating from the pervasive coexistence of informal and formal institutions. It was raised on the following basis: the erstwhile moral betrayal of the PDIP nationalist dream, the emotional outbursts accusing Ahok of selling out Jakarta to capitalists, and the illegal phase of policymaking frameworks. Ahok's idea was reinforced on the grounds to ambitiously expand Jakarta EPZ into an SEZ to accommodate Jakarta's growing population and economic activities which differed to DeArmas and Sadni-Jallab's logic (2002) where jobs are only significant to small population countries. However, what often goes unnoticed is how his neoliberal idea was justified to bring in subtle, yet comprehensive change for Jakarta while ignoring the public's need not only in terms of fisherman's livelihood but Jakarta fishery supply in general. The interest of big business was prioritised by deliberately undermining the legitimate constitutional procedure in the policy change. Moreover, in the reclamation licence, it generates politics of duality involving a multiplicity of actors evolved within the executive and provincial level. This had spawned the *intra-elite rivalries* between technocrats and technologists which allowed more flexibility in the SEZ policy directives by the central government and political parties mainly due to a regulatory ambiguity context.

In retrospect, as far as SEZ initiatives in Jakarta were concerned, the conflicted ideology between PDIP and Ahok has not only prevented both entities from conducting a fruitful and clear dialogue with their constituencies on the importance of the initiative but caused a 'one step forward two steps backwards'

attitude in both parts. Their orientations were not transparent, rarely touched the grassroots for public opinion, and limited to only a handful of higher elites. Furthermore, despite Ahok's justification as an ideologue conciliated some of the debates within the party, it opened up new ground for factional tension on issues of neoliberal establishment of free private enterprise from state intervention.

Ahok's justification was that capitalism is required to build a new strategy by adopting an entirely global trade structure to accelerate growth and 'accumulation of capital'. Therefore, SEZ was seen as an adequate shortcut by Ahok to recover from these issues and overcome problems of infrastructure, inefficient bureaucracy, and the high-cost economy. Hence, he deliberately cut the proper bureaucratic channel for the Jakarta reclamation policy to quickly be implemented. Even though it was done by keeping the formula of 'to get things done' and tough measures, he encountered tough decisions against the elites' 'reluctance to go beyond their comfort zone' in the short-sightedness circle of political power around him. But findings suggest that a political conundrum remains even until the final process of thesis writing in 2017 with regard to Ahok as to whether: first, he genuinely set his unique SEZ operational practices for growth *per se*; second, a hidden agenda has taken over his adeptness for change (ahead of regional election in 2017); or third, under ideological, political, and administrative challenges his entrenched misbehaving circle of power seeks to sustain the *status quo*.

Against Williamson's (1975) thesis to embrace hierarchies that serve as organisations or in this regard 'the state' in order to allocate mechanisms, mediate and economise transaction costs—not only private firms but also state bureaucracies—this thesis has also examined Pepinsky's (2012: 8) argument on the difficulties to distinguish which problems are associated with the principal and the agent if the role of each individual in the Indonesian case is unclear. There has been a shift in accountability structure in the RDO from the strict bureaucracy of the NO. Therefore, it is unlikely to identify a specific principal-agent relationship because accountability is a dynamic process that moves either up or down the government level. The finding also revealed that basic features of governance structures and their design can be fashioned by numerous actors (policymakers, bureaucrats, or other influential actors) through political means. These actors are subject to high transaction costs and large cognitive demands, and generally, play games and utilise resources through political lobbying (access and use their legitimate rights) to control decisions and make choices based on evolving trial and error (Brousseau and Glachant 2008). There were difficulties in ensuring all actors coordinate. Therefore, actors can affect and deliberately delineate a governance structure and regulatory frameworks depending on whether in need of overall reform such as restructuring a country's political authority (e.g. big-bang regional autonomy and revenue sharing policy) or through smaller changes (e.g. BIDA restructuring and fiscal incentive policy), or in need of abandonment (exit from the competition), while the overall governance structure is subject to evolutionary change (Williamson 1975: 20-30).

Batam FTZ has experienced two major leaps over four decades, in 1974 during NO and in 1999 during RDO, concerning the separation of powers, which have resulted in conflicts of interest and shifting series of key players in the FTZ institutional arrangement. Findings suggest Batam has an exceptionality in its FTZ trajectory. The finding also considers that although decentralisation was in effect, the central government still put pressure towards the local Batam authority to make Batam as a prototypical for resource-based industrialisation while being hesitant to discuss Batam status due to the fragmented jurisdictional authority in *Reformasi* Indonesia.

It was shown that Batam's economic and political events, as well as policy processes in the RDO, were still dominated by general features of the NO's political economy legacy where sometimes greatly limiting the space and weakens the roles and responsibilities for the local Batam authority to establish and implement operational rules and regulations. The sites and structure of the patronage network, as well as basic oligarchic authority and predatory elites, remained. A high dispersion of numerous political, economic, and social forces was noticeable within this period signalled by the fluctuation of winners in Batam local government structure and party participation in every election. Similar to Jakarta, Batam has assumed inordinate authority via the regional autonomy policy. However, despite Indonesia's drastic institutional reforms with the devolving power structure, the transformation from authoritarian to promoting democratic rule was superficial. Their use of this greater authority has not always been effective as it has fuelled more jurisdictional ambitions and dominant political competition, for instance, from a volatile mixture of Batam's dual power centres—the BIDA and *Pemkot* Batam. BIDA has been known to represent the central government to oversee the development of Batam; therefore, the central government officials not only regularly interfere in FTZ daily decision-making within the local authorities, but *Pemkot's* role as the executive branch has been insignificant. These unlikely roles have triggered risk of increasing the violation of procedures through manipulation and rent-seeking practices.

Nevertheless, the systematic moral hazard and adverse selection elements (Azfar 2006) which occurred in every regime caused the likelihood of the legitimate political authority in Batam to be unclear and made the FTZ policy counterproductive. How particular regulatory-free zone policies make it onto the policy agenda is itself a complicated matter. Some FTZ policies were proposed by the incumbent leaders under the guise of public welfare or shutting down abusive transactions. Those initiatives were politicised since such themes resonate with each constituency of their respective parties.

Based on the discussion, the principal-agent problem persisted with varying degrees of contingency. It is attributed to, for instance, Megawati (as a principle) appointed Ismeth Abdullah as BIDA chairman and continued in the SBY period who then appointed Ismeth as *Kepri* governor (as agent). Due to

asymmetric information between the principal and the agent, the principals were unable to observe the transactions made by the agents. What remains a controversy is that the transformation of Batam Island as an SEZ was highly motivated by the agent's hidden action and the dysfunctional land delivery concerns by the land mafia within BIDA.

Moreover, it is interesting to note that compared to the Jakarta case, the Batam case showed that *intra-elite rivalries* between technocrats/neoliberals and technologists/nationalists were far less visible. It can be recognised that the *Reformasi* era led by Habibie, Wahid, and Megawati sought to find economic and political alternatives to the discredited technocratic economic policymaking process. While in the segmented democracy era of SBY, the old technocracy influence was insignificant and generally left the process to ex-reformists and young economists as his key players in prioritising macroeconomic stability. Despite their presence, technocrats were unable to contribute practical advice to overcome the ongoing conflicts identified between BIDA-*Pemkot* Batam since the 1970s, and between the executive and legislative bodies since the penultimate decade of Soeharto.

Prior to the 1998 NO demise, the President was the key policy player and main programme planner of the FTZ policy which made FTZ a robust policy and the first SEZ ever built in Indonesia. From 2000, after decentralisation was issued, FTZ developed into a combination between *de facto* and *de jure* status to oversee the area, especially after a constitutional amendment in 1999 when some functions of the executive branch were acquired by the legislative, and they became powerful authorised key players. Nevertheless, the new constitutional amendment after NO, as in the Jakarta reclamation case, not only caused political prerogatives to be unclear between the legislative and executive branches but there was a duplication of authorities among key players in the government branches (provincials and regionals). The key players were used as veto device by the contending political elites after decentralisation. Compared with the Jakarta case, four *inter-factional tensions* were identified between the executive and legislative bodies: the first and second tensions constitute a political disharmony over the FTZ law proposal during the Wahid and Megawati rules, the third strain over inaccurate constitutional procedure during the SBY period, and the fourth over parliamentary approval during the SBY period. In addition, the BIDA and *Pemkot* dispute persist on such an alarming scale but in different nuances, such as the two *interjurisdictional competitions* between BIDA and *Pemkot* identified in the RDO and over territorial authority since the Wahid period and over projects and budget allocation since the Megawati period.

These events open the opportunity for formal political manoeuvres by the non-state actors (businesspersons and associations) where they were divided between the two patrons. Nevertheless, despite being impacted by the persistent change in GOI's FTZ policy decision, the business community has not been consistent in infiltrating the process of policymaking. Their influence mostly occurred

where the political and business interests were not synchronised and have been the exception rather than the rule. Whilst both power centres have a solid legal basis, BIDA's vast patrimonial network and past money inherited from the NO era have more power to gain support from business communities compared with *Pemkot* Batam and/or DPRD. BIDA's role continued as Jakarta's representative while business communities were actively involved in shaping local politics through lobbying Jakarta's elites for contributions to campaigns. The business community even plays a major role as members of the DPRD and *Pemkot* Batam. It was revealed that generating funds from 'goods' through formal (taxation and other project sanctioned) and informal means (patronage networks) was highly needed by both *Pemkot* Batam and DPRD in order to quickly build their power foundation against the domination of BIDA. Furthermore, the conflicts of power between different government levels had also been amplified by the erosion of *Kepri* provincial government's (*Pemda*) oversight authority.

7.3. Concluding Remarks

To sum up, this thesis illustrates the insights of Williamson's theory of hierarchy (2000). The cases presented here to some extent prove that SEZ policymaking in Indonesia during the RDO era took a deviating route which to some extent is more complex, full of polarised power and transactions, when the interest groups (individual or organisation) inside the nation-state erode governance gridlock; a lot of redundancy in the system produces assemblages of territory authority.

Findings suggest that any institutional changes affect the process of policymaking. It depends on how the changing key policy actors in each regime government deal with the institutional intricacies and negotiate with each other, while the ruling elites sustain their outdated rhetoric and short-sighted character. The view here, therefore, is that Indonesian political economy particularly the SEZ policy is a complex and dynamic set of variables; whether it will remain unchanged under a new regime government is difficult to depict and ascertain in hindsight, and highly unpredictable as a future form.

The NO and the RDO era have essential dissimilarities in their policymaking styles and mechanisms, but both bought their way to preserving power. Competition for access to resources in different political settings is an indispensable aspect of political consensus and the access affects the ways in which political actors devise economic policies. Even after decentralisation—often thought to improve the allocation of resources, minimise and recover transaction cost, accountability, and reduce corruption in policy delivery (Phelps 2004a, 2004b; Azis 2008; Bunnell and Miller 2010)—ample evidence presented in chapter 4 to 6 suggests that it has not led to better policymaking or it only addressed the policy inappropriateness.

In addition, although not explicitly admitted, neoliberalism flourished while the industrial structure still lags behind due to overdependence on foreign capital and high exploitation of natural resources.

Consequently, the foreign capital in these SEZs can easily shift, whereas almost no domestic entrepreneur is able to change the situation. This results in a drastic decline in export performance, foreign exchange earnings, and employment. Even though SEZ has many forms with fundamentally different policies, there are still some comparable features to be considered. Notably, these economic tools were characterised by their neoliberal consensus that disregarded Indonesia's economic nationalism and self-sufficiency initiated by the old order (Cassing 2000, 2002).

Furthermore, the SEZ policymaking process based on the above illustration still leaves some complexity of problems. To confirm Pepinsky's (2012) accountability thesis, the cases showed that different transactions have different governance needs. The regional autonomy law has created an unclear 'principal-agent' relationship. Specifically, in line with Spiller *et al.* (2003), these were expressly recognised as to whether Batam governments' credible commitments were undertaken to promote exchange (FTZ policy formulation) either to support Batam resource-based industrialised development or in support of their respective alliances in the reform programme. Under such pressures, between facing the political pressure on the one hand (*status quo*) and economic pressures on the other, Batam political elites are likely to carry out risky choices through a covert manner utilising their authority and not by appealing with the stakeholders or relevant interest groups. The experience in Batam FTZ policy transition plotted by the central government with the help of BIDA over the last three decades recounts one such case. However, despite reaching a high-level credible commitment, transaction cost will also be much higher than mainstream NCE due to the higher cost of exchange in formulating an institutional framework.

The institutional change presented in the Jakarta Bay reclamation and Batam FTZ law proposal was seen as 'unintended results of intentional action'. The idea for economic efficiency (Hanisch and Schluter 1999a, 1999b) was questioned when in the Jakarta case, the Governor tried to bypass the standard reclamation policy procedure and disregard the constitutional rules. Meanwhile, in the Batam case, the new FTZ law proposal was not approved by the parliament due to its urgency being questioned and the executive being unable to demonstrate the emergence for the rule to be passed.

The policies deliberately offered by Jakarta governor and the executives were unable to show the urgency for it to be formulated, approved, and legalised and spawned some actions unsupported by the vested interest in other executive members and the parliament. The lines of accountability in Jakarta provincial government generates unclear rules of the game, ownership authority (institutional-environment) and governance structure (institutional arrangements), and although not entirely absent, there is a lack of control mechanism (reward and punishment) which ultimately leads to an increase in transaction costs. Corresponding to North's (1990) study, credibility refers to good

institutions that must have clear rules, are widely accepted, predictable (high level of certainty), organised correctly and properly implemented.

The lines of accountability between the executive and parliament in both Jakarta and Batam cases are too weak in deciding who becomes principal and agent, and what the supervisory agency becomes. The condition leads to credible threats appearing in the context of conflicts and rivalries. The last lines of accountability are also weak between constituents as principal and local government as an agent. However, constituents have limited information (*bounded rationality*) to elect members of parliament (MPs) or political parties. With limited supervision, unscrupulous MPs perform a moral-hazard behaviour (*opportunistic behaviour*). This condition was used by those actors by setting up agreements for both parties to endorse SEZ policies that hurt their constituencies and organisations. In return, these elites are promised some form of output-based compensation or extra incentive to sustain or increase their stronghold as illustrated in Batam (i.e. financial rewards, better political authority, promotion, etc.). These practices pose a great risk of biased socio-economic stability which continues to be propagated by the dominating section of 'small kings' in the Batam society or a group of political elites who tend to disintegrate from national rules. As North would argue, in order to reduce transaction cost and adapt to environmental changes on market-based contracts under regional autonomy, the RDO government initially delegated their work by ordering technocrats to specify and enforce contracts—which can be problematic—to cover the costs of negotiating, calculating, and imposing exchange (North 1991 in Klein 2000: 464) but further delegating their power to BIDA. By corollary, given their inaccuracy in putting trust in BIDA to take advantage of market mechanisms (Williamson 1989, 1996), the RDO government failed in mitigating hazards from the transactional exchange carried out by BIDA.

The roots of corruption in Indonesian political history can be traced to the entrenched rent-seeking practices since the pre-independence era. The widespread entrenchment of patron-client and patrimonial relationships in chapters 5 and 6 suggests that a change in the presidency simply transforms the appearance of government but not the policymaking processes. The patrimonial groups in both cases undisputedly have other hidden agendas to orient policy toward their best interest through a back-door approach to the politicians. Chapter 6 shows the intricacy between BIDA and *Pemkot* Batam which was backed by the relations of politico-business. The politico-business relationship reappeared in a more orderly and respectable manner through intense political party involvement which endured as "*expressions of shifting alliances of predatory interests*" (Hadiz 2004: 619). Chapter 6 also displays the formal institution as a consequence of the unconstitutional approach when the key player (neoliberalists) and the group of nationalist compete for the lion share of the President's blessing and parliamentary approval.

Compared to chapter 6, in chapter 5 despite MPs having been frequently reconfigured, the budgetary planning has always been systematically influenced by the enduring corruptive behaviour of the powerful elites in the parliament which the trend indicates, as a few MPs have business backgrounds. For instance, the instrumental role of the vice president, Jusuf Kalla, a businessman and devotee of GOLKAR's New Order immersed in patronage politics far more devoted to political intrigues in Jakarta than political discretion in representing the constituents. He established a political alliance through a patron-client relationship with the masses in order to reduce the cost of exchange. Technocracy was also no longer shielded from his 'political and business interest'. It implies that the big political issue is still the mainstream agenda of the parliament who extensively transform from an ideal form of constituency representation to mere rent-seekers and try to sustain or buy their way to stay in power. The main lesson here is that aligning the incentives of agents with the interests of principals, and improving information flow about actions and outputs can improve outcomes.

An SEZ should be free from complex regulatory bureaucracy; however, in support of the study by Wahyuni (2009), the Indonesian cases suggest the existence of bureaucracy encumbers and regulatory confusion still occurs, raising issues of investor confidence in the political-economic stability. Moreover, an SEZ according to Easterling (2007: 81): *".....prefers to manipulate both state and non-state sovereignty, alternately releasing and laundering their power and identity to create the most advantageous political or economic climate."* Indonesian economic downturn in the aftermath of the AFC intensified the distrust. SEZs in Indonesia is a resource-based policy where the central government has been consolidating its authority over primary commodities after decentralisation, i.e. timber, coal mining and other minerals, and palm oil licences by opposing the district and provincial governments which contradict the regional autonomy law (McCarthy in Aspinall and Klinken 2011: 103). Thus, it is almost impossible to ignore the political factors when the local government officials make strategic decisions. In contrast, empirical evidence suggests the ability of local government officials to reform is dependent upon their ability to form a strong political coalition and expand their network of public support. Moreover, as mentioned in the second section when the political coalition becomes ever more decisive, local officials tend to put more consideration to the constellation of political parties in the region.

The thesis reveals that the SEZ policymaking process in the following regimes has been potentially affected by the bureaucratic legacy of previous authoritarian rulers. The continual *intra-elite rivalry* and *interjurisdictional competition* still seemed to colour the access to state power while *inter-factional tension* emerged with higher intensity in the RDO era, often reflected in elite polarisation resulting in highly polarised policies as evident in the variants of SEZ policy schemes.

Based on this evidence, this study confirms the first and second hypotheses that: informal measures bring influence to the formal rules and actors' choice of institutions directs to the use of informal practices rather than formal practices in the SEZ implementation level. It also indicates that rather than the formulation level, actors use informal measures at the implementation level more due to the policy has been established and running and the actors' cultural and ideological beliefs are developed at the implementation level. Furthermore, bounded rationality and opportunistic behaviours emanate when actors unable to settle conflicts occurred in the policy process. The study has also proven that principal-agent, moral hazard, and adverse selection problems in SEZ governance structure at the central government level render contractual relationships to be unclear at the local government level.

These institutional findings are believed to be applicable to many other developing countries, but other case studies on other countries are required to accumulate more lessons, and to examine in detail the factors which affect the effective institutions in the politics of policymaking. This study as a whole will spur further in-depth studies on the topic of SEZ and institutions in Asia.

7.4 Research Contribution

The study contributes to the knowledge that institutions do matter in the policymaking process, particularly, its influence towards SEZ policy and the nature of the institutional interaction and constraints in SEZ policymaking. It further contributes to the methodological application of Williamson's institutional constraints.

First, from the influence of institutions in SEZ policymaking based on the literature review in chapter 2 that not only institutions matter on economic reform policy but on actor's behaviour and action in their policy decision. NIE conceptualises the roles that specific 'institutions' and 'institutional change and reform' have on structuring socio-cultural and political economic ways of human interaction.

Second, by utilising the insight originally conceived by North (1990) and further reinvigorated by Williamson (2000) and the seminal institutional concept of 'transactions and their related costs' that Coase (1960) accentuated (Ménard and Shirley 2011: 3), this study perceived a causal logic that some institutional elements constrain the state (political actors and economic agents as SEZ policymakers) into making the market (SEZ policy) well-functioning causing the increased risk of frequent change in SEZ policy. The analytical chapter in chapter 4 combines the causal mechanism of institutional constraint model by Williamson (2000) to study the influence of institutions on the SEZ policymaking process. The thesis contributes through providing other option of analytical approach on how and why institutions affect actors' policy decisions and through applying the approach in the case of SEZ policymaking in Indonesia. The actors' policy preferences pose great risks that through the institutional

interaction they increase transaction cost through complex political-economic dilemma rather than minimise them by reducing the political-economic uncertainty.

Third, the decentralisation period marks the beginning of another shift of getting the rules of the game (institutional environment) right but governance structures (institutional arrangement) wrong from the reform order and in SBY's *ex-post* governance to 'get the institutional support right' due to the lessons learned from previous administrations is not a good prescription of eliminating informal institutions. The study uncovered that informal institutions remain due to political allegiance that exists even before the reform and democratic phases. The commitment to change rest on the change of the social structure embedded in society.

Fourth, this study contributes to the methodological application to the study on the effects of institutions (Hazakis 2014) to SEZ policymaking. Extant literature mostly focuses on a quantitative method to study institutions (Spiller *et al.* 2003) which add to the breadth of knowledge while this study contributes on the qualitative method to study the phenomenon of institutional aspects of policymaking which add to the depth of knowledge. This study fills the gap by mixing multiple approaches into the methodology (Yin 2003) which include interpretive, analytic narrative, and content analysis methods to explain the causal mechanism and help answer the how and why questions.

Three empirical chapters help clarify the SEZ policy process from what intrigues the actors to choose SEZ as a policy instrument, how did they propose on maintaining the policy as their political tool, and why did they choose to do so. The empirical chapters deepened the knowledge through mixed evidence of how SEZ policy as a global phenomenon yield mixed results not only between countries who adopt it but within a country in different periods such as in Indonesia.

These findings on SEZ policy processes and performance that lead to the establishment of new forms of SEZ are a departure from literature i.e. Knoth (2000), Seshadri (2011), and Moberg (2012, 2013) specifically on SEZ policy in China and India. The literature has tended to treat SEZ policy process without clear acknowledgment of SEZ variances in different period of government with political economic and collective action complexities in the size, homogeneity and purpose of the policy actors that can be construed as key determinants of success (Kherallah and Kirsten 2001) as well as their institutional patterns at different government levels.

7.5. Delineations and suggestions for further research

This section explains the shortcomings of this study and justification for further research.

The limitation of this study is that apart from the difficulties faced during the course of the research as pointed out in chapter 3 the study of institutions and the influence of it to the SEZ policy process is dynamic and tend to change over time. It should be noticed that institutional change occurred when there is an outstanding event happening in a country such as economic crisis or war, therefore the institutional framework most probably changes and the entire policy structure will also change.

Moreover, using a single case study on Indonesia as the research design is not generalizable to other countries in the world. It is better to incorporate a comparison of two or more countries in the study and better to make it a repeatable formula to get more understanding as economic reform evolved over time. Lastly, this study only generates information from a few respondents which only used subjective understanding and cannot represent the general public in assessing the SEZ policy objectively.

Suggestions for further research

This study presents two empirical case studies that represent two among many issues of national SEZ policymaking process in Indonesia or perhaps globally. This is a micro-study research that points out two episodes of political intrigues among the key actors involved in setting up the SEZ policy. There are many rooms for further research as this study is just a tip of the iceberg within the SEZ policymaking.

First, the qualitative approach used in this study can be developed and complemented with quantitative surveys of responses to generate more data and more general insights on the SEZ policy study under-researched. Second, the research sites can be added with more areas where institutions have influenced other SEZ policies located in other regions to gain more insights. Third, the methods gleaned from Williamson's model are not well-developed, therefore future research requires more ways of employing the model as any form of policy also have institutional constraints laying in the background that causes the policy not run properly or not as expected.

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Appendix 1

List of Interviewees

No	Institution	Position and Responsibilities		Interview Date
1.	Ministry of Finance	Former Deputy Director of Revenue Policy Evaluation at Centre for State Revenue Policy		30 October 2014
2.	Institute for Global Justice (IGJ)	Researcher		31 October 2014
3.		Main Research Contributor		
4.	Fiscal Policy Agency (BKF)	Former Deputy Director for State Revenue Policy Evaluation		6 November 2014
5.		Section Chief for Customs Policy Evaluation with reference to SEZ		
6.		Expert Staff with reference to SEZ		
7.	Directorate General of Customs and Excise	Former Director of Customs Information System/Now Deputy Minister of Finance		8 November 2014
8.		Former Director of Customs Facility/Now Director General		
9.		Director of International Affairs		
10.		Section Head of Duty Exemption, Directorate of Customs Facility		
11.		Head of Marunda Customs Office		4-5 December 2014
12.		Head of Cakung Customs Office		
13.		Head of Customs Facility Section		
14.	Data processing personnel			
15.	The Parliament (House of Representatives and People's Consultative Assembly/DPR and MPR)	MP - GOLKAR Party faction	Commission VI and XI on Trade, Investment and Development Planning related issues	10-12 November 2014
16.		MP - Democrat Party faction		
17.		MP - PDIP Party faction		
18.		MP - Gerindra Party faction		
19.		MP - PPP Party faction		
20.		Budget Policy Staff		
21.		Budget Policy Staff		
22.		Former Vice Chairman of People's Consultative Assembly (MPR) – GOLKAR Party faction (2009-2014)		
23.	Jakarta local parliament (DPRD)	Former MP		10 November 2014
24.	University of Indonesia	Assistant Professor of Economics and Business with reference to Southeast Asia		11 November 2014
25.	Investment Coordinating Board (BKPM)	Former Deputy Chairman for Investment Planning		13 November 2014
26.		Former Director of Investment Services and Regional Planning		
27.	Ministry of SOE	Former Deputy Director		
28.	SEZ National Council	Secretary		13-14 November 2014
29.		Head of Information Management Division		
30.		Head of Planning Subdivision		
31.		Staff in charge for programme evaluation, monitoring and reporting		

32.	Sei Mangkei SEZ, Jakarta Office	Head of Planning and Development of <i>PT Perkebunan Nasional (PTPN) -III</i>	24 & 27 November 2014
33.		Secretary to Head of the North Sumatra Regional Development Planning (Bappeda)	
34.	Tanjung Lesung SEZ, Jakarta Office	Secretary of the Tanjung Lesung Zone Management	
35.	Palu SEZ, Jakarta Office	Team Leader Palu SEZ	
36.	Bitung SEZ	Head of Regional Industry and Commerce, Bitung, North Sulawesi	
37.		Assistant Vice Mayor of Bitung	
38.	Morotai SEZ, Jakarta Office	Jababeka Morotai Ltd company representative	
39.	Tanjung Api-Api SEZ	Head of South Sumatera Regional Development Planning	
40.		Head of Regional Industry and Commerce, South Sumatera	
41.	Mandalika SEZ	Assistant Regional Secretary of West Nusa Tenggara	
42.	Maloy Batuta Trans Kalimantan SEZ	Head of East Kalimantan Regional Development Planning	
43.	Forwarder and Expedition Association of Indonesia (GAFEKSI)	Chairman of Batam office	24 November 2014
44.	PT. KBN Marunda	General Manager	25 November 2014
45.		Manager of Operation	
46.		Staff of IT and data operations	
47.		Staff of Procurement and Licensing	
48.	Ministry of Manpower	Staff of Litigation	
49.	EPZ firm representative	Marketing Manager	
50.		EPZ firms' Marketing Manager	
51.	PT. KBN Cakung	General Manager	26 November 2014
52.		Manager of Sales and Marketing	
53.	Batam Authority (BIFZA)- Jakarta Office	Marketing and Operations Manager	
54.		R&D Manager	
55.	CORE Indonesia	Economist/Executive Director	28 November 2014
56.	Coordinating Ministry of Economic Affairs (CMEA)	Deputy Chairman for the Acceleration of Infrastructure and Regional Development/Chairman of the Executive Team of the SEZ National Council	8 & 29 December 2014
57.		Assistant Deputy/Vice Chairman of SEZ National Council	
58.	Ministry of Transportation	Former official of Sea Transport Directorate	12 December 2014
59.		Former Staff of Sea Transport Directorate	
60.	Regional Planning Agency, Batam	Vice Head	12 December 2014
61.	Batam Industrial Development Authority (BIDA), Jakarta Representative	Head of Data and Information	
62.	Ministry of Industry	Former Head of Centre of Regional Trade Cooperation	15 December 2014
63.		Former Director General of Industrial Area Development	

64.		Former Head of the Agency for the Policy Analysis and Business Industry Climate	
65.	National Development Planning Agency (BAPPENAS)	Staff of Directorate of Regional and Area Development	16 December 2014
		Staff of Directorate of Industry, State Owned Enterprise, and Information Technology	
66.	Governor Team to Development Acceleration (TGUPP)	Former Staff	
67.	Ministry of Trade	Former General Secretary	19 December 2014
68.		Former Deputy of Foreign Trade	
69.	Indonesian Industrial Estate Association (HKI)	Secretary	5 January 2015
70.	ASEAN Secretary	Assistant Head of data, ASEAN FTA secretariat	
71.	Centre for Strategic and International Studies (CSIS)	Economist/Researcher	6 January 2015
72.		Secretary	
73.	Regional Autonomy Watch/KPPOD	Assistant to Executive Director	
74.	Ministry of Home Affairs	Senior Advisor for the Minister on Governance	7 January 2015
75.		Staff of Regional Autonomy Directorate	
76.	Chamber of Commerce (KADIN)	Policy Advisor	9 January 2015
77.	Indonesian Logistics and Forwarders Association (ALFI)	Policy Advisor	
78.	Statistics Indonesia Jakarta Office (BPS)	Export data processing staff	13 January 2015
79.		Production and Balance Sheet Statistics Staff	
80.	Indonesian Central Bank (BI)	Staff of Central Management of Information Systems	
81.	<i>Media Indonesia</i>	Journalist	14 January 2015
82.	<i>Kompas</i>	Journalist	
83.	<i>Bisnis Indonesia</i>	Journalist	
Total Number: 83 interviewees			

Appendix 2

GOVERNMENT PACKAGES ON GRADUAL TRADE DEREGULATION AND PROTECTION POLICIES
16 January 1982
<ol style="list-style-type: none"> 1. Arranging export / import and foreign exchange traffic to strengthen the competitiveness of Indonesian exports 2. Issued a counter purchase policy
6 May 1986
<ol style="list-style-type: none"> 1. Improve the competitiveness of Indonesian exports and ameliorate barriers that lead to a lack of investor's interest 2. Policies that include facilitating the non-oil export trading , the import duty refund system, exemption from import duty, and the enforcement of bonded zones
<p>1.Short term stabilisation programmes or demand management policies in the form of fiscal, monetary and exchange rate policies with the aim of lowering the level of aggregate demand. In this case the GOI run policies that reduce the budget deficit by cutting or removing various subsidies, raising interest rates (tight monetary policy) to control inflation, maintaining a realistic exchange rate (mainly through the devaluation of September 1986).</p>
25 October 1986
Lowering production costs by reducing a number of commodities' import duties, protection of domestic production through tariff system, granting a new swap facilities, and investment policy.
15 January 1987
Enhance the smooth supply of goods for the production and protection of domestic industries more efficiently by converting non-tariff to tariff policy for a number of specific commodities
Increasing the productive capacity of the economy through the promotion of savings and investment. Improvements in government savings through fiscal reforms, increasing private savings through financial sector reforms and promote investment by providing incentives and loosening restrictions
24 December 1987
<p>The opening of mobilisation of funds in the money market, to facilitate licensing in the production, services and investments sectors in general, as well as to facilitate the flow of exports and imports</p> <p>The December Package I Policy 'Pakdes I/1987' promoted taxation thus revived the capital market</p>
1988
Structural policies in order to boost output through increased efficiency and resource allocation by reducing the distortion due to price controls, taxes, subsidies and trade barriers, tariff and non-tariff controls. November Package Policy or 'Paknov 1988' which removes the import monopoly for some steel products and other essential raw materials, has pushed the market mechanism to function effectively at the time.
the October Package Policy 'Pakto 27/1988' led to the proliferation of private banks
the December Package II 'Pakdes II/1988' deregulated the insurance business and a variety of financial services
The May Package Policy 'Pakem 1986' and June Package Policy 'Pakjun 3/1991' reduced barriers to international trade and provide incentives that are very attractive to foreign investors and the
28 May 1990
The government has set to replace the national industry protection mechanism from strict import regulation to the imposition of import tariffs in order to improve and strengthen the competitiveness of national industries
6 July 1992
The government eased the import regulation and the core of the policy so that any manufacturer can directly import without requiring further recommendation from the Ministry of Industry
10 June and 23 October 1993 Policy Package and De-bureaucratisation
Consisting of deregulation of automotive, export/import, investment and business licensing, and pharmacy sectors
July Package 'Pakjul 1993' aimed to facilitate the investment licensing
Creating legal and institutional environment policies that can encourage the effective operation of market mechanisms including property rights assurances and various supporting measures such as the laws and regulations reforms, rules of the game that ensured free competition and a variety of programmes that allow such an environment. The enactment of Copyright and Intellectual Property Rights Laws was also part of the various packages above.

Appendix 3

Development Progress of Batam

INDICATOR	Remarks	2010	2011	2012	2013	2014
TOTAL CUMULATIVE INVESTMENT	US\$ Billion	14.59	14.92	15.69	16.47	17.71
GOVERNMENT CUMULATIVE INVESTMENT	US\$ Billion	2.92	3.00	3.09	3.37	3.62
FOREIGN CUMULATIVE INVESTMENT	US\$ Billion	5.94	6.16	6.78	7.28	8.27
DOMESTIC CUMULATIVE INVESTMENT	US\$ Billion	5.73	5.75	5.82	5.82	5.82
PUBLIC AND PRIVATE INVESTMENT RATIO	Comparison	1:3.99	1:3.97	1:4.07	1:3.89	1:3.89
BATAM TAX REVENUE	Billion Rupiahs	1,817.39	2,101.75	2,674.84	2,411.39	3,932.35
OWN-SOURCE REVENUE	Billion Rupiahs	161.84	335.41	409.98	606.34	359.48
NON OIL EXPORT	US\$ Billion	8.48	9.35	8.62	9.36	9.15
GROSS DOMESTIC REGIONAL PRODUCT	Trillion Rupiahs	47.30	52.62	57.65	65.55	65.55
ECONOMIC GROWTH	Percentage	7.77	7.20	6.78	5.83	5.83
INFLATION	Percentage	7.40	3.76	2.02	7.81	7.61
FOREIGN CUMULATIVE FIRMS	Firms	1,247	1,349	1,443	1,563	1,699
SMALL AND MEDIUM CUMULATIVE ENTERPRISES	Firms	9,900	9,900	10,726	10,726	10,726
POPULATION	People	1,056,701	1,137,894	1,235,651	1,135,412	1,030,528
INDONESIAN WORKERS	People	288,318	313,544	330,592	330,592	330,592
FOREIGN WORKERS	People	5,108	5,510	5,970	5,970	5,970
PERCENTAGE OF WORKERS COMPARED TO TOTAL POPULATION	Comparison by Firms	1:3.60	1:3.57	1:3.67	1:3.67	1:3.67
FOREIGN TOURIST	Visitors	1,007,446	1,161,581	1,219,608	1,336,430	1,454,110
FOREIGN TOURIST REVENUE	US \$ Billion	353.76	371.48	438.83	438.83	438.83
REMITTANCE	Billion Rupiah	376.36	440.31	497.99	497.99	497.99
ELECTRICITY (POWER) +PRIVATE	Million Watt	372.25	371.66	509.63	509.63	502.42
CLEAN WATER	Litre/second	2,463.00	2,623.37	2,702.53	2,903.25	2,771.90
ROAD INFRASTRUCTURE	Kilometre	434.64	437.74	438.46	438.46	438.46
STARRED HOTEL	Hotels	58	58	64	64	70