GLOBALIZATION AND THE ROLE OF LOCAL GOVERNMENTS:
CASE STUDY OF THE SURABAYA METROPOLITAN AREA IN INDONESIA

by

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We accept this thesis as conforming
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ABSTRACT

The central government of Indonesia has played a central role in planning and implementing economic policies to attract and utilize foreign investment for industrialization. At the same time, the government has been trying to promote decentralization since the early period of independence. However, the two policies of national economic development and decentralization are sometimes in conflict because of institutional contradictions and the balance of power and responsibilities between central and local government.

With this background in mind, the research question of this thesis concerns the linkage between decentralization policies and Indonesia's links with the global economy. To find out an answer to this research question a field study was carried out in the Surabaya Metropolitan Area (SMA), which is the second largest metropolitan area in Indonesia.

The case study demonstrates the crucial role that foreign investment plays in local economic development. Foreign investment activities, including both foreign direct investment (FDI) and ODA, have propelled metropolitan population growth and rapid urbanization due to the expansion of jobs and the attractiveness of the SMA to rural migrants. Through such foreign based development projects, local governments and local enterprises have their own linkages to the world economy (especially overseas investors). In turn, the autonomy of local governments has begun to increase, although as yet this can be seen only to a limited extent within Indonesia's 'delayed' decentralization framework. The impact of the global economy on Surabaya has not only a positive economic aspect, but also adverse environmental and social aspects, although these last two aspects have been mainly an indirect result of foreign investment.

Governments have to make clear frameworks which can address the critical influence of the global economy on local communities. However, decentralization policies in Indonesia have to be considered in relation to national and local circumstances. Hence, while maintaining its centralized government structure to some extent at least, the Indonesian government should clarify the responsibilities of each level of government within the country's two tier structure of local governance and strengthen the necessary functions of each level of government.
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GLOSSARY

(Terms)

Bupati
Head of Local Government Level II Kabupaten (rural and urban areas)

Dinas
Local Government Level I and II (Provincial or Kabupaten / Kotamadya) Department Agency

Goton-royong
Mutual self-help

Kabupaten
Regency, Local Government Level II, Sub-division of Province, headed by a Bupati, status equal to that of Kotamadya

Kampung
Traditional residential area, often called as village or urban neighborhood

Kecamatan
District

Kelurahan
Sub-district

Kota Administratif
Administrative Town

Kotamadya
Municipality and/or City, Local Government Level II, Sub-division of Province, headed by a Walikotamadya (Mayor), status equal to that of Kabupaten

Musyawarah
Collective deliberation

Propinsi
Province, Local Government Level I

Rupiah
Currency of the Republic of Indonesia

Tingat I, II
Level I, II; also refers to government administration at Provincial and Kabupaten / Kotamadya

Walikotramadya
Head of Local Government Level II Kotamadya (urban areas)

(Abbreviations)

ADB
Asian Development Bank

AL
Adjustment Lending (the World Bank aid programme)

ASEAN
Association of Southeast Asian Nations

Bappeda
Local (Regional) Development Planning Board

Bappenas
National Development Planning Board

BKPM
National Investment Coordination Board

BKPMĐ
Regional service agency of BKPM

B.O.O.
Built-Operate-Own

B.O.T.
Built-Operate-Transfer

BPN
National Land Agency

DAC
Development Assistance Committee
**CGI**
Consultative Group for Indonesia

**Dinas**
Local government service department, responsible to the provincial governor or to Bupati at district levels, and with indirect links to the relevant central government department

**DPR**
People’s Consultative Assembly

**DPRD I**
People’s Local Representative Council *Tingat I* (Provincial)

**DPRD II**
People’s Local Representative Council *Tingat II* (*Kabupaten / Kotamadya*)

**GDP**
Gross Domestic Product

**GRP**
Gross Regional Product

**GKS**
*Gerbangkertosusila* (urban agglomeration of the Surabaya city and the surrounding six municipalities and regencies)

**EPTE**
Export Oriented production Entreport programme

**HWP**
Human Waste Programme

**IBRD**
International Bank for Reconstruction and Development

**IGGI**
Inter-Governmental Group on Indonesia

**IMF**
International Monetary Fund

**INPRES**
Presidential Instruction Grants (for special allocation fund for development)

**UIDP**
Integrated Urban Infrastructure Development Programmes

**JICA**
Japan International Cooperation Agency

**Kandep**
Local Office of Central Ministry in *Kabupaten / Kotamadya*

**Kanwil**
Local Office of Central Ministry in Province

**KIP**
Kampung Improvement Programmes

**KIM**
*Kawasan Industri Maspion* (Industrial park in Maspion)

**KMS**
*Kotamadya Surabaya* (Surabaya Municipal Government)

**KSKS**
Statistical Office of Surabaya Municipality

**LEPELITA VI**
Sixth National Plan Between 1995 and 2000

**LIDAP**
Local Government Development Action Plan in UIDP

**MPR**
People’s Consultative Assembly

**NICs**
Newly Industrialized Countries

**NGO**
Non-governmental Organization

**NIDL**
New International Division of Labor

**ODA**
Official Development Assistance

**OECEF**
Overseas Economic Cooperation Fund of Japan

**O & M**
Operation and Maintenance
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<td>Transnational Corporations</td>
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<td>PBB</td>
<td>Land and Property Tax</td>
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<td>PBL</td>
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<td>PDAM</td>
<td>Local Water Supply Enterprise</td>
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<td>RIAP</td>
<td>Revenue Improvement Action Plan in IUIDP</td>
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<td>RT</td>
<td><em>Rukun Tenaga</em>; formal community unit which consists 40-50 households</td>
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<tr>
<td>RW</td>
<td><em>Rukun Tenaga</em>; formal community unit which consists 5-15 neighborhood (<em>RT</em>)</td>
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<td>SMA</td>
<td>Surabaya Metropolitan Area</td>
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<td>SUDP</td>
<td>Surabaya Urban Development Project</td>
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<td>UMU</td>
<td>Urban Management Unit (of Surabaya City)</td>
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CHAPTER 1
INTRODUCTION

1.1 Background of the thesis

The 1970s and 1980s saw an important shift from an "international" to a "global economy." In the international economy, trade across national boundaries largely comprised goods and services produced by individuals and firms from different countries, and this trade was generally regulated by sovereign nation-states. In the more recent global economy, goods and services are produced and marketed through an interacting network of global corporations operating beyond national boundaries and only loosely regulated by nation-states. Because of this growing phenomenon, foreign direct investment (FDI) by internationally mobile firms is now expanding faster than trade between nation-states and all major 'circuits of capital' are becoming integrated on a global scale (Knox, 1995, Allen, 1995, Douglass, 1991). Similarly economic globalization has profoundly altered the social, economic and political reality of regions and cities which tend to interact more and more with a world economy operating beyond national territories (Sassen, 1991, 1994).

This global economy has not made an exception of developing countries. Besides their traditional role in the international division of labors as locations of strategic raw materials, these countries are now vigorously competing to be chosen as investment sites and centers of production in this new global system, mainly due to their lower labor costs and growing domestic markets. Furthermore, in developing countries deregulation policies for attracting foreign investment have been launched, as foreign investment is considered as necessary capital for economic development. In this way, the economies of developing countries are strongly connected to the global economy, and some regions particularly in the newly industrializing countries (NICs) of East Asia have already become important players in this global arena. Because of the influx of foreign capital, several primate cities in Southeast Asia such as Bangkok,
Manila and Jakarta are increasingly divorced from their own national peripheral regions as transnational linkages increase (McGee, 1995, Friedman and Wolff, 1982).

It is also true that economic and demographic growth in developing countries tends to focus on primate cities, most of which are capital cities due to the high access to decision makers, the high concentration of mass markets and the better infrastructure in these areas. Rapid urbanization of these primary cities has been always accompanied by various problems such as environmental degradation, traffic congestion, insufficient infrastructure provision and housing shortages (Sit and Mera, 1982, cited in Lin, 1994). In addition, a strong centralized government structure in many developing countries has often negative effects on local communities. This is because central authorities do not always grasp local situations properly. The politicians and bureaucrats in the central governments of developing countries often tend to make use of their power for their own interests. Consequently, the international development community such as the World Bank has used the promise of aid funding to lobby for decentralization of power to regional and local governments, arguing that sustainable economic growth in developing countries cannot be attained without decentralized planning. In particular, institutional development by local governments is considered to be a prerequisite for sustainable development (Walker, 1991). But as one can see from many examples in Southeast Asia, many states have hesitated to proceed with such policies because of fears that such action would undermine national unity and disrupt centrally-defined national priorities, as one can see in Indonesia (ibid.). Furthermore, it seems to be difficult for entrenched bureaucratic hierarchies, reinforced by the persistence of nepotism, to surrender their planning and decision-making authority to local bodies (Slater, 1989, Rondinelli, 1990).

With this background in mind, my research questions concern the linkage between decentralization policies and the global economy in Indonesia. In Indonesia, foreign direct investment, accompanied by advanced technology for industrialization, has played an important part in overall economic development. Yet in the current development stages of Indonesia it is
central authorities who play the major role in attracting the necessary foreign capital. On the other hand, as noted above, decentralization of authority is also needed for the appropriate development of local communities. For Indonesia, such a process has not advanced far, still the government of Indonesia has already started decentralizing efforts since the early 1970s in order to achieve effective regional development and the balanced development of regions. However, as will be described in this thesis, the two policies economic development and decentralization are sometimes in conflict because of the institutional contradictions between the central and local levels. In addition, it is not easy for Indonesia to create a government system which has an appropriate administrative and financial balance between the center and the regions or even among regions. This is because Indonesia is an extensive archipelago state with diverse population and unbalanced resource distribution.

Decentralization in Indonesia has caused much internal debate, most of which has focused on local autonomy and appropriate political responsibility at each level of government (see MacAndrews, 1986, Morfit, 1986, Devas, 1989). But, as a recent trend, local cities or areas are themselves beginning to be directly influenced by the global economy due to the rapid inflow of large-scale foreign investment projects. Therefore, managing the linkage between decentralization of governments and the global economy is an important agenda for both national government and local communities in Indonesia.

1.2 Research questions and study methodology

With the above-mentioned background in mind, my research directions concerning Indonesia’s decentralization and globalization can be specified in the following questions: First, even though the impact of the global economy has been concentrated in Jakarta and its metropolitan area for the last several decades, to what extent does the new global economy (especially ‘new generation’ foreign investment activities encouraged by the government’s recent deregulation policies) influence secondary cities and their metropolitan areas? Further, what kind
Chapter 1 Introduction

of impact does such foreign investment have on local communities in terms of local governance, and also in terms of environmental and social aspects? In other words, what have been the adverse outcomes of these investment activities? Lastly, are the present local governments up to the job of managing the impact of this globalization? That is, in the context of such globalization, what kind of role should local governments play in negotiating with overseas investors as well as planning and development?

In order to find out answers to these research questions, a field study was carried out to assess recent conditions in the Surabaya Metropolitan Area (SMA) in June and July, 1996. The SMA is the second largest metropolitan area in Indonesia behind the Jakarta Metropolitan Area, and now shows rapid population and economic growth. As will be seen in the following chapters, this growth has been strongly influenced by a new wave of foreign investment activities since the early 1990s. Hence, the case study in the SMA will be a useful example for considering the linkage between Indonesia's decentralization policies and the new global economy (which have occurred since the mid-1980s) and their effectiveness or otherwise of these policies. The study consisted of a field survey and the collection of secondary data on urban development trends in the SMA, together with interviews conducted with personnel engaged in planning and development (see Appendix A). This thesis is based on the result of this field survey as well as a review of the relevant literature concerning government decentralization and globalization both in Indonesia and other developing countries.

1.3 Thesis outline

The second and following chapter describes general comments on central-local relations and the linkage between decentralization and globalization in developing countries through reviewing the relevant literature. Classification criteria for decentralization policies and a broad-scale evaluation of developing countries' decentralization efforts are also examined.
Chapter 1  Introduction

The third chapter discusses the impact of globalization on Indonesia’s economic development. The present situation of foreign investment and the government’s policies for dealing with it are discussed. This includes consideration of foreign aid contributions to Indonesia and the role of overseas governments and agencies in foreign investment activities.

The fourth chapter discusses the overall situation of government decentralization in Indonesia. This includes the history of Indonesia’s decentralization policies and their implementation, government structure and planning systems, and the evaluation of Indonesia’s decentralization programmes.

The fifth chapter examines the result of my field study in the Surabaya Metropolitan Area (SMA). This includes the following aspects: First, the basic background of the SMA is given including its history, population growth and current urban issues. Second, the regional economic development situation and the factors causing rapid investment growth are considered. Third, this chapter addresses the major urban development projects now being implemented such as industrial parks, commercial and housing projects and infrastructure projects. Fourth, the role of governments (the central and local governments) with respect to urban planning and development in the SMA are discussed.

The sixth chapter provides a broader analysis of the case study. This will address the research questions described above. This includes the influence of the global economy upon the local communities in the SMA in terms of economic, environmental and social factors, and the role of local governments in the context of globalization.

The seventh chapter is the conclusion. This includes the summary of research findings from the case study, a review of local governance and autonomy in the SMA, policy recommendations for decentralization policy in Indonesia, and recommendations for further research.
CHAPTER 2

DEBATES OVER DECENTRALIZATION AND GLOBALIZATION

This chapter will review the literature concerning administrative decentralization and globalization. The more general debate over the merits of government decentralization will be discussed first followed by debates over the linkage between decentralization and globalization, and finally a discussion of local governments’ new roles and structures in the context of the global economy.

2.1 Debates over government decentralization

Although decentralization efforts have been carried out in many developed and developing countries, the policies adopted by each differ in many ways depending upon a particular country’s situation. In several cases decentralizing efforts have ended up not accomplishing the expected results (see several examples in Africa described by Slater, 1989). One of the crucial facts found in the process of reviewing the literature is that the meaning of decentralization has been understood in different ways by each country. Therefore, the criteria for a more general classification and evaluation of such policies should first be considered, prior to discussing the specifics of Indonesia’s decentralization policies.

(i) The situation of decentralization in developing countries

In many cases developing countries tend to have a strong centralized government structure. According to Slater (1989, 503-506), the main factors that have contributed to the centralization of state power can be considered as follows:

1. Establishment of state enterprises; historically, the governments of many developing countries have presided over the development of certain key economic functions, such as transportation, communications, energy and basic industries. (e.g. Latin American countries, after the Second World War)

2. Impact of external forces; with trends towards increased concentration and trans-nationalization of capital, the local and regional organs of the state have tended to be weakened. The transnational nature of capital tends to reinforce the mediating role of the central state.
3. **Concentration of power and political culture**: political classes or bureaucracies grow accustomed to functioning in a centralized manner, and the state bureaucracy has a tendency for self-sustained and self-accumulating growth. The concentration of powers in the administration, and economic activities in or around the capital city, contributes to reinforcing the centripetal bias of development.

4. **Dynamic of organizations**: centrality is, in part, sponsored by the organizational process. The hierarchical nature of the organizational structures of the state tend to strengthen the centralization of internal decision-making processes. For example, the rationing, procurement and contractual functions of the state tend towards centralization.

5. **Socialist attitudes**: developing countries' left-wing political parties have tended to adopt centralizing approaches to social and economic development. The customary association of local elites with the power of landed privilege has tended to bolster combined images of centralism and socialist progress.

6. **Existing threats to the state**: in many developing countries guerrilla organizations constitute a continuous threat to the political jurisdiction and control of the state. Consequently the concentration of power has been intensified still further on military governments.

These situations sometimes have negative effects on local communities. This is because central authorities do not always grasp local situations properly, and politicians and bureaucrats in developing countries often tend to make use of their power for their own interests. It is no wonder that the international development community, such as the World Bank, argues that sustainable development cannot be attained without planning for decentralization (Walker, 1991).

Harris claim that decentralization can be:

- a unifying force in the consolidation of new national identities;
- a technical solution to problems of bureaucratic inflexibility and the over-concentration of decision-making in central government ministries;
- a policy that will soften resistance to the inevitable and potentially destabilizing social changes that development brings about (Harris, 1983).

Aiming at these objectives, many developing countries have planned or implemented decentralizing policies, modeled on those of the developed countries. However, decentralization policies do not always have a positive effect on local communities in these countries.
One can see several examples of the deficiencies of decentralization efforts in developing countries. These include:

- **pretended or bogus (administrative but not political) decentralization policies:** Administrative deconcentration policies are not always accompanied by actual political decentralization. These kinds of policies can even increase the power of the state, by creating an organizational structure for deeper penetration and control. For instance, in the case of Tanzania's 'development villages' policy in the 1970s, although approximately forty per cent of the central government budget was allocated to the local regions, to be utilized for regional projects, these funds did not come under local control, but were controlled from above. In addition, there is often little attempt made to facilitate mass participation in the decision making structure with these types of policies (Slater, 1989).

- **unequal distribution of resources in local communities:** If power at the local level is highly concentrated, a decentralization policy will only make things worse for the poor, since only local elites obtain the benefit. This kind of situation sometimes occurs because [as Rondinelli suggests (1979)] local governments can easily be captured by elite groups or vested interests, who are unwilling to share power or allow greater participation in decision making.

- **inefficiency of decentralized systems:** While decentralized systems often show inefficiency, centralized planning systems work more efficiently in some respects. Services of a national level that benefit from economies of scale can only be distributed equitably by a large government; those that can create territorial spillover effects may be better administered by central governments. For instance, according to Slater (1982, 1989), Cuba, a highly centralized state, has carried through policies of income and land redistribution as well as effecting important reductions in the degree of regional inequality. Yet it is also true in other centralized Latin American countries that the provision of social services and the maintenance of social welfare at the local level are far superior.
(ii) Classification of decentralization policies

As one can see from case studies in developing countries described by scholars such as Slater and Rondinelli, decentralization policies have various characteristics and show various results. In some cases, as for example in Tanzania, 'pretended or bogus' decentralization policies were implemented in order to appease local communities or international criticism. Yet such a policy eventually ended up strengthening the central government's control over local governance. In order to summarize the wide range of decentralization approaches, some general criteria for the classification of decentralization policies will now be discussed. These criteria will be used later in this part to evaluate Indonesia's decentralization policies.

From the literature, there are several criteria for classifying decentralization policies. First, under the politico-administrative rubric fall classification criteria such as government functions, their type, level of importance and territorial distribution. Various local administrative bodies and their activities can be examined to identify these criteria of decentralization. Generally, expanding responsibility and the range of decision spheres of local or regional governments will enhance the degree of decentralization. It is also important to know whether the statutory right for certain local activities to take place comes via the central government or directly from local legislatures, and whether the personnel of local institutions, especially the executive class, is selected at the local level or whether they are appointed by the central government. Second, under the economic rubric, the relative power of revenue raising at a local level is usually seen as the crucial criterion. The proportion of total state revenue that is raised locally, and the level of local expenditure as a proportion of total public spending, can give an useful indication of the extent of decentralization (Slater, 1989, Rondinelli, 1990, Samoff, 1990).

Keeping these criteria in mind, Samoff classifies decentralization efforts and ideas as follows:
• administrative (organizational or administrative arrangements); political (transfer of decision making authority to previously underrepresented or marginal groups); and economic (transfer of budgetary authority or expansion of local revenues);
• deconcentration (spatial relocation of decision making); delegation (assignment of specific decision making authority); and devolution (transfer of responsibility for governing understood more broadly);
• partial decentralization (transfer of only a small portion of responsibility) and real decentralization (Samoff, 1990).

(iii) **Policy considerations for developing countries’ decentralization**

There is no general strategy or universal model for decentralization, because the conditions for policy implementation are quite different in each country. In addition, there is an unresolved debate concerning decentralization policy, as one can see in a series of debates between Slater, who is said to have a neo-Marxist approach, and Rondinelli, who is said to have a neo-liberalist approach (see Slater, 1989, 1990, Rondinelli, 1990). Nevertheless, the following several points can be made as significant for considering effective and equitable decentralization policies in developing countries:

a) **popular participation (local democracy)**: greater decentralization does not necessarily imply greater democracy. Hence, a crucial issue is who is to have access to decision making after decentralization. Local democracy can breath real life into decentralization.

b) **selective use of decentralization and the levels of local government involved**; some services are efficiently provided under decentralization, but some services can be properly provided only under a centralized system. Therefore, as Rondinelli et al. mention (1989), decentralization policies must begin with a clear understanding of which services can effectively be decentralized. In addition, the levels of local government which will be able to provide government services effectively and efficiently will be different, depending upon the nature of a government service; in some cases, this will be provincial level governments, but, in other cases, this will be municipal level governments.
c) **resource mobilization;** transfer of financial responsibility to local governments is essential for real decentralization. A World Bank report (1988) points out that decentralizing both spending and revenue authority can improve the allocation of resources in the public sector, by linking the costs and benefits of local public services more closely.

d) **ethnic and cultural considerations;** since the rural population in developing countries does not always conform to Western assumptions, as Rondinelli et al. (1989) describe for countries with Islamic and Buddhist cultures, special consideration will be needed in this respect. Otherwise, ethnic and cultural divergence may undermine the stability of the whole nation.

e) **privatization and deregulation;** public and private partnership often works well for effective -- in particular cost-effective -- and efficient service provision, and for expanding access to services and infrastructure to local communities. Deregulation policies will promote the private sector's activities and foster the private sector itself. And small-scale private enterprises play a crucial role in generating income for the poor in many developing countries (Rondinelli, 1990).

f) **collaboration with NGOs;** several NGOs are quite sensitive to social and cultural values at the local community level. Therefore, they can complement governments' decentralization policies, and the collaboration between government and NGOs might encourage popular participation in development in local communities (Walker, 1991).

### 2.2. Debates over decentralization and globalization

#### (i) The overall debate over decentralization and globalization

As several scholars point out, in the context of the emerging global economy some cities and regions, which have become new engines of prosperity, have direct links to other countries beyond their national borders and their state's government control. For example, Sassen (1994) provides the notion of "a world [global] city," defining cities which have evolved into the
transnational market space, such as New York, London, Tokyo, Sao Paulo, among others. Ohmae (1995) also documents how affluent economic zones (regions), such as Hong Kong and the adjacent portion of the Chinese mainland, San Diego and Tijuana, which form natural business units, have arisen throughout the world. He describes how these “region states” have closer links to other “region states” than to their host nations.

As Ward (1995) describes, however, many scholars have analyzed such “global cities” and regions mainly from the point of view of their importance as production, control or financing centers. The political-administrative structures through which such cities and regions are governed and managed have been given insufficient consideration:

> [K]ey issues concerned with city administration and governance have been neglected because they do not offer immediate and easy ‘purchase’ upon global issues, and because, at best, they are only very indirect outcomes of international process (Ward, 1995, 301).

But in fact, the global economy has influenced both the functions of local administrators and their actions, because global changes are creating new, complex and decentralized economic and social systems that will not be able to be handled by the old centralized systems of governance. Jun and Wright (1996) suggest the importance of strengthening local autonomy in order to adapt to such global changes:

> It is necessary to reform governing structures and processes in order to allow more autonomy at the local level so that local administrators can learn to become effective in solving local problems and active in promoting international activities. Centralized governments, in general, respond slowly not only to domestic but also to international problems (1996, 4).

In the United States, for example, in the past two decades state and local governments have expanded their activities into foreign affairs not only on economic issues but also in other areas, such as immigration and nuclear issues. Although many still believe that foreign affairs is a national function, such activities of state and local governments cannot be ignored in the emerging
global economy. The Advisory Commission on Intergovernmental Relations notes that rapid internationalization is requiring American state and local governments to revamp their export programmes, trade missions, foreign investment programs, cultural exchanges, tourist programmes, immigrant services, and so on (Beaumont, 1996).

In Japan, which in contrast with the United States local autonomy has been delegated down from the excessively centralized state, internationalization and globalization have also done much to bring about local autonomy. Today prefectural governments have to deal with unemployment caused by the hollowing out of their industrial structures and stagnation of their economies. These factors are directly influenced of the global economy:

[T]hey are aiming to attract new domestic and foreign investment in the industrial sector. They are also attempting to create new industries by expanding airport, with an eye toward promoting international exchange, and by developing human resources through establishing prefectural engineering and design colleges. All these activities suggest that the prefectures that were once branch offices of the central government have been changing gradually into organizations that support local autonomy (Hoshino, 1996, 368-369).

(ii) Debates within developing countries over decentralization and globalization

Until recently, much of the documentation on the growth of “world cities” has focused on the cities of developed countries. Little has been done on the emergence of such cities in developing countries (Lin, 1994). But some scholars point out that several primate cities of developing countries have followed the world city model of developed countries. Armstrong and McGee (1985) link the process of trans-nationalization of capital with the changing functional structure of urban hierarchies in developing countries in their study of the urbanization process in Asia and Latin America:

In many underdeveloped countries, patterns of primate city growth have followed those of the global cities of the industrial capitalist nations in certain respects -- in providing central
places for transnational corporations, world financial institutions, and business, administrative and political elites. (1985, 48).

There is a growing consensus that the increasing scale at which production and distribution are organized within the world economy has a substantial impact on urbanization and the structure of the city. However, the extent of the influence of the global economy on urbanization in developing countries is still unclear. Lin (1994) divides existing studies into two seemingly opposing schools of thought. According to proponents of the “dependency school” like Kentor (1981), trade and investment dependent upon global capital has exacerbated the problem of the growth of huge primate cities, increased the likelihood of ‘over-urbanization,’ and hindered more equal income distribution. In contrast, other empirical studies by Kelly (1984), Fuchs and Pernia (1987), for example, show that foreign capital influx has had no effect on overall urbanization. The urban situation in developing countries reflects each country’s level of economic development, its existing patterns of economic activity, and its population and infrastructure rather than foreign investment. The assessment of the impact of the global economy on the urbanization of developing countries has thus become a subject of unresolved debate (Lin, 1994).

The debate over the impact of the global economy on developing countries’ local governance is unresolved as well. Although in the United States and Japan globalization and internationalization are expanding local government activities and requiring more local autonomy, some scholars point out that in developing countries globalization contradicts decentralization policies. According to Slater (1989), the global economy is one of the major factors that have contributed to the centralization of state power in developing countries:

With trends towards increased concentration and trans-nationalization of capital, reflected in the operations of both industrial and banking corporations, the local and regional organs of the state have tended to be weakened. The accelerated spatial mobility, and
transnational nature, of capital tends to reinforce the mediating role of the central state (1989, 503).

(iii) The role and structure Local government in the global economy

Although Slater discusses the weakening of local governance in the context of the global economy, others stress the necessity of strengthening local government functions. According to Townroe (1996), the prime role of local governments in developing countries in the past half century has been twofold:

First, to establish the core infrastructure of a modern industrial state: key energy supplies, communication infrastructures, central health care and education systems, governmental institutions, supports for industrial and commercial investment. Secondly, to absorb a rising population, with associated pressures on rural labor markets. The challenge of policies to relieve urban poverty remains close to the top of all city government agendas (1996, 23).

Then, Townroe (1996) describes new roles for local governments which are now being added to these two prime roles in the new international economic context of the late twentieth century:

First, there is a role for the city in supporting the progressive upgrading of quality and value for money in the export sectors. This requires investment and improved labor skill to secure rising labor productivity and falling unit labor cost. The city has to facilitate access to capital (domestic and foreign), and to new technology. The second role lies in fostering new lines of economic activity, in the externally traded sectors in both manufacturing and in services. These new activities may come from existing local companies and organizations or from inward investors from elsewhere. A third role lies in providing for the consumption aspects of a modern state. Even in poor cities the media and entertainment sectors of the local economy will be large and significant (1996, 24).
New forms (or structures) of local governance, accompanied by new local roles required in the context of the global economy, may also be demanded. In this respect, Ward (1995) explores a two-tier structure of city- or metropolitan-scale local governance amongst his primary principles of successful local government management and administration as follows:

There should be one authority with responsibility for the whole of the city or metropolitan area, with executive powers over certain macro-level activities such as planning and primary zoning; collective transportation planning and development; primary service networks and procurement; as well as other first-tier services such as hospitals and higher education centers, etc. Then all other activities should be decentralized to a number of local level city halls (borough or municipal), which should provide lower-order services such as planning and secondary zoning; installation and maintenance of utilities and service infrastructure; licensing; health centers and general practice organization; schools, etc (1995, 303).

Friedmann (1996) calls such new forms of local governance in the global era "a new territorial division of powers." He describes the importance and difficulty of its actualization as follows:

An optimum territorial division of powers can probably only be imagined. The tension between centralization and decentralization will probably never be resolved once and for all. Nevertheless, it is not a trivial question. If governance does not extend to the whole of the city region, and if local units of government are given insufficient powers, it is likely that other objectives vital to world city formation can be achieved (1996, 20).

Summary of chapter 2

Many developing countries, which tend to have strong centralized government structures, have planned or implemented decentralization policies. However, the policies adopted differ in many ways depending upon a particular country's situation, and such policies do not always have a positive effect on local communities. In this chapter, therefore, the criteria for classification and
evaluation of decentralization policies and policy considerations have been examined in order to review the specifics of Indonesia's policies.

In many developed countries, such as the United States and Japan, globalization and internationalization are expanding local government activities and requiring more local autonomy. However, the debates concerning globalization and decentralization in developing countries are still unresolved: in the context of the global economy some scholars describe expanding local governance, while others describe weakened local and regional organs.
CHAPTER 3

GLOBALIZATION AND INDONESIA'S ECONOMIC DEVELOPMENT POLICIES

The thesis now moves to a discussion of how the new global economy has impacted on Indonesia's economic development. This will set the scene for the more detailed study of the Surabaya Metropolitan Area's (SMA) links to the world via foreign direct investment (FDI) and aid programmes.

At the global level, industrial activities traditionally associated with Western countries have either been established in or relocated to some of the developing counties. The new international division of labor (NIDL) is in part due to new developments in communications, transport, and production technologies, allowing major international investors to identify niches in various locations within a global production system for export. ASEAN has been a major focus of this investment over the past two decades (McGee, 1995, 18-19). In Indonesia, this trend has been occurring especially since the 1990s, following Thailand and Malaysia, where the investment boom started in the 1980s. This section will discuss the economic influence of the global economy upon Indonesia, considering the present situation of foreign investment and the state's policies for dealing with it.

3.1 Foreign investment in Indonesia

3.1.1 Present situation of foreign investment

In 1994, the approved amount of foreign investment reached US$ 23.7 billion. This was the first time in Indonesian history that the amount of foreign investment surpassed US$ 20 billion a year, almost twice the largest amount of foreign investment before 1994 (US$ 10.3 billion in 1992) (see Figure 3.1). The number of approved foreign investment projects in 1994 was also the largest in Indonesian history with 451 projects. These figures continued to rise; in 1995 the approved amount of investment reached US$ 39.9 billion (BKPM, 1995 in Jetro, 1996, Kagaya, 1996).
In the history of private foreign investment in Indonesia, there were three major investment booms after the promulgation of the foreign investment act in 1967. The first investment boom was from 1967 to 1974, in which investments occurred mainly for import substitution industries, such as automobile, electronics and textile industries. But due to the state’s policies restricting foreign investment, after 1974 foreign investment became stagnant for more than 10 years. The second investment boom was from 1987 to 1990, due to a series of deregulation policies and the appreciation of the Japanese and Newly Industrialized Countries’ (NICs’) currencies. However, during this period, although the amount of investment in Indonesia increased, foreign investments in ASEAN were mainly focused on Thailand and Malaysia which had already created better infrastructure and had initiated drastic deregulation policies. In contrast with these investment booms, the third boom, which started in 1994 and still continues today, has been dramatic. In this period, foreign investment has been made not only in import substitution and export oriented industries, but also in supporting industries. This rapid increase of foreign investment derives mainly from Indonesia’s drastic deregulation policies in the early 1990s, increasing labor costs in the NICs and other ASEAN countries, and maturing domestic markets (Oguro and Kohama, 1996, and Jetro, 1996).
Regarding the sectoral compositions of foreign investment, although some service sectors -- such as trade, hotels and real estate -- had increased from the late 1980s, in the 1990s the industrial sector (especially the manufacturing sector) still had the largest share (see Table 3.1). Thus, in 1992, the share of foreign investment in the manufacturing sector was more than 60 per cent (Hill, 1996, 78).

**Table 3.1 Approved Foreign Investment by Sector, 1980 and 1992 (per cent)**

<table>
<thead>
<tr>
<th>Year</th>
<th>1980</th>
<th>1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry</td>
<td>82.8</td>
<td>68.5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>67.2</td>
<td>61.4</td>
</tr>
<tr>
<td>Mining</td>
<td>14.7</td>
<td>6.1</td>
</tr>
<tr>
<td>Construction</td>
<td>0.9</td>
<td>1.0</td>
</tr>
<tr>
<td>Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade, hotels</td>
<td>7.3</td>
<td>28.0</td>
</tr>
<tr>
<td>Mining</td>
<td>2.7</td>
<td>11.6</td>
</tr>
<tr>
<td>Real estate, business services</td>
<td>2.6</td>
<td>11.8</td>
</tr>
<tr>
<td>Transport and communications</td>
<td>1.7</td>
<td>2.6</td>
</tr>
<tr>
<td>Other</td>
<td>0.3</td>
<td>2.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>9.8</td>
<td>3.4</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


In terms of regional patterns of foreign investors, since the 1960s Japanese investment has been the largest. Thus in 1980 Japan’s share of foreign investment reached about 50 per cent. But after 1990 the share of NICs’ investment has increased, while Japan’s share decreased. In 1994 Japan’s share of the value of cumulative foreign investment plunged to about 20 per cent. However, this still forms the largest investment share in Indonesia. Moreover, Fujita and Hill suggest that since Japan has developed a horizontal division of labor with the NICs, there are many cases in which investment projects classified as originating in Hong Kong or Singapore are in reality Japanese. In addition, Japan’s practical ratio of carrying out these approved investments (the realized investment ratio) is usually higher than that of other countries.¹ Therefore the

¹ For example, in 1987, the Japan’s practical ratio of carrying out the approved investment was 55.9 per cent; that of Hong Kong was 44.3 per cent and that of the U.S. was 16.4 per cent (Oguro and Kohama, 1995).
presence of Japanese investment can be considered to be still quite large (Fujita and Hill, 1995 and Oguro and Kohama, 1995).

3.1.2 The contribution of foreign investment to Indonesia’s economy

Foreign investment has made a significant contribution to Indonesia’s economy. Considering the development of the oil and mining industries by foreign sectors, foreign investment has been the mainstay of Indonesia’s economic development as a whole since the 1970s. As for the manufacturing sector, it is undeniable that foreign investment has brought new technology and industries to Indonesia. According to Hill (1988, 151), in comparative international perspective Indonesia’s industries have not been a large recipient of foreign investment, and such investment has mainly contributed in terms of transfer of technology and techniques rather than utilizing investment capital. At the same time, Mihira (1988) indicates that foreign investment has led to a structural change in Indonesia’s industries, namely from traditional industries to modern ones.

Until the early 1980s, however, foreign investment had not produced the effects of technology transfer and employment generation that had been expected by the state authorities. In terms of technology transfer, the major investments were concentrated in the assembly sector, and so in many cases the technology transferred did involve production techniques. Still, these investments were made for the local market, and so local subsidiaries had little incentive in improving and catching up with world-wide rapid technological change. In terms of employment generation, labor intensive projects were allocated to local enterprises and capital intensive projects to foreign enterprises by the state, therefore foreign investments did not generate the large employment levels that local enterprises did (Oguro and Kohama, 1995).

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1 Among the developing market economies of East Asia, only Korea and the Philippines have received less foreign investment as a percentage of various macroeconomic aggregates (Hill, 1996, 78). However, some local enterprises produce some manufacturing goods using foreign technology, and these goods are counted as domestic production statistically rather than FDI (Ishikawa, 1992). Therefore, in this sense the contribution of foreign investment can be considered to be larger that the statistics show.
Since several liberalization packages were promulgated in 1987, the contribution of foreign investment in Indonesian economy has become much larger than before, and the share of foreign capital in several manufacturing sectors such as the automobile and electronics industries has increased drastically. The market orientation of FDI has also changed from local to global markets, and the amount of Indonesia’s exports has therefore increased rapidly. It can be considered that the augmentation of exports in the 1990s derives from foreign investment since 1987. Moreover, local enterprises, which had observed the successful results of Japan’s and the NICs’ investment in Indonesia, have raised their own levels of investment in export-oriented industries such as electronics and wood. This economic development, led by the export-oriented industries, has also triggered growth in Indonesia’s whole economy. For instance, due to this rapid economic development Indonesia’s domestic consumption has increased, the country’s economy has improved, and investment opportunities in the service sector, such as constructing office buildings, housing and leisure facilities, have widened (ibid.).

During this rapid economic development, several local large conglomerates have been formed in Indonesia, by utilizing foreign capital and technology. As a result, employment generation and technology transfer have been further promoted. One has to notice that these practices have been carried out within the sphere of state economic policies (Hill, 1996, Jetro, 1996). The next section will discuss the major state economic policies directed at attracting foreign investment.

3.2 Indonesia’s economic policies in the context of a global economy

3.2.1 Deregulation policies in Indonesia

As described above, foreign investment in Indonesia has rapidly increased since 1987 and especially since 1994. These periods of growth have coincided with the time at which the state implemented a series of drastic deregulation and liberalization policies for attracting foreign investment. Therefore, it can be considered that these economic policies have produced their
desired results. In addition, in the late 1980s international investment conditions became favorable to Indonesia. For instance, Japanese and NIC currencies sharply appreciated, and labor costs in nearby Thailand and Malaysia increased. Indonesia’s economic policies for attracting foreign investment from 1986 are shown in Appendix B. These major deregulation and incentive policies which provided a crucial impact on foreign investment are discussed below.

(i) **Devaluation of the rupiah and the liberalization package of 1986**

The first structural adjustment policies that had a crucial effect on foreign investment in the 1980s were the liberalization package for imports and foreign investment enacted in May 1986, and the devaluation of the rupiah in September 1986. Due to these policies, Indonesia’s export-oriented industries could import cheaper materials and equipment, and the value of the rupiah was set at an attractive rate to encourage trade. As a consequence, foreign investment in export-oriented industries increased rapidly. These policies were followed in 1987 and 1988 by a series of drastic liberalization packages for improvement of the foreign investment environment (see Appendix A) (Oguro and Kohama, 1995, Jetro, 1996).

(ii) **The Export Oriented Production Entrepot Programme (EPTE), 1993**

The state introduced not only deregulation policies but also incentives for attracting foreign investment in export-oriented industries. In June, 1993, the state initiated Export Oriented Production Entrepot Programme (EPTE, or Entrepot Produksi Untuk Tujuan Ekspor) which is a special zone or a facility for producing tariff-free goods, mainly for export. Under this system, various manufacturing goods and raw materials which are necessary for producing export goods are exempt from tariffs. In addition, customs procedures for exports and imports are simplified. Before this system was introduced, there was no such incentive under tax and customs practices in Indonesia. On this point, therefore, Indonesia was at a disadvantage in comparison with neighboring countries, such as Thailand and Malaysia, which had various incentive measures from the 1960s and 1970s (ibid.).
(iii) Government regulation No. 20, 1994

In 1994, the state issued the most drastic deregulation policy for foreign investment since 1974, when the Indonesian government had started its protective policies against foreign capital. In this regulation, the following three restrictions on foreign investment were abolished: first, the restriction concerning share ownership in companies established under foreign capital investment; second, the obligation for transferring management rights to local capital within a certain period; and third, the restriction on the minimum amount of investment. In terms of share ownership, before this regulation was issued, foreign capital had to establish joint ventures with local capital comprising at least a 20 per cent share; 100 per cent foreign ownership was allowed only in special conditions, such as in projects costing more than US$ 50 million. In terms of the obligation to transfer management rights, before this regulation the majority share of companies had to be transferred to local ownership within 20 years after starting operation. In terms of the minimum amount of investment, before this regulation foreign investment had to be more than US$ 1 million. This had been a large obstacle preventing small- and medium-sized foreign enterprises investing in Indonesia (East Java BKPM, 1994, Jetro, 1996).

In addition to these liberalization policies, under this regulation the following nine fields related to public works are also opened to investment by foreign capital: sea ports; power generation and transmission, as well as distribution of electricity for public use; telecommunications; shipping; air lines; potable water; public railways; atomic energy reactors; and mass media. Foreign capital is now allowed to invest in these fields with a maximum share of 95 per cent. This means that the new regulation has paved the way not only for foreign investment but also for privatization of these types of public works (ibid.)

Due to this regulation, in principle the state’s protective policies have been abandoned and foreign investment practice has been liberalized. It is said that these drastic deregulation policies are countermeasures to China and Vietnam which have been promoting the opening of their economies to FDI through liberalization of their overseas investment policies. At the same time,
however, this 1994 regulation is so drastic a change from previous practice that several Indonesian cabinet members still oppose these new pro-investment policies, even after they have come into effect (*Financial Times*, June 6, 1994 in Oguro and Kohama, 1995).

3.2.2 Indonesia's policies towards TNCs: foreign investment and local economic linkages

Douglass (1991) argues that trans-national corporations (TNCs) in developing countries often avoid fostering local capital either by technology transfer or through hiring practices of management personnel. He indicates key reasons for this as being: maintaining control over technologies; selling off old plant equipment no longer appropriate in home countries; employing transfer pricing techniques, and using inflated prices for imported inputs from subsidiaries in other countries to lower tax liabilities (ibid., 31). In this way, foreign investment in developing countries tends to remain exclusionary, with few positive local linkages with domestic producers and markets.

In Indonesia's case the government was also a prime cause of lack of local linkages. Thus, foreign investment during the 1970s and 1980s had been restricted from entering domestic business and using local production for finished products had been demanded for distributing in domestic markets. Compared with other ASEAN nations, Indonesia's protective measures of its own local industries had been more severe and continued longer. According to Mihira (1992), due to these import substitution policies, technology transfer has been successfully promoted in some industries such as automobiles and electronics where foreign investment was concentrated. These local industrial linkages with foreign investment are still prevalent. Even after the promulgation of deregulation policies, many foreign enterprises still practice joint ventures with local capital (ibid. and Jetro, 1996).

Considering the automobile industry, for instance here the government of Indonesia demanded a fixed per cent share of local production for domestic markets, technology transfer and
better working relations between foreign manufacturers and indigenous firms, as other ASEAN countries’ governments had done (Ho, 1993, cited in Fujita and Hill, 1995). In 1974, the state prohibited the import of finished automobiles completely, and started placing foreign car makers under an obligation to purchase a certain portion of automobile parts locally. At the same time, since the state restricts direct foreign investment in the car parts business, overseas car parts manufacturers have offered technological licensing to local capital, rather than direct investment. As a result, in 1990 the ratio of local production for a ton class commercial car had reached 75 per cent by value, compared with 65 per cent in Thailand and 40 per cent in Malaysia, respectively (Sato, 1992).

During the liberalization period in Indonesia since the late 1980s, this kind of government stance did not change. From 1989, by the initiative of Japanese car manufacturers, the export of car parts among ASEAN nations commenced in order to supply car parts economically to each other (Kawahara, 1996). However, this movement contradicted the government’s policy of promoting local production in Indonesia. In 1988, ASEAN nations initiated a ‘brand to brand complementation’ policy in the auto industry. This meant that countries would cut tariffs for car components made by one of the participant members, and parts imported from other ASEAN nations would also count as local content requirements in the importing nation. But the government of Indonesia did not wish to participate in this agreement, due to its strict local production policy (Goldstein, 1990, cited in Fujita and Hill, 1995). This is also true for other industries in Indonesia, such as the electric appliance industry (Ishikawa, 1992).

Due to the government’s strong policies for fostering and protecting domestic enterprises, trans-national corporations (TNCs) in Indonesia have contributed not only to employment generation in new industries, but also to the transfer of advanced stages of technology, and this has fostered local industries and enterprises. This is also true for Japanese TNCs, which have been recognized as having a structure that excludes local suppliers. Fujita and Hill (1995) for instance describe Japanese TNCs’ characteristic in the United States, as follows:
Some host-nation supplier firms [in the United states] criticize the Japanese keiretsu system for being collusive and excluding them from participating in transplant production (ibid., 15).

By contrast, in Indonesia many Japanese TNCs operate within the framework of the state’s industrial policies, and create strong industrial linkages with local capital (Sato, 1992).

In this way, while the state has implemented deregulation policies in order to attract foreign investment, it also has taken the initiative in utilizing foreign investment to create positive local linkages with domestic producers and markets. This is one of the crucial factors in the fact that several Indonesian local enterprises have become large conglomerates and have become competitive even in world markets during the last two decades.

3.3 Foreign aid in Indonesia

3.3.1 Foreign aid in Indonesia: the basic facts

Foreign official assistance has played a crucial role in Indonesia’s economic and industrial development for a long time. While private foreign investment has fluctuated at intervals, foreign aid has constantly been offered at a certain amount during almost the entire period of the Soeharto regime. Table 3.2 shows foreign capital flows, including both official and private flows, into ASEAN countries in 1991. The official flows to Indonesia, which include official development assistance (ODA) and other official flows (OOF),\(^1\) accounted for US$ 5.7 billion, and balance of private flows for US$ 1.2 billion. These flows made up for most of the fiscal deficit of that year, US$ 8.7 billion. Compared with other ASEAN countries, not only the value of official flows, but also the ratio of official flow to private flows was extremely high. In addition, these official foreign capital flows accounted for a large part of the total investment in Indonesia including both domestic and foreign investment, and accounted for about 14 per cent in 1991. The similar figure

\(^1\) According to the OECD document, ODA has to have a grant element of at least 25 per cent. Therefore, other official aid is recognized as OOF (1974).
for Thailand in that year was 6.4 per cent, and for Malaysia was 5.9 per cent (OECD, 1992, Oguro and Kohama, 1995).

Table 3.2 Foreign Capital Flows in ASEAN in 1991 (US$ million)

<table>
<thead>
<tr>
<th></th>
<th>ODA (gross)</th>
<th>Total Official Flows (gross)</th>
<th>Private Flows</th>
<th>Total Flows</th>
<th>Ordinary Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>32.7</td>
<td>183.6</td>
<td>791.3</td>
<td>974.9</td>
<td>4,208</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2,499.8</td>
<td>5,706.1</td>
<td>1,218.8</td>
<td>6,929.9</td>
<td>-8,726</td>
</tr>
<tr>
<td>Malaysia</td>
<td>433.2</td>
<td>819.8</td>
<td>1,457.2</td>
<td>2,277.0</td>
<td>-4,530</td>
</tr>
<tr>
<td>Philippines</td>
<td>1,142.0</td>
<td>2,404.2</td>
<td>-215.1</td>
<td>2,189.1</td>
<td>-1,034</td>
</tr>
<tr>
<td>Thailand</td>
<td>887.8</td>
<td>1,740.2</td>
<td>2,522.0</td>
<td>4,262.2</td>
<td>-7,564</td>
</tr>
</tbody>
</table>

Source: OECD (1992)

The value of foreign official assistance to Indonesia, including OOF, has steadily increased from US$ 3.2 billion in 1988 to 4.5 billion in 1992. As for the official flows, DAC countries had increased their share from 45 per cent in 1988 to 80 per cent in 1992. Table 3.3 shows the share of ODA flows to Indonesia from 1989 to 1992. During this period, the ODA flows from DAC countries accounted for a larger part of the total value, more than 90 per cent. Within DAC, Japan has been the top donor since the 1980s, providing the largest amount of ODA value, from 50 per cent in 1990 in to 60 per cent in 1992. However, considering the total value of foreign assistance to Indonesia, including OOF, from 1988 to 1994 the year 1988 was the only year that the bilateral aid (aid offered directly by a country) value exceeded that of the multilateral

Table 3.3 Share of ODA Flows to Indonesia (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>DAC</td>
<td>92.7</td>
<td>89.4</td>
<td>94.2</td>
<td>94.0</td>
</tr>
<tr>
<td>Australia</td>
<td>3.5</td>
<td>3.3</td>
<td>2.9</td>
<td>2.7</td>
</tr>
<tr>
<td>Japan</td>
<td>59.9</td>
<td>48.9</td>
<td>55.3</td>
<td>60.3</td>
</tr>
<tr>
<td>Netherlands</td>
<td>8.1</td>
<td>9.9</td>
<td>7.2</td>
<td>2.0</td>
</tr>
<tr>
<td>United States</td>
<td>4.1</td>
<td>4.4</td>
<td>3.3</td>
<td>3.2</td>
</tr>
<tr>
<td>International Institution</td>
<td>6.4</td>
<td>8.9</td>
<td>4.8</td>
<td>5.2</td>
</tr>
<tr>
<td>ADB</td>
<td>2.9</td>
<td>5.6</td>
<td>1.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total Value</td>
<td>2,349.1 million</td>
<td>2,315.8 million</td>
<td>2,498.8 million</td>
<td>2,812.4 million</td>
</tr>
</tbody>
</table>


1 The Development Assistance Committee (DAC) was established in 1963, in order to coordinate and monitor ODA programmes of OECD member countries (OECD, 1974).
aid (aid offered through multilateral institutions such as the World Bank). In other years, the multilateral aid always exceeded the bilateral aid (OECD, 1990, 1991, 1992, 1993).

3.3.2 Aid structure in Indonesia: IGGI to CGI

Until recently, the Inter-Governmental Group on Indonesia (IGGI) had been the principal arena for donors’ relations with Indonesia. After the coup in 1965, the Indonesian economy suffered from hyperinflation, and its scheduled debt service payment exceeded total foreign earnings by a large margin. Indonesia, therefore, needed to arrange a debt-rescheduling agreement and attract new aid. In 1966, non-communist creditors held a meeting for this purpose, and ways of bailing out Indonesia effectively were discussed. In the following year the IGGI was formed as a regular forum to discuss Indonesia’s economic problems and coordinate donors’ aid packages. The IGGI meeting was held every year in the Hague, being attended by 10 member countries and 3 observer countries, as well as the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), the Asian Development Bank (ADB) and OECD. From its inception in 1967, the IGGI played a crucial role in managing the international financial community’s response to Indonesia’s recurrent financial crises (Kingston, 1993).

In 1992, a serious difference of opinion developed between the Dutch and Indonesian governments over the behavior of the Indonesian military in dealing with dissidence in East Timor. In the end, the Dutch publicly and strongly criticized the Indonesian government. The Indonesian government was particularly sensitive to criticism from the Dutch, who were the chair of the IGGI and Indonesia’s former colonial master. As a result, the Indonesian government decided that it did not need Dutch aid, nor the Dutch in the IGGI. Consequently, the IGGI was disbanded, and a new consortium, the Consultative Group for Indonesia (CGI), was formed, 2

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2 This is because the flow from IBRD were not counted as ODA, due to their lending conditions (Nelson, 1995).
with the World Bank as chair. Actually, the CGI consists of the IGGI members, minus the Dutch (Ibid., and Kohama, 1995).

3.3.3 Aid programmes to Indonesia

There was a marked shift in the proportion of development assistance received in the form of 'programme aid,'¹ which fell from 83 per cent in 1969 to 1 per cent in the early 1980s. This shift reflected Indonesia’s more comfortable balance of payments position and the improved capacity of its bureaucracy to initiate, implement and evaluate development projects. By the mid-1980s, however, foreign aid suddenly become more significant; its share of government revenue jumped from 15.7 per cent in 1985 to 30.3 per cent in 1988. This was because the government revenue from oil plunged sharply. The form of aid also quickly shifted back into ‘programme aid;’ from 2 per cent of the total in 1985, to 34 per cent in the following year. The World Bank aid programmes during this period took such a form. Some aid flows virtually took the form of direct budgetary grants. The large Japanese aid programmes were particularly significant in this respect (Hill, 1996, 79). These two donors’ programmes will be discussed below.

(i) The World Bank aid programmes

The main aid programs to Indonesia by the World Bank in the late 1980s were non-project assistance, such as adjustment lending (AL) or policy-based lending (PBL).² In normal practice, AL is provided, with some policy-reform conditions on recipients. For example, recipients have to implement deregulation policies, such as opening the international trade market, as conditionality for the lending. However, it is notable that AL programs to Indonesia by the World Bank do not have conditionality. The World Bank makes Indonesia the only exception to its

¹ “Programme aid” is offered for long-term macroeconomic policies, such as a five year national plan, while “project aid” is offered for specific projects regardless of its recipient’s long-term economic policies (Oguro Kohama, 1995).
² Until the 1980s, non-project assistance accounted for large part of aid programmes of the World Bank. But today such non-project assistance has to be less than 25 per cent of IBRD funds and 30 per cent of IDA funds (Ohno, 1995).
lending policies. The government of Indonesia has never received credit that has conditionality, such as stand-by credit from IMF (Oguro & Kohama, 1995).

In the late 1980s, as policy-based lending programs to Indonesia, the following programmes have been provided (ibid.):

a) Trade Policy Adjustment Loan (TPAL) I / II

To support the government’s policies for promoting non-oil export-oriented industrialization, US$300 million in 1987 and the same amount in 1988, which would be used for importing commodities, were funded to the government of Indonesia.

b) Private Sector Development Loan I / II

To support the government’s policies for fostering business in the private sector, US$ 350 million in 1989 and US$250 million in 1991 were funded to the government of Indonesia.

(ii) Japanese aid programmes

In contrast to the World Bank programmes, Japan’s aid to Indonesia has been dominated by ‘project lending.’ Until now, Japan’s aid to Indonesia has focused primarily on providing the country with the economic infrastructure that is indispensable to economic development. In recent years, more emphasis has been given to maintaining and upgrading basic infrastructure that mitigates environmental problems. Funding for education and poverty alleviation is also beginning to increase. According to the OECF1 report in 1995, the target areas of Japan’s assistance to Indonesia are as follows:

a) To increase equality, Japan will support poverty alleviation, basic human needs, and regional development, in particular in eastern Indonesia.

b) Human resource development support will include the strengthening of primary and secondary education and professional human resources development.

c) Assistance will be extended to protect natural resources, improve the urban living environment, and contain pollution.

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1 OECF was established in 1961, in order to serve as a conduit for bilateral loans. Bilateral grants are mainly dealt with by another institution, Japan International Cooperation Agency (JICA) (OECF, 1995).
d) Japan will support the readjustment of industrial structures, advise Indonesia on macroeconomics management, and help promote non-oil export-oriented industrialization and agricultural development.

e) Support for Indonesia’s economic infrastructure will include power development, water resources development, and transportation and telecommunications facilities, with due consideration to the prospect of privatization (OECF, 1995).

In fiscal 1994, OECF had funded a total of 515 loans projects. However, economic infrastructure projects still accounted for about half of the total aid value: transportation for 23 per cent, electric power and gas for 19 per cent, telecommunications for 6 per cent (OECF, 1995). It is said that the extent of this aid in the electric power and gas fields was for the sake of Japanese private investors, who prefer to invest in these fields (Saito, 1996).

3.3.4 Foreign aid contribution

The contribution of foreign aid to the Indonesian economy has been crucial. Aid has supported the policy reform environment and facilitated continuing access to international capital markets in a number of ways. In contrast to the volatility of private flows, the stability of foreign aid flows has been a crucial contribution to the country’s economy. Constant foreign aid raised the reliability of the country in the eyes of foreign investors. This is quite an important point, because, since the Indonesian economy was fragile soon after the Soeharto regime started, foreign investors showed little interest until foreign official flows had assisted the government, and international agencies had provided a positive assessment of the government’s economic management and its prospects. Hill discusses the importance of foreign aid projects as follows:

[T]hey provide a basis on which governments may plan longer-term investment projects and they enable nations to endure difficult economic periods and to enact policy reforms less painfully than would be the case in their absence (1996, 80).

In addition, foreign aid has facilitated large technological transfers, primarily within the public sector. These projects have yielded net social returns in excess of the interest charges (ibid.).
In this way, it is undeniable that foreign assistance has contributed largely to the economic development of Indonesia, but at the same time the government of Indonesia has not been a passive recipient. Indonesia has gained a reputation for being a model debtor (Kingston, 1993, 57). As Hill says:

It is clear that Indonesia has strenuously resisted falling into the trap of the “aid-dependent” syndrome, and that the government has always set the major economic policy parameters (1996, 81).

3.4 Role of governments in attracting and coordinating foreign investment

Considering Indonesia’s stage of development and the nature of policy formulation in the global economy, it is natural that the central government has played a central role in controlling foreign investment. As described above (in 3.2, 3.3), economic policies in the context of the global economy and policies (or requests) for foreign aid have been managed by the central authority and its bureaucrats.

From the beginning of the Soeharto regime, besides the army group that was brought into power, a strong bureaucracy has controlled the Indonesian government, particularly in the economic field. Within this, two major groups are of particular significance. One is composed of the so-called technocrats, a group of civil servants who mainly received education in the United States. They have played a major role in developing economic policies, from the 1960s to the present day. Another group is a far larger body of civil servants, composed of graduates of the country’s major prestigious universities, such as the University of Gajah Mada and the University of Indonesia. These small groups at the top echelon of central government have been central in formulating economic policy (MacAndrews, 1986, 34).

In terms of foreign investment, regardless of its location and size, all of it has have been managed by the central authority; that is, one central government agency, the Investment Coordination Board (BKPM), examines and coordinates all foreign investment in Indonesia. BKPM was established in 1973, and in 1984, in order to simplify procedure, it became the only
window for foreign investment. BKPM is a central government non-departmental institution, and subordinate, and directly responsible to, the President (Yamada, 1995, Tanaka and Takahashi, 1994). According to BKPM, its main task is:

- to assist the President in formulating investment policies;
- to conduct investment planning coordination;
- to give information to prospective investors and the business world in general;
- to give approval for domestic and foreign investment applications;
- to issue investment permits;
- to supervise their implementation;
- to give various investment licenses and facilities (East Java BKPM, 1996).

After investigating development plans and local partners for joint ventures, and coordinating among various ministries within the government, BKPM offers permission to foreign investors. Each of the provinces has a regional investment agency, called the Regional Investment Coordinating Board (BKPM). BKPM, which is also under the immediate control of the President, accepts all applications for foreign investment in each province instead of BKPM. Regardless of the location and size of investment, foreign investors’ activities are totally controlled by the state. As one of the application procedures, the location of the proposed facilities or infrastructures is also examined. This procedure thereby becomes an effective method of urban management. For example, in 1995, since the western part of the Jakarta Metropolitan Area was suffering serious urban problems, such as environmental degradation, traffic congestion and a housing shortage, the President ordered the chairman of BKPM to investigate the situation, and, as a result, the area has been restricted for new industrial development since then (Yamada, 1995).

Summary of chapter 3

Since the late 1980s foreign direct investment (FDI) in Indonesia has increased drastically, and has been concentrated in the industrial sector, in particular the manufacturing sector. Along
with the enormous amount of constantly provided foreign aid, FDI has triggered growth in Indonesia’s whole economy. However, such foreign capital is controlled by the state, and the economic policies which strongly influence FDI have also been formulated by the central authority. For such overseas investment, therefore, the role of local governments does not seem to be large due to the nature of their governance.
CHAPTER 4
DECENTRALIZATION IN INDONESIA

After discussing of the impact of globalization on Indonesia, the thesis now turns to Indonesia’s decentralization policies and government structure. These will be discussed by using the criteria for classification and evaluation developed in chapter 2. This discussion will also set the scene for a more detailed study of the Surabaya Metropolitan Area in the following chapter.

4.1 Decentralization policies and government structure in Indonesia

The experiences of other developing countries discussed earlier have shown that there is no easy way to create a model for administrative and financial balance between the center and the regions, or even among the regions, which could guarantee sustained and harmonious economic growth, justice, distribution of resources and national unity. This issue is critical because Indonesia is a huge archipelago state with a diverse population and an unbalanced distribution of resources, and with a huge variety in the levels of economic and social development in and among its different regions. With this specific background in mind, this section will discuss Indonesia’s decentralization policies, government structures and planning systems, and the financial relationships between the center and the regions.

4.1.1 Decentralization policies in Indonesia

(i) Decentralization before independence

The history of decentralization in Indonesia has followed changes in the country’s political conditions. The first draft of legislation on decentralization was introduced in 1893 by a member of the Dutch Parliament. In general, this early decentralization law was based on political considerations, with its aims being administrative efficiency and the involvement of the local elites in local governments. In practice, this decentralization was only ‘administrative decentralization,’ with little or no policy making power, due to the fact that the implementation of duties in the regions continued to be carried out by authorities acting as extension arms of the central government. During the Japanese wartime regime, the occupying forces basically continued the
local government system, which had been established by the Dutch, making minor changes, such as substituting Japanese for Dutch in local ordinances (Hoessein, 1996, cited in Tuerah, 1996).

(ii) The Basic Act of Governance in Local Areas in 1974

These principles of decentralization were adopted by the present government of the Republic of Indonesia, as reflected in Basic Law no. 5 of 1974. This law formulated the legal framework for local governments and established the idea of ‘autonomous regions’ within Indonesia, and it is still in effect. On the basis of this Act, two tiers of autonomous local governments have been created; Propinsi (province / level I local government), and Kabupaten or Kotamadya Daerah Tingkat II (regency or municipality / level II local government). Besides these two autonomous levels of government established by the deconcentration policy (spatial relocation of decision making) of the central administration, several administrative territories have been established; Propinsi (province), Kotamadya (municipality), Kabupaten (regency), Kota Administratif (administrative town), Kecamatan (district) and Kelurahan (sub-district). The terms ‘province’ and ‘regency’ or ‘municipality’ used in this regard reflect the deconcentration policy of the national level administration, while the labels ‘level I and II local government’ reflect the decentralization policy of autonomy (see Figure 4.1) (Oetomo, 1996).

In this way, this Act included two contradictory concepts for local government systems in terms of how they conduct their duties or functions. Concerning the broad principle of the deconcentration, local administration is only carried out by executive institutions established as the agencies or representatives of central government. According to this structure, the head of a local administration is the single coordinator of all central government duties or functions in his / her territory. All central government development activities in the region, which are under the full responsibility of the central government, are conducted by its regional offices. On the other hand, according to the principle of decentralization, local authorities include separate legislative and executive institutions. The legislative institution is the Local Assembly, Dewan Perwakilan
Figure 4.1 The Local Governance Structure in Indonesia

Source: Tuerah (1996)

Notes:

*Kanwil* = abbreviation of *kantor wilayah* (provincial level office of a central government ministry)

*Kandep* = abbreviation of *kantor department* (regency or municipality level office of central government ministry and some *kandeps* at sub-district levels)

*Dinas* = local government service department, responsible to the provincial governor or to *Bupati* (head of regency) / *Walikotamadya* (mayor) and with indirect links to the relevant central government department

*Bappenas* = National Development Planning Board

*Bappeda* = Local (Regional) Development Planning Board
Rakyat Daerah (DPRD), and the executive institution is controlled by the Head of Local Government, appointed by the Ministry of Home Affairs on the nomination of DPRD. In practice, however, these two principles for the local administration system are merged at almost all levels of local government. The coverage area (boundary) of the autonomous level I local government is the same as the administrative territory of a province. This also applies for any level II local governments (ibid.).

(iii) Decentralization policies for municipality / regency level

Thus, the local administrative systems promulgated by the Basic Act of 1974 are complicated, and in reality local governments are still obligated to organize and manage their own affairs in accordance with prevailing regulations determined by the central government. In particular, the administrative autonomy of level II local governments (municipality or regency level) has been severely limited. Therefore, realizing that the autonomous regions some of which are facing rapid urbanization recently are very important, the central government from the mid-1980s has begun increasingly to focus on this level of regional administration. For instance, in 1992 the central government issued Government Regulation No. 45, which stressed the implementation of administrative autonomous regions with emphasis on this level. Nevertheless, virtually no new major initiatives have been implemented since then, except minor changes in the regional grants formulae, increasing changes in the regions’ fiscal autonomy, and small steps towards greater civil service mobility among the provincial governments (Hill, 1996, 235).

(iv) The Integrated Urban Infrastructure Development Programmes (IUIDP) as local institutional development programmes

The IUIDP are comprehensive infrastructure programmes currently implemented in several cities in Indonesia. These programmes are also considered to be useful tools for the institutional development of local governments, in particular level II local governments. In 1985, with the aim of optimizing infrastructure provision and mobilizing additional local resources, the Government of Indonesia initiated the IUIDP, which were aimed at overcoming the following problems:
that centrally administered infrastructure provision does not always reflect local needs sufficiently, and is often inadequately operated and maintained by local governments (and local communities);

• that previous infrastructure programmes of central, provincial and local governments showed much duplication and little coordination of effort, resulting in an inefficient use of limited resources;

• that overdependence on the central government’s grant funding for many elements of urban infrastructure could be replaced, to a large degree, by local self-financing (Hoff and Steinberg, 1993).

The IUIDP expands the earlier experience gained in the Kampung Improvement Programme (KIP) (self-help human settlements projects in Indonesia, see Steinberg, 1992 for the KIP) into a city-wide urban improvement and urban infrastructure development programme. The IUIDP covers eight major service components, which fall under the Directorate General of Human Settlements (Ditjen Cipta Karya) in the Ministry of Public Works: water supply, sewage and human waste, solid waste management, drainage, flood control, urban roads, housing and settlement (which includes the KIP), spatial urban planning, and the Market Infrastructure Improvement Programme. With the World Bank’s and the Asian Development Bank’s bilateral assistance, in 1987 the central government took initial steps to undertake a nationwide program for IUIDP preparation and implementation (ibid.).

The IUIDP includes not only these comprehensive infrastructure provisions, but also institutional development and resource mobilization for local governments, such as the Revenue Improvement Action Plan (RIAP) and the Local Government Development Action Plan (LIDAP). However, although the IUIDP have already been implemented in several metropolitan areas of Indonesia, so far these programmes have not attained all their original objectives sufficiently. According to a recent study of the IUIDP in the Jabotabek region (the area surrounding Jakarta), local governments have seen the IUIDP as a “big” project with a combination of funding sources,
rather than as a decentralization of urban infrastructure development. As a result, the IUIDP management tool, LIDAP, was not seen as particularly important. One of the reasons for the occurrence of this kind of situation is that the central government did not provide sufficient guidelines and training. The other reason lies in the inexperience of local governments in dealing with such big public investment programmes (Ichwan, 1996).

This is also true for the Revenue Improvement Action Plan (RIAP) in the Jabotabek region, which emphasizes increasing the rates of some taxes, fees and charges, as well as more efficient collection (e.g. improving data accuracy) and promoting institutional development related to revenue administration. Still under this programme some districts have not yet improved their own-source revenues. There are several reasons for this failure. For example, in the same way as occurred in institutional development projects, the central government did not provide sufficient guidelines. Moreover, the vertical structure of local governments obstructed the progress of such projects, and local politicians sometimes resisted increasing user charges. Finally, local governments had a limited amount of available human resources to carry out such bold infrastructure plans (ibid.).

4.1.2 Government structures and planning systems

(i) Government structures

At Indonesia's central government level the People's Consultative Assembly (MPR) is the country's highest political body. Every five years the MPR elects both the National President and the Vice President. The President holds much power since his tasks include the appointment of both government ministers and the governors of the provinces. The People's Representative Council (DPR) consists of members chosen from the MPR. This council has to be consulted by the President on the enactment of laws, as well as on budgetary affairs. In addition to the various departments for which ministers bear direct responsibility, a number of very powerful non-
governmental agencies are also present at the central level. These bodies report directly to the President (Tuerah, 1996).

At the provincial level of government, Indonesia is divided into 27 provinces, each of which is divided into a number of districts and municipalities. These districts and municipalities are subdivided into sub-districts. The government, at the provincial, as well as at the district and municipality levels, is comprised of legislative and executive arms. The legislative arm for the provincial level is the People’s Representative Regional Council (DPRD Tingkat I); and for the district or municipality level it is the People’s Representative District Council (DPRD Tingkat II), which is mainly comprised of elected representatives from the province and the district or municipality respectively. However, apart from these locally elected bodies the central government also has substantial influence at the local level. At the district and municipal level, the head of the executive arm is appointed by the governor. For each provincial and district or municipal level, there are offices of a central government ministry, which supervise and advise local governments (ibid.).

(ii) Planning systems

In Indonesia, two different levels of development planning, sectoral (socio-economic) planning and spatial planning, are dealt with by the three tiers of governments described in Figure 4-1: the national, provincial and regency / municipal governments. At the central level, planning is largely carried out by the National Development Planning Board (Bappenas) and the various sectoral departments in charge of transportation, housing, education, and so on. Bappenas is responsible for preparing long-term national socio-economic plans, while each sectoral ministry under the co-ordination of Bappenas looks after its own sectoral duties, at the national and regional level. Spatial planning at the national level is conducted by the National Coordination Board for Spatial Planning, appointed by Presidential decree; it consists of multi-departmental members. This board is chaired by the State Minister for National Development Planning, who is also the head of Bappenas. The provincial / level I local governments also prepare sectoral (socio-
economic) as well as spatial development plans for their areas. These are carried out under the co-ordination of the Regional Development Planning Board (Bappeda Tingat I). At the level II local government, Bappeda Tingat II is responsible for co-ordinating the many sectoral and spatial plans of local governments (Oetomo, 1996).

Indonesia’s planning system therefore uses both centralized and decentralized processes. Two tiers (province and municipality / regency) of local government have the responsibility of preparing their own sectoral and spatial plans. Principally, the present framework is aimed at the implementation of a combination of ‘bottom-up’ and ‘top-down’ planning. However, since the administrative structure is highly centralized, in practice the ‘top-down’ planning is more prevalent (ibid.).

All local governments operate under the direction of the Ministry of Home Affairs. For preparing their sectoral plans, full authority is given by the law to these local governments through decentralization of power. Thus, they can prepare and authorize their plans by themselves. In this process, they are backed up by certain sectoral planning bodies, which are the central government regional offices operating at the provincial and regency / municipal levels. These regional offices are set up under the deconcentration process. On the other hand, for preparing a spatial plan two procedures of authorization are applied. Even though, technically, local governments can prepare their own plans, to come into effect these plans still must be authorized by the central government (the Ministry of Home Affairs). This system of authorization is applied to provincial spatial plans and city plans for the capital city of a province, other big cities and strategic cities which are designated by the central government. For other cities not specified above, plans require only authorization from the governors of their respective provinces (ibid.).

The right and authority to conduct the spatial planning process has been transferred to local governments since 1987 by the Government Regulation No. 14. However, there is problem with these statutory spatial plan, particularly on the overlapping responsibility of a wide range of government agencies in its implementation. At least, three main institutions (at the same level) are
related this matters; the Development Planning Board, the National Land Agency and the Public Works / Urban Planning Department. Each of these institution issues a special permit for the particular development stage (ibid.).

4.1.3 Financial relationships between the center and the regions

With regard to the implementation of local autonomy, the central government of Indonesia has transferred some responsibilities for governance duties and community services to local governments at both the provincial government and district (regency or municipality) levels. In addition to subsidies and grants, the central government has also handed over some tax resources to local governments. Thus, in the middle of the 1980s the central government started local taxation reform, which allowed local governments to raise considerable funds from their own sources of revenue. The objectives of the reform were to simplify and streamline the system of local taxation and to increase local tax revenue in order to reduce the dependence of local government on central government grants. At that time, these objectives were important, because the state government revenues from oil production had been much reduced due to fall of world-wide oil prices. Thanks to this reform, the local own-source revenue has increased due to the higher growth of the tax income available to local governments (Devas, 1989, 55).

However, these various taxes are classified as ‘dry resources’, as they are relatively small. By contrast, the central government has retained the tax sources which are relatively large, such as income taxes and value-added taxes. As a consequence, the funds that can be gathered by local governments for their own revenues are a small fraction of the total funds they require (Tuerah, 1996). According to recent statistics, for level I local governments (provinces) in 1993/1994, on average about 70 per cent of revenue came from the central government, in the form of grants. For level II governments (regencies or municipalities) in 1992/1993, on average about 80 per cent came from the central government. Among these grants, about 70 per cent were used for personnel expenses and projects authorized by Presidential decree (Ministry of Finance, 1995,
cited in Jetro, 1996). Compared with other Asian countries, the local governments of Indonesia are heavily dependent on grants from the central government. In particular, level II governments’ own revenues are quite small (see Devas, 1989 and 1991).

The relatively small proportion of total revenues allocated to level II governments derives from the distribution system of revenue resources, which are unevenly distributed among district, provincial and central governments. Not only does the central government benefit from the current wealth of revenues such as income tax, value-added tax, export-import fees, and other taxes, but some favored provincial governments also get their share (Tuerah, 1996). At the provincial level, the two most important sources of tax revenue are the motor vehicle registration tax, and the tax on ownership of vehicles. Indonesia is in fact unusual among developing countries in assigning motor vehicle taxes to a sub-national level of government. Given the high elasticity of demand for motor vehicles in Indonesia, it is to be expected that revenues from motor vehicle taxes will grow more rapidly than GDP in those provinces where they have not already done so. For instance, the Jakarta Special Region (which has provincial status) receives by far the most revenue from motor vehicle taxes in per capita terms (Booth, 1996). In addition to the routine revenues which are already decided by the central government, there is a tendency for provincial governments to make every effort to dominate other potential resources (Tuerah, 1996).

Among a range of taxes collected by the level II local governments, the most important one is the hotel and restaurant tax, although this yields substantial revenues only at some tourist destinations. Recent findings by many researchers indicate that revenues available at this level are inherently less elastic than those available to the provinces. But this level of government (regency / municipality) has another important source of revenue in the form of the Land and Property Tax (PBB). This tax has been substantially reformed over the last decade, with a consequent growth in revenues, especially from urban property and from the mining sector (Kelly, 1993 in Booth, 1996). However, in spite of the rapid growth in revenues collected by provincial and some second level (regent / municipal) governments since the 1980s, total local collections remain very
low relative to central government domestic revenues. The figures contained in the sixth national plan indicate that provincial and district own-revenues were around 5 per cent of central government revenues from domestic sources in both 1986-87 and 1991-92 (Booth, 1996).

In terms of the fiscal linkages between local and central governments, the ‘top-down’ process is also prevalent for almost all forms of revenue. That is, before local governments collect taxes directly from citizens, they have to draft and stipulate local regulations for each area of those taxes or fees. For level I local governments, these local regulations have to be authorized by the Minister of Home Affairs; for level II local government, by the governor / head of level I governments (Oetomo, 1996).

4.2 An evaluation of Indonesia’s decentralization programmes

This section now continues Indonesia’s decentralization experiences in light of the overall review of the literature given on chapter 2, prior to the detailed case study of the Surabaya Metropolitan Area.

As described above, in Indonesia the government has tried to decentralize certain of its administrative functions from the Dutch colonial period until today, but these efforts have not included political decentralization. The Basic Law no. 5 of 1974 formulated the legal framework for local governments. However, this did not mean the creation of semi-independent local bodies. President Soeharto expressed his opinion about local autonomy as follows: ‘[l]ocal autonomy in Indonesia is not for political independence of local regions, but for implementation of social welfare for the citizens’ (KOMPAS, 1990, cited in Jetro, 1996).

Judging from the criteria described in the previous section, Indonesian decentralization policies can be classified as policies focusing on ‘administrative’, rather than ‘political’ and ‘economic’ decentralization, and ‘delegation’ rather than ‘devolution’. These policies also might be described as ‘partial’ decentralization, because, despite the government’s intention for
decentralization, most statutory rights, personnel and revenue continue to come from the central government.

There are a number of significant theoretical points regarding decentralization, as described in chapter 2. Here, in light of such points Indonesia’s decentralization policies and experience will be examined.

a) popular participation (local democracy)

As described above, Indonesia’s administrative system is essentially hierarchical. In this centralized structure popular participation is quite limited at any level of government. Although in Indonesia there is a long tradition of community activity and formal participatory systems at the lower level, these practices have only been utilized by the authorities as a way to mobilize labor as described below.

As one can see in the Indonesian terms [e.g. musyawarah (collective deliberation) and gotong royong (mutual cooperation)], Indonesia has a long tradition of community activity. However, in particular, the term, gotong royong, has been utilized by the state for political purposes, and the meaning of this term has often been altered by the government. After independence in 1945, gotong royong was well-suited as a slogan for national unity. It was primarily used to describe the horizontal interaction between the functional groups that made up the nation; but in the New Order (after the coup of September 30, 1965), this term has been primarily used to underwrite state intervention into village life. Gotong royong has become a ‘cultural-ideological’ instrument for the mobilization of village labor; i.e. obligatory service for the state, rather than voluntary service or reciprocity. Such labor was used, for example, in assistance for the repair of an irrigation system, or for the construction of a district road (Bowen, 1986).

This kind of situation can be seen in Indonesia’s lower level organizational structure, the RW / RT system. The RW (Rukun Warga) consists of 5 to 15 neighborhoods, and the RT
(Rukun Tenaga) constitutes 40-50 households. This system is supposed to provide a mechanism for negotiating with people for the local delivery of government services and programmes like Kampung Improvement Programmes (KIP) at the local level. However, the RW / RT system does not always bring about local democracy. For instance, in theory, RT heads in each village are elected directly in a neighborhood meeting with unanimous agreement, while the RW heads are elected by the RT heads. But, in many cases, these figures are merely appointed by upper level government bodies. This system sometimes prohibits local democracy for the poorer groups, because the government only tends to hear the opinions of people who are better off and better educated (Karamony and Dias, 1986, cited in Steinberg, 1992).

Thus, in Indonesia there has been a tradition of community participation before the colonial era and current lower level formal participatory systems. However, those practices have become an obligatory participation, imposed by the state, rather than a voluntary one. As Porio suggests, the recent relative political stability allows more autonomy for local governments, and the growing political maturity of different segments of civil society has also led to an increasing demand for greater political participation and better urban services which could be provided by local governments (Porio, 1996, 75). In fact, following the suppression by the authorities of an opposition group which ignited a riot in Jakarta in 1996, the state has taken steps to appease the maturing civil society, and shown willingness to allow a more democratic process and a larger devolution of power to local authorities (Kagaya, 1997).

b) selective use of decentralization and the levels of local government involved

An important aspect of the Indonesian local government system concerns the division of functions between levels of government. Essentially, there is no clear division of functions between governmental tiers in this system. Broadly speaking, strategic and international matters such as national planning, defense and security are central government responsibilities; large-scale infrastructure systems, such as irrigation, are generally handled by provinces; urban services are second level responsibilities. But the pattern is much more complex than that. In
addition, the boundary definitions for government functions may vary widely from one region to another. Table 4.1 shows the very broad distribution of functions between the levels of government (Devas, 1989).

Indonesia's essentially hierarchical administrative system, with its strong centralized structure, appears to be effective for dealing with international matters and the strategic development of the nation. For instance, the Indonesian government recognizes that foreign direct investment (FDI) and transfer of technology are inevitable for continuous economic development. Thus FDI is promoted by the state not only by deregulation policies but also by other factors to attract investment, such as stable social conditions and the reliability of governments and financial circles. As currently practiced in Indonesia, these issues are central government matters. At the same time, in this extensive and diversified national territory, the central government has a role in redressing economic and social differentials, by adopting measures such as comprehensive poverty alleviation policies and a priority allocation of budget resources for the poorer regions.

**Table 4.1  A Generalized Division of Functions Between Levels of Government**

<table>
<thead>
<tr>
<th>Sector</th>
<th>National</th>
<th>Provincial</th>
<th>Regent / Municipal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Irrigation</td>
<td>planning of water resources</td>
<td>primary systems, most secondary systems</td>
<td>some work on secondary and tertiary systems</td>
</tr>
<tr>
<td>Education</td>
<td>policy / curriculum, tertiary education, secondary schools, books supplies</td>
<td>operation of primary schools</td>
<td>construction of primary schools</td>
</tr>
<tr>
<td>Health</td>
<td>policy / supervision, training / research, special / referral, hospitals</td>
<td>major hospitals, public health, drug supplies</td>
<td>local hospitals and clinics, rural water and sanitation</td>
</tr>
<tr>
<td>Road</td>
<td>national roads</td>
<td>provincial roads</td>
<td>district roads</td>
</tr>
<tr>
<td>Transport</td>
<td>supervision of most transport systems, traffic management in some provinces</td>
<td>traffic management in some provinces</td>
<td>virtually none</td>
</tr>
<tr>
<td>Urban services</td>
<td>strategic planning</td>
<td>virtually none</td>
<td>most services</td>
</tr>
</tbody>
</table>

Source: Devas (1989, 7)
This approach can be seen in the current five year national development plan, *REPELITA VI* (Devas, 1989, Jetro, 1996).

However, under the hierarchical administrative system (with the unclear division of functions between governments), functions which are more suitable for lower local governments (e.g. various planning authorities described in the previous section) will tend to be insufficiently provided. Considering the rapidly changing situation of many metropolitan areas in Indonesia, the urban services (see Table 4.1) that the second level, regency / municipal (*kabupaten / kotamadya*), governments provide are urgently required. For example, affordable housing and small-scale infrastructure, such as sanitation and water distribution for low income areas, are all urgently required. But, as described in the previous section, while the regional administrative capacities of the provincial level governments have gradually increased, those of the second level are still weak.

c) resource mobilization

In Indonesia, the economic and social imbalance between affluent regions, such as Java and other resource-rich areas, and the poorer regions, in particular East Indonesia, has recently widened still more. This is also true for local governments’ revenues. As Hill (1996, 236) suggests, economically more powerful provinces have been able to develop their own funding resources to a great extent, in part because the commercial activities on which subnational taxes may be levied are found disproportionately in these regions. Therefore, it might be inevitable that the central government retains control, to some extent, of a large part of the national budget in order to redress the economic and social imbalances in the nation. In practice, the Indonesian government has policies that mitigate regional imbalances. For example, there are allocations to the *INPRES* programmes, the purpose of which is to enable provincial, district and village administrations to carry out much-needed rehabilitation of infrastructure (roads, bridges, irrigation facilities, village halls, etc.). Since the mid-1980s, using earmarked grants from the center,
poorer local governments have been given higher priority than richer ones. This has been particularly true in the 1990s (Booth, 1996, 113).1

However, the revenue resources of local governments, especially those of level II (kotamadya and kabupaten) governments, are extremely small. At level II, local governments have responsibility for provision of various urban services and services for the poor, since these governments can consider the needs peculiar to each local community due to the small size of their administrative territory. Thanks to the fiscal reform in the 1980s, local revenues have increased due to the growth of the tax income available to local governments. But total local collections remain low relative to central government domestic revenues. In addition, higher growth taxes work favorably only in highly urbanized or tourist-attracting districts, not in poorer districts (ibid.).

In areas of Indonesia in which various urban services are not sufficiently provided, therefore, fiscal decentralization has to be promoted focusing on the level II local governments. As one of its recent efforts, since April 1995 the state has started pilot projects for increasing local revenue resources to strengthen local autonomy choosing 26 districts all over Indonesia (Tuerah, 1996).

d) ethnic and cultural considerations

Indonesia possesses diverse ethnicities, languages and cultures. Although the exact classification is difficult, more than 250 independent languages exist.2 According to ex-National Defense Chief (Kopkamtib) Sudomo, there are 60 ethnic groups in the country. The country’s religion is not homogenous, although about 87 per cent of the population is Muslim, which makes Indonesia the largest Muslim country in the world. However, other religious groups exist, such as Christian (17.3 million), Hindu (3.5 million) and Buddhist (1.8 million). In Indonesia’s

1 This does not mean the state allocation policies have been always coherent and equitable. Azis suggests that the budget distribution between western and eastern Indonesia has been strongly in favor of western Indonesia (1992).

political scene, since its independence in 1945 discussion of this diversity of the nation has been under a taboo, because this issue might undermine the national unity. This taboo is called "SARA" in Indonesia; S = Sulcu (ethnic issue), A = Agama (religious issue), R = Ras (racial issue) and A = Antar-Golongan (inter-social group issue) (Kuroki and Kohama, 1995, 17, Jetro, 1996, 12).

Due to this issue, events that shake the political entity of the state frequently occur. In many cases, people's indignation turns against the ethnic Chinese. Although there are no precise data, Chinese economic dominance in the country is prominent.3 Within this decade, large ethnic Chinese conglomerates in Indonesia have become ever more visible. In 1994, only two pribumi (indigenous Indonesian) firms made it into the top 20 conglomerates, and the top seven are all in the hands of Sino-Indonesian individuals or families (Hill, 1996, 109-111). In spite of their economic success in Indonesia, or because of their economic dominance, anti-Chinese sentiment among indigenous Indonesians has always existed. Sometimes such feeling causes riots by students, intellectuals and Muslims in the big cities, such as the riot against ethnic Chinese in Medan, in 1994. Besides anti-Chinese sentiment, racial struggles, such as between internal-immigrants and indigenous groups, are also prevalent, as one can see from the recent events in West Kalimantan (Jetro, 1996, Kagaya, 1997)

Considering this situation, it is understandable that since 1945 the state has had Bhinneka Tunggal Ika (Unity in Diversity) as Indonesia's national slogan, and has maintained a highly centralized and authoritarian structure. The Soeharto regime has sought to construct a unity based on certain 'sacred' principles -- the constitution, as well as Pancasila (the five national principles): the belief in one God, the office (and person) of the President, the national language, and national rituals such as Independence Day. In this way, local cultural and social expressions have both been legitimated and restrained by the state. On the other hand, these expressions have struggled

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3 Hiizumi notes that 80 per cent of the Indonesian economy is dominated by ethnic Chinese capital (1993); and Tempo (the Indonesia's influential weekly magazine) reports that it is 60 per cent (Tempo 20 July 1991, in Hill, 1996).
against the pressures of state directives. Guiness describes the persistent strength of these local expressions in the Soeharto regime; these are not the obstinacy of tradition, but rather flexible and ever-changing expressions of local identity (Guinness, 1994, 303). Diversity of social and cultural forms has probably always been a feature of Indonesia. Therefore, while the state maintains centralized systems for national unity, policies that allow social and cultural diversity are also necessary. Considering the recent relative political stability of the nation for the last several decades, more autonomy for local governments and regions seems likely and this will maintain diversified local expressions and local identities, seems to be possible.

**e) privatization and deregulation**

The state encouragement of private sector participation first began in 1986, when deregulation policies were gradually promoted throughout the nation. *REPELITA V* (the fifth national plan between 1989 and 1994) stresses the state’s intention that the private sector should play a greater role in the development of urban communities. The plan includes an increased emphasis on private sector participation, and on cooperation or partnership between the public and private sectors, in urban infrastructure provision. A number of reasons lay behind the expansion of private sector participation. First, in many areas certain urban services were not covered by the public sector, because it could not catch up with the current rapid urbanization due to lack of funds and experiences. Second, deregulation policies launched by the state in other sectors, which will be explained in the succeeding section, provided a favorable climate for privatization. Third, private sector involvement had to be considered where there was a strong need to expand development and where government funds were limited. In fact, there have been many instances of successful private sector participation in the delivery of urban services, particularly in the case of large infrastructure investments, such as toll roads, housing, industrial estates, transportation, electricity, and telecommunications facilities (Soekamto, 1994, 38-41).

However, there have been negative experiences associated with privatization in Indonesia. For example, in the East Java province, privatization of the water-supply was allowed in 1988.
But the negotiations between the public and private sectors have been unsuccessful until now. The major reasons include an inadequate regulatory framework to arrange privatization projects, lack of regulation enforcement, and overt political intervention (Suami, 1993, 53). Although privatization is not always effective, under appropriate conditions the private sector can play a valuable and cost-effective role in meeting growing urban service and infrastructure needs. Consequently, proper privatization will complement decentralization policies in Indonesia, where local authorities lack adequate financial and technical capacity.

**f) collaboration with NGOs**

In many developing countries, NGOs have concentrated on income-enhancing community group activities, which frequently have the effect of integrating individuals and small interest groups into broader-based organizations. They can and do act as catalysts to increase levels of education and information access, as well as promoting the formulation and articulation of community interests, allowing these eventually to reach and to influence the decision-makers (Samuel and Israel, 1991). In regional development, the activities of NGOs (in particular indigenous NGOs) have also often been encouraged, because unlike government agencies such NGOs have the capacity to identify with the grass roots issues. NGOs, which are usually more sensitive to social and cultural values than large bureaucratic structures, can often be effective in bringing about necessary change, while minimizing cultural destabilization (Walker, 1991).

In Indonesia, from the mid-1980s, the dwindling resources of the state and the trend towards privatization have led some local governments to look at NGOs to help in local resource mobilization. Although still vulnerable to government control, NGOs provide potential avenues for influencing the state to be more open to participatory politics. Currently, *KADIN* (the Chamber of Commerce and Industry) constitutes an effective lobby group for economic policies, while social development NGOs are influential in environmentally-related issues (Porio, 1996). The contributions of NGOs in Indonesia are becoming well documented, in such papers as that by Eldridge (1989). For example, in the Small Scale Irrigation Project in South Sulawesi, which
was funded by the government of the U.S. and the government of Indonesia from 1990 to 1994, the indigenous NGO, *LP3ES*, organized the peasant groups in the whole project area, and then promoted discussion within each peasant group about the project scheme. This NGO finally brought about a settlement within and between the groups, and the opinion of the peasants was adequately reflected in the project (Koyama, 1994).

In this way, the abilities of NGOs are expected to complement Indonesia's local governments' limited capacities. Although, in some cases, NGOs have certain limitations and pitfalls, such as limited technical capacities for large scale or complex projects, and unclear political accountabilities, governments have in many cases recognized the NGOs for what they can do best: in particular reaching the people (Walker, 1991).

**Summary of chapter 4**

In Indonesia, which is a huge archipelago state with diverse population and unbalanced resource distribution, it is difficult to create a balanced administrative structure, which guarantees harmonious economic growth and national unity. From the early period of its independence, principles of decentralization have been adopted by the state and two tiers of autonomous local government have been created. However, the administrative and financial autonomy of these local governments, in particular municipal (regency) level, has been limited and a 'top-down' process dominates for various (sectoral and spatial) planning activities. With this background the thesis now moved to the case study of the Surabaya Metropolitan Area.
CHAPTER 5
THE CASE STUDY OF THE SURABAYA METROPOLITAN AREA

The previous chapters of this thesis have addressed the overall situation of decentralization and globalization in Indonesia. We will now turn to the Surabaya Metropolitan Area (SMA) as a case study of a local area in Indonesia, in order to closely look at the local development situation and the potential role of both central and local governments for planning and urban development. As will be described below, the SMA has been strongly influenced by systems in the world economy, in particular the rise in overseas investment in Indonesia since 1990. Therefore, this case study of the SMA will examine a local city (or region) which is influenced by the global economy, in terms of trade and foreign direct investment (FDI). This part is based on official statistics and reports concerning the SMA, as well as a field survey in the SMA (June and July 1996) and interviews with personnel who are engaged in planning and development in the Surabaya Metropolitan Area (see interview list in Appendix A; [ ] shows interview code number).

In this chapter, we will discuss the background of the SMA, its history and population growth, as well as current economic development and urban development. The role of governments in local urban planning and local development projects is also examined. In the SMA the increasing level of foreign investment has become a critical factor behind recent rates of economic growth, and these investment activities have concentrated in the industrial sector, particularly the manufacturing sector. Therefore, most of the discussion in this section will be devoted to foreign investment in the manufacturing sector.

5.1 The Surabaya Metropolitan Area: the basic background

5.1.1 Administration of the SMA and its history

(i) Administration of the SMA

Surabaya is the capital city (kotamadya) of East Java Province, as well as its commercial and administrative center. GKS (GERBANGKERTOSUSILA) is the urban agglomeration of the city of Surabaya and the surrounding six kotamadya (municipality) and kabupaten (regencies);
Chapter 5  The Case Study of the Surabaya Metropolitan Area

Gresik, Bangkalan, kotamadya Mojokerto, kabupaten Mojokerto, Sidoarjo and Lamongan (see Figure 5.1). GKS has been selected by the central government as a focus for the development of East Indonesia, and, in fact, a disproportionate amount of the regional population growth occurs in this metropolitan area. However, there is substantially no metropolitan authority for controlling and managing this area’s land use and development (Ministry of Public Works, 1982) [A-1]. In the thesis, GKS is called the Surabaya Metropolitan Area (SMA).

Figure 5.1  GKS (Surabaya Metropolitan Area) Area Map

Source: Ministry of Public Works (1982)
(ii) History of the SMA

The history of Surabaya as a port city goes back more than four hundred years. During the sixteenth century, the Portuguese, whose trading activities converged upon India and the Malay Peninsula at that period, did not settle on Java, but maintained trading posts in Surabaya, as well as establishing Bantam as the main port of West Java before Batavia (Jakarta) was established. However, before such several trading ports were established by Europeans, indigenous cities had already been created in this area. In the thirteenth century, the ancient capital, *Majapahit*, was moved to the lower reaches of the Brantas River, near the modern town of Mojokerto (the southwestern regency of Surabaya) (Cobban, 1971).

By the middle of the eighteenth century, control of the economic life of Java by the Dutch was complete under the aegis of the United East Indian Company, and Java was well established as a Dutch colony. Unlike the colonial capitals in other Asian countries, Batavia (Jakarta) was not located in the rural heartland of the country. Therefore, the export of agricultural surpluses did not necessarily pass through Batavia, but instead stimulated the growth of other port cities, such as Surabaya and Medan. In the beginning of the nineteenth century, the Dutch built “Fort Kalimas” at the estuary of the Mas River, which runs through the center of Surabaya. Subsequently, Surabaya expanded to the north and south. In the middle of nineteenth century, as the result of the Dutch business interests, the European community was formed in the area lying along one of the tributaries of the Mas River. Around 1900, Surabaya was the largest city in the Dutch colony, having a population of over 100,000 (Douglass, 1991b, Mackie and Zain, 1989, Ministry of Public Works, 1982).

After independence from the Dutch, in particular after Soeharto took power, Jakarta became the center of trade, industry and politics, and began to grow rapidly. At the same time, an inter-island coastal trade network was expanded in Java. In turn, Surabaya began to expand as a port town, which played an important role in importing consumer goods and shipping natural resources directly to international markets as well as the other coastal cities of Java. In particular,
Surabaya has continued to be the main focus of interurban linkages throughout the post-independence years. In the 1960s and early 1970s, the Surabaya Metropolitan Area (SMA) was the country's leading industrial center, even though it lost its pre-eminent position to some extent after that (Douglass, 1991b, Hill, 1990).

5.1.2 Population growth and urbanization

(i) Population and its growth trends in the SMA

<table>
<thead>
<tr>
<th>Table 5.1 Population and Annual Growth in the SMA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population by Census (thousand)</td>
</tr>
<tr>
<td>-------</td>
</tr>
<tr>
<td>The SMA total</td>
</tr>
<tr>
<td>Surabaya</td>
</tr>
<tr>
<td>Gresik</td>
</tr>
<tr>
<td>Bangkalan</td>
</tr>
<tr>
<td>kod. Mojokerto</td>
</tr>
<tr>
<td>kab. Mojokerto</td>
</tr>
<tr>
<td>Sidoarjo</td>
</tr>
<tr>
<td>Lamongan</td>
</tr>
</tbody>
</table>


The SMA is now the second largest metropolitan area in Indonesia, following the Jakarta Metropolitan Area. Between 1961 and 1980, the population of the city of Surabaya more than doubled (about 3 per cent growth per year), and between 1980 and 1990, it grew at an average annual rate of 2.1 per cent. In 1994, the city of Surabaya had around 2.6 million population. But if the population figures had included informal settlements, by 1990 the total level had already reached 3.5 million (see Table 5.1). For the SMA as a whole, between 1961 and 1980, the population grew at an average annual rate of 2.1 per cent, and it had reached about 6 million in 1980. Between 1980 and 1990, the population of the SMA grew at an average annual rate of 1.8 per cent, and it had reached about 7.3 million in 1990. In the same way as with the city of Surabaya, if the population figure had included informal settlements, by 1990 the total level had
reached 8 million. While the population growth rate of Surabaya had decreased since the 1980s, two southern areas, the regency (kabupaten) of Sidoarjo and the city (kotamadya) of Mojokerto, showed rapid population growth between 1980 and 1990 (KMS, 1994, World Bank, 1994, Ministry of Public Works, 1982).

(ii) Urbanization in the SMA

**Historical process of the urbanization in Surabaya**

In the nineteenth century the original city center (in which a European community was formed and around which ethnic groups lived) lay between the Pegirian River running through the middle of the present city and Jalan Indrapura one of the city’s main roads. This area is about 4 km south from the coast line of Surabaya. Around the turn of this century, the port was constructed at Tanjung Perak, the present international harbor area, and trading and commercial activities were expanding rapidly, centering on the port. As a result, the urban area began to expand to the south. The urban growth in the first half of this century was supported by a steam tram service, which was initially designated to carry workers from south of the city to the port in the north. This factor had a decisive effect on the physical pattern of the north-south corridor in Surabaya. This pattern of urban growth, expanding from north to south continued until the 1950s (Ministry of Public Works, 1982).

In the 1960s, a new aspect of urbanization appeared. It was the expansion toward the east and the west, along the major arterial roads. After that, urban growth continued towards the western hill area, despite the unstable soil conditions. In the 1970s, the pattern of urban growth in the western area changed from linear to sprawl. During this period, new residential developments and other land development projects, mainly industrial development constructed by both public and private sectors, appeared within the area lying 5 -10 km from CBD (see Figure 5.2). Major manufacturing facilities were established in the following areas: first, Surabaya Industrial Estate Rungot (SIER) (operated since 1974) and its surroundings; second, the area near
the southern border to Sidoarjo, along the Surabaya River; third, the area along the main westward arterial road to Gresik (ibid.).

**Figure 5.2** Urban Growth in Surabaya Between 1969 and 1981

Source: Ministry of Public Works (1982)

**Current urbanization in the SMA**

In this way urbanization has taken place mostly within the administrative boundary of the city of Surabaya but is currently spreading to the neighboring jurisdictions, in particular along the southern border with the regency of Sidoarjo, where both industrial and residential (formal and informal) developments have occurred. It has also spread to the western border with the regency of Gresik, which has been designated as a major center for industrial development (World Bank, 1994).
Besides Surabaya and its surrounding areas, new industrial and housing developments have occurred in the areas which are far away from the city of Surabaya. For instance, in the areas along the expressway heading toward the southern regencies, Sidoarjo and Pasuruan, new industrial developments and then housing developments that provide employees to such industrial estates have been established. Due to these developments, the regency of Sidoarjo has showed rapid population growth in this decade, with an average annual rate of more than 3 per cent. At the same time, in the areas along the arterial road heading toward the southwestern regency, Mojokerto, industrial developments have occurred in the food, steel and paper industries. Within the regency of Gresik as well, the growth of industrial developments, in particular heavy industry, has continued [A-1, B-2].

The current situation of the urbanization in the SMA is consistent with the notion of “the extended metropolis,” which has been advanced by McGee et al. (1991, 1995) as a unique feature of the urbanization process in Asian countries. This extended metropolis is characterized by an intensive mixture of agricultural and non-agricultural activities occurring side by side. In the SMA, in the areas surrounding the metropolitan center, socio-economic changes have been taking place over the last couple of decades, due to improvements in transportation and communication infrastructure, the increasing flow of foreign investment, and growing diversification of agricultural activities. At the same time, the prevalence of small, privately owned mini-vans allows people to move from the countryside to town and back again easily. According to interviews with food and pharmaceutical manufacturers there, while many men are still engaged in agriculture, women have become a major labor source in such manufacturing activities [C-5, C-6].

5.1.3 Urban issues in the SMA

Today the SMA has become the focal point for East Java regional development. As will be described in the succeeding part, large numbers of people and large amounts of capital are
flowing into the area. However, according to a World Bank report (1994) and interviews with local government officials, the following urban problems can be observed there: environmental degradation by industrial and domestic waste; transportation problems, such as congestion at peak hours; and housing shortages, especially for the poor. The World Bank report points out that infrastructure provision for the area has not caught up with the demand for services. We will now turn to these current urban problems in the SMA.

(i) Environmental conditions and infrastructure provision

Among urban problems in the SMA, poor environmental conditions seem to be the most serious. As the World Bank report describes, this area has been a relatively clean developing city within Indonesia. However, rapid urban growth and industrialization which will be described in the succeeding part have been depleting the area’s natural resources, degrading ground, river and coastal water with domestic and industrial waste, polluting the air, and contaminating the soil. Pollution of the city’s Surabaya River has been recently recognized as a major risk to public health, because it is the main raw water source for municipal water treatment plants. In 1990, depleted oxygen and high concentration of pollutants caused serious fish kills and hindered water treatment plant operations. This situation adversely affects the health and quality of life of the residents and the economy of the area (World Bank, 1994, Ministry of Public Work, 1982).

In order to tackle these environmental issues, several policies have been started by the city and the provincial governments, such as a pollution control programme initiated in 1985 by the city of Surabaya, and the Clean River Programme recently coordinated by the East Java Province. However, both domestic and industrial pollution remains at high levels, due to the lack of adequate enforcement of controls. As with other metropolitan areas in developing countries, infrastructure provision to address these issues in the SMA has not kept pace with the present situation (ibid.).

---

1 The city of Surabaya has won the Indonesia's award for a “notable city” for sustainable improvement of environmental quality (ADIPURA) for the last five years (World Bank, 1994).
In terms of water supply, the city of Surabaya is the highest service area in the SMA. But only 40 per cent of the city population has direct access to the piped water system. Other districts have less than 20 per cent distribution from such a system. The regencies of Lamongan, Sidoarjo and Mojokerto have less than 10 per cent. Many people rely more on high-priced water, sold to them by vendors and neighbors, and on extremely low quality water from hand-dug wells, rivers and canals. Groundwater in many of the coastal areas is saline, while that in other areas is deep and reliable, as the silty clay has very low transmissivity. Sales of bottled water are booming but are too costly for the poor. As for solid waste management, collection operations are carried out in the city of Surabaya and small areas of Sidoarjo. In the city area, collection coverage is relatively high, about 65 per cent. However, the city’s two final disposal facilities are problematic; the western disposal site is in the city’s rainfall catchment area, while the eastern disposal site is on coastal flats, causing surface water pollution and endangering coastal fishing and aquaculture. Similar problems are caused by poor and inadequate sanitation. There are only a few small areas in the SMA, the limited central area in Surabaya, that have sanitary sewer systems. These systems are over 60 years old, built during the Dutch colonial period, and only carry wastewater from connecting residences to nearby drainage ditches. These systems are no longer effective. Night soil collection is operated in Surabaya by private companies, but the collected night soil is mainly disposed of in the river within the city of Surabaya. The lack of infrastructure provision has resulted in polluted drains, especially in the large retention basin in the north of the Surabaya near port. At the same time, the incidence of infant mortality and of gastroenteric, pulmonary, and viral diseases caused in part by polluted and congested conditions, is high among the poor and those living in the northern, flood-prone areas of the city (ibid.).

1 In the city of Surabaya, the sold water is about Rp. 3,000 / m³, while the water distributed by the provincial water supply system is Rp. 300 m³ (World Bank, 1994).
(ii) Transportation conditions

According to the Surabaya Area Transportation Study (Ministry of Communications and Tourism, 1977), the transportation system was in need of improvement and had the deficiencies associated with physical problems with road networks (roads were narrow and winding, and were severed by the river); operational problems; driver's behavior; and problems with the public transportation system (network and operational problems). Today an urban expressway has been developed in the western part of the city, but the current excessive influx of cars and motorbikes has meant that the situation of the 1970s has not changed very much, and, if anything, it has become worse. In the central area of the city of Surabaya, drivers suffer traffic congestion at peak hours, and pedestrians have difficulties when crossing roads due to the physical structure of the road system and to poor traffic management. In addition, as observed in other metropolitan areas in Indonesia, weak and fragmented government agencies without adequate coordination, as well as weak links between land management and transport policies, have exacerbated the situation of Surabaya. For other regencies, since new industrial and residential developments have occurred along main arterial roads, various kind of traffic have tended to concentrate on these roads. In many areas, therefore, such main arterial roads have been congested at the peak hours, and new road systems to address these deficiencies have not been provided sufficiently until today [B-1, B-2].

(iii) Housing conditions

In suburban Surabaya, as in comparable areas of Jakarta, one can see several private development projects for luxurious real estate being constructed which are single-use, low-density, and based on automobile-dependent residential areas. In the city of Surabaya, however, about 70% of the population still lives in unauthorized settlements, with higher population densities and poorer living conditions than more regular residential developments. The rapid population growth and urbanization for the last several decades has made such settlements much higher in density and poorer. In addition, unauthorized settlements have spread to the swampy
and flood-prone area of the northern and western part of the city, and these settlements have caused environmental problems in the river and nearby sea (World Bank, 1994) [A-1, B-2].

In this way, the housing problem has been serious in Surabaya. Still, the city government of Surabaya has a diverse and long experience in various housing and human settlement programs for the poor. The Kampung Improvement Programmes (KIP) and the Rural Housing Improvement Programs are examples of the city's determination to improve the quality of human settlement (Silas, 1989). However, the rapid influx of people and the land management policies for low-density formal land development encourage unauthorized settlements, which increase the costs and problems of infrastructure development, due to right-of-way obstruction and the need for population resettlement (World Bank, 1994).

Compared to the influx of population and the scale of economic activities in the Jakarta Metropolitan Area (described in Firman and Dharmapatni, 1993), the urban problems in the SMA do not seem to be as serious. But if the present high growth rates continue, then the situation of the SMA may deteriorate rapidly, because of its ecologically sensitive terrain; most of the SMA is located in the low plain areas which are between the three main river basins, and has an elevation of less than 25 m above sea level. Particularly in the city of Surabaya, the alluvium from the Surabaya River forms a very large plain with little difference in relative elevation, less than 1.0 m above the sea. Therefore, without proper sewerage systems environmental conditions in the SMA will soon deteriorate (Ministry of Public Work, 1982).

5.2 Economic development in the SMA

The region's industrial sector, in particular the manufacturing sector, has been influenced intensively by foreign investment activities since 1990. Therefore, this section addresses economic development, characteristics of industrialization and current investment activities in the SMA.
5.2.1 Regional characteristics of industrialization

As has always been the case, Java currently dominates Indonesia's economy. According to the 1990 statistics, it contributed 62 per cent of the country's non-oil GDP. Within the provinces of Java, West Java, Jakarta and East Java accounted for the greatest share of this GDP. As for East Java province, where the SMA is the core region for the regional economy, its gross regional product (GRP) had been the largest in the country during the 1970s and 1980s (Hill, 1989 and 1990a). Today East Java's GRP is the second largest after West Java (Hill, 1996). However, on the scale of per capita GDP East Java in 1990 ranked rather low, below the national average. This was because within East Java province besides the SMA there are some notably poor regions, such as Madura Island and the south-western group of dry, limestone-based districts. Considering this regional imbalance of East Java province, the contribution of the northern sub-region centering around the SMA to the large amount of East Java's huge GRP is evident (ibid.).

Concerning East Java's GRP in each sector, in 1990 the industrial sector had increased about twice as much as that in 1975 (see Table 5.2). East Java's MVA (manufacturing value added per Km²) in 1990, Rp. 127.6 mil., was also much higher than the country's average, Rp. 13.0 mil. (Hill, 1996). The service sector had increased as well, from 45.3 per cent in 1975 to 53.0 per cent in 1990. In contrast, a decline in the share of GRP contribution by the agriculture sector was evident during this period, even though its physical output growth was impressive (Hill, 1989 and 1996).

<table>
<thead>
<tr>
<th></th>
<th>1975 (%)</th>
<th>1990 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Agriculture</td>
<td>Industry</td>
</tr>
<tr>
<td>East Java</td>
<td>43.0</td>
<td>11.8</td>
</tr>
<tr>
<td>Indonesia</td>
<td>40.0</td>
<td>9.5</td>
</tr>
</tbody>
</table>

* The industrial sector includes mining (non-oil, gas)

Source: REPELITA VI, cited in Bappenas (1994)
Since Soeharto came to power, the rapid increase of the industrial sector in East Java has followed Indonesia’s trend as a whole; indeed East Java has been the country’s leading center for industrialization. In particular, in the 1960s and early 1970s, East Java’s industrial base was the largest in the country (Douglass, 1991, Azis, 1989). Currently, East Java has lost its pre-eminent position due to the growth of Jakarta and its surrounding area, but its industrial share remains large (the second largest in Indonesia) (Hill, 1996). East Java’s employment share (number of employees) was still the highest in Indonesia, whether including or not including small firms (Hill, 1990b). The SMA has been the core area for the industrial sector, in particular for relatively capital intensive industries. Here, the characteristics of the manufacturing industry in the SMA will be described.

**Industry in the SMA**

East Java’s industrial output has been dominated by sugar-milling and *kretek* (cigarette containing chopped cloves) manufacture, producing the largest quantity of both items in Indonesia (Hill, 1989). But in the SMA, besides the food and wood sectors, so-called capital intensive manufactures have developed, such as the chemical, basic metal and machinery industries. The concentration of manufacturing facilities, particularly heavy industries, into the SMA is notable. Although the data is outdated, in the early 1980s the share of basic metal and machinery manufacture in manufacturing total output was 67 per cent of the total of East Java, and that of chemical and chemical products manufacture was 78 per cent (Ministry of Public Works, 1982).

With regard to the location of these factories, most have been built in the city of Surabaya and its immediate peripheral area. The three regencies, Surabaya, Sidoarjo and Gresik, together have about 80 per cent of the total manufacturing sector establishments in East Java, and about 90 per cent of the total manufacturing employees. From interviews, different characteristics for various locations in the SMA by industrial sector were recorded as follows (ibid.) [B-1, B-2]:

- The food and beverages sector has tended to be located along the Surabaya-Sidoarjo (north-south) corridor, with almost no such sector in Gresik (the western part of Surabaya).
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- The chemical sector has been located mainly in three areas; Gresik, Surabaya-Sidoarjo corridor and the Surabaya-Mojokerto (northeast-southwest) corridor along the Surabaya River.

- The non-metallic and mineral products sector has a similar tendency to the chemical sector.

- The metal processing sector has tended to be located mainly within the city of Surabaya and in the peripheral area between Surabaya and Sidoarjo.

- The factories in the miscellaneous sector have been mainly located within the city of Surabaya, in particular in the public industrial park (SIER).

As for small-scale factories and handicrafts (defined as factories with less than 5 employees), many units have been located in the rural areas supported by agricultural industry. For instance, factories for batik products are located in the rural areas of Bangkalan and Sidoarjo. Those for shrimp products are located in the rural areas of Sidoarjo and Gresik (ibid.) [B-1, B-2].

**Table 5.3 Industries in Surabaya (1980 -- 1995): Units, Workers and Production Values (million Rp.)**

<table>
<thead>
<tr>
<th></th>
<th>Large / medium scale industries</th>
<th>Small scale industries</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>number of units</td>
<td>number of workers</td>
</tr>
<tr>
<td>1985 / 1986</td>
<td>907</td>
<td>57,749</td>
</tr>
<tr>
<td>1994 / 1995</td>
<td>817</td>
<td>75,704</td>
</tr>
</tbody>
</table>

*The average number of worker of large / medium scale industries is 76.7 person / unit.
That of small scale industries is 14.3 person / unit.
Source: KSKS (Statistical office of Surabaya municipality)(1994)

A recent characteristic of the location of industrial development has been for large and medium-scale manufacturing facilities to be located outside the city of Surabaya, in the regencies of Sidoarjo and Gresik. By contrast, small-scale manufacturing facilities (see the scale of facilities in Table 5.3) tend to be located in the city of Surabaya. Table 5.3 shows units, workers, and
production values of the large-scale and small-scale industries in the city of Surabaya between
1980 and 1995. During this period, the number of units and workers in Surabaya’s large and
medium-scale industries did not change so much, although their production value increased
drastically. On the other hand, during this period the number of units and workers in Surabaya’s
small-scale industries almost doubled. The large and medium-scale industries in this figure
include metal, chemical, food, and wood manufactures, and so on. For the small-scale industries,
there are no data by sector (KSKS, 1994).

5.2.2 Investment in the SMA

Until the end of the 1980s, both domestic and foreign investment in East Java and the
SMA had been relatively small compared with Jakarta and West Java, although the amount of
investment had been higher than the country’s average. As for domestic investment, East Java’s
share of total investment in Indonesia between 1967 and 1990 was 9.2 per cent, while West
Java’s share was 35.8 per cent. As for foreign investment in this period, Jakarta and West Java
attracted almost 60 per cent of approved foreign investment, excluding oil and finance. On the
other hand, East Java’s share had been surprisingly small, merely 10 per cent of the Jakarta-West
Java total (Hill, 1996). This limited amount of investment in East Java, in particular foreign
investment, had flowed mainly into the SMA and its surrounding areas. Of the cumulative value
of investment in East Java between 1968 and 1982, about 70 per cent of domestic investment and
about 80 per cent of foreign investment was concentrated in the SMA. In particular, the city of
Surabaya had received a large amount; about 30 per cent of East Java’s domestic investment and
about 50 per cent of its foreign investment (Ministry of Public Works, 1992).

In the 1990s, the trend of concentration of investment in the SMA and its surrounding
areas has not changed; investment into East Java and the SMA, in particular foreign investment,
has increased drastically. Table 5.4 shows the development of domestic and foreign investment
approvals from 1989 to 1995. For domestic investment, East Java’s cumulative investment value
between 1967 and 1995 had reached Rp. 38 trillion, but 76 per cent of it had been generated after 1990. This domestic investment was concentrated in the SMA, and between 1967 and 1995, the SMA had received 78 per cent of cumulative investment. The recent increase of foreign investment has been much more drastic than that of domestic investment. East Java's cumulative foreign investment between 1967 and 1995 had reached US $ 23.5 billion, but 95 per cent of it had been generated after 1990. Today the cumulative foreign investment value has exceeded that of domestic investment; significantly such a phenomenon cannot be observed in other regions in Indonesia. This foreign investment had also been concentrated in the SMA and its surrounding area. Between 1967 and 1995 the SMA had received 40 per cent of this cumulative investment of East Java total, but if the adjacent two regencies, Pasuruan and Probolinggo, are included, the figure would amount to more than 80 per cent. This is because in Pasuruan a major public

Table 5.4  Domestic and Foreign Investment Approvals in East Java (1989 --1995)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Projects</th>
<th>Value (Rp. million)</th>
<th>Year</th>
<th>Number of Projects</th>
<th>Value (Rp. million) (US. $ thous.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>115</td>
<td>2,643,983</td>
<td>1990</td>
<td>32</td>
<td>2,027,604 (1,067,160)</td>
</tr>
<tr>
<td>1991</td>
<td>90</td>
<td>4,439,994</td>
<td>1991</td>
<td>34</td>
<td>1,464,827 (743,017)</td>
</tr>
<tr>
<td>1993</td>
<td>72</td>
<td>4,015,327</td>
<td>1993</td>
<td>40</td>
<td>5,636,900 (2,698,200)</td>
</tr>
<tr>
<td>1994</td>
<td>111</td>
<td>9,496,800</td>
<td>1994</td>
<td>52</td>
<td>14,706,827 (6,777,340)</td>
</tr>
<tr>
<td>1995</td>
<td>79</td>
<td>5,823,590</td>
<td>1995</td>
<td>84</td>
<td>24,312,110 (10,710,181)</td>
</tr>
<tr>
<td>Total (1990 --1995)</td>
<td>509</td>
<td>30,083,916.0</td>
<td>Total (1990 --1995)</td>
<td>267</td>
<td>48,761,835.0 (22,293,335)</td>
</tr>
<tr>
<td>Total (1967 --1995)</td>
<td>1,122</td>
<td>38,793,831.0</td>
<td>Total (1967 --1995)</td>
<td>346</td>
<td>51,420,099.0 (23,508,662)</td>
</tr>
</tbody>
</table>

Source: East Java BKPMD (East Java Regional Investment Coordinating Board) (1995a)
industrial park has been developed, and this is operated by the same sector as that of the industrial estate in Surabaya (SIER). Moreover, in Probolingo a major electric power plant which will distribute electricity to the whole of East Java is now being constructed (East Java BKPMD, 1995a) [A-2].

In terms of investment sector, the paper, chemical and non-metal industries (i.e. machinery) have been the major domestic investment projects located in East Java. These three sectors accounted for 50 per cent of the cumulative value of domestic investment between 1967 and 1995. In terms of the number of projects, besides these sectors there have been large numbers of food, metal goods and wood industry projects. In terms of the foreign investment sector, the chemical, electric, metal goods and food industries had been the major fields of investment in East Java. In particular, the chemical industry had accounted for 55 per cent of the total cumulative value of foreign investment between 1967 and 1995. In terms of the number of foreign investment projects, besides the chemical industry, there has been a large number of metal goods, food, and textile industry projects. As for the origin country of this foreign investment, Hong Kong had been the largest investor in East Java in terms of cumulative investment value between 1967 and 1995. Besides Hong Kong, United Kingdom, Australia, the United States, Japan, and Taiwan have been the major investors by value, and Japan and Taiwan by number of projects (ibid.).

5.2.3 Factors of rapid investment growth in the SMA

In this way, both domestic and foreign investment in the SMA and its surrounding regencies drastically increased since the early 1990s. As described in chapter 3, from the end of 1980s the rapid increase of foreign investment has been the trend for all of Indonesia, but this has only benefited a small number of metropolitan areas in the more recent period. In particular, the Jakarta Metropolitan Area has been the major location of both foreign and domestic investment in
the country for the last twenty-five years. In fact, about two-thirds of the total foreign investment during 1967-1991 was located in Jakarta and West Java (Firman and Dharmapatni, 1993).

The factors that lead the Jakarta region to attract domestic and foreign investment in this way include its better infrastructure, mass markets, pools of skilled labor and entrepreneurs and access to government decision makers (ibid.).

But in the case of the SMA, what are the factors for the rapid growth of investment? According to interviews with personnel engaged in urban and industrial development there, the following factors are considered to be important in attracting large amounts of foreign and domestic investment into the SMA:

1. Jakarta is now beginning to suffer serious urban problems, due to rapid and excessive urbanization and industrialization, such as congestion, wage increases, soaring land prices, environmental degradation, and insufficient infrastructure provision [A-1, C-1, C-2],

2. The SMA is positioned to catch the spill-over from the Jakarta region, because it is geographically close to Jakarta (located on the island of Java, with road networks, which connect the two areas in about 15 hours)\(^1\) [A-1, C-1, C-2],

3. Compared with other metropolitan areas, it also has better infrastructure (the urban expressway systems, the international port and airport, well-equipped public and private industrial parks), which could accept the new investment [B-2, C-2],

4. As a regional center of eastern Indonesia, including other islands, it covers a large economic hinterland, which offers a mass market and labor pool, and it already has accumulated local capital and local industries [C-1, C-3],

5. Politically, it seems to have an advantage over other secondary cities outside Java, like Medan, because many incumbent cabinet members come from Java [C-1].

\(^1\) If subcontractors in the SMA ship their products to Jakarta in the evening, this shipment will reach there in the morning. A Japanese auto parts manufacturer actually practices business this way [C-1].
As described above, one of the main reasons for the SMA attracting foreign investment is the presence of local enterprises. Local enterprises in Surabaya have been fostered through the long process of industrialization there. Surabaya has been developed as a heavy industrial center in East Java from the early stages of industrialization. On top of that, the state has supported industrial development in the SMA through fully-equipped public industrial parks and various infrastructures such as a highway system, international port and airport which have been developed from the early period of the Soeharto regime (the 1970s). In consequence, a range of local enterprises, from small to large, have already been established (Douglass, 1991, Azis, 1989, Hill, 1989, 1996).

The presence of large local enterprises is useful for foreign capital, because before the government deregulation policy (No. 20 / 1994) (covered in chapter 3) which allows foreign capital to establish a company with 100 per cent ownership, foreign capital had to do joint business with local enterprises. But even after this deregulation policy (e.g. in the automobile industry), foreign manufacturers still have been guided by the state to use local subcontractors for parts supply (Yamada, 1995) [B-3]. Consequently, besides formal investment procedures there are several advantages for foreign investors to conduct joint ventures with local capital in the SMA. According to interviews with personnel of Japanese trading companies there are several reasons [C-1, C-3, C-4]:

• In many cases, local partners (local enterprises) have a connection with influential politicians and bureaucrats in the central and local governments; accordingly joint companies can easily obtain necessary permissions for starting business.

• Local partners often have a rich network for domestic marketing; this is particularly useful for a company that will make products for local Indonesian consumption.

• Local partners provide useful information regarding the location of a company’s facilities, in terms of distribution of products, labor supply, basic infrastructure and so on.
Due to the local networks and political connections of local partners, companies can secure stable and sufficient supplies of necessary raw materials or parts.

Local companies can receive sufficient human resources for a new project, especially middle-class managers who are often regarded as difficult to secure for foreign enterprises.

5.3 Urban development projects in the SMA

As described in the previous section, both domestic and foreign investments have sharply increased in the early 1990s. These recent investment activities, which mainly have flowed into the manufacturing sector, have propelled metropolitan population growth and rapid urbanization due to the expansion of jobs and the attractiveness of the SMA to rural migrants. This section discusses the recent urban development projects in the SMA, such as industrial parks, commercial and housing developments which have occurred alongside this rapid growth in investment activity. The urban development projects described below are divided into the following three categories: first, industrial development projects which are a direct result of foreign investment, as well as joint ventures between foreign and domestic capital in the SMA; second, housing and commercial development projects which are mainly an indirect result of foreign investment there; third, infrastructure projects which become necessary for coping with the current rapid urbanization and population growth.

5.3.1 Industrial development projects

Governments have tried to confine new industrial activity in the SMA to designated industrial areas such as public and private industrial parks. Recently, construction of industrial parks has boomed in the whole country, especially in Java and Batam Island where about 50 industrial parks have been or are being constructed (Jetro, 1996). In the SMA, the major public industrial park, Surabaya Industrial Estate Rungut (SIER), was developed in the early 1970s by the public joint corporation, P.T.SIER. At that time, SIER was the first fully-equipped industrial
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estate in Indonesia. Today, in the SMA and the adjacent regency, Pasuruan, 8 large-scale industrial parks have been or are being constructed (East Java BKPMID, 1995a).

In the SMA plans for designated industrial areas have been developed by each municipality / regency government based on an overall regional plan for the SMA developed in the early 1980s by the central government (Ministry of Public Works). In this regional plan the SMA was divided into three different categories: an area where industry is encouraged, an area where industry is controlled, and an area where industry is severely restricted (see Appendix D). By this regional plan, areas mainly in Gresik, Surabaya, Sidoarjo and Bangkalan were designated as areas where industrialization was encouraged. The industrial parks described above are located in such areas.

In these areas, two representative industrial parks now being constructed are discussed below; one is publicly funded and the other is privately funded.

(i) A public industrial park: Pasuruan Industrial Estate Rembang (PIER)

This newly developed public industrial park, Pasuruan Industrial Estate Rembang (PIER), is located in the regency of Pasuruan, 50 km south from the downtown area of Surabaya (about an hour’s drive by car). When completed this estate will comprise a total of about 500 ha., within which 150 ha. of land has already been constructed as the first stage development. The price of land in PIER is between US$ 30 and 36 per m², which is from half to two thirds of that for constructing industrial parks near Jakarta. The developer of PIER is the same as that of SIER, P.T.SIER, the public joint corporation created by the central government (Ministry of Finance), the Surabaya city government and the East Java provincial government (Jetro, 1996) [B-3].

According to an interview with a personnel member of P.T.SIER, who is also an East Java provincial government official, a number of reasons lay behind the construction of PIER. First, since properties in the older SIER industrial park had almost been sold out, other industrial parks that would accommodate the rise in investment activities in the SMA were needed. Second, the land price in PIER was much cheaper than that in Surabaya and there was abundant labor in and around its new location. Third, although PIER was distant from downtown Surabaya and the
international harbor, the expressway from PIER to Surabaya will soon be developed (about 80 per cent of it had already been developed by 1996, and a remaining route was also planned to be completed within two years) [B-3]. A Japanese trading company which had experience with developing industrial parks in the Jakarta Metropolitan Area became an agent for selling PIER's estates in 1995. This trading company was in fact a window for a Japanese investor in PIER. An interview with personnel of this Japanese trading company brought out other reasons for the construction of PIER -- mainly relating to the perceived disadvantages of the existing SIER estate. For example, as land prices and labor costs in Surabaya had increased recently, the industrial estates in the extended area of SIER had not sold well. Moreover, the condition of the designated industrial area in western Surabaya, Tandes Area (as will be described below), sometimes caused floods and drainage problems (particularly in the rainy season, the drainage of Tandes Area was considered to be terrible) [C-4].

Appendix C (Table C.1) shows the list of enterprises which were constructing facilities in PIER during 1996 and their types of business. Of 30 investors, 15 of them were foreign investors. In terms of property size, the foreign investors had purchased much larger plots; the average plot size of foreign investment enterprises was about 9,500 m² while that of domestic enterprises was about 4,500 m². There was no special distinction between the types of business engaged in by either domestic or foreign investment. The businesses listed for PIER included plastic, wood, food, textile, chemical and electronic enterprises [B-3].

(ii) A private industrial park: Kawasan Industri Maspion

A major privately developed industrial park, Kawasan Industri Maspion (KIM), is located in the regency of Gresik, 25 km west from the downtown area of Surabaya (about a half hour journey by car). When completed this park will comprise about 450 ha. in total area. The price of land in KIM was between US$ 40 and 60 per m², which was about two thirds of that for

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1 In 1996, the price of estates in the extended area of SIER was Rp. 350,000 per m², which was more than three times higher than that of PIER, and much higher than that of industrial parks now constructing near Jakarta [C-4].
constructing industrial parks near Jakarta (US$ 55 and 85 per m²). The developer of KIM is the P.T. Maspion Industrial Estate, one of the Surabaya-based corporations of the Maspion Group. This group was originally an electrical appliance company and now has the largest share of the electric fan market in Indonesia (Azuma, 1996) [E-1].

According to an interview with a personnel member of P.T. Maspion Industrial Estate, there were a number of advantageous points of this industrial park. For instance, the estate would be fully equipped (e.g. sufficient water and energy supplies and waste treatment systems), yet the price of land was much cheaper than that in SIER. Moreover, the distance from downtown Surabaya was about half of that of PIER, and KIM was located at the entry point of the expressway being constructed, Surabaya-Gresik Freeway. In addition, the industrial park would have a chemical jetty, to facilitate loading and unloading of chemical materials [E-1].

Because such facilities are available, the chemical industry is to set to occupy a large part of this industrial park, about one third of its designated land. No list of enterprises planning to invest in KIM was made available, but according to an interview with KIM personnel, several foreign investors, mainly in the steel and machine industries from Taiwan, Thailand and Japan, were constructing facilities. Another characteristic of KIM is that about one third of its property will be developed by its ‘own group’ (the Maspion Group) enterprises. In these plots, two manufacturing facilities were being constructed (see Appendix C, Figure C.4). One will be a steel pipe factory, and another will be a stainless steel factory, both of which were joint ventures with Japanese trading companies. In this way, enterprises in KIM were planned to be mainly chemical and heavy industry oriented such as steel and heavy machinery. These industries were similar to those already located in nearby Gresik. The investors will be mainly foreign enterprises and joint ventures between the Maspion Group and foreign enterprises [E-1].

(iii) A designated industrial area: Tandes Industrial Area in Surabaya

As described above, governments have designated areas where industrialization is encouraged by the regional plan. Within these designated industrial areas, Tandes Industrial Area,
in the city of Surabaya, is the largest in the SMA, with an area of about 2,700 ha. (see Figure 5.3) [A-1, B-2].

In Tandes Industrial Area, various industrial facilities, from large-scale to small-scale, had already been established along the arterial road heading toward Gresik. There were no data for small-scale industries, but in 1994 more than 110 units of large-and medium-scale industries were located there. In terms of the types of industry the main industries were the wood, food, metal and machine industries (KSKS, 1994). The advantageous points of this Tandes Industrial Area include lower land prices (less than one third of that of the SIER) and its advantageous location, which is adjacent to downtown Surabaya and the international harbor. However, Tandes Industrial Area had a serious problem as a large part of it lies in a flood-prone area, less than 1.0 m above sea level and adjacent to a swampy area. In addition, the infrastructure for drainage there has not been well developed. Therefore, particularly in the rainy season, such
conditions cause serious floods and drainage problems in this area (see Appendix C, Figure C.6) [B-2].

5.3.2 Housing and commercial development projects

While little foreign investment has found its way into the housing and commercial development sectors, these projects are considered to be an indirect result of foreign and domestic investment in the manufacturing sector. This is because many housing and commercial projects have been developed for the sake of accommodating the increasing demand that derives from industrial development.

(i) Housing development projects

In the SMA as a whole, the number of housing units has increased along with recent economic and population growth as described in 5.1 and 5.2. Judging only by official statistics it is difficult to grasp the entire situation for housing development. This is because official government data do not include informal housing development which accounts for a large part of housing development throughout Indonesia. According to interviews with Surabaya city government officials, formal large-scale housing developments have occurred mainly around the boundary between Surabaya and Sidoarjo and in the southern hilly area in Surabaya. At the same time, large-scale housing developments have occurred mainly adjacent to the industrial developments along the expressway from Surabaya to Sidoarjo (see Figure 5.2). Along the other arterial roads, such as the Gresik-Surabaya and Mojokerto-Surabaya routes where industrial developments had occurred recently, existing villages provide labor to such industrial sectors. Informal housing development has occurred mainly in the northern and eastern areas of Surabaya city, where many residential facilities had not previously existed due to the swampy and flood-prone condition of these lands [A-1, B-2].

The principal housing policy of each municipal or regency government is not to provide new housing estates but to improve high-density residential areas. This kind of policy has been
proposed mainly in the city of Surabaya, where more than 2,000 ha. of high-density residential areas exist. Until today, in order to address various urban issues in such an area, the Kampung Improvement Programme (KIP) has been implemented in Surabaya. In Indonesia, KIP was started in 1969 and is considered by the state to be one of the principal means of reducing urban poverty. KIP in Surabaya has been involved with 'bottom-up' planning and project implementation, while Jakarta's KIP had more of a conventional public works, 'top-down' approach (Steinberg, 1992). Besides KIP, the city government of Surabaya has diverse and long experience in various housing and human settlement programmes. Interestingly, most of these programmes have been conceived and financed locally and implemented by local experts. In Surabaya, the local community has been able to initiate its own proposals as well as request budget funding and go on to self-managed implementation (Silas, 1989).

**Table 5.5 Cumulative Results of KIP in Surabaya (1976 -- 1987)**

<table>
<thead>
<tr>
<th>Area (Ha.)</th>
<th>Pop. (thou.)</th>
<th>Cost (m Rp.)</th>
<th>Road (tho.m)</th>
<th>Path (tho.m)</th>
<th>Public Toilet</th>
<th>Piped Water</th>
<th>Drain (tho.m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban II (1976--1979)</td>
<td>431</td>
<td>252</td>
<td>3.03</td>
<td>23.2</td>
<td>45.8</td>
<td>131</td>
<td>64.1 tho.m</td>
</tr>
<tr>
<td>Urban III (1979--1984)</td>
<td>890</td>
<td>347</td>
<td>5.97</td>
<td>39.4</td>
<td>108.4</td>
<td>81</td>
<td>100.0 tho.m</td>
</tr>
<tr>
<td>Urban IV (1984--1987)</td>
<td>615</td>
<td>260</td>
<td>5.28</td>
<td>30.8</td>
<td>62.9</td>
<td>34</td>
<td>14.4 tho.m</td>
</tr>
<tr>
<td>Total</td>
<td>1,936</td>
<td>860.2</td>
<td>14.28</td>
<td>93.42</td>
<td>217.11</td>
<td>246</td>
<td>178.63</td>
</tr>
</tbody>
</table>

Source: Silas (1987)

The World Bank commenced assistance to KIP in Surabaya from the middle of the 1970s, and made the projects more comprehensive, on a larger scale and with higher standards. These projects have covered already about 2,000 ha. and accommodated one million people along with the development of various infrastructure facilities (see Table 5.5). Community participation in the planning process and project implementation and utilization were also important factors in the World Bank assistance. Later, support for KIP came from UNEP (1978 -- 1980) and UNICEF
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(1981 -- 1983) as well, although commitments were limited only to pilot projects. Both institutions required active participation by local communities in order to achieve maximum results and ensure sustained activities based on the needs of the community itself (Silas, 1987).

Outside the traditional kampung, new housing development projects in the city suburbs have been developed by the private sector. Many of these projects have been initiated to cater to the new forms of foreign or domestic investment in Surabaya. Formal housing development projects now being constructed in suburban Surabaya are a typical example of contemporary metropolitan housing developments in Indonesia. One such project can be seen in the western hilly area along the urban expressway in Surabaya. This is a luxurious single-use, low-density housing development project where the developer is a local real estate corporation, P.T.Pakuwon Jati. This project will include various sports facilities, such as a golf course and a gymnasium, as well as a shopping center and an international school. Appendix C (Figure C.7, C.8) shows the development image and the site of construction; besides detached houses, European style town houses were also being constructed (see Figure C.9). The cost of a typical town house dwelling unit (about 100 m2) was Rp. 130 million (about US$ 6,000).¹ The cost of a detached house unit was more than double that of a town house. According to an interview with sales personnel of P.T.Pakuwon Jati, the major buyers of this estate, in particular of detached houses, had so far been foreign business persons and ethnic Chinese Indonesians [E-2].

Another example of new housing projects by the private sector is the townhouse style of housing developments which mainly occurred around the boundary between Surabaya and Sidoarjo. According to official statistics of the city of Surabaya, between 1990 and 1994 about 5,000 new housing units had been constructed per year, and most of these new developments had occurred in such southern border areas (KSKS, 1994). Usually this type of project has much smaller structures and lots than those in the above-mentioned luxurious projects. In addition, the

¹ In 1990, the percentage of the people whose monthly expenditure was more than Rp. 60,000 (about US$ 30) in East Java was 4.6 per cent (Hill, 1996). In 1994, a monthly payment for average factory worker in Indonesia was Rp. 250,000 (about US$ 115) and that of office worker was Rp. 420,000 (about US$ 195) (Jetro, 1996).
housing materials are much cheaper and the design is much simpler (see Appendix C, Figure C.10). Therefore, these housing estates are much more affordable, but these locations are relatively far from downtown Surabaya, and their feeder roads leading to the arterial roads have not yet been well developed [B-2].

(ii) Commercial development projects

In the 1990s, large-scale commercial facilities have been established in the SMA, particularly in downtown Surabaya. Two large shopping malls, Tunjungan Plaza and Surabaya Plaza, have been completed recently in downtown Surabaya, both developed by Surabaya-based real estate corporations. The developer of Tunjungan Plaza, which is the largest shopping facility in the SMA, is the same as that of the luxurious housing project, P.T.Pakuwon Jati. These large-scale shopping malls are modern-style buildings accommodating various stores, such as expensive boutiques and car dealers, as well as movie theaters (see Appendix C, Figure C.11, C.12). Compared with the relatively old marketplaces in downtown Surabaya, however, customer turnout (customer levels) for such new department stores was not very large, due to the much more expensive prices of goods there.

Another characteristic of commercial development in downtown Surabaya in the 1990s have been a rapid increase in hotel development. Hotels in the SMA have been developed by both domestic and foreign developers. According to official statistics of East Java BKPMD, between 1990 and 1995 the number of investments in hotels amounted to 26. Of these, 15 projects were invested in by domestic capital and 11 projects by foreign capital (East Java BKPMD, 1995a). During these few years major foreign capital hotels, such as the Hotel Sheraton and the Hotel Shangri-La, have been completed in downtown Surabaya.

5.3.3 Infrastructure development projects

Lastly, infrastructure projects in the SMA will be discussed. These projects have become necessary for coping with rapid urbanization and population growth which have been caused
mainly by both domestic and foreign investment activities. The recent rapid population growth occurring in the fringe areas of Surabaya and Sidoarjo provides additional property tax revenues to local governments. Still, the infrastructure needs of these areas have yet to be fully addressed. As described in 5.1.3 (urban issues), considerable deficiencies of infrastructure provision remain both in coverage and quality. A wide range of deficiencies in infrastructure were reported on the provision of micro-level infrastructure, such as water distribution, drainage, services for sanitation for the poor, downtown traffic and management systems. Moreover, macro-level infrastructure such as wide-area transportation networks and the stable provision of electricity were also found to be deficient (World Bank, 1994). Various levels of government as well as the private sector have made a number of efforts to address these problems. Such efforts are now examined and divided into the public and private financing of infrastructure projects. Interestingly, most of these projects, both public and private, have been heavily financed by foreign investment.

(i) Public financing projects: Surabaya Urban Development Project (SUDP)

As described in the chapter 4, the government of Indonesia has initiated comprehensive infrastructure programmes at a national level, the Integrated Urban Infrastructure Programmes (IUIDP), in order to optimize infrastructure provision and mobilize additional local resources. The Surabaya Urban Development Project (SUDP) was one of these IUIDP projects and a six year project that started in April 1993. The major three elements which are each more than US$ 140 million equivalent value comprise urban transportation and traffic management, water supply, and storm-water drainage. Other elements in the SUDP, which are of less than US$ 30 million equivalent, include solid waste management, human waste management, a KIP programme, technical assistance and training to the local city government of Surabaya [called Kotamadya Surabaya (KMS)], human resource development and training assistance to the KMS (see Table 5.6) (World Bank, 1994).
The central government has played a supervisory, technical advisory and monitoring role, as it assists the local government in both obtaining foreign financing and monitoring the progress of program execution. Throughout the program implementation period, several central government officials have been sent to Surabaya city government (KMS) to work on the project, and some of them will live and work there until the project is completed. To implement the SUDP practically and sufficiently a special Urban Management Unit (UMU) was established within the KMS for this project. As described in chapter 4, one of the objectives of IUIDP is the institutional development and capacity-building support of local governments. Therefore, the project includes strengthening KMS's staff capacity and providing a comprehensive training program for the agencies involved in urban development in Surabaya [B-2].

The total cost of the SUDP will reach US$ 617 million by 1999. This sum is financed by the budget of the Government of Indonesia, loans from the World Bank and loans from Overseas Economic Cooperation Fund of Japan (OECF) (see Table 5.7). As described in 3.3.3, the World Bank and Japanese ODA have always accounted for about two-thirds of the total value of such assistance. Financial management including disbursement and repayment of loans has been

<table>
<thead>
<tr>
<th>Project cost (US$ million)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban road &amp; Traffic management</td>
<td>121.0</td>
</tr>
<tr>
<td>Water supply &amp; distribution</td>
<td>160.6</td>
</tr>
<tr>
<td>Storm drainage works &amp; equipment</td>
<td>141.7</td>
</tr>
<tr>
<td>Solid waste collection &amp; disposal</td>
<td>6.6</td>
</tr>
<tr>
<td>Human waste collection &amp; disposal</td>
<td>19.9</td>
</tr>
<tr>
<td>Kampung Improvement &amp; Community</td>
<td>22.7</td>
</tr>
<tr>
<td>Resettlement &amp; Rehabilitation</td>
<td>2.2</td>
</tr>
<tr>
<td>Technical assistance</td>
<td>33.6</td>
</tr>
<tr>
<td>Base cost</td>
<td>508.3</td>
</tr>
<tr>
<td>Physical &amp; price contingencies</td>
<td>109.3</td>
</tr>
<tr>
<td>Total project cost</td>
<td>617.6</td>
</tr>
</tbody>
</table>

Source: Surabaya Urban Development Project by World Bank (1994)
executed independently by each local sector, the city government (KMS) and the provincial water supply authority, (PDAM). But during the project period, these activities in KMS and PDAM have been supervised by central government staff, as one of the human resource development programmes in SUDP. Appendix E (Figure E.1) shows that SUDP funds from international institutions (IBRD and OECF) are provided through the central government agency (Ministry of Finance) (World Bank, 1994) [B-2].

Table 5.7 Financing Plan of SUDP

<table>
<thead>
<tr>
<th>Total budget (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government of Indonesia</td>
</tr>
<tr>
<td>The World Bank</td>
</tr>
<tr>
<td>Japanese Loan (OECF)</td>
</tr>
<tr>
<td>Other (Private Sector)</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td>227.8</td>
</tr>
<tr>
<td>186.0</td>
</tr>
<tr>
<td>174.8</td>
</tr>
<tr>
<td>29.0</td>
</tr>
<tr>
<td>617.6</td>
</tr>
</tbody>
</table>

(1): the land owners of the planned roads & drainages
Source: Surabaya Urban Development Project by the World Bank (1994)

(ii) Private finance projects

Although OECD countries and international institutions have been offering official economic assistance to Indonesia, the value of official funds does not seem to be expected to increase drastically hereafter. This is because the government of Indonesia is already suffering under the need to repay colossal cumulative foreign loans, estimated at about $ 50 billion in 1991. In the 1991 fiscal budget, the share allocated for the repayment of foreign loans was about 30% of the total budget. In addition, due to its favorable economic performance, as compared to other developing countries such as those in sub-Saharan Africa, Indonesia has found it difficult to receive free “grants” instead of payable “loans”. However, private capital, mainly in the form of direct foreign investment, is beginning to flow into infrastructure fields and in part this makes up for any lack in government budget for infrastructure provision (Sasaki and Kojima, 1992).
As described in chapter 3, a Presidential Decree (Government Regulation No. 20 / 1994) in 1994 was a drastic deregulation policy for promoting foreign investment. Besides the abolition of several investment regulations this decree opened nine sectors for foreign capital investment that had previously been closed, mainly in infrastructure areas, such as sea ports, the generation and transmission as well as distribution of electricity for public use, telecommunications, shipping, air lines, potable water, public railways, atomic energy reactors, and mass media. The decree induced foreign capital to invest into these new fields in Indonesia, and between 1994 and 1996 the SMA benefited from this new investment. One example is the Madura Bridge Project, which is not set to use foreign official development aid (ODA), but rather finance from two Japanese trading companies and one Indonesian public sector company as a so-called ‘built-operate-transfer’ (B.O.T.) project. Another project is an electric power plant currently being constructed in the southern adjacent regency, Probolinggo. This project is financed by a Japanese trading company, an American power company and an Indonesian coal mining company, as a so-called ‘built-operate-own’ (B.O.O.) project. Yet another is an electric power plant project in the southern adjacent district, Pasuruan, which is financed by a Japanese trading company, as a B.O.O. project [C-2, C-3, C-4].

In this way, it is interesting to note that Japanese trading companies have played a major role as developers in such macro-scale infrastructure projects in the SMA. In fact, they have also been engaged in many other infrastructure projects throughout Indonesia. One has cooperated on a water supply project in Jakarta with a British company, which will be the first case in Indonesia of a water supply project making use of private capital. Another trading company has examined a subway project in Jakarta [ibid.]. Japanese trading companies have engaged in many infrastructure projects in Indonesia for a long time, but most were to assist bilateral Japanese ODA projects such as a public railway in Jakarta and a hydroelectric dam in Sumatra. Compared to these ODA projects, private financing projects are considered to have a higher level of risk, because infrastructure projects are usually long term projects (i.e. it will take a long time for the
private sector to recover investments.). By way of illustration, in the example of the Madura Bridge Project, the bridge itself is planned for completion in 1999, but it will take until the year 2025 for investment recovery through the bridge's toll fees [C-2].¹ The private sector also has to run an investment risk (country-risk analysis), because in the case of a developing country the state is not always politically stable. Why, then, have Japanese trading companies begun to invest in many infrastructure projects in Indonesia? According to interviews with several personnel of Japanese trading companies now engaged in infrastructure projects in the SMA and Jakarta, the reasons for participating in the projects include the following:

1. It is difficult to judge the profitability of infrastructure projects due to a long-term payment period and the high country-risk. However, a project will also generate other business opportunities through construction activities such as the purchase and sale of construction machines and trade in raw materials [C-2].

2. In contracting the project, the Indonesian government has offered favorable conditions for the private sector so that investment recovery would be guaranteed for a long period (i.e. to reduce risk). For example, in the case of power plant projects, the Indonesian government cannot refuse to buy the electric power from these plants in any circumstances [C-3].

3. In most cases, the Indonesian public sector takes part in projects in order to mitigate such projects' risks [C-2, C-3].

4. The Indonesian government strongly urged trading companies to join infrastructure projects, and such companies, who need strong connections with the government to do other business in Indonesia, can not refuse it. The trading companies fear that refusal of projects might adversely influence their relationship with the Indonesian government [C-2, C-3].

¹ The total project cost is estimated at US$ 240 million. By the end of this year, the joint company for the project will be established [C-2].
5. The Japanese government provides supporting measures to Japanese corporations who will take part in infrastructure projects by means of trade insurance and financing, which in effect is one of the ways of economic assistance by the Japanese government to Indonesia [C-2, C-3].

The case study of the SUDP and other private financing projects in the SMA indicates that infrastructure provision there would not be sufficiently developed without the important role of foreign official and private capital.

5.4 The role of governments for urban development in the SMA

The previous chapter has examined the overall government structure and the situation of decentralization policies in Indonesia. As part of the more detailed case study of the SMA, this section addresses local governments’ and the central government’s role in urban development. As described above (5.2, 5.3), urban development in the SMA has been influenced markedly by Indonesia’s ‘opening up’ to the global economy. In such circumstances, what kind of role has each government played in the rapid urban development of Surabaya? In this section, linkages between foreign investment and the central government are first considered, followed by local governments’ role in urban development.

5.4.1 Foreign investment and the central government

Foreign capital since 1990 has played an important role in the current urban development of the SMA, although domestic capital is still dominant in some sectors such as in housing and commercial development. With the country as a whole, the ratio of foreign investment to total investment value in the SMA has been extremely large.\(^1\) At the same time, many local (domestic) manufacturers have conducted joint ventures with foreign investors, excluding some fields closed to the foreign sector such as wood industries. For example, enterprises in the chemical industry,

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\(^1\) In Indonesia as a whole, the foreign investment value has always been less than half that of domestic investment for this decade (see Table in Pangestu and Azis, 1994).
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which has been one of the largest industries in the SMA since the 1980s, now generally conduct business as part of joint enterprises with foreign capital (Ishida, 1992) [B-3].

The important thing to note here is that both official and private foreign investment have been carried out through formal and informal central government screening. In fact, foreign investment, regardless of its value, cannot be made without central government permission. As described in the chapter 3, the investment coordinating board (BKPM) examines and coordinates all foreign investment in Indonesia. As one of the major application procedures, the location of the proposed facilities or infrastructures is first examined by the central government, and so this procedure becomes an effective method of urban management as in the case of the Jakarta Metropolitan Area in 1995. In East Java province, a branch office of the investment coordinating board (BKPMD) accepts applications and issues permissions for investment in the name of the President. In addition, according to interviews with personnel of several Japanese trading companies, to start business in Indonesia it is very important to create informal connections with central government officials, because each official exerts a strong informal influence on each field [C-1, C-4].¹ In the same way, many privately financed infrastructure projects now being developed in the SMA (i.e. energy projects) are also controlled (or coordinated) by the central government. It is said that the central government urges foreign investors to joint venture with these projects. For example, the Madura Bridge Project has been strongly promoted by the Minister of Science and Technology, who has asked directly foreign investors to join the project [C-2].

Beyond its screening of overseas investors, the central government also exerts a great influence on the SMA through its control over public overseas institutional financed infrastructure development as part of ODA given to Indonesia. For instance, as mentioned in the previous section, about two-thirds of the SUDP project funds come from the World Bank and OECF.

¹ The first thing each worker in Japanese trading companies must do after arriving in Indonesia is to establish personal connections with government officials, and this often takes at least two years [C-2].
Although local authorities have a responsibility for financial management of such lending, all funds flowing from foreign institutions have been audited by the central government agencies, and all original requests for loans to donors (OECD members and international institutions) have originated with the central government. After starting a project, the central government monitors its progress by sending their own personnel to the city (World Bank, 1994) [D-1]. Since the total amount of official economic assistance has been coordinated between donors and the government of Indonesia, official foreign flows can therefore not be used without considering the central government's intentions.

Here, one has to notice that foreign investments, both official ODA and private capital flows, appear to strengthen each other's growth. First, infrastructure investment by the private sector tends to be related to other investment projects, such as those in the manufacturing sector. The developers of infrastructure tend also to benefit from doing other complementary business effectively. For example, one Japanese trading company, which is now constructing a major power plant in the SMA, is also planning to invest in several nonferrous metal factories there that require a large quantity of electricity [C-2, C-4]. Second, official capital (ODA) flows, in particular bilateral cooperation, are often used in the donor countries' interests (in strengthening private investment flows). That is, as many scholars point out, in the case of bilateral assistance between Japan and Indonesia, the official development assistance (ODA) has often been offered, because these projects support Japanese private investment (see Yasutomo, 1995, Hook, 1995, Kuroki, 1995).1 Therefore, one can say that ODA and foreign investment are interrelated through the indirect influence of the central government on the local development scene.

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1 Until the 1980s, Japanese government officials and politicians clearly avowed that Japanese ODA would be used for assisting the Japanese private sector to invest in the recipient countries (Kuroki, 1995). For example, a large hydroelectric dam in Sumatra was built using Japanese ODA in the 1970s. But at that time the electricity was needed for a Japanese aluminum refinery investment [C-4].
5.4.2 Role of local governments in urban development

We have seen that the central government has played a principal role in controlling and allocating foreign private capital and ODA in the SMA. Yet what of the role of local (provincial and regency / municipal) governments? In fact, as described in chapter 4, in Indonesia's current political and bureaucratic systems and with limited budgetary resources, it seems to be extremely difficult for local governments to take any initiative in planning and implementing local development, particularly in projects using foreign capital. In addition, a planning authority in the central government, BPN (National Land Agency), was established by the central government as one of the policy initiatives for local land use planning and implementation. According to the World bank report and author's interviews with local government officials, the activities of BPN have had an overly negative impact in the SMA, especially as permits to developers by BPN have often locked up land ripe for development. In many cases large properties in the downtown areas which have been dealt with by BPN have remained idle for a long period, due to the speculative intention of developers. This has increased land prices and detrimentally diminished local governments' control over local land use management (World Bank, 1994) [B-2].

Besides BPN activities, many unclear relationships exist between the authority of local and central governments in Indonesia over local planning, and this makes the local development scene confusing for both developers and local governments. This is especially true for development using foreign capital. After issuing the deregulation package in 1993, some development permits, such as the Location Permit, the Building and Nuisance Permit and the Right of Building,¹ were delegated to the local governments from the Regional Investment Coordinating Board (BKPMD) in order to simplify development procedure. However, the way of dealing with these permissions differs depending on provinces, and even within the same province it differs according to the scale

¹ The Right of Building permits construction and ownership of buildings for a maximum period of 30 years. There is usually automatic renewal of this right for a further 30 years, subject to payment of a premium of 2 - 4 per cent of the capital value (East Java BKPMD, 1995b). This right can be used as security for foreign developers, because in Indonesia foreign investors cannot purchase land (Yamada, 1995).
and use of the development under consideration. For example, in East Java, the Right of Building is dealt with by the National Land Agency (BPN) or its provincial officer, but sometimes by the second-level regency / municipal land affair office. As for the Location Permit, it is also unclear whether the provincial or regency / municipal governments have authority to issue such permits (East Java BKPMD, 1995b) [C-4]. In the case of small-scale domestic investment then, basically development has been controlled by local governments, but large-scale (or high-value) investment has sometimes been taken at the initiative of the central government without local planning permission [A-1, B-2]. Thus, it can be argued that central government interference in the planning and implementation of large projects -- whether funded by overseas ODA, private investors, joint ventures or public funds -- is not always sensitive to local planning needs.

According to interviews with central government officials, the local governments of the SMA, in particular Surabaya city government and East Java provincial government, already have had a broad history of involvement in local planning and development, and so have a better potential for playing a leading role in local development in terms of their technical capacity and know-how [A-1].

One example of this is the local public industrial parks developer P.T.SIER, described in the previous section. Although the central government helped with the establishment of P.T.SIER in the early stage of its development in 1974, by 1996 most of the personnel of P.T.SIER come from local governments (Surabaya city and East Java provincial governments), and they have managed its three industrial properties since the 1970s. As for investment procedures in SIER, instead of the central government, P.T.SIER can accept investment applications directly from both domestic and overseas investors. This allows foreign and domestic investors to cut costs and save time in the complicated and time consuming system of central government development procedure. In addition, local governments in SIER asked a Japanese trading company to become their overseas sales agent to promote the sale of properties at their industrial parks to Japanese
investors. These local governments' efforts have been successful in attracting foreign investment in their industrial parks from Japan [A-1, B-3, C-4].

Moreover, the city government of Surabaya has had a long experience in various housing and human settlement programs for the poor. As described in the previous section, the Kampung Improvement Programme (KIP) is an example of this kind of city government endeavor. Other attempts to help the poor include helping “becak” drivers to become taxi owner-drivers. The allocation of special areas for street hawkers is another example of a program which achieved some success in dealing with unemployment and low-income problems for the poor. Effective solutions to the problems of the urban poor have been proposed by the city government, although they are not yet fully implemented (Silas, 1989).

On the central government side, several policies have been launched to promote decentralization which have helped to strengthen local planning capacity in the SMA. As for fiscal autonomy, East Java province, which has the second largest metropolitan area in Indonesia (SMA) and various industrial sectors, has been able to keep a relatively large share of its own revenue. In 1991, East Java received the second highest value of revenue in Indonesia after Jakarta (Bappenas, 1994). However, as described in 4.2, since 1992 the central government has emphasized decentralization in the second level (regency / municipal) governments, and there has been little progress in this area (Hill, 1996). This is also true for the city of Surabaya; its financial performance has been relatively robust but still heavily relies on central government grants (World Bank, 1994).

One of the recent government decentralization efforts for this level, the IUIDP in Surabaya (SUDP), includes institutional development and capacity-building support. This is because the technical capacity of local government has to be strengthened for O&M (operation and maintenance) activities involving urban infrastructure, in particular those which require micro-scale services such as sanitation, water supply and solid waste management. SUDP comprises a number of components for this objective including technical assistance and training, as well as
human resources development and training assistance. Both involve overseas courses, workshops, and on-the-job training in computers and project management, and so on. This assistance is offered to the city government (KMS) and to the provincial water supply authority (PDAM) by central government agencies. Through this project, the central government has also transferred some authority to local governments so that they can implement projects by themselves (World Bank, 1994) [A-1].

Nonetheless, according to interviews with the central government officials who are now assisting the SUDP in Surabaya, as well as the local government officials and an OECF official who is in charge of SUDP, there are several problems with implementing these institutional development projects. For example:

- The program constantly has to be rescheduled, due to the slow pace of local government officials' work [D-1].

- Many local government personnel, in particular older persons, do not understand the recent rapid urbanization trends tied to the world economy, and they have trouble adopting to the changing situation [A-1].

- Institutional development has been obstructed, due to the strong vertical structure of the central government (i.e. each ministry issues orders for different aspects for a single project.) [D-1].

- A lack of adequate budget will be a problem in the future because the local government has not secured sufficient sources of revenue for O&M [B-2].

As one can see from the IUIDP project of Surabaya, which is often considered as the local body having perhaps the best potential for decentralization because of its planning experience, there seem to be several problems in the side of both central and local governments for strengthening local government capacity. However, in the SMA the presence of local investors is beginning to affect the behavior of local authorities.
In the SMA, there are several local investors who have direct connections to foreign capital. One example is the Maspion Group, the developer of KIM. Through joint ventures with foreign capital they have established a strong business network with several transnational corporations [E-1]. Another example is P.T.S.K.Foods, which, with Japanese investors, has established food processing factories outside the city of Surabaya. This business was started using personal connections from their previous business experiences (Yamada, 1995). In this way, local investors in the SMA are beginning to take part in joint ventures with foreign investors without using central government coordination, which until recently had been the major force in creating overseas business connections [B-3, C-4].

Such connections between local investors and foreign investors might lead to new relationships between foreign investors and local governments in the SMA. This is because local authorities can now make contact with foreign investors through planning and building procedures as well as infrastructure provisions, as one can see in the activities of the P.T.SIER personnel. This is true, even though inter-governmental responsibilities for planning and development are unclear. According to interviews with city government personnel, rapid urbanization in the SMA, accompanied by mainly foreign investment, has obliged them to change their attitude toward their jobs, as the scale and pace of the projects in which they are now engaged is quite different from before. Still, it is rare in Indonesia for a local region to have been so strongly influenced by the global economy in this way. Therefore, regulations, which can properly deal with the influence of globalization on local communities, have not been developed yet [A-1, B-2, C-3].

From the results of the author's interviews, Figure 5.4 is an attempt to summarize the new relationship between private foreign capital and ODA and the central government, as well as their relationship with local governments and local capital since 1990. As for the foreign investment scene, almost all investments are controlled by or processed through the central government, and private foreign investment in infrastructure has usually had a direct relationship with other private investment, such as that in the manufacturing sector. At the same time, official development
assistance (ODA), which mainly flows into the infrastructure field, has sometimes had an indirect relationship with this private investment, as in the case of Japanese ODA in the 1970s and the 1980s.

**Figure 5.4 Foreign Capital and Local Development in the SMA**

As for the local development scene, the central government also takes initiative for planning and development. To some extent, local governments have responsibilities for planning and development, as well. However, under the current planning and development system, who ultimately controls local capital is now unclear. For foreign official loans, each local government has a responsibility for financial management of its own investment programmes, but central government agencies monitor this procedure. Joint ventures between local capital and foreign capital have increased, and this has begun to create new relationships between local governments and foreign investors. Note that while this model applies to Surabaya in the mid-1990s it cannot
be applied for all local planning and development in Indonesia, because the role of local
government is different in each province or area.

Summary of chapter 5

Since 1990 foreign capital has played an important role in the current urban development
of the SMA, in particular industrial and infrastructure development, although domestic capital is
still dominant in some sectors such as in housing and commercial development. The central
government has principally been controlling and allocating these foreign private capital and ODA
funds. In addition, under the current planning system, control over the investment of local capital
is unclear. Therefore, local governments' responsibility for planning and development is limited.
However, foreign capital, both private and ODA funds, has begun to create new relationships
between local governments and foreign investors in the SMA.
CHAPTER 6
ANALYSIS OF THE CASE STUDY

As one can see in chapter 5, the SMA has been strongly influenced by events in the world economy, as well as by deregulation of Indonesia’s economy by the central government. This can been seen especially through the rapid increase in investment, urban development and job generation since 1990. Therefore, the example of the SMA will provide useful clues for considering Indonesia’s decentralization policies in the context of the new global economy and the growth of overseas investment in the country. This chapter analyzes the environmental and social aspects of SMA’s urbanization, and then examines local governments’ role in these aspects.

6.1 Analysis of the SMA’s urban situation

Foreign investment in the SMA, along with domestic investment by means of joint ventures, has played a crucial role in local economic development and has had various impacts upon local communities there. This section discusses the first research question of the thesis, i.e. the influence of the global economy upon this metropolitan area. Here, the influence of the global economy is examined not in terms of its economic aspect which has already been discussed in chapter 5, but in terms of its environmental and social aspects.

6.1.1 The environmental impact of globalization

In terms of environmental impact, it was predictable that the recent rapid increase in investment could have negative impacts upon this area due to its concentration on the manufacturing sector and lack of sufficient infrastructure provision. But growing foreign investment activities have not caused serious environmental problems directly. For example, in the public industrial park, SIER, where many large- and medium-sized foreign factories are located, the discharge from such factories is strictly controlled by the local authority and industrial waste is treated at the processing plant established within the industrial park [B-3]. This is also true for foreign-operated large-sized factories located along the arterial road. Indeed, according to
interviews with local government officials, foreign medium- and large-sized factories usually obey the industrial standard strictly [A-1], and the manager in the Japanese food factory in the SMA proudly said that his establishment discharges cleaner water than its intakes [C-6].

However, the small- and medium-sized domestic-owned factories which mainly supply the foreign assembly plants and which are located surrounding the industrial parks, or surrounding large-sized foreign factories, cause serious environmental problems. In addition, since such small factories are located in the middle of rice fields (see Figure F.2), the environmental impacts of these facilities upon the surrounding fields and residents are serious due to the nature of the wet rice paddy system [B-1]. Appendix F (Figure F.1) shows the situation surrounding the SIER in which small- and medium-sized factories are found. Many of these seem to be subcontract factories of SIER.

The growth of the manufacturing sector in the SMA has propelled metropolitan urban expansion and population growth due to the rapidly increasing job opportunities and attractiveness of the SMA to rural immigrants. However, the supply of housing has not caught up with this rapid population growth and illegal settlements have emerged, mainly in the marshy areas to the east and northeast. As a result, wastewater from these areas has caused serious environmental problems in both the river and nearby sea (World Bank, 1994) and this is yet another indirect effect of the recent high input into this area of investment, of which foreign capital has accounted for the largest part. As described in chapter 5 (5.1.3), this situation has resulted in seriously polluted drains in the northern area of Surabaya. At the same time, the incidence of infant mortality and of gastroenteric, pulmonary and viral diseases is quite high among the poor and those living in flood-prone areas of the SMA (ibid.).

In order to address these environmental problems, infrastructure projects for sanitation have been implemented, as one of the Surabaya Urban Development Projects (SUDP). Among these programmes, the Human Waste Programme (HWP) provides sanitation infrastructure in the several areas of Surabaya, and the Kampung Improvement Programme (KIP) also provides
sanitation facilities for the poor. These sanitation programmes are now in the process of selecting several pilot project areas, because each area has a different character in terms of income, population density, soil and ground conditions, water supply, and diffusion of septic tanks (World Bank, 1994) [A-1].

However, the largest shortcoming of these sanitation programmes of the SUDP is the scale of these projects. Overall they will cover only a small portion of the city of Surabaya. The HWP is designed to provide just a few sanitation facilities for each representative area in the city: i.e. in the high-income kampungs, the low-income kampungs, and the commercial district. The KIP programme also covers only a small portion of kampung settlements, less than 5% of the total kampung areas of the city. Considering the poor sanitary conditions there, these programmes have to be extended to cover a larger area to have any significant effect (ibid.).

One of the main reasons for this deficiency appears to be the limited budgets allocated to this programme. As shown in Table 5.6 in chapter 5, within the total budget of SUDP the large-scale infrastructure programmes such as urban roads, water supply and drainage programmes received significant amounts of budget. In contrast the SMA sanitation programmes received only a small portion of budget. This unbalanced allocation of budget resources seems to stem from the funding of the project. That is, the SUDP is mainly funded by foreign institutions (see Table 5.7), whereas the sanitation programmes are mainly funded by domestic sources. In general, foreign official assistance tends to flow into large-scale urban infrastructure projects because generally such projects can be completed in short periods and be easily monitored by foreign funding agencies. In particular, if foreign official assistance takes the form of loan commitments, the service costs of these projects might have to be recoverable through project operation. In the case of SUDP, all foreign official assistance comprise loan commitments rather than grants commitments. Considering the wastewater treatment methods that would be applied in the SMA, it seems to be difficult for foreign institutions to appropriate large amounts of loans due to the difficulties of cost recovery. Since infrastructure provision there has relied upon foreign funds in
this way, overall budget allocation, distribution of resources and therefore the condition of infrastructure are all necessarily influenced by programmes originated by foreign institutions.

6.1.2 The social impact of the globalization

The recent rapid increase in investment has also had a number of adverse effects upon urban society in the SMA. Although new employment has been created in various sectors, the people who benefit most from rapid economic growth and who attain high positions in major companies, particularly in foreign enterprises, comprise only a small portion of the population. While this is not directly attributable to overseas investment per se, it arises indirectly because of the hiring and promotion practices of foreign enterprises in Indonesia. According to my interviews, of domestic enterprises in the SMA, those owned by ethnic Chinese account for a large part as in the case of other metropolitan areas in Indonesia [C-1, C-4]. In general, Chinese enterprises are largely based on family enterprises and use consanguineous relationships as their organizational medium. Therefore, if the family business were really successful, and the firm grew larger, only more relatives would be included as employees (Hamilton, 1996). Moreover, Japanese enterprises in the SMA are usually reluctant to offer indigenous personnel high managerial positions as is also the case in other developing countries (Yoshihara, 1997). According to interviews with Japanese manufacturers, however, local people's attitudes also contribute to this phenomenon. That is, there is a perception that indigenous managerial-class personnel often change jobs and consequently Japanese firms have difficulty in placing such people in important positions [C-5, C-6].

Although this kind of unequal treatment in employment can be seen in almost every enterprise in Indonesia, it is widely perceived that ethnic Chinese are especially privileged in the current wave of development. The recent appearance of luxurious housing complexes and modern-style large shopping malls in the SMA, both of which are for the use of only a few people (middle-income ethnic Chinese and foreign business families), appears to have ignited such a
feeling. In June, 1996, eleven Christian churches in Surabaya were set fire by Muslim rioters. It is said that the poorer Muslims who lived outside or on the periphery of the urban area expressed their dissatisfaction at the widening gap between rich and poor by turning against the Christian churches to which most ethnic Chinese people belong. This event echoes other recent riots in the large metropolises throughout Indonesia against Chinese shops and Christian churches, and which are also said to have been caused by the disparity in wealth among Muslims themselves, who use the Chinese as scapegoats (Kagaya, 1997).

Another social issue which has arisen alongside high levels of growth in the SMA is the conflict between local people and those from Madura Island who immigrated to Surabaya looking for job opportunities. According to interviews with Japanese manufacturers, people from Madura sometimes create friction (e.g. quarreling) with Surabaya’s local population in workplaces and on local streets [C-5, C-6]. In this way, economic development in the SMA which has been mainly led by foreign investment has led to a number of social problems -- both directly and indirectly -- including dissatisfaction among the poor at the disparity in wealth as well as interracial and interregional tensions.

6.2 The role of local governments

The influence of the rapid increase in investment upon the SMA can be seen in its environmental and social aspects as well as in the economic aspect described in the previous chapter. With this background in mind, the role of local governments in the SMA will be discussed in relation to each of these aspects.

6.2.1 The role of local governments in economic issues

In Indonesia, local economic activities have occurred within a framework planned and implemented by the state. As described in chapter 5, foreign investment in the manufacturing sector has been the major driving engine for the SMA’s economy, and this is monitored and administered by the central government. The branch office of the Regional Investment
Coordination Board in East Java (East Java BKPM) is under the immediate control of the President and is the central authority for processing all foreign investment applications. Although several kinds of permissions for development are delegated to local governments, BKPM’s controlling authority is still strongly prevalent, and this is the case regardless of the location or size of investment.

The SMA has attracted large amounts of foreign investment due to its advantages such as better infrastructure than other metropolitan areas, abundant cheap labor, a relatively better environmental situation than Jakarta, and the presence of large local enterprises. However, it can be said that many of these advantageous conditions for investment have been fostered by the central government. That is, in Indonesia, foreign aid and the growth of the manufacturing sector show an uneven spatial impact (Hill, 1996, 238), and the SMA has enjoyed a favorable share, along with the Jakarta Metropolitan Area. For instance, except for Jakarta, Surabaya is the only metropolis that has an urban expressway. The fully-equipped public industrial park was constructed with state support in the 1970s. Some regulations for industrial activities have been blatantly favorable to Java and this region, such as the requirement that rattan must be processed in certain designated centers mainly on Java (ibid.). According to interviews with personnel of Japanese trading companies, influential bureaucrats and politicians have strongly recommended them to join in large-scale infrastructure projects in the SMA, because such officials came from the SMA or the surrounding regions [C-2, C-3].

Arguably, the central government has to have a role in allocating revenue and foreign aid in order to reduce existing regional economic imbalances in Indonesia as described in 4.3. There are, however, several deficiencies in the current centralized system. First, the distribution of such funds has not always been done in a rational and objective way. Some regions, mainly Java, have absorbed more than their fair share. In REPELITA VI (the sixth five year national plan from 1994 to 1998), the development of East Indonesia, which has been underdeveloped for a long period, is claimed as a first priority. However, it is said that this policy was made really to appease people’s
dissatisfaction about widening regional economic imbalances because no specific prescriptions for action were indicated in the plan (Jetro, 1996). Then, there are problems associated with the low rate efficiency of investments. That is, the monopolization of various business rights by the privileged class (e.g. influential politicians and their families), decreasing public development funds due to corruption, protective trade policies, and excessive regulations have combined to lower the efficiency of investment projects (ibid.). Moreover, there are problems associated with a lack of consideration for the specific characteristics of local regions. Hill (1989, 1996) provides numerous illustrations of the failure to exploit regional comparative advantages and the tendency to transplant Java-oriented programmes to other parts of the archipelago. The final point is the complexity of investment and export procedures. Despite a series of deregulation efforts by the central government (see 3.2), when compared with neighboring ASEAN nations, investment and export procedures in Indonesia are still considered to be more complex and to have a much larger 'informal' portion (i.e. guidance by governments as described in the SMA's investment procedures is not formal) (Azuma, 1996) [C-1]. As a result, many intricate licensing procedures are also influencing foreign investors to establish their facilities around Java's major industrial complexes (Hill, 1996).

However, local governments in the SMA have more of their own linkages to the world (overseas investors) than might be expected. As described in chapter 5 (5.2.3), currently many joint venture projects between foreign and domestic investors are being generated from their own previously-established business networks rather than with state coordination. These investment activities have also created local government linkages to the world through delegation of the authorities to local issuing of several development permissions. Besides these permissions, local governments have established their own connection to transnational corporations (TNC) through their long experience of management of public industrial parks. Although local planning and development procedures among governments are still confusing after drastic policy changes in this
decade, local government officials in the SMA are obliged to face the reality of the strong influence of the world economy upon their territories through such linkages.

Increased investment and development within their territories have raised local governments' own revenues. The land and property tax (PBB) and the development tax are important revenue sources for the second level (regency / municipality) governments (see 4.2.3). The revenues from these taxes and fees for issuing permissions have recently been increased by investment activities. For example, the construction of international hotels has brought development tax revenues to local governments of this level. Meanwhile, the activated local economy stimulated by investment activities has also raised its own tax revenue for the provincial government through the gasoline sales tax and the motor-vehicle tax. Therefore, local governments have an incentive to create international linkages which will produce new investment activities and, in turn, raise their own governments' revenues. In 1997, the East Java provincial government is planning an overseas advertising-campaign in major cities, such as Tokyo, Singapore and Hong Kong, to promote investment [A-2].

Nevertheless, according to interviews with personnel of the second level (regency / municipality) governments, many government officials at this level have not coped well with this intensive impact of the world economy upon their territories. This can be see even in Surabaya city which has taken the initiative in various planning endeavors so far, as well as other regency governments in the SMA [A-1, D-1]. One reason for this might be the lack of personal incentives. In the present system even if government revenues have increased from various taxes and fees, this does not always mean that the personal revenues of personnel also increase. In addition, in Indonesia many government officials who are working in local governments also belong to the central government.¹ In the case of Surabaya city, in 1994 63 per cent of government officials were also central government civil servants (KMS, 1994).

¹ Although civil servants in Indonesia all belong to the national civil service, in practice they are divided into two main categories, those recruited to the central government civil service and those recruited at the provincial level, who usually spend their careers in one area (MacAndrews, 1986).
6.2.2 The role of local governments in environmental issues

Local governments in the SMA, in particular the second level, regency and municipal (kabupaten and kotamadya) governments, will be able to manage the environmental impacts of both industrial and domestic waste. This is because industrial waste and other environmental pollution such as air pollution and water pollution is supposed to be regulated at this level of government as described in Table 4.1 (a rough division of function between levels of government). For example, the location of factories is controlled in line with the land-use plans made at this level of government (although plans have been developed based on the rough regional plan developed by the central government in the 1980s). Monitoring the operations of factories to see if they obey environmental regulations is also their responsibility. However, local governments do not seem to function well in this role because of the scale of services they have to cover. As described in the previous section (6.1.1) small- and medium-sized factories illegally settle outside designated industrial areas. Under the confusing land development circumstances in Indonesia the effectiveness of land-use plans made by local governments is questionable. Designated industrial areas and non-designated industrial areas are delineated in the land use plan of Surabaya city (see Figure 5.3.1). A non-designated industrial area is an area in which industrial facilities have already been established (without government permissions). But some non-designated industrial areas are still included in this plan as undeveloped areas. This means that even today land use is being decided without considering the city's land use plan; local politics has exerted an influence on development procedures [B-2]. When attempting to monitor factory operations, local governments have an insufficient number of personnel to adequately reduce industrial pollution, even though the state has instituted strict environmental standards using foreign technical assistance [A-1].

1 According to interviews with Japanese manufactures, some environmental standards in Indonesia are much more strict than those of developed countries, therefore, it seems to be difficult for local small- and medium-scale factories to obey them [C-5, C-6].
Moreover, the control of domestic waste such as solid waste and waste water also depends upon the endeavors of regency and municipal level governments. As described in the previous part, in Surabaya, the KIP and SUDP projects have been created in order to tackle this issue, and the main responsibility for these projects lies with the kotamadya (city) government, although they are supervised by the central government and international institutions. For more than 20 years the city government of Surabaya has produced a comparatively large achievement in this field through the KIP projects, but as a World Bank report illustrates it has so far been unable to match the rapid urbanization of the 1990s (1994).

Arguably, greater decentralization of environmental controls is necessary together with a vast upgrading of local financial, technical and human resources. The technical, institutional and fiscal capacities of local governments, in particular at the regency and municipal levels, have to be improved. The IUIDP programmes include projects for institutional development and resource mobilization and so would be ideal mechanisms to achieve this. However, as described in chapter 4 (4.2), such capacity-building components of IUIDP are not always seen as particularly important by local government personnel due to insufficient state guidelines and training, and consequently local governments lack of experience with this kind of programme (Soekamto, 1994, Ichwan, 1996). According to interviews with personnel who are in charge of SUDP, the capacity building procedure of the programme has also lagged behind because of several reasons described in 5.4, such as the lack of recognition of recent globalization trends by local officials (who fail to grasp the city’s entire situation), lack of appropriate guidelines by the central government and lack of an adequate budget [A-1, B-2, D-1].

6.2.3 The role of local governments in social issues

According to official statistics in Indonesia, the incidence of poverty has gradually been decreasing. For instance, 40.1 per cent of the total population in 1976 were defined as poor and this fell to just 13.5 per cent in 1993 (BPS, 1991, cited in Hill, 1996). But the most commonly
used poverty standards in Indonesia are lower than those in many other countries (ibid.). A World Bank report (1990) has addressed this issue and showed that many people defined as non-poor are in reality in a precarious, near-poor position. Raising the poverty line by just 10 per cent, for example, would increase the numbers in poverty by a similar percentage to those already defined to be poor. A number of studies on social development in Indonesia (e.g. see Edmundson, 1994, Singarimbun, 1993) suggest that there has been a general improvement in living standards for the last couple of decades, and few instances of rising impoverishment. They point out, however, that rural incomes have risen more slowly in the past two decades than those in urban areas, and that social inequality has risen in this respect. The findings of these studies reflect current social circumstances in the SMA, which have seen poorer Muslims living outside or on the periphery of the urban area, and who often feel disadvantaged, thus contributing to social instability in the region (Kagaya, 1997).

So far, the state has implemented several pro-poor policies, although it has been criticized more generally for paying insufficient attention to poverty and inequality. Local Development Projects and Employment-Generation Programs in rural areas are successful examples of such policies; some areas' living standard has improved through such programmes. The education programmes for improving standards of basic literacy are another important example (Hill, 1996, 198 and Jetro, 1996). Several pro-poor policies have been presented in REPELITA VI, as well. Nevertheless, it is questionable whether these efforts have a wide impact across the country. As most antipoverty policies have tended to emphasize rural communities rather than urban communities, and the implementation of plans is insufficient when government funds do not always flow to the poor (Jetro, 1996).

In this way, antipoverty policies are the prime responsibility of the central government through BAPPENAS (Ministry of Internal Affairs and National Development Planning Board), while lower level governments have responsibility only for policy implementation set from above (ibid.).
Summary of chapter 6

The central government has played the major role in monitoring and administering overseas investment. However, local governments in the SMA have more of their own linkages to the world (overseas investors) than might be expected. Increasing revenues and opportunities for dealing with such investment projects have strengthened local governments' autonomy to a certain degree.

Since 1990 such overseas investment in the SMA has been the major driving engine for its economy, but development activities derived from this investment have had a number of adverse environmental and social impacts on local communities. These issues are supposed to be dealt with by local governments. However, they do not seem to function well in this role.
CHAPTER 7

CONCLUSION

This chapter comprises the major conclusions of the thesis. These include a summary of research findings from the case study in the SMA, a review of major findings concerning decentralization and globalization, as well as policy recommendations and recommendations for further research.

7.1 Summary of the case study

This study has focused upon the crucial role of foreign investment upon economic development in the SMA. Since 1990 increasing investment in the SMA by foreign or foreign and domestic joint ventures has concentrated on the industrial sector, in particular the manufacturing sector. These investment activities have propelled metropolitan population growth and rapid urbanization due to the expansion of jobs and the attractiveness of the SMA to rural migrants. Foreign investment has been associated directly with many new industrial parks and industrial establishments along arterial roads, while housing and commercial development projects in the downtown and suburbs of Surabaya city are mainly the indirect results of such investment. Moreover, infrastructure development projects initiated as both private and public projects have also been funded heavily by the foreign sector.

Through such foreign-related development projects, local governments and enterprises in the SMA now have their own linkages to the world economy through overseas investors. The autonomy of local governments, in particular East Java provincial and Surabaya city governments, is beginning to increase due to increased revenues from taxes and fees and opportunities for land management. Considering Indonesia’s centralized administrative and political structure, the SMA’s decentralization has been more extensive than might have been expected. However, within Indonesia’s highly centralized planning and administrative system, this can be seen as yet only to a limited extent. Although the government of Indonesia has been trying to promote decentralization since the 1970s, the power of the central authority is still strong. At the same
time, current planning and development responsibilities among governments are unclear after drastic policy changes in this decade, and there is much overlap of responsibilities.

The impact of the rapid increase in overseas investment upon the SMA has not only an economic aspect but environmental and social aspects as well. Although environmental and social impacts upon local communities have been mainly an indirect result of foreign investment activities, such impacts have nonetheless been serious. For instance, environmental degradation in the northern and western flood-prone areas of the SMA has been aggravated in recent years. Increased industrial and domestic waste water from illegal facilities and settlements has been the direct causes of this, but it might also be seen as a phenomenon related to metropolitan population growth and urbanization propelled by overseas investment activities. At the same time, several social issues, such as dissatisfaction among the poor at the disparity in wealth, along with interracial and interregional tensions, have caused social instability in the urban area of the SMA. This is also considered to be one of the indirect results of overseas investment activities.

7.2 Review of local governance and autonomy in the SMA

As described above, the current planning situation in the SMA is confusing: planning and development responsibilities amongst governments are unclear and overlap. This situation not only exists between central and local governments but also between local governments. In general, however, the responsibilities of the central government are much greater, so ‘top-down’ planning is more prevalent in the SMA as is the case in Indonesia as a whole (this was described in chapter 3).

Considering the SMA’s current urban situation, urban services have become pressing issues in terms of dealing with the environmental and social aspects discussed above. Second level (regency / municipal) governments are supposed to have responsibility for such services. However, the autonomy of this level of government, except for that of Surabaya city, is weak, while the autonomy of the provincial government has to some extent been fostered by state’s
decentralization policies. Even in Surabaya city major planning has proceeded within the frameworks developed by the central government, and necessary urban services have not been well provided. Therefore, a clear two tier structure of local governance and much stronger autonomy for second level governments within such a structure are both needed in the SMA. Word (1995) explores such a model in his primacy principles of successful local management and administration (see 2.2 iii).

In terms of the influence of globalization, the autonomy of local governments has increased through increased revenues from taxes and fees and opportunities for land management. It is interesting to note that this increased local autonomy in the SMA has progressed beyond Indonesia's original planning and administrative concept. This situation contradicts Devas's description of Indonesia's division of function between governments (see 4.2), as well as Slater's idea of the impact of the global economy on developing countries' local governance (see 2.2. ii). Devas (1989) describes international matters as central government responsibilities, and Slater (1989) argues that the transnational nature of capital tends to reinforce the role of central government.

In order to modify the strong centralized government structure in Indonesia, these global linkages might be utilized for strengthening local autonomy. Townroe (1996) stresses the necessity of strengthening the functions of local governments in developing countries within the international economic context (see 2.2 iii). However, considering Indonesia's specific background, this issue is not easy to deal with. This is because Indonesia is a huge archipelago state with a diverse population and unbalanced distribution of resources and with a huge variety in the levels of economic and social development in and among the different regions. Therefore, a centralized planning system is necessary, to some extent, in order to obtain and allocate private and official foreign capital effectively and efficiently, and decentralization policies have to proceed carefully considering this specific background.
7.3 Policy recommendations

Governments have to provide clear planning frameworks which can address the critical influence of the global economy on local communities, but decentralization policies in Indonesia have to be considered within the context of Indonesia’s specific background. Hence, while maintaining its centralized structure, both clarifying the responsibilities of each level of government within Indonesia’s two tier structure of local governance and strengthening the necessary functions of each local government are required. Here, policy recommendations are presented in economic, environmental and social aspects as well as in the aspect of foreign aid.

(i) Economic issues for decentralization

In terms of economic issues, since today the country is crucially influenced by the global economy, the state has to maintain its centralized structure. That is, in order to get and allocate private and official foreign capital effectively and efficiently, a centralized planning system is necessary, to some extent at least. However, in order to rectify regional economic imbalances and to create a system that can more adequately reflect local regions’ opinions regarding economic policies, local autonomy would have to be strengthened. In this respect, as Ward (1995) says authority has to be established at metropolitan (or in Indonesia provincial) levels for macro-level activities such as supporting the export sector, facilitating access to capital and new technology, and fostering new economic activities in the external trade sector (see 2.2 iii). Today the influence of the global economy has promoted decentralization at the SMA’s provincial level to some extent, but as described above this has occurred mostly outside Indonesia’s original planning and administrative design. Therefore, clarifying responsibilities between the central government and this level of government would be necessary both to make use of international linkages more effectively and to create a specific investment system for each local community.

(ii) Environmental and social issues for decentralization

In terms of environmental and social issues, corresponding with Ward’s (1995) primary principles of structure of local governance, the second (in Indonesia regency or municipal) level
local governments are supposed to have appropriate technical, fiscal and institutional capacities (see 2.2 iii). Therefore, it is desirable that decentralization policies, which already have produced some results at the provincial level, have to be extended to much lower government levels.

In terms of dealing with environmental issues, land management authorities have to be strengthened. As described in the previous chapter, land use plans created by local governments are not effective. To reduce illegal settlements which have caused serious environmental problems, land management at this level of government has to be improved. Moreover, the monitoring and enforcing standards of local governments also have to become more effective and stronger to address industrial wastewater problems.

The comprehensive infrastructure programmes (IUIDP) appear to have been a desirable concept in promoting decentralization policies. This is because the IUIDP include infrastructure and human settlement components to cope with environmental issues, and include at the same time institutional development programmes for the operation and maintenance of these facilities at the local government level. However, as several examples of IUIDP implementation show, programmes for institutional development and resource mobilization have not been seen as particularly important by local government officials. In order to further promote such programmes, it will be important to provide sufficient guidelines to supplement the lack of experience of local governments together with strengthening local governments’ capacity of financial management for the operation and maintenance of infrastructure. Moreover, cooperation with the central government is necessary since the vertical planning structure of these programmes has often become an obstacle to their implementation. In addition to these points, most of the IUIDP projects have been implemented within a 6 year project period and decentralizing efforts will have to be continued beyond that.

The ability of local governments to deal with social problems caused by rapid economic growth also has to be strengthened. Until recently, Indonesia’s poverty alleviation policies have been focused upon rural areas. But considering the present urgent situation in urban areas --
where dissatisfaction among the poor at the disparity in wealth has caused social instability — social policies in urban areas should also be implemented. In order to do this effectively, it is better to involve the second level and lower level (RW / RT) local authorities in policy planning procedures, as they are able to grasp the real situation of the poor and to consider detailed policies which meet the needs of their particular society. However, they currently have difficulty in dealing with this issue due to personnel and budgetary deficiencies at this level of government. In this respect, collaboration with NGOs should enhance local governments’ limited capacities. Usually, NGOs are sensitive to social and cultural values, and in turn they are closer to grassroots needs.

(iii) Foreign aid in decentralization efforts

Finally, foreign aid has to be focused more on such decentralization efforts. Until today, foreign aid to Indonesia has tended to flow into large-scale infrastructure projects such as urban roads, and water supply and drainage programmes. In contrast, the institutional development programmes that in the SUDP are funded by domestic sources rather than international sources. This is mainly because such large-scale infrastructure projects can be completed in short periods and be easily monitored by foreign funding agencies. In addition, these types of projects tend to be utilized by donor countries to boost their own investment and trade activities. However, it is usually difficult for local governments in developing countries to foster their capacities of operation and maintenance (O & M) for infrastructure within such projects.\(^1\) So, if foreign institutions wish to use their aid more effectively, they will have to focus more on strengthening local governments’ capacities to assure their O & M abilities for infrastructure projects. This is particularly true for the sanitation field in Indonesia’s urban areas which requires community (neighborhood) level care in order to operate. Foreign aid also has to be considered more in relation to such issues. In this respect, the institutional development of local governments and their ability to collaborate with NGOs could be enhanced by utilizing foreign aid. Consequently,

\(^1\) Yasutomo [1995] explicitly criticizes Japanese ODA on this point.
in order to promote decentralization in Indonesia, Indonesia's governments and the international community must work together.

7.4 Recommendations for further research

First of all, in order to grasp Indonesia's overall situation, similar studies have to be conducted in other metropolitan areas such as Medan, Semarang and Ujungpadan as well as Jakarta. According to official statistics, the economies and populations of these areas have been growing like those of the SMA (Bappenas, 1994). Each area has a different geographical, social, economic and political background, so such studies would be useful for considering Indonesia's decentralization policies in specific cases.

Moreover, this thesis has examined overseas investment activities mainly through Japanese TNCs, because their activities have been vital in the SMA. However, other TNCs activities also appear to be important in Indonesia, in particular, those of ethnic Chinese capital such as from Hong Kong, Taiwan and Singapore. As many describe (see Hiizumi, 1993, Oguro and Kohama, 1995), this is because many investment activities from these countries have been done through their personal (sometimes consanguineous) linkages to Indonesia's ethnic Chinese capital. Therefore, such TNCs' activities might show other types of global linkages between Indonesia's capital and the world which critically affect Indonesia's economy.
BIBLIOGRAPHY


Bibliography


East Java BKPM. 1996. *Indonesia’s Investment Regulation and Investment Opportunities in East Java Province*. Surabaya, Indonesia: East Java BKPM.


Works in Japanese


Bibliography


### Appendix A  
**Interview List**

<table>
<thead>
<tr>
<th></th>
<th>sector or company</th>
<th>position (or section)</th>
<th>date / month *</th>
<th>time</th>
</tr>
</thead>
<tbody>
<tr>
<td>A-1</td>
<td>Central Government</td>
<td>Deputy chairman of UMU</td>
<td>24 / Jun.</td>
<td>9am to 11am</td>
</tr>
<tr>
<td>A-2</td>
<td>Central Government (BKPM)</td>
<td>Chairman of East Java Regional Investment Coordinating Board</td>
<td>12 / Jun.</td>
<td>2pm to 3pm</td>
</tr>
<tr>
<td>B-1</td>
<td>Kotamadya Surabaya</td>
<td>Director of Pemerintah (transportation section)</td>
<td>12 / Jun.</td>
<td>9am to 9.5am</td>
</tr>
<tr>
<td>B-2</td>
<td>Kotamadya Surabaya</td>
<td>Staff of UMU</td>
<td>12 / Jun., 13 / Jun., 21 / Jun.</td>
<td>10am to 11am, 9am to 9.5am</td>
</tr>
<tr>
<td>B-3</td>
<td>P.T.SIER (East Java Provincial government)</td>
<td>Promotion manager of PIER</td>
<td>13 / Jun.</td>
<td>2.5pm to 3pm</td>
</tr>
<tr>
<td>C-1</td>
<td>Itochu Corporation</td>
<td>Finance &amp; general manager</td>
<td>7 / Jun.</td>
<td>3pm to 4.5pm</td>
</tr>
<tr>
<td>C-2</td>
<td>Itochu Corporation</td>
<td>Construction &amp; real estate manager</td>
<td>5 / Jul.</td>
<td>9am to 10.5am</td>
</tr>
<tr>
<td>C-3</td>
<td>Mitsui &amp; Corporation</td>
<td>Deputy director of Paiton private power</td>
<td>20 / Jun.</td>
<td>2pm to 3pm</td>
</tr>
<tr>
<td>C-4</td>
<td>Sumitomo Corporation</td>
<td>Surabaya branch manager</td>
<td>25 / Jun.</td>
<td>2pm to 3pm</td>
</tr>
<tr>
<td>C-5</td>
<td>P.T.Meiji Indonesia</td>
<td>Director</td>
<td>14 / Jun.</td>
<td>1pm to 2pm</td>
</tr>
<tr>
<td>C-6</td>
<td>P.T.Ajinomoto</td>
<td>Director</td>
<td>18 / Jun.</td>
<td>2pm to 3.5pm</td>
</tr>
<tr>
<td>D-1</td>
<td>Overseas Economic Cooperation Fund of Japan (OECF)</td>
<td>Representative of Jakarta office</td>
<td>9 / Jul.</td>
<td>10am to 11am</td>
</tr>
<tr>
<td>D-2</td>
<td>Japan International Cooperation Agency (JICA)</td>
<td>Assistant resident representative Indonesia office</td>
<td>5 / Jul.</td>
<td>1pm to 1.5pm</td>
</tr>
<tr>
<td>E-1</td>
<td>P.T. Maspion</td>
<td>Promotion manager of Maspion Industrial Park</td>
<td>17 / Jun.</td>
<td>10.5am to 11am</td>
</tr>
<tr>
<td>E-2</td>
<td>P.T. Pakuwon Jati</td>
<td>Promotion manager of Laguna Inda</td>
<td>23 / Jun.</td>
<td>1pm to 2pm</td>
</tr>
</tbody>
</table>

*All interviews were carried out in 1996.*
### Appendix B  Deregulation Policies, 1986 -- 1996

#### Table B.1 Chronology of Major Deregulation Policies from 1986

<table>
<thead>
<tr>
<th>Month / Year</th>
<th>Contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr. / 1986</td>
<td>Simplification of custom clearances, and reduction of a tariff rate</td>
</tr>
<tr>
<td>May / 1986</td>
<td>Major liberalization package for foreign investment and import</td>
</tr>
<tr>
<td>Jun. / 1986</td>
<td>45 per cent devaluation of the rupiah</td>
</tr>
<tr>
<td>Oct. / 1986</td>
<td>Major import liberalization package, comprising a tariff decrease</td>
</tr>
<tr>
<td>Jan. / 1987</td>
<td>Further import liberalization announced, affecting textiles, iron and steel</td>
</tr>
<tr>
<td>Jun. / 1987</td>
<td>Foreign investment regulations liberalized; the textile export quota is liberalized</td>
</tr>
<tr>
<td>Dec. / 1987</td>
<td>Major liberalization package effecting imports, foreign investment, the stock market and tourism</td>
</tr>
<tr>
<td>Oct. / 1998</td>
<td>Major financial sector reforms enacted; entry provisions liberalized, reserve requirements reduced, and a withholding tax on bank deposits imposed</td>
</tr>
<tr>
<td>Nov. / 1988</td>
<td>Deregulation of foreign investment, shipping and imports (plastic and steel) extended</td>
</tr>
<tr>
<td>Dec. / 1988</td>
<td>Further liberalization of the financial sector</td>
</tr>
<tr>
<td>May / 1989</td>
<td>Liberalization package for foreign direct investment</td>
</tr>
<tr>
<td>May / 1990</td>
<td>A further trade reform package</td>
</tr>
<tr>
<td>Jun. / 1991</td>
<td>Additional trade reforms introduced</td>
</tr>
<tr>
<td>Feb. / 1992</td>
<td>Liberalization of purchasing a bank stock by foreign buyer</td>
</tr>
<tr>
<td>Apr. / 1992</td>
<td>100 per cent foreign ownership of firms permitted in certain circumstances</td>
</tr>
<tr>
<td>May. / 1992</td>
<td>The prohibition on log exports is removed and replaced by high export taxes</td>
</tr>
<tr>
<td>July / 1992</td>
<td>Liberalization package for foreign investment and import</td>
</tr>
<tr>
<td>Jun. / 1993</td>
<td>Minor trade reform package introduced, mainly directed at the automobile industry</td>
</tr>
<tr>
<td>Oct. / 1993</td>
<td>Further minor simplification of the foreign investment regime, including mitigating the condition for 100 per cent foreign ownership of firms</td>
</tr>
<tr>
<td>Jun. 2 / 1994</td>
<td>Abolishment of regulations for; 100 per cent foreign ownership of firms, obligation of transferring management right</td>
</tr>
<tr>
<td>Jun. 27 / 1994</td>
<td>Reduction of a tariff for 739 items, and abolishment of a surcharge for 121 items</td>
</tr>
<tr>
<td>May / 1995</td>
<td>Decreasing import duty and import duty tariff, and reviewing investment negative list, such as palm oil, cigarettes</td>
</tr>
<tr>
<td>Jan. / 1996</td>
<td>Increasing effectiveness of former deregulation, and decreasing import duty</td>
</tr>
</tbody>
</table>

Appendix C  Urban Development Projects in the SMA

(1) Pasuruan Industrial Estate Rembang (PIER)

Figure C.1 The Arterial Road of PIER
Arterial roads in PIER are divided by greenbelt, and various kinds of tropical tree are planted along these roads.

Figure C.2 The Gate of the Export Processing Zone (EPZ)
The Export Processing Zone, in which several taxes are exempted and import and export procedures are simplified, is established (about 50 ha.) within PIER.
### Table C.1 List of Enterprises in PIER (Summer / 1996)

<table>
<thead>
<tr>
<th>No.</th>
<th>Company name</th>
<th>Plot size (m²)</th>
<th>Type of business</th>
<th>Origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Andy Ong</td>
<td>2,080</td>
<td>Plastic molding</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>2</td>
<td>Ansento Indonesia, PT</td>
<td>17,000</td>
<td>Furniture</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>3</td>
<td>Box Time, PT</td>
<td>4,720</td>
<td>Jewelry box</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>4</td>
<td>Citra Panagantama Sejahtera</td>
<td>8,970</td>
<td>Foods</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>5</td>
<td>Dyno Indra, PT</td>
<td>8,064</td>
<td>Glue</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>6</td>
<td>E T A Indonesia</td>
<td>6,195</td>
<td>Electronic</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>7</td>
<td>Edward Low, Tn</td>
<td>6,228</td>
<td>Furniture</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>8</td>
<td>Eka Nobel Indonesia</td>
<td>51,093</td>
<td>Chemical paper</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>9</td>
<td>Fajar Artasari, PT</td>
<td>3,920</td>
<td>Plastic</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>10</td>
<td>Fronte Classic Indonesia, PT</td>
<td>10,165</td>
<td>Carpet</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>11</td>
<td>Grasindo Primadya, PT</td>
<td>2,665</td>
<td>Granite</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>12</td>
<td>Hadi Setiwan, Tn</td>
<td>2,080</td>
<td>Cold storage</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>13</td>
<td>Handy Gondokusmo</td>
<td>5,950</td>
<td>Construction</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>14</td>
<td>Indonesia Pine Chemical</td>
<td>10,050</td>
<td>Chemical wood</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>15</td>
<td>Ir. Harry Minarto, TN</td>
<td>2,665</td>
<td>Plastic</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>16</td>
<td>Jarkay File Indonesia, PT</td>
<td>15,003</td>
<td>Hand tool</td>
<td>Foreign Inv.</td>
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<tr>
<td>17</td>
<td>Kurimpex, PT</td>
<td>2,320</td>
<td>Button</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>18</td>
<td>Luisiana Far East, PT</td>
<td>3,750</td>
<td>Cold storage</td>
<td>Foreign Inv.</td>
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<tr>
<td>19</td>
<td>Massynd Geilang, PT</td>
<td>2,665</td>
<td>Leather Gloves</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>20</td>
<td>Modern Sinar Jayantara</td>
<td>6,885</td>
<td>Cold storage</td>
<td>Domestic Inv.</td>
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<tr>
<td>21</td>
<td>Pegeg &amp; Co</td>
<td>4,368</td>
<td>Souvenir goods</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>22</td>
<td>Perum Gas Negara</td>
<td>2,050</td>
<td>Gas</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>23</td>
<td>Purba Mega Nusa, PT</td>
<td>4,496</td>
<td></td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>24</td>
<td>Sika Nusa Pratma, PT</td>
<td>4,633</td>
<td></td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>25</td>
<td>Suarindo Utama, PT</td>
<td>2,665</td>
<td>Food</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>26</td>
<td>Sugianto</td>
<td>2,080</td>
<td>Painting</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>27</td>
<td>Surawangi Prima, PT</td>
<td>8,044</td>
<td>Leather</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>28</td>
<td>Tn Franki Sanyoto</td>
<td>2,080</td>
<td>Cold storage</td>
<td>Domestic Inv.</td>
</tr>
<tr>
<td>29</td>
<td>Utepe Indonesia, PT</td>
<td>6,623</td>
<td>Tobacco</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td>30</td>
<td>Welcome Nusantra, PT</td>
<td>2,975</td>
<td>Plastic Wires</td>
<td>Foreign Inv.</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>212,482</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: PT SIER (1996)
(2) Kawasan Industri Maspion (KIM)

Figure C.3 Signboard at Construction Site of KIM
The signboard at the construction site of KIM shows the block plan and facilities which will be provided at the industrial park.

Figure C.4 Construction Site of KIM
A stainless steel factory is being constructed alongside the arterial road of KIM, by a joint venture between local capital (the Maspion Group) and a Japanese trading company.
(3) Tandes Industrial Area

Figure C.5 Drainage Facility of the Tandes Industrial Area
Most drainage facilities in the Tandes Industrial Area have not been completed yet, although many industrial buildings have already been established.

Figure C.6 Feeder Roads of the Tandes Industrial Area
In the Tandes Industrial Area, feeder roads are not paved. After heavy rain, most are flooded due to the flood-prone condition of the land and the delayed infrastructure development there.
In suburban Surabaya, a luxurious single-use, low-density housing development project is now being constructed by the Surabaya-based local real estate corporation, P.T. Pakuwon Jati.

The development will include a golf course, shopping centers and an international school.
Housing Development Projects

European style town houses are also being constructed in this suburban housing project, along with the same European style shopping malls.

Compared with the project by P.T.Pakuwon Jati, structures and lots are smaller, and materials are much cheaper. In many cases, frontal roads are not paved.
(5) Shopping Malls: Surabaya Plaza & Tunjungan Plaza

Figure C.11 Exterior of Surabaya Plaza

Figure C.12 Interior of Tunjungan Plaza

This shopping mall accommodates various stores, such as expensive boutiques and car dealers, as well as movie theaters.
Appendix D  Industrial Plan in the SMA

Figure D.1 Industrial Plan in the SMA

Source: Ministry of Public Works (1982)
Appendix E  SUPD Funds Flow

Figure E.1 SUDP Funds Flow
Appendix F  Surrounding Situation of SIER

Figure F.1 Surrounding Situation of SIER (June 1996)

Figure F.2 Industrial Facilities Located Surrounding SIER
Many factories and warehouses are located in the middle of rice fields or adjacent residential buildings.