

**School of Social Sciences and Asian Languages  
Department of Social Sciences**

**The Impact of Decentralisation Policy on  
Small Business in Indonesia:  
A Study of Politics in Bantul District, Yogyakarta and  
Gianyar District, Bali**

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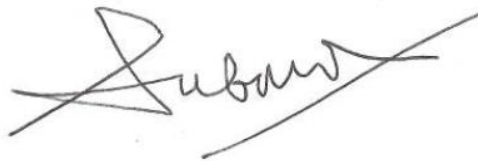
**This thesis is presented for the Degree of  
Doctor of Philosophy  
of  
Curtin University**

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## Declaration

To the best of my knowledge and belief this thesis contains no material previously published by any other person except where due acknowledgment has been made.

This thesis contains no material which has been accepted for the award of any other degree or diploma in any university.

A handwritten signature in black ink, appearing to read 'Suban', with a long horizontal stroke extending to the right.

Signature: .....

Date: 9 September 2014

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## ABSTRACT

The objective of this study is to analyse the impact of decentralisation on the relationship between local governments and small businesses in Bantul, the province of Yogyakarta and Gianyar, the province of Bali in Indonesia. It presents three research questions: Firstly, to what extent does decentralisation give more power to the local governments to serve and control small businesses?; Secondly, can political decentralisation drive district heads and political parties to be closer to small businesses owners?; Finally, does political decentralisation create opportunities for small business owners to be involved in the process of decision making at district level?

This study is based on qualitative and quantitative evidence. Data was collected by interviews, documentation and survey. Then, it was analysed by qualitative and quantitative analysis.

Theoretically, the relationship between local government and small businesses can be examined from three aspects: Firstly, the regulations aspect, which is to analyse the extent to which the regulations facilitate or obstruct small businesses; Secondly, promotion policy, with the aim of assessing local governments' actions in promoting small businesses; Thirdly, the political influence aspect that explores how local authorities influence small businesses and the extent to which small businesses can be involved in the process of decision making at the local level.

This study found that local regulation on levies cannot be implemented effectively because of economic and political reasons. Small business activities are relatively independent from the district government policies. Thus, district governments cannot use local regulations to control small businesses.

In relation to promotion policy on small business, the district head of Bantul more intensively promoted small businesses than the Gianyar district. The district head of Bantul is known as a populist leader and close to small businesses but neither in Gianyar. The relationship between local government of Bantul and small business is characterised by supportive relationship. However, decentralisation cannot encourage local politicians to be close to small business owners. Therefore, they use money and materials to influence voter behaviour of small business owners.

In the case of Bantul, political parties developed networks with business associations but not so in Gianyar. Therefore, small businesses have more power to make bargain with local government and participate in the process of decision making at the district level. Both in Bantul and Gianyar, small business owners are not interested being involved in political parties and activities because they cannot conceive this providing a benefit to them.

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## GLOSSARY OF ACRONYMS AND ABBREVIATIONS

APEC	Asia-Pacific Economic Cooperation is a forum for 21 countries (formally Member Economies) that seeks to promote free trade and economic cooperation throughout the Asia Pacific region.
ASEPHI	Export and Handicraft Association
<i>Bappeda</i>	<i>Badan Perencanaan Pembangunan Daerah</i> (Local Development Planning Board)
<i>Banjar</i>	Association of Customary Local Community
<i>Bendesa</i>	Head of <i>Desa Pakraman</i> (Customary Village) in Bali
BPD	<i>Bank Pembangunan Daerah</i> (Regional Development Bank – owned by Province Government)
BPHTP	<i>Bea Perolehan atas Hak Tanah dan Bangunan</i> (Acquisition fees and Building Land Rights). Object duty of acquiring land rights and buildings such as buying and selling, exchange, grants, inheritance, gift, etc.
BUMN	<i>Badan Usaha Milik Negara</i> (State Owned Enterprise)
<i>Bupati</i>	Head of District Head
DBH	<i>Dana Bagi Hasil</i> (Revenue Sharing Fund)
DAK	<i>Dana Alokasi Khusus</i> (Special Allocation Fund)
DAU	<i>Dana Alokasi Umum</i> (General Allocation Fund)
<i>Dekranas</i>	Handicraft Local Board
<i>Desa</i>	Village
<i>Desa Pakraman</i>	Customary Village in Bali
<i>Diperindagkop</i>	<i>Dinas Perindustrian, Perdagangan dan Koperasi</i> (Local Agency for Industry, Trade and Cooperative)
<i>Dusun</i> or <i>Pedukuhan</i>	Hamlet
<i>Golkar</i>	<i>Golongan Karya</i> (Working Group) – government political party of the New Order Government comprises local bureaucrats and military
GRDP	Gross Regional Domestic Product

IUI	<i>Ijin Usaha Industri</i> (Permit for Industry)
<i>Kadinda</i>	Local Chamber of Commerce and Industry
<i>Kecamatan</i>	Sub-district
<i>Kelian</i>	Head of <i>Banjar</i> (Association of Local Customary Community). There are two types of <i>Kelian</i> : <i>Kelian Adat</i> and <i>Kelian Dinas</i> .
<i>Kelian Adat</i>	The <i>Kelian</i> has jobs related to customary affairs such as funeral ceremony and wedding ceremony.
<i>Kelian Dinas</i>	The <i>Kelian</i> has jobs to related to official affairs such as KTP (Resident Identity Card) and migration
LPD	<i>Lembaga Perkreditan Rakyat</i> (Institution for People's Credit)
PAD	<i>Pendapatan Asli Daerah</i> or Locally derived revenue or Regional own revenue
PAN	<i>Partai Amanat Nasional</i> (National Mandate Party – Secular party with <i>Muhammadiyah</i> link)
<i>Partai Golkar</i>	<i>Golkar</i> party
<i>Partai Hanura</i>	<i>Partai Hati Nurani Rakyat</i> (People's conscience Party)
<i>Partai Patriot</i>	Patriot Party – Secular nationalist party)
<i>Partai Pelopor</i>	Vanguard Party – Secular nationalist party)
PD	<i>Partai Demorat</i> (Democratic Party- Secular nationalist party)
PDI-P	<i>Partai Demokrasi Indonesia Perjuangan</i> (Indonesian Democracy Party of Struggle – Secular nationalist party)
PDP	<i>Partai Demokrasi Pembaruan</i> (Reform Democracy Party)
PDS	<i>Partai Damai Sejahtera</i> (Prosperous Peace Party – Christian Party)
<i>Pedukuhan</i>	Hamlet
Perda	<i>Peraturan Daerah</i> (Local regulation)
PKB	<i>Partai Kebangkitan Bangsa</i> (National Awakening Party – Secular party with <i>NU</i> link)
PKPB	<i>Partai Karya Peduli Bangsa</i> (Nationalhood and Caring Party – Secular nationalist party)

PKS	<i>Partai Keadilan Sejahtera</i> (Prosperous Justice Party – Islamic party)
PNBK	<i>Partai Nasional Banteng Kemerdekaan</i> (Freedom Bull National Party)
PNIM	<i>Partai Nasional Indonesia Marhenisme</i> (Mahaernism Indonesian Nationalist Party – Secular nationalist party)
PPIB	<i>Partai Perhimpunan Indonesia Baru</i> (New Indonesian Association Party – secular party)
PPP	<i>Partai Persatuan Pembangunan</i> (United Development Party – Islamic Party)
Rp	<i>Rupiah</i> (Indonesian currency)
RT	<i>Rukun Tetangga</i> (Local Community Association)
SI	<i>Sarekat Islam</i> (Islamic Union)
SIUP	<i>Surat Ijin Usaha Perdagangan</i> (Trade Business Permit)
SMEs	Small and Medium Enterprises
TDG	<i>Tanda Daftar Gudang</i> (Store Registration Identification)
TDP	<i>Tanda Daftar Perusahaan</i> (Company Registration Identification)

# INTRODUCTION

## 1. Introduction

In most market economies, small businesses are sometimes given special support on the grounds that these enterprises are inherently disadvantaged by the free operation of markets. Government usually helps small businesses by providing financial assistance, technical assistance and other proportional benefits. Small businesses in Indonesia are particularly important as this sector represents 97 percent of the total number of enterprises and therefore accounts for a primary component in understanding Indonesia's industrialisation. For this reason the Indonesian government has given priority to the sector over other sectors with the aim to protect and promote this sector.

Small businesses have become an even more important subject of study and policy analysis as authorities in Jakarta have implemented decentralisation measures since 2001. Although some practical reports and evaluation studies on the impact of decentralisation reform are available to practitioners such as policy makers and bureaucrats at the local level, the relationships between local authorities and small businesses have remained largely unexplored in the literature. Historically, there had been a dynamic and close relationship between small businesses and the national authorities. The national authorities in Jakarta still continue to extend material benefits to small businesses for maintaining their political legitimacy. In return, small businesses have contributed to the political stability in Indonesia.

Since implementation of decentralisation measures in 2001, the Indonesian political structure has changed, with closer political ties between local authorities and small businesses. Local governments have more authorities to regulate small business sector. In contrast, small business owners have a large opportunity to participate in the process of decision making.

Political decentralisation involves the delegation of decision-making powers from the national government to sub-national governments. This provides a basis for self-

government which leaves local governments free to make major decisions. In the process of decentralisation, local government bureaucrats and politicians may gain more power and resources over the local populace. Nonetheless, they must also depend on public support from local people and businesses for the successful implementation of their decision-making. This dissertation will examine the impact of Indonesia's decentralisation on the relationship between local authorities and small businesses during 2001– 2009. It will investigate whether decentralisation policy in fact provides more power to district governments to control small businesses and whether decentralisation provides more opportunity for small business owners to participate in the process of decision making at local level.

### **1. Background of the Study**

Small and Medium Enterprises (SMEs) have emerged as an engine of growth in several developed and developing economies of the world (Prasad, 2004, p. v). In developed countries of Europe and America, SMEs contribute to economic development. SMEs comprise well over 90 percent of all enterprises in the Asia-Pacific region. Additionally, they have an important economic role in the individual economies of East and Southeast Asia (Berry & Mazumdar, 1991). This is vital to creating employment, generating exporting opportunities, and as the source of future successful SMEs (Harvie, 2002a; Charles Harvie & Boon-Chye Lee, 2002). In countries of East Asia, such as China, Hong Kong, Indonesia, Japan, South Korea, Philippines, Singapore, and Vietnam, SME's employment ranges from approximately 40 percent to 80 percent of the workforce. They also contribute around 50 percent of the region's GDP and about 30 percent of direct exports (Charles Harvie & Boon-Chye Lee, 2002, p. 6).

Although SMEs are important across the regions, there are differences in the role of SME's in the various economies. For instance, SME's play a larger structural role in South Korea, Taiwan, China, Japan, Thailand and Vietnam, where they contribute over 70 percent of employment. In Indonesia they contribute to around 40 percent. In addition, the contribution of SMEs to exports also varies. SMEs are more export oriented in China, South Korea, Taiwan and Thailand than in Japan and Indonesia (Charles Harvie & Boo-Chye Lee, 2002).

Before further discussion of small businesses, it is important to try to define small business with the aim to provide the same concept and avoid ambiguity. There is no consensus on definition of SMEs. Definitions of SMEs differ widely among the East Asian economies, APEC and countries of the world, depending on the phase of economic development as well as social conditions. A number of indexes are utilized to define SMEs, such as number of employees, invested capital, total amount of assets, sales volume, and production capability. The most commonly used index, however, is the number of employees (Charles Harvie & Boon-Chye Lee, 2002). This study will use the number of employee and size of capital in defining small businesses because the data related small businesses in Indonesia is based on these criteria.

In Indonesia, there are many definitions regarding small business. Different institutions adopt different definitions according to their respective purposes. For instance, Law No. 20/2008 uses size of capital in defining small business. This criteria for defining small business equates to capital above 50 million rupiah up to 500 million rupiah. Medium business is categorized as capital above 500 million rupiah up to 2.5 billion rupiah. These criteria are simple because they only use a single defining factor. A different definition of small business is proposed by the Central Bureau of Statistics (BPS), which uses the number of employees. Small business is thus defined according to this criteria as a business unit which has numbers of employees from 6 up to 19, while medium business has numbers of employees from 20 to 100. This criteria is also simple because it is only based on the number of employees. Like Law 20/2008, Bank Indonesia (B.I) uses the criteria of capital in defining small business. According to B.I. small business is characterised by capital less than Rp 600 million, excluding land and buildings. The Department of Industry and Trade uses capital in defining small business. Its' criterion for defining small business refers to capital less than Rp 200 million excluding land and building (*Kepmenperindag* No. 254/MPP/Kep/7/1997).

I use combined criteria of capital and number of employee in defining small business, drawn from the criteria of capital based on Law No. 20/2008 and the criteria of the number of employee based on BPS. These two criteria were issued by the Indonesian government when this study was commenced in 2008. I suggest that



combining two criteria is better than using just one. These dual criteria for SMEs will be used throughout this paper.

The number of employees and size of capital is also used by developing economies countries in defining small business. Australia, New Zealand, Taiwan, Vietnam and Indonesia use those criteria. Japan, Korea and the Philippines slightly differ by using number of employees and assets criteria (Charles Harvie & Boon-Chye Lee, 2002, pp. 4-5).

In Indonesia, the number of SMEs are around 97 percent of total enterprises, provided employment for 42 percent of the workforce and accounting for 10.6 percent of total exports in 1999 (Charles Harvie & Boon-Chye Lee, 2002, p. 6). During 2005-2009, the Department of Cooperatives and SMEs reported that the number of SMEs continuously increased. In Indonesia, SMEs play important roles at least in three areas: Firstly, SMEs become the backbone in industrial development; secondly, they create many employment opportunities for local people, and thirdly they contribute to central and local government revenue from exported products.

Business historically has played an important role in Indonesian political movements and economic development. For instance, during the Dutch colonialist period, Tirtoadisurjo founded *Sarekat Dagang Islam* (Islamic Commercial Union) in 1909 with the aim to promote the interest of indigenous business owners. In 1912 the organisation changed its name to Islamic Union, *Sarekat Islam* (SI) and extended its membership beyond the original trading association and Java (Ricklefs, 2001). By 1920, SI was the largest nationalist organisation in the colony.

In 1912 the *Muhammadiyah* was founded as a religious movement (rather than a political movement) by Haji Ahmad Dahlan in Yogyakarta to reform Islamic ideologies and practices (Nakamura, 1976). He attempted to reform religious life in the *Budi Utomo* organisation because *Budi Utomo* members were *priyayi* (aristocrats) and *abangan* Moslems<sup>1</sup> (Ricklefs, 2001, p. 207). Although the *Muhammadiyah* was not a political party, many members such as Dahlan were also

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<sup>1</sup> A Javanese term used to describe those whose adherence to Islam was seldom more than formal, nominal commitments (Ricklefs, 2001, p. 207).

involved in political parties such as *Budi Utomo* and *Sarekat Islam* (Nakamura, 1976; Ricklefs, 2001). *Muhammadiyah* formally had no economic objectives but in practice many members of the organisation such as Dahlan had business interests. It is clear that Dahlan had commercial as well as religious purposes (Nakamura, 1976, p. 110). Even *Muhammadiyah*'s founders in the city of *Kotagede* were business owners (Nakamura, 1976, pp. 123-145). Many members were business owners and played an important role in political movements.

Historically business has had an important role in the Indonesian political movements until 1920s. For example, *Sarekat Islam* and *Muhammadiyah* are tokens that business was linked with politics. The chairmen of *Sarekat Islam* and *Muhammadiyah* were involved in political activities. The relationship between politics and businesses in Indonesia was also developed in the early years of Indonesian independence (1945s). In 1945, the Soekarno government introduced the *Benteng* program that gave privileges to the indigenous business people in acquiring import licenses (Denny, 1999; Robison, 1987; Suryadinata, 1992). However, this program failed because the *pribumi* recipients of the *Benteng* program facilities tended not to be established importers, but were nonetheless politically connected with power holders and sold their licenses to Chinese importers (Mackie & Coppel, 1976, p. 13). In contrast, the Chinese big businesses develop rapidly.

When Soeharto came to power in 1967, his regime relied heavily on foreign investment and was closely linked to conglomerate businesses. However, after the unrest in the early 1970s Soeharto paid more attention to the poor through the provision of agricultural credit schemes. In the beginning of the 1980s when the government retained the profits from the oil boom, it launched Small Scale Investment Credit (*Kredit Investasi Kecil* or KIK) and Permanent Working Capital Credit (*Kredit Modal Kerja Permanen* or KMKP). However, the program is not optimal in achieving the goal of providing access to indigenous small businesses because small businesses often did not have sufficient collateral to obtain commercial loans (Pagestu, 1996). When oil prices collapsed in the mid-1980s, the government introduced the 'foster-parent program' where large businesses were supposed to sub-contract a part of their work to small businesses. However, this

program failed because the small businesses produced low quality products and these products were subsequently rejected by the 'foster' businesses (Husaini, 1996).

During both Soekarno's and Soeharto's regimes (1945-1997), a few programs that were introduced by the government were able to develop small businesses, but the large businesses fast became larger because they operated more efficiently. Other views have indicated that large business, especially Chinese business had tight family relationships. They grew well due to integration of firms with tightly knit family structure into well-developed credit and distribution networks, both in Indonesia and overseas (Robison, 1987). In contrast, Suryadinata (1992) argued that they could develop well because they collaborated effectively with power holders.

The need for knowledge of small-scale enterprises in Indonesia has increased following the economic crisis in 1997 and socio-political upheavals in the years after Suharto's resignation in 1998. Following the collapse of many large enterprises, the Indonesian government started to show increasing interest in the small-scale economic sector. They often viewed the sector as a 'safety net', generating employment for vulnerable groups by creating new opportunities for the working class and entrepreneurs in small towns and rural areas (Rutten, 2003). Yet information about the impact of the crisis on the small-scale enterprise sector was scattered and diverse. Some studies indicate that medium and small firms lost much of their market and reduced their workers (Rodriguez, 2002; Rutten, 2005). Yet other studies indicate that micro enterprise employment in Indonesia expanded immediately after the crisis (Berry, Rodrigues, & Sandee, 2001; Sandee & Lamotte, 2002). Studies conducted on various sub-sectors such as food processing, garment industry, wooden furniture and business services in Java point out that some small-scale firms were still able to boost their sales in both domestic and foreign markets (Akatiga, 2002).

Generally, these studies suggest the strength of the small-scale sector in a time of crisis. During the economic crisis, small and medium businesses were able to survive. They point to the resilience and flexibility of medium and small enterprise, providing employment and income to the poor who lack sufficient means to cope with the crisis (Sandee & Lamotte, 2002, p. 25). On the whole, these studies indicate

that medium and small-scale enterprises have proven to be stronger in weathering the crisis than large companies. In particular, the small-scale firms operating in export markets benefited greatly during the economic crisis, not because of any real increase in productivity, but because the fall in the value of the *rupiah* caused production cost to fall (or at least not to rise) while income from export sales rose substantially (Akatiga, 2002; Sandee & Van Dierman, 2004). Thus, most small business exporters could survive during the economic crisis because they obtained benefit from exported products.

Moreover, small businesses play an important role in daily economic activities at the local level by providing goods and services for local people. The majority of small businesses use local raw materials as input for their production (Akatiga, 2002, p. 42). Therefore, local governments can help small businesses by facilitating the supply of local raw materials such as woods or leather. Local governments can also promote small businesses by providing financial assistance.

After the *Reformasi* in 1998, the Central Government gave more power to local governments in managing many development sectors as well as in developing local autonomy. The shift of power from the central to local governments has the potential to promote democratization by allowing for greater responsiveness, representativeness and accountability in the processes of government (Antlov, 2003). Thus, local governments become closer to local communities. Presently, district heads are directly elected by local people. In this context, local politicians will look for support from the local voters to promote their political position. Owners and workers of small businesses in Indonesia are potential voters for the candidate running in elections for district head. Local politicians pay attention to the need of small businesses and open opportunity for them to participate in the process of decision making.

Before the *Reformasi* period (1968-1998), the political system was centralized and authoritarian. The district heads (*Bupati*) were elected by local legislature members (*Dewan Perwakilan Rakyat Daerah* or DPRD) from 3 to 5 candidates, who would be nominated by the DPRD to the central government. The candidate who won a majority in election was not always appointed by the central government to be

district head (Law No.5 of 1974). In addition, local people did not directly elect DPRD, but elected a political party who then selected the district head. The election determined what percentage of the parliamentary seat each party would be allocated. Political party leaders would choose who will be put into the legislative assembly from the list of legislative candidates. Under the next president B.J. Habibie, there was change of the district head election system. The election system became more democratic.

President Suharto was toppled on 21 May 1998 and replaced by B.J. Habibie, vice president. He carried out political reform due to public demands for democracy. Under Habibie's regime, most of the governmental functions were delegated to local governments except for monetary and fiscal, securities affairs, foreign policies, justice, religious affairs and other strategic and national policies (Law 22/1999). According to this Law, the district heads were elected by the DPRD without intervention from the central government. Article 132 of Law 22/1999 on district head election became effective in 2001.

President Habibie was replaced by Abdurrahman Wahid in 1999 who ruled Indonesia for just two years (1999-2001). The successor of Wahid as president was Megawati Sukarnoputri, who was a vice president under the Wahid government. At that time, there were public demands to revise Law No. 22 of 1999. As a result, President Megawati replaced Law 22/1999 by Law No. 32 of 2004 that became effective in 2005. According to this new law, the district head and mayor are directly elected by local people. In other words, the Indonesian government has operated under the crucial reform of political decentralisation since 2005.

Moreover, the 2009 general election for national and local parliament members was based partly on a system of district elections in which candidates for parliament members should be known by the public. Politicians and political parties approached voters, including the owners and workers of local small businesses and generally made promises to help local small businesses. In this context, the local small business owners could use political parties and politicians to articulate their interests such as to promote local regulations that could support small businesses. In turn,

these developments expanded the political sphere such that local small business owners could participate in the process of political decision making.

Administrative, fiscal and political decentralisation drives local government to seek new sources for supporting decentralisation. The local governments are required to increase their revenue generating capacity to implement local autonomy and to cope with decreasing subsidies previously granted by the central government. In general, locally derived revenue (*Pendapatan Asli Daerah* or PAD) was low in related to total district government's income. As an example, in 87 percent of local governments, the PAD income contributed less than 10 percent of their total budget in 2002. In contrast, the PAD income contributed more than 50 percent of total district budgets for only 0.3 percent of local governments (Brojonegoro, 2004, p. 136). Until 2009 data showed that local governments' budgets were still highly dependent on central government subsidies. Therefore the question arises, can fiscal decentralisation drive local governments to generate locally owned revenue?

The central government gives grants in form of specific grants and general grants to local governments, which have increased considerably in recent decades. The local governments now have greater discretionary power to use general grants. In addition, local governments have discretionary power to spend local tax incomes and levy incomes. However, the use of general grants, local taxes and levy incomes should be approved by local parliaments. And it is an open question whether local governments support local business sufficiently.

Decentralisation does give more opportunities for local governments to use local potential resources in local economic development. Small business sector is one of potential resources at the local level. There are many small businesses both in the Bantul district (Central Java) and Gianyar districts (Bali) that act as local potential resources in generating district revenue. The local governments can obtain revenue from local levies or license fees from small business owners.

However, during the decentralisation era, some scholars found that many regions developed new taxes as instruments to increase district government income. These created financial burdens and had other harmful effects for the business sector

(Collongon, 2003; SMERU, 2002). Increasing taxes makes it difficult to imagine that local businesses could flourish. Some local bureaucracies also were not sensitive to the long term needs of local businesses. Colongon (2003), Sandee and Dierman (2004) both note that local governments lack the institutional capacity to develop policies for small businesses which led to inappropriate policies for local small businesses.

Developing local businesses requires a politically stable climate, including clear regulation of labour and taxes. A survey conducted on 60 local governments in 20 provinces by the Economic and Management Research Institute (LPEM), Faculty of Economics, University of Indonesia in 2002 found that only 10 local governments were supportive in promoting a productive local business climate through such initiatives a low tax/fee rate and simplify licensing for businesses (Brojonegoro, 2004, p. 131). In fact the majority of local governments provided less support for the developing business sector.

The role of local governments in developing small businesses increased as a result of decentralisation. Local governments have more power to promote and to facilitate small businesses. The relationship between local governments and local small business draws even closer under decentralisation policy. Small business owners hope to obtain financial and material assistance as well as lighter fees levies. The critical issue lies in whether local governments can in fact control small businesses. Another important issue is whether decentralisation does in fact provide more access for small businesses in the process of decision making. This relationship between local authorities and small business is not extensively explored in the literature.

The relationship between state and business at national level in the case of Indonesia has been studied by scholars such as Robison (1987) and MacIntyre (1991). As an example, Robison (1987) found that the state facilitated the development of domestic business groups, which were encouraged to develop into big business groups and were subsequently able to influence the authoritarian centralized state structure during Suharto's regime. In another study, MacIntyre (1991) found that the textile association was able to influence state policy. For an example, the Department of

Trade grants a monopoly to the association in import raw materials used by the spinning industry.

This study focuses on the relationship between local government and business at local level. Two key questions arise here:

- (1) Can local governments develop and protect small business sector?; and
- (2) Are local business associations able to play an important role in the process of decision making?

### **3. Significance of the Study**

This study seeks to fill the gaps in existing studies. Until recently, there have been two types of research on business-government relations at local level in Indonesia. One focuses on the dynamics of small business and the other focuses on government policies towards this sector. Studies on their dynamics have often been local studies from a bottom-up perspective, and have dealt with aspects of entrepreneurship and labour relations (I. Abdullah, 1994; Purwanto, 2004; Rutten, 2003; Tambunan, 1994). Studies on government policies towards small business have focused mostly on policies at the national level, and employ a top-down perspective (Pagestu, 1996; Schiller & Schiller, 1997; Tambunan, 2000).

During the decentralisation era, most studies of local development focused on political aspects: the development of civil society (Bruinessen, 2004; H.S. Nordholt, 2003; Wiloso, 2004) or of local democracy (Hidayat & Antlov, 2004; Schiller, 2003). Yet few studies have focused on the relationship between local government policy and small businesses. For instance, Marijan (2006) studied decentralisation and cluster industry policy in Indonesia with case studies in Sidoarjo and Pasuruhan, East Java. Pramusinto (2005) studied the dynamics of change in decentralisation and its implications for local government-business relations with focus on local corruption. He found that decentralisation cannot reduce corruption in the relationship between local government and the business sector. The studies mentioned above did not focus on the relationship between local government and small businesses as a result of decentralisation policy.



This study focuses on the impact of decentralisation on the relationship between local government and small business. It will examine the extent to which local government allocates its budget to assist and improve public services for small businesses and how far small businesses contribute to district government revenue. Furthermore, it will explore the extent to which political decentralisation policy creates opportunities for small business owners and business associations to be involved in the process of decision making as well as in political activities and whether small businesses are politicized by local authorities. By discussing these hopefully we will obtain a better understanding of the relationship between local government and small businesses. This study will also hopefully be valuable in assessing the implementation of decentralisation policy.

#### **4. Objective of the Study**

The objective of this research is to examine the impact of Indonesia's decentralisation on the relationship between local government and small business from 2001 until 2009, with a focus on 2005-2009. This period is considered because Law 22/1999 commenced operation effectively in 2001. This law provided administrative and fiscal decentralisation to the district governments. This study seeks to examine the extent to which administrative and fiscal decentralisation give more power to local government in providing better public services for small businesses.

Six years later this law was replaced by Law 32/2004, which was implemented in 2005. This law provided political decentralisation to district governments through direct election for district heads (*pilkada*). Starting in 2005, political decentralisation changed the nature of relationship between the central and local government as well as the relationship between the local governments and local small businesses. Thus, this study seeks also to examine the extent to which small businesses owners can participate in the process of decision making and political activities.

#### **5. Research Questions**

The main issue of this research concerns how the decentralisation policy changes the relationship between district governments and small businesses. Based on this,

several research questions will be explored further in order to obtain a better understanding of the relationship between local government and small businesses.

- (1) To what extent does Indonesia's decentralisation give more power to the local governments to serve and control small businesses?
  - (a) To what extent do the district governments carry out local regulation reform to promote small businesses?
  - (b) Can the district governments use regulations on local levies to control small businesses?
  - (c) To what extent do district governments develop small business promotion policy?
- (2) Can political decentralisation drive district heads and political parties to be closer to small business owners and help them?
  - (a) Have district heads responded the needs and interests of small business owners?
  - (b) In what ways do local politicians approach small business owners with the aim to obtain votes in election of district head and local legislative member?
- (3) To what extent does political decentralisation create opportunities for small business owners to be involved in the process of decision making at district level thus they can articulate their interests?
  - (a) Have business associations involved themselves in the process of decision making at district government level?
  - (b) To what extent do small business owners participate in political parties as well as political activities?

## **6. Organisation of Thesis**

Chapter One will discuss a theoretical framework on the relationship between local governments and small businesses. In the beginning of this chapter, it discusses the concepts of decentralisation. Then, it explores the typology of decentralisation and its impacts. Finally, it examines the potential impact of decentralisation on the relationship between local government and small businesses.

Chapter Two will present a discussion on the social, economic and political setting of Bantul, a district within the major city of Yogyakarta in Central Java. This chapter

shows that the existing social, economic and political structures can influence the implementation of decentralisation and the dynamics of local political activities.

Chapter Three provides an investigation of the social, economic and political setting of Gianyar. A district where there are many small businesses in province of Bali. This investigation examines how existing social, economic and political structures influence the dynamics of local political activities and the implementation of decentralisation. Gianyar is supported by trade, hotel and restaurant sector. Politically, in Gianyar local legislative members consists of nationalist parties.

Chapter Four examines the impact of decentralisation on small businesses in Bantul district. This chapter explores the extent to which the district government regulates small businesses by developing policies on business license, local tax/levy and protection policies for small businesses. Furthermore, this chapter discusses how the local government promotes small businesses by providing financial assistance, training programs, technological assistance as well as infrastructure facilities. Finally, this chapter examines political influence of local authorities and politicians over small business owners as well as their participation in the process of decision making and political parties.

Chapter Five explores the impact of decentralisation on small businesses in Gianyar. This chapter is divided into three sections. Firstly, it discusses how the Gianyar district government regulates small businesses by revising business license permits policy and local tax/levy policy. Secondly, it examines how the district government promotes small businesses through providing financial assistance, training programs, material assistance as well as infrastructure facilities and market development. Thirdly, it explores political influence of local politicians on small businesses and examines the extent to which business associations participate in the process of decision making and the participation of small business owners in political party.

Chapter Six presents the conclusions of this research. It discusses the comparison of the case studies of small business of Bantul and Gianyar, identifying similarities and differences as a result of the implementation of decentralisation policy.

## **7. Limitation of the Study**

There is one limitation of this study. The study only relates to small businesses owners chosen as sample in this survey. In Bantul district this survey took 60 small business owners (30 percent), whereas in Gianyar district, the survey focused on woodcraft small businesses and took 100 business owners (22 percent) as samples.

## **8. Research Methodology**

It was not easy to investigate the relationship between local bureaucrats and small business owners by using questionnaires because respondents cannot deeply express their views. Therefore, the information of relationship is studied from in-depth-interview. By interviewing, a researcher could investigate the reason of each answer from respondents. In addition, a researcher could obtain detailed information from respondents regarding a certain case and their view of local government policy in relation to small businesses.

### **8.1. Case Study Research**

A case study approach was chosen because this study will answer “how” and “why” questions as Yin (2003) argues. The question of how and why can lead a researcher to provide argumentative answer in detail. Moreover, case studies also emphasize detailed contextual analysis of a limited number of events (Soy, 1997, p. 1).

Several cases can provide description and comparisons regarding small businesses-local government relations as well as small businesses-political parties relations. The researcher recorded testimonies, stories, and illustrations which can be used in analysis. For instance, a story of financial and technological assistance from local government can be used to identify the relationship between local government and small businesses owners.

This research focuses on two districts rather than surveying many districts with the aim to examine whether decentralisation policy has different impact on different localities. On the outset the Bantul district is different from the Gianyar district in terms of social, economics and political settings. So, the important question is, whether the impact of decentralisation in Bantul is different from Gianyar.

## 8.2. Research Location

This research was done in the Bantul district in province of Yogyakarta and Gianyar district in province of Bali. The characteristics of these locations are different. Bantul is different from Gianyar in terms of its politics, society and local economy. Political parties in Bantul are pluralist in nature. Some political parties are based on religious affiliation and others are based on secular nationalism. There are also local NGOs as well as local business associations. In Gianyar there are only two large secular nationalist parties, the *Golkar* party and the Indonesian Democracy Party of Struggle (PDI-P party). In addition, the society of Gianyar is primarily homogenous in terms of religion and ethnicity. The structure of economy of Bantul is supported by agricultural sector (24 percent) whereas the structure of the economics of Gianyar depends on trade and the hotel and restaurant sectors (30 percent). The different social, economic and political aspect of these locations assists in the examination of whether decentralisation policy has different impact on different localities.

Both Yogyakarta and Denpasar are famous tourism destinations in Indonesia. Many foreign and domestic tourists visit both cities because of their many famous attraction and beautiful places. There are average 5,751,080 tourists per year visit to Bali while the number of Bali population only 3.6 million in 2010 whereas the number of tourist who visited to Yogyakarta was 1,456, 980 in 2010. I argue that small businesses can play a vital role in promoting tourist destinations because they can offer various products for tourists.

In addition, these two regions have adopted a patrimonialistic political culture in which personal connections predominate in local politics. For instance, in Gianyar, the district head comes from *Puri* (Royal House) who has strong political influence to Balinese people. The members of Gianyar Puri are an aristocratic family included in the Kshatriya caste. In Bali, the Kshatriya caste has high social status and is highly influential in Balinese society and towards the head of *Desa Pakraman* and *Banjar*. In Yogyakarta, the head of the Yogyakarta Special Province is a king called *Sultan*. Bantul is a district of Special Province of Yogyakarta which is influenced by patrimonialistic political culture. The Bantul district head, Idham Samawi is close to the Sultan and supports patrimonialistic culture. In addition, he developed a political dynasty in Bantul district. For instance, he supported his wife to be involved in

electing the Bantul district head in 2000. It is important to understand whether in two areas, Denpasar and Yogyakarta, with similar patrimonialistic political cultures, will have the influence on small businesses.

### **Why was the Bantul District Chosen?**

There are three aspects which justify the research on the Bantul District. Firstly, Bantul district is one of five districts in the province of Yogyakarta occupied by 17,911 small businesses with approximately 79,904 workers in 2007. Therefore, there is abundant information regarding small businesses in this region which can be studied.

Secondly, since the promulgation of local autonomy, the local government of Bantul has paid much attention to small businesses, as for example through the establishment of the Gabusan Art Market with the aim of promoting small business owners. The local government has also helped small businesses by providing financial and material assistance, as well as market development. Thus, several types of assistances can be used to analyse local government policy in relation to small businesses.

Thirdly, at the same time, political decentralisation has progressed rapidly in the region. Since *Reformasi*, the position of district head in Bantul has been filled by businessmen. This is significantly different from the previous New Order Government period (1968-1998) when the district heads of Bantul were all from military backgrounds. During the decentralisation era, the district head has become more responsive to the needs of small businesses especially in comparison to previous regime. The current district head of Bantul is from a journalistic, mass media background and son of the owner of the prominent *Kedaulatan Rakyat* daily newspaper in Yogyakarta.

### **Why was the Gianyar District Chosen?**

The second location of research is Gianyar district in Bali. There are three reasons which justify my choice of the Gianyar district. Gianyar is one of nine districts of Bali, located about 30 kilometres north east of Denpasar city with a population of 390,698 in 2008. Over 50 percent of the Gianyar population works in industries and

various trade sectors, and particularly small business sector. Most of small businesses of Bali were located in Gianyar, comprising 22,144 small businesses, which employed approximately 656,800 workers in 2008. Most of small businesses in Gianyar are concentrated on woodcraft in Tegallalang sub-district. Further, the growth of small business in Gianyar has been faster than other districts. Thus, much information of small businesses is available in Gianyar. This information is valuable to this study.

Secondly, the district head of Gianyar gives his political attention to small-business by making a memorandum of understanding with the BNI Bank, which facilitates credit without collateral with low interest (Daily-newspaper-Bali-Pos, 9-7-2008; Daily-newspaper-Bisnis-Bali, 9-7-2008). The local government of Gianyar has also helped small businesses by providing training, developing markets and providing financial assistance for small business owners. The district head of Gianyar also had a business background experience. Types of policies regarding small businesses can be used to analyse the relationship between local government and small businesses.

### **8.3. Data Collection Methods and Source of Data**

This study is based on qualitative and quantitative evidences. As suggested by Yin (2003, p. 15), case studies can mix two methods, yielding both qualitative and quantitative evidence. Data was gathered from the local bureaucracy, politicians and small business owners both in Bantul and Gianyar. Qualitative data was collected through in-depth interviews and documented methods whereas quantitative data was collected by survey and documented methods.

#### **8.3.1. Documentation Method**

The documentation method was used to collect data from national and local government. At national level, the relevant regulations include Law No. 20/2008 on Micro, Small, and Medium Scale Business (*Undang-Undang tentang Usaha Mikro, Kecil, dan Menengah*), Law 22/1999, Law 25/1999, Law 32/2004 and Law 33/2004. At the local level, the researcher studied local regulations (*Peraturan Daerah, Perda*) and Decrees of District Head (*Keputusan Bupati*) related to business sector. Documents were collected from the secretariat of the district governments, local government agencies and secretariat of local parliaments.

### 8.3.2. In-Depth Interview

I prepared interview guides before going to field work in 2009. The field work was conducted from April to June 2009. Yin (2003:89) argues that the interviews are guided rather than structured conversations. The interview can be further developed during the process of fieldwork. The case study interviews were thus likely to be fluid rather than rigid. Interviews were conducted with local bureaucrats, local politicians, local small business owners, head of business association, heads of local communities, scholars and journalists who expert in small business.

Local bureaucrats to be interviewed were selected according to structural position and function. In Bantul, the local bureaucrats interviewed included the District Head (*Bupati*), Vice District Head (*Wakil Bupati*), Secretary of District Government (*Sekretaris Daerah*), Head of Local Agency for Industry, Trade, and Cooperative (*Dinas Industri, Perdagangan, dan Koperasi*), Head of Local Board for Regional Development Planning (*Bappeda*), Head of Local Agency for Service of Licenses (*Dinas Perijinan*), and Head of Local Agency for Manpower (*Dinas Tenaga Kerja*), Head of Local Agency for Law (*Bagian Hukum*) and Head of Agency for Local Finance and Assets (*Dinas Pengelolaan Keuangan dan Aset Daerah*). A list of interviewees can be seen in Appendix 3

In Gianyar, local bureaucrats interviewed included the District Head, Vice District Head, Head of Local Agency of Industry and Trade, Head of Local Agency of Cooperative, Small and Medium Businesses (*Dinas Koperasi, Usaha Kecil dan Menengah*), Head of Local Board for Regional Development Planning (*Bappeda*), Head of Local Board for Integrated Permit Services (*Badan Pelayanan Perijinan Terpadu*), and Head of Local Agency of Manpower (*Dinas Tenaga Kerja*), Head of Local Agency of Law (*Bagian Hukum*), Head of Local Agency for District Government Revenue (*Dinas Pendapatan Daerah*) (Appendix 4).

There are different names for similar local agencies between Bantul and Gianyar. As In Bantul for example, small businesses are serviced by the Local Agency for Industry, Trade, and Cooperatives, while in Gianyar they are serviced by the Local Agency of Cooperative, Small and Medium Businesses. Moreover, in Bantul, types of licences are issued by the Local Agency for Service of Licenses, whereas in



Gianyar they are issued by the Local Board for Integrated Permit Services. Finally, in Bantul, district government revenues and expenditure are serviced by the Agency for Local Finance and Assets, while in Gianyar they are managed by the Local Agency for District Government Revenue.

The local politicians of Bantul who were interviewed included the heads of district parliament and of the industry and trade committee of local legislature. Chairpersons of five large political parties of Bantul were also interviewed, namely: Chairperson of the Indonesian Democracy Party of Struggle, *Partai Demokrasi Indonesia Perjuangan* (PDI-P); Chairperson of the Golkar Party, *Partai Golkar*; Chairperson of the Democrat Party, *Partai Demokrat* (PD), Chairperson of the National Mandate Party, *Partai Amanat Nasional* (PAN), Chairperson of the Justice and Welfare Party, *Partai Keadilan dan Sejahtera* (PKS) (Appendix 3).

In Gianyar there are two large political parties: *Golkar* party and PDI-P party. Therefore, the Chairperson of Golkar party and Chairperson of PDI-P party were interviewed for this research. The head of the local parliament and head of the industry and trade committee of the local parliament were also interviewed with the aim to explore the extent to which local legislature facilitated regulations to promote and assist small businesses (Appendix 4).

The researcher interviewed some small businesses owners with the aim to understand the perception of small business owners on the district government policy and local regulations on small businesses. Beyond small business owners, the researcher also interviewed the chairperson of small business cooperatives and the chairperson of business associations (Appendix 4)..

In Bantul, the researcher interviewed the Chairperson of Small Business Cooperative, Chairman of Bantul Craft Association, the Chairperson of Handicraft Local Board (Dekranas or *Dewan Kerajinan Nasional*), the Chairperson of Local Chambers of Commerce and Industry (*Kadinda* or *Kamar Dagang dan Industri Daerah*), the Chairperson of Indonesia Furniture Industry and Handicraft (Asmindo or *Asosiasi Industri Permebelan dan Kerajinan Indonesia*) and the Head of Export and Handicraft Association (ASEPHI) (Appendix 3).

In Gianyar, the researcher interviewed the Chairperson of Wood Association and Chairman of Local Chamber of Commerce and Industry (*Kadinda*). The researcher also interviewed selected local small business owners to gain information regarding their businesses, their view of the role of local government in promoting small businesses and their view of the role of political parties in promoting small businesses (Appendix 4).

In addition, the researcher interviewed scholars and journalists to obtain their perspectives on the relationship between small businesses and local government. In the Bantul district, the researcher interviewed: (1) W.U., a senior lecturer of Gadjah Mada University and an expert in local government; (2) P, the Dean of Faculty of Social and Political Sciences, Gadjah Mada University and an expert in local government and business affairs (Appendix 3). In the Gianyar district, the researcher interviewed: (1) D.A., the Director of Bali International Institute of Tourism Management and an expert in small businesses; and (2) M.Y., senior lecturer and an expert in small business at Faculty of Economics, Udayana University, Denpasar (Appendix 4).

In regards to local media, in Bantul district, the researcher interviewed B.S., a senior journalist of *Kompas* daily, the largest national daily newspaper and N.H., a senior journalist of the largest local daily newspaper, *Kedaulatan Rakyat* to gain their perception on the relationship between local government and small business (Appendix 3). In the Gianyar, the researcher interviewed two journalists of *Bisnis Bali* daily newspaper, the largest local (Appendix 4).

In Bantul, the *Dukuh* (head of hamlet) and Heads of RT (Head of neighbourhood association) were interviewed (Appendix 3). In the case of Gianyar, the researcher interviewed the *Kelian*<sup>2</sup> (Heads of *Banjar* or Association of local customary community) and the *Bandese* (Head of *Desa Pakraman* or Head of Customary Village) (Appendix 4).

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<sup>2</sup> Head of local customary community is called *Kelian*. There are two types of *Kelian*. *Kelian Adat* and *Kelian Dinas*. *Kelian Adat* serves the needs of customary community such as funeral and wedding ceremonies, whereas *Kelian Dinas* serves official duties such as Resident Identity Card.

### 8.3.3. Survey methods

The researcher used a survey method for collecting data with the aim of gaining a better understanding of the responses of small business owners to the local government policy and political parties. However, due to difficulties in obtaining precise data on total number of small businesses both in Bantul and Gianyar, it was difficult to determine the exact total number of the sample, in order to representative. *Dinas Industri, Perdagangan dan Koperasi or Diperindagkop* (Local Agency of Industry, Trade, and Cooperative) of Bantul, was supposed to responsible for data on the number of small business owners, but the local agency did not separate between the total number of micro and small businesses unit. *Dinas Koperasi, Usaha Kecil dan Menengah* (Local Agency of Cooperative, Small and Medium Businesses) of Gianyar also combined the number of micro and small businesses units. Therefore, total small businesses could not be identified precisely.

Based on secondary data and interview results with local bureaucrats, it was seen that small businesses of Bantul were concentrated on ceramics and woodcraft. However, in Gianyar most of the small businesses were concentrated on woodcraft. This study is focused on ceramic and woodcraft small businesses of Bantul and woodcraft small businesses of Gianyar as the unit analysis.

Most small businesses of Bantul were located in Kasihan and Imogiri sub-districts and most small businesses of Gianyar were concentrated in Tegallalang sub-district. Therefore, the survey was focused on Kasihan and Imogiri sub-districts in Bantul and Tegallalang sub-district in Gianyar. Respondents were selected by random sampling, where each unit in the population to be covered has a calculable probability of being selected. As discussed above, the local governments had only data which was the combined total of micro and small businesses. However, according to secondary data from Bantul and Gianyar, the total of micro and small businesses in Kasihan and Imogiri was 397 in 2008. The total for micro and small businesses in Tegallalang was 450 in 2008. Based on my observations during fieldwork in 2009, the total of micro businesses was larger than that of small businesses. Therefore, it can be argued that the total of small businesses of Kasihan less than 200 and the total of small businesses of Tegallalang was also less than 225. The surveys involved 60 small business owners (30 percent) in Kasihan and Imogiri

sub-district in Bantul (Appendix 5) and 100 small business owners (22 percent) in Tegallalang sub-district of Gianyar (Appendix 6). The sample size over 20 percent of total population is accurate. In the case studies, the focus is more on depth and intensity rather than sample size (Gilbert, 1993, p. 155). I argue that respondents can provide accurate information on the relationship between local government and small business in this study. It may be concluded that data collection method can be instrument to obtain accurate data for answering the research question as discussed above.

#### **8.4. Method of Data Analysis**

Collected data was analysed by qualitative and quantitative analysis. The researcher used a combined socio-economic and socio-political approach in analysing data. Data collected by interviews was analysed by qualitative method by presenting interview results related to the certain case. Survey and document data are analysed by quantitative methods such as cross tabulation and percentage. The next chapter discusses theoretical framework with the aim to theoretically answer the research questions.

# **CHAPTER ONE**

## **ANALYTICAL FRAMEWORK: DECENTRALISATION AND SMALL BUSINESS**

### **1.1. Introduction**

This chapter seeks to identify analytical frameworks for explaining the causal relationships between decentralisation measures and small business activities. Decentralisation can cause local governments to have more power over administrative functions as well as over fiscal policy and political processes. With administrative decentralisation, local governments can have more discretionary functions to improve public services and develop specific local agencies to help small businesses. With fiscal decentralisation, districts governments have discretionary policy to provide financial and infrastructure assistance for them. With political decentralisation, elected local officials can make policy independent of the national government and local residents are able to hold elected local officials to be accountable for their performance.

The layer of government closest to the people, namely the local government system, helps shape the wave of decentralisation around the globe. With more than three quarters of world's countries already proceeding with some form of power delegation to sub-national government by the mid-1990s (Beall, 2005, p. 30), this upsurge of decentralisation has given rise to the search for new dynamic roles of sub-national governments in efficient and fair governance. If political resources and opportunities are in the hands of the central government, national authority would be less likely to be responsive and accountable for locally specific needs. But, if decision-making powers and fiscal capacity is delegated from national to sub-national levels, sub-national government will be potentially capable of responding to, and being accountable for the needs of local community. The transfer of authority and responsibility from the central government to lower levels of governments is a core part of the decentralisation process (Richard M. Bird & Vaillancourt, 2008; De Vries, 2000; Eaton, 2001). Decentralisation policy provides local government with

more discretionary power to meet the needs of local communities. As a result, the local government becomes closer to local communities and local businesses.

The decentralisation policy is likely to cause a significant change in the relationship between local government and small businesses. As the central government transfers functions to local governments, local governments' functions will increase. Decentralisation functions allows local government to become a direct service provider to the local communities including small businesses and helps to increase opportunities for small businesses to participate in policy making at a local level. Decentralisation policy may also bring small businesses under regulatory control by local government.

The main question of this research is: how does decentralisation policy change the relationship between local government and small businesses? Here I will break it into more detailed questions such as: Whether the district governments can control small businesses. To what extent do district governments improve public services for small businesses? Do local authorities have political influence over small businesses? To what extent does decentralisation empower small businesses to influence local authorities through participating in the process of decision-making at the local level?

This chapter focuses on the theories of decentralisation that are used to explain the impact of decentralisation on small businesses. The impact of decentralisation will be analysed by three types of decentralisation: administrative, fiscal and political decentralisation as proposed by World Bank (1999) and Falleti (2005). Using one type of decentralisation is not sufficient to explain the relationship between local government and small business in the context of decentralisation because each type provides partial explanation in relation to the decentralisation. Therefore, this study combines three types of decentralisation with the aim to better understand the impact of decentralisation. I believe that this study differs from previous studies on Indonesian decentralisation because in previous studies by Bruinessen (2004); Hidayat & Antlov (2004); Wiloso (2004) only focused on political decentralisation. Dwiyanto (2002, 2003) only emphasized administrative and political

decentralisation, whereas Marijan (2006), Pramusinto (2005) and SMERU (2002) explored only administrative and fiscal decentralisation.

This chapter consists of six sections. The first section reviews the concept of decentralisation. Discussing the concept of decentralisation is important to ensure consistency in the use of this concept because decentralisation is an ambiguous word with many different meanings. The second explores the typology of decentralisation with the aim of looking at the patterns and scope of that phenomenon. The third section examines the implementation of administrative decentralisation. This section is intended to promote better understanding of how functions/tasks are delegated by a central government to sub-national governments. The fourth examines the implementation of fiscal decentralisation with the aim of exploring the extent to which fiscal decentralisation increases local governments' financial discretion and increases the efficiency and equity of public services. The fifth explores the implementation of political decentralisation for local policy-making processes. This section will discuss the possibility of public participation in local agenda-setting, policy formation and implementation. It also examines the emergence of politicization in local community affairs as a result of political decentralisation. The sixth section examines the implementation of administrative, fiscal and political decentralisation specifically with regard to the relationship between local government and local small businesses, proposing an alternative model which differs with previous studies. My contribution is to study the relationships between local government and small businesses in the two different regions of Gianyar and Bantul to obtain a more comprehensive analysis. For researchers, this study sheds light on the neglected areas in studies of Indonesia's decentralisation and provides a new perspective in understanding the impact of decentralisation on small business.

## **1.2. Understanding the Concept of Decentralisation**

Decentralisation has been assigned many different meanings and definitions in studies of public administration and politics. It is an ambiguous word. It is important to present the terminology of decentralisation which in turn can facilitate comparing the different meanings of decentralisation (Dubois & Fattore, 2009)). In a political sense, decentralisation is a devolution of autonomous political and fiscal power from the central government to lower levels of government (O' Nell, 2003, p. 1070).

Decentralisation can be defined broadly not only as a type of organisational relationships within the public sector but also that between the public sector and private sector (Rondinelli & Cheema, 1983, p. 18).

Decentralisation is the transfer of planning, decision making, or administrative authority from the central government to its field organisations, local administrative units, semi-autonomous and *parastatal* organisations, local governments, or non-governmental organisations.

From this perspective, decentralisation is not only a transfer of authority from central to local government, but also a transfer of authority from national government to organisations beyond government, such as semi-autonomous and private organisations.

This study will follow Crook and Mannor (1998, p. 6) who define decentralisation more narrowly as the transfer of power by the central government to different sub-national levels of government. That definition is clear and relevant to my study, as my focus is only on government organisation. In this study, I refer to decentralisation as a transfer of power from the central government to the district governments – the regencies and municipalities (*kabupaten and kota*). The case studies in this thesis will explore the transfer of power from the central government to two district governments in Bantul and Gianyar, with the aim to account for the similarities and differences of the impact of decentralisation on small business.

But why do modern nation-states delegate decision-making authority to lower levels of government? In the early 1950s, newly independent countries in the Third World such as Indonesia, Philippines and India began to build modern nation-states. State-led development in most Third World countries was initially intended to gain momentum through top-down national leadership. The modernization drive of nation-building and economic development in Asia-African countries was thus led by central control in accordance with the economic growth theory of economic development<sup>3</sup> in the late 1940s. The ultimate objective of these late-developers was to maximize their gross national product by shifting from labour intensive to capital intensive industrialization. The policy was prescribed by the World Bank to promote

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<sup>3</sup> For instance, Rosenstein-Rodan and Nurkse argues that industrialization and mobilization of international capital is necessary to raise income in under-developed countries (Hunt, 1989).



modernization and accelerate social and political change (Rondinelli & Cheema, 1983, p. 12).

By the end of the 1960s, however, the state-led economies had largely failed to achieve the expected goals as economic growth remained sluggish in most Third World countries during that decade. Equally important, income disparities between the rich and poor in developing countries widened and developmental gaps among regions worsened. This was not only because state intervention was ineffective, but also because it was incapable of promoting equitable growth among communities within developing countries. In the patterns of recent development, policy decision-making related with the needs of local communities is uniformly defined by the central government. As a result, local governments had difficulty in implementing the decisions because of a lack of support for locally specific needs. The centrally defined policies were not necessarily in accordance with the needs of local communities. In turn, the uniformly imposed policies had little positive impact on regional development. Subsequently, in the early 1970s, policy makers in many developing countries, such as the Philippines (1967),<sup>4</sup> China (1980),<sup>5</sup> Chile (1974)<sup>6</sup> and Mexico (1976)<sup>7</sup> began to adopt a decentralisation system to achieve equitable growth. Decentralisation allows sub-national governments to make development planning based on local needs and resources. In addition, it opens up more political opportunities for local citizens to participate in decision making process. The decentralisation policy in Indonesia is expected to provide district governments with more structures to play an important role in local developmental planning and provide more opportunities for local citizens to be involved in decision making process.

The important question is: what factors simply drive the emergence of decentralisation? The literature identifies a set of determinants for the adoption of

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<sup>4</sup> In 1967, President Marcos enacted Republic Act No. 5185 regarding decentralization act.

<sup>5</sup> Fiscal decentralization in China started in 1980 but fiscal decentralization reduces provincial economic growth as found by (Zhang & Zou, 1998).

<sup>6</sup> In 1974, the Chile government enacted Law No. 573. According this Law, municipalities were considered territorially decentralized units in terms of the formal sense, but still influenced strongly from the central government.

<sup>7</sup> The government of Mexico introduced decentralization policy under President José López Portillo (1976-1982). Then, a series of political and administrative reforms was continued by President Miguel de la Madrid (1982-1988).

decentralisation measures. These determinants will be discussed in this section. After discussing these we will understand which determinants are relevant to the emergence of decentralisation in Indonesia. However, there is a possibility that the emergence of decentralisation may be caused by combined many determinants because decentralisation is multi-dimensional and complex.

Possible determinants for adopting decentralisation are as follows: Firstly, decentralisation can be understood as the outcome of a political bargaining between national politicians – presidents and legislators - and sub-national politicians, each having somewhat conflicting preferences. Political parties provide the medium through which such bargaining takes place among them (Willis, Garman, & Haggard, 1999). Decentralisation results from bargaining amongst politicians at different levels of government to obtain power and financial benefits. It can be adopted because of strong demand from political parties at local levels. It may be thus designed to ease challenges emanating from the lower levels of government.

Secondly, decentralisation is seen as the consequences of strategic electoral calculation by political parties. Political parties and individual party politicians tend to prefer decentralisation if they predict their future electoral success to be better at the sub-national level than the national level. In contrast, they tend to choose a centralised system if they predict that they will be able to control power at the national level (O' Nell, 2003). By gaining an electoral victory at the sub-national level, parties will be able to hold power in both the executive and legislative sectors. That being the case, political parties will have better access to public resources to be used as material incentives to the local constituencies. In this example the main factor of decentralisation derives from the political opportunities for political parties to hold real power at sub-national levels, even though they may lose control at the national level.

Thirdly, according to Eaton (2001), decentralisation is adopted because democratically elected officials at lower levels of government demand decentralisation measures as a means to increase their decision-making authority. However, Bird and Vaillancourt (2008) argue that the success of such sub-national

demand is less likely in authoritarian systems such as in China, because the central government is weakly responsive to sub-national pressure.

Fourthly, decentralisation could occur as a result of a legitimacy crisis. Based on comparisons of decentralisation in Argentina, Bolivia, and Venezuela, it was argued that decentralisation was driven by the elite recognition that the political system had been in danger of collapse and thus required decentralisation for the solution (Gonzalez, 2008). In this sense, decentralisation can be seen as a way to restore citizens' trust in government by building greater participation and accountability (Gonzalez, 2008). By decentralizing power to local governments, a policy to meet the needs and preferences of local citizens is to be in the hands of local governments. Policy makers who are closer to local citizens can better understand their needs and preferences than the central government. Political decentralisation also opens greater opportunities for local citizens to be involved in the process of decision making and can thus increase the trust local citizens have in the government. In the Philippines and Indonesia, decentralisation was adopted following the sudden collapse of authoritarian regimes, such as that of Marcos in 1986 and of Soeharto in 1997 (World-Bank, 2005).

Fifthly, decentralisation may result from pressure from international agencies such as the World Bank. The World Bank, for example, played an important role in promoting decentralisation in Latin American countries, especially during the 1990s (Stalling, 1992, 1995). The World Bank believes that sub-national governments' investment will significantly contribute to growth in per capita income in developing countries. Fiscal decentralisation will then be required to provide sub-national authorities with fiscal capacity for their investment. Increased per capita income of people in regions of developing countries will create a potential market for products from capitalist developed countries such as the US and West European countries.

After discussing possible determinants of decentralisation above, I try to identify what determinants apply with regard to emerging decentralisation in Indonesia. I argue that decentralisation was caused by a legitimacy crisis of the Soeharto regime in 1997 (World-Bank, 2005). Following the economic crisis in 1997, the Indonesian government faced political crisis in 1998, then the successor, Habibie carried out

decentralisation policy in 1999 by introducing Law 22/1999. Besides that, decentralisation policy was also driven by pressure from international agencies such as the World Bank. International donors have recently shifted to supporting better governance and with it, greater local participation and autonomy (Asian-Development-Bank, 2001).

Decentralisation policy can create a greater opportunity for local citizens and local social and business groups to participate in the process of decision making. Local decisions can thus be accordance with their needs. If decision-making powers and fiscal capacity is delegated from the central government to sub-national level, sub-national governments will be potentially capable of being responsive to, and accountable for the needs of local citizens, local social and business groups.

A nationwide political crisis tends to create popular pressure for the delegation of power to localities. Based on political experiences in many countries, such as the Philippines, Indonesia, South Korea, Argentina, Bolivia and Venezuela, I believe that the emergence of decentralisation is largely driven by political crises at the national level. The political elites at the national level had no other way but to seek to restore order and respond to societal demands for delegating power to local governments. In relation to small business, the important question is how decentralisation policy can be made relevant. As discussed above, one of reasons for decentralisation derives from citizen demands for the delegation of power to their local authorities and communities. Once decision-making authority is delegated to sub-national levels of government, a number of sub-national actors, including small businesses, put pressure on sub-national governments to meet each of their different preference and needs. This raises several questions. Does local government provide access for local citizens to participate in the process of decision making? In the case studies, does decentralisation policy increase small businesses' ability to petition or lobby elected district heads and local legislators for protecting and promoting their interest? Does decentralisation policy really provide much benefit for local citizens including small businesses?

In this context of decentralisation that drives the Third World, there are two relevant schools of thought regarding the benefits of decentralisation, name the economic

approach that emphasizes administrative efficiency, and the political approach that aims to ensure social equity (Smith, 1985, p. 4). Schönwälder (1997, p. 757) uses the terms “pragmatic approach” and “political approach”- parallel to those two different efficiency vs equity approaches. The pragmatic approach is synonymous with the economic approach, which draws heavily on the theory of fiscal federalism (Hayek, 1945; Oats, 1972, 1999; Tiebout, 1956) and is supported by economists and specialists in the field of public administration. According to this approach, decentralisation is a strategy to increase the efficiency of service delivery. Its proponents argue that people’s interest and needs vary from one part of a country to another so that local officials must know more about what local community needs rather than national officials.

Hayek (1945) discusses the use of local knowledge to support the decision making process. Local governments have better access to local information, so that they can provide better public goods and services which are in accordance with local preferences and needs. Tiebout (1956) argues that under fiscal decentralisation and inter-jurisdiction competition in minimizing local taxes and maximizing public services, citizens can vote to stay in a region which provides better public services. Different local governments can offer different public tax-expenditure bundles, and citizens can exit from local governments that provide unsatisfactory services and taxes, and then move to another region which provides better welfare and public services. Oats (1972) developed a theory of fiscal federalism, stressing the capacity of a decentralised government to improve resource allocation in the public sector through the diversification of public outputs in accordance with local needs. Through the appropriate assignment of taxes and expenditures by the various levels of governments, community welfare can be improved.

In contrast, proponents of the political approach argue that the principal goal of decentralisation is not to increase administrative efficiency, but to provide broader opportunities for public participation, thus ensuring social equity (Crook & Mannor, 1998; Nzouankeu, 1994; Smith, 1985). They accept the economists’ argument that autonomous local governments are more able to deliver services efficiently than a centralized government, but they criticize the economic approach for diverting attention away from the issues of political participation (Malley, 2003, p. 102).

In practice, administrative efficiency and participatory democracy are often diametrically opposed. Efforts to achieve efficiency often impede participation and efforts to encourage participation often compromise efficiency. The ideal goal of decentralisation is to provide benefits by increasing both efficiency of public services and public participation simultaneously. Public services provided by local government can reflect local communities' needs, as local community members are able to have access to participate in decision making processes. So, it is important to create political institutions based on democratic elections that facilitate the process of political participation (Malley, 2003, p. 104).

As discussed above, decentralisation is a transfer of authority and power from the central government to sub-national governments.<sup>8</sup> The next question is, to what extent authority is delegated by the central government to sub-national governments. According to Bailey (1999) and Cheema & Rondinelli (1983), national government can devolve responsibility to sub-national government with or without decision making powers. The former is called devolution in which local government has the ability to make operational decisions within set policy parameters. The latter is deconcentration which is a transfer of function to lower levels of government without delegation of decision-making power.

Devolution involves the transfer of functions and decision-making from the central government to local governments. Thus, sub-national government officials have authority to make decisions, which can reflect local people's preferences since local governments are closer to people and more responsive to various demands. Locally elected council persons hold chief executives and their local administration accountable for their decision-making. Deconcentration involves the redistribution of responsibility from the central government to sub-national governments without transferring the authority to make decisions or exercise discretion. The local government officials merely implement what has been decided by the central government officials. Therefore, officials at the local level neither have access to decision-making nor learn much about policy-making. The decision-making might

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<sup>8</sup> Authority is a power based upon certain legitimacy, justification, and the right to exercise it. Authority is often used interchangeably with the term of "power", but power simply refers to the ability to achieve certain ends with or without justification or rights.

not reflect preferences of local people because it had been made by the central government officials. Deconcentration is the weakest form of decentralisation whereas devolution is a strong form of decentralisation from the view point of local accountability. However, degree of decentralisation will be an approximation to the ideal type of deconcentration or to the ideal type of devolution.

Based on the discussion above, I would expect that devolution provides greater roles for local government to make decisions in accordance with the needs of local small businesses. However, policies undertaken by local governments toward the same policy areas will be quite different across regions, since local capacity varies under the same measure of devolution. In my study for instance, local government policies to promote small businesses are expected to be different between the two research sites, Bantul and Gianyar, because of differences in the capacity of local resources and the capacity of small business' needs. The relationships between decentralisation and small businesses activities will be discussed in section number of 1.7 in this chapter.

To articulate the patterns and nature of both devolution and deconcentration, we need to further discuss the discrete types of decentralisation. The following section will discuss a typology of decentralisation as a base in analysing the impact of decentralisation. Based on the typology we can systematically classify various impacts of decentralisations in the next section.

### **1.3. Typology of Decentralisation**

The conventional World Bank analysis of decentralisation focuses on its administrative, fiscal, and political dimensions (World-Bank, 1999, p. 108). Following this convention, Falleti (2005, p. 329) suggests that there are three types of decentralisation: administrative decentralisation, fiscal decentralisation and political decentralisation. By using three types of decentralisation, it easily identifies the impact of decentralisation on small businesses. However, in a practical sense the impact of each of type decentralisation overlaps each other.

In practice, the degree of implementation of administrative, financial and political decentralisation can be different according to the capacity of each region. This is

called asymmetric decentralisation. The number of decentralised functions that are given to the local governments may be different among regions due to different financial capacity of each region, and refers to an asymmetric administrative decentralisation (Richard M. Bird, 2003, p. 9). Moreover, asymmetric fiscal decentralisation is related to authority of local government that given by central government in tax policy. As an example, Basque and Navarre regions in Spain were given authority to administer taxes locally such as income, corporate and inheritance and wealth taxes (Garcia-Mila & McGuire, 2002, p. 5). Asymmetric political decentralisation is relation to degree of opportunity for local community to elect district head. In China, as an example, sub-national government were given authority in administrative and fiscal discretion but head of local government was appointed by Communist Party (Chien, 2008, 2010).

These three types of decentralisation will nevertheless be used as an analytical framework to look at the efficiency and equity of decentralisation-driven practices in the Bantul and Gianyar districts, with the aim to understand why the similarities and differences exist between the two districts in terms of the impact of decentralisation on small business. The following section is to examine the typology and to identify the relevance of each type of decentralisation to its impact on small business.

### **1.3.1. Administrative Decentralisation**

Administrative decentralisation involves the sharing of responsibilities between central and sub-national governments. It comprises a set of policies that transfer the administration and delivery of public services such as health, education, public work and social welfare to lower levels of government (Falleti, 2005, p. 329). This is a linkage process in which the national government increases the ability and discretion of local administration for service delivery. In other words, administrative decentralisation is the transfer of functional responsibilities from the central government to local governments. It can be measured by the extent to which sub-national government has functional responsibilities.

The implications of administrative decentralisation for administrative efficiency and social equity are as follows: firstly, sub-national governments become functionally autonomous and central authorities are normally unable to exercise direct control



over the implementation of service delivery. Secondly, local governments need to secure financial resources to perform their functions. Thirdly, local governments must build its policy capacity to provide services to local citizens. Finally, the central government depends on local government for the successful implementation of national policy (Rondinelli & Cheema, 1983, p. 22). Administrative decentralisation can be understood as the pure form of deconcentration. That being the case, while the way of providing public services is nationally defined, sub-national authorities may have some functional discretion to the extent that national government is unable to monitor the sub-national performance. Although they may not have sufficient independent fiscal capacity to provide services, they have some functional discretion to meet locally specific needs that called devolution.

Administrative decentralisation is a necessary condition for sub-national governments to learn to translate policy objectives into practice and turn practice into desired outcomes. However, this is not sufficient to achieve the efficiency and social equity of decentralisation goals without subsequent fiscal decentralisation. The following section will discuss fiscal decentralisation.

### **1.3.2. Fiscal Decentralisation**

Fiscal decentralisation refers to a set of policies designed to increase the financial discretion or fiscal autonomy of sub-national governments. This is a linkage process that relates the national treasury to increased autonomy and capacity of local finance (Falleti, 2005). Degrees of fiscal decentralisation can be measured by the extent to which sub-national governments have discretion to make decisions related to local taxes/levies rising. According to Bahl (1999), if the items and rates of local taxes are decided by local authorities, they are more likely to reflect the financial capacity of local communities to pay and the local tax payers are more willing to meet the fiscal need. In relation to local public spending, local governments are responsible for allocating public resources equitably as well as efficiently (Zhang, 2006),

However, to ensure social equity, fiscal equalization is required across a wide range of sub-national governments. This equalization arrangement has the potential for undermining the fiscal discretion that decentralisation measures wish to increase. Here it is necessary to develop an appropriate arrangement for national transfer

payments to lower levels of government because it can assure adequate revenue for sub-national governments to provide more and better services to their residents. In general the forms of intergovernmental fiscal transfer include general purpose transfers and specific purpose transfers. General transfer payments carry fewer national requirements than specific transfer payments. General or block payments, thus allows localities greater discretion to advance local autonomy.

The aims of the fiscal transfer are to bridge the vertical fiscal gaps, improve horizontal fiscal balance and fund national priorities. This provides the potential for re-centralization to the extent that national transfer payments place sub-national authorities in a position to simply implement national policy.

In relation to vertical gaps, transfer payments from the central government to sub-national governments will reduce the financial capacity of the central government, but they can also increase the financial capacity of sub-national governments. Transfer payments can also reduce horizontal gaps between rich and poor regions because regions with little fiscal capacity to meet their fiscal need may receive transfer payments from the central government. Nonetheless, the central government can transfer national funds with strings attached as it directs sub-national governments to develop a certain sector for national priorities. In this study, the district governments of Bantul and Gianyar received transfer payments from the central government in the form of a DAU fund (general grants), a DAK fund (specific grants), and shares of tax revenue and natural resources from the national government, as it will be discussed in Chapters 2 and 3.

As highlighted by Bird and Vaillancourt (2008, p. 3) fiscal decentralisation can improve efficiency in the use of public resources because well-informed decisions about public expenditure can be taken by a local government to meet locally specific needs. But attention needs to be directed to the consequences of fiscal decentralisation that different sub-national governments can differ over how much to raise their funds and how to spend their revenue. As a result, there will be competition among regions in providing the better tax-to-service ratio. Without a national transfer to sub-national governments, fiscal decentralisation promotes

competition among sub-national governments for limiting taxing power and maximizing their service delivery (Tiebout, 1956).

Therefore, fiscal decentralisation in terms of devolution can improve the efficiency and quality of public services. On the other hand, fiscal decentralisation can also increase fiscal gaps among regions and thus undermine social equity. However, competition among regions, as suggested by Tiebout, is less likely to occur in Indonesia because local tax items and local tax rates are nationally defined and standardized<sup>9</sup> except for local levy rates which are fixed locally by sub-national governments.

There are certain pre-conditions for local governments to implement successful fiscal decentralisation. Bahl (1999, p. 61) cites several. First, there need to be elected local legislators so that citizens can express their preferences through elections and hold legislators accountable. Secondly, local governments must have some significant taxing power, so that local governments can set tax rates and adjust both the level of the budget and the cost of services. Thirdly, local governments must have a significant degree of autonomy in determining service levels. To this end, local governments must have freedom to choose how they allocate their revenue resources among competing expenditure demands. Fourthly, local governments must have the administrative capacity to collect those revenue sources that are assigned to it. In the case of Indonesia, district governments have not yet been given their legal authority to create a new local tax beyond that stipulated in Law No. 34/2000.

Administrative and political decentralisation is more likely to be implemented effectively to achieve the goals of efficiency and equity if local governments have sufficient financial capacity. Both administrative decentralisation and political decentralisation are interrelated with fiscal decentralisation. With this in mind, I will discuss political decentralisation with the aim to look at the relation of increased citizen participation to social equity. Political decentralisation provides opportunities for local citizens to elect district head and local legislature members as well to

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<sup>9</sup> Based on Law No.34/2000 on local taxes and Levies (Pemerintah-Indonesia, 2000b), the central government enacted types of local taxes and levies whereas *Peraturan Pemerintah* (Government Policy) No. 66/2001 on of local levies regulated detailed type of local levies. The local government has discretion to enact local levies, but not local taxes.

participate in the process of decision making. Through political decentralisation local citizens can articulate their needs and policy makers can make decisions in accordance with the those needs.

### **1.3.3. Political decentralisation**

Political decentralisation refers to the distribution of political power between central governments and sub-national governments (Fesler, 1965; Gonzalez, 2008; Smith, 1985). Smith (1985, p. 1) says: “it is concerned with the extent to which power and authority are dispersed through the geographical hierarchy of the state and the institutions”. This is related to efforts of the national government to increase the power and responsibility of sub-national government and reduces the power and responsibility of the central government. According to Falleti (2005, p. 329), political decentralisation policies are designed to devolve political authority or electoral capacity to sub-national governments. This aims to give citizens and their elected representatives more power in the formulation and implementation of public policy. It is associated with democratization as well as representative government because political decentralisation allows local citizens to directly elect district leaders and local parliament members who know better the needs and preferences of their local constituencies.

Political decentralisation does not only provide political rights for local citizens to elect their local chief executives and local parliament members but also opportunities to participate in local decision-making process (Hentic & Bernier, 1999; Hutchcroft, 2001). When local citizens have authority to make decision, this is devolution. According to Bernier and Hentic (1999, p. 197), public participation can help to develop the autonomy of communities by encouraging people to become more creative and more productive in public affairs and thus increases political accountability. Political accountability refers to specific conditions within the political system which enables citizens to have the ability to demand answers from agents within the public sector (Eckard, 2008, p. 5). Since 2005, citizens in Indonesia have had the right to directly elect a district government head. This holds the district government head to be more responsive and accountable to local needs.

In general, a transfer of political power from a central government to sub-national governments occurs in a democratic regime. In a democratic regime, decentralisation policy is often a result of pressure from democratically elected sub-national officials. However, political decentralisation also occurs in a transition of democracy (Gonzalez, 2008; Hadiz, 2004a). For instance, in the case of Latin American countries, their transition from authoritarian regimes to democratic regimes was accompanied with political decentralisation. This is because the transitional period of democracy created popular pressure from civil society on the central government to decentralize political power to sub-national governments. In a similar way, Indonesia's political decentralisation took place during a democratic transition, following the fall of Soeharto's authoritarian regime in 1998. Under this democratic transition, there were public demands to decentralize political power to local governments. As a result, the central government stipulated Law No. 22/1999 to decentralize power to sub-national governments.

In order for political decentralisation to fully contribute to democratization, including ensuring social equity, it must be followed by the expansion of functional and fiscal discretion at the local level. Without independent resources and functions, political autonomy cannot meet locally specific needs. The three kinds of decentralisations - administrative, fiscal and political decentralisation - are thus to be implemented simultaneously for democracy-building. However, the experiences of development in many countries indicate that national government officials tend to have a lack of political commitment to introduce those three kinds of decentralisation simultaneously, because they fear losing their power (Bunte, 2009; Olowu, 1989; Rondinelli & Cheema, 1983). In Indonesia, the central government has transferred political power and administrative functions to sub-national governments, but an influential part of fiscal authority was still in the hands of the national government (Bunte, 2009, p. 108). As a result, sub-national governments face a financial constraint in implementing their functions, although sub-national authorities are now publicly elected to represent their local interest. In the next section I will examine the potential impact of those three types of decentralisation on small business.

## **1.4. Implementation of Administrative Decentralisation**

Administrative decentralisation can be understood as a transfer of functions from the central government to sub-national governments. As a result, the responsibility of local administration will increase and subsequently requires local capacity-building to carry out the increased functions. This section will examine how the increased functions and responsibility affect the interests of small business from the viewpoint of administrative efficiency and social equity.

### **1.4.1. Increased Local Functions**

In Indonesia, most public services are delegated by the national government to district governments, except for policy areas such as monetary and fiscal, securities affairs, foreign policies, justice, religious affairs and other strategic and national policies. Small business was one of the policy areas delegated by the central government to the district government in 2001. The district government is now in a position to play a primary role in promoting and regulating the practices of small business.

Administrative decentralisation enables local governments to make policies in accordance with the needs of the local community to the extent that the national government delegates not only functions, but also decision-making power, to local governments. This is because local policy makers are well informed about local community affairs and easily able to identify the needs of local communities (Smith, 1985, p. 5). Equally important, administrative decentralisation helps to reduce red-tape and overcome the adversities of highly bureaucratic procedures (Cheema & Rondinelli, 1983; Takao, 1999) because tasks are controlled directly by local governments without going through different layers of government management.

What kind of functions/tasks can be delegated by the central government to local government? Generally, the central government has three exclusive roles in the public sector: macroeconomic stabilization policies, redistribution of income and allocation of resources (Musgrave & Murgave, 1989; Oats, 1972, 1999). Economic stabilization is aimed to improve the overall economy through fiscal and monetary policy. To attain stability functions, the government has responsibility for promoting full employment, price stability, economic growth and a stable balance of payments

(Hughes, 1998, p. 86). Income redistribution is intended to reduce the degree of inequalities in wealth and income among citizens. The major part of redistribution is the provision of social welfare, including transfer payments to the poor and disadvantaged (Hughes, 1998, p. 86). Resource allocation is related to the provision of public goods: what services, how much, and in what ways they should be provided publicly (Finot, 2002, p. 135).

In general, under administrative decentralisation, macroeconomic stabilization and income redistribution are in the hands of the central government whereas resource allocation (or service delivery) can be given to sub-national governments. In this context, local governments are expected to increase administrative efficiency to allocate public resources to local residents and organisations, including small businesses, yet they are not in a strategic position to redistribute income thus promoting social equity. To meet the need of administrative efficiency, local governments should provide local residents with proper kinds and amounts of public services without unnecessary spending or waste. In the policy area of small business, Indonesia's district governments provide access to a number of credit schemes funded by state agencies and private banks, issue business permits, impose taxes and local levies, and offer job training. The key issue is whether a range of those incentives and regulations will correct the disadvantages of small business in markets or rather impose constraints on small business' competitiveness. District governments are expected not to over protect the special interest of small business (which tends to cause small business' dependence on government help) but to help small business without undermining its entrepreneurship.

The kinds and amount of governmental functions delegated by the national government to sub-national governments are different across countries because they are influenced by many variables such as national government's interest, fiscal capacity of local governments, complexity tasks and others. Given a governmental function, sub-national governments are to adapt the sub-national administration to this administrative decentralisation.

In a region where there are many small businesses such as Bantul and Gianyar, the district government immediately needs to reform local government agencies and

implement regulation measures related to small businesses with the aim to help inefficient and marginal firms. In Indonesia the adaptation to administrative decentralisation has been performed primarily through two ways: first, the district governments establish a local government agency given a specific job to promote small businesses, and second, they impose regulations on small business by integrating variety types of business permits in markets.

The increased tasks for district governments can cause an increased responsibility for local bureaucracy. The capacities of local administration need to be enhanced in order to successfully implement its tasks. The next section will discuss this increased responsibility of local bureaucracy. This section will argue that local bureaucracies need to be reformed so they are able to provide better public services in terms of responsiveness to small businesses. Administrative decentralisation can cause local governments to have more complicated jobs and additional functions. Thus, the local governments need to improve the skills of local bureaucrats to implement those jobs and functions.

#### **1.4.2. Capacity Building of Local Bureaucracy**

The responsibilities of local bureaucrats increase as a result of tasks/functions delegated by the central government to sub-national governments. The sub-national governments have more responsibility to provide public services for local communities. To fulfil the increased responsibilities, local administration requires sufficient financial, jurisdiction and staff resources while functioning under strong chief executive's leadership. Perhaps, one of the most important yet often neglected requirements for successful fulfilment of those responsibilities is the capacity of local administration: information, expertise and policy innovation in a range of policy areas. Poor capacity of local bureaucrats could become a constraint in implementing the decentralisation policy. Indeed, implementation of decentralisation in developing countries often faces problems because the transfer of responsibility is accompanied by a lack of administrative preparation at the local level (Hentic & Bernier, 1999, p. 202).

In dealing with the issues of the under-developed capacity of local bureaucracy, Mardiasmo, Barnes, & Sakurai (2008, p. 17), observe that human resources capacity



is one of the strongest impediment variables of regional government in implementing decentralisation policy measures. Based on research findings in six districts of Indonesia, Kristiansen (2008, p. 82) concluded that during the decentralisation era, local public bureaucracy had poor capacity to understand the particulars of budgeting techniques and detailed data and thus, there was a lack of financial transparency in managing public finance. Brojonegoro & Assanuma (2000, p. 120) argue further that many local governments were not ready for fulfilling their responsibilities in an autonomous way in terms of planning, programming and executing development projects. As a result, the performance of local bureaucracy is far below public expectation. The capacity of local bureaucracy needs to be improved via organisational learning and capacity-building.

The Government Regulation No. 101/2000 stipulates three kinds of capacity-building for civil servants: leadership, functional and technical training. The leadership training is mandatory for civil servants holding structural positions. The functional training is designed to improve the performance of administrative service delivery, whereas technical training is aimed to improve the general technical skills, such as computer literacy (Turner, Imbanuddin, & Sutiyono, 2009, p. 240). Despite such a capacity-building mechanism, Asian Development Bank or ADB (2004) found that the content of the leadership training program was too general and excessively formal to improve performance and leadership capability. In other words, the training programs were yet to be improved to increase the capacity of civil servants.

It is important to note that there are indications of conscious efforts to improve the capability of public servants by providing training and education. For instance, the province of North Sumatra, which was supported by JICA (Japan International Cooperation Agency Research Institute), provided a series of training sessions in good governance for its district civil servants during 2004-2005. Also, there are some efforts to use a strict merit system and a proper test in selecting key senior district officials. In many district governments, a master degree qualification is required to fulfil the position of a local agency head.

Improving the education credentials of public servants is needed because higher educational qualifications are more likely to improve the capacity of local administration. Beyond a higher degree of education, change in behaviour of public servants or a commitment of public servants to capacity-building is necessary in order to provide better public services for local citizens. However, Dwiyanto (2002, 2003) found that there were no significant positive changes in local bureaucracies' attitudes toward performance improvement in the early implementation of decentralisation in Indonesia. This study was conducted in 2002, one year after implementing decentralisation, in 150 districts of 20 provinces. The low capacity of local bureaucrats caused poor performance and thus produced low quality of public services.

### **1.5. Implementation of Fiscal Decentralisation**

Fiscal decentralisation has a potential to increase local governments' revenue because decentralised fiscal measures could allow sub-national authorities to set up their own local taxes and tax rates. Moreover, it may improve efficiency and equitability in the use of public resources because decisions about public expenditure are made by a local government which is close to its constituents and accountable for local needs. Therefore, it is necessary to discuss the implementation of fiscal decentralisation for district governments' revenue raising.

#### **1.5.1. District Government Revenue Raising**

In general, there are two types of revenue sources of district governments': the first is revenue from local taxes, local levies and borrowing; the second is transfer payment from higher levels of government (Takao, 1999, p. 14). In Indonesia, income from local taxes is one of components of the locally derived revenue (the PAD income).<sup>10</sup> The PAD income varies across regions because of differences of size of areas and natural resources. For instance, in 2010 the PAD income of the Trenggalek district in the Province of East Java was only 6.8 percent of the total district government income. In Bantul, the PAD income was 10.3 percent of the total district government's revenue in 2010, whereas in Gianyar, the PAD income was 13.26 percent in 2009. For the Indonesian case, in 87 percent of local governments

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<sup>10</sup> The PAD income consists of local tax income, local levy income, income from local government owned enterprises and other legal revenue income.

nationwide, the PAD only amounted less than 10 percent of their total budget. The PAD contributed more than 50 percent of the total local budget for only 0.3 percent of local governments (Brojonegoro, 2004, p. 136).

In other countries, local tax income is often the main source of the local government's revenue. For instance, in 1997 Denmark's local taxes accounted for 51 percent of the total district government's income whereas Sweden's represents sixty one percent (Bailey, 1999, p. 87). However, in Indonesia, income from local taxes account for small part of district government's income. In 2010, Bantul's local taxes income accounted for 1.9 percent of the total district government income, whereas its local levies contributed 6.4 percent to the district government income.

Incomes from local taxes consist of various types of tax. The question is: what types of local tax provide the largest contribution? The types of local taxes which provide the most contributions are different across countries. In France and Britain, for instance, a large part of local taxes income derives from levies on the value of private land. In France, property tax as a percentage of local tax revenue was 45 percent in 1984. In Japan and Sweden, the main source of local tax revenue is individual and corporate taxable income. In Japan, income tax as a percentage of local tax income was 66.8 percent in 1984 and in Sweden the percentage was 93.3 percent in 1984 (Takao, 1999, p. 14 & p. 41). In Gianyar, local tax on Hotel and restaurant account for the most part of total local tax income in 2009. This means that the financial capacity of Gianyar was supported by the service sector (hotel and restaurants), not the agricultural sector.

Fiscal decentralisation could provide sub-national governments with more discretion in determining types of tax and tax rates. However, this generally occurs in federal states. In a unitary system, such as in Indonesia, the central government normally decides types of tax and tax rates for lower levels of government. The central government provides limited fiscal power to local governments. As a result, local governments have less opportunity to increase the scope of financial discretion for local decision making.

The central government provides transfer payments to the district governments to equalize the quality of local services across the nation. By transferring payments, the central government performs redistribution functions as stated by (Oats, 1972, 1999) and (Musgrave & Musgrave, 1989) with the goal to reduce the degree of inequalities in wealth and income between citizens and regions.

The transfer payment to sub-national governments can be categorized in two basic forms: general purpose transfers or grants and special purpose transfers or grants (Krelove, Stotsky, & Verhorn, 1997, p. 214). Bailey (1999, p. 181) and Smith (1985, p. 104) use the terms of general grants and specific grants respectively. General grants are intended to provide sub-national governments with some financial discretionary power by not specifying how to use the funds. Specific grants come with strings attached by specifying how to spend the funds. General grants can be used to finance the broad range of services provided by local government, whereas specific grants are paid in respect to specific services and can only be spent on those services. Local governments that received specific grants must normally prepare matching funds in certain percentages. The total budgets of general grants are usually greater than specific grants. For instance, in the case of Indonesia in 2008, the general grant was 179.5 quintillion rupiah and the specific grant was 21.2 quintillion rupiah. Then in 2009 the general grant increased to 186.4 quintillion rupiah and the specific grant became 24.8 quintillion rupiah. Because the general grant was higher than the specific grant amounts, the sub-national government had discretionary policy to spend it. In 2010 the general grant was 195.8 quintillion rupiah and specific grant was only 20.5 quintillion rupiah. In 1997, in 13 European countries, general grants accounted for at least quarter of municipal revenues (Bailey, 1999, p. 183).

Starting in 2001 under 25/1999, the central government provided shares of revenue derived from the exploitation of local government's natural resources income to sub-national governments: 15 percent of oil revenue income, 30 percent of natural gas revenue and 40 percent of reforestation fees compared with zero previously. Then in 2005 there were small changes amounting to 15.5 percent of oil revenue, 30.5 percent of natural gas revenue and 40 percent of reforestation fee which were distributed to sub-national governments. The local governments also received shares

of revenue from geothermal mining revenue, 32 percent with zero previously (Law 32/2004).

The Revenue Sharing Fund<sup>11</sup> received by among regions was also different because of difference of natural resources among regions. Basically, this fund is general fund because the sub-national government has discretionary policy to spend it. Local governments with rich natural resources and a large area, therefore, will have a large transfer payment. For instance, the municipality of Bontang in the Province of East Kalimantan obtained a share of revenue from the natural resources and tax income of seventy seven percent of total municipality government income in 2009.<sup>12</sup> In contrast, local governments with poor resources and small areas, like Bantul and Gianyar, only received small revenue sharing funds from the central government. The revenue sharing funds will be discussed in Chapter 2 and 3.

It is most common that transfer payments in the form of grants are also used as effective tools of control over local finance. A large scale of national transfer payments could cause financial dependency for sub-national governments. As a result, local chief executives are less responsive to their constituents (Takao, 1999, p. 15). In my opinion, if the transfer payment is more than 50 percent of sub-national governments' budget, it may create financial dependency for sub-national government to the central government. In contrast, if most parts of the sub-national governments revenues derive from local tax incomes, local chief executives will become more responsive and accountable to local communities. In Indonesia, almost all district governments depend on transfer payments from the central government in the form of a general and special grants and a share of revenue from natural resources and tax income. As a result, district governments may have difficulty in implementing decentralised functions without the central government grants. In addition, decentralisation may cause a financial capacity gap between region with rich natural resources and regions with poor natural resources. Regions with rich natural resources can obtain larger grants in the form of shares of revenue from natural resources than those of poor regions.

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<sup>11</sup> Revenue Sharing Funds sourced from tax income and natural resource income.

<sup>12</sup> *Perda Kota Bontang No. 3/2009* concerning of APBD 2009 (Pemerintah-Kota-Bontang, 2009).

### 1.5. 2. District Government's Discretionary Spending

Fiscal decentralisation enables sub-national governments to have more discretion in adjusting local budgets to local preferences and can better distribute local public services for local citizens (Bahl, 1999, p. 4). Fiscal discretion provides local governments with freedom in selecting programs that will be financed. These selected programs are more likely to be in accordance with the needs of local people and promote locally specific economic growth. As mentioned in the previous section, if sub-national governments are able to provide better public services and minimize local taxes, businessmen from other regions will come to the region to operate their businesses and promote economic growth as stated by Tiebout (1956). However, it is still debatable whether Tiebout's theory can be applied to non-federal states.<sup>13</sup> Equalization payments are cash payments made even in some federal systems of government, from the federal government to sub-national governments with the objective of offsetting differences in available revenue or in the cost of providing services. In this case, Tiebout's theory is also less relevant.

Does local fiscal discretion drive economic growth at a local level? There are two perspectives in the context of relationships between fiscal decentralisation and economic growth. The first perspective argues that fiscal decentralisation is likely to cause economic growth at the local level (Akai & Sakata, 2002; Iimi, 2005; J. Jin & Zou, 2005; Lin & Liu, 2000), while the second perspective states that the relationship between fiscal decentralisation and economic growth is negative (Davoodi & Zou, 1998; Im, 2010; Zhang & Zou, 1998).

Lin and Liu (2000, p. 2) claim that empirical evidence from the experience of development of China shows decentralisation can increase economic growth. Before 1980, the Chinese central government collected all revenues and prepared a consolidated budget for governments at all administrative levels. But in 1980, the central government enacted an arrangement of source of local government revenues. Under this arrangement, revenues were classified into central fixed revenues (including customs duties and revenues remitted by centrally owned state enterprises), local fixed revenues (including agricultural taxes, revenues remitted by

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<sup>13</sup>As discussed in section number of 1.3.2 in this chapter.

locally owned state enterprises and other taxes and levies of local nature), and central-local shared revenue (including profits of large-scale enterprises under dual leadership by the central and local government). As a result, this can increase economic growth at local level. The economic growth can be seen from growth rate of output per capita.

Moreover, Akai & Sakata (2002) found that in the United States, fiscal decentralisation contributed to economic growth because the local income elasticity allowed the provision of infrastructure as well as human capital that was formulated by local government to be more sensitive to local needs and more effective in encouraging economic development than centralized policies that ignored geographical differences and local resources. Jin, Qian & Weingast (2005) found that decentralisation is not only good for economic growth but also for social equity based on data 1982-1992 in China. This research indicates that fiscal decentralisation allows sub-national governments to support local businesses, especially non-state enterprises. As a result, local economic growth increased. Based on studies of 51 countries - 7 low income countries, 10 lower-middle income countries, 12 upper-middle countries, and 22 high income countries – used with data for the period from 1997 to 2001, Iimi (2005) found that fiscal decentralisation had a significant positive impact on per capita GDP growth.

On the contrary, other studies found that fiscal decentralisation had a negative relationship on economic growth. For instance, Davoodi and Zou (1998), using data for 46 developing and developed countries during the 1970-1989 period, found that the relationship between fiscal decentralisation and economic growth was negative in developing countries, but null in developed countries. Fiscal decentralisation is defined as the spending by sub-national governments as a fraction of total government spending. Fiscal decentralisation increased if spending by state and local governments rises relative to spending by the federal government. There are two reasons why the aforementioned relationship was negative: firstly, it did not distinguish between current spending (wage and salaries) and capital spending; nor did it distinguish spending on welfare and social security from infrastructure spending. Excessive spending by sub-national government on the wrong expenditure items can lead to lower growth. Secondly, lower growth can result from the wrong

revenue assignment. Sub-national government might have been raising revenue using a tax instrument which should have been used by the central government (Davoodi & Zou, 1998, p. 254).

Based on his study in 63 countries<sup>14</sup>, Im (2010:518) found that there was no significant relationship between fiscal decentralisation and GDP growth in 17 developed countries whose GDP per capita was over 30,000 US dollars. In his study of 15 semi-developed countries, the relationship between fiscal decentralisation and GDP growth was negative. In the remaining 31 developing countries, there was no significant relationship between fiscal decentralisation and GDP growth. Thus, fiscal decentralisation could not be considered a formula for GDP growth for all countries.

Zhang & Zou (1998) also found that a higher degree of fiscal decentralisation was associated with lower regional growth in China. Based on annual data on 28 provinces in China during period 1986-1992, the coefficient of fiscal decentralisation, which is measured by the rate of per capita provincial budgetary spending to per capita central budgetary spending was negative. This means that an increase in subnational government level expenditure caused a decline in the real growth rate of regional income.

Beyond efficiency and economic growth, fiscal decentralisation is seen as a means to promote equitable distribution of goods and services with the aim to meet social equity and welfare (Lindaman & Thurmaier, 2002; Oats, 1972). By increasing local expenditure, local governments can increase the physical infrastructures and financial assistance for promoting business sector.

Given the mixed results of the findings on the impact of decentralisation on development, some scholars suggest that the important issue is how to arrange the central and local government relationship to stimulate economic development at local level (Marijan, 2006, p. 31). Although sub-national governments applied decentralisation policy, the central government still provides transfer payment to

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<sup>14</sup> The 63 countries are categorized into three groups. Countries whose GDP per capita is less than 10,000 US dollar are categorized as developing countries. Countries which have a GDP per capita between 10,000 US dollars and 30,000 US dollars are classified as semi-developed countries; and more than 30,000 US dollar as developed countries.



sub-national government with the aim to meet social equity, welfare as well as promote local small businesses. Without transfer payments from the central government, there may be a financial capacity gap among poor and rich regions.

My study will not simply focus on the relationship between decentralisation and economic growth, but more specifically examine the relationship between fiscal decentralisation and small businesses productivity/competitiveness. In relation to district government's spending I will examine the extent to which the district government allocates district government budgets to help small businesses by providing financial and training assistance as well as physical infrastructures. In general, small businesses lack financial capacity, use traditional technology in the process of production and have limited skills in managing their business. Financial assistance may increase capital and upgrade of technology, whereas training programs may improve skill and management for small businesses. Physical infrastructures such as roads, market buildings and Automatic Teller Machines (ATM) may also facilitate their operations.

### **1.6. Implementation of Political Decentralisation**

Political decentralisation is expected to contribute decisively to popular participation (Agrawal & Gupta, 2005; Agrawal & Ostrom, 2001; Crook & Mannor, 1998; Finot, 2002; Lindaman & Thurmaier, 2002; O' Nell, 2003) and to provide more access for political party members to be elected in public officials (O' Nell, 2003; Sabatini, 2003) at the sub-national level. This section will discuss the implications of political decentralisation for localities in three affected areas: political participation, responsiveness and accountability, and party politics. Firstly, let us look at its implication on political participation by local communities. The degree of participatory autonomy can be measured by how the chief executives and representative bodies are selected at the sub-national level. In Indonesia, all local chief executives and all local council members are publicly elected. The local residents thus directly participate in the choice of their local representatives. Secondly, increased popular participation in the decision-making process can increase acceptability and responsiveness of elected local officials to the public. A direct public election increases residents' ability to determine the scale and scope of local services. Thirdly, political decentralisation tends to cause partisan politicization

of local government services and thus serves to clarify the different points of local policy at issue. Due to more resources at the local authorities' disposal, political decentralisation can cause political parties to increasingly engage in a struggle over the increased resources at the local level.

### **1.6.1. Participation of Local Communities**

Decentralisation has emerged as a major strategy for many nation states to achieve development goals, improve the quality of public services and increase public participation (Agrawal & Gupta, 2005; Agrawal & Ostrom, 2001; Carrel, 1969; Crook & Mannor, 1998; Hentic & Bernier, 1999; Lindaman & Thurmaier, 2002). Some empirical studies confirm this to be the case, Crook and Mannor (1998, p. 271), for instance, investigated the impact of decentralisation on public participation in two Asian and two African countries. They found that in all the four countries – India, Bangladesh, Cote d'Ivoire, and Ghana – the popular participation, both direct (electoral) and indirect (non-electoral) forms, increased. Although there was some variation across the cases, the overall rating of participation experienced a rise in all cases. Agrawal and Ostrom (2001) studied two cases of forest management in India and two cases in Nepal, concluding that the decentralisation policy caused increased participation of community Forestry in India and Nepal. Local groups actively have to pursue opportunities opened up by decentralised reforms.

It is important to note that there are different types of public participation. Huntington & Nelson (1976, p. 12) distinguished political participation as follows:

- (1) electoral activities, voting, campaign contributions, working in election, and proselytizing on behalf of candidate;
- (2) lobbying that includes individual or group efforts to contact governmental officials and political leaders with a view to influence their decision;
- (3) organizing activity that involves participation as a member or officer in an organisation that has as its primary and explicit goal of influencing government decision making;
- (4) contacting that is an individual action directed to government officials and normally designed to produce benefits for small number of people; and
- (5) violence that influences governmental decision making by doing physical damage to a person or property.

Decentralisation can enhance the opportunities local people have to participate in the local decision-making process. Involving more people in the process of decision-making can lead to more people benefitting from the outcome (Lindaman & Thurmaier, 2002, p. 931). Local people can articulate their preferences when they participate in the decision-making process. As a result, this can improve the quality of local policy and improve the allocation of services toward equitable distribution services and goods. Participation can also avoid an authoritarian system in the decision-making process and increase accountability. In term of politics, participation can be defined as activity by private citizens designed to influence governmental decision making (Hutington & Nelson, 1976, p. 4).

By participating, on the one hand, local communities have more opportunities to influence the content of decisions in accordance with their preferences. On the other hand, local officials can catch a wide range of interests within a civil society (those of cultural, economic, social and political groups, and those of business people, trade unions, community groups and the media) (Hentic & Bernier, 1999, p. 204). Thereby, it enables a compromise between the ideas from local people and ideas from local officials in formulating a policy. By participating, citizens can communicate and discuss certain issues - political, business-related, social, and environmental - which will enhance a better understanding of the issues. Participation also leads to greater articulation about political choices (Ikeda, Kobayashi, & Hoshimoto, 2008).

Local governments should provide institutional mechanisms that enable local people to participate in the process of governance as well as a framework for allowing the community's interests to be represented in government decision-making structures (Hentic & Bernier, 1999). The institutional mechanism and framework that enables people to participate could be different across regions. The participation of local communities can be done through local parliament, political parties, meeting with local officials at districts, sub-districts and village levels.

To enable participation in the process of decision making, local citizens must be informed regarding public issues, so that they are able to provide input in the process of decision making. In Japan, for instance, since 1980 the local authorities have

guaranteed local citizens the right to information in the form of local government ordinances (Takao, 1998, p. 954). In the Indonesian case, since 2008 citizens have had the right to obtain public information regarding the process of policy making and the government programs with the aim to increase public participation (Law No 14/2008).<sup>15</sup>

By opening access to public information, citizens can have information regarding certain issues, enabling them to criticize the process of decision making in order to provide input. It is believed that participation of local citizens in the process of decision making does not only increase the quality of decisions but also increases acceptability of the decision. However, in practice, it is not easy for one to obtain public information because of the low commitment of public officials. For instance, local bureaucrats in several district governments in Indonesia conceive that the annual official district government budget is a confidential document.<sup>16</sup> Therefore, the preparation of the district government budget, involves only the local elites (Dwiyanto, 2003, p. 130).

Although local communities articulate their preferences through the process of political decentralisation, the local officials may be not able to meet the needs of local communities because of limited fiscal capacity (insufficient fiscal decentralisation) and a lack of functional discretion in decision making (limited administrative decentralisation) (Takao, 1999). As a result, local officials may less responsive to local communities' needs and it could decrease the degree of local community's participation. In other words, increased participation of local communities will be meaningful if local governments have the fiscal and functional capacities to respond it.

### **1.6.2. Elected Local Officials**

In Indonesia, elected local officials consist of district heads and local legislators. Under the decentralisation system, district heads are popularly elected by local

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<sup>15</sup> Law No.14/2008 regarding Openness of Public Information (*Keterbukaan Informasi Publik*) which was enacted in April 2008, but started effectively in 2010 (Pemerintah-Indonesia, 2008).

<sup>16</sup> Some local bureaucrats and local legislators conceive that the district government budget is secret document. As a result, access for local citizens to obtain public information and to be involved in the process of decision making is intentionally limited.

citizens. On the contrary, under the old centralized policy, district heads were appointed by the national government or by elected local legislators. Some local legislators were also appointed by the national government. For instance, based on the Indonesian experience, under the Soeharto's authoritarian regime (1967-1998), a part of the national and local legislator members were appointed by the government.

When the central government devolves authority to local governments, the local legislators have more responsibility to make and implement policies than ever. Innovative policy making by local legislators is expected to meet their local need (Takao, 1998, p. 957). The direct elections also serve to make local legislators more accountable to local citizens (Sabatini, 2003, p. 139). This enables elected local legislators produce local policies and regulations in accordance with the preferences and needs of local citizens. To understand the preferences and needs of local citizens, local legislator members must communicate to local citizens and provide the opportunity for local citizens to present their needs and interests.

The direct elections also make elected district heads more accountable and responsive to local citizens' preferences. In addition, local citizens' direct participation in electing district heads and local legislators provide opportunities for local communities to become acquainted with the process of democratic building at the local level (Takao, 1999, p. 10).

The direct elections of mayors and regents are usually accompanied by the increased transfer of resources and responsibilities from the central government to local governments. The district governments have more complex tasks/functions as a result of decentralisation policy. Therefore, district heads need a high capacity to manage local public resources and implement complex tasks. The district head also must be able to respond to the local communities' preferences and needs, and then formulate these into local policies. Studies on leadership indicate that district leader needs to have the characteristics of political entrepreneurs who are political activists adept at accumulating a variety of political resources and using them to gain influence and additional resources (Pressman, 1972).

According to Pressman (1972, p. 512), the success of district government leader depends on: (1) the political structure of the district (electoral system, political parties). (2) Governmental structure (sufficient staff, financial resources). (3) Personality of the district head himself. Therefore, the three factors simultaneously contribute to the success of district government head.

In the case of Indonesia, for instance, the success of Syaekani as district head of Kutai Kartanegara in the Province of East Kalimantan was found to be influenced by three factors, namely possessing a strong personality of leadership, supported by a strong political party and supported by financial resources (Evaquarta, 2008). Firstly, in relation to a strong personality, beyond a district head, Syaekani was also the chairman of the Association of the District Government in Indonesia (APKASI) and the chairperson of the Eastern Kalimantan Golkar party as well as other various associations. Secondly, Syaekani was supported by *Golkar* party that occupied more than half of the local legislator membership. As a result, the district head's policies were supported by local parliament members. Thirdly, the district government of Kutai Kartanegara was one of richest district governments in Indonesia due to income from natural resources. Therefore, the district government was able to increase salaries for local public servants and deliver village funds as high as 2 billion rupiah per village every year via the *Gerbang Dayaku Program* in 2006. In other words, decentralisation measures are not sufficient to ensure the goals of decentralisation. Chief executives' leadership and entrepreneurship are also required.

However, the implementation of decentralisation in Kutai Kartanegara under Syaekani's regime was followed by corruption. Decentralisation can cause the district government to have much grant in form of share of revenue from natural resources. Then, Syaekani made policy that provided financial benefits for himself.<sup>17</sup> Local legislature members were also involved in case of corruption in Kutai Kartanegara.<sup>18</sup>

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<sup>17</sup> In 14 December 2007, the Corruption Court (*Pengadilan Tindak Pidana Korupsi*) punished Syaekani with 2 years in jail because of corruption amounting to 113 billion rupiah of district government funds.

<sup>18</sup> All local legislature members were suspected in corruption of as much as 2.6 billion rupiah (*Kompas* daily, 24 November 2010).

### **1.6.3. Party Politics**

The devolution of political power from the central government to sub-national governments has made local politics more competitive and political positions are more attractive (Ufen, 2009, p. 167). During the centralization era, local public resources were in the hand of the central government. Decentralisation policy means a transfer of resources from the central government to local governments (Sabatini, 2003, p. 139). As a result, local public resources are under control by local governments. Therefore, political parties will compete to pursue political positions in both executive and legislative office in order to control and obtain local resources. Political decentralisation does not only provide a greater opportunity for political parties to engage in local politics but also increases their participation in local decision making (Hutchcroft, 2001)). For local politicians, political decentralisation also provides political education because they can learn much about political affairs at a local level. In several countries, career paths for national politicians started from local levels as local politicians (Smith, 1985).

Political parties can effectively carry out these functions if they are well institutionalized and have strong roots in society (Ufen, 2009, p. 154). The institutionalization of a party is indicated by the stability of party and whether there is a sharing of similar values among party members and society. The party has roots in society when the party has links to civil society organisations.

The effectiveness of political parties under decentralisation measures depends on their intra-party structure. The centralized system of political parties can be measured by the degree to which the national political party leaders control party members at the local level (Smith, 1985, p. 89). If the system of political parties is centralized, the elites of local political parties may be less responsive to local communities' preferences because they are controlled from the headquarters of political parties. In contrast, if the political party system is decentralised, political parties may be braver to presents and articulate local communities' preferences. In turn, for example, they are able to represent the preferences and interests of small businesses at a local level with the aim to promote small businesses.

Furthermore, political devolution can also cause political parties to become closer to local citizens because party-affiliated district heads and local legislators are directly elected by local citizens. Thus, district head and local legislator candidates approach local citizens with the aim to obtain political support in elections. The important question is whether the implementation of political decentralisation in Indonesia can in fact cause a political party to become close to local citizens.

We can see that the political party system in Indonesia remains highly centralized, although political decentralisation was introduced since 2001. For instance, the national leaders of political parties have the authority to dismiss party leaders and control the nomination of party members at a local level (Malley, 2003, p. 105). The candidate for a district government head proposed by local political parties must also be approved by political party headquarters. As a result, the behaviour of political parties has not yet changed since the implementation of decentralisation (Legowo, 2003, p. 79). Implementation of political decentralisation in Indonesia caused political party to be involved in money politics. In the case of North Sumatra, for instance, PDI-P party charged potential candidates between 200 million and 300 million rupiah to be included in its official list of contestants for provincial legislature members and 400 million rupiah for national legislature members (Hadiz, 2004, 2004a).

Political parties are managed by a centralised system. Thus, political party elites at the district regions prefer to develop networks with political party elites at the national level rather than with the local community at the grassroots level. Local parliament candidates and district head candidates from political parties approach local communities by providing incentives such as money and material. Therefore, candidates for local parliament membership or district head positions need to generate funds to support themselves in the election. The candidates generally provide money to parties in order to be nominated as official candidates and provide money to local communities for buying votes.

In addition, in Gianyar, patrimonialistic political culture still prevails. The local parliament candidates and district head candidates develop networks with local traditional leaders (*tokoh adat*) to influence the constituency in electing local



parliament members and district heads. The traditional leaders play an important role in influencing behaviour of the constituencies in traditional political culture. For instance, in Bali local parliament candidates and district head candidates generally developed network with the heads of *Banjar* and heads of *Desa Pakraman* with the aim to obtain votes in election. Because there are no *Banjar* and *Desa Pakraman* in Yogyakarta, the candidates generally developed networks with heads of villages, heads of hamlets and social organisations at grass root level. The candidates thus expected to obtain many votes in elections because they believed that the heads of villages, heads of hamlets and heads of social organisations would be able to influence the local community's behaviour in elections.

In the discussion on Indonesian politics today, it is important to ask whether or not *politik aliran* (political and/or philosophical streams of thought) still exist. The concept of *politik aliran* was advanced by Geertz (1963) that is based on his research in a region in Java in 1950s. The *politik aliran* is often used in explaining political behaviour especially regarding results of elections in Indonesian. The political support from *santri* went to the right wing of NU and Masyumi party while the political support from *abangan* went to left wing of PNI and PKI party in 1955 election.

The New Order regime (1965-1998) under Suharto started to depoliticise society and set to erase *politik aliran*. The party official hierarchy only applies until the district level. There is no party official at sub-district and village level. The New Order government developed politic of floating mass at sub-district and village level. Nowadays, political parties are not rooted at the grass roots level. It is different from the 1950s, when political parties were deeply rooted at the grass root level. In addition, primordial loyalties are weaker now than in the 1950s due to socio-economic progress, the improvement of educational facilities, urbanization and the impact of the mass media. In the 1950's ethnic or religious affiliation largely determined partisan loyalties and voting behaviour, but the relationship nowadays is much more complex (Ufen, 2009, p. 13). The Islamic parties did not gain majority vote in 2009 election although the majority of the Indonesian population are Muslim. The total votes of the Islamic parties was only 24.15 percent consisting of the PPP party (5.32 per cent), PKS party (7.88 per cent), PAN party (6.01 per cent) and PKB

party (4.94 per cent) compared with the higher results of secular parties such as the Democratic party (20.85 per cent), PDI-P Party (14.03 per cent) and Golkar party (14.45 per cent). Therefore, I argue that presently politics of *aliran* does not exist in Indonesia.

According to Robison and Hadiz (2004, p. 258), politics in Indonesia today is driven increasingly by the logic of money politics. Candidates for local parliament and district heads need funds in order to be nominated in election. In addition, they need funds to support their campaigns during campaign election. The majority of candidates give money or material to their constituencies to influence political behaviour. The important question is how they generate funds. They can raise funds in two ways. Firstly, the candidates generally use their saving and sell their properties to generate funds. Secondly, the district head candidates not only use their savings but also gain donations from private entrepreneurs or big businessmen. Consequently, businessmen will be able to influence political decisions when the candidate is successful in holding power. For instance, in the province of Banten, a big businessman played an important role in provincial government, especially in terms of the economy (Hidayat, 2009, p. 135).

It could be concluded that presently the politics of *aliran* does not exist in Indonesia, and the relationship between politicians and constituency at the grass root level is determined by money politics. In addition, politicians usually used local organisations to influence political behaviour of constituency. Type of local organisations might be different for each region. Therefore, each region has specific local organisation which can influence local policy making. For instance, in Gianyar politicians use head of *Banjar* and *Desa Pakraman*, while in Bantul they use heads of hamlets and social organisations at grass root level.

In addition, the local elites of political parties have established networks with the national elites of political parties to gain political support in pursuing positions in local legislative and executive institutions. For instance, it is no secret that the candidate for a district government head has to develop a network with political party headquarters to obtain approval through providing money. Based on the discussion above, it can be concluded that the implementation of decentralisation can

be adopted simultaneously. However, the degree of decentralisation of each types of decentralisation may be different. The following section will discuss in detail the relationship between local government and small businesses.

### **1.7. The Potential Impact of Decentralisation on the Relationship between Local Government and Small Business**

In this section, the consequence of decentralisation will be put in the context of relationships between central and sub-national governments. The degree of decentralisation or centralization can be measured by the extent to which sub-national governments have discretion to make decisions. In relations to small businesses, the degree of decentralisation is related to the ability of district governments to regulate or promote small businesses at the local level. As discussed before, there are three types of decentralisation: administrative, fiscal and political decentralisation. Each type of decentralisation is linked to the capacity of district government to constrain or support small businesses development.

Administrative decentralisation can be understood as a transfer of functional responsibilities from the central government to sub-national governments. As a result, the responsibility of local bureaucracy increases and subsequently requires local capacity to carry out the increased functions. In relation to small businesses, as responsibility of local administration increases, local authorities have more administrative discretion to control small business activities by providing a range of public services, such as regulatory functions and promotion measures. As a result, small business may either enhance their productivity and competitiveness or receive restrictive rules and regulations.

In relation to fiscal decentralisation, the central government allows sub-national governments to set up their own local taxes/levies and tax/levy rates for small businesses. Local governments may create new local taxes/levies and increase taxes/levies rate with the aim to increase their revenue. Increased tax/levy rate may increase local governments' revenue, but also may increase financial burden on small businesses in paying taxes/levies or receive more material benefits and incentives than before. If increased local tax/levy causes financial burden on small

business owners, it can be called an exploitative relationship between local government and small business.

Increased local government revenue can be used to increase financial and technological assistances as well as infrastructure facilities for small businesses. As a result, it may increase capital and improve technology in the process of production for small businesses. Then, it can increase productivity and profits for small businesses. If local small businesses can receive potential benefit and incentive from local government, it can be called a supportive relationship between local government and small business.

In political terms, however, if local authorities are corrupted by clientelism, local government will have difficulty in providing financial and technological assistance as well as infrastructure facilities for small businesses. Subsequently, they may have difficulty in improving their productivity and competitiveness under fiscal decentralisation. This means, if local government revenues are corrupted by local bureaucrats, they are not supportive to small businesses.

If the central government delegates limited discretion in fiscal policy to sub-national governments, the local governments may have their limited capacity to raise their tax revenue. As a result, they cannot provide adequate financial and technological assistances as well as infrastructure facility for small businesses. To overcome the weakness of local fiscal, the central government normally provides local authorities with general and specific grants for them.

Political decentralisation is expected to provide small businesses with access to participate in the allocation of resources at the local level. Subsequently, the decisions regarding resource allocation can be made in accordance with the needs and preferences of small businesses. Political decentralisation also creates political opportunities for small businesses to elect their preferred local officials. As a result local officials may be responsive and accountable to the needs of small businesses. However, small businesses must be well informed about the political process of local communities and local affairs. They may not participate in the process of local decision making if local governments do not provide public information regarding the process of policy making.

Based on discussion above, decentralisation policy may not automatically increase public services or provide favourable material benefits for small businesses. Local authorities have more functional responsibilities and administrative discretion; however, the increased local tasks need to be supported by the increased fiscal capacity and discretion. If they have no sufficient funds to meet the fiscal need, the central government will have to provide grants/transfer payments for them. Increased public services, financial and technological assistances as well as improved infrastructure facilities may accordingly support small businesses in improving their productivity as well as increasing their benefit. As a result, prosperous small business may contribute to local government revenue by paying more taxes and levies. The success of small businesses may further encourage them to become politically involved in the process of decision making at the local level. Thus, in the context of decentralisation, there is a possible relationship between local government and small businesses.

There are two different views in assessing at the relationships between local government and the growth of small business. Some scholars argue that local governments play an important role in promoting small businesses called supportive relationships (Best, 1990; Brusco, 1992; Brusco & Righi, 1989; Trigilia, 1986; Wilson, 1995). Support for small businesses is generally based on three reasons. Firstly, there are benefits for the country as a whole from having a strong small business sector because the sector creates a large proportion of employment in most countries. Secondly, a strong small business sector will not emerge without support from the state because of failures to provide fair market places to this sector, in relation to big business' competitiveness. This sector suffers disadvantages in the markets because of their size of businesses. Thirdly, programs aimed at supporting a small business sector have been justified more in terms of their welfare impact than economic efficiency because support for this sector is seen as a way to help the poor (Humphrey & Schmitz, 1996, p. 1859).

Other scholars, such as Schmitz and Musyck (1994), Humphrey and Schmitz (1996) and Rabelotti (1995), argue that the role of local governments in supporting small businesses is less important. For instance, in the cases of European industrial

districts such as those in Italy, Southern German, Denmark and Belgium, the emergence of the industrial districts did not result from the government's strategy. The district government generally does not play any important role in the early phase of growth of industrial districts, but takes a role in the later stage of growth of industrial districts (Humphrey & Schmitz, 1996; Schmitz & Musyck, 1994). Based on a case study in two clusters of footwear industries in Italy and two cluster enterprises in Mexico, Rabelotti (1995, p. 39) found that local governments did not play any active role in industrial policy at all. Based on those cases, the relationship is called by un-supportive relationship.

Based on the case study in Italy, local trade unions and small firms employers' organisation had a potential power to bargain with local policy maker in order to have policy in accordance with the interests of small businesses (Pyke, 1992, p. 29). In another case in Thailand, business associations had power to bargain in reducing a variety of transaction costs for small businesses (Brimble, Oldfield, & Monsakul, 2002, p. 226). It indicates that business associations can have power to bargain with policy makers to make policy in accordance with the interests of small businesses. In this context, it is called a bargaining relationship between district government and small businesses.

The role of district government in promoting small businesses has been much discussed by many scholars. According to Trigilia (1986) and Wilson (1995), as a result of decentralisation policy, the district government has two roles in promoting small businesses: the role associated with regulator to small businesses such as business license regulation and protection regulation; and the role dealing with promotion to small businesses such as financial, training and technological assistance as well as infrastructure facilities.

In practice, the extent to which local governments provide public services for small businesses may be different from each other. In Modena, Italy, for instance, local government supports small businesses through three kinds of intervention: policy of land use and construction, financial assistance and creation of "real service centre", which is directed to supply information, technology and market (Brusco & Righi, 1989). According to Brusco (1992, p. 187), "The provision of real services involves

supplying companies, in return for payment, with those goods or services that they require instead of giving them the money that they need to go out and buy these goods or services on the market.” The provision of information regarding technical standard of products in various foreign countries and services regarding the test of products of small businesses are such cases in point.

In the case of the Canadian small business, local government promotes small business through the creation of broad networks with production companies, service firms as well as local institutions (Julien, 1992). Beyond the role of local government, social and political environment can affect local administration in developing small businesses. In some countries like Italy, German and Japan, as will be discussed below, political parties can influence industrial policy at the local level.

In relation to politics, political parties usually use small businesses to obtain votes in elections (Patterson, 1994, p. 430). On the other hand, small businesses can use political parties to support their interests (Schmitz & Musyck, 1994, p. 904). In Japan, a political party also played an important role in promoting small businesses. The Liberal Democratic Party (LDP) politicians politicized small businesses with the aim to electoral purpose (Patterson, 1994, p. 430). The electoral support obtained from small businesses may affect the amount of financial aid extended through government institutions to small businesses (Patterson, 1994, p. 442). In other words, the government’s policy on small business was driven by politicians’ interest to obtain votes in elections. In another case in Baden-Wurttemberg, German, the local government is led by the Christian Democrat party that took the lead in shaking off simplistic neo-liberal prescriptions about industrial policy (Schmitz & Musyck, 1994, p. 904).

Small business development in Italy in the decade of 1980s was a result of the process of adjustment of economic and social tension. Political parties and interest groups in Italy played an important role in the process (Trigilia, 1986). In responding the development of capitalism and the creation of the nation-state at the end of nineteenth centuries, the parties established socialism and Catholicism in local areas. In the areas where socialist party was predominant, this process involved unions, labour organisations, friendly societies, cooperatives and communes, whereas in the

areas where Catholic party was predominant, it involved a network of rural savings and other banks, agricultural organisations, cooperatives and friendly societies (Trigilia, 1986, p. 165).

Does central government still play an important role in developing small businesses under decentralisation era? Based on development experience in many countries, central governments were still involved in promoting small businesses. In the case of small businesses in South Korea, for instance, the central government was quite influential to provide financial loans to small businesses. Even, under Chun Doo Hwan's authoritarian regime (1980-1988), the government gave small businesses better access to bank loans than large firms (Park, 2001, p. 851). Under the democratic regime, starting in 1997, the South Korean government was more focused on helping small businesses by increasing the total loans ceiling to US \$6.3 billion in 1998 from the US \$ 3 billion one year before (Gregory, 2002, p. 249).

In Japan, both central and local governments play a vital role in promoting small businesses. The central government was active in developing small businesses through developing financial institutions given tasks to distribute loans and providing technological and infrastructure assistance for small businesses (Park, 2001; Patterson, 1994). At the same time, local governments were actively involved in facilitating, physically housing and providing services for small businesses. For instance, a number of technical centres known as *kohsetushi*, are scattered across Japan for making technical assistance and management advice to many small businesses at local level (Aoyama, 2000, p. 55).

In Malaysia, the central government policy supported small business started in 1960s when the Malaysian government established the First Five Year National Development Plan (1966-1970). This national policy was restated under the New Economic Policy (NEP) in 1971 and reaffirmed in the following Five Year National Development Plan (M. A. Abdullah, 1999; Lim, 1986). The national government program offered to small businesses could be classified into six targets: financial and credit assistance, entrepreneur development, business management and human resources management, consultancy and marketing services, technical and vocational



programs, locational and infrastructural facilities and fiscal incentives (M. A. Abdullah, 2002, p. 196).

Based on experiences of development in Italy, Canada and Japan, the local government plays an important role in supporting small businesses by improving regulations and promoting financial, technological assistances as well as infrastructure facilities. On the other hand, other cases such as those in South Korea, Japan and Malaysia indicate that their central governments still heavily engage in supporting and promoting small businesses. The important question is: how the Indonesian government policy has developed in the area of small businesses?

Both the central and local governments in Indonesia play an important role in promoting small businesses. The Indonesian national government introduced three groups of policies to help small businesses: financial policy, technical assistance, and regulation (Hill, 2001, p. 250). Firstly, the financial assistance policy involved subsidized credits and a requirement that banks should allocate a certain percentage of their portfolio to small businesses. This policy reached a peak during the oil boom period 1973-1982. Secondly, technical assistance involving training schemes, industrial extension services, specialized vocational programs, and domestic and international marketing advisory services started in 1969. Thirdly, regulations referred to various policies intended to promote small businesses such as *program bapak angkat* (foster-parent program) where large businesses were supposed to sub-contract a part of work to small businesses, reservation schemes in which only firms of a certain size are permitted to produce some goods, preferential government procurement programs and regulation reform for business permits. This policy started in 1980s when the Indonesian government introduced regulation reform on business sector. However, in 2001 the Indonesian national government devolved small business development to the district governments as a result of decentralisation policy. Subsequently, the central government plays a less important role while the district governments assume a more responsibility in developing small businesses. As a result, the relationship between district governments and small businesses is expected to change significantly.

However, during the decentralisation era, many regions developed new taxes as instruments to increase district government income. They caused increased financial

burden and other harmful effects for business sector (Collongon, 2003; SMERU, 2002). By increasing taxes, it was hard to imagine that local businesses could flourish in local regions. This indicates that relation between district government and small business which is called an exploitative relationship.

Based on the discussion above, relationships between local government and small business can be analysed from three aspects. The first is a regulatory aspect. Regulations deal with the rules of business licensing, local policy on taxes/levies and protection policy (Trigilia, 1986; Wilson, 1995). Second is the promotional aspect that is associated with financial, training and technological assistance and infrastructure facilities (Brusco, 1992; Brusco & Righi, 1989; Julien, 1992). Third is a political influence with the aim to analyse the political influence of local authorities over small businesses and participation of small businesses in the process of decision making (Patterson, 1994; Schmitz & Musyck, 1994; Trigilia, 1986). Each aspect will be discussed from three types of relationship (Table 1.1).

Relationships between local government and small business can be examined from the three types of supportive relationship (Aoyama, 2000; Best, 1990; Brusco, 1992; Brusco & Righi, 1989; Trigilia, 1986; Wilson, 1995); bargaining relationship (Brimble et al., 2002; Patterson, 1994; Pyke, 1992) and exploitative relationship (Collongon, 2003; SMERU, 2002). Each aspect and type of relationship will be discussed in the next section.

### **1.7.1. Regulation for Small Businesses**

As discussed above regarding administrative decentralisation, decentralisation aims to reach efficiency in public services. In relation to efficiency of public services for small businesses, district governments need to carry out regulation reforms regarding business licenses, local levies and protection policies for small businesses.

Local regulations mean using laws made by local government to affect the business sector. Transparent and clear regulations can promote the business sector but complicated regulations can hinder the progress of this sector. Local regulations involve allowing or prohibiting activities in the business sector through the legal

system such as licenses, taxes, levies, and protection (Hughes, 1998, p. 89) that will be discussed in the next section.

#### **1.7.1.1. Business License Policy**

Regulation can be divided into economic and social regulations. The former aims at encouraging business and other economic actors to undertake certain activities and to avoid other activities. The social regulation is understood as attempting to protect the interests of citizens and consumers (Hughes, 1998, p. 89). In practice, a regulation may include economic and social rules. For instance, business license rules may not only aim to promote business sector but also to protect the public from the dangers of pollution. The regulations concerning business licenses need to be transparent with clear mention the cost of each type of business license as well as duration of time of the process of business licenses.

However, a World Bank study (World-Bank, 2005, p. 244) found that in the Indonesian case, license regulations are complex and cause many policy uncertainties. As a result, the business sector has been constrained rather than promoted in this sense. Complex rules and uncertainty policies can cause black market and illegal fees in the process of business license. This indicates that the local government does not support small businesses. It is called an unsupportive relationship between local government and small business.

#### **1.7.1.2. Tax and Levy Policy for Small Businesses**

As discussed before, fiscal decentralisation provides more opportunities for local governments to create types of local taxes/levies and change local tax rates with the aim to increase their fiscal capacity. In contrast, local government can minimize local tax rates and provide better public services to attract new investors. In practice, different countries have different policies on taxation. In Sweden, the constitution allows local governments to raise taxes independently thus creating a great deal of administrative autonomy, whereas in Japan, local taxes are centrally regulated (Takao, 1999, p. 16). In Indonesia, all local regulations on local taxes must be approved by the central government and the central government has identified kinds of permissible local taxes as stipulated in Law No. 34/2000.

Local taxes need to meet the criteria as good taxes. According to Bailey (1999, p. 154), the criteria for taxation efficiency are as follows:

- (1) equity in horizontal and vertical terms for which taxpayers in similar financial situations should pay similar amounts of tax and taxes and should not take higher proportions of income from low-income groups than from high-income groups;
- (2) allocative efficiency that local taxes should promote;
- (3) economy that local taxes should achieve in order not to be so costly to collect and to be simple to understand and easy to comply with;
- (4) accountability to taxpayers who should know exactly how much and why they are paying taxes;
- (5) revenue sufficiency for which the tax yields should be sufficient to finance the levels of services for local people; and
- (6) local autonomy to the extent which local government and their taxpayers are free to determine the kinds and rates of taxes.

Therefore, district governments need to use these criteria above to stipulate new local taxes in order to increase economic efficiency and social equity.

Taxes can be used by local government to encourage the business sector. Local government can promote the business sector by adopting low taxes/levies rates. As a result, the business sector will grow as suggested by Tiebout (1956). According to Tiebout (1956, p. 418), fiscal decentralisation can promote competition among sub-national governments for limiting their taxing power and maximizing their service delivery. Citizens can exit from local governments providing unsatisfactory services and taxes, moving to those providing their welfare and cheap tax rate. Therefore, businessmen will move to localities where public services and taxes are acceptable and in favour of their business activities.

I argue that Tiebout's theory is less relevant in the case of Indonesia because local taxes are stipulated by the central government. Types of local taxes and tax rate among regions are the same, so that taxes are not influential in competing among regions to promote the business sector. This is different from the Federal state, where a sub-national government has authority to decide types of taxes and tax rates. In Indonesia, local governments have limited authority to decide types of local taxes,

but the local governments have more discretion in local levies because local governments have authority to enact the local levies rate. Thus, local levies could cause competition between regions to attract investors or promote the businesses sector.

In contrast, if local governments have small revenue, they may increase their revenue by developing heavy taxes/levies for small businesses called an exploitative relationship between local government and small businesses. However, heavy local tax can cause difficulty for small businesses to develop. In turn, a majority of small business owners might disobey local regulations on business permits and operate without licenses. As a result, local government might not be able to control small businesses.

### **1.7.1.3. Protection Policy for Small Businesses**

Do local governments stipulate protection policy to small businesses? In a market economy such as in the United States, small businesses have difficulty in competing with big businesses because they lack of capital, networks and access to market. Without protection policies, small businesses may be unable to compete in market places with large businesses. In a state in which developmental orientation predominates such as South Korea,<sup>19</sup> state authority also plays an important role in protecting small businesses sector because the failure of market to support financial and technical assistance to this sector.

Under decentralisation, local regulations are expected to meet the needs of small businesses because local policy makers – executive and legislative – are now popularly elected by local communities. If small business is a primary source of their tax revenue and if employees represent a large proportion of their constituency, then elected local officials need political support from the small business sector. Local policy makers are thus likely to formulate and implement protection policies for small businesses.

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<sup>19</sup> In the process of industrialization, the state historically carried out economic functions in which there are two different orientations of national economy: market economy driven by market rationality or regulatory orientation (for example: the United States) and state-led economy (developmental functions).

In the Indonesian experience, during the centralized political system (1968-1998), the policy on trade and investment promotion as well as monetary policy provided more benefits to the large industries, and they did not preferentially protect small businesses (Hill, 2001; Sandee & Van Dierman, 2004). Started in 2001 the Indonesian government implemented decentralisation, so the policy on trade and industry including small business was delegated to sub-national governments. As a result, the role of central government in developing small businesses became less important. In contrast, the role of district governments became more influential. In this context, district governments were able to make specific policies with the aim to protect small businesses against big businesses. The next section will discuss the role of local government in promoting small businesses.

### **1.7.2. Promotion Policy for Small Businesses**

As discussed in administrative decentralisation before, district governments have more functions as a result of decentralisation policy. One of the functions of district government is to promote the business sector. In relations to small business development, district governments are legally in a position to provide financial and technological assistance as well as infrastructure facilities for small businesses as carried out by local governments in Italy (Brusco, 1992). In contrast, if local governments have limited financial resources, they may less provide financial assistance and infrastructure facilities for small businesses. The next section will explore financial assistance from local government and financial institutions to small businesses.

#### **1.7.2.1. Financial Assistance for Small Businesses**

The sources of fund raising for small businesses are classified into many types: state-owned banks, private banks, leasing companies, other non-bank financial institutions, money lenders, family and relations. For small businesses, access to credit is essential to finance the upgrade of technology, to expand production capacity and to purchase larger inputs and better material. However, small-scale businesses generally have difficulty in obtaining credits from formal financial institutions due to collateral and administrative requirements, while credits from non-financial institutions impose very high interest on small business (Bannock,

2005; Freeman, 2004; Liedholm & Mead, 1999; Lim, 1992a). As a result, small businesses have difficulty in increasing their productivity and competitiveness.

By implementing fiscal decentralisation, local governments have more power to allocate local budgets in providing financial assistance for small businesses. There are two ways to help small business in relation to financial assistance. Firstly, local government can establish its public institution for job creation in the small business sector. Secondly, local governments can develop a network with state/private banks and village financial institutions in order to provide credits to small businesses. The local government can deposit funds to financial institutions, so that the financial institutions will have greater funds to be distributed to small businesses. The financial assistance is extended to increase capital or to upgrade technology of small businesses. Based on the experience in the case of Italy and Denmark, the local financial institutions or local banks played a vital role in promoting small businesses. According to Becattini (2004, p. 29), at the local level in Italy, the main reason for small businesses being at a disadvantage compared to large ones, was because of difficult access to credits. He suggests that establishing local commercial bank is the best way to help small businesses because it is very closely linked with local small businesses and knows the needs of them. In the case of Staling district, Denmark, Kristensen (1992) describes the importance of local banks during the setting up of the businesses:

...many furniture makers have traditionally used skills as carpenters and cabinet-makers to start up in the building and construction industry during boom periods in local industry..... In such initial periods, the small local savings banks have been able to use their detailed local knowledge as a basis for providing loans for the creation of new building and construction businesses (Kristensen, 1992, p. 149).

It is clear that local banks can be responsive to the needs of local small businesses because they are closely positioned to them and involved in the local life of small businesses.

#### **1.7.2.2. Training and Technological Assistance**

The success of small businesses is not only dependent on small business entrepreneurs but also on workers. Unfortunately, most workers have low levels of formal education or no practical training. Small businesses generally do not have the

resources to provide training programs for improving the quality of workers. There is no doubt that small businesses do carry out less training for employees and managers than large businesses (Bannock, 2005, p. 147). As a result, small businesses produce a low quality of products and have a limited market.

The low education and lack of skill of small business workers can be overcome by providing training programs (Freeman, 2004, p. 228). Local government can also cooperate with non-government organisations or state-owned enterprises to provide training to small businesses. By providing training to small businesses, it will improve the quality of productivity.

Further, technology can provide small businesses with an opportunity to increase their efficiency and productivity with tools to better manage their business. For an example, Malaysian government provides technological assistance to small businesses by issuing matching grants (Saleh & Ndubisi, 2008, p. 289).

In a market economy such as in the United States, small businesses have to compete with big businesses which have huge capital, extensive business networks and are supported by high technology. Although adopting a free market policy, the US government has a long history of government help for small businesses. The Small Business Administration (SBA), established in 1953 to champion small business, provides them with financial, technical and management assistances (Shanmugaratnam, 2004, p. xix). The technical assistance includes training and marketing advice services. It is clear that government intervention is necessary in developing small businesses by facilitating training, infrastructure and technological assistance for the small business.

### **1.7.2.3. Infrastructure Facilities**

As discussed before, in fiscal decentralisation the district government has fiscal discretion to allocate its funds in improving physical infrastructure facilities for small businesses, such as roads, markets building, electricity and telephone networks or what Brusco calls “real service” (Brusco, 1992). For instance, if the district government can improve roads between city centre and small business villages, the



buyers can easily come to these villages for shopping. Developing market buildings is important to facilitate small businesses in selling their products.

Developing physical infrastructure is influenced by the financial capacity of local governments. If the local government has a lack of financial capacity, as a result of poor local resources, the central government needs to provide grants for them. As discussed above, the experience of development in Japan indicates that the central government plays an important role in promoting small businesses while at the same time local governments also promote them by providing housing and technical assistance as well as management advice (Aoyama, 2000, p. 55).

### **1.7.3. Political Influence over Small Businesses**

Political decentralisation can change the relationship between local government and small businesses. Firstly, elected public officials and political parties attempt to approach small businesses with the aim to gain good will for electoral and political purposes. As mentioned above, Italian political parties in the decade of 1980s played an important role in developing small businesses (Trigilia, 1986). In the case of Japan, politicians influence bureaucrats in providing financial assistance to small businesses based on political support obtained from them (Patterson, 1994). In another case in Baden-Wurttemberg in German, the Christian Democrat party influenced the local government in policy-making on industrial districts (Schmitz & Musyck, 1994). In this context, the activities of small businesses may be politicized by local politicians and authorities because there are many potential voters from the small business sector. It can be concluded that bureaucrats and politicians can promote small businesses by providing financial assistance and support regulation. It can be called a supportive relationship between local government and small businesses.

Secondly, decentralisation policy creates a greater opportunity for small businesses to participate in the process of decision making. Therefore, they can articulate their interest and preferences. As a result, local policy may be made in accordance with the needs of small businesses. Participation of small businesses in the process of decision making can be classified into two levels: Individual and organisational. At the individual level, small businesses can be involved in the process of decision-making in local government and participate in a political party. As discussed in

beginning this chapter, political decentralisation is designed to devolve political authority or electoral capacity to sub-national governments. This means political decentralisation allows local citizens and small businesses to directly elect local leader and local parliament members as well as participate in local policy making. Thus, political decentralisation provides political space for small to be active in political activities and decision making process.

At the organisational level, small business can use business associations to influence local policy. Business associations have voices and potential power to influential local government policy. In the case of Italy, for instance, local trade unions and small firms employers' organisation have helped to persuade local governments to become more responsive to needs of local small businesses (Pyke, 1992, p. 29). Another case, for an example, in Thailand, business association can reduce a variety of transaction costs for small businesses by helping pool resources and disseminate information to its members. Additionally, business associations can foster linkages within an industry between the various producers and suppliers in the value chain (Brimble et al., 2002, p. 226). It indicates that business associations have power to make a bargain with policy makers with the aim to produce suitable policy for the interests of small businesses. In the case of Indonesia, it is important to explore whether business associations at the local level such as *Kadinda* and *Dekranas* are able to influence district government policy regarding the business sector.

**Table 1.1**  
**Type of Relationship between Local Government and Small Business**

Aspects	Typology of Relationship		
	Supportive	Bargaining	Exploitative
1. Regulation	1. Transparent and clear procedure for obtaining business licenses. 2. Light tax/levy on small businesses 3. Protection policy for small businesses	Small businesses and business associations are involved in the process of local regulation making	1. Heavy tax/levy on business licenses 2. Punishment for small businesses without license
2, Promotion	Local governments provide: <ol style="list-style-type: none"> <li>1. Financial assistance,</li> <li>2. Training and technological assistances</li> <li>3. Infrastructure facilities to small businesses</li> </ol>	<ol style="list-style-type: none"> <li>1. There is a sharing of the cost of organizing the exhibition business between small business owners and local government</li> <li>2. Business associations can pressure local government to reduce a variety of transaction cost for small businesses</li> </ol>	Local governments set up loans with high interest for small businesses
3. Politics	Local bureaucrats and politicians respond the needs and interests of small business owners	<ol style="list-style-type: none"> <li>1. Business associations have network with political parties or district head</li> <li>2. Business associations can pressure policy makers to make policy in accordance with the interests of small businesses.</li> <li>3. Small businesses can influence political parties.</li> </ol>	Politicians use small business owners to support their political position, but they are not able to help small businesses.

### 1.8. Conclusion

Based on the discussion above, the impact of decentralisation on the relationship between local government and small businesses will be analysed from three aspects: regulation, promotion and political influence. The regulation aspect attempts to analyse the relationships between local government and small business from

business licenses, tax/levy and protection policy, whereas the promotion policy aspect examines the extent to which the relationships from policy on financial, training and technological assistance as well as infrastructures facilities. Then, the political influence aspect explores how local authorities influence small businesses and the extent to which small businesses can be involved in the process of decision making at the local level.

Further, each aspect above can be categorised into three possible relationships: supportive, bargaining and exploitative (Table 1.1). However, each aspect may have one or more characteristic of relationships. This is because each aspect consists of several sub-aspects or indicators.

A comparative approach will be taken in this study to examine the impact of decentralisation on the relationships between local government and small businesses in two different sites, Bantul and Gianyar districts. As discussed before, the social, economic and political settings of Bantul and Gianyar are different with each other. Socially, Bantul is heterogeneous in terms of ethnicity and religion, but Gianyar is homogenous. Economically, Bantul is supported by the agriculture sector with low income per capita. On the other hand, Gianyar is supported by the industrial and trade sector with high income per capita. Politically, Bantul has multi-political parties: political parties based on religions and political parties based on secular nationalists, whereas Gianyar has only secular nationalist parties. By comparing the two different regions, this project will assess more accurately their similarities and differences in the impact of decentralisation policy.

By starting to analyse the impact of decentralisation on the relationships between local government and small businesses, the next two chapters examine existing social, economic and political structures of Bantul and Gianyar. The objective is to provide insights into how decentralisation influences the dynamics of local political activities and changes of institutions of local governments to promote small businesses. It will indicate that decentralisation policy has different impacts on existing social, economic and political structures in the two different districts.

## CHAPTER TWO

### THE SOCIAL, ECONOMIC, AND POLITICAL SETTING OF BANTUL

#### 2.1. Introduction

This chapter provides a survey of the social, economic and political setting of Bantul as a basis for examining the case of Bantul. The survey first describes the existing social, economic and political structures that may influence the implementation of decentralisation measures.

The economic and political structures are important variables because they can play an important role in promoting or preventing the implementation of decentralisation. Economic structures such as the level of gross district product and the availability of natural resources can determine the fiscal capacity. The implementation of decentralisation is influenced by the scope of fiscal decentralisation. Thus, if the district government has a high level of fiscal capacity, it may meet the fiscal needs of local communities. In contrast, district governments with poor natural resources may have limited source of tax revenues. As a result they will face fiscal constraints on the delivery of decentralised functions and the provision of public services for small businesses. Therefore, implementation of administrative decentralisation is influenced by fiscal capacity. The following section discusses the political decentralisation in relation to popular participation.

Political decentralisation can provide an opportunity for small business owners to participate in electing the district head and local legislature members. A large number of small business owners in Bantul may play an important role in the election of the district head and local legislature members as well as participate in the decision-making process. Business associations such as *Dekranas* (Bantul Handicraft Board), *Kandinda* (Bantull Chamber of Industry and Trade) and Bantul Craft Association can also play an important role in the decision-making process at a district level. These associations can persuade district governments to become more responsive to the needs of small business. The implementation of decentralisation

measures needs to be adopted by the district government with specific demographic and socio-economic conditions. The central point is to explore how the specific district may promote or constrain the process of decentralisation.

This chapter is divided into five sections. The first section accounts for the impact of a geographic and demographic setting on the implementation of decentralisation policies. It seeks to examine how geographic factors, such as the location, land area, size of population, and availability of natural resources in Bantul promote or prevent the implementation of decentralisation measures. The second section concerns the economic structure of Bantul. It will explore the extent to which economic factors, such as the gross district product, economic growth rates, locally derived revenue, the industrial sector and employment trends in Bantul affect the autonomous capacity (especially financial capacity) of Bantul district to manage local affairs. The third section discusses political institutions such as political parties and the local parliament. It examines the extent to which political parties and local parliament have changed since the decentralisation era and whether or not they try to promote small businesses. The fourth section concerns local bureaucracy. It discusses how the implementation of decentralisation policy influences the local bureaucracy's behaviour and style of district head leadership in providing services for small businesses. The fifth section assesses how the social structure of Bantul, such as citizens' groups, business and neighbourhood associations affect the decentralisation process. This chapter argues that the social and political factors of Bantul provide a positive contribution to the implementation of decentralisation, while economic factors provide less support.

## **2.2. The Geographic and Demographic Setting**

The location, size of the area, natural resources and the size of the population of Bantul district may influence the implementation of decentralisation policy. For instance, natural resources influence the district government's income. In turn, the district government income may influence the implementation of administrative and political decentralisation. The district government needs the financial capacity to implement decentralised functions as a result of administrative decentralisation. Besides that, the district government needs financial support for implementing elections of the district head and local legislature members.

### **2.2.1. The Location, Area and Natural Resources.**

Bantul is a district of the Special Province of Yogyakarta, located about 25 km south of Yogyakarta city. Administratively the territory of Bantul consists of 17 *kecamatan* (sub-districts). There are 75 villages that are distributed into 17 sub-districts within an area of 506.85 square kilometers. The territory of Bantul is bordered by Yogyakarta city and the district of Sleman to the north, Gunungkidul in the east, Kulonprogo in the west, and the Indonesian ocean in the south (Figure 2.1).

The size of the Bantul district is smaller than that of other districts outside Java. In comparison, the district of Kutai Kartanegara in the province of East Kalimantan has an area 27,263.10 km<sup>2</sup>. The district of Buru in the province of Maluku has an area of 12,655 km<sup>2</sup>. District of Lahat in the province of the South Sumatera has an area of 6,618.27 km<sup>2</sup>. The district of Koala in province of the Southeast Sulawesi has an area of 6,918.38 km<sup>2</sup>. As expected, small areas can be more easily controlled by a district head than larger areas. Thus, Bantul has a significant opportunity to implement decentralisation policy effectively because of its small area. The distance between the centre of district government and the most remote area of sub-districts is approximately 40 km, allowing the district government to efficiently provide better public services to small businesses and local citizens.

In recent times, the Bantul district has become known as an important tourist site where local people produce ceramics, handicrafts, woodcarvings and other fine arts for overseas and domestic markets (Sulistiyanto, 2009, p. 192). The Bantul district also has beautiful beaches, such as Parangtritis and Samas, which attract tourists. These two beaches play an important role in contributing to locally derived revenue because visitors have to buy admission tickets to enter the beach regions. Many small businesses also operate on these two beaches. As more tourists come into the region, greater opportunities are being created for small businesses to sell their products. The Bantul District has also developed market building to promote small businesses. In 2004, the Bantul district established the Gabusan Art Market (*Pasar Seni Gabusan*) for developing small businesses, located on the main road between Yogyakarta city and Parangtritis beach with the aim at inviting tourists to buy small businesses' products. By facilitating the market, the small businesses are expected to develop. Concurrent with Bantul as a tourist destination there are natural resources in

Bantul and the extent to which natural resources also support the implementation of decentralisation needs to be considered.

Figure 2.1.  
Map of Bantul District



Source: *Pemerintah Kabupaten Bantul*, (2008a).

Bantul is different from the local governments outside of Java such as the district of Kutai Kartanegara and Bontang East Kalimantan and the municipality of Dumai in province of Riau, which are rich in natural resources and have extensive forests. Bantul does not have any of those same potential natural resources, such as forestry, general mining, oil, natural gas or geothermal mining. Unlike other surrounding districts, the government of Bantul cannot rely on natural resources to support the infrastructure nor can it support the implementation of decentralisation. In addition, some areas in the Bantul region are limestone hills, and thus not fertile for agriculture. A lack of agricultural products also limits district government income. An examination of the population of Bantul, however, also indicates that there are many individuals below the poverty line, as will be discussed below.

### 2.2.2. The Population

In 2008, Bantul's population was 909,812 people, approximately 26 percent of Province of Yogyakarta and a population density of around 1,752 persons per km<sup>2</sup>.



The high population density in the small area allows local government to easily provide physical infrastructures such as roads, school buildings and hospital buildings due to the lower level of finance required compared to a larger area. In 2008, the percentage of population age between 0-14 years old was 22.86 percent, 15–39 year olds at 41 percent, and 36.07 percent were above the age of 40. This means that the majority of population aged between 15-39 and 40-65 which may contribute the dynamic of business activities.

The total population below the poverty line was 229,436 people (25 percent equalling to 57,539 families). More than 10 percent of the population had never attended primary school. These statistics caused a financial burden for local government because of the need to provide financial assistance for the poorer families. The district government head (*Bupati*) of Bantul focused on two programs to overcome the problem: health and education programs, by providing health insurance for poor families and scholarships for less fortunate students. This means local government needed to allocate more of the local budget for health and education sectors. As a result, there was a limited local budget for developing public roads and transportation, and adopting new technologies for supporting services.

Around 25 percent of Bantul's population work in the agricultural sector. The remaining 21 percent are in trade sector, approximately 19 percent in the industrial sector and around 16 percent work in the services sector. The rest are distributed in building construction, transportation, mining and finance sectors. As indicated previously, a large portion of the population work in agriculture and their income is generally low. Data shows that the income per capita in 2007 was Rp 3.448.948<sup>20</sup> or approximately US \$381 per year. These figures equate to approximately 19 hours of paid work (two days work) in Australia. According to the World Bank's measurement, based on US\$ 2 per day, the income per capita of population of Bantul districts was below the poverty line. Since the implementation of decentralisation policy, the income per capita has not changed significantly (Table 2.3). The following discusses religion, culture and political party with the aim to explore the relationship between religion and political party membership.

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<sup>20</sup>US \$1 is equivalent with Rp. 9,050 in 24 September 2011.

Culturally, the people of Bantul are Javanese. According to data from the Bantul Statistics Bureau, about 95.12 percent are Muslims with others distributed among four other religions: Catholic 3.18 percent, Protestant 1.58 percent, Hindu 0.08 percent and Buddhist 0.05 percent. Most of the Muslims are related to *Muhammadiyah* (modern Islamic organisation) and *Nahdlatul Ulama* (NU) or traditional Islamic organisation. The *Muhammadiyah* is associated with National Mandate Party, whereas *Nahdlatul Ulama* is associated with the National Awakening Party. The differences of political affiliation between *Muhammadiyah* and *Nahdlatul Ulama* potentially contribute to local political dynamics and the implementation of decentralisation as the two organisations participate in political arena.

### **2.3. Economic Structure**

This section will discuss Gross Regional Domestic Product (GRDP), the district government's revenue and industrial sectors in Bantul with the aim to understand the extent to which they provide financial capacity for implementing decentralisation policy.

#### **2.3.1. The Gross Regional Domestic Product (GRDP)**

The economic structure of Bantul is supported by: the agricultural sector, which accounts for around 24 percent of GRDP; the manufacturing industry sector contributed around 17 percent; the trade, hotel and restaurant sector which accounted for around 19 percent in 2007 and the services sector which contributed 13 percent. The remaining 23 percent was distributed across other sectors. During 2005-2007 almost all sectors were stagnant, except for the construction sector. This sector rose around 50 percent due to the increased need for housing in Bantul as a result of rising urban to rural migration. Many citizens live in the Bantul and commute to work in the city of Yogyakarta (Table 2.1).

**Table 2.1**  
**Percentage of Distribution of Gross Regional Domestic Product of**  
**Bantul District at Constant Price 2000, 2005-2007**

No.	Sector	2003	2004	2005	2006	2007
1.	Agriculture	27.75	27.16	24.89	24.69	24.31
2.	Minning	1.42	1.61	1.01	1.03	1.02
3.	Manufacturing Industry	18.86	18.87	19.93	17.22	16.88
4.	Electricity, Gas and Water Supply	0.48	0.56	0.90	0.82	0.85
5.	Construction	8.15	7.46	8.54	11.57	11.99
6.	Trade, Hotel and Restaurant	17.39	17.96	18.95	18.92	19.12
7.	Transport and Communication	6.58	7.35	6.88	6.65	6.81
8.	Financial	5.14	5.09	6.34	5.86	5.87
9.	Services	14.23	13.93	12.98	13.24	13.15
	Total	100.00	100.00	100.00	100.00	100.00

Source: *Pemerintah Kabupaten Bantul* (2008a, p. 377).

The contribution from the agricultural sector to the GRDP decreased slightly from 27 percent in 2003 to 24 percent in 2007. This is largely due to the decreasing size of the agricultural area, as some farmable land was then used for housing. For instance, the size of the agricultural area decreased about 289,335 ha or 0.06 percent during 2002-2006. At the same time, the share of the manufacturing sector to the GRDP also decreased slightly. This means that efforts by the Bantul district to develop the industrial sector were unsuccessful. The percentage distribution of trade, hotel and restaurant sector increased slowly from 17.39 percent in 2003 to 19.12 percent in 2007. Thus, it was insignificant for the GRDP. The implementation of decentralisation policy may have encountered difficulties for two reasons: Firstly, the economic structure of Bantul was dependent on the agricultural sector which was limited in future growth. Secondly, the growth of industrial sector was slow and provided only a small contribution to GRDP (Table 2.1 and Table 2.10).

Economically, Bantul still depends on the activities of workers who commute to Yogyakarta city (Sulistiyanto, 2009). Bantul's large population also supplies cheap labour for Yogyakarta city. In addition, Bantul supplies a variety of agricultural products to the markets of Yogyakarta city (Huisman and Stoffer 1998). This means that, any increase in demand for agricultural products in Yogyakarta will provide more benefit for agricultural suppliers from Bantul. Some products of small

businesses in Bantul are also sold in markets of Yogyakarta city. Therefore, the dynamics of markets of Yogyakarta city may influence the degree of business activities in Bantul.

The economic growth of Bantul averaged 4.29 percent through 2002-2007 and did not significantly changed with the exception of 2004 when the economic growth rate increased to 5 percent. This may related to the fact that the District Head (*Bupati*) of Bantul was actively working at the end of his first term to achieve success in order to run again as candidate for the district head in the 2005 election. The success of economic growth would provide this candidate with a positive image as a successful leader which could positively influence voters.

However, in 2006 economic growth decreased to 1.98 percent when a huge earthquake (6.2 Richter) hit the region and destroyed physical infrastructures such as roads and housing, markets, small businesses, schools and offices. Remarkably the district government of Bantul quickly overcame this damage. Economic growth increased again to 4.57 percent in 2007 (Table 2.2) and income per capita also increased by 3 percent (Table 2.3). This indicated that the district government had effective responsiveness to the needs of the local community. As an example, the district government prepared funds to buy agricultural products when the price of such products dropped during harvest. Then the district government sold these products when the prices subsequently rose to a normal price. The following section will further elaborate an income per capita in Bantul.

**Table 2.2.**  
**Growth of GRDP of Bantul at Constant Price 2000**  
**2002-2007**

No.	Year	GRDP (Million Rp)	Growth Rate of GRDP (%)
1.	2002	2.800.956	4.46
2.	2003	2.932.377	4.69
3.	2004	3.080.312	5.04
4.	2005	3.234.172	4.99
5.	2006	3.298.366	1.98
6.	2007	3.448.948	4.57
		Average	4.29

Source: *Pemerintah Kabupaten Bantul* (2008b, p. 186).

The growth of income per capita of Bantul was on the average of 2.2 percent during 2002–2007. During this period the growth rate of income per capita did not significantly change (Table 2.3) with the exception of 2007. In 2007 income per capita was Rp 3,845,008<sup>21</sup> about US \$ 424.86 per year, US\$1.16 per day, remaining below the poverty line by the World Bank's criteria. Thus the implementation of administrative and fiscal decentralisation had no impact on income per capita (Table 2.3) nor economic growth (Table 2.2.). The next section will discuss district government income with the aim of investigating whether or not total district government income could support local autonomy and the implementation of decentralisation.

**Table 2.3**  
**Growth Rate of Income Per Capita at Constant Price 2000**  
**2002-2007**

No.	Year	Total (Rp)	Growth
1.	2002	3,432,034	2.0
2.	2003	3,515,428	2.4
3.	2004	3,613,252	2.8
4.	2005	3,712,307	2.7
5.	2006	3,732,268	0.5
6.	2007	3,845,008	3.0
		Average	2.2

Source: *Pemerintah Kabupaten Bantul* (2008b, p. 187).

### 2.3.2. District Government Income

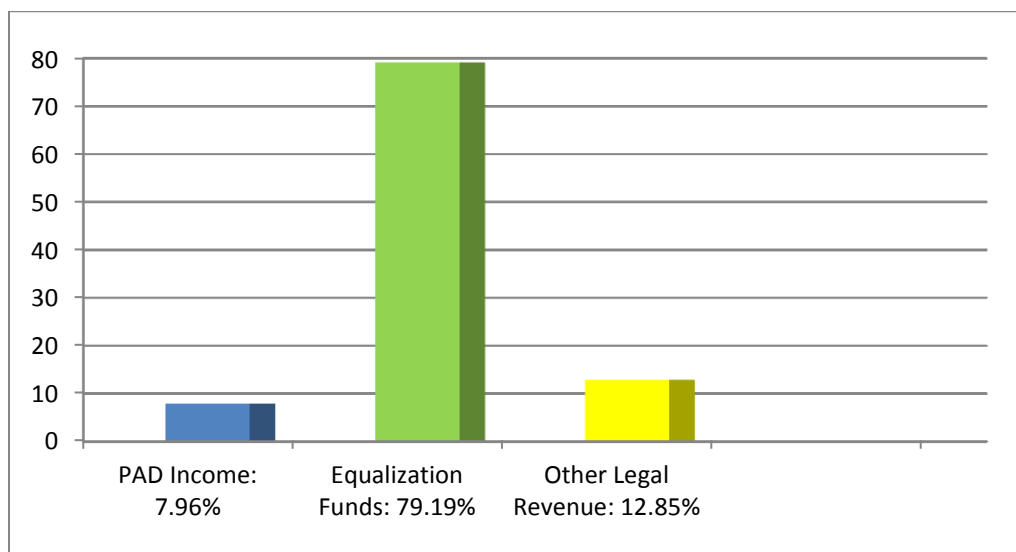
According to Law No. 33/2004 regarding Fiscal Balance between the Central Government and the Regional Government, the total district government income consists of locally derived revenue (PAD income), equalization funds<sup>22</sup> (*Dana Perimbangan*), and other legal income. In the case of the Bantul district government, in 2009 majority of the total district government income was derived from equalization funds (79 percent). The second source was from other revenue such as income from interest, sales from district government assets and from donations (12.85 percent). Lastly, the PAD income contributed 7.96 percent (Chart 2.1). This means that the local government of Bantul financially depended on the central government subsidy. The small income of the PAD was due to the small amounts

<sup>21</sup> US\$ 1 is equivalent with Rp 9,050 in 25 September 2011.

<sup>22</sup> The Equalization fund is a grant fund from the central government to sub-national governments consist of general grant, specific grant and revenue sharing fund.

obtained from local taxes. Local tax income thus provided only a small contribution to the financial capacity of the district and it could not support the implementation of decentralisation policy. I argue there were two reasons why income from local tax was low. Firstly, the local government only had authority to manage less potential taxes. The potential taxes such as income tax and selling tax were in the hands of the central government. Secondly, the district government had not yet effectively implemented local regulations on taxes and levies.

**Chart 2.1**  
**Distribution of District Government Revenue, 2009**



Source: *Pemerintah Kabupaten Bantul* (2009).

Details of the district government income that consists of the PAD income, equalization funds, and other legal revenue will be discussed below. From that discussion we can ascertain which of those provided the greatest contribution to the district government revenue.

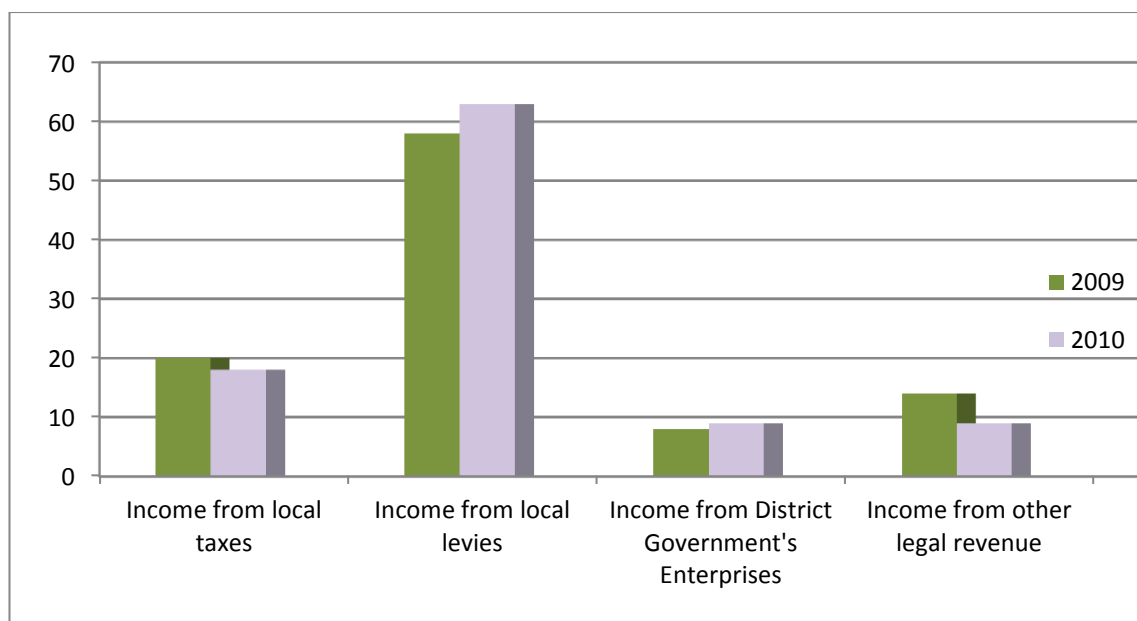
### **2.3.2.1. The PAD Income (Locally Derived Revenue)**

The first source of total district government revenue is the PAD income or locally derived revenue. In 2009 the PAD income was 65,991.51 million rupiah (7 percent of total district government revenue), whereas in 2010 the PAD income was 90,238.88 million rupiah or 10.30 percent of total district revenue. The PAD income is an indicator of the financial capacity of local government. A greater income from

PAD is likely to cause a greater financial capacity to implement decentralisation policy. The PAD income consists of income from local taxes, local levies, district government enterprises and other legal revenues. During 2002-2010, the average of growth of the PAD income was 7.91 percent per year. The majority of PAD income derived from local tax income. The percentage of local tax income slightly decreased from 20 percent in 2009 to 18 percent in 2010 but the percentage of income from local levies increased from 58 percent to 63 percent. At the same time, income from other legal district revenue decreased from 14 percent to 9 percent (Chart 2.2).

In 2010, the PAD income derived from: (a) Local Tax Income: 16,489.58 million rupiah (18.27 percent of total PAD income); (b) Local Levies Income (*retribusi*): 56,473.04 million rupiah (62.58 percent of total PAD income); (c) Proceeds from the management of local assets set aside for the purpose (district government's enterprises): 8,573.00 million rupiah (9.5 percent of total PAD income); and (d) Other legal revenue: 8,703.26 million rupiah (9.64 percent of total PAD income) (Chart 2.2.).

**Chart 2.2.**  
**Distribution of the PAD Income, 2009-2010**



Source: *Pemerintah Kabupaten* (2008, 2009).

Table 2.4 indicates that in 2007 the PAD income of Bantul increased twice of that in 2002. In 2009 the PAD income was almost three times of that in 2002. By 2010, the PAD income was four times of that in 2002. However, the PAD income still remained as a small part of total district income, around 8 percent. The PAD income was only sufficient to finance public servants' salaries. In 2010, the PAD income was only 90,238.88 million rupiah equivalent to 15 percent of budget for local public servants. Due to the PAD income being small, it was not sufficient to finance the district government's spending. As a result, the Bantul district government was heavily dependent on the central government's subsidies. A lack of financial capacity was a constraint in implementing decentralisation policy. I suggest that in the long term, Bantul district needs to develop local business activities based on local potential resources, so that the locally derived revenue can increase. As discussed in the Introduction of this thesis there are many small businesses in Bantul which export some of their products. Thus, small businesses have the developmental potential to increase the district government's revenue. In addition, the district government may develop beach areas on the ocean as tourist attractions as a way to return revenue to local government. To date, some beaches along the Indian Ocean (see Map of Bantul, Figure 2.1) remain underdeveloped for tourism. In summary: the decentralisation policy will not be well implemented unless the Bantul district is able to finance its expenditure.

**Table 2.4**  
**Locally Derived Revenue (PAD Income) of Bantul District**

No.	Year	Total District Income	Locally Derived Revenue (PAD Income)	Percentage of PAD Income to Total District Income
1.	2002	336,570,263,783.43	22,425,146,059.70	6.66
2.	2003	389,393,986,778.40	32,882,358,490.40	8.44
3.	2004	398,879,892,641.80	30,777,820,174.83	7.72
4.	2005	442,291,639,792.62	37,683,848,341.38	8.52
5.	2006	595,956,853,508.79	44,005,310,869.67	7.38
6.	2007	693,827,536,928.60	57,229,726,493.62	8.25
7.	2008	995,971,702,905.41	59,069,544,315.41	5.93
8.	2009	829,474,653,164.38	65,991,513,134.38	7.96
9.	2010	876,204,469,555.28	90,238,879,583.48	10.30
		Average		7.91

Source: *Pemerintah Kabupaten Bantul* (2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010).



My research findings indicate that income from local levies was higher than income from local taxes. For instance, in 2009 income from local taxes only accounted for 20 percent of the PAD income, whereas income from local levies accounted for 58 percent of the PAD income (Chart 2.2). The income from local taxes was low because there were no large industries such as large foreign companies or development of luxury hotels and restaurants in Bantul from 2000 to 2009. Most of local levies income was derived from small businesses in local public markets. The sellers in the local public markets had to pay a daily local levy to the district government. The levy on the stalls was about 175 rupiah per metre per day. Income from market levies was 1,210 million rupiah in 2009, and increased 2,270 million rupiah in 2011. Additional income from levies on the use of market toilets contributed 45.1 million rupiah in 2010.

After discussing locally derived revenue (PAD income) of Bantul, the discussion now moves to the equalization funds. These funds are important because they provide significant contribution to district government revenues. Although the Bantul district adopted a decentralisation policy, the central government still played an important role in promoting small businesses at district level through the provision of funds.

### **2.3.2.2. The Equalization Fund (*Dana Perimbangan*)**

The second source of the district government revenue is a grant or transfer payment from the central government, known as an equalization funds in Indonesia. The transfer payment contributes the most to its annual revenue. As an example, throughout 2002-2010, the average of equalization fund as percentage of total district revenue was 82 percent. Financially, the local government of Bantul was heavily dependent on the central government (Table 2.5). The Bantul district government had difficulty to implement the decentralisation policy without the assistance from transfer payments because its locally derived revenue was only on average 7 percent of total district government's budget.

**Table 2.5**  
**Equalization Funds**  
**Received by the Bantul District Government, 2002 - 2010**

No.	Year	Total District Income (Million rupiah)	Equalization Fund (Million rupiah)	Percentage of the Equalization Fund to Total District Income
1.	2002	336,570.26	271,592.60	80.69
2.	2003	374,266.60	321,134.45	85.80
3.	2004	398,879.89	343,129.04	86.02
4.	2005	432,516.37	361,068.31	83.48
5.	2006	597,788.83	551,956.19	92.33
6.	2007	693,827.54	593,244.92	85.50
7.	2008	995,971.70	674,191.34	67.69
8.	2009	829,474.65	656,885.49	79.19
9.	2010	876,204.47	683,081.41	77.96
		Average		82.07

Source: *Pemerintah Kabupaten Bantul* (2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010).

As discussed in Chapter one, the central government can provide grants to local governments. The grants consist of a general grant and a specific grant. The Indonesian government also adopted these grants. In Indonesia, the general grant is called General Allocation Funds or DAU fund (*Dana Alokasi Umum*), while the specific grant is called Specific Allocation Fund or DAK fund (*Dana Alokasi Khusus*). Beyond these, the central government provides revenue sharing fund or *Dana Bagi Hasil* (DBH Fund). These funds are derived from natural resources and tax incomes. The DBH fund is a general grant because the district government has discretionary power to spend that fund.

In 2010, total equalization funds (central government grants) were 683,081.41 million rupiah that consists of:

- a. General Allocation Fund (DAU Fund): 573,512.34 million rupiah (83.96 percent of total equalization funds);
- b. Special Allocation Fund (DAK Fund): 60,565.50 million rupiah (8.87 percent of total equalization funds) );
- c. Revenue Sharing Fund (DBH Fund): 49,003.57 million rupiah (7.17 percent of total equalization funds).

The details of each type of equalization fund is analysed in the following section.

### 2.3.2.2.1. The DAU Fund (General Grant)

The DAU is a general grant from the central government to sub-national governments. Before 2001 the DAU grant was called a Subsidy Fund for Autonomous Region (*Subsidi Daerah Otonomi* or *SDO*) (Marijan, 2006). The DAU fund allows more opportunities for local government to use the grant based on their needs as well as overcoming fiscal problems among regions. According to the Law No. 33/2004 which concerns fiscal balance between the central and regional governments, 26 percent of the central government's domestic revenues must be channeled to the DAU fund.

In the case of Bantul, the average of the DAU fund received by the district government of Bantul was 71.83 percent of total district government's budget during 2002-2010 (Table 2.6). The DAU fund was also used to pay local public servant salaries.

**Table 2.6**  
**General Allocation Fund (DAU Fund)**  
**Received by the Bantul District, 2002 - 2009**

No.	Year	Total District Income (Million rupiah)	DAU Fund (Million rupiah)	Percentage of the DAU Fund to Total District Income
1.	2002	336,570.26	258,680.00	76.86
2.	2003	374,266.60	292,700.00	78.21
3.	2004	398,879.89	292,700.00	73.38
4.	2005	432,516.37	308,106.00	71.23
5.	2006	597,788.83	470,847.00	78.76
6.	2007	693,827.54	524,293.00	75.57
7.	2008	995,971.70	583,169.35	58.55
8.	2009	829,474.65	568,510.00	68.54
9.	2010	876,204.47	573,512.34	65.45
		Average		71.83

Source: *Pemerintah Kabupaten Bantul* (2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010).

### 2.3.2.2.2. The DAK Fund (Specific Grant)

The DAK fund is a specific grant intended to finance special needs such as national priorities, or needs which are not covered by the DAU fund such as projects that have large spill-over effects across regions (Marijan, 2006, p. 50). Local governments which receive the DAK fund must match the funds by at least ten

percent of the total of DAK fund. However, local governments fitting certain criteria as poor regions are not required to do so.

Table 2.7 shows that DAK funds received by Bantul district average of 4.74 percent of the total district budget during 2002-2010. In 2009 and 2010, the DAK fund was almost 7 percent of total district government income. This means that the central government contributed an equal amount of 7 percent to improve development in Bantul such as development in health sector and education sector.

**Table 2.7**  
**Special Allocation Fund (DAK Fund)**  
**Received by the Bantul District, 2002–2009**

No.	Year	Total District Income (Million rupiah)	DAK Fund (Million rupiah)	Percentage of the DAK to Total District Income
1.	2002	336,570.26	n.a.	n.a.
2.	2003	374,266.60	1,000.00	0.27
3.	2004	398,879.89	11,680.00	2.93
4.	2005	432,516.37	12,060.00	2.79
5.	2006	597,788.83	33,890.00	5.67
6.	2007	693,827.54	47,709.00	6.88
7.	2008	995,971.70	57,448.00	5.77
8.	2009	829,474.65	55,635.00	6.71
9.	2010	876,204.47	60,565.50	6.91
		Average		4.74

Source: *Pemerintah Kabupaten Bantul* (2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010).

#### **2.3.2.2.3. The Revenue Sharing Fund (DBH Fund)**

Beyond general and specific grants, the central government provides a Revenue Sharing Fund derived from natural resources and tax incomes of the district. Theoretically, this fund is classified as general grant as it does not require specifications on how to spend the funds. The revenue sharing fund contributed an average of 3.88 percent to total district government income during 2002-2010 (Table 2.8). A region with rich natural resources will obtain a greater income from the revenue sharing fund which consists of a share in revenue from income taxes and from natural resource income.

The DBH income is sourced from income tax and consists of:

- a. Land and Building Tax Income (*PBB*). The Revenue Sharing Fund from Land and Building income such as 16.2 percent for provincial government, 64.8 percent for local government (*kabupaten/kota*), 10 percent for the central government, but it should be distributed into all districts and municipalities (*kabupaten* and *kota*).
- b. Land Rent (*BPHTB*) income. The income from BPHTP is distributed 80 percent for local government and 20 percent for the central government (*Peraturan Menteri Keuangan* No. 32/PMK.03/2005).
- c. Personal Income Tax. Income from personal income tax is distributed 20 percent to local government and 80 percent to the central government (*Peraturan Pemerintah* No. 115/2000).

According to Article 14 of Law No. 33/2004, revenue sharing fund sourced from natural resources consists of income from the following:

- a. Income from forestry. Revenue from Forest Exploitation Rights (*HPH*) and Forest Resource Provision (*PSDH*) shall be divided by 20 percent for the central government and 80 percent for the region concerned. Revenue from the Reforestation Fund shall be divided by 60 percent for the central government and 40 percent for the region concerned.
- b. Income from general mining. Revenue from general mining shall be divided by 20 percent for the central government and 80 percent for the region concerned.
- c. Income from fisheries. Revenue from fisheries received on a national basis shall be divided by 20 percent for the central government and 80 percent for all districts/municipalities.
- d. Income from oil mining. Revenue from Oil Mining shall be divided, after tax and other levies in accordance with the prevailing laws and regulations, be divided by 84.5 percent for the central government and 15.5 percent for the region concerned.
- e. Income from natural gas mining. Revenue from natural gas mining, after tax and other levies in accordance with the prevailing laws and regulations, is divided by 69.5 percent for the central government and 30.5 percent for the region concerned.

- f. Income from geothermal mining. For revenue from Geothermal Mining as Non-tax State revenue shall be divided by 20 percent for the central government and 80 percent for the region concerned.

It can be seen that the central government received larger revenue sharing from potential natural resources, such as from income from oil mining and income from natural gas mining than local government. As an example, for oil mining the central government receives 84.5 percent and local government received 15.5 percent which will be distributed into 3 percent for the province concerned, 6 percent for the producing district government, and 6 percent for other district governments within the province concerned. In the case of Bantul and all of district governments of province of Yogyakarta, this is a rarity as oil mining resources are scarce. Thus, the Bantul district government got only small income from the Revenue Sharing Fund from oil mining. In turn, Bantul did not have the financial capacity to implement decentralisation policies.

**Table 2.8**  
**Share of Revenue from Taxes and Natural Resources Income**  
**Received by the Bantul District Government, 2002 - 2010**

No.	Year	Total District Income (Million rupiah)	Share of Revenue from Taxes and Natural Resources Income (Million rupiah)	Percentage
1.	2002	336,570.26	12,912.60	3.84
2.	2003	374,266.60	13,307.31	3.55
3.	2004	398,879.89	17,152.22	4.30
4.	2005	432,516.37	17,252.22	3.99
5.	2006	597,788.83	19,349.19	3.24
6.	2007	693,827.54	21,242.92	3.06
7.	2008	995,971.70	33,573.99	3.37
8.	2009	829,474.65	32,740.49	3.95
9.	2010	876,204.47	49,003.57	5.59
		Average		3.88

Source: *Pemerintah Kabupaten Bantul* (2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010).

Data in Table 2.8 above shows that income from the share of revenue from taxes and natural resources was an average of less than 4 percent during 2002-2010. As a result, it provided only a small contribution for the district government's revenue.

Effectively it decreased the support in implementing decentralisation policy. The next section will discuss the industrial sector with the aim to show the extent to which it contributed to the implementation of local autonomy.

### **2.3.3. The Industrial Sector**

The industrial sector contributes to the implementation of decentralisation policy in two ways: creating job opportunities and providing local taxes/levies. In relation to job creation, the manufacturers in Bantul were able to employ up to 79,904 workers in 2007. Most of the manufacturers were non-formal or unregistered with no business permits. As a result, they did not pay local levies to the district government. When the researcher questioned the district head of Bantul his view on unregistered manufacturers, he commented that it was not pertinent problem. The district head noted it was more important for local people to have business activity regardless of having business permits or not, as non-formal manufacturers also contributed to absorbing employees and had multiple influences.<sup>23</sup> For instance, non-formal manufacturers provided double employment opportunities compared with formal-manufactures (Table 2.9).

During 2006-2007, the absorption of labour in the industrial sector only grew to 1,121 employees (Table 2.9). At same time, the total unemployment in Bantul was 39,106, meaning that the industrial sector only created a few additional employment opportunities. An increase in rates of unemployment could cause social problems and further constrain the implementation of decentralisation.

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<sup>23</sup> Interview with District Head of Bantul, 25 June 2009.

**Table 2.9**  
**The Number of Small and Medium Businesses (SMB) and Employees by Sub-Sector**  
**In Bantul District 2007**

No.	Sub-Sector of Industry	Number of Manufactory		Total	Number of Employee		Total
		Formal	Non-Formal		Formal	No-Formal	
1.	Manufacture of Food	259	7,140	7,399	3,841	20,655	24,496
2.	Clothing and Leather	211	477	688	3,620	21,117	5,737
3.	Handicraft	334	5,886	6,220	7,466	14,410	21,876
4.	Chemical and Materials	377	2,349	2,726	11,400	14,330	25,730
5.	Metal and Services	99	779	878	706	1,359	2,065
	Total	1,280	16,631	17,911	27,033	52,871	79,904
	2006	1,250	16,615	17,865	26,054	52,729	78,783

Source: *Pemerintah Kabupaten Bantul* (2008a, p. 277).

As discussed in Chapter One, small businesses are expected to provide a financial contribution to the district government income by paying local levies. However, in case of Bantul, most small businesses owners did not pay local levies as demonstrated. The Case of Bantul showed that foreign investment was smaller than domestic investment and the growth of investment was slow. In 2007 it decreased (Table 2.10). Thus, these investments provided a small contribution in creating employment opportunities and district government revenue.

**Table 2.10**  
**Domestic and Foreign Investment in Bantul, 2004-2007**  
**(In Million Rupiah)**

No.	Year	Domestic Investment (DI)	Growth of DI	Foreign Investment (FI)	Growth of FI
1.	2004	85,460		59,898	
2.	2005	85,463	0.0	59,898	0.0
3.	2006	86,952	1.7	75,076	25.3
4.	2007	86,052	-1.0	4,179	-94.4

Source: *Pemerintah Kabupaten Bantul* (2008b, p. 169)

As depicted in Table 2.10, during 2004-2007, the growth of the industrial sector was sluggish and the local government had difficulty in obtaining more income from local levies as most of the manufacturers ignored business permits and never paid



local levies. The income from local taxes was small as there were no luxury hotels, restaurants or a large foreign investment in Bantul. To date, the Bantul district government has failed to enhance local financial capacity from the industrial sector.

From the economic structure discussed above, it may be concluded that the agricultural sector accounts for the largest contribution of the gross district product. However, the Bantul district has difficulty to enhance gross district product from this sector because of limited agricultural field area. Until now, the Bantul district government is dependent on the central government grants. Without the central government grants, decentralisation policy will not be implemented effectively. The next section will discuss political institutions with the aim of examining the extent to which they play an important role in the dynamics of local political activities.

#### **2.4. Political Institutions**

Political institutions consist of the local parliament and political parties. As discussed in Chapter One, decentralisation policy may increase the role of local parliament and political parties in local politics. Both local parliament members and local political parties may try to pursue public resources because under the decentralisation era public resources are in the hand of local government. This section will discuss the political dynamics of local parliament as well as political parties as a result of decentralisation policy. The analysis questions if political parties do in fact become more responsive to the interests and needs of small businesses; and the extent to which can they articulate the interests of small businesses into local regulations.

##### **2.4.1. Local Parliament**

Under the New Order Government (1967-1998) the Bantul district was controlled by the Golkar Party and supported by military power. Other parties such as the Indonesian Democracy Party (PDI) and United Development Party (PPP) always followed the path of the Golkar Party. However, following the 1998 *reformasi*, the Indonesian government adopted a decentralisation system in development due to public demand. The public demanded the Indonesian government to develop democracy and open access for popular participation. At that time many political parties emerged to compete for political position both in the executive and legislative

institutions with the aim to obtain political and economic resources. Decentralisation policy means a transfer of resources from the central government to local government. Thus, the dynamics of local politics greatly developed under the decentralisation era.

In Bantul district there were 48 political parties involved in the 1999 election for the local and national legislature. However, only 10 political parties gained seats in the local legislature. In the next election in 2004, 16 political parties participated. However, only eight of these obtained seats as local parliament members. The Indonesian Democracy Party of Struggle (PDI-P) obtained the majority of seats (35.56 percent). Further, in the 2009 election, the number of political parties involved in the election increased to 24, yet only nine gained seats in the local parliament (Table 2.11). In that election, PAN party gained seven seats or 15.56 percent whereas PKB gained three seats or 6.67 percent in local parliament (Table 2.11). Both PAN and PKB were born as process of democratic transition in Indonesia. The PAN party was established in 1998 while the PKB party was developed in 1999. The democratic transition has opened a new climate for the emergence new parties. In the previous period under the Suharto regime, the Indonesian government only permitted three political parties: Golkar, PDI party and PPP party. In addition, the process of democratic transition has encouraged the Indonesian people to demand decentralisation policy.

Beyond PAN party and PKB party, there were more two Islamic parties: the Justice and Prosperity party (PKS party) obtained five seats and United Development Party (PPP party) 4 seats. Thus, Islamic parties occupied 19 seats (42 percent) of 45 seats in local parliament membership of Bantul (2009-2014). Previously (2004-2009) the Islamic parties occupied 21 seats (47 percent) of 45 seats in local legislature members. This means political parties based on Islamic religion are still supported by about half of the population of Bantul district. This is different from Gianyar district, in which there is no political party present, based on religion, as will be discussed in Chapter 3.

**Table 2.11**  
**Distribution of Seats among Political Parties in Local Parliament of**  
**Bantul 2004-2009 and 2009-2014**

No.	Political Parties	2004-2009		2009-2014	
		Seat	Percentage	Seat	Percentage
1.	Indonesian Democracy Party of Struggle ( <i>Partai Demokrasi Perjuangan</i> or PDI-P)	16	35.56	11	24.44
2.	National Mandate Party ( <i>Partai Amanat Nasional</i> or PAN)	7	15.56	7	15.56
3.	National Awakening Party ( <i>Partai Kebangkitan Bangsa</i> or PKB)	6	13.33	3	6.67
4.	Justice and Prosperity Party ( <i>Partai Keadilan dan Sejahtera</i> or PKS)	5	11.11	5	11.11
5.	Golkar Party ( <i>Partai Golkar</i> )	5	11.11	5	11.11
6.	United Development Party ( <i>Partai Persatuan Pembangunan</i> or PPP)	3	6.67	4	8.89
7.	National hood and Caring Party ( <i>Partai Karya Peduli Bangsa</i> or PKPB)	2	4.44	2	4.44
8.	Democratic Party (PD)	1	2.22	5	11.11
9.	<i>Gerindra</i> Party	-	-	3	6.67
	Total	45	100	45	100

Source: KPUD Bantul, 2009.

The Indonesian Democracy Party of Struggle (PDI-P) was the winner in the 1999, 2004 and 2009 elections. However, in the 2009 election, the PDI-P party lost four seats in local parliament because some voters moved their support to Democratic Party and the *Gerindra* party. This indicated that political parties had become more competitive in pursuit of political power in local parliament. Since the decentralisation policy was adopted in the Bantul district, the political power in local legislature has changed. The PDI-P party occupied the majority of local parliament seats during 1999-2004 and 2005-2009 whereas before decentralisation era (1972-1999), the *Golkar* party occupied majority of local parliament seats. During the decentralisation era, political power in the local legislature was fragmented among several political parties, but the PDI-P party was able to control it. The emergence of several new political parties in local legislature did not increase the performance of the legislature because of low performance of its members as described in the following section.

### Case 2.1: Low Quality of Local Legislature Members

Local legislature members were only viewed with one eye<sup>24</sup> by the district head. Most of them did not understand their job, local social and political issues. They became local legislature members because of money politics. They thought, they would obtain money for approving the annual district budget. In addition, they had no innovative policy to carry out the functions of local legislature.<sup>25</sup>

The district head of Bantul also stated that the quality of local legislature members decreased because the political parties did not select them based on effective criteria. In contrast, they proposed them as candidates for the legislature because they provided money to their political parties. As a result, the performance of local legislature was low.<sup>26</sup> The majority of them did not understand their functions as local legislature members nor the needs of local communities.<sup>27</sup>

Regarding their low performance, it is important to explore the backgrounds of these local legislature members to determine whether or not their background influenced them negatively in implementing the legislature's functions. Most the local parliament members (2004-2009) had previous positions as lecturers and senior high school teachers (35 percent). Approximately 31 percent of local parliament members were businessmen previously and only about 26 percent of them were political activists (Table 2.12). Although the majority of local parliament members had previous careers as teachers and businessmen, they had no innovative policy to promote the education or the business sector. In fact they only supported the district head's programs. For instance, local legislature members were not motivated to protect small businesses, yet the district head issued the district head's decree (*Keputusan Bupati*) No. 503/5439 to protect small businesses.

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<sup>24</sup> Local legislature was viewed 'with only one eye' (*dilihat dengan sebelah mata*), being the Indonesian metaphor to describe that the low capacity of of these local legislators compared with the capacity of the district head.

<sup>25</sup> Interview with head of B Committee of Local legislature of Bantul, 15 June 2009.

<sup>26</sup> Interview with District Head of Bantul 25 June 2009.

<sup>27</sup> Interview with W.U., Senior lecturer at Faculty of Social and Political Sciences, Gadjah Mada University, 18 June 2009.

**Table 2.12**  
**Background of Local Parliament member of Bantul, 2004-2009**

Previous Job of Parliament Member	Local Parliament Members	
	Number	Percentage
Bureaucrats	1	2.22
Politicians	12	26.67
Business persons	14	31.11
Teachers/Lecturers	16	35.56
Building Contractor	1	2.22
Farmers	1	2.22
Total	45	100.00

Source:Field work 2009.

After discussing problems of the local legislature, further discussion examines the extent to which political parties had discretionary policy and could be responsive to the interests of small businesses.

#### **2.4.2. Political Party**

Traditionally, the political parties in Bantul can be classified into those based on religion and those based on secular nationalist persuasions. The National Mandate Party (PAN party), National Awakening Party (PKB party), Justice and Prosperity Party (PKS party), and United Development Party (PPP party) are classified as Islamic parties whereas Indonesian Democratic Party of Struggle (PDI-P party), *Golkar* party, Democratic party (PD party), *Gerindra* party and National Hood and Caring Party (PKPB party) are categorised as secular nationalist parties.

Political parties in Bantul do not have sufficient financial resources to develop. The revenue of political parties derives from local government funds, fees from party members who become local parliament member and donors. The local government provides funds for political parties based on total seats held in local parliament. For each seat, the local government provides 19.5 million rupiah. The PDI-P party, for instance, obtained 312 million rupiah in 2008 from the district government because the PDI-P party had 16 seats in local parliament.<sup>28</sup> Each local parliament member also contributes to his/her party based on its party's decision. For instance, each local parliament member from PAN Party has to contribute around 20 percent of his/her

<sup>28</sup>Interview with Secretary of the PDI-P Party, Bantul branch, 26 June 2009.

salary per month.<sup>29</sup> However, local parliament members from the PDI-P party are obligated to contribute Rp 2.5 million each month, around 25 percent of his/her salary.<sup>30</sup> This indicates that the financial source of a party is derived from the local government's subsidy and the party members who act as a local legislator. The more seats obtained in local parliament, the more funds are obtained from the local government. Thus, political parties compete intensely in local legislature member elections to pursue the financial resources in order to influence political decisions. A lack of financial resources for a political party can cause difficulties in making innovative policy and developing a viable network with constituents. However, the development of a constituent network can be also be carried out by political party cadres who have strategic position in other organisations such as a business association or a social organisation.

The PDI-P party developed networks with small businesses through the *Dekranas*, a business association because the head of *Dekranas* was a cadre of this party. The local government of Bantul delivered funds to small businesses through the *Dekranas* for helping business exhibition and financial assistance. This means, the PDI-P party indirectly obtained political benefits from the *Dekranas*. In 2010 the head of *Dekranas* competed for the district head election and succeeded as the head of *Dekranas* gained more than 70 percent of total votes. This suggests that the *Dekranas* was used by politician to obtain political position.

Based on the discussion above, it may be concluded that before 2000, local legislature was controlled by the *Golkar* party, but then political power in local legislature of Bantul was controlled by the PDI-P party. However, the performance of local legislature remained low because of the money politics in elections for local legislature candidates. A lack of financial capacity of political parties might have caused them to select the local legislature candidates based on money considerations and not on the performance of the candidate. As a result, the performance of local legislature was low and contributed less to promoting small businesses. The next section will discuss local bureaucracy with the aim to explore the behavioural changes in providing public services for small businesses.

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<sup>29</sup>Interview with Chairman of PAN party, Bantul branch, 10 June 2009.

<sup>30</sup>Interview with Secretary of the PDI-P party, Bantul branch, 26 June 2009.

## 2.5. Local Bureaucracy

This section will answer the question as proposed in Introduction: Have local bureaucrats and district heads responded to the needs and interests of small business owners? As discussed in Chapter One, decentralisation policy has an impact on local bureaucrats and district government leaders, who have more tasks and responsibilities as a result of decentralisation. This section will examine the extent to which decentralisation policy can influence the behaviour of local bureaucrats and district leaders in providing public service to small businesses.

### 2.5.1. The Behaviour of Local Bureaucrats

This section explores to what extent the behaviour of local bureaucrats changed as a result of decentralisation policy and whether or not they became responsive in providing public services. First, in order to understand civil servants, we need to explore the number of civil servants of the Bantul district based on their education. Did the factor of education influence their behaviour? The total number of civil servants in the Bantul district was 12,703 people. Most of them (67.23 percent) were employed by the local educational institutions (the first rank). The second rank was 1,334 people (10.50 percent) who work in the local health agencies. The third rank was 484 people (3.81 percent) who worked across 17 sub-districts. The others were distributed into 10 *Dinas* (local government agencies), *Badan* (local government board), and the District Government's secretariat (Table 2.13). However, the total number of public servants should be effective if they were educated. Therefore, it is important to classify public servants based on their education level.

**Table 2.13**  
**Civil Servants of the Bantul District Government**

No.	Location of Work	Total	Percentage
1.	Local Government: Education	8,540	67.23
2.	Local Government Health Agencies	1,334	10.50
3.	Other 10 Local Government Agencies	1,398	11.00
4.	17 Sub-District Government	484	3.81
5.	4 Local Government Boards	244	1.92
6.	District Government Secretariats	385	3.03
7.	Others	318	2.51
	Total	12,703	100

Source: *Pemerintah Kabupaten Bantul* (2008, pp. 29-30).

Only 8.40 percent of civil servants were university graduates with bachelor degrees, and 0.80 percent with masters degree. Around 55.73 percent graduated from senior high schools, 3.10 percent graduated from junior high schools and around 1.89 percent graduated from primary schools. These results indicate that less than 10 percent of civil servants were university graduates. It appears that the district government needed more civil servants educated at university graduate in order to perform complex jobs resulting from administrative decentralisation. That is, higher education of civil servants might provide better performance. Therefore, in decentralisation era, the district government should have facilitated scholarship for selected local public servants who wished to pursue higher education. The following will discuss the change of political positions of public servants from participant to passive/ non-participant in politics.

During the New Order Government (1968-1998), civil servants became the key buffer of the Golkar party. The Golkar party controlled civil servants through Civil Servants Association (*Korpri*) and the National Civil Service Agency (BKN: *Badan Kepegawaian Nasional*) as well as all district heads and all governors in Indonesia. However, following the fall of Soeharto, the government introduced Law No. 43/1999, in which the civil servants became non-participant in politics. They were not allowed to be a political party member. As a result, civil servants become increasingly critical in carrying out their duties. Previously, they were passive and did not dare express their opinion. The following case describes the change of local bureaucrat's behaviour toward critical local bureaucrats. Critical local public servants can provide better performance in public services.

### **Case 2.2: Change of Local Bureaucrat's behaviour**

The local agency heads, local board heads, and sub-district heads always propose their ideas in meetings with *Bupati*. The *Bupati* always extended the time of the meeting. This condition never occurred before decentralisation era when Bantul was controlled by *Bupati* who were military. Under a military regime, the local government agencies heads and local government board and sub-district heads were passive and only followed *Bupati*'s direction.<sup>31</sup>

According to head of Local Agency for Industry and Trade (*Diperindagkop*), there was paradigmatic change of local bureaucrats from 'requesting to be served' (*minta dilayani*) to becoming 'services providers' (*memberikan pelayanan*) because of

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<sup>31</sup> Interview with *Bupati* of Bantul, 25 June 2009.



public demand. As a result, local bureaucrats often went to the grassroots level. The Head of *Diperindagkop* also became more open in responding to local people's interests who came to his office.<sup>32</sup> Furthermore, a journalist commented that during decentralisation era the behaviour of bureaucrats changed in regard to local citizens and other journalists. They became open and transparent in providing public services. They were aware that district government needed support from local citizens.<sup>33</sup> The following case shows that the district government was responsive to the needs of small businesses.

**Case 2.3: Local Bureaucrats were responsive to the needs of Small Businesses**

District government helped small business owners to participate in business exhibitions, create markets and infrastructure facilities. The behaviour of local bureaucrats has changed under Idham Samawi's regime. He was concerned with small businesses.<sup>34</sup>

Mr. T.M. commented that district government really had provided financial assistance and training program to small businesses. He felt that both financial and training assistances were useful in promoting his own business.<sup>35</sup>

Indeed, a small business owner recognised that there was a behavioural change of local bureaucrats, albeit small. There was less innovation in policy making. In contrast, policies were made simply, as they simply copied previous policies.<sup>36</sup> The survey data from 60 small business owners showed 45 percent of respondents revealed that the behaviour of local bureaucrat changed under decentralisation era. However, 25 percent said that the behaviour of local bureaucrats did not change (Chart 2.3). It may be concluded that decentralisation policy tended to cause small change of behaviour of local bureaucrats.

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<sup>32</sup> Interview with Head of *Diperindagkop*, 3 June 2009.

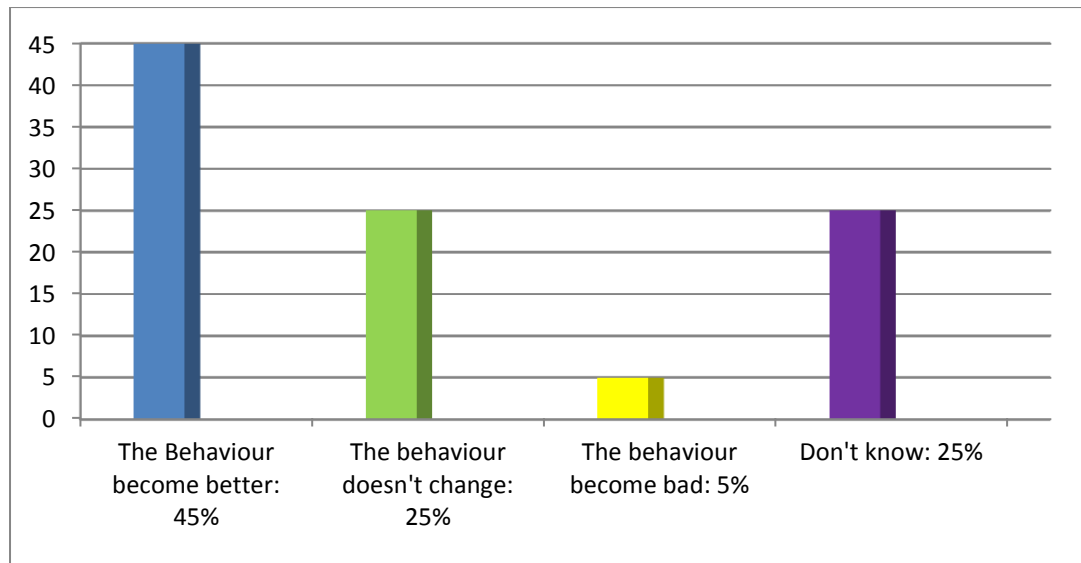
<sup>33</sup> Interview with Mr. B.S., Journalist of Daily Kompas , 7 June 2009.

<sup>34</sup> Interview with Mr. S.H., Small business owner, 9 July 2009.

<sup>35</sup> Interview with Mr. T.M., Small business owner, 23 Jenu 2009.

<sup>36</sup> Interview with Mr. A.T, a businessman, 19 June 2009.

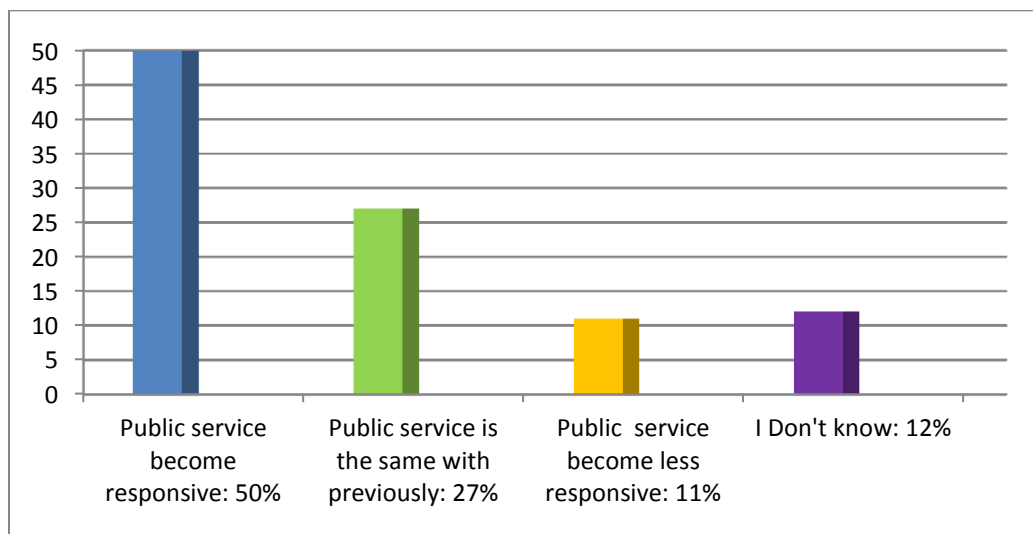
**Chart 2.3**  
**The Perception of Small Business Owners on Behaviour of Local Bureaucrats**  
**(N=60)**



Source: Survey data, 2009.

The important question is whether or not public services changed during the decentralisation era. The findings indicate that 50 percent respondents said that public services provided by local government had improved. Twenty seven percent commented that public service was the same as before the decentralisation era. Only 11 percent argued that public services had become less responsive and 12 percent were not sure (Chart 2.4). It may be concluded that under decentralisation policy, public services for small business tended to improve in comparison to the previous administration. For example, the district government built *Pasar Seni Gabusan* (the Gabusan Art Market) as well as three public market buildings in Niten, Imogiri and Piyungan with the aim to facilitate small business.

**Chart 2.4**  
**The Perception of Small Business Owners on Public Services**  
 (N=60)



Source: Fieldwork, 2009

Based on the research findings above, it may be concluded that the behaviour of local bureaucracy in providing public services had changed. As a result, public services had been improved. The next important question is, whether the style of the district government head leadership had also changed during the decentralisation era.

### 2.5.2. Style of District Head Leadership

This section concerns whether the district head leadership of Bantul under decentralisation policy was different from that under centralized policy. Following *reformasi* 1998, there was significant political change that provided more power to the district head in managing the development sectors as well as in developing the local democracy.

Under the centralized political policy which was based on Law 5/1974, district heads were elected by local parliament members. However, the candidates had to be approved by central government. Starting in 2001, the Indonesian government moved toward a democratic transition. Law No. 5/1974 was replaced by Law 22/1999 whereby district heads were elected by local parliament members without intervention from the central government. Five years later Law 22/1999 was replaced by Law 32/2004, which provided local people access to involvement in the election

of district heads. Then in 2005 district heads were directly elected by local people. In this context, local political actors sought support from the local voters to promote their political positions. The new system of district head elections caused the dynamics of local politics to change because the candidates for district heads and political parties had to be active in approaching local citizens to obtain their political support. They used many ways in approaching local citizens such as providing money to local communities (money politics) and by using the head of hamlet (*Dukuh*) and the head of local community associations (RT) to influence their members in electing local legislative members.

Under New Order Government (1967-1998), the *Bupati* of Bantul always came from within the military and the regime was characteristically authoritarian. Following the collapse of Soeharto's regime and the *Golkar* party, the PDI-P party gained majority of seats in local parliament in Bantul district. Since 1999, the Bantul district has been controlled by Idham Samawi, from the PDI-P party and son of the owner of *Kedaulatan Rakyat* daily in Yogyakarta. As a former journalist, Idham Samawi had strong support from the media community in Bantul and Yogyakarta (Sulistiyanto, 2009, p. 202) and as a political party member he was strongly supported by the PDI-P party in the implementation of decentralisation policy. Thus, it was easy for him to socialise his programs in mass media and its implementation. District government policies were supported by the majority of legislative members who came from the PDI-P party and *Golkar* party. This is because the vice district head came from *Golkar* party.

Under Idham Samawi, this region became more democratic because he opened access for local bureaucrats and local people to propose ideas through the local community meeting and mass media. Populist policies were introduced to protect farmers and small businesses in Bantul. For instance, local government launched soft loans program for traditional market sellers to protect them from exploitative creditors (known pejoratively as *lintah darat*). This suggests that based on promotional aspect, the relationship between the district head and small business is characterised by protective relationship. In addition, he provided health insurance program for poor families in Bantul with aim to improve public health. These

programs indicated that the district head of Bantul was concerned with the poor people, different from those of the previous regime.

In the education sector, the *Bupati* of Bantul introduced a scholarship program from 2004 until now for junior and senior high school teachers to take masters degrees programs at universities in Yogyakarta. He also provided scholarships for students of Bantul who were poor but demonstrated high academic achievement. The Bantul district launched financial incentives for all teachers of 250 thousand rupiah per 3 months. These programs aimed to improve the quality of human resources in the education sector. To date approximately 158 of 4,500 teachers of the Bantul district graduated from a masters program.

In the agricultural sector, as the district head of Bantul, in 2008 Idham Samawi continued to implement populist policies which benefited farmers. The district government introduced a scheme to protect farmers by buying agricultural products (rice, chilli, shallots and corn) during the harvest season when the prices of these products dropped. The district government then would sell these products when prices rose again. The district government of Bantul prepared funds of 3.5 billion rupiah for this initiative's inception 2001. During the harvest season, the price of corn dropped to Rp 900 per kg, despite the local government deciding that the floor price of corn was Rp 1800 per kg. Therefore, the local government bought the corn from farmers at Rp 1800 per kg.<sup>37</sup> The case of agricultural sector mentioned suggests that the district head of Bantul had a clear protection policy for small farmers.

In addition, in the social and political sectors, during 1999-2004 Idham Samawi was active in developing social organisations at the grassroots level. He supported the *Paguyuban Lurah Tunggal Jati*, an association of village bureaucrats consisting of village heads and their employers in Bantul district. In 2003, he mobilized thousands of villagers and village heads of the Bantul district to support the re-election of the Sultan Hamengkubowono The Tenth as the Governor of Special Province of Yogyakarta (Sulistiyanto, 2009). The association showed loyalty to Idham Samawi by supporting his policies. Further, in accelerating development in sub-districts and

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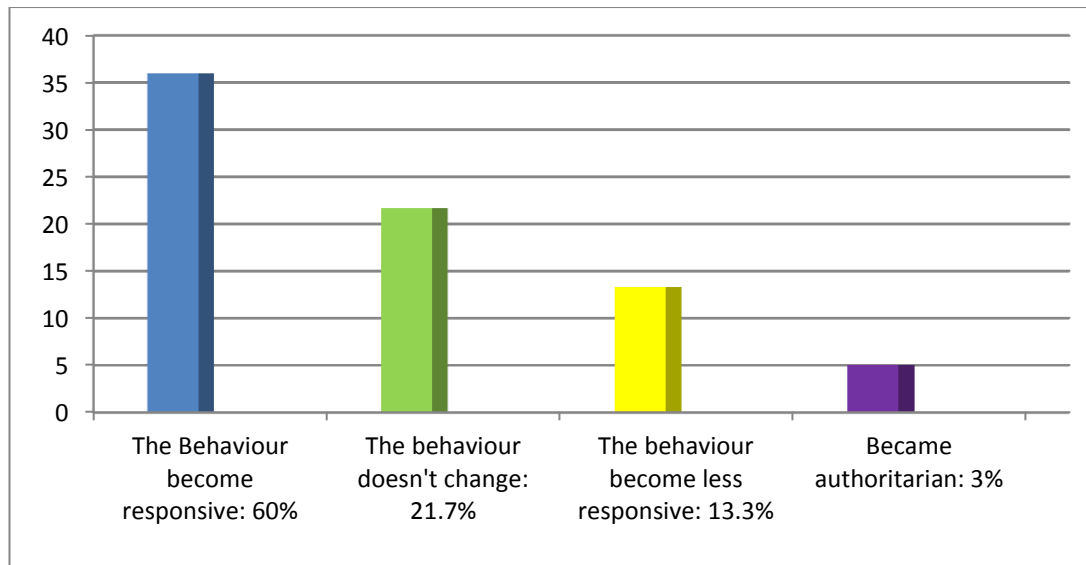
<sup>37</sup> Interview with District Head of Bantul, 25 June 2009.

controlling grassroots level demands, the district government head provided additional jobs to all local agency heads. Each local agency head was given responsibility in each sub-district to identify local demands and needs. Therefore, Idham Samawi was able to control all sub-districts of Bantul.

Moreover, the television program, *Plengkung Gading* was developed in 2007 to communicate with local people. This program aimed to introduce the development programs and to gain input from local people. Through the television program the *Bupati* could build an image as a good leader, particularly in the first period of his position as the *Bupati*. This program suggests that local government created an opportunity for local people to participate in the process of decision making. As discussed by Hentic and Bernier (1999) in Chapter One, local government should develop a mechanism and framework that enables people to participate in that government. The television media was chosen by local government because it could disseminate public policy information throughout local people. This is similar with the case of city Oakland in the United States as stated by Pressman (1972), using mass media such television and newspapers could help a leader to obtain political support.

Survey data from 60 small business owners indicated that 60 percent of those respondents revealed that the behaviour of the district head had become responsive and closer to local citizens under decentralisation. Twenty one percent said that there was no change. Only 13 percent perceived that district head became less responsive (Chart 2.5). This means decentralisation policy tended to cause district heads to become close and responsive to small business owners as local citizens. The district head actively helped local citizens particularly in the case of buying of agricultural products as discussed above.

**Chart 2.5**  
**The Perception of Small Business Owners on Behaviour of District Head**  
**(N=60)**



Source: Fieldwork, 2009.

The evidence above suggests that the style of the district head of Bantul had changed from an authoritarian style of leadership during New Order Government (1968-1998) to a democratic style of leadership during decentralisation era (1999-now). Since 1999 the district head leadership of Bantul has been characterized by populist concerns for poor peoples' interests. In relation to small businesses, the district head of Bantul strongly supported small business development. There were three factors that influenced the success of Idham Samawi. First, he was supported by local social organisations. Second, he used mass media (both newspaper and television) to introduce his programs and develop an image as populist leader. Third, he was able to control a big political party, the PDI-P party which occupies majority seats in local legislative. After discussing local bureaucrats and local leaders, it is important to explore community structure of Bantul. The following section discusses this topic.

## **2.6. Community Structure**

Decentralisation policy provides greater opportunities for local citizen groups and local business groups to participate in the process of decision making. This section will discuss to what extent local citizen groups and local business associations are involved in the process of decision making at local level. Then it examines the role of neighbourhood associations in the dynamics of local politics. It will be shown

whether or not they can articulate their preferences to policy makers in both the executive and legislative arena.

### 2.6.1. Citizen's Group and Business Associations

In general, we can classify non-government organisations into two types: non-business organisations or citizen's groups (Table 2.14) and business organisations (Table 2.15). Each group will be discussed in order to explore its role in decision making process.

#### 2.6.1.1. Citizen's Group

Until 2008 there were 153 non-business organisations (Table 2.14). Most of them were social organisations such as *Macan Tamil* (Tamil Tiger), *Garda Nusantara* (National Fortress), *Paserbumi*, *Brantas*, *Pordasi* and *Lappera* that were active in responding to social and political issues. These organisations always supported Idham Samawi (Sulistiyanto, 2009, p. 202). Bureaucratic Associations at village level such as APDESI (*Asosiasi Pemerintah Desa Indonesia*) or the Association of Village Administration, AKDESI (*Asosiasi Kepala Desa Seluruh Indonesia*) or the Association of The Village Head, and the Association of The Village Secretary were also active in local politics and supported Idham Samawi. For instance, at the end of 2009 APDESI declared support of Mrs. Sri Suryawidati (Idham Samawi's wife) to become the candidate for district head in 2010 *Pilkada*. Idham Samawi supervised these local organisations to obtain political support during his position as district head, particularly in facing critics from the local legislature members. These local organisations were often mobilized to support Idham Samawi (Case 2.4).

**Table 2.14**  
**Non-Business Organisation**

No.	Name of Organisation	Number
2.	Religion Organisation	21
3.	Educational Organisation	9
4.	Youth Organisation	13
5.	Societal Organisation ( <i>Organisasi Masyarakat</i> )	100
6.	Professional Organisation	10
	Total	153

Source: *Pemerintah Kabupaten Bantul* (2008a, p. 1999).



Before the elections for district head in 2010, the APDESI was mobilized by local politicians to support one of candidate for the district head position (Case 2.4).

**Case 2.4: Networks between APDESI and Political Party**

In March 2009, there was a meeting for discussing development called *Sarasean Pembangunan*, organized by APDESI. This meeting suggested that members of APDESI should submit a project proposal to the district government, and then the district government would respond to it as soon as possible. Some local legislature members who are the same party attended to this meeting. However, this meeting was criticized by PKS party as hidden campaign from PDI-P party.<sup>38</sup>

The next case showed that APDESI strongly supported Idham Samawi. Although Law 32/2004 states that one can be the district head maximum two periods (10 years), the APDESI proposed to central government to provide an exception for Idham Samawi (Case 2.5).

**Case 2.5: Networks between APDESI and the District Head**

The chairman of Bantul branch of APDESI, Jiyono said that Idham proved as a leader who was loved by local people and achieved success in leading the Bantul district. Based on this reasons, APDESI proposed to central government to provide an exception for Idham Samawi to allow him to be re-elected in the third district head election.<sup>39</sup>

It was clear that citizen group such as APDESI was used by the district government head to support his interests. However, they were not involved in the process of decision-making. This differed with business associations such as *Dekranas* which was involved in decision-making at district government level. The following section will discuss the involvement of business associations.

**2.6.1.2. Business Associations: *Dekranas***

The discussion of this section focuses on *Dewan Kerajinan Nasional or Dekranas* (Bantul Branch - National Handicraft Board) because this business organisation played a more important role than others in promoting small businesses and developing its networking with the district government. As we can see in Table 2.15, there are eight small business associations. However, the *Dekranas* is close to the local government and was involved in the process of decision-making at the district level. This association was more active in promoting small businesses than others.

<sup>38</sup> Daily newspaper *Suara Merdeka* (7 March 2009) and Daily newspaper *Harian Jogja* (6-3-2009).

<sup>39</sup>(1-7-2008)

**Table 2.15**  
**Business Associations in Bantul**

No.	Name of Association	Chairperson
1.	<i>Dewan Kerajinan Nasional</i> (National Handicraft Board - Branch of Bantul District)	Mrs. Sri Suryawidati (Idham Samawi's wife and Candidate for <i>Bupati</i> 2010 election)
2.	<i>Kamar Dagang dan Industry</i> or <i>Kadinda</i> (Bantul Chamber of Industry and Trade)	Slamet Subagyo (Bantul Local Parliament member)
3.	<i>Koperasi Satya Bawana Kasongan, Bantul</i> (Kasongan Small business Cooperative)	Dr. Timbul Raharjo (Lecturer of ISI)
4.	Bantul Craft Association	Supriaswoto
5.	<i>Paguyuban Karya Sejahtera Mandiri</i> ( <i>Manding Handicraft Association</i> )	Sagimin
6.	ASEPHI ( <i>Asosiasi Exportir dan Handicraft</i> ) or Association of Exporters and Handicraft)	Endah Rahayu Murniati, SE (Candidate for National parliament of Democrat Party in 2009)
7.	ASMINDO ( <i>Asosiasi Industri Permebelan dan Kerajinan Indonesia</i> ) or Indonesian Furniture Industry and Handicraft Association	Ambar Tjahjono, SE (Candidate for National parliament of Democrat Party in 2009)
8.	APIKRI (Foundation of Indonesian People's Handycraft Development) <sup>40</sup>	Amir Pansuri

Source: Fieldwork, 2009.

*Dekranas* was headed by Mrs. Sri Suryawidati, who is Idham Samawi's wife. He was head of the Bantul district government and the deputy of National Board of the PDI-P party. Therefore, it is understood that the association is supported by district government. Additionally, the association received funding from the Bantul district through *APBD* (*District Government Budget*) for promoting small businesses. The *Dekranas* program consists of facilitating market promotion, workshops and providing loan assistance for small businesses. *Dekranas* also developed a network with the Indonesian University of the Arts (ISI) to introduce new designs of Batik and ceramic handicrafts and workshops for small businesses. The programs of *Dekranas* are supported by the *Diperindagkop* (Local Agency for Trade, Industry and Cooperative). As an example, when the researcher was invited by chairman of *Dekranas* to attend in the meeting with small business participants on the 11 June 2009, the head of *Diperindagkop* also attended the meeting and supported it. In the

<sup>40</sup> *Apikri* (*Asosiasi Pemasaran Industri Kerajinan Rakyat Indonesia*) was established by small business owners and NGO activists in 1987. The name was changed to *Asosiasi Pengembangan Industri Kerajinan Rakyat Indonesia* in 1989 and In 1990 replaced by *Yayasan Pengembangan Industri Kerajinan Rakyat Indonesia*.

practice of the Indonesian bureaucratic culture, the level of official (*pejabat*) attendance at an event is an indicator of the importance of the event (Pramusinto, 2005, p. 319). In the case of *Dekranas*, it is clear that the district government supported the *Dekranas* by facilitating funds and infrastructures. In contrast, the *Dekranas* was able to make a bargain with the district government to produce local policy in accordance with the needs and interests of small businesses.

Based on discussion above, it can be argued that there is a patronage relationship between *Dekranas* and the district government of Bantul. The district head of Bantul helped small business owners through *Dekranas* with the expectation that the *Dekranas* would become strong and have the power to influence small business owners. In local politics of Bantul, kinship played an important role in leadership succession. As I have discussed in previous page (117), Sri Suryawidati, chairman of *Dekranas* is the wife of Idham Samawi, District Head of Bantul. This opened a large access for the head of *Dekranas* to be appreciated by public with the expectation she would gain many votes in the district head elections in 2010. It was a remarkable result as Sri Suryawidati obtained almost 70 per cent of total votes in those elections. Idham Samawi as Bantul district head had prepared his wife to replace his position and developed a political dynasty in Bantul district. This is evidence that the patrimonial system was adopted in the Bantul district.

However, a patrimonial system is not only adopted by the Bantul district but it is also adopted by other districts in Indonesia where kinship and other family ties determine the relationship between business and politics such as in the district of South Tangerang, where head of district of South Tangerang, Airin Rachmy Diani provided facilities to the business man, Tubagus Chaeri Wardhana, the husband of South Tangerang district (Tribunnews.com. 14 November 2013).

Other business associations, as an example, *Kadinda* also received funds from local government because the chairman of *Kadinda* is a *Golkar* party member and a local legislative member. This association received 40 million rupiah from the Bantul district government in 2008.<sup>41</sup> It can be concluded that both the *Golkar* party and

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<sup>41</sup> Interview with Mr. S.B., Chairman of *Kadinda*, 15 June 2009.

PDI-P party developed their own networks with business associations. Golkar developed networks with *Kadinda* whereas PDI-P party with *Dekranas* with the aim to obtain political support. At the same time the association obtained financial benefit.

Besides these two business associations, there are other business associations such as Bantul Craft, Manding Handicraft Association, ASEPFI, ASMINDO, APIKRI and Kasongan Small Business Cooperative. However they have not developed networks with political parties, and thus rarely receive funds from the local government of Bantul. They prefer to be autonomous associations (Case 2.6).

**Case 2.6: Bantul Craft Association want to be Autonomous Association.**

The Bantul Craft Association only received 375 million rupiah once in 2006 from central government but they could still survive. These funds are aimed to make economic recovery to small business owners after the earthquake, which destroyed small business shops and houses, and thus the products of small businesses decreased. The chairman of the Bantul Craft Association, for instance, argued that this association became an autonomous institution without a district government grant. This association collected funds monthly from its members and if the member sold their products through the association, they had to provide 1 percent of total price. The association did not want to depend on the local government.<sup>42</sup>

The *Manding Handicraft Association* was also not involved in the process of decision making at district level. In 2006, this association received technological assistance such as a sewing machine and compressor from the provincial government.<sup>43</sup> The others 6 business associations never received funds from the district government of Bantul.

It can be concluded that business association named *Dekranas* and *Kadinda* have links with political parties and receive funds from the Bantul district government. It is seen that *Dekranas* had more influence to district government than *Kadinda* because characteristics of the relationship between *Dekranas* and district government is patrimonialism. These associations were used by political parties to obtain political position.

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<sup>42</sup>Interview with Mr. S.A., chairman of the Bantul Craft Association, 16 June 2009.

<sup>43</sup>Interview with Mr. Sg., chairman of *Manding Handicraft Association*, 7 July 2009.

### 2.6.2. The Neighbourhood Association

The community structure in Bantul is different from that in Gianyar, which will be described in more detail in the next chapter. As discussed above, the territory of Bantul is officially divided into sub-districts, and each sub-district is divided into villages. A village is divided into several hamlets (*pedukuhan*), which is headed by a *Dukuh*. Finally, the *pedukuhan* is divided into several neighbourhood associations (*Rukun Tetangga* or RT). Beyond official structure, there is however no traditional customary structure.

In Gianyar, there is a non-official government structure at a village level called *Desa Pakraman* (customary villages) beyond official villages (*Desa Dinas*). At the hamlet level (*pedukuhan*), there is the *Banjar*.<sup>44</sup> Both *Desa Pakraman* and *Banjar* are recognised by the Gianyar district government. At the *pedukuhan* level, the *Banjar* plays an important role to influence a communities' behaviour. For instance, in the campaign season for the legislative member election, the *Banjar* played an important role as mediator between local communities and local political actors.

Based on Law 32/2004, which started operating in 2005, the *Bupati* was directly elected by local citizens. As a result, there was change of role of neighbourhood associations (*RT* and *Pedukuhan*) at grassroots level. Both the head of RT and head of *Pedukuhan* played important roles as mediators between local politicians and voters. Legislator candidates and district head candidate approached the head of RT and head of *Pedukuhan* to obtain political support by providing funds and materials. They assumed that head of RT and head of *Pedukuhan* were able to influence voter behaviour at the grassroots level. However, the head of *Pedukuhan* stated that they allowed their members to vote for candidate based on their preference.<sup>45</sup> The head of RT also argued that he did not force his members to vote for a certain candidate. In contrast, he allowed them to vote for a candidate based on their preference.<sup>46</sup>

By mediating through *Pedukuhan* and *RT*, local communities can demand politicians to represent their needs. Some groups of society could politically bargain with

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<sup>44</sup>*Banjar* is customary local community organization at lowest level of social structure hierarchy

<sup>45</sup> Interview with Mr. N, Head of *Pedukuhan* of Kasongan, 14 July 2009.

<sup>46</sup> Interview with Mr. P., Head of RT, *Pedukuhan* of Karangasem, 9 July 2009.

legislature candidates. Several cases show that local communities could request funds from the local legislator candidate. For instance, the local communities in *Pedukuhan* Tirto request 4 million rupiah for buying loudspeakers from the local legislator candidate from the PAN party.<sup>47</sup> Other local communities of *Pedukuan* Karangasem request the local legislator from the PDI-P party 500,000 rupiah to improve local roads.<sup>48</sup> The local legislator candidate from the PDI-P party recognises that he provides T-shirts and materials to local community because the community ask him.<sup>49</sup>

In other case, some candidates of legislature member provided directly money to local people individually to influence constituents' behaviour. As a result, the behaviour of constituents will be based on a pragmatic reason in terms of money received rather than ideological reasons or programs offered by the candidates. Money politics emerged in political campaigning before electing legislature members. The *Bupati* of Bantul also told the researcher that there was change of behaviour of constituents from rationalism toward pragmatism which caused the decreased quality of local legislature members. This could endanger democratic development.<sup>50</sup>

Based on the discussion above, it can be concluded that *Dekranas* is one local business association which is used by the district head of Bantul to support his policy. *Dekranas* is supported by the district government and develops networks with political party in promoting small businesses. By this way, *Dekranas* is able to make a leverage with district government in local decision making.

At the grassroots level, the RT played an important role as mediator between local politicians and local people as constituents. Local politicians competed in pursuing political position and used RTs to influences behaviour of local communities in local legislative member elections. The decentralisation policy increased the dynamics of local politics but money politics emerged at the local level.

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<sup>47</sup> Interview with Mrs. S., Head of *Pedukuhan* Tirto, 7 July 2009.

<sup>48</sup> Interview with Mr. P, Head of RT, *Pedukuan* Karangasem, 9 July 2009.

<sup>49</sup> Interview with Mr. A, local legislator candidate from the PDI-P party, 26 June 2009.

<sup>50</sup> Interview with Bupati of Bantul, 25 June 2009.

## **2.7. Conclusion**

Geographically, the size of area of Bantul is small, so it is easily controlled by local government in implementing decentralisation. Bantul is not rich in natural resources and this provides small revenue for district government. The District government, therefore, has limited fiscal capacity to implement decentralised functions. In other words, the district government has difficulty in implementing administrative decentralisation.

Demographically, the total population of Bantul is small, but the population density is high. This provides positive contribution in the implementation of decentralisation because the small population and high population density can be more easily served by the district head. In addition, the district government can easily provide physical infrastructures and public services for local population such as roads, market buildings, hospitals and education.

The agricultural sector provided the largest contribution (24 percent) for the gross regional domestic product of Bantul, while the industrial sector only contributed 16 percent. The growth of industrial sector has been slow. The average of locally derived revenue (PAD income) is only 7 percent of total district government revenue (from 2002 to 2010). Therefore, the financial capacity of local government has been very low and in-sufficient to support the implementation of decentralisation policy. As a result, the district government has depended on central government grants. It may be concluded that without the central government grants, Bantul has difficulty to implement administrative decentralisation.

In terms of economic structure, the research finding found that the decentralisation policy has not given benefit to district government in revenue from local taxes because the district government has lack of control over taxes. The central government determined types of tax and tax rates. In relation to spending of local taxes, the local government has discretionary power. The local government of Bantul has discretionary power to help small businessmen by using revenue from tax incomes. In addition, the local government has discretionary power in terms of revenue and expenditure levies because local governments can control the type and amount of levy charges. Based on the Law 28/2009, district government has

discretion to determine three types of levies such as levy of general public service, levy of business service and levy for certain license. The number and variety of each type of levy is different among districts. Therefore, the district government tends to develop many levies with the aim to increase its locally derived revenue. The local government of Bantul established seven types of business levies such as levy for using local government's assets, levy for place fish sales, levy for passengers in bus station, parking levy, husbandry abattoir levy, levy for sport centre and entertainment, and levy for agricultural products.

The district government income consists of the PAD income and equalisation funds. The PAD income consists of income from local taxes, local levies and district government enterprises. The local government has discretionary policy to use income from local taxes, local levies and district government enterprises. Since 2001 the central government has provided equalisation funds to the district government in form of general grants<sup>51</sup> and specific grants. In relation to specific grants, the local governments have no discretionary power to use them. In respect to general grants, the local government has discretionary power in terms of spending. It is concluded that decentralisation policy could increase discretionary power of local government in terms of spending general grants and the PAD income.

Based on the discussion of political decentralisation, it is understood that all local legislative members have been directly elected by local citizens since 2004, whereas the district head has been directly elected by local citizens since 2005. Therefore, politicians approached local citizens to obtain political positions both in the executive and legislative institutions. There was a change of political power in local legislature and emergence of new political parties during decentralisation era, but the performance of local legislative members did not change. They were not qualified because they are involved in money politics in the election process. As a result, the performance of local legislature members was low.

Political parties had financial problems because they depended on the local government grants. In addition, they were not innovative in making policy and were

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<sup>51</sup> One of component of general grants is share of revenue from natural resources.



not able to represent the interests of local small businesses and local citizens. It is interesting that political parties developed networks with business associations such as the PDI-P party with *Dekranas* (Bantul Handicraft Board), and the *Golkar* party with *Kandinda* (Bantul Chambers of Industry and Trade). As a result, the business associations received funds from the Bantul district government. The relationship between business associations and political parties provided benefits for small businesses. However, the relationship between *Dekranas* and district government may also be called a patronage relationship because the chairman of Dekranas is wife of district head of Bantul. Business associations will be further discussed in Chapter Four.

Based on the discussion of local bureaucracy, it is understood that style of district head leadership has changed since 2004, under *Bupati* Idham Samawi. The district head actively supports poor people by providing credit and protection policy for small businesses. Following the change of style of the district head leadership, local bureaucrats changed their behaviour in providing public services to small businesses. The majority of small business owners perceive that the behaviour of local bureaucrats have improved under decentralisation. This means that political decentralisation encouraged district the head and bureaucrats to become close to local small business owners and increase public services. It indicates that the relationship between district head and small businesses is called supportive relationship.

In addition, the district head developed networks with non-government organisation to obtain political support. At grassroots level, political decentralisation encourages local politicians to approach the chairman of local community associations such as heads of hamlets (*Pedukuhan*) and heads of RTs with the aim to influence voter behaviour by providing money and material to local communities. Thereby, the candidates for local legislative members could obtain political support from local communities.

The next section will discuss the social, economic and political setting of the Gianyar district with the aim of examining their process in comparison to that of Bantul. The

main concerns addressed are whether social, economic and political differences affect the implementation of decentralisation.

## **CHAPTER THREE**

### **THE SOCIAL, ECONOMIC, AND POLITICAL SETTING OF GIANYAR**

#### **3.1. Introduction**

This chapter investigates the social, economic and political setting of Gianyar which will be used as a basis for exploring how decentralisation measures change the dynamics of local political activity. The social, economic and political structures are important variables that can influence the capacity of the district government in implementing local autonomy. Social factors such as high population density below the poverty line can be constraints for the district government in implementing decentralisation. In contrast, regions with rich natural resources and a high income from the local taxes/levies might have the financial capacity to implement the decentralised function.

Political decentralisation may provide an opportunity for small businesses to participate in elections for district heads and local legislature members as well as participate in the process of decision-making. A large number of small business owners in Gianyar were potential voters in this election and potential participants in the decision-making process. Business associations may persuade local government to become responsive to the needs of small business owners.

The chapter is divided into five sections: The first examines the impact of the geographic and demographic setting on the implementation of decentralisation in the Gianyar district. It explores how geographic factors, such as location, population size, and the available natural resources of Gianyar promote or prevent the implementation of decentralisation measures. The second section studies the effect of the economic structure such as the gross district product, the economic growth rates, the industrial structure and the employment trends as well as the financial capacity of district government. The extent to which the economic structure can support financial capacity in carrying out decentralised functions. The third section examines political institutions that consist of local legislature and political parties

with the aim to analyse the extent to which they are responsive to the interests of small businesses. The fourth section examines the local bureaucracy. It discusses the behaviour of local bureaucrats and the style of district head leadership. The last section deals with the community structure. It will examine how the social structure of Gianyar such as business groups, citizens' groups and neighbourhood associations affect the implementation of decentralisation policies. This chapter argues that although geographic factor such as the size of area and social factor such as the total population contributed effectively to the implementation of decentralisation, economic factors such as district government revenue and industrial sector had less of an impact on contributed less to local autonomy.

### **3.2. Geographic and Demographic Setting**

The geographic factors such as the size of area and the natural resources can influence income for the district government. In turn, this affects the financial capacities of district government in implementing decentralisation policy. The demographic factor such as the population size can influence the effectiveness of the implementation of decentralisation. The objective of the discussion is to explore the extent to which the geographic and demographic factors influence the implementation of decentralisation.

#### **3.2.1. The Location, Area, and Natural Resources**

Gianyar is a district in the province of Bali, located about 30 km north east of Denpasar city. Administratively, the territory of Gianyar covers 368 km<sup>2</sup> and consist of 6 *kelurahan* (villages in urban areas) and 64 *desa* (villages in rural areas), and 523 *Banjar*,<sup>52</sup> spread across 7 *kecamatan* (sub-districts) (Figure 3.1). The region of Gianyar is fertile for agriculture. However, the majority of the population works in handicrafts, woodcarving and stone-carving industries. This may be due to the fact that these jobs provide greater economic benefits than the agricultural sector. Generally, people of Gianyar pass on their artisan skills to the next generation.

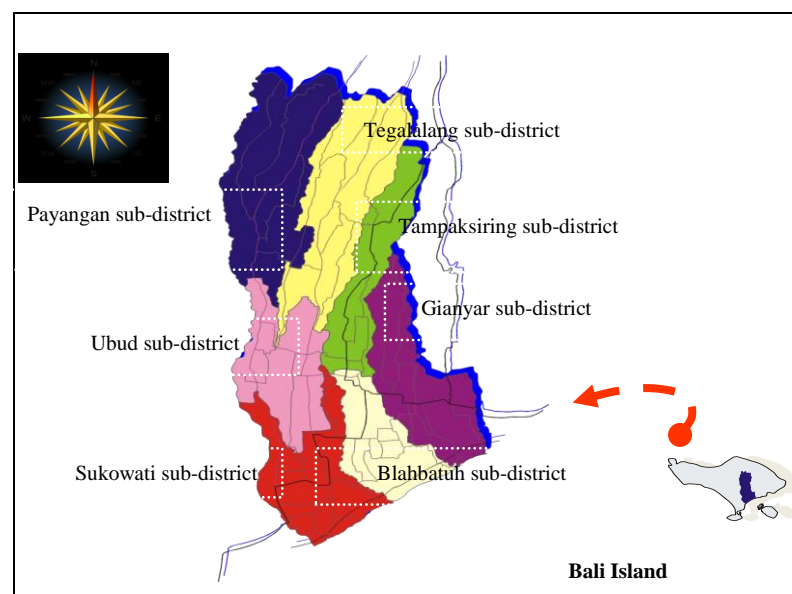
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<sup>52</sup> *Banjar* is the term of a customary hamlet, the lowest level of the local customary community association in Gianyar. It is similar to a *Pedukuhan* in Bantul. However, the *Pedukuhan* is officially the lowest level of local community association.

The territory of Gianyar is a combination of both urban and rural areas. The territory is bordered by the city of Denpasar in the west, the district of Bangli in the north, the district of Kelungkung in the east and the Indonesian ocean in the south. Transport from Denpasar city to the eastern and northern districts of Bali passes through Gianyar territory. As a result, art shops, markets and small businesses activities have emerged between the Denpasar city and the eastern and northern districts. They have contributed to the economic growth of Gianyar. Unlike the Bantul district, the location of Gianyar district is strategic and provides more opportunity for developing business activities. In turn, these activities support Gianyar's economic growth and contribute to the efficient implementation of decentralisation policies.

The area of Gianyar is smaller than that of Bantul and also that of the districts of Sumatera and districts of Kalimantan. The district of Agam in West Sumatera, for example, has an area of 2,232.30 km<sup>2</sup>, while the district of Banyuasin in the province of South Sumatera has an area of 11,822.99 km<sup>2</sup>. The district of Banjar in the province of South Kalimantan has an area of 4,688 km<sup>2</sup>, whereas the district of Sambas in the province of West Kalimantan has an area of 6,395.70 km<sup>2</sup>. The small area makes it possible for local government to easily provide physical infrastructures such as roads, market, hospital and school buildings. These pre-existing conditions have contributed to the effective implementation of decentralisation policy.

**Figure 3.1.**  
**Map of Gianyar District**



Source: *Pemerintah Kabupaten Gianyar* 2008, p.3.

About 40 percent of total area of Gianyar is rice fields, which produced 106,434 thousand tons of rice in 2007. Gianyar had surplus rice because the local consumption of rice was only 67,141 thousand tonnes in 2007. The fishery sector produced 733.20 tons in 2007. The area of plantations is only 0.12 percent of the total area of the Gianyar region, and these produced products such as coffee, coconuts, and tobacco. The Gianyar district does not have any natural resources such as oil, natural gas or geothermal resources. As a result, the district of Gianyar had only small income from natural resources and this was a constraint in the implementing local autonomy. The Gianyar district had difficulty in carrying out decentralised functions because of limited fiscal capacity.

### **3.2.2. The Population**

In 2008, the population of Gianyar was 390,698, consisting of 194,947 males and 195,751 females with a population density of 1,062 people per km<sup>2</sup>. The population growth rate was less than 2 percent over four decades (1960 to 2000). For the first five years of the last decade (2000–2005), the population growth was only 1.38 percent. In 2008, the population of 0-14 years was 97,467 (22 percent), age 15 to 64 years was 303,334 (70 percent) and above 65 years was 34,048 (8 percent). This means that the majority of the population was of a productive age, which could contribute to the dynamics of economic activities and increase the gross regional domestic product.

The number of families below the poverty line was 4,234 or approximately 4.19 percent of total families in 2003. In 2004 it increased to 5.43 percent. After that, it increased to 6.00 percent in 2005. In 2006, population number below the poverty line in Gianyar is the same as the number of the population below the poverty line throughout the Province of Bali, which was 7.0 percent. In 2007 it increased slightly to 7.47 percent or 8,391 families. In 2007, the number of population below poverty line in the province of Bali was 6.3 percent and this was 6.17 percent in 2008. However, the population below the poverty line in Gianyar is smaller than that in Indonesia overall which was 17.75 percent in 2006, 16.58 percent in 2007, and then decreasing slightly to 15.42 percent in 2008 (Pemerintah-Indonesia, 2009, p. 48).

Small population numbers provide a good opportunity in implementing local autonomy because the local government does not need to spend a lot of funds for providing public services and infrastructures. However, larger population figures below poverty line may become constrained in implementing decentralisation because local government is required to fund their assistance. As a result, local government had a lack of funds to develop physical infrastructures such as roads, schools and hospital buildings.

Most of the people of Gianyar follow the Hindu religion (97.82 percent). The remainder is distributed among four other religions: Islam 1.69 percent, Buddhism 0.18 percent, Protestantism 0.18 percent, and Catholicism 0.13 percent. Indeed, Hindu values influence the behaviour of people in their social activities and working environments toward greater harmony and less conflict (H. S. Nordholt, 2007). In turn, it contributes to the implementation of local autonomy. Although the people in Gianyar are religious, in local parliament, there are no political parties with religious links. The characteristics of all political parties of Gianyar are those of secular nationalist parties. The researcher believes that pluralist secular nationalist parties may contribute to pluralist society development and reduce the degree of conflict among societies. The following section discusses the economic structure of Gianyar with the aim of analysing their influence on the financial capacity of the district.

### **3.3. Economic Structure**

The objective of this section is to examine the extent to which fiscal capacity of Gianyar can support the implementation of decentralised functions. The fiscal capacity is influenced by variables such as the gross district product, the economic growth rates, the industrial structures and the market conditions.

#### **3.3.1. The Gross Regional Domestic Product**

In general, the structure of gross regional domestic product (GDRP) during 2003-2008 did not change significantly (Table 3.1). Unlike the Bantul district, where the agricultural sector accounted for most of the GDRP, the trade, hotel, restaurant, and services sectors provided the greatest contribution in the Gianyar district amounting to about 48 percent to the GRDP. The agriculture sector only contributed approximately 19 percent and the industrial sector contributed approximately 19 percent. This means that the economic structure of Gianyar was not dependent on the

agricultural sector. Sectors of trade, hotel and restaurant played an important role in providing job opportunities for local people. More than 50 percent of the population worked in the industrial and trades sectors.

**Table 3.1**  
**Percentage Distribution of Gross Regional Domestic Product of**  
**Gianyar District at Constant Price 2000, 2003-2008**

No.	Sector	2003	2004	2005	2006	2007	2008
1.	Agriculture	19.01	19.11	19.33	19.54	19.21	18.66
2.	Minning	0.42	0.40	0.41	0.40	0.39	0.38
3.	Industry	19.06	18.76	18.44	18.29	18.47	18.72
4.	Electricity, Gas and Water Supply	0.86	0.85	0.84	0.86	0.88	0.91
5.	Construction	4.63	4.45	4.34	4.20	4.15	4.14
6.	Trade, Hotel and Restaurant	31.84	31.39	31.03	30.73	30.62	30.66
7.	Transport and Communication	4.66	4.74	4.77	4.80	4.83	4.88
8.	Financial	4.88	4.87	4.87	4.94	5.01	5.09
9.	Services	14.64	15.43	15.97	16.24	16.44	16.97
		100.00	100.00	100.00	100.00	100.00	100.00

Source: *Pemerintah Kabupaten Gianyar*, (2008b, p. 79).

The economic growth increased from 3.60 percent in 2004 to 4.87 percent in 2008. In 2006, the economic growth rate was 5.75 percent, which was the highest growth rate during the period 2003-2008. However, the economic growth rate decreased slightly to 4.49 percent in 2007, and then it increased slightly to 4.87 percent in 2008. During 2004-2007, the economic growth did not significantly change (Table 3.2). The economic growth rate of Gianyar in 2008 was the same as that of Indonesia, which was 4.7 percent in 2007. Decentralisation policy could not drive economic growth because the Gianyar had limited local resources which provided only a small benefit for district government revenue. Furthermore, this was an obstacle in the implementation of decentralisation.



**Table 3.2.**  
**The Economic Growth of Gianyar at Constant Price 2000, 2003-2008**

No.	Year	GRDP (Million Rp)	Growth Rate of GRDP (%)
1.	2003	5,505,984.88	
2.	2004	5,704,075.22	3.60
3.	2005	5,939,335.13	4.12
4.	2006	6,281,044.63	5.75
5.	2007	6,562,892.80	4.49
6.	2008	6,882,677.86	4.87

Source: *Pemerintah Kabupaten Gianyar* (2008b, p. 75).

After discussing the contribution of each sector to the GRDP and the economic growth, the next section will examine the district government income with the aim to evaluate to what extent the district government income can support the implementation of decentralisation.

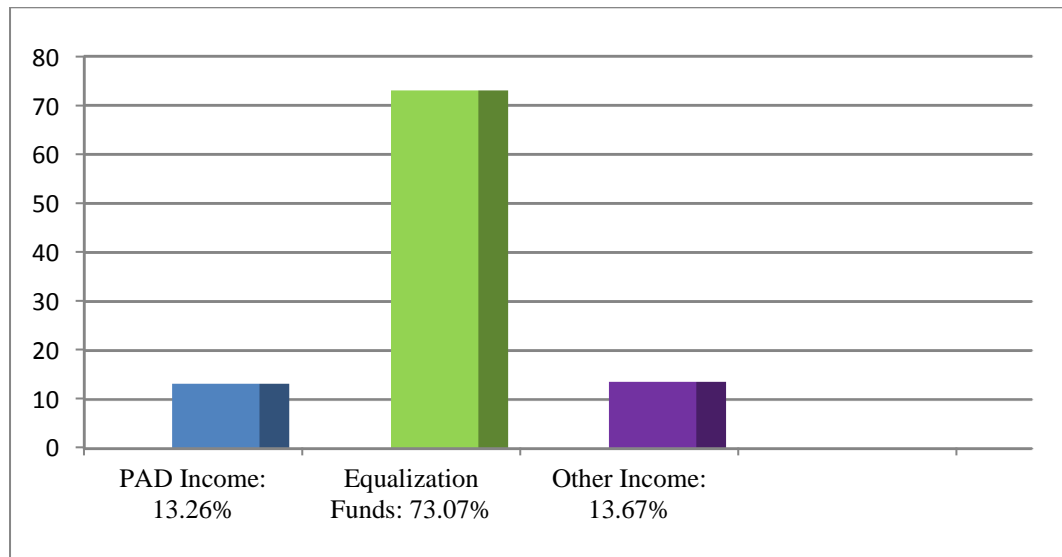
### 3.3.2. District Government Income

Law 33/2004 on Fiscal Balance between the Central Government and the Regional Governments states that the total district income comprises of locally derived revenue (PAD income), equalization funds<sup>53</sup> (*dana perimbangan*) and other income. In the case of Gianyar in 2009, the total district government income was 652,453.02 million rupiah. The PAD income was 86,533.56 million rupiah or 13.26 percent of total district government income whereas the equalization funds from the central government were 476,757.75 million rupiah or 73.07 percent of total district government. The other income was 89,161million rupiah or 13.67 percent of total district government income (Chart 3.1). This means that the locally derived revenue was very small. As a result, the acquired revenue was not able to support the implementation of decentralisation policy. In other words, although Bantul district adopted the decentralisation policy, the central government still provided grants. The district government faced constraints in the implementation of decentralisation policy without the central government grants because it is not able to carry out decentralised functions. The following section will discuss each type of district government income.

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<sup>53</sup> Equalization funds are grants from the central government to sub-national governments which consist of general grants, specific grants and revenue sharing funds.

**Chart 3.1**  
**Distribution of District Government Revenue, 2009**

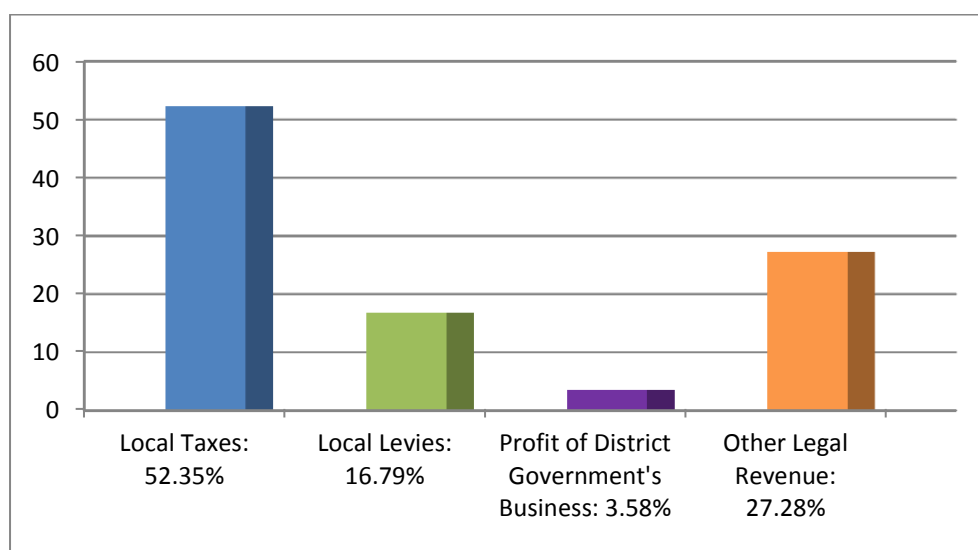


Source: *Pemerintah Kabupaten Gianyar* (2009).

### 3.3.2.1. The PAD Income

The first source of district revenue is locally derived revenue or PAD income. The PAD income derived income from local taxes/local levies, profits of local government owned companies and other legal revenue. In 2009, the PAD income was 86,533.56 million rupiah derived from (1) Income from local taxes was 45,301.72 million rupiah or 52.35 percent. (2) Income from local levies was 14,526.27 million rupiah or 16.79 percent. (3) Income from profit of the district government owned companies was 3,100.00 million rupiah or 3.58 percent. (4) Income from other legal revenue was 23,608.56 million rupiah or 27.28 percent (Chart 3.2). This means that income from local taxes accounted for the greatest contribution for the PAD income. As discussed in Chapter Two, local taxes consist of taxes on hotels, restaurants, entertainment, public advertisement, public street lighting, and local natural resources exploitation (category C). The important question is what kind of local tax that can greatly contribute to PAD income. Taxes on hotels accounted for the largest contribution to the total tax income because there were many hotels and restaurants in Gianyar, especially in the sub-district of Ubud. To highlight the tax contribution, there were 14 star hotels and 433 non-star hotels in 2006 .

**Chart 3.2**  
**Distribution of the PAD Income, 2009**



Source: *Pemerintah Kabupaten Gianyar* (2009).

Since the implementation of decentralisation policy in 2001, a majority of the local governments of Indonesia have attempted to increase their PAD income because one of indicators of the local government's capacity was the proportion of the PAD income to total district revenue. The greater PAD income would contribute to greater total district government revenue. The percentage of PAD income to total district revenue during 2003-2009 can be seen in Table 3.3.

**Table 3.3**  
**Locally Derived Revenue (PAD) of Gianyar District**  
**2003-2009**

No.	Year	Total District Income (Million Rp)	PAD Income (Million Rp)	Percentage PAD Income Total District Income
1.	2001	302,024.98	50,107.88	16.59
2.	2002	337,877.45	54,386.43	16.10
3.	2003	279,914.63	37,131.73	13.27
4.	2004	298,649.18	49,738.94	16.65
5.	2005	320,461.30	55,006.63	17.16
6.	2006	466,546.45	68,447.92	14.67
7.	2007	549,618.07	74,906.98	13.63
8.	2008	616,693.54	87,780.87	14.23
9.	2009	652,453.02	86,533.56	13.26
		Average		15.06

Source: *Pemerintah Kabupaten Gianyar* (2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009).

In general, the ratio of the PAD income to total district income in Gianyar was higher than that in Bantul (15.06 percent for Gianyar and 7.91 for Bantul). This means that financial capacity of the Gianyar district government was higher than that of the Bantul district government. However, the PAD income of Gianyar was also not able to support the district government's expenditures. This suggests that financial capacity was a main problem of Gianyar extending to other districts in implementing decentralisation policy.

During 2003-2009, local levy income accounted for an average of 15.15 percent of total district revenue. The local levies consist of 21 types of local levies such as local fees for: building permits, disturbance permits, transport permits, trading business permits (SIUP), industrial business permits (IUI), parking fees, market fees and public health service fees.

### 3.3.2.2. Equalization Funds (*Dana Perimbangan*)

The second source of district revenue is that granted from the central government, called equalization funds. During 2003-2009, the main source of district government income is derived from central government. In 2009, the Gianyar district government received equalization funds of 476,757.75 million rupiah or 73.07 percent of total district income (Table 3.4). This indicates that the Gianyar district government was financially dependent on the central government. It was difficult for the district government to implement administrative and political decentralisation without central government subsidy.

**Table 3.4**  
**Equalization Funds**  
**Received by the Gianyar District Government, 2006 - 2009**

No.	Year	Total District Income (Million rupiah)	Equalization Fund (Million rupiah)	Percentage of Equalization Fund to Total District Income
1.	2003	279,914.63	231,304.19	82.63
2.	2004	298,649.18	223,226.21	74.75
3.	2005	320,461.30	252,117.56	78.67
4.	2006	466,546.45	387,600.13	84.79
5.	2007	549,618.07	412,970.26	76.71
6.	2008	616,693.54	459,755.12	74.55
7.	2009	652,453.02	476,757.75	73.07
		Average		77.88

Source: *Pemerintah Kabupaten Gianyar* (2006, 2007, 2008, 2009).

In the case of Indonesia, equalization funds consist of a general allocation funds (the DAU fund) or general grants, special allocation funds (the DAK fund), specific grants and revenue sharing funds (the DBH fund). In 2009, as an example, the DAU fund was 393,604.97 million rupiah or 60.33percent of total district government income. The DAK fund was 59.614 million rupiah or 9.14 percent and the revenue sharing fund was 23,538.78 million rupiah or 3.61 percent (Table 3.5, Table 3.6 and Table 3.7). The details of each funds will be discussed the following.

#### **3.3.2.2.1. The DAU Fund (General Grant)**

The general fund or the DAU Fund played an important role in supporting local autonomy in the Gianyar district government because the average of the DAU Fund was 64.08 percent during 2001-2009 (Table 3.5). The local government had discretionary policy to spend this fund. If we compare the DAU funds between Gianyar and Bantul, the financial dependency of Bantul was higher than that of Gianyar because in Bantul the average of the DAU fund was 71 percent, whereas in Gianyar it was 64.08 percent. This condition was a result of limited fiscal decentralisation given by the central government to local government, so that the local government did not have sufficient discretion to increase local fiscal capacity. Law No. 34/2000 provides limited discretion policy on local taxes, whereas Law No.66/2001 provides discretion policy on local levies for local governments. In a long term perspective, the implementation of decentralisation could not succeed, unless the central government provided larger discretion in fiscal policy to sub-national governments. However, local government had discretionary policy to spend these funds.

**Table 3.5**  
**General Allocation Fund (DAU Fund)**  
**Received by the Gianyar District, 2006 - 2009**

No.	Year	Total District Income (Million rupiah)	DAU Fund (Million rupiah)	Percentage of the DAU Fund to Total District Income
1.	2001	302,024.98	195,040.73	64.58
2.	2002	337,877.45	190,521.15	56.39
3.	2003	279,914.63	203,642.04	72.75
4.	2004	298,649.18	193,932.61	64.93
5.	2005	320,461.30	198,172.00	61.84
6.	2006	466,546.45	314,673.00	68.84
7.	2007	549,618.07	347,800.00	64.61
8.	2008	616,693.54	385,187.68	62.46
9.	2009	652,453.02	393,604.97	60.33
		Average		64.08

Source: *Pemerintah Kabupaten Gianyar* (2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009).

#### **3.3.2.2.2. The DAK Fund (Specific Grant)**

The DAK fund is a specific grant that aims to finance special needs such as educational, health and business development. During 2003-2009, the total DAK fund increased every year. In 2009, the Gianyar district government received the DAK fund 59.614 million rupiah or 9 percent of total district government income. The total DAK fund received by the Gianyar district government was higher than that of the Bantul district government. In 2009, for instance, the percentage of the DAK fund in Giayar was 9.14 percent of the district government income, while the DAK fund in Bantul was only 6.7 percent. The total DAK fund increased every year (Table 3.6).

**Table 3.6**  
**Special Allocation Fund (DAK Fund)**  
**Received by the Gianyar District Government, 2006 - 2009**

No.	Year	Total District Income (Million rupiah)	DAK Fund (Million rupiah)	Percentage of the DAK to Total District Income
1.	2003	279,914.63	999.95	0.36
2.	2004	298,649.18	5,000.00	1.67
3.	2005	320,461.30	12,620.00	3.94
4.	2006	466,546.45	30,530.00	6.68
5.	2007	549,618.07	43,147.00	8.00
6.	2008	616,693.54	50,927.00	8.26
7.	2009	652,453.02	59,614.00	9.14
		Average		5.44

Source: *Pemerintah Kabupaten Gianyar* (2006, 2007, 2008, 2009).

### 3.3.2.2.3. The Revenue Sharing Fund (DBH Fund)

The revenue sharing fund is a general grant as the district government has discretionary policy to spend the fund. During 2001-2009 the Gianyar district government received revenue sharing funds equating to 7.04 percent of total district income (Table 3.7). This means that income from natural resources was very small for the district government. In other words, this region did not have potential natural resources such as oil and gas mining.

**Table 3.7**  
**Share of Revenue from income from Taxes and Natural Resources (SR of TNR)**  
**the Gianyar District Government, 2006 - 2009**

No.	Year	Total District Income (Million rupiah)	Share of Revenue from Taxes and Natural Resources Income (Million rupiah)	Percentage SR of TNR to Total District Income
1.	2001	302,024.98	16,642.54	5.51
2.	2002	337,877.45	21,319.44	6.31
3.	2003	279,914.63	26,662.20	9.53
4.	2004	298,649.18	24,283.60	8.13
5.	2005	320,461.30	41,325.56	12.90
6.	2006	466,546.45	47,987.19	10.29
7.	2007	549,618.07	23,460.00	4.27
8.	2008	616,693.54	23,640.44	3.83
9.	2009	652,453.02	23,538.78	3.61
		Average		7.04

Source: *Pemerintah Kabupaten Gianyar* (2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009).

Based on the data above, the Gianyar district remained financially dependent on the central government's subsidies because total district government income was not sufficient to support its expenditure. Gianyar had difficulty in enhancing public services as well as physical infrastructures for small businesses. In other words, the implementation of decentralisation in Gianyar faced financial constraint without the central government subsidy.

### 3.3.3. The Industrial Sector

Rather than large-scale industry development, the Gianyar district government focused more on small and medium scale industry development because there were many small business activities in this region. For instance, the number of small businesses increased from 15,912 in 2001 to 22,144 in 2007. In 2003 the small and medium industries absorbed 30,730 employees, and this increased to 65,802 employees in 2007. However, most of the small and medium businesses were informal and were not registered (Table 3.8). As a result, the Gianyar district government did not obtain income from local levies from these small businesses. This indicated that the Gianyar district government could not control small businesses. Although the district government enacted local regulation on business permits, most small businesses ignored them. They could exist despite not possessing legal business permits such as Trade Business Permit or Industry Business Permit. In other words, they were not dependent on the local government.

**Table 3.8**  
**The Number of Small and Medium Businesses (SMB) and Employees**  
**in the Gianyar District 2001-2007**

No.	Year	Number of SMB		Total	Number of Employee		Total
		Formal	Informal		Formal	Informal	
1.	2001	277	15,635	15,912	2,856	27,874	30,730
2.	2002	306	18,150	18,456	3,440	39,878	43,318
3.	2003	417	19,399	19,816	4,397	45,830	50,227
4.	2004	438	20,262	20,700	4,685	50,592	55,277
5.	2005	455	21,418	21,873	4,839	56,544	61,383
6.	2006	471	21,426	21,897	5,353	59,519	64,872
7.	2007	489	21,655	22,144	5,690	60,112	65,802

Source: *Pemerintah Kabupaten Gianyar* (2008b).



In 2007, the industrial sector absorbed the largest proportion of employees at 32.70 percent of total employees. Most of them worked in the small business sector. The agricultural sector absorbed 25.36 percent, whereas the sectors of trade, hotels, and restaurants absorbed 20.55 percent. The other sectors reflected 12.44 percent of the total employees (Chart 3.2).

**Chart 3.3**  
**Distribution of Employment by Sector**



Source: *Pemerintah Kabupaten Gianyar* (2008b, p. 23).

In 2003, the unemployment rate was 8.01 percent. It decreased sharply to 3.51 percent in 2004, but increased again to 7.59 percent in 2005. In 2006 it decreased slightly to 4.51 percent and further in 2007 the unemployment rate fell steeply to 2.80 percent. At this time the unemployment rate in Indonesia was 9.11 percent. Reflecting in 2007 that the unemployment rate in Gianyar was lower than the national level.

From the economic structure, it may be concluded that most of the PAD income is derived from local tax revenue. However, the PAD income was not sufficient to support the total expenses of the district government. The economy of this region remains dependent on central government's subsidies, both general and specific grants. The ratio of the PAD income to total district government revenue in Gianyar

is larger than that in Bantul (Table 3.3 and Table 2.4). I suggest that the financial capacity of Gianyar was higher than that of Bantul in supporting the implementation of decentralisation policies. The next important question is whether political institutions in Gianyar improved to support the implementation of decentralisation.

### **3.4. Political Institutions**

The aim of this section is to explore changes of political institutions at a local level as the result of decentralisation policy. As discussed in Chapter One, political decentralisation may increase the power of political parties and local parliament. The important question relates to whether increased power of political parties as well as local parliament can increase their role in local politics particularly in promoting small businesses.

#### **3.4.1. Local Parliament**

During 2004-2009, there were seven political parties in local parliament of Gianyar (Table 3.9). Local politics was relatively homogenous because secular nationalist parties, the Indonesian Democracy Party of Struggle (PDI-P party) and *Golkar* party occupied more than 50 percent of the total seats in the local parliament. Although there were many political parties in local parliament, there were no political parties with religious links. Even though people of Gianyar were religious, the characteristics of all political parties in Gianyar were those of secular nationalist parties. As a result, it may have minimized conflict among religions.

**Table 3.9**  
**Distribution of Seats among Political Parties in Local Parliament of**  
**Gianyar 2004-2009 and 2009-2014**

Political Parties	2004-2009		2009-2014	
	Seat	Percentage	Seat	Percentage
Indonesian Democracy Party of Struggle ( <i>Partai Demokrasi Indonesia Perjuangan</i> or PDI-P Party)	19	47.50	16	40.00
<i>Golkar Party</i>	10	25.00	6	15.00
New Indonesian Association Party ( <i>Partai Perhimpunan Indonesia Baru</i> or PPIB)	4	10.00	2	5.00
<i>Freedom Bull National Party (Partai Nasional Banteng Kemerdekaan</i> or PNBK)	4	10.00	2	5.00
Democrat Party ( <i>Partai Demokrat</i> or PD)	1	2.50	5	12.50
Mahaenism Indonesian Nationalist Party ( <i>Partai Nasional Indonesia Marhaenisme</i> or PNIM)	1	2.50	2	5.00
Nationhood and Caring Party ( <i>Partai Karya Peduli Bangsa</i> or PKPB)	1	2.50	1	2.50
People's Conscience Party ( <i>Partai Hanura</i> )	-	-	3	7.50
Reform Democracy Party ( <i>Partai Demokrasi Pembaruan</i> or PDP)	-	-	3	7.50
Total	40	100	40	100

Source: KPUD of Gianyar, 2009.

In the 2009 election of legislature members, the PDI-P and *Golkar* parties lost 3 seats and 4 seats respectively in the local legislature, because the voters moved to the People's Conscience party, the Reform Democracy party and the Democrat party (Table 3.11). However, the PDI-P and *Golkar* parties were still the majority in the local parliament. The election results in Gianyar were not in line with that at national level. At national level, the Democrat party obtained the majority votes (21 percent), whereas in Gianyar this party only obtained 5 seats or 12.5 percent of total local legislature seats.

The Freedom Bull National Party (PNBK) and Marhaenism Indonesian Nationalist Party (PNIM) were actually fragments of the Indonesian Democracy Party of Struggle (PDI-P party), but only the PNBK party integrated into the PDI-P faction (*Fraksi PDI-P*) in the local parliament. The PNIM party, the Nationhood and Caring Party (PKPB), the Democrat party (PD) and the New Indonesian Association Party (PPIB) formed a new coalition called the *Fraksi Gianyar Bersatu* (United Gianyar

Faction) in the local parliament. I suggest this created a sound political climate for developing local democracy because there were many factions in the local parliament. Moreover, the *Gianyar Bersatu* faction, who often criticized the district government policy for not providing sufficient benefits to local people.<sup>54</sup> Unfortunately, the membership of the faction was small (25 percent), so it could not influence local government policy in promoting or advocating for benefits small businesses. The important question is the extent to which local legislature members could carry out the local legislature functions such as articulating the preferences of local communities. One local legislature member described the problem to me as follows:

### **Case 3.1: Low Performance of Local Legislature Member**

Basically, local legislature members were not innovative because they had no knowledge regarding the legislature's functions. In addition, they had no data and information related to social, economic and political issues. Most of them did not attend local parliament meetings (such as committee, fraction and general meetings) and meeting between legislature and executive bodies. This indicated that the performance of local legislature was low.<sup>55</sup>

One vice chairman of local legislature said that there was no change of performance of local legislature during decentralisation era (Case 3.2).

### **Case 3.2: The Behaviour of Local Legislature Members**

During decentralisation era, the behaviour of local legislature members did not significantly change. They have not yet produced local regulations, which have a large impact on local communities. In contrast, they only focused on developing local regulation with the aim to increase district revenue.<sup>56</sup>

The question arises as to whether or not local parliament members who came from business backgrounds were able to promote the interest of the small business sector in Gianyar. Table 3.10 indicates that more than half of local parliament members were previously businessmen, but they did not represent nor were able to articulate the interests of small business. The *Kadinda* (local business association) suggested them to help the interests of business sector, and they failed to respond.<sup>57</sup> The next

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<sup>54</sup> Interview with Mr. B.M., member of *Fraksi Gianyar Bersatu* of Gianyar Local Parliament, 23 April 2009.

<sup>55</sup> Interview with Mr. B.M., Gianyar Local legislature member, 23 April 2009.

<sup>56</sup> Interview with Mr. R.K., Vice Chairman of Gianyar Local legislature, 28 April 2009.

<sup>57</sup> Interview with Mr. A.A., Chairman of Gianyar Chamber of Industry and Trade, 24 April 2009.

section will discuss the extent to which political parties played an important role in promoting the small business sector.

**Table 3.10**  
**Background of Local Parliament members of Gianyar, 2004-2009**

Previous Job of Parliament Member	Number	
	Number	Percentage
Bureaucracy	3	7.50
Politicians	6	15.00
Businessmen	23	57.50
Teacher/Lecturer	2	5.00
Building Contractor	4	10.00
Doctor	1	2.50
Private Bank	1	2.50
	40	100.00

Source: Field work, 2009.

### 3.4.2. Political Party

Under the centralized system (1967-1998), there were only three political parties in Gianyar: the *Golkar* party, the Indonesian Democracy party and the United Development party. Following the fall of the authoritarian regime in 1998, the Indonesian government adopted a decentralised policy. The policy caused the emergence of new political parties in Gianyar region, as in other regions in Indonesia. In 2009, 24 political parties were involved in national and local legislature member elections. However, only 9 political parties obtained seats in local legislature.

The main problem for political parties of Gianyar was insufficient financial capacity to support their activities. There were three sources of political party income. Firstly, there was the income derived from members. Each local legislature member had contributed around 10 percent of his salary to his party. Secondly, political parties received funds from the district government based on the number of seats held in the local legislature. As an example, in 2008 the district government of Gianyar allocated Rp 760,000,000 to 8 political parties which had seats in local parliament. Then it slightly decreased to Rp 759,999,999 in 2009. Further, in 2010 it also fell to Rp 750,348,312. Thirdly, political parties can receive funds from donors. Based on anecdotal evidence from the political parties, they primarily depended on the first

and second financial sources. Although many political parties emerged during decentralisation era, the performance of political parties remained low. They had not yet articulated the preferences of local communities.

### **Case 3.3: Party did not help the poor.**

Political parties did not pay attention to the poor. Generally, they helped the poor only throughout the political campaigns to attract sympathy from the poor by providing money or materials. Thus, they failed to develop sustainable policy to support populist economic activities (*ekonomi kerakyatan*). This was a result of weak leadership and management of the political parties.<sup>58</sup>

One small business argued that political parties were not responsive to the needs of small businesses.<sup>59</sup> One party member said that the process of recruitment within parties to be a legislator candidate was not fair because it was based on financial capacity, not intelligence or experience. As a result, a person who was able to pay a high level of funds to party was chosen by party to be candidate.<sup>60</sup> This indicated that the behaviour of party was not based on preference of cadres' qualifications, but rather on money. The behaviour of political parties had not yet changed. As a result, they could not respond the need of local communities nor small businesses sector.

## **3.5. Local Bureaucracy**

This section will answer the question as proposed in Introduction: Have local bureaucrats and district head responded the needs and interests of small business owners? As discussed in Chapter One, in many countries decentralisation policies may increase tasks and responsibilities for the local bureaucracy as well as the district heads. Thus, the behaviour of local bureaucracy and the district head demand improvement. This section will examine the extent to which the behaviour of local bureaucrats and district head had changed as a result of decentralisation policy.

### **3.5.1. The Behaviour of Local Bureaucrats**

The section examines change of local bureaucrats behaviour as a result of decentralisation. In 2008, there were 8,557 employees in Gianyar district,

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<sup>58</sup> Interview with D.A., Director of Bali International Institute of Tourism Management, 4 May 2009.

<sup>59</sup> Interview with Mr. A.P, Small Business Owner and *Kelian Adat*, Banjar Kendran, Desa Kedran, Tegallang, 23 May 2009.

<sup>60</sup> Interview with Mr. B.M, political party member and local legislature member, 23 April 2009.

distributed across 27 local government bodies such as agencies, boards, sub-districts government, the district secretariat, hospital and election office. It was a complex task for the Gianyar district government to improve the behaviour of local bureaucrats due to the numbers and scope of overseeing the task. The local government needed funds to provide training with the aim to increase skills and knowledge of local bureaucrats. If they had good skills and a better understanding of their jobs, they might have been able to serve small businesses well.

During 1967-1998, the *Golkar* party controlled the civil servants of Gianyar. However, following the fall of the New Order Government in 1998, *Golkar* could not control civil servants because the central government enacted Law No. 43/1999 which banned all civil servants from participating in political parties. These circumstances raise a critical question as whether local bureaucrats became more responsive to the needs of small businesses without the influence of politics.

According to Mr. B.M, a member of local legislature of Gianyar, local bureaucrats were still passive and not innovative. In general, decisions made are not supported by accurate data.<sup>61</sup> In relation to small businesses, the *Diskop dan UKM* (Local Agency for Cooperatives, Small and Medium Businesses) has responsibilities to promote small businesses. As a new local government agency, the *Diskop dan UKM* has not yet achieved much for promoting small business. Upon conducting this research and questioning the strategic plans of this agency, one staff of member answered that it did not have a strategic plan to promote small business.<sup>62</sup> Thus, this local agency may not be carrying out its functions to provide public services and promotion of the sector. The research findings were concurrent with the result of interviews of small businesses as well as survey data. The interviews indicated that public services for small businesses have not yet changed significantly until since the implementation of decentralisation as stated by the Chairman of *Kadinda* of Gianyar.

### **Case 3.4: Less Support for Small Businesses**

The business sector has provided funds to support the district government revenue, but the district government has not yet improved public services for them, such as physical infrastructures (roads, market building, car park

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<sup>61</sup>Interview with Mr. B.M., a local legislature member, 23 April 2009.

<sup>62</sup>Interview with Mr. M.A, Head of Section of Business Development, *Diskop dan UKM*, 30 April 2009.

areas), financial and material assistance. We expected that the district government was able to better promote the small business sector.<sup>63</sup>

The following case showed that the district government did not provide physical infrastructures such as market buildings, car parks and roads to facilitate the sector.

### **Case 3.5: Less Physical Infrastructure Supports for Small Businesses.**

One small businessman told the researcher that the district government had not improved the roads around Tegallalang sub-district where there were many small businesses. The roads were still narrow and there was no parking available along as this road. As a result, buyers had difficulty to park their cars for shopping.<sup>64</sup>

In relation to local bureaucrats and their jobs, research findings show that the local bureaucrats were less interested in improving office equipment and computers to support their jobs. As a result, they could not provide better public services for small businesses. This indicated that behaviour of local bureaucrats had not changed in providing public services for small businesses (Case 3.6).

### **Case 3.6: Less Office Equipment**

One staff member of the UPTD reported to her boss that some computers in UPTD<sup>65</sup> did not work. As a result, she and other employee could not perform their work. Despite knowing the situation, the boss failed to action any change. As a result, the performance of the UPTD in providing public services for small business deteriorated.<sup>66</sup>

This means that during decentralisation era, the district government had not significantly improved public services for small businesses. The interview referred to above was supported by a survey data from 100 small business owners, which showed most respondent (29 percent) revealing that local bureaucrat behaviour did not change during decentralisation era. A further, 18 percent said their behaviour worsened and 26 percent did not chose to comment further. However, 27 percent argued that their behaviour improved (Chart 3.4).

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<sup>63</sup>Interview with Mr. A.A., the chairman of the Gianyar *Kadin*, 24 April 2009.

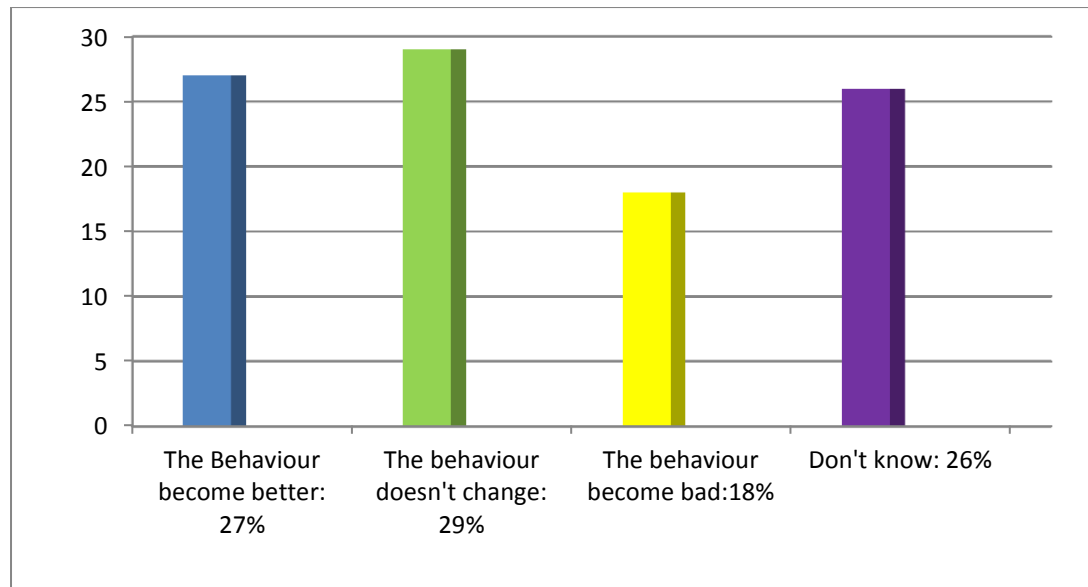
<sup>64</sup>Interview with Mr. A.W., Small business owner and Kelian Dinas in Tegallalang sub-district, 23 May 2009.

<sup>65</sup>UPTD is *Unit Pelaksana Teknis Dinas* (Technical Unit of *Diskop* and *UKM*).

<sup>66</sup>Interview with M.R., one of the UPTD Staff, 22 April 2009.



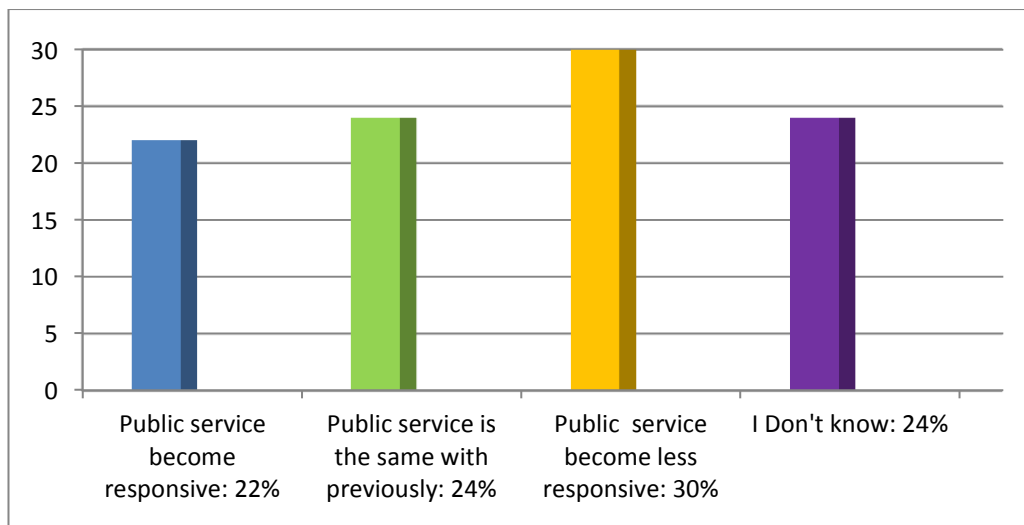
**Chart 3.4**  
**The Perception of Small Business Owners on Behaviour of Local Bureaucrats**  
**(N=100)**



Source: Fieldwork, 2009.

The behaviour of local bureaucrats who can not change can result in poor public service. Survey data indicates that the majority of respondents (24 percent) said that public services remained the same. Further, 30 percent noted that public service became less responsive. This means that public services did not improve. Only 22 percent of respondents commented that public service became responsive (Chart 3.5). In other words, only a few small businesses recognised that the behaviour of local bureaucrat changed to improve public services for small businesses. This suggests that increased power of local bureaucrats as a result of decentralisation policy could not cause improvements to public service.

**Chart 3.5**  
**The Perception of Small Business Owners to Public Services**  
 (N=100)



Source: Field work 2009

Based on the discussion above, it can be concluded that decentralisation did not drive changes of behaviour of local bureaucrats. As a result, public services for small businesses become poor.

### 3.5.2. Style of Leadership of the District Head

As discussed in Chapter One, decentralisation policy can cause the district head to become closer to local communities because the district head is directly elected by local communities. This section will examine whether the district head of Gianyar became closer and more responsive to the needs of small businesses. Before discussing the leadership of the district government head, it will explore the background of the Gianyar district head to ascertain whether the personal background of the district head can influence the style of leadership.

As a district head, Tjokorda Oka Ardhana known as Cok Ace was a son of the Royal House of Ubud (*Puri Ubud*),<sup>67</sup> chairman of the Bali Branch of the Indonesian Association of Hotels and Restaurants, BPD PHRI<sup>68</sup> and vice-head of the Bali Tourism Board. He was also a lecturer in the Faculty of Engineering, Udayana University, Bali. In 2002 he competed as a candidate for the district government

<sup>67</sup> *Puri* is house of Balinese nobility.

<sup>68</sup> BPD PHRI is the *Badan Pimpinan Daerah - Perhimpunan Hotel dan Restoran Indonesia*

head. However, he failed to become candidate because he was not supported by majority of political parties of local legislature. At that time the candidates for the district head required nomination by political parties and election by the local legislature members.

In the 2008 election for the district head (*Pilkada*), Cok Ace was proposed by a coalition of several small political parties: the PPIB party, Demokrat party, Patriot *Pancasila* party, PDK party, *Pelopor* party, PKPL party, PNBK party, PNI *Marhenisme* party and the PKPB party. These parties had only 11 seats in the local legislature. Then, Cok Ace tried to gain more political support from Golkar party by participating in the *Golkar* party convention on 1 September 2008. Finally, he was supported by the Golkar party and aforementioned parties. During the *pilkada* campaign, Cok Ace (with his running mate, Dewa Made Sutanaya) launched seven programmes: no tuition fees for education, free health care for poor families, fertilizer subsidies, subsidies for land-ownership and building taxes, credit without collateral for small business, credit for new overseas employees, enhancing the tourism industry and equitable development of all sectors. Cok Ace and Dewa Made Sutanaya won by a small margin from the incumbent *Bupati*, A.A. Gde Bharata (with running mate Yudha). Cok Ace won 136,182 votes and Bharata 134,527. As district government head, Cok Ace appears to have fulfilled the promises made during his political campaign. To implement the credit program for small businesses without collateral, Cok Ace developed networks between local government and financial institutions such as BNI Bank, BPD Bank or *Bank Pembangunan Daerah* (Regional Development Bank) and LPD to help small businesses. The BNI Bank is the State Owned Company, the BPD is Provincial Government owned company and the LPD is a Customary Village Owned Company. These networks will be discussed in the following section.

Firstly, Cok Ace signed a memorandum of understanding (MOU) with BNI Bank in mid 2008 with the aim of providing low interest loans to small businesses in Gianyar. However, when the researcher asked some small businesses about the program, not all of them were aware of its existence. This was likely because it was a new program and the district government did not intensively inform small businesses

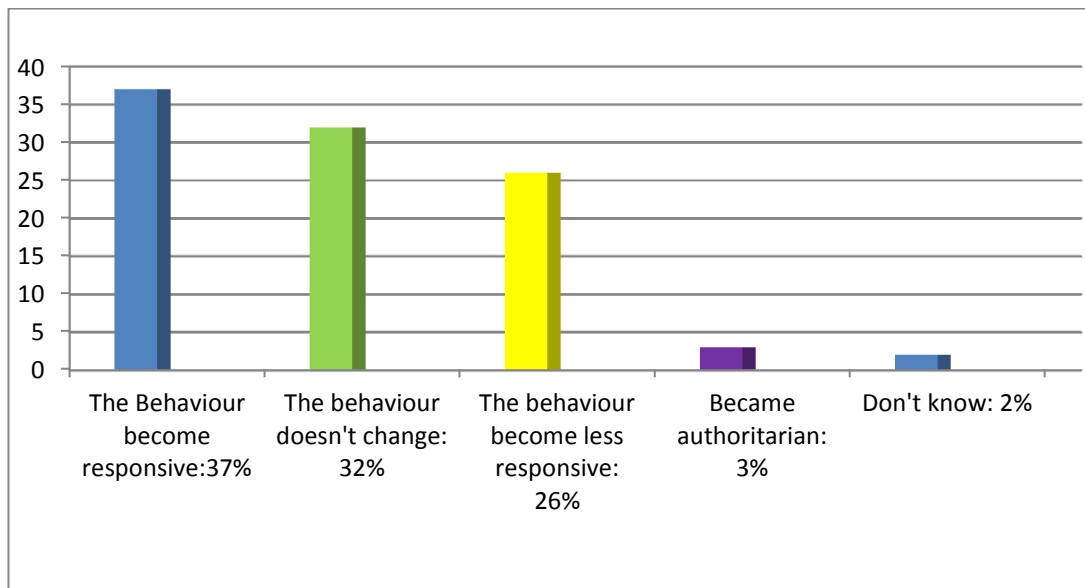
about it. In other words, the Local Government Agency for Cooperative, Small and Medium Businesses (*Diskop dan UKM*) has not yet operated efficiently.

Secondly, in 2009 the Gianyar District deposited 500 million rupiah in the BPD Bank, which was subsidized with two billion rupiah by the BPD Bank. Thus, in total, 2.5 billion rupiah was available to be distributed to small businesses and small business cooperatives. One small business could receive 7.5 million rupiah whereas one cooperative could also receive this same amount. In 2009, 59 small businesses received loans from the BPD Bank without collateral.

Thirdly, the Gianyar district head introduced credit schemes to help small businesses through the Institution for People's Credit (*Lembaga Perkreditan Desa* or LPD). The majority of the small businesses preferred to borrow money from the LPD rather than from the BPD Bank. This was because the process for obtaining the credit from the LPDs was faster and required simpler administration than that of the BPD Bank. The number of LPD loans increased from 255, in 2003 to 266, in 2007. Ideally, each *Banjar* has a LPD, but in fact not all *Banjar* have them. Moreover, the survey indicated that small businesses were able to survive without credit from state banks above because they depended on private financial institutions such as LPD and credit from family and friends. Their businesses also depended on domestic and foreign market rather than help from local government. Based on the discussion above, it can be concluded that the district head paid little attention to small business during decentralisation era. The important question is the extent small business owners perceive the district head of Gianyar. Does the behaviour of district head become responsive and close to small business owners?

Based on survey data from 100 small business owners, 37 percent of respondents perceived that the district head became responsive and close to small business, 32 percent revealed that there was no behaviour change at the district head. Twenty six percent had the view that the district head became less responsive (Chart 3.6). The finding was different from that in Bantul where 60 percent of respondents said that district head had become more responsive. This means that decentralisation policy had a bigger impact on behaviour of the district head of Bantul than that of Gianyar.

**Chart 3.6**  
**The Perception of Small Business Owners on Behaviour of District Head**  
**(N=100)**



Source: Field work, 2009.

It can be concluded that district head provided only financial assistance to small businesses owners through financial institutions such state banks and LPDs. Although the district government head had a business background, he was less responsive to the needs and interests of small businesses. This suggests that the district head of Bantul was more supportive of small businesses than the district head of Gianyar. The next section will discuss the community structure in Gianyar with the aim to explore the effect of community structure in implementing decentralisation policy.

### **3.6. Community Structure**

Community structure reflects local citizen groups and business associations at the local level. This section will explore the role of business associations and local citizen groups in the process of decision making at local level. It will show the extent to which they play an important role in the decision making process at local level.

#### **3.6.1. Business Associations**

There are four business associations in Gianyar district: the Business Association for Wood (*Asosiasi Pengusaha Kayu*), the Business Association for Silver (*Asosiasi*

*Pengusaha Perak*), the Business Association for Fabric (*Asosiasi Pengusaha Kain*) and the Gianyar Chamber of Commerce and Industry (*Kadinda*). From these four business associations, only *Kadinda* was active within the community. Despite four business associations in existence, only a few business people are involved because the associations have not yet played important roles in promoting the interests of businesses. For instance, less than 40 percent of the total wood businessmen are involved in the Business Association for Wood.<sup>69</sup> Most small businesses did not participate in the associations because they felt the associations did not provide substantial assistance. For instance, the Chamber of Commerce and Industry of Gianyar has no mediation between the district and its business people. The association has not yet become a pressure group, demonstrated by the following cases.

### **Case 3.7: Powerlessness of Business Association**

In 2008, some traders brought timbers from the Gianyar region to other regions for sale. As a result, Gianyar had a lack of timbers and business owners had difficulties in purchasing timber as an input of their businesses. However, the Chamber of Commerce and Industry of Gianyar could not pressure the local government to overcome this problem by stopping the trade of timbers out of Gianyar. Indeed, the business association expected that the district government could help small businesses. This case indicated that the relationship between business group and the local government was not well institutionalised.<sup>70</sup>

The case above indicates that business association was not able to reach an agreement with district government to produce local policy which provides benefits for small businesses. Furthermore, local government and the *Kadinda* really could not help the business sector when they faced a problem. The business sector had to overcome their problems without intervention from local government, indicating that the business sector was not dependent on local government (Case 3.8).

### **Case 3.8: Lack of input supply**

The district government of Gianyar and the Chamber of Commerce and Industry could not do anything when businessmen in Gianyar faced a lack of supply of timber because an investor established a new plywood factory in the Bangli district, absorbing the timber resources from the Gianyar region.<sup>71</sup>

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<sup>69</sup> Interview with Mr. A.A., Chairman of Gianyar Business Association for Wood, 24 April 2009

<sup>70</sup> Interview with Mr. A.A., Chairman of Gianyar Business Association for Wood and Chairman of Gianyar Chamber of Industry and Trade, 24 April 2009

<sup>71</sup> Interview with Mr. A.A., Chairman of Gianyar Business Association for Wood and Chairman of Gianyar Chamber of Industry and Trade, 24 April 2009.

These cases indicate that the Gianyar Chamber of Commerce and Industry has not yet played an important role as mediator between business people and the local government. In addition, the business association has not yet helped business people to solve the problems of the supply inputs. The relationship between business association and local government has not developed into an institutionalized and inclusive partnership, despite the local government head's background in business.

### 3.6.2. Neighbourhood Association

The social structure of Gianyar is different from Bantul. The lowest level of social organisation in Gianyar is called a *Banjar*, which regulates rights and obligations of the Balinese community. These rights and obligations are documented in the “*aweg-aweg*”.<sup>72</sup> A *Banjar* is headed by a notable person (*tokoh adat*), who understands customary behaviour. In Gianyar, there are official villages called *Desa Dinas* and customary villages called *Desa Adat* or *Desa Pakraman*. There are 523 *Banjar* and 271 *Desa Adat*. Historically *Desa Pakraman* and *Banjar* arose from Dutch colonial rule.

In the 1930s, Dutch colonial rule introduced a distinction between administrative (*dinas*) and customary (*adat*) rules at the village level. This construction was designed to retain Balinese religion and culture (H. S. Nordholt, 2007, p. 27). However, when the New Order Government took power in 1968, *desa adat* became subordinate to *desa dinas*. The Law 5/1974 on Regional Government only recognized *desa dinas*. During the *reformasi* period, Law 5/1974 was replaced by Law 22/1999, which recognised *desa dinas* and *desa adat*. Following suite, Law 32/2004 abolished Law 22/1999, which opened sphere of the relationship between *desa dinas* and *desa adat*.

In 2001, the provincial government of Bali issued a local regulation (Perda No. 3/2001) on the role of the *desa adat* which replaced Perda 6/1986 in which *adat* was sub-ordinated to the interests of national development. The word *adat* was replaced by the word *pakraman*. *Krama* refers to customary practice as well as the village council. Moreover, Perda No. 3/2001 provided *desa pakraman* full authority to

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<sup>72</sup>*Aweg-aweg* is local regulation of Balinese behaviour at *Banjar* level.

manage their internal affairs and make the village council the highest authority. *Desa pakraman* even has authority over village land, deterring land that can not be sold (Nordholt, 2007:28). However, the concept of *desa pakraman* has been criticized. Firstly, the local regulation creates double standards because it articulates that the migrants are members of the *desa pakraman*, and no obligations to fulfil religious practices. Secondly, the concept of *desa pakraman* creates a fragmented autonomy at the village level (Nordholt, 2007).

The *Desa Pakraman* is headed by *Bendesa*,<sup>73</sup> who receives a monthly salary from the local government. During the political campaign for the local legislature member election and district head election, local politicians approached *Bendesa* to obtain political support from local communities by providing money or materials to *Desa Pakraman*. The local politicians expected that the *Bendesa* could influence the behaviour of local communities (Case 3.9).

#### **Case 3.9: Local politicians approached *Bendesa***

Candidates for district head, A.A.Gde Agung Bharata and Cokorda Oka Ardana Sukawati approached the notables of customary organisations such as *Bendesa* and heads of villages to gain political support in the 2008 district head election. The candidates showed their appreciation for political support by providing money. They assumed that by addressing the *Bendesa*, they would easily win because *Bendesa* were able to influence voter behaviour.<sup>74</sup>

During the political campaign for the legislative election in 2009 and the district head election election in 2008, *Banjars* also played important roles as mediators between candidates for the legislature and small businesses as voters. The candidates usually gave money to local community (Case 2.10).

#### **Case 3.10: The Role of *Banjars* during Local Parliamentary Elections**

During the political campaign for local parliamentary elections in 2009, there were five candidates for the local legislature who came to a *Banjar* meeting to introduce themselves and asked support from the *Banjar* members. Each candidate gave about Rp 500,000 up to Rp 1,000,000 to the *Banjar*. This money was called “*uang sukarela*” or voluntary contribution. This money was distributed to Pura (temples) to finance religious ceremonies. Furthermore, in the campaign for *Pilkada*, one of candidates for district head also came to give money, called “*sesari*”, for religious ceremonies. However, after finishing religious ceremonies, the remaining money could be used for

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<sup>73</sup> *Bendesa* is head of customary village

<sup>74</sup> Radar Bali, 2-1-2007 quoted by Imfath (2008, p. 85).



the needs of the *Pura* and the needs of local society. By providing funds, the candidates hoped they could influence voter behaviour.<sup>75</sup>

The cases above showed that *Banjars* were used by local politicians to obtain political support. Although *Banjars* received funds from politicians, they were not able to lobby politicians to get more than what was given. In another case, candidates for the local legislature gave materials to local community (Case 3.11).

### **Case 3.11: Money Politics during Local Parliamentary Elections.**

One candidate for the local legislature gave a bulldozer during his campaign to the local community through the *Banjar* with the aim to influence voters behaviour. The bulldozer was used by the local community to build a football field. Another candidate for the legislature gave Rp 50 million to local community. However, the head of *Banjar* let the *Banjar* members elect their candidate based on their individual preference.<sup>76</sup>

When the current district head was competing in the district head election (*Pilkada*), as the incumbent, he could use public resources with the aim to obtain political support in election for district head (Case 3.12 and Case 3.13).

### **Case 3.12: Obscurity between Public and Private Resources**

One of the candidates for district head who was the incumbent gave 1.5 million rupiah to a *Pura* during his campaign for *pilkada*, but it was difficult for ordinary people to judge whether he was acting in his position as district head or as a candidate for district head.<sup>77</sup>

Another case indicates that during the campaign, the district head of Gianyar, as incumbent donated materials and services to local people (Case 3.13).

### **Case 3.13: Seeking Political Influence by Providing “Sembako”<sup>78</sup> and Health Services for Poor People**

The *Bupati* of Gianyar, Agung Bharata headed a “safari” for public health services for villages. Thousands of local people received free health services. In addition, the *Bupati* delivered “*sembako*” packages to tuberculosis disease sufferers.<sup>79</sup>

Based on the discussion above, it can be concluded that business associations in Gianyar had not yet become pressure groups and most of the business people are not involved in these association. They also had not yet played an important role as

<sup>75</sup> Interview with Mr. A.W., head of *Kelian Dinas* and *Kelian Adat*, Banjar of Bonjaka, 23 May 2009.

<sup>76</sup> Interview with Mr. K.K., head of *Kelian Dinas*, Banjar of Sapat, 14 May 2009.

<sup>77</sup> Interview with N.S, Head of *Kelian Dinas* and *Kelian Adat*, Banjar of Pujung Kaja, 23 May 2009.

<sup>78</sup> *Sembako* is human basic foods such as: rice, sugar, cooking oil, etc.

<sup>79</sup> Radar Bali Daily, 24-09-2007 quoted by Imfath (2008, p. 69).

mediators between local government and business people. In other words, business association had no power to make a bargaining with district government.

Further, *Bendesa* and head of *Banjar* was the customary organisation at village level, but they played an important role as mediator between local politicians and local communities. Local politicians approached *Bendesa* and the head of *Banjar* to influence local communities in the election for local parliament members and the district head.

### **3.7. Conclusion**

Demographically, the population of Gianyar is small. Culturally, the population is homogeneous with Hindu culture. It is postulated that the small population and homogeneous culture contributes to the implementation of decentralisation policies because there is a little conflict among the population. However, many individuals below the poverty line implicate a financial burden for district government because the district government needs to allocate funds to help the poor people.

Gianyar is not rich in natural resources such as minerals and forests. Further, the district government has only a small income from natural resources and tax revenue. As a result, the district government has difficulty in implementing administrative decentralisation such as providing public services, financial assistance and training programs for small business. The administrative decentralisation thus has only a minimal impact on the relationship between local government and small business.

In 2008, the sector of trade, hotel and restaurant accounted for the most part of gross regional domestic product of Gianyar (30 percent), whereas the agricultural sector was only 18 percent. This means that economic structure of Gianyar was not dependent on the agricultural sector. This differed with Bantul, which depended on the agricultural sector as the basis of its economy. As in the case of Bantul, locally derived revenue of Gianyar was not sufficient to support the district government's expenditure. As a result Gianyar was financially dependent on the central government's grants. Gianyar had limited fiscal decentralisation to increase financial capacity. I suggest that without central government grants, financially the local bureaucrats of Gianyar faced constraints to implement the decentralisation policies.

Decentralisation policy provides discretionary power to the district government in terms of using local tax incomes, levy incomes and general grants because the central government does not determine how to use such incomes. The central government also gives authority to local government to develop types of levies and determines charge of each levy. Therefore, the district government can give financial assistance to small businessmen by using incomes from taxes, levies and general grants.

Based on the political institutional discussion, we understand that both the behaviour of political parties and local legislature members did not change during decentralisation era. Following decentralisation policy, many political parties emerged and they competed intensively in pursuing public resources and official position in executive government and legislature at local level. However, their competitiveness was accompanied by money politics. As a result, many local legislature members were not qualified and not able to carry out their functions. While political parties were not able to articulate the preferences of local small business owners. It can be concluded that political institutions such as local legislature and political parties had difficulty in improving their roles because they were involved in money politics.

Local bureaucrats and district heads have not dramatically changed in providing public services during decentralisation era. Although most of local legislature members and district heads came from business background, they were less responsive to the interests of the business sector. However, by comparison the district head of Bantul is more responsive to help small business sector than the district of Gianyar.

*Kadinda* as a business association was not involved in the process of decision making at district level because the district government and local legislature did not provide access to participate in the process of decision making. As a result, the role of business associations in promoting small businesses' interests was limited. The business association had no power to influence local policy. In the other words, political decentralisation did not increase participation of business associations in the

process of decision making. As a result, business association had no power to make a bargain with district government.

Political decentralisation caused local politicians to approach the heads of *Desa Pakraman (Bedesa)* and the heads of *Banjars (Kelian)* to obtain political support by providing funds and materials. In return, they expected that the head of *Desa Pakraman* and head of *Banjar* could influence voter behaviour in elections for the district head and legislature members. However, the *Banjars* have no power of negotiation with local politicians to get benefits for local small businesses and citizens. In fact some politicians directly provided money to individuals with the aim to buy votes.

The next two Chapters will analyse the implication of decentralisation on small business in Bantul and Gianyar. The objective is to provide insights into how decentralisation influences the relationship between local government and small business and to analyse what kind of benefits are obtained by small business as result of decentralisation policy.

## **CHAPTER FOUR**

### **THE IMPACT OF DECENTRALISATION ON SMALL BUSINESS IN BANTUL**

#### **4.1. Introduction**

Chapter Two discussed how the social, economic and political setting of Bantul influenced the implementation of decentralisation. Chapter Three then examined the social, economic and political settings of Gianyar. This chapter will discuss the impact of decentralisation on small businesses in Bantul. Do the increased functions and political power of the district government as a result of decentralisation policy have an impact on small businesses? The extent to which local government carried out regulations reform to provide better public services and help small businesses in the form of financial assistance, training as well as technological assistance and infrastructure facilities are also discussed.

In Indonesia, administrative and fiscal decentralisation policies implemented since 2001 have institutionally changed the structure of fiscal and functional relationships between central and local government. However, the effects of policy in developing autonomy and capability local governing entities are not yet evident. Decentralisation policy was quite effectively implemented in terms of functional decentralisation (or redistribution of functions to sub-national levels), but not carried out effectively in fiscal terms. The central government did not adequately delegate the power of revenue-raising to local governments. The poor local governments had difficulties in delivering the decentralised functions such as small business development; they had no choice but to depend on transfer payments from the central government to meet their financial demand. Therefore, the central government still played an important role in promoting small businesses although local governments adopt decentralisation policy. Further, another important issue is whether political decentralisation can increase political participation of small businesses.

In locality of Bantul, political decentralisation has opened opportunities for small business owners and business associations to participate in the process of decision making. However, political decentralisation failed to encourage political parties to be close to small business owners. Further, political parties were not able to represent the interests of local small businesses in an accountable and responsive way. In addition, small business owners were not interested in being involved in political parties.

Furthermore, the local government of Bantul has promoted small business by providing financial, training, technological assistance and market development as well as infrastructure facilities. However, this aid provided small impact on small businesses because only few small businesses received this aid. Under the on-going reform, the local governments pass on few public services, including services and goods to small businesses. However, improved public services had a minimal overall impact on the small business sector because local government had small financial capacity.

This chapter analyses the relationship between local government and small businesses. The structure of this chapter is divided into three sections. The first section examines the impact of decentralisation policy on business licenses, local tax/levy policy, and policy to protect small businesses. The relationship between local government and small businesses is influenced by regulations that can promote or prevent small businesses. The second section explores the extent to which decentralisation can encourage local government to promote small businesses by providing financial assistance, training and technological assistance and infrastructure facilities. Under decentralisation era, local government has discretionary policy to help small businesses. The important issue is the extent to which local government could use local public resources to help small businesses. The third section analyses political influence of local authorities as well as politicians over small businesses and participation of small businesses owners in the process of decision making. Decentralisation can change the relationship between local authorities and small businesses owners as the local authorities are directly elected by local communities which include small businesses owners. As a result, they intensively approach small business owners to obtain political support. The

important question is then in what way did they influence small businesses owners to obtain votes?

## **4.2. Regulation of Small Businesses**

This section will answer the questions that have been proposed in Introduction: Firstly, to what extent do the district governments carry out local regulation reform to promote small businesses. Secondly, can the district governments use regulations on local levies to control small businesses?

As discussed in Chapter One, administrative decentralisation can cause local governments to have more functions as well as discretionary policy to carry out regulation reform with the aim to provide public services for small businesses. In this context of small businesses, local governments have authority to improve regulation concerning business license, local tax/levy policy and policy to protect small businesses. Each policy will be discussed separately with the aim to provide detail analysis of the policy.

### **4.2.1. Business License Policy**

Regulations can be used by national and local government to affect business sector. Both national and local government can regulate business sector with the aim to promote businesses sector and protect citizen. They can promote the business sector by providing various assistances such as subsidy, financial, material and technological assistances as well as facilitating infrastructures such as roads, electricity, water and gas. In addition, they can set up policy to protect business and interests of citizens or consumers especially in regard to quality standard, safety levels and pollution control. For instance, by controlling business license policy, government can control business activities and protect citizens or consumers.

Regarding business license, although the central government delegated some business licenses or functions to district governments, the central government was still holding many authorities. The Minister of Investment/Chairman of Coordinating Agency for Capital Investment (*Meninves/Kepala BKPM*) issued decree No. 57/SK/2004 on Manual Procedure of Applying for Investment Established in Framework of Domestic and Foreign Investment. According to that decree, the

*Meninves/Kepala* BKPM has authority to issue: (1) Limited Importer Identification Number (*Angka Pengenal Impor Terbatas*); (2) Business License and Permanent Business License (*Ijin Usaha dan Ijin Usaha Tetap*); (3) Plan for Use of Foreign Employees (*Rencana Penggunaan Tenaga Kerja Asing*); (4) Recommendation for Visa for Foreign Employees (*Rekomendasi Visa bagi Tenaga Kerja Asing*); (5) License for Foreign Employees (*Ijin Tenaga Kerja Asing*) (6) Extensions for Foreign Employee Permits (*Perpanjangan Ijin Tenaga Kerja Asing*); and (7) Approval for Waiving/Reduction of Import Duty on Imported Goods (*Fasilitas Pembebasan/Keringanan Bea Masuk atas Pengimporan Barang*). The local government had only authority for License of Location; Certificate for Land-Ownership; Permit for Building Establishment; and Disturbance Permit.

The aforementioned authorities indicate that local governments had limited functions and jurisdiction in providing investment licenses because some authorities related to investment license were in the hands of the national government. In the case of Bantul, the district government carried out organisation reform with the aim to improve various services of licenses. For instance, the district government established a new local agency called the local agency for provision of licenses (*Dinas Perijinan*) with the aim of improving public services to business sectors and promote this sector. This local agency had authority to issue business licenses.

The Bantul local government carried out two kinds of reform with the aim to provide better public service for small business: institutional reform and administrative reform. In relation to institutional reform, the local government established *Dinas Perijinan* which functions to issue various types of business permits. Effective on 1 January 2008, all types of permits were issued by *Dinas Perijinan*. Previously, various types of permits were issued by several local agencies. For instance, a permit for trade business was issued by *Diperindagkop*; a permit for building and location was issued by *Dinas Pekerjaan Umum* (local Public Works Agency). Under *Dinas Perijinan*, all types of permits became more accessible for customers.

Administrative reform aims to simplify procedures of processing for obtaining business licenses as well as to shorten waiting times for obtaining permit. Presently there is a clear period of time for obtaining a business permit. For instance, a permit



for industry registration identification should be issued by local government within a maximum of 12 working days after the completed document is submitted. Furthermore, a permit for store registration identification should be issued within a maximum of 5 working days (Table 4.1). This is different from previous local regulations where the procedure process for obtaining business permit required a long time and did not even mention a period of time for obtaining a business permit. Consequently, in many cases, business licences were issued by local government after more than one month.

Furthermore, local government also enacted fixed cost of for each type of permit. For instance, an industry business permit (IUI) was 250 thousand rupiah; a large trade business permit (*SIUP Besar*) was 200 thousand rupiah; and middle trade business permit (*SIUP Menengah*) was 150 thousand rupiah whereas a small business trade (*SIUP Kecil*) was free. This is different from previous local regulation which the cost for obtaining business permit was unclear.

**Table 4.1**  
**Type of Permits under Local Agency for service of Licenses of Bantul**

No.	Type of Permit	Time Service
1.	<i>Ijin Lokasi</i> (Permit for Building Location)	12 work days
2.	<i>Ijin Mendirikan Bangunan</i> or IMB (Permit for Building Establishment)	12 work days
3.	<i>Ijin Gangguan</i> (Disturbance Permit)	12 work days
4.	<i>Ijin Daftar Industri</i> (Permit for Industry Registration Identification)	12 work days
5.	<i>Ijin Usaha Industri</i> or IUI (Industry Business Permit)	12 work days
6.	<i>Ijin Tanda Daftar Industri</i> or TDI (Permit for Industry Registration identification)	12 work days
7.	<i>Ijin Perluasan Industri</i> (Permit for extended Industry)	30 work days
8.	<i>Tanda Daftar Perusahaan</i> (Company Registration Identification)	12 work days
9.	<i>Tanda Daftar Gudang</i> (Store Registration Identification)	5 work days
10.	<i>Surat Ijin Usaha Perdagangan</i> or SIUP (Trade Business Permit)	12 work days
11.	<i>Surat Ijin Usaha Jasa</i> (Services business Permit)	12 work days
12.	<i>Ijin Usaha Hotel Bintang</i> (Star Hotel Permit)	12 work days
13.	<i>Ijin Usaha Hotel Melati</i> (Non-Star Hotel Permit)	12 work days
14.	<i>Ijin Penginapan</i> (Inn Permit)	12 work days
15.	<i>Ijin Usaha Pasar Seni</i> (Art Market Permit)	12 work days

Source: Dinas Perijinan Kabupaten Bantul (2009).

The impact of implementation of local regulation reform regarding licenses above is the total small businesses owners who applied for permits increased. The number of Trade business permit (SIUP) doubled from 213 in 2002 to 410 in 2007. The total of Company Registration Permits (TDP) increased from 257 in 2002 to 309 in 2004 and to 358 in 2006, and increased sharply to 437 in 2007 (Table 4.2). In other words, local regulation reform may have increased the total number of registered small businesses. However, the majority of small businesses remain without business permits. Therefore, the impact of administrative reform is not significant if its aim is to increase the number of small businesses with proper business permits.

**Table 4.2**  
**The Number of Local Business Permits, 2002-2007**

	Types of Permit	Number of Local Business Permits					
		2002	2003	2004	2005	2006	2007
1.	Trade Business Permit (SIUP)	213	226	321	311	336	410
2.	Company Registration Identification (TDP)	257	317	309	229	358	437
3.	Industry registration identification (TDI)	46	76	72	70	45	12
4.	Industry Business Permit (IUI)	3	58	22	20	15	12
5.	Store Registration Identification (TDG)	35	1	-	-	2	-
6.	Cooperative Registration Permit	11	23	19	16	11	44
7.	Total	565	701	743	646	767	915

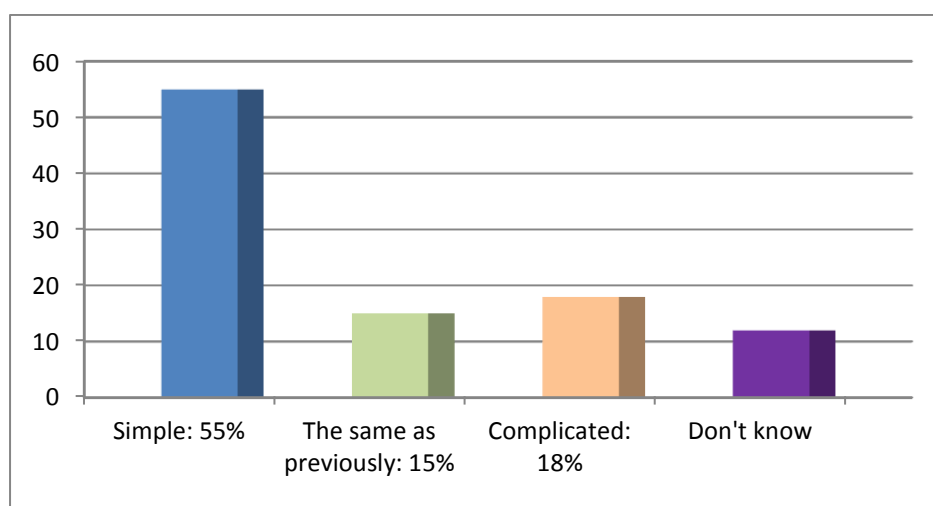
Source: *Diperindagkop Kabupaten Bantul* (2009).

Data obtained by interviews with small business owners also showed that most of them did not have business licenses. According to interviewees, business licenses were not important because they could operate their businesses without business licenses. It indicated that small business owners were able to function relatively independent from local government regulations. The business licenses were only needed when they sought credit from the state banks or commercial banks and the district government. This suggests that small business owners actually did not need financial support from formal financial institutions and local government.

In addition, the possession of business licenses also could be considered when the district government recruited small business owners to be involved in training activities and national and international business exhibitions. The local government gave subsidies for small businesses to be involved in trade exhibition activities as well as provided assistance in form of daily transportation costs when they participated in training activities. It could be concluded that business license could be considered as incentive but it was not significant because data showed that most small business owners still did not have business licenses (Table 2.9).

Does the reason of the unregistered small business owners relate to the complicated procedure for obtaining licenses? The research finding indicated that most respondents perceived that the procedure for obtaining business licenses was uncomplicated (55 percent). Only 18 percent of the small business owners perceived that the procedure was complicated. Lastly, 15 percent of the respondents said that the procedure for obtaining business permits remained the same (Chart 4.2). It can be concluded that the reason for not owning business permits was less likely associated with the procedure.

**Char 4.1**  
**The Perception of Small Business Owners regarding Procedure for Business Licenses**  
**(N=60)**



Source: Data obtained by survey questionnaire, 2009.

The next section will examine local taxes/levies regarding small businesses with the aim to analyse the extent to which small business owners obeyed paying taxes/levies

and the extent to which local government can use the local tax/levy policy to control small businesses. This is important because if the majority of small business owners paid local taxes/levies, the district government revenue could increase. As a result, the fiscal capacity of Bantul district might increase. Further, the district might be able to meet the fiscal needs of local small businesses such as public services, training and physical infrastructures for small businesses.

#### **4.2.2. Local Tax and Levy Policies**

As discussed in Chapter One, fiscal decentralisation can cause the district governments to have authority to set up their own local taxes/levies and tax/levy rates. Further, it may improve efficiency in using public resources based on the needs of local communities. Discussion of this section will be divided into two subsections: Firstly, the local tax policy and secondly, the local levy policy.

##### **4.2.2.1. Local Tax Policy**

Before discussing the impact of local taxes on small businesses, it is important to present the analyses of contribution of local tax income to the district government's revenue in Bantul. Data indicates that the local tax income account for the total district government income was an average of 1.5 percent during 2002-2010 (Table 4.3). The income from local tax was insufficient to pay the salaries of local bureaucrats. For instance, in 2009, income from local tax was 13,000 million rupiah, yet the total salary for local bureaucrats was 533,231 million rupiah. In other words, income from local tax only contributed 2.44 percent to budget for public servants salary. In 2010, the budget for local public servants salary was 557,144 million rupiah, whereas the income from local tax was only 16,489.58 million rupiah or 2.96 percent. It can be concluded that income from local taxes was insufficient to pay the local public servants salaries for one month.

**Table 4.3**  
**Local Tax Incomes of the Bantul District Government, 2002-2010**  
**(Million rupiah)**

No.	Year	Total District Income	Local Taxes Income	Percentage Local taxes Income to Total District Income
1.	2002	336,570.26	4,803.61	1.43
2.	2003	374,266.60	6,080.85	1.62
3.	2004	398,879.89	6,951.70	1.74
4.	2005	432,516.37	7,688.50	1.78
5.	2006	597,788.83	8,740.45	1.46
6.	2007	693,827.54	8,104.47	1.17
7.	2008	995,971.70	9,507.00	0.95
8.	2009	829,474.65	13,000.00	1.56
9.	2010	876,204.47	16,489.58	1.88
		Average		1.50

Source: *Pemerintah Kabupaten Bantul*, (2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010)

The small income from local tax has two implications: Firstly, financially, the district government of Bantul was dependent on the central government. The district government received funds from the central government in the form of general allocation fund, special allocation fund and revenue sharing fund as discussed in Chapter Two. Secondly, the district government had difficulty carrying out decentralised functions to increase public services as well as financial assistance for small businesses. As a result, administrative decentralisation had not yet provided valuable changes for small businesses.

In contrast, when the district government gains much income from local tax and levies, the district government can allocate the funds to improve roads, assistance for equipment, capital and training for small businesses. The local government has discretionary policy to use local tax and levy income as well as general grant derived from the central government. In relation to roads, the district government can improve roads between location of handicraft village and city with the aim to facilitate domestic and foreign tourists to visit the handicraft village or facilitate small business owners to bring their product to markets or harbor. For instance, in 2007 income from local taxes and levies in Bantul was low. Consequently, the Bantul district did not have adequate finances to repair damage roads. Data shows that there were many damaged roads in Bantul (Table 4.10). In my opinion, many

damaged roads were hardly an incentive for small businesses. In addition, financial inadequacy could cause local government to have difficulty in facilitating training activities for small business and facilitating local public health services.

As stipulated by Law 34/2000, the local tax income derived from taxes on (1) hotels (2) restaurants; (3) entertainment; (4) public advertisement; (5) public street lighting; (6) local natural resources exploitation (Category C); and (7) parking. This means that district government of Bantul had limited discretionary policy to set up tax policy. In the case of Bantul, income from tax on public street lighting contributed most part of the total local taxes income, which was the first rank. The second rank was income from tax on public advertisement; the third rank was income from tax on restaurants; the fourth rank was income from tax on entertainment; and the fifth was income from tax on hotels.

According to Law 34/2000, the district government has authority to create other local taxes beyond those mentioned above with the following criteria: (1) tax objects must be located in the particular district and possess relatively low mobility across district boundaries; (2) the tax does not contradict the public interest; (3) the tax does not constitute a national or provincial tax; (4) the tax has sufficient revenue potential, (5) the implementation of the tax will not negatively impact the local economy; (6) the development of the tax takes into consideration issues of fairness to and capacity of local residents; and (7) the tax guards the environment. However, all local taxes should be approved by the central government. In practice, until now the local government of Bantul has not yet identified types of local taxes beyond those mentioned by Law 34/2000. This means that the district government of Bantul had difficulty to increase tax revenue because of limited fiscal decentralisation.

In relation to small business activities, the central government had the opportunity to obtain income from small businesses in the form of selling tax whereas the district government may only obtains income from tax on billboard from small businesses. However, most of small businesses did not pay tax in selling their products because their business transactions were not recorded. Most of small businesses also did not pay billboard tax because most of them had no advertising. Moreover, tax policy had minimal effect on small businesses because small businesses were not the target of

local tax. In contrast, small businesses were only the target of local levies. For instance, levies from licenses for building establishment, building location licenses, disturbance licenses, industry business; therefore, the next section will discuss local levies related to small businesses.

#### **4.2.2.2. Local Levy Policy**

This section will discuss the impact of local levies on small businesses and the extent to which the district government used local levies to control small businesses. Local levies are one of the sources of potential revenue for the district government of Bantul. Since decentralisation policy was implemented in 2001, the Bantul district government has improved local regulations on business permits related to local levies.

- 1) Levies on Building Location License (local Regulation No. 23/2000)
- 2) Levies on Building Establishment License (Local Regulation No. 7/2002)
- 3) Levies on Disturbance License (Local Regulation No.15/2001)
- 4) Levies on Industry Registration Identification License (Local Regulation No. 12/2002)
- 5) Levies on Industry Business License (Local Regulation No. 12/2002).
- 6) Levies on Extended Industry License (Local Regulation No.12/2002)
- 7) Levies on Company Registration Identification License (Local Regulation No. 15/2002).
- 8) Levies on Store Registration Identification (Local Regulation No. 15/2003).
- 9) Levies on Trade Business Permit (Local Regulation No. 11/2002)
- 10) Levies on Market (Local Regulation No. 13/2007).
- 11) Levies of Hotel and Inn (Local Regulation No. 10/2003).
- 12) Levies on Entertainments (Local Regulation No. 11/2003).
- 13) Levies on Restaurant (Local Regulation No. 2/2005).

One question that arises is whether or not these local regulations regarding levies could be effectively applied in this region. Another is whether local levies could cause a financial burden for small businesses owners. Before answering these questions, it is important to present the income from local levies for the district government of Bantul with the aim to understand the role of local levies in generating the district government revenue. Through this process it will be evident

the contribution of income from of business license to the district government revenue.

Data indicates that during 2002-2010 the total income from local levies increased every year. In 2010 the total income from local levies was more than three times of that in 2002. During 2002-2010, the average of local levy income of total district government income was 4.58 percent (Table 4.4). Income from levy on markets provided most contribution of the total local levies income. For instance, the income from the levies on markets was 1.01 million rupiah in 2007 increased to 1.21 million rupiah in 2010.

**Table 4.4**  
**Local Levy Incomes of the Bantul District Government, 2002-2010**  
**(Million rupiah)**

No.	Year	Total District Income	Local Levies Income	Percentage Local Levies Income to Total District Income
1.	2002	336,570.26	12,538.45	3.73
2.	2003	374,266.60	17,378.25	4.64
3.	2004	398,879.89	19,620.69	4.92
4.	2005	432,516.37	23,343.94	5.40
5.	2006	597,788.83	26,045.89	4.36
6.	2007	693,827.54	27,329.70	3.94
7.	2008	995,971.70	31,479.63	3.16
8.	2009	829,474.65	38,366.19	4.62
9.	2010	876,204.47	56,473.04	6.44
		Average	28,063.98	4.58

Source: *Pemerintah Kabupaten Bantul*, (2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010).

The income from local levies was larger than the income from local taxes during 2002-2010 (Table 4.4 and Table 4.3). In 2010, the total income from local taxes was less than one quarter of the total income from local levies. This means that local levy income played a more important role than local tax income in contributing to district government revenue. The data also indicates that local government preferred to introduce local levy than local tax because Law 34/2000 provided more discretion in introducing local levy than local tax. This Law mentioned types of local taxes and that the district government was limited in set up local taxes.



The total income from local taxes plus income from local levies was insufficient for budgetary requirements for local public servants salaries during a year. In 2010, for instance, income from local taxes plus income from local levies was only sufficient to pay the local public servants salaries for one and half months.

Regarding the question of whether or not these local regulations regarding levies could be effectively applied in this region, this research suggests that most small businesses did not have licenses and never paid local levies. As presented in Chapter Two, Table 2.9 showed that in 2006, there was only 6.99 percent of small business owners who had business licenses and in 2007 there was 7.15 percent.<sup>80</sup> In other words, most small businesses ignored local regulation on licenses. The figure was in line with data obtained from interviews that indicated most small businesses did not have licenses. This means that small businesses operated without obeying the district government policy. Local regulation on business licenses could not effectively be implemented by the district government. There are two implications from this. Firstly, the district government was not able to use the local regulations to control small businesses. Small businesses were not dependent on district government policy in operating their business. In practice, the district government never forced small businesses owners to apply for licenses. As a result, most small business owners ignored these regulations. They would only apply for business licenses if they wanted to obtain financial assistance from the district government or credit loan from state banks. In fact, without the financial and material assistance from the district government, small businesses could still survive. Secondly, financially the growth of small businesses could not impact on the district government revenue because most of them never paid local levies. The district government could not expect to increase the district government's revenue from small businesses. However, the district government recognised that small businesses created large employment opportunities for local people.

A further question is how the district government viewed small business owners who had no licenses. This study found that the local government of Bantul did not fine small businesses when they had no licenses such as licenses for building location, for

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<sup>80</sup> In 2006 there was 1,250 of 17,865 small businesses had business licenses and in 2007 there was 1,280 of 17,911 small businesses had business licences.

building establishment and for trade. I propose four arguments to explain this case. Firstly, I argue that the aim of local regulations on business licenses was not to increase district government income. For local government, the most important aspect of the existence of small businesses was absorption of employees, even though they contributed a small amount of levies income for district government's revenue.<sup>81</sup> For instance, the absorption of employee rate in the industrial sector increased from 77,600 workers in 2005 to 78,783 workers in 2007. If the local levy regulations were strictly applied for small businesses, the financial burden would result in most of them and having difficulty developing.

Secondly, I argue that politically the district head and politicians of Bantul viewed small businesses as vote source in elections for district government head and local parliament members. It was important to gain their sympathy rather than to force them to pay local levies. Data showed that there were 17,911 small and medium businesses with a number of 79,904 workers in 2007. Based on the growth rate of small business about 0.25 percent, I estimated that there were around 18,003 small businesses in 2009; and based on the growth rate of employee about 0.15 percent, I estimated that the number of employees were 80,143 in 2009. If each was owned by two people typically a husband and wife, the number of people who were involved in small businesses increases to 116,149.<sup>82</sup> The important issue is what percentage of small businesses' voted in the total vote for the election for district head and local legislature members in 2009. According to KUPD<sup>83</sup> of Bantul, the number of constituents in election for legislature members in 2009 was 697,021. This means that about 16.66 percent of constituents came from small businesses. I estimate that in 2010, when the Bantul district held district head election, the number of constituents who came from small businesses could be around 16.69 percent.

Thirdly, in my opinion, the district head of Bantul tried to gain political support from small businesses by ignoring local levies to develop an image as a populist leader. Former district head of Bantul, Sri Roso Sudarmo was from an authoritarian regime led by the military. He governed coercively and had a reputation for dealing harshly

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<sup>81</sup> Interview with Head of District Government of Bantul, 25 June 2009.

<sup>82</sup>  $18,003 \times 2 + 80,143 = 116,149$ .

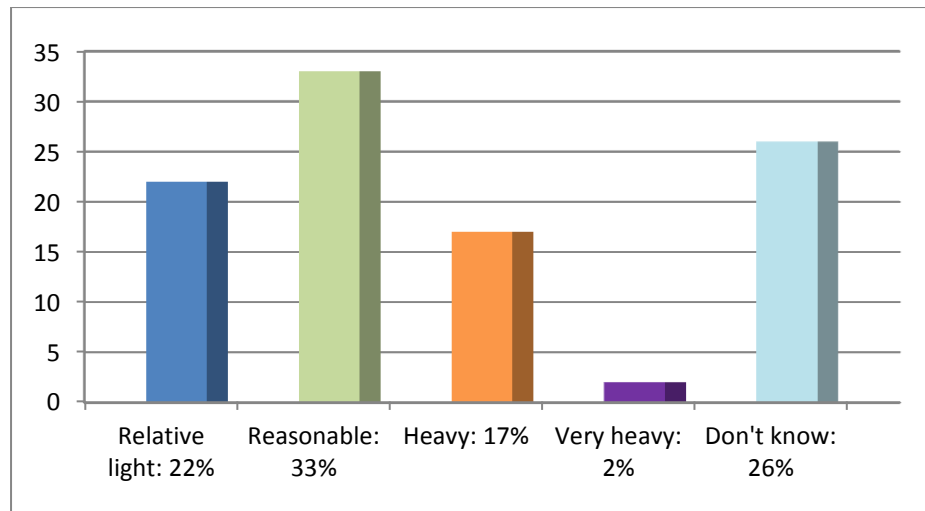
<sup>83</sup> KPUD (*Komisi Pemilihan Umum Daerah*) is the Committee for the General Election at district government level.

with dissenters and protesters. In contrast, the next district head, Idham Samawi, worked consistently to develop an image as populist leader.

Fourthly, the local government of Bantul intended to provide good public services for small businesses. By doing so, the businesses could remain in the Bantul region despite having no business permits. Tiebout's theory (1956), as discussed in Chapter One suggests that businesses will stay in a region which provides good public services and taxes, but will leave if local government services are unsatisfactory. In my view, the Bantul district government policy is concurrent with the Tiebout's theory. In the case of Indonesia, types of local levies and local levy rates among regions are not the same. Furthermore, local government can promote small businesses through providing good services and implementing relatively light local levies. In another case, a local government may protect small businesses from competition with big businesses with the aim to promote them. The next section will discuss protection policy for small businesses.

Does the fact of unregistered small business owners relate to cost of permits? Based on the survey data from 60 small business owners, the majority of respondents (33 percent) perceived that the cost of local levies was reasonable, whereas 22 percent said that cost of local levies was light. In the other words, 55 percent respondents revealed that cost of local levies was not heavy (combined reasonable and light). Only 2 percent said that cost of local levies was too heavy and 17 percent said that local levy was heavy (Chart 4.1). Thus, cost of levies was not the main reason for not having business licenses for small business owners. This research finding differed from Pramusinto's work (2005) which indicated that cost of local levies was perceived as a financial burden by businessmen in Sidoarjo district, East Java. Thus, some businessmen did not pay local levies.

**Chart 4.2**  
**The Perception of Small Business Owners on Local Levies**  
**(N=60)**



Source: Data obtained by survey questionnaire, 2009.

I argue that the absence of fines was the main reason for not having business permits for the small business owners. They perceived that business licenses were not important because they could operate their business without licenses. In other words, the existence of small businesses did not depend on the district government. It depended on markets. If there were more buyers seeking products from small businesses, small businesses may develop. It indicates that district government had difficulty to use local regulations on business permits to control small businesses.

#### **4.2.3. Protection Policy for Small Business**

Generally, small businesses have a lack of capital and technology in operating their business. As a result, they produce products of low quality. In contrast, big businesses are supported by huge capital and high technology, so they can produce high quality products. Small businesses may have difficulty in competing with big businesses without protection from district government. The intervention of the district government is necessary to promote small businesses. In the case of Bantul, in September 2008 the district head of Bantul introduced Bupati's Decree (*Keputusan Bupati*) No. 503/5439 to protect small businesses and local public markets. According to the Bupati's decree, big entrepreneurs were not allowed to develop supermarkets in Bantul regions because they generally succeed in competing with small businesses.

In the following, two cases indicate district government of Bantul protected small businesses are discussed. Firstly, case 4.1 shows the district government protected small seafood businesses from a big business. Based on my observation during fieldwork in 2009, small seafood businesses in Parangtritis beach used a traditional way to cook fish and prawns because they lack capital, technology and skill. The district government expected that they could develop by protecting them from big businesses.

#### **Case 4.1: Case of Parangtritis**

The district head did not permit Mr. Ciputra, a conglomerate of Jakarta who has a plan to build a large luxurious restaurant in Parangtritis beach. The district head thought that many seafood restaurants, which were owned by local small businesses would become bankrupt if Mr. Ciputra was allowed to realize his plans. As a result, this would cause unemployment and social problems in Bantul.

The case above indicates that the district government protected small seafood businesses against a large business. However, I suggest that the protection policy could not be maintained continuously. Small seafood businesses in Parangtritis could become well developed and compete with larger businesses if they were supported by technological and skill assistance such as stove, gas, cooker, refrigerator and freezer as well as good service training.

Secondly, the following case concerns the conflict between the owner of a mini market and traditional market sellers. In this case, district government supported interest of small businesses.

#### **Case 4.2: Case of Piyungan**

In Piyungan sub-district, traders in traditional markets complain to *Bupati* when their business dropped because a new mini-market was established by a businessman where the location is close with the traditional market. *Bupati* responded by asking the owner of mini market to change the business hours, starting at 09.00 am. Previously, the business hours of the mini market were the same as the business hours of traditional market sellers at 6 am. In 2008 *Bupati* launched *Bupati's* decree to postpone permits for new mini markets establishment before Bantul district introducing local regulations (*Perda*).<sup>84</sup>

The case of Piyungan sub-district above shows that small businesses had power to bargain with the district head with the aim to provide benefit for them. Further, the

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<sup>84</sup> See *Bupati's* Decree No. 503/5439 in 27 September 2008.

district government head is now very strict in issuing business permit for mini-markets. This aims to protect sellers in local markets. The case also indicates that small businesses were not ready to compete in a free market system and asked the district government to protect them. Large business increased their own buying power and pushed small players out of the market place. However, the protection from large businesses is not the best way in long term because it may cause the dependency of small businesses on the district government. Without district government intervention, mini markets and supermarkets are able to attract larger buyers than small businesses because they offer higher quality goods and services than those of small businesses. I argue that protection policy is only temporary when small businesses are still weak. Both the case of Parangtritis and Piyungan indicates that district head of Bantul was strongly responsive to the needs and interest of small businesses. This suggests that the relationship between district head and small businesses was responsive relationship.

Based on the discussion above it can be concluded that the district government of Bantul carried out local regulation reform on business permits with the aim to provide better public service for small businesses. Following *reformasi* 1998, the district government developed local regulation on business permits more transparent and accountable than previously. Additionally, the district government enacted protection policy for small businesses. From the regulation aspect, characteristic of the relationship between the district government and small businesses is called responsive relationships as discussed in Chapter One. However, the district government could not use the local regulations to control small businesses. Most of small businesses owners could operate without business licenses. They were relatively independent from the district government policy. Research findings show that small businesses had power to negotiate with the district government with the aim to provide benefit for them.

### **4.3. Small Business Promotion Policy**

This section will answer the question as proposed in Introduction: To what extent does the district government develop small business promotion policy? As discussed in Chapter One, administrative decentralisation may cause local governments to create functions to promote small businesses and distribute public resources to them.

The promotion of small businesses includes providing financial assistance, training and technological assistance as well as infrastructure facilities, will be discussed below.

#### **4.3.1. Financial Assistance**

The allocation of public resources must be undertaken by the district government because a free market economy failed to ensure citizen welfare. Chapter One indicated that the most obvious problems faced in developing countries is the limited capital of small businesses entrepreneurs. In this context, the local government can play an important role in providing financial assistance for small businesses with the aim to increase capital. The local government of Bantul used two ways in providing financial assistance for small businesses. Firstly, the district government provided direct financial assistance to them and secondly, the local government cooperated with financial institutions in order to provide them with a credit scheme.

In Chapter Two, it was shown that small business affairs are served by the *Diperindagkop*.<sup>85</sup> The Bantul district allocated its local budget to the *Diperindagkop*, then distributed funds to small businesses in the form of financial assistance for increasing capital or for supporting business exhibition. In 2007, the *Diperindagkop* distributed 11.5 million rupiah to 28 people who produced handicraft, ceramic, woodcarving and other fine art in *Pasar Seni Gabusan*. The *Diperindagkop* also facilitated funds of 485.9 million rupiah to support thirty one business exhibitions in *Pasar Seni Gabusan* in 2007 with an aim to attract buyers.

Financial assistance was also used to support business exhibitions. For instance, in 2006 the Bantul district government allocated 44.9 million rupiah for 51 small businessmen who participated in a domestic business exhibition in Jakarta, Bandung, and Jogjakarta. Then, in 2007, the Bantul district allocated 337.87 million rupiah for small business owners, who were involved in the business exhibitions. In 2008, the Bantul district financed 10 small business owners to participate in Jogja Business Exhibition and Jakarta Business Exhibition. The Bantul district also held the Bantul

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<sup>85</sup>*Diperindagkop* is local agency for industry, trade and cooperatives.

Business Exhibition at Gabusan Art Market Centre and Jogja Expo *Sekaten* in Yogyakarta city to promote furniture and craft products.

The *Diperindagkop* also provided financial assistance to small business owners through *Dekranas* (business association). For instance, in 2007, the *Diperindagkop* allocated 9.6 million rupiah to *Dekranas* for supporting business exhibition. The local budget for *Diperindagkop* was lower than that of other local government agencies (education, health, public work, and transportation) (Table 4.5). However, it is difficult to say that the Bantul district provided small financial assistance to small business activities because not all came through the *Diperindagkop*. *Dinas Tenaga Kerja dan Transmigrasi*<sup>86</sup> as well as *Dinas Pertanian dan Kehutanan*<sup>87</sup> also reserved funds to help small businesses used and provide training.

The local government also allocated fund for small businesses in local markets through Market Bank (*Bank Pasar*), a district owned enterprise. The *Bank Pasar* provided a credit scheme for small businesses in local public markets with the aim to protect them from exploitative creditors called *lintah darat*. According to the local regulation No. 13/2001 regarding *Bank Pasar*, the local government has to invest 15 billion rupiah in *Bank Pasar*. However, if it is needed, the local government can add capital to *Bank Pasar*. As a result, small businesses at public markets of Bantul could seek credit loan from *Bank Pasar*.

**Table 4.5**  
**Allocation of District Government Budget to Selected Local Agencies,**  
**2008-2009, (Million rupiah)**

No.	Name of Local Agency	2008	2009
1.	Local Agency for Industry, Trade, and Cooperative ( <i>Diperindagkop</i> )	7,111	5,460
2.	Local Agency for Education	383,530	384,566
3.	Local Agency for Health and Local Hospital	83,605	87,006
4.	Local Agency for Public Work	265,377	122,277
5.	Local Agency for Transportation	3,529	3,531

Source: *Pemerintah Kabupaten Bantul*, (2008, 2009).

<sup>86</sup>*Dinas Tenaga Kerja dan Transmigrasi* is the Local Agency for Employment and Internal Migration.

<sup>87</sup>*Dinas Pertanian dan Kehutanan* is the Local Agency for Agriculture and Forestry.



Besides the local budget, *the Diperindagkop* also received part of national budget as a transfer payment from the Ministry of Cooperative and Small and Medium Enterprises (*Kementerian Koperasi dan Usaha Kecil*) for developing small businesses. During 2004-2006, the average percentage of transfer payments of total local budget was around 26 percent. Then, it decreased sharply to 15 percent in 2007 and to 4 percent in 2008 (Table 4.6). It was important to develop coordination between the central and local government in providing public services. Both local budget and transfer payment were used for training program, workshop, marketing development and loan for small business. During 2004-2005 data indicated that the total transfer payment decreased, but the total local budget increased every year (Table 4.5). After discussing financial assistance, a discussion on the response of owners of small businesses on the financial assistance follows with the aim to understand whether or not financial assistance was useful for them.

**Table 4.6**  
**Financial Source for Sporting Small Businesses, 2004-2007**  
**(Million rupiah)**

Source of Budget	2004	2005	2006	2007	2008
District Local government budget	1,284.33 (74.04)	1,240.35 (73.75%)	1,240.35 (73.75%)	1,284.83 (84.87%)	4,125.06 (95.38%)
Transfer payment	450.32 (25.96%)	441.52 (26.25%)	441.52 (26.25%)	229.12 (15.13%)	199.92 (4.62%)
Total	1,734.65	1,681.88	1,681.88	1,513.96	4,324.98

Source: *Diperindagkop-Kabupaten Bantul* (2004, 2005, 2006, 2007, 2008).

The responses of small business owners were obtained from interviews and survey methods. In the interviews with owners of small businesses, they recognized the district government has already provided financial assistance to help them. The following case indicates the financial assistance from the district government to small businesses (Case 4.3).

#### **Case 4.3: Financial Assistance from District Government**

Mr. SB., a business owner and political party member started his business in 1980. He commented that under the Idham Samawi regime, local government had provided much help for small businesses through financial assistance,

market development and administrative facilities in obtaining business permits.<sup>88</sup>

The next case presents the comparison of financial assistance between centralised system and decentralised system in Bantul district (Case 4.4). It indicates that under decentralisation era the district government strongly promoted small businesses by providing financial assistance.

#### **Case 4.4: Financial Assistance under two Different District Government Systems**

Mr. SW started his business in 1982 under the authoritarian regime of the New Order Government. He could compare the role of local government between the centralised system and the decentralised system. In the decentralisation era, local government provided much assistance for small businesses in the form of loans and infrastructures compared with previously.<sup>89</sup>

The district government of Bantul cooperated with State Owned Enterprises (BUMN) to support small businesses. For instance, Mandiri Bank, *PT Peruri*, *PT Angkasa Pura*, and *Perum ASEI* have provided loans with low interest to small businesses. The *Perum ASEI* has distributed 200 million rupiah to two cooperatives and 335 million rupiah to nine small businesses in 2005. *PT Garuda*, *PT Angkasa Pura*, and *PT Bank Mandiri* supported the market development by financing transport and accommodation costs to small business people who were involved in business exhibition.<sup>90</sup> From interviews with small business owners, they recognised that the State Owned Enterprises played an important role in supporting them (Case 4.5).

#### **Case 4.5: Financial Assistance from State Owned Enterprises**

Mrs. Pj who was a business owner and started her business 25 years ago has not yet received financial support from the local government. However, she has received credit from *PT Angkasa Pura* (State Owned Enterprises) 400,000 rupiah with a rate of interest 0.8 percent<sup>91</sup>.

Another case showed that small businesses preferred to choose the Village Financial Institution to support their businesses rather than banks because the institution was more flexible (Case 4.6).

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<sup>88</sup> Interview with Mr. S.b. is small businessmen, 9 June 2009.

<sup>89</sup> Interview with Mr. S.W. is small businessmen, 7 July 2009.

<sup>90</sup> Interview with Mr. E.S., 7 July 2009.

<sup>91</sup> Interview with Mrs. Pj., 7 July 2009.

#### Case 4.6: Financial Assistance from Village Financial Institution

Mr. MU started business in 1971 and employed 35 workers. He sold his products for export. Indeed, there were opportunities from private banks offering loans but he only borrowed once. He preferred to borrow funds from village cooperative. He told me that when he borrowed a million rupiah from village cooperative, he only received 9,800,000 rupiah because he had to pay administration fee two hundred thousand rupiah. Further, he had to return twelve million rupiah in twenty months.<sup>92</sup>

In general, small business owners could borrow money from village cooperatives, but most were not members of cooperatives.<sup>93</sup> Survey data indicates that only 20 percent of respondents are members of cooperative. In 2007 there were 6 Village Handicraft Cooperatives with 278 members. It is different from experience in Italy (Becattini, 2004) and Denmark (Kristensen, 1992) as discussed in Chapter One, where village financial institutions can play an important role in developing small businesses. The village institution is very closely linked with local small business owners and understands their needs. The responses of owners of small businesses to financial assistance also could be obtained from survey method. The survey data indicates that about 36 percent of respondents said that district government was financially supportive and 26 percent perceived that district government was very supportive. In contrast, about 36 percent of respondents answered not at all or they did not know about it (Table 4.7).

**Table 4.7**  
**The Perception of Small Business Owners on Financial Support**

What do you think about the local government's financial support (financial aid, subsidies, favourable business taxes, low interest loan) for local small business?	Frequency	Percent
Very supportive	16	26.7
Supportive	22	36.7
Not at all	22	36.7
Total	60	100

Source: Data obtained by survey questionnaire, 2009

<sup>92</sup> Interview with Mr. M.U., 23 June 2009.

<sup>93</sup> Interview with Head of Village Small Business Cooperative of Kasongan, 11 June 2009.

Based on the discussion above, it is clear that although the Bantul district implemented decentralisation policy, the central government still provided financial assistance to develop small businesses. However, during 2004-2008 the total financial assistance from the central government decreased slowly every year. This has implications that future district governments would have more responsibilities to small businesses by providing financial and training support. The next section will discuss training programs for small businesses with the aim to improve the skill of workers.

#### **4.3.2. Training for Small Business**

Small businesses generally have limited skills in managing their business. Additionally, the quality of workers of small business is low. Training programs are one of the ways to improve the owner managerial skills of small businesses and to overcome the low quality skills of workers.

Since the implementation of decentralisation policy (2001-present), the local government of Bantul has provided various training programs with the aim of enhancing quality of management and products of small businesses (Table 4.8). During 2004-2008, the number of small businessmen owners involved in training increased, except in 2006. In 2006 the local government only provided training three times because the Bantul district government had problems resulting from a huge earthquake. The earthquake caused severe damage to the government office building, public market building, school building and roads. The district government therefore had to re-allocate much of the local budget to rebuilding them. Subsequently, there was only a small amount of the local budget left for training programs.

**Table 4.8**  
**Training Program for Small Businesses**  
**2004 – 2008**

No.	Year	Number of Training Program	Number of Participants
1.	2004	3	90
2.	2005	50	120
3.	2006	3	60
4.	2007	6	200
5.	2008	10	400

Source: *Diperindag Kabupaten Bantul* (2004, 2005, 2006, 2007, 2008).

The training program was financed by the district and central government budget. Although several training programs were solely financed by the central government, the training programs were serviced by the local government of Bantul. The central government has devolved the function of training to the Bantul district government, with the subject of training on the hand the local government.

Furthermore, the district government of Bantul developed BLK or *Balai Latihan Kerja* (Centre for Employment Training) with the aim to increase quality skill of workers including small business workers. The BLK is controlled by *Dinas Tenaga Kerja dan Transmigrasi* (Local Agency for Employment and Migration), whereas small businesses are serviced by *Diperindagkop* (Local Agency for Industry, Trade and Cooperative). Therefore, *Diperindagkop* needed to coordinate with *Dinas Tenaga Kerja dan Transmigrasi* to facilitate training for small businesses. Small business promotion was not only the responsibility of *Diperindagkop* but also of other local agencies such as *Dinas Tenaga Kerja dan Transmigrasi*, *Dinas Perijinan* (Local Agency for Service of Licenses), BPR or *Bank Perkreditan Rakyat* (Bank for People's Credit) and *Bank Pasar* (Bank of Market). It can be concluded that small business promotion required coordination between the central and local governments and among local agencies at district level.

The response of small business owners to the training program can be seen in Table 4.9. According to 20 percent of respondents, the Bantul district was very supportive in providing training program; about 40 percent responded that the Bantul district was supportive. However, 40 percent didn't know or did not provide response. From interview data it can be understood that a few small businesses did not provide positive response to training program (Case 4.7).

**Table 4.9**  
**The Perception of Small Business Owners on Training Program**

What do you think about the local government's facilitating training to local small business?	Frequency	Percent
Very supportive	12	20
Supportive	24	40
Not at all	24	40
Total	60	100

Source: Data obtained from survey questionnaire, 2009.

### **Case 4.7: Small Business Owners were not responsive to training program**

During the decentralisation era, small businesses owners were less responsive to training programs held by district government. Some small business owners refused to be involved in training program, unless the local government provided them daily transport fee during the training. The daily transport fee was assumed as an opportunity cost while they were involved in training program. Based on the small business person's experience, the daily transport fee varies from 15,000 rupiah up to 25,000 rupiah.<sup>94</sup>

The case 4.7 suggests that a few small business owners had a low awareness of the benefit of the training program. They did not understand its benefit in improving the management skills and production quality. Beyond the training program, technological assistance was also needed to improve the quality of products as majority of small businesses used traditional tools.

#### **4.3.3. Technological Assistance**

The Bantul district developed the UPT or *Unit Pelayanan Teknis* (Unit of Technical Services) with the aim to increase the quality of product of small businesses. Today there are 4 UPTs in Bantul: The UPT of Ceramics in Kasongan, the UPT of Leather in Manding, the UPT of Various Handicrafts in Gunung Sempu and the UPT of Furniture in Potorono. In practice, the UPTs provided workshop and introduced new technology to small businesses with the aim of enhancing the quality of products.

The UPT of Ceramic in Kasongan, as an example, introduced new technology in enhancing quality of ceramic products. Additionally, in 2004, the Bantul district government provided a dryer tool for wood at the price of 49.8 million rupiah to small business owners of Kasongan village with an aim to increase the quality of product. As a result, the quality of ceramic products improved and a majority of products were exported to Australia and European countries. For instance, Mr. T.R, a small business owner exported his product to European countries such as Netherlands, Italy, France, Spain and Australia.<sup>95</sup> Examples of ceramic products can be shown in Figure 4.1.

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<sup>94</sup>Interview with the Chairman of Kasongan Small Business Cooperative, 11 June 2009 and with Mr. Sb., a small businessman, 9 June 2009.

<sup>95</sup>Interview with Mr. T.R., small business owner, 11 June 2009.

**Figure 4.1**  
**Ceramic Products of Small Business in Kasongan Village**



Source: Fieldwork, 2009.

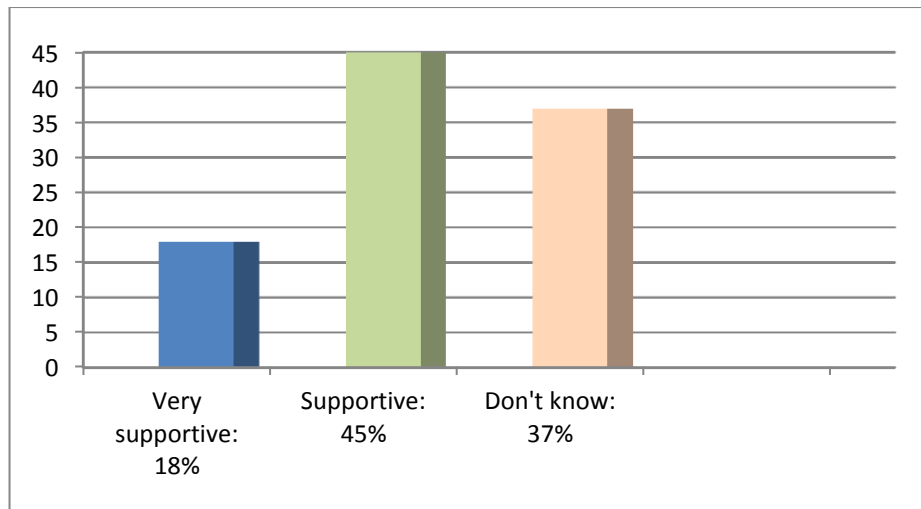
In relation to the UPT of Leather in Manding, small businesses were able to increase the quality of leather craft products, thus could penetrate larger markets. Beyond the UPTs, in 2006, the Yogyakarta provincial government also provided technological assistance such as sewing machine and compressors to small businesses producing leather craft in Manding village.<sup>96</sup> As a result the quality of leather products increased. For instance, Mr. Sn, leather craft small business owner of Manding said that 70 percent of his products are exported to many countries such as the Australia and European countries.<sup>97</sup>

Based on the discussion above, the district government provided technological assistance for improving products of small businesses. The important question is what perception of small business owners on this assistance. The survey data indicates, most respondents perceived that local government was supportive in providing technological assistance, although one-third did not know about it (Chart 4.3). This means that the technological assistance from district government has not yet spread widely to small businesses of Bantul. After discussing technological assistance, a discussion on the infrastructure facilities for supporting small businesses activities will follow.

<sup>96</sup>Interview with Mr. Sg, chairman of *Manding Handicraft Association*, 7 July 2009.

<sup>97</sup> Interview with Mr. S., small business owner of Manding Village, 9 July 2009.,

**Chart 4.3**  
**The Perception of Small Business Owners on Material Assistance**  
**(N=60)**



Source: Survey research 2009.

#### **4.3.4. Physical Infrastructure Facilities**

The infrastructure facilities for small business such as roads, banks and automatic teller machine (ATM), market building, telephone networks and electricity are useful for developing business activities. As discussed in Chapter One, under administrative decentralisation, resources allocation or service delivery can be delegated to sub-national governments. Thus, the district government has a responsibility to facilitate the physical infrastructures as part of public services. Each will be discussed as follows:

##### **4.3.4.1. Roads**

In relation to physical infrastructures support, the local government improved roads at the location of Kasongan handicraft village with the aim of facilitating domestic and foreign tourists to visit the village. As discussed before, small businesses are concentrated in Kasongan and Imogiri sub districts. The local government asphalted the roads from the city of Yogyakarta to the two villages (Figure 4.2).



**Figure 4.2**  
**Road in Kasongan Village**



Source: Fieldwork 2009.

In general, the district government improved the quality of roads of Bantul. For instance, the number of good roads increased from 305 in 2005 to 362 in 2007. In contrast, number of seriously damage roads decreased from 59.35 in 2005 to 49.53 in 2007. In the same period, the number of damage roads also decreased from 231.75 to 214.45 (Table 4.10). Good condition of roads may have facilitated buyers to come to the handicraft villages. It indicates that the district government seriously improved roads with the aim at facilitating small business development.

**Table 4.10**  
**Length of Roads by Condition of Roads (Km)**  
**2005-2007**

No.	Condition of Road	2005	2006	2007
1.	Good	305.28	341.23	362.95
2.	Moderate	304.65	284.00	272.90
3.	Damage	231.75	223.15	214.45
4.	Serious damage	59.35	51.45	49.53
	Total	901.03	899.83	899.83

Source: *Pemerintah Kabupaten Bantul* (2008a, p. 307).

#### **4.3.4.2. Banks**

As discussed in Chapter Two, Kasongan and Manding are handicraft villages where many small businesses exist there. Most small businesses of Kasongan concentrated on ceramic products while majority of small businesses of Manding concentrated on leather craft. The Bantul district government suggested the *Mandiri Bank* provide an

Automatic Teller Machine (ATM) in Kasongan village as well as in Manding village with the aim of supporting local business activities.

In addition, in 2008 there were 17 BPR or *Bank Perkreditan Rakyat* (Bank for People's Credit) and 2 branch offices of State banks: BRI Bank and BPD Bank in region of Bantul. All banks could facilitate credit for small businesses.

#### 4.3.4.3. Electricity

Electricity is another important infrastructure for developing the industrial sector. The state owned enterprise (PT PLN) installed power facilities in Bantul regions. Table 4.11 shows the growth of installed capacity by PT PLN for consumers in Bantul district. However, the number of installed capacity in 2007 was twice that in 2004 whereas the number of customers increased 73 percent. In my view, the electricity facilities may have encouraged small businesses activities because the process of production needs electricity. When an earthquake struck Bantul district in 2006, many buildings were badly damaged, including art shops and homes of small businessmen. The district head of Bantul suggested that the PLN (State Owned Company for Electricity) waive electricity bills for small businesses in several months, thus also proving that the district head was conscious of helping small businesses. The aim of this policy was to accelerate the rebuilding and economic recovery in Bantul, resulting with small businesses swiftly reopening.

**Table 4.11**  
**Number of Electricity Installed Capacity and Costumers, 2004-2007**

No.	Year	Total Number of Installed Capacity (VA)	Total Number of Customers
1.	2004	76,726,590	114,883
2.	2005	80,186,881	117,797
3.	2006	126,700,677	154,542
4.	2007	158,363,072	198,763

Source: *Pemerintah Kabupaten Bantul* (2008a, p. 281)

#### 4.3.4.4. Telephone Networks

Telephone networks are an important facility to support business for entrepreneurs. Based on the data in Table 4.12 telephone networks did not significantly change during 2004-2006. The number of telephone networks decreased about 2 percent in

2005 due to an increase in mobile phone usage. However, in 2006 they increased again to 4,955. The data signifies that the district government could not pressure the *PT Telkom* (State Owned Company for Telephone) to facilitate a telephone network in Bantul.

**Table 4.12**  
**Number of Telephone Networks**

No.	Year	Number of Networks	Growth
1.	2004	4,828	
2.	2005	4,719	-2.26%
3.	2006	4,955	5.00%

Source: *Pemerintah Kabupaten Bantul* (2008a, p. 312)

#### 4.3.4.5. Market Buildings

In 2004, the district of Bantul established the Gabusan Art Market (*Pasar Seni Gabusan*) to assist small business owners in selling their products. The *Pasar Seni Gabusan* was not only for the market place for 4,444 small businesses but also a business exhibition place and the business information centre (Figure 4.3). The small businesses who occupied the stalls in the *Pasar Seni Gabusan* did not have to pay the cost of renting. The manager of the *Pasar Seni Gabusan* developed networks with travel bureaus with the aim of increasing buyers to visit *Pasar Seni Gabusan*. The travel bureau was able to bring many domestic and international tourists and buyers to *Pasar Seni Gabusan* to shop. In 2007, there were 150,000 visitors/buyers, increasing to 200,000 in 2008.

Figure 4.3  
*Pasar Seni Gabusan*



Source: [www.yogyes.com](http://www.yogyes.com)

One of constraints in developing the market was the behaviour of small business owners. Some of them did not manage their businesses seriously. For instance, there were no exact business hours. As a result, buyers were inconvenienced (Case 4.8).

**Case 4.8: Small businesses owners had no exact business hours**

One day in May 2009 about at 8 am, some domestic tourists arrived by buses visit the *Pasar Seni Gabusan* but the sellers have not yet opened their business. The visitors then cancelled their shopping in the market. In other case, when the domestic tourists came to the market at 4 pm, some of the sellers had closed for the day.<sup>98</sup>

The case above indicates that small business owners were not responsive to the interest of buyers. This finding was in line with Freeman's study (2004) as discussed in Chapter One regarding small business in Laos, Myanmar, and Vietnam. He found that poor understanding of the market expectations was an obstacle faced by small businesses owners. Many did not know that they should be responsive to the needs of market.

Besides developing the *Pasar Seni Gabusan*, in 2007 the Bantul district also established new buildings for local public markets to replace the old local public market building in Niten, Imogiri and Piyungan sub-districts. An example of the new local public market building is presented in Figure 4.4. According to the district head, the new local public market building could attract local buyers. The Bantul people would not shop at these markets unless the local government could develop good facilities such as a parking area and good stalls. By developing local public markets, local people could shop at these markets and increase the dynamics of business activities of Bantul.

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<sup>98</sup> Interview with Mr. T, General Manager of *Pasar Seni Gabusan*, 11 June 2009.

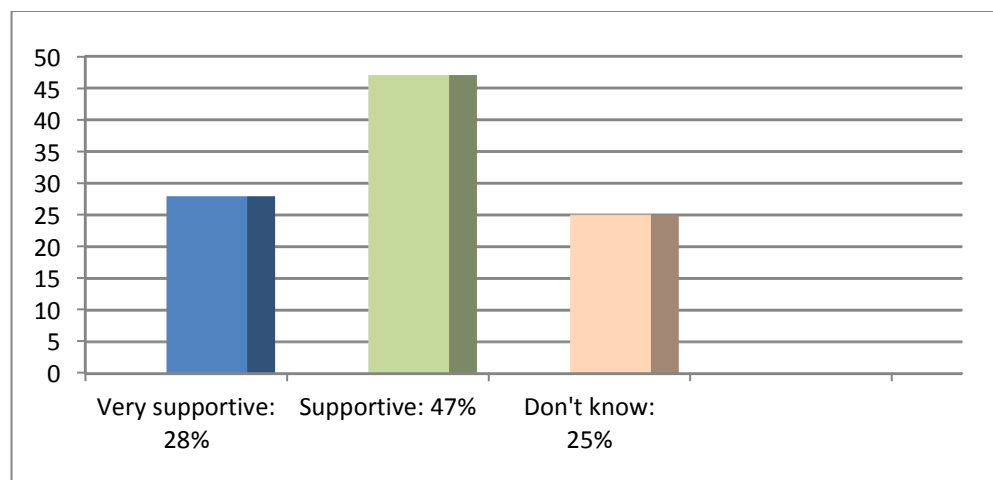
**Figure 4.4**  
**New Local Traditional Market of Piyungan Sub-district**



Source: Fieldwork, 2009.

Despite the district government acting to help small businesses by developing market buildings, it is necessary to analyse the responses of small business owners regarding market development assistance. Data obtained from a survey in 2009 indicates that most small business owners thought that the Bantul district was supportive (47 percent) and very supportive (28 percent) in developing market (Chart 4.4). This means that, most small business owners felt satisfied with what local government had done to help them. However, 25 percent answered that they did not know about the developing market.

**Chart 4.4.**  
**The Perception of Small Business Owners on Market Development**  
**(N=60)**



Source: Survey Questionnaire, 2009.

Based on the above, it can be concluded that the district government of Bantul was supportive to help small businesses by providing financial assistance, training program, technological assistance and physical infrastructure facilities, particularly market building. It indicates that characteristic of the relationships between district government and small business was a supportive relationship. The following section discusses political influence. As discussed in Chapter One, in many countries, small businesses were politicised by local authorities. The important question is, whether or not small businesses in Indonesia were also politicised by local authorities.

#### **4.4. Political Influence**

This section will answer the questions as proposed in Introduction: Firstly, can political parties help small businesses? Secondly, in what ways did local politicians approach small business owners with the aim to obtain votes in election of district head and local legislative member? Thirdly, have business associations and small business owners involved themselves in the process of decision making or political parties as well as political activities?

As discussed in Chapter One, political decentralisation may cause change in the relationships between local politicians and small businesses as well as political parties and small businesses. Politicians may become close to small business owners because they seek political support in obtaining political position in both executive and legislature. Under decentralisation policy, both district head and local legislature members are elected by local citizens including small business owners.

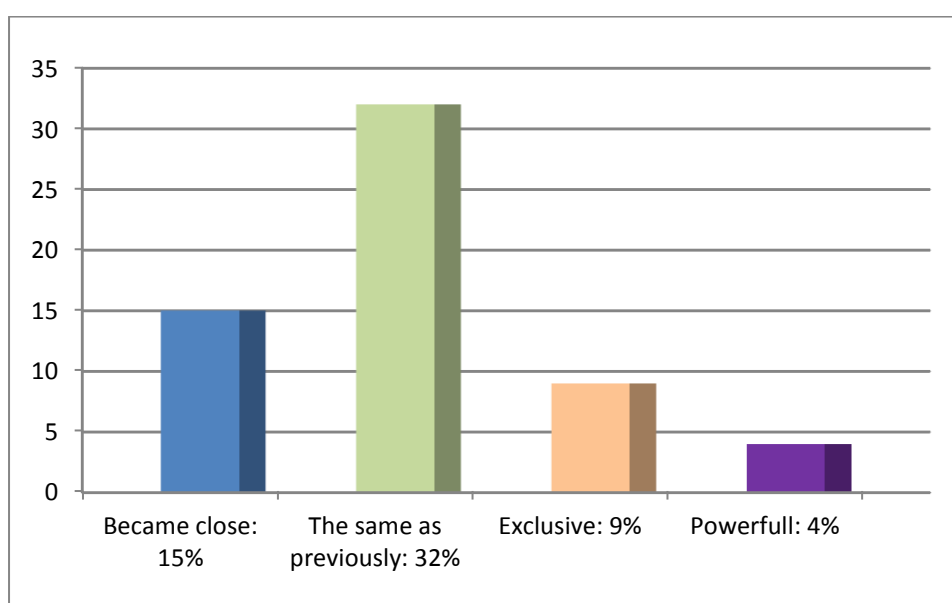
Political decentralisation also creates an opportunity for small business owners to participate in the process of decision-making at district level as well as participate in political parties and political activities. This section will be divided into two sub-sections. Firstly, it analyses political influence of local politicians as well as political parties over small business owners and secondly, it discusses the participation of business associations and small businesses owners in the process of decision-making at district level.

#### 4.4.1. Political influence of Politicians over Small Businesses

As discussed in Chapter One, the result of political decentralisation, the district head and local legislature members are elected by local citizens. Local legislators came from elected political party members. The important question is whether or not political party members became close to local small business owners for their benefit. The next question is in what way political parties and politicians influence behaviour of small business owners in elections for district head and local legislature members, and the extent to which small business owners could influence political parties in the process of decision making at district level.

Data obtained from survey research showed that most respondents perceived that the behaviour of political parties were the same as previously (32 percent). Only 15 percent said that behaviour of political parties became close to small business owners (Chart 4.5). Resulting in political parties not obtaining sympathy from small business owners and they were not close to small business owners. The next question concerns how they could influence small business owners to obtain political votes in local legislator and district head elections.

**Chart 4.5**  
**The Perception of Small Business Owners on Political Party**  
(N=60)



Source: Fieldwork, 2009.

According to most small business owners (48 percent), political parties never did anything to support small businesses. Further, 45 percent of respondents said political parties were somewhat supportive of their business. Only 5 percent of respondents revealed that political parties supported small businesses (Table 4.13). It was clear that in general, political parties paid little attention to small businesses. Several respondents said that political parties approached small business only throughout their political campaign as they were seeking political support.

**Table 4.13**  
**The Perception of Small Business Owners on Political Party's Support to Small Business**

No.	In general to what extent political parties support your business?	Frequency	Percentage
1.	Very supportive	1	1.7
2.	Supportive	3	5.0
3.	Somewhat supportive	27	45.0
4.	Not at all	29	48.3
	Total	60	100

Source: Data obtained from survey questionnaire, 2009.

Although political parties understood that small business owners were potential voters in election for local legislature members, they did not provide assistance to develop small businesses. For instance, most small business owners (93 percent) said that political parties never helped them in facilitating legal aid, 85 percent revealed that political parties never helped them in developing network with financial institutions and 76 percent respondents perceived that political parties never helped in facilitating training programs to small businesses (Table 4.14). It can be concluded that political parties were not close to small business owners and most of them did not help small business owners.



**Table 4.14**  
**Kinds of Political Parties' Support to Small Business**

No.	Various Kinds of Facilities	Answer			Total
		Always	Sometimes	Not at all	
1.	Developing network with financial institutions	1 (1.17%)	8 (13.3%)	51 (85.0%)	60 (100%)
2.	Developing network with the markets	13 (21.7%)	47 (78.3%)	-	60 (100%)
3.	Facilitating training	1 (1.7%)	12 (20.0)	46 (76.7)	60 (100%)
4.	Facilitating legal aid	1 (1.7%)	3 (5.0%)	56 (93.3%)	60 (199%)

Source: Data obtained from survey questionnaire, 2009.

About 78 percent of respondents said that political parties sometimes helped them in developing network with the markets and 20 percent said that political parties sometimes helped them in facilitating training. Only around 13 percent perceived that political parties sometimes helped them in developing a network with financial institutions (Table 4.13). For instance, Golkar Party, the Indonesian Democracy Party of Struggle (PDI-P Party) and Justice and Prosperity Party (PKS Party) assisted in developing networks between banks and small businesses (Case 4.9 and Case 4.10).

**Case 4.9: The Role of Golkar Party in Developing Network between Small Businesses and Financial Institutions**

The *Golkar* party asked the social organisations affiliated to the *Golkar* party to organize meetings among small business owners, the *Mandiri Bank* and the *BRI Bank* to help small business owners by providing loans and training. The *Golkar* party also encouraged its members who were active in business to encourage small businesses. The Chairman of *Kadinda*<sup>99</sup> is now in the hands of a *Golkar* Party member. Thus, the *Golkar* party had no difficulty asking the financial institutions to facilitate loans for small businesses.<sup>100</sup>

The PDI-P party is now controlling the *Dekranas* (National Handicraft Board-Bantul Branch) because the chairman of *Dekranas* is member of the PDI-P Party. The *Dekranas* was intensively involved in promoting small businesses. According to the secretary of the PDI-P Party, Bantul branch, the party had an important role in promoting small businesses as follows:

<sup>99</sup> Kadinda is Chamber of Commerce and Industry – Branch of Bantul district

<sup>100</sup> Interview with Chairman of Golkar party – branch of Bantul district, 10 June 2009.

#### **Case 4.10: The Role of PDI-P Party in Developing Networks between Small Businesses and Financial Institutions**

The PDI P party also had programs to help small businesses by facilitating loans from banks and introducing small business owners to buyers. Under President Megawati (2001-2004), the PDI-P Party established a Micro Financial Institution to help small businesses. The Micro Financial Institution was supported by one of the ministers of PDI-P party who came from the Bantul district.<sup>101</sup>

The PKS party also helped small businesses by facilitating them in gaining loans from BCA Bank and Mandiri Bank. Furthermore, the PKS party provided guidance to small business owners. For instance, the PKS party cadres provided training for owners of small businesses.<sup>102</sup>

Interviews with small businesses owners indicated that during the political campaign season for the local legislator election, local politicians intensively approached local small businesses owners to obtain political support. They provided money and materials to small business owners through the *Rukun Tetangga or RT* (Neighbourhood Association), but some of them directly provided money and materials to individuals. According to the politicians, they voluntarily gave money to local small business owners because they lacked capital. Several politicians suggested the local small businesses owners proposed a project regarding the problems related to their village such as damage roads and lack of capital for small business owners. Subsequently, the politicians responded by providing financial assistance. For instance, local community of Kasongan village proposed a loudspeaker for the local legislator candidate then the candidate delivered it to the RT.<sup>103</sup>

The RT Head of *Karangasem Pedukuhan*<sup>104</sup> in Imogiri sub-district said that during the 2009 political campaign, three political parties – the Democrat party, PAN party and Golkar party-visited and contacted the villagers. The Democrat Party gave 500,000 rupiah and *Golkar* party also gave 500,000 rupiah for improving the village roads. The PAN party gave one million rupiah to establish a guardhouse (*Gardu or*

<sup>101</sup> Interview with Secretary of PDI P Party – branch of Bantul district, 26 June 2009,

<sup>102</sup> Interview with Mr. S, Head of Research and Development of PKS Party.

<sup>103</sup> Interview with Mrs. Sm., Head of *Pedukuhan* of Tirto, Bagunjiwo, sub-district of Kasihan, 7 July 2009.

<sup>104</sup> *Dusun* or Hamlet is lowest level of administrative government.

place for village security).<sup>105</sup> The cases mentioned suggest that local politicians used RT to obtain political support by providing funds. However, the head of RT was not able to pressure politicians to articulate their interests. In other words, the head of RT had no bargaining position.

Regarding matters of money politics in Bantul during the political campaign season for parliament elections, the secretary of the PDI-P party related to me the following:

**Case 4.11: Money Politics during Political Campaign Season**

The evidence showed that politicians offered money and material to local people – individual and groups - during political campaigns. It was approximately 15,000 rupiah or 20,000 rupiah per voter. The money was given to voters one day before voting. For local voters, money was very important because they generally were poor. However, he confessed that he did not give the money to individuals but gave it to groups to help the needs of these groups. He also gave t-shirts to members of these groups.<sup>106</sup>

According to politicians, money politics still occurred up to one day before the election. Mr. S.B. who was local legislator member and chairman of *Kandida* of Bantul told me the following:

**Case 4.12: Money Politics in Local Legislator Election**

According to his estimate, he would obtain 400,000 votes in the election for local parliament members, but he only obtained 2,548 votes. This was because he did not indulge in money politics. He knew that other candidates gave money to voters at around 15,000– 20,000 *rupiah* per person. The voters elected the candidate based on money due to the weaknesses in the ideology of the voters<sup>107</sup>.

Another local legislator candidate from the PDI-P Party, Mr. S.H. allocated the funds to the Neighbourhood Association or RT around two hundred and fifty thousand *rupiah* per RT to obtain votes in election for the local legislature members in 2009.<sup>108</sup> Regarding another political case, Mr H, the chairman of PAN Party told me that some candidates from this party asked the cadres to give the RTs as much as three hundred thousand rupiah per RT to buy votes in election for local legislature members. However, the money was directly distributed to constituents by the party

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<sup>105</sup> Interview with Mr. Pm, head of RT 5, Karangasem Dusun, 9 July 2009.

<sup>106</sup> Interview with Mr. Ay, Secretary of PDI-P Party, 26 June 2009.

<sup>107</sup> Interview with Mr. S.B., the Chairman of *Kandida* and local parliament member, 15 June 2009.

<sup>108</sup> Interview with Mr. S.H., the candidate for local legislator, 9 July 2009.

cadre. Consequently, the party cadre was prosecuted and punished by the Local Court.<sup>109</sup>

Further, one of the national legislator candidates from the Democrat party, who was a big businessman, spent about one billion *rupiah* during the political campaign season in 2009.<sup>110</sup> The cases of money politics above highlight that political party cadres were supported by large capital. Logically, political parties preferred to recruit big business owners than small business owners because the big business owners were able to provide financial support for the parties. Political party members faced high financial cost to obtain political positions. Today, political parties have become a political vehicle for big business owners to pursue political positions both in executive and legislative institutions.

Based on the discussion above, we understand that during the decentralisation era, political parties were not close to small business owners and even less support were given them. The relationship between political parties and small business owners was accompanied by money politics. Politicians used money politics to influence the voting behaviour of small business owners for obtaining political support. Thus, voters used pragmatic reasoning in electing candidates for parliament.<sup>111</sup> As a result, programs proposed by the candidate were not important during the political campaign season because the behaviour of voters was based on money, not ideology and program.<sup>112</sup> Subsequently, it caused a low quality election in the local democracy.

Did small business owners use political parties to articulate their interest? Data obtained by survey research and interviews showed that most small business owners were not political party members. This means that they thought that they could not use political parties to articulate their interests. Survey data also indicated that most small business owners perceived that they could influence political parties through business associations (26.7 percent) and personal networking with politicians (25

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<sup>109</sup> Interview with Mr. H.W., the Chairman of Bantul PAN Party, 10 June 2009.

<sup>110</sup> Interview with Mr. A.P., the candidate for national legislator, 19 June 2009.

<sup>111</sup> Interview with Mr. W.U., senior lecturer at the Faculty of Social and Political Sciences, Gadjah Mada University.

<sup>112</sup> Interview with Mr. Sm., Chairman of B Commission, Local Parliament of Bantul

percent). Only about six percent perceived that they could influence political party through mass media (Table 4.15). This has two implications: Firstly, business associations could play an important role in the relationship between small businesses and political party. In the Bantul district we could see that the *Dekranas* was a business association which was close to the local bureaucrat and the PDI-P party. Small business owners preferred to communicate with the *Dekranas* because they knew that the chairman of *Dekranas* was close to policy makers at the district government level. Secondly, the relationship between political parties and small business was characterised by personal relations, not institutional relations. Thus, a personal figure in a political party had more dominance rather than the role of party itself.

**Table 4.15**  
**The Influence of Small Business to Political Party**

No.	How do small business people attempt to influence political parties so that they will support their business	Frequency	Percentage
1.	Providing funds	5	8.3
2.	Creating personal networks	15	25.0
3.	Using small business associations to influence political party	16	26.7
4.	Developing opinion in mass media	4	6.7
5.	Mass mobilization	3	5.0
6.	Combined between no. 1 and 3	3	5.0
7.	Combined between 1 and 5	2	3.3
8.	Combined between no 2 and 3	4	6.7
9.	Combined between no. 3 and 4	3	5.0
10.	Other	5	8.3

Source: Data obtained from survey questionnaire, 2009.

Table 4.15 indicates that the relationship between small businesses and political parties was not institutionalised but personalised. The role of a personal figure is more important than the role of the party itself in influencing small business owners. Based on the discussion above, it can be concluded that local politicians approached small business owners to obtain votes in election of legislative members by providing money and material called money politics. Additionally, political parties developed networks with business associations, such as the PDI-P party developed a network with *Dekranas* while the *Golkar* party developed a network with Kadin. The following section will discuss participation of small business owners.

#### **4.4.2. Participation of Small Businesses**

The aim of this section is to examine the participation of business associations in the process of decision making at district level and the participation of small business owners in party as well as in political activities.

##### **4.4.2.1. Participation of Business Association**

As discussed in Chapter One, business associations may have potential power to influence local government policy so that local government becomes more responsive to needs of local small business owners (Pyke, 1992). The important question is, whether or not business associations in Bantul could influence the district government policy. As discussed in Chapter Two, in Bantul, there are many business associations, but only the *Dekranas* was active in helping small businesses because the association was strongly supported by district government. The association developed cooperation with *Diperindagkop* as well as the Indonesian Institute of the Art to facilitate credit, workshops and training for small businesses. The *Dekranas* obtained political and financial support from the district government because its chairperson was the wife of the district head of Bantul. The relationship between *Dekranas* and district government may be called nepotism.

The local government of Bantul allocated the district budget to the *Dekranas*, and then the *Dekranas* distributed financial assistance to help small businesses. *Dekranas* played an important role in promoting small businesses. As an example, in the case of *Pasar Seni Gabusan*, *Dekranas* was involved in the process of policy making. According to the manager of *Pasar Seni Gabusan* and head of *Diperindagkop*, the chairman of *Dekranas* was involved in managing small businesses in *Pasar Seni Gabusan* because she had the power to influence small business owners. The *Dekranas* operated at grassroots level and could persuade small business owners to obey local government policy. The relationship between *Dekranas* and local bureaucrats was quite intensive in promoting small businesses. As an example, on 11 June 2009 the *Dekranas* held a meeting with small businesses at *Pasar Seni Gabusan* with the aim of encouraging small businesses to produce good quality products. Present at this meeting was the head of *Diperindagkop* who came to support it. According to Indonesian political culture, the level of officials (*pejabat*) attending an event is an indicator of the degree of the relationship between the

official and the invitor (host).<sup>113</sup> Additionally, the chairman of *Dekranas* created the opportunity for small business owners to articulate their interests and problems. As a result, many attended and most assumed that the chairman of *Dekranas* would help them in mediating with the district government to obtain financial assistance. This indicates that the *Dekranas* played an important role in the relationship between small businesses and local government.

Further, the *Dekranas* was used by the district head to control the business sector in Bantul. By allocating budget through the *Dekranas*, the district head and head of *Dekranas* gained their loyalty from small business owners. In my view, the *Dekranas* was used by Sri Suryawidati (the head) as the first political ladder before involving in the district head election. In May 2010, Sri Suryawidati obtained almost 70 percent of the votes in the district head election. This was a remarkable result as Sri Suryowidati obtained nearly the same total votes obtained by Idham Samawi in 2005, 70 percent. In other words, the *Dekranas* was used by Sri Suryowidati to achieve political support.

Another business association such as Bantul Craft Association and Bantul Chamber of Industry and Trade (*Kadinda*) received less support to promote small businesses although they have received funding from the district government. The Bantul Craft Association was established in 2003 headed by Supriastowo and received financial assistance from the local government. However, the association tried to become autonomous and run independent of the local government.<sup>114</sup> The Bantul Chamber of Industry and Trade (*Kadinda*) was headed by Slamet Subagyo, a *Golkar* party politician received 40 million rupiah in 2008. Both the Bantul Craft Association and *Kadinda* were invited by the district government to discuss draft regulations regarding business and trade.<sup>115</sup> However, the *Dekranas* had more influence in decision making process than the Bantul Craft Association and *Kadinda*. As example, *Dekranas* was involved by *Diperindagkop* to organise small business in Gabusan Art Market. By involving in decision-making process *Dekranas* was able to make a bargain with local government with the aim to provide benefit for small

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<sup>113</sup> The chairman of *Dekranas* invited me to attend this meeting.

<sup>114</sup> Interview with Mr. Sp., 16 June 2009.

<sup>115</sup> Interview with Chairman of *Kadinda*, 10 June 2009.

businesses. For instance, small businesses which occupied in the Gabusan Art Market did not have to pay rental costs.

The cases of the *Dekranas* and *Kadinda* indicate that political parties developed a network with business associations with the aim to obtain political support from small business owners in electing district head and local legislative members. This is because politicians aware that many small businesses exist in Bantul region. They were potential source of votes in the election of legislative members and the district head.

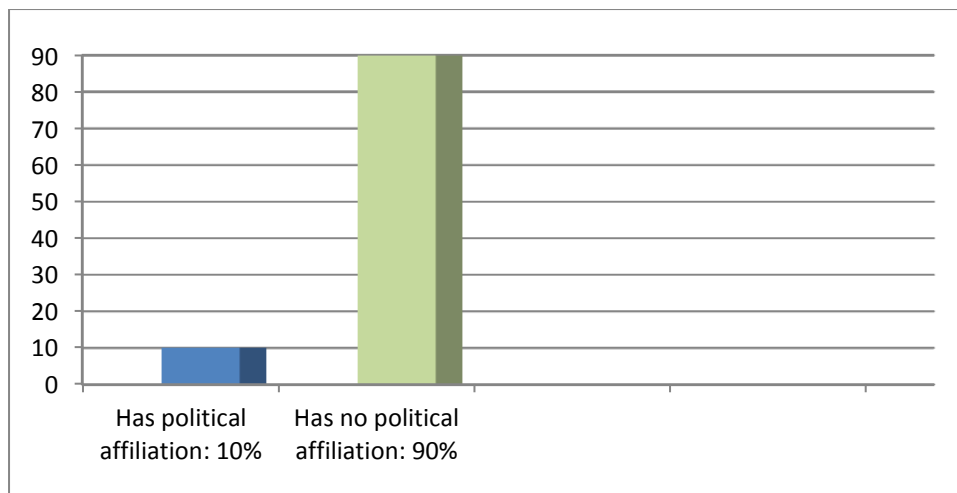
Based on the discussion above, it can be concluded that as a business association, the *Dekranas* is able to negotiate with district government in order to make local policy in accordance with the interests of small businesses. Moreover, political parties developed a network with business associations for supporting their interests. This leads to a discussion of the participation of small business owners in political parties and their activities with the aim of understanding whether political decentralisation drives small business owners to participate in politics.

#### **4.4.2.2. Participation of Small Businesses Owners**

In this study, the degree of political participation is measured by indicators such as: (1) Becoming a member of political party; (2) Participating in political campaign; (3) Attending regular political party meetings; (4) Becoming a member of an executive committee of political party; (5) Providing political donation or funds; (6) Becoming a candidate or member for local parliament. Data obtained by survey research indicated that most small businesses were not interested in participating in the political parties because there were no benefits for them. Only 6 out of 60 small businessmen owners were affiliated to a political party (Chart 4.6). It was clear, from the view of the small businesses that being involved in a local political party was not important.



**Chart 4.6**  
**Participation of Small Business Owners on Political party**  
**(N=60)**



Source: Data obtained from survey questionnaire, 2009.

Data obtained by interviews with small businesses owners also showed that most of them were not political party members and they were not interested in participating in political activities (Case 4.13; Case 4.14; and Case 4.15).

**Case 4.13: Small Business Owners were not interested in Political Party.**

Mrs. E.R, the owner of a small business in Kasongan village, who employed 10 workers, said that she was not a political party member because the political party did not help her business. She also never attended political campaigns for parliament member election.<sup>116</sup>

The case above was consistent with next case as told by Mrs. P.

**Case 4.14: Small Business Owner was not interest in Political Party**

Mrs. Pj started her business in 1986, and said that now she employs 25 workers. She also told me that she was not interested in participating in political parties because the political parties never supported her business.<sup>117</sup>

The following case told us that the owner of small businesses was not a member but was affiliated with a political party.

**Case 4.15: Small Business Affiliated in Political party**

Mr. TM, owner of a small business of Kasongan village started his business in 1971. He employed 35 workers. He said that the Bantul district government supported his business by providing training facilities, but the

<sup>116</sup> Interview with Mrs. E.R. of Kasongan Village, 23 June 2009.

<sup>117</sup> Interview with Mrs. Pj of Kasongan village, 7 July 2009

political party never helped him. He was not a member of the political party but he affiliated to the Democrat party because he liked Mr. Susilo Bambang Yudhoyono, the chairman of the board of supervisor of Democrat party.

The three cases above show that most of small businesses did not want to participate in political parties and were not interested to be involved in political activities because political parties did not provide benefit for them. As a result they had difficulty to articulate their interest through political parties.

During the 2009 political campaign season, only 15 percent of respondents participated in political campaigns. Further, 50 percent of respondents never participated in campaigns held by a political party and 85 percent never participated in regular political party meetings. It was noted that 91 percent never became member of executive committee in political party. Eighty eight percent never provided funds and 91 percent never became candidate for local parliament member (Table 4.16). It indicates that political parties could not expect funding from small business owners because only 3 percent of respondents provided donations. Political parties expected to obtain votes from small businesses by buying votes.

**Table 4.16**  
**Political Participation of Small Business**

No.	Indicator of Political Participation	Answer			
		Always	Sometimes	Never	Total
1.	Participating in local election campaigns	9 (15%)	21 (35%)	30 (50%)	60 (100%)
2.	Regular participants in political party meetings	2 (3.3%)	7 (11.7%)	51 (85.0%)	60 (100%)
3.	Member of an executive committee in a political party	-	5 (8.3%)	55 (91.7%)	60 (100%)
4.	Providing a political donation or funds	2 (3.3%)	5 (8.3%)	53 (88.4%)	60 (100%)
5.	Candidate or member for local parliament		5 (8.3%)	55 (91.7%)	60 (100%)

Source: Data obtained from survey questionnaire, 2009

Based on the discussion above, it can be concluded that political parties hardly helped small businesses by developing networks with financial institutions or markets as well as facilitating legal aid. However, the PDI-P party and *Golkar* party developed networks with business associations with the aim to obtain political

support. Further, small business owners were neither interested in nor involved in political party activities. In other words, decentralisation policy could not encourage small business owners to participate in the process of decision making. In addition, political parties failed to be close to small businesses and failed to provide benefits for small businesses. In contrast, political parties rather preferred to recruit wealthy people or big business owners who can be expected to provide funding for political parties. They assumed that voter behaviour could be influenced by money politics. Thus, most of politicians approach small business owner by providing money or material to obtain political positions. It indicates that characteristic of the relationship between political parties and small business is unsupportive relationship, but may be exploitative.

#### **4.5. Conclusion**

Based on the discussion above it can be concluded that administrative decentralisation was not effectively implemented in Bantul because of limited fiscal capacity. Although the district government devised regulations and institutional reform, the regulations cannot be effectively implemented. Local government could not implement regulations on business permits nor could not use local levies to control small business owners. The majority of small business owners did not obey local regulations requiring business permits. In contrast, the local government did not fine them because of economic and political reasons. With local regulations, the district government of Bantul protected small businesses against large capitalists because small businesses are able to make bargain with district head. From the regulation aspect, the characteristic of the relationship between district government and small business was a supportive relationship.

Further, from view of promotion policy for small businesses, the district government was very supportive to promote small businesses because the district government intensively provided financial assistance, training and technological assistance, as well as physical infrastructure facilities and market development.

Political decentralisation was able to encourage district heads to be close to small business owners. The district head strongly responded the needs and interests of small businesses. In contrast, political decentralisation failed to encourage political

parties to be close to small businesses owners as well as failed to encourage small owners to participate in political parties and become involved in political activities. Political parties preferred instead to recruit big capitalists or big business owners as party cadres because they can provide benefit for parties. Political parties assumed that voter behaviour of small businesses could be influenced by money. As a result, politicians approached small business owners by providing money and materials during legislative member election with the aim to achieve an electoral purpose. This means that the relationship between politicians and small businesses was based on financial transaction.

Further, political decentralisation policy has not created equally opportunity for business associations to participate in the process of decision making. For instance, the business association named *Dekranas* was given a large access to be involved in the process of decision making and as mediator between local government and small businesses because of a *patrimonialism* relationship. The business association are able to make a bargain with district government with the aim to provide benefit for small businesses. The next chapter examines the impact of decentralisation on the relationship between local government and small businesses in Gianyar with the aim to assess whether the impact of decentralisation is similar or different.

## CHAPTER FIVE

### THE IMPACT OF DECENTRALISATION ON SMALL BUSINESS IN GIANYAR

#### 5.1. Introduction

Based on Chapter Two and Three it can be concluded that social, economics, and political aspects between Bantul and Gianyar are different. Chapter Four discussed the impact of decentralisation on small businesses in Bantul. This chapter will examine the impact of decentralisation policy on small businesses in Gianyar and whether or not the impact is different to Bantul.

The implementation of decentralisation has changed the relationship between the central and local governments. As a result, authorities and functions of the central government decreases while authorities and functions of sub-national governments increase. Local governments have more power to regulate as well as to promote small businesses since 2001. However, the local levy on business has yet effectively implemented. Additionally, local government of Gianyar less promoted small businesses because of limited fiscal capacity. To overcome the limited fiscal capacity, the central government provides grants to the government of Gianyar. Thus, under decentralisation policy, the central government is still involved in promoting small businesses.

Political decentralisation is expected to increase political participation of local citizens and small business owners in the process of decision making. In addition, it is hoped to encourage political parties to be close to local citizens. However, in Gianyar, political decentralisation could not cause political parties to be close to local small business owners and support them. Local politicians used heads of local customary associations such as *Bendesa* and *Kelian*<sup>118</sup> to influence voter behaviour. Political parties were not able to represent the interest of small businesses.

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<sup>118</sup>*Bendesa* is the head of a customary village (*Desa Pakraman*), whereas *Kelian* is head of a *Banjar*.

The structure of this chapter is divided into three sections: Firstly, it examines local regulations with the aim to uncover the extent to which the regulations promote small businesses. Secondly, it explores promotion policy for small businesses. The extent local government facilitates small businesses by providing financial assistance, training programs, material assistance as well as physical infrastructure facilities and market development is also analysed. Thirdly, it analyses political influences of local politicians over small businesses and participation of small businesses in the process of decision-making.

## **5.2. Regulation of Small Businesses**

This section will answer the questions as proposed in Introduction: Firstly: to what extent does the district government carry out local regulation reform to promote small businesses? Secondly: can the district government uses regulations on local levies to control small businesses?

As discussed in Chapter One, local regulation means using law by local government to affect the business activities. The local regulation can provide incentives or disincentives for small businesses. The regulation also involves allowing or prohibiting activities in business sector. There are three regulations that will be discussed: business license policy, local tax/levy policy and protection policy.

### **5.2.1. Business Licensing Policy**

As discussed in Chapter Four, although the Indonesian government adopted a decentralisation policy, the central government still holds authority over investment licenses. For instance, the Minister of Investment/Chairman of Coordinating Agency for Capital Investment (*Meninves/Kepala BKPM*) has authority to issue: (1) Limited Importer Identification Number; (2) Business License and Permanent Business License; (3) Plan for Use of Foreign Employment; (4) Recommendation for Applying for a Visa for Foreign Employment; (5) License for Foreign Employment; (6) Extensions for Foreign Employment License; and (7) Approval for Providing Facilities of Import Duty. The local government has only authorities of: License of Location; Certificate for Land-Ownership; Permit for Building Establishment and Disturbance permit. Therefore, the district government of Gianyar has limited functions and authority in implementing administrative decentralisation.

The local government of Gianyar has provided improved public service, particularly in business licensing. In achieving this goal, the local government of Gianyar implemented institutional and administrative reform. In respect to institutional reform, in 2001 the district government started to reform the UPT (*Unit Pelayanan Terpadu*) or the Unit for Integrated Permit Service by changing the UPT to KUPT (*Kantor Unit Pelayanan Terpadu*), known as the Office of Unit for Integrated Business Permits. The reasoning behind the change was that the Unit was a part of local agency which has limited power and was supported by fewer staff. The *Kantor* is at a higher level of hierarchy than the unit and has more power by comparison. Then, in 2004, the KUPT changed its name became KPT (*Kantor Pelayanan Terpadu*) known as the Office of Integrated Business Permits. To increase power and responsibility of KPT, in 2008, the KPT was revised to become *Badan Pelayanan Perijinan Terpadu* (Local Board for Integrated Permit Services) with an aim to improve providing service of various permits (Local Regulation No.6/2008). The local board is the same level of hierarchy as the local agency (*Dinas*) which has more power and authority and under the direct control by the district head. All businesses permits were issued by the *Badan Pelayanan Perijinan Terpadu*. The office building of *Badan Pelayanan Perijinan Terpadu* was located next to the office building of the district head. The building looks impressive compared with other local board and local agency buildings.

In relation to administrative reform, the procedure for obtaining business permits was made more transparent and accountable for small businesses (Table 5.1). The transparency is important as small businesses are aware of the long process of issuing business permits by the district government. Accountability is also important, thus the district government announced the fee for each type of business permit. Before the implementation of administrative reforms, the process of business permits was not transparent in terms of the timing and costs of the permits. Small businesses using the public service often paid extra money to obtain business permits. In conclusion, the local regulations related to business permits have dramatically improved as the process to obtain business permits is more transparent and accountable.

At present, there is a simplification of processing for obtaining business licenses as well as a shorter waiting time for obtaining permits. Business location permits and disturbance permits, for instance, are issued by the local government within a maximum for 4 working days after submission and trade businesses permits (SIUP) and industry business permits (IUI) should be issued by local government within a maximum for 10 working days (Table 5.1). In relation to business permit fees, enterprises with capital of more than 5 billion rupiah, for example, should pay fees for trade business permits up to 3 million rupiah. In general, as depicted below most of types of business permits are issued in 14 days or less (Table 5.1).

**Table 5.1**  
**Type of Permits under Local Board for Integrated Permit Services**

No.	Type of Permit	Time of Service
1.	<i>Ijin Lokasi</i> (Permit for Building Location)	14 working days
2.	<i>Ijin Mendirikan Bangunan, IMB</i> (Permit for Building Establishment)	15 working days
3.	<i>Surat Ijin Tempat Usaha dan Ijin Gangguan</i> (Permit for Business Location and Disturbance Permit)	4 working days
4.	<i>Surat Ijin Tempat Usaha–Minuman Beralkohol</i> (Permit for Business Location for alcoholic Beverage)	4 working days
5.	<i>Ijin Usaha Industri (IUI)</i> or Industry Business Permit.	10 working days
6.	<i>Surat Ijin Tempat Usaha</i> (Permit for Business Location)	4 working days
7.	<i>Surat Tanda Daftar Perusahaan</i> (Company Registration Identification Permit)	10 working days
8.	<i>Surat Ijin Usaha Perdagangan (SIUP)</i> or Trade Business Permit.	10 working days
9.	<i>Surat Ijin Usaha Perdagangan (SIUP)-Minuman Beralkohol</i> or Trade Business Permit for Alcoholic Beverage).	10 working days
10.	<i>Ijin Pemasangan Reklame</i> (Permit for Advertizing)	7 working days
11.	<i>Ijin Usaha Sarana Pariwisata</i> (Permit for Tourism Facilities)	14 working days
12.	<i>Perpanjangan Ijin Usaha Sarana Pariwisata</i> (Extended Permit for Tourism Facilities)	14 working days
13.	<i>Ijin Penyimpanan Bahan Bakar Minyak</i> (Permit for Storage of Oil)	-
14.	<i>Mutasi Pajak Bumi dan Bangunan</i> (Change of Ownership for Building and Land-Ownership Tax)	1 working days
15.	<i>Sertifikat Tanah</i> (Permit for Certificate for Land-Ownership)	90 working days
16.	<i>Akta Kelahiran</i> (Birth Certificate)	7 working days
17.	<i>Kartu Pencari Kerja</i> (Card for Job Seekers)	1 working days

Source: *Badan Pelayanan Perijinan Terpadu* (2008).



The impact of institutional and administrative reform can be explained as follow: Data showed that the majority of small businesses did not have business permit. In 2006, there were only 471 or 2.15 percent of 21,426 small businesses who had business permit. Then, in 2007 there were only 489 or 2.21 per cent of 22,144 small businesses with business permits (Table 3.8). Institutional and administrative reform did not encourage small businesses to apply for business permits. It is therefore argued that both institutional and administrative reform had a little impact on small business.

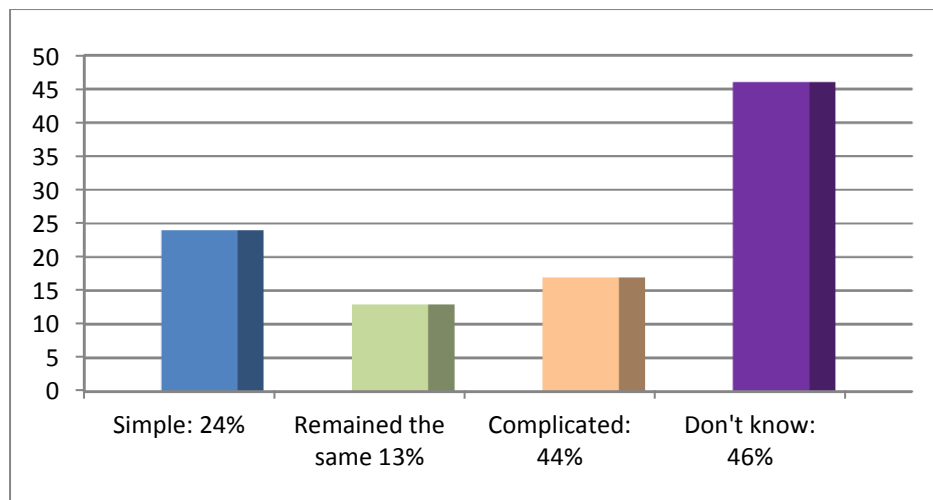
The impact of institutional and administrative reforms in both Bantul district and Gianyar district is the same. The majority of small business did not have business permits. The administrative and institutional reforms have not encouraged small business owners to obtain business permits.

Based on the survey data from 100 small business owners, 44 percent of respondents perceived that the procedure for obtaining permits was complicated and 13 percent viewed that the procedure for obtaining permits remained the same as previous experience. This totalled that 57 percent of respondents viewed that the procedure remained complicated. With only 24 percent commenting that the procedure was simple. However, a significant proportion of respondents (46 percent) noted that they did not know because they had not obtained a business permit (Table 5.2). The findings differed from Bantul where majority of respondents viewed that the procedure for obtaining permits as simple. It is suggested that the complicated procedure for obtaining business permits could cause small business owners to disobey local regulations. Evidence shows that majority of small business owners do not have business permits,<sup>119</sup> thus, they did not pay local taxes and levies. The important question is, whether local taxes and levies could be implemented effectively. The following section will discuss local taxes and levies.

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<sup>119</sup> See Table 3.8 of Chapter Three.

**Chart 5.1**  
**Perception of Small Business Owners on Procedure of Business Permit**  
**(N=100)**



Source: Data obtained from survey questionnaire, 2009.

### 5.2.2. Local Tax and Levy Policy

This section will be divided into two sub-sections: Firstly, local tax policy will be discussed and secondly local levy policy.

#### 5.2.2.1. Local Tax Policy

This section will examine the extent to which district government has discretionary fiscal policy and whether or not the district government can use local tax to control small businesses. Local tax is one source of district government revenues. Local tax income contributed to small part of total district government revenue (Table 5.2). Throughout 2003-2009, the average local tax income to district government revenue was 7.40 percent. The local tax income increased from 17,704.61 million rupiah in 2003 to 45,301.72 million rupiah in 2009. Income from tax on hotel contributed to the most part of local taxes income at 58 percent in 2007.

However, local tax revenues were insufficient to pay local bureaucrat salaries. For instance, in 2008 local tax incomes were only 9.95 percent of budget for local bureaucrats salaries. In 2009 budget for local bureaucrat salaries was 426,253.03 million rupiah whereas local tax revenues were only 45,301.72 million rupiah or 10.62 percent. In other words, the local tax revenues were only sufficient to pay local bureaucrats salaries for one month. The small income from local taxes could have

caused the Gianyar district government difficulty in improving public services for small businesses such as financial assistance and training as well as to facilitate physical infrastructures such as market buildings, roads and electricity supply.

**Table 5.2**  
**Local Taxes Income of the Gianyar District Government, 2002-2010**

No.	Year	Total District Income (Million rupiah)	Total Local Taxes Income (Million rupiah)	Percentage Local taxes Income to Total District Income
1.	2003	279,914.63	17,704.61	6.32
2.	2004	299,761.81	24,860.64	8.29
3.	2005	323,433.20	31,076.86	9.61
4.	2006	457,115.47	33,510.55	7.33
5.	2007	538,325.98	37,575.00	6.98
6.	2008	616,693.54	39,395.73	6.39
7.	2009	652,453.02	45,301.72	6.94
		Average		7.40

Source: *Pemerintah Kabupaten Gianyar* (2003, 2004, 2005, 2006, 2007, 2008, 2009).

Although local tax income of the Gianyar district government was small, the district government did not introduce a new local tax to increase district government revenue. The district government had difficulty imposing new local taxes as the central government has stipulated types of local taxes as stated in Law 34/2000 (Pemerintah-Indonesia, 2000a). The district government had limited discretionary fiscal policy in decentralisation. The list of local tax policies as follows:

- 1) Tax on Hotel (Local regulation No. 2/2011).
- 2) Tax on restaurant (Local regulation No. 3/2011).
- 3) Tax on entertainment (Local regulation No. 11/2011).
- 4) Tax on public advertisement (Local regulation No. 9/2010).
- 5) Tax on parking (Local regulation No.12/2007).
- 6) Tax on public street lighting (Local regulation No. 12/2011).

As discussed in Chapter Four, small businesses are not the subject of local tax, but they are subject to central tax such as sales tax. Small businesses owners generally did not pay sales tax although they were subject to this tax because their business transactions were not recorded. Only a few of business owners paid this tax. The central government did not strictly implement this tax upon small businesses owners.

Currently, small businesses owners of Gianyar are relatively free from the local government regulations in terms of taxes regulations. The district government was not able to control small businesses by using tax policy. Therefore, decentralisation policy had minimal impact on small businesses in terms of local taxes. The next discussion on local levies examines the contribution of local levy incomes to the district government revenue and the impact of local levies on small businesses.

Existence of small businesses has been recognised as important economic activities by local governments because it absorbs many employees and contributes to locally derived revenue. I argue that there three variables that influence each local government in providing financial and material assistance to small businesses, namely the local government's commitment to small businesses, market conditions and the annual local budgets.

Firstly, in relation to local government's commitment to small businesses, the local government of Bantul allocated its local budget of Rp 1,284.83 million in 2007 and it increased up Rp 4,125.06 million in 2008. In contrast, the local government of Gianyar only allocated local budget of Rp 28,305 thousand for supporting small business training in 2006 and there was no local budget for small business training in 2007. In my opinion the district head of Bantul has higher commitment to support small businesses than in Gianyar.

Secondly is market condition for small businesses. The location of Gianyar is a famous tourism destination in Bali. Many foreign and domestic tourists visit Bali and they buy small businesses' products. Therefore, small business could develop well without the financial assistance from the district government. For instance, in 2009 the district government of Gianyar provided training assistance only to small business beginners. In contrast, in Bantul, training assistance was not only for beginners but for all small businesses. In my opinion, small businesses in Gianyar are easier to develop because market condition. In Bantul, small businesses need strong support by local government to develop. Therefore, small business market conditions differ between Gianyar and Bantul, so government attitudes towards small businesses were also different.

Thirdly, as in the discussion before, since 2001 the central government has given increased equalization funds to the local governments in form of general grants and specific grants. The local government has discretionary policy to use general grants, tax incomes and levy incomes to support small businesses. The process of determining the program in the district government is as follows: First is discussion at village level. The village bureaucracy and villagers discuss many issues to make a project proposal and its budgeting. The project proposal consists of many programs. Then the project proposal is submitted to sub-district. Second is discussion at sub-district level. The project proposal derived from village government to be discussed by head of subdistrict and local people at subdistrict level. The sub-district government integrate many programs from villages and its result was submitted to district government. Third is discussion at district level. The district government bureaucracies discuss the project proposal derived from sub-district and determine program priority. In Bantul, the local government and local parliament invite local business associations in discuss annual local budget and programs, especially for small businesses program. In contrast, local business associations in Gianyar were not involved in discussing annual local budget and programs. Consequently, local business association could not provide input in formulating annual local budget. It could be concluded that small business is not a priority for budgetary support

#### **5.2.2.2. Local Levy Policy**

Local levy income is one source of revenue for the district government. The important question is, whether or not local government can use local levy to control small businesses. All local levies are regulated by *Perda* (local regulation) which is stipulated by the district head and local parliament. The Gianyar district revised local levy policies with the aim to improve public services for small businesses. The list of revised local levy policies as a follows:

- 1) Levy on Building Establishment License (Local Regulation No.13/1998).
- 2) Levy on Permit for Business Location (Local Regulation No. 5/1994).
- 3) Levy on Industry Business License (Local Regulation No.7/2005).
- 4) Levy on Trade Business License (Local Regulation No.6/2005).
- 5) Levy on Disturbance Permit (Local Regulation No. 17/2010).
- 6) Levy on Company Registration Identification License
- 7) Levy on Market (Local Regulation No. 13/2007).

- 8) Levy on Trade Business Permit for Alcoholic Beverage
- 9) Levy on Advertisement Permit (Local Regulation No. 9/2010)
- 10) Levy on Permit for Tourism and Sport Facilities (Local Regulation No. 8/2010).
- 11) Levy on Change of Ownership of Building and Land Ownership (Local regulation No. 16/2010).
- 12) Levy on Certificate for Land Ownership

Throughout 2003-2009, the ratio of local levy income to the total district government income was 5.15 percent (Table 5.3.). The local levies consist of 21 types of local levies such as local fees for building permits, local fees for disturbance permits, local fees for transport permits, local fees for trading business permits (SIUP), local fees for industrial business permits (IUI), parking fees, market fees and public health service fees.

The majority of local levy incomes are derived from the income raised by levies on the market. In 2007, the income from levies on all business permits was only 1,914 million rupiah equating to 6.58 percent of total local levy incomes. The results infer that income from levies on business permits accounted for a small part of total local levy incomes. It may be concluded that decentralisation policy had a small impact on small businesses in locality of Gianyar in terms of local levies. This condition was not far different from that of the Bantul district government.

**Table 5.3.**  
**Local Levy Income of the Gianyar District Government**  
**2003 – 2009**

No.	Year	Total District Income (Million rupiah)	Local levy Income (Million rupiah)	Percentage Local Levy to Total District Income
1.	2003	279,914.63	13,085.73	4.67
2.	2004	299,761.81	16,500.83	5.50
3.	2005	323,433.20	20,421.63	6.31
4.	2006	457,115.47	27,946.40	6.11
5.	2007	538,325.98	29,961.68	5.57
6.	2008	616,693.54	34,953.99	5.67
7.	2009	652,453.02	14,526.27	2.23
8.		Average		5.15

Source: *Pemerintah Kabupaten Gianyar* (2003, 2004, 2005, 2006, 2007, 2008, 2009).

The data indicates that the local tax incomes were greater than the local levy incomes (Table 5.2 and Table 5.3). Majority of local tax incomes are derived from hotels and restaurants. In contrast, Bantul result calculated that local levy incomes were higher than local tax incomes.

The district government of Gianyar expanded local regulation to local levies with the aim to increase district government revenues. However, the majority of small businesses owners did not have business permits such as a business location permit, trade business permit, or a building location permit. As a result, they did not pay levies on business permits. They ignored business permits and local levies as the district government did not impose fines. For instance: Ninety seven percent<sup>120</sup> of Gianyar small businesses did not have a business permit and never paid local levies. This has two implications: Firstly, it appears that there was no relationship between local government and small businesses activities. Small businesses could operate without a business permit from local government. They only applied for a business permit if they required credit from the state or private bank as these banks demand business permits for administrative purposes in providing loans. Secondly, local government was not able to use local levy policy to control small businesses at the local level. Increased number of small businesses might not affect increased district

<sup>120</sup> See Table 3.10 in Chapter 3 where there were 21,655 of 22,144 small business owners had no business permits.

government revenue. In the other words, local levy policy had a small impact on small business activities and district government revenue.

It is important to note that the district government did not effectively implement local regulation on business permits. On one hand, the district government created local regulation on business permits with the aim to increasing its revenue. On the other hand, the district government ignored small businesses who were operating without business permits with many reasons as will be explained as follows:

Economically small businesses create employment opportunities for a local community, which in turn, contributes to decreasing the unemployment rate. From local government's view, a low unemployment rate contributes to social and political stability, despite small businesses providing a small local levy for district government income. As discussed in Chapter Three, small and medium businesses of Gianyar provided a large number of employment opportunities for the local community. The small and medium businesses of Gianyar provided employment opportunities for 30,730 workers in 2001, and then increased to 65,802 workers in 2007.

Politically small business owners were a voter source for politicians seeking election for district government head and local parliament members. Typically, politicians gained support from small business owners by allowing owners to operate despite having no business permits. In doing so, politicians expected that they would gain many votes from small businesses in the election of district government head and local parliament members. In 2007, the total number of small and medium businesses was 21,665 with the number employees were 65,802. Based on the growth rate of small and medium businesses of 3.12 percent<sup>121</sup>, I estimated that in 2009 the total number of small and medium businesses was 23,546. Further, based on the growth rate of employment 7.36 percent<sup>122</sup>, in 2009 the total number of employees of small and medium businesses was 75,844 workers. If each small business was owned by two people (husband and wife), in 2009 the total number of

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<sup>121</sup> The average of growth rate of small and medium businesses was 3.12 per cent during 2002-2007.

<sup>122</sup> The average of growth rate of employee in small and medium businesses was 7.36 per cent during 2002-2007.



people involved in small business was 129,936.<sup>123</sup> In Gianyar, there were 330,000 constituents in 2009 general election.<sup>124</sup> This means, 39.37 percent of the constituents were came from of small businesses sector, thus, small businesses were potential voters in terms of vote total number.

On a final note, the local government disregard for small businesses that did not pay a levy may have been due to the need for such businesses to remain in the region of Gianyar. As discussed in Chapter One, businesses will remain in a region which provides good public services and taxes. In contrast, they will exit from regions if local government provides unsatisfactory services and taxes (Tiebout 1956). The district government of Gianyar tried to provide better public service to small business owners as stated by the district head and outline below:

**Case 5.1: The view of the District Government on Local Levies**

For the district government of Gianyar, the spirit of local regulation on businesses permit was not only intended to increase district government income but to keep order among small businesses owners. The district government was obligated to increase welfare to small business owners and did not want to place financial burden upon them. The district government was also obligated to maintain security, so that small business owners could safely operate their business.<sup>125</sup>

It was clear that local regulations on business permits have not been effectively implemented by local government. Formally, the district government regulated small business by stipulating local regulation on local levies, but practically, both the district government and small businesses did not care about local regulations on local levies. The view of small businesses on local levies can be obtained from the following.

When conducting survey research, 100 small businesses owners were questioned with, “What do you think about local levies on small businesses?” Six alternative answers were provided:

- (A) Generally, the local levies were relatively light;
- (B) The local levies were reasonable;
- (C) The local levies were heavy;

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<sup>123</sup>  $23,546 \times 2 + 75,844 = 122,936$ .

<sup>124</sup> KPUD (Committee of Local Election).

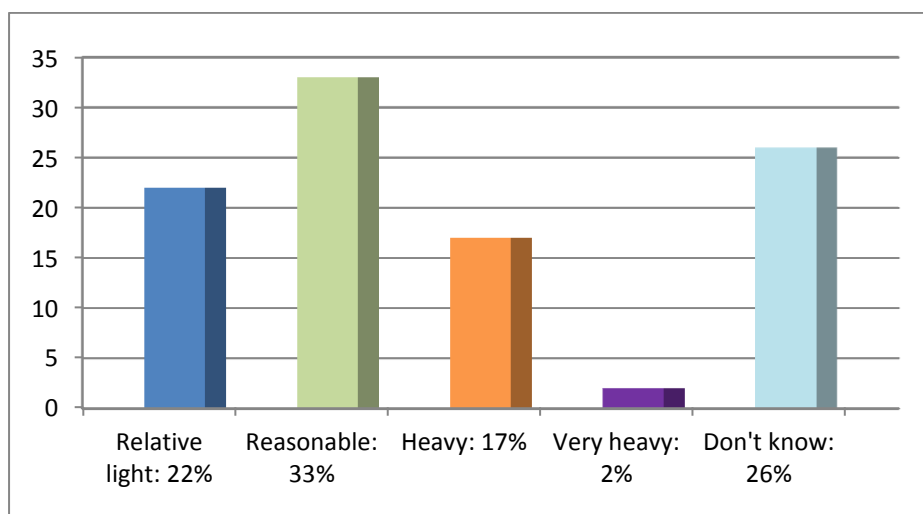
<sup>125</sup> Interview with the District Government Head of Gianyar, 23 April 2009.

(E) the local levies were very heavy; and

(F) Don't know.

The survey data indicated that most respondents perceived that local levies were reasonable, 33 percent; and about 22 percent responded that it was relative light or cheap. This means that more than 50 percent of small business owners had the opinion that local levies were not expensive (combined between light and reasonable answers). Seventeen percent of them perceived that they was heavy or expensive; only 2 percent perceived that local levy was very heavy and 26 percent of them said they did not know (Chart 5.2). The result reflects that most owners do not pay local levies. Data obtained by interviews with small businesses owners also indicated that most of them had no business permits and did not view this as an issue for their business.

**Chart 5.2**  
**Perception of Small Business Owners on Local Levies**  
(N=100)



Source: Data obtained by survey questionnaire, 2009.

According to several small businesses owners, the local government did not seriously promote small businesses. For instance, small business owners of Tegallalang sub-district said that local government had not improved physical infrastructures such as roads or local market buildings. As a result, they feel free from the obligation for the local government. Furthermore, they were able to survive in their business without receiving assistances from local government. Finally, they

did not care about business permits. One small business owner said that he would not to look for business permit because his business can operate without it and the local bureaucrats never forced him to apply for the permit.<sup>126</sup> It appears that small businesses were not dependent on local government. The following discussion concerns whether local government protect small businesses.

### **5.2.3. Protection Policy for Small Businesses**

As discussed in Chapter Four, the Bantul district developed a protection policy for small businesses with the aim to promote them. In contrast, the Gianyar district did not implement such a policy. The Gianyar district government handed over free market mechanisms to promote small businesses. Although the district government facilitated financial assistance for small business owners, there was not a protection policy against big businesses.

Based on the data in Chapter Two and Three, there are more small businesses in Gianyar than in Bantul. Despite the figure, the district government of Bantul intensively developed and protected small businesses by making various policies such as not allowing supermarkets to operate in all regions of Bantul.

The Gianyar district government did not install protection policies for small businesses, however small businesses could still be developed (Table 3.8). This means that growth of small businesses was not dependent on the district government policy yet on the market. The majority of small businesses products were exported to countries such as the United States, European countries and Australia. During 2003-2007, the export growth rate of Gianyar was 6.30 percent. In 2003, non-oil export of Gianyar was 23,855,349.33 *rupiah* and in 2007 it was 31,367,132.02 *rupiah*<sup>127</sup>. The majority of exports were derived from wood handicraft products such as wood statues, wood decorations and various woodcrafts (Figure 5.1 and 5.2). Further, the majority of exported products from the Bali province were derived from Gianyar district.<sup>128</sup> Thus, the growth of small businesses was more influenced by demand of

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<sup>126</sup> Interview with Mr. P.D., Small Business Owners and *Bendesa* of *Banjar* Jasan, 23 May 2009.

<sup>127</sup> *Pemerintah Kabupaten Gianyar*, (2008b, p. 51)

<sup>128</sup> Interview with Mr. A.S., District Head of Gianyar, 23 April 2009.

international market than the local government protection policy. The next section will discuss policy to promote small businesses.

**Figure 5.1**  
**Wood Statues of Small Business Products**



Source: Field work, 2009

**Figure 5.2**  
**Handicrafts of Small Business Products**



Source: Field work, 2009

Based on the discussion above, it can be summarised that the district government of Gianyar carried out institutional and regulation reform in 2001 with the aim to provide better public services for small businesses. The district government developed Local Board Integrated Permit Services and improved the procedure for obtaining business licenses. However, most of small business owners ignored business permits and did not pay local levies. This suggests that district government failed to use local regulation on business permits to control small businesses.

### **5.3. Promotion Policy for Small Businesses**

This section will answer the question as proposed in Introduction: To what extent does the district government develop small business promotion policy? As discussed in Chapter One, administrative decentralisation is concerned with sharing responsibilities between central and sub-national governments. It comprises a set policy that transfers the functions and delivery of public services such as the business sector, public works to sub-national governments. This section will discuss the extent to which the sub-national government of Gianyar provided financial, training and material assistance as well as infrastructure facilities and market development for small businesses.

#### **5.3.1. Financial Assistance for Small Businesses**

In Chapter One, it was discussed that to overcome a lack of financial capacity in small businesses, local government could provide financial assistance them so that they could improve their products. There are two ways to provide financial assistance to small businesses. Firstly, local government provides direct financial assistance to small businesses. Secondly, local government develops a network with state/private banks and village financial institutions in order to provide credits to small businesses. In the case of Gianyar, the local government tends to use the latter way in providing financial assistance to small businesses. The state banks consist of the *Bank Pembangunan Daerah* (Provincial Government Bank or BPD) and Bank BNI. The following discussion will discuss financial assistance from the Bank BPD, Bank BNI and the village financial institution.

Starting in 2009 the Gianyar district government developed joint cooperation with the *Bank Pembangunan Daerah* (Provincial Government Bank or BPD) to help small businesses. The Gianyar district government deposited money in the BPD bank amounting to 500 million *rupiah*. The BPD provided a subsidy of 2 billion *rupiah*. Therefore the total fund was 2.5 billion *rupiah* that was available for distribution as a loan without collateral for small business owners. Small business owners could borrow up to 7.5 million *rupiah* with the condition of being repaid over three years.

Secondly, the local government of Gianyar signed a memorandum of understanding (MOU) with BNI Bank in mid 2008. This program aimed at helping small business

activities in Gianyar by providing credit scheme. Small businesses could borrow up to 30 million rupiah with the condition of repayment in three years. However, upon interviewing small business owners, many were unaware of the program because the district government only promulgated the program through local daily newspapers and not all small businesses owners read the newspaper.

Thirdly, the Gianyar district government developed cooperation with the Institution for People's Credit (*Lembaga Perkreditan Desa* or LPD). The LPD is owned by the *Banjar* and operates at a customary village (*desa adat*) level. Besides the district government of Gianyar, the provincial government of Bali also provided financial assistance to the LPDs (Table 5.2). The LPDs provided loans for villagers including small business owners with a simple administrative procedure. Thus, small business owners and villagers preferred to borrow money from the LPDs rather than to the State Banks or Commercial Banks (Case 5.2).

#### **Case 5.2: Financial Assistance from Village Financial Institutions**

Mr. P.D. lives in *Banjar* Yasan, sub-district of Tegalalang. He has operated a small business since 1993, and he employed 16 workers. He borrowed money from the LPD to increase capital. He preferred to borrow money from LPD rather than from state or private banks because the administrative requirement was simple. He borrowed 60 million rupiah from the LPD and repaid the loan over a year.<sup>129</sup>

Another small business owner also commented that he preferred to borrow money from the LPDs because they were not able to fulfil the administrative requirements for borrowing from state or private banks. He also has not received loans from the district government.<sup>130</sup>

The district government provided very small financial assistance to the LPDs. For instance, in the case of Sukowati sub-district, the district government provided only 24 million *rupiah*, although there were 32 LPD. In Balbatuh sub-district, despite there were 36 LPDs, the district government only provided thirty million *rupiah*. This means, both in Sukowati sub-district and Balbatuh sub-district, every LPD received less than one million *rupiah* (Table 5.4).

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<sup>129</sup> Interview with Mr. P.D., Small business Owner, 23 May 2009.

<sup>130</sup> Interview with Mr. A.W., Small Business Owner and *Kelian Dinas*, *Banjar* Bonjaka, *Desa* Sebatu, Tegalalang, 23 May 2009.

**Table 5.4**  
**Financial Assistance for LPDs, 2007**

No.	Sub-district	Number of LPD	Provincial Government Financial Assistance (million rupiah)	District Government Financial Assistance (million rupiah)
1.	Sukowati	32	3	24
2.	Blahbatuh	36	1	30
3.	Gianyar	39	3	31
4.	Tampaksiring	36	3	28
5.	Ubud	32	5	20
6.	Tegallalang	43	3	25
7.	Payangan	48	3	40
	Total	266	21	198

Source: *Pemerintah Kabupaten Gianyar* (2008a, p. 222)

The LPDs played an important role in providing financial assistance to small businesses at the grassroots level and prevented small business owners from resorting to illegal money lenders. As discussed in Chapter One, in Denmark as an example, local banks also played an important role in developing small businesses (Kristensen, 1992, p. 149). However, the role of local government in supporting the LPDs was limited. It indicates that financially the local government of Gianyar paid little attention to small businesses.

Based on the data above, it was clear that the Gianyar district government provided financial assistance for small businesses through financial institutions, but the total amount financed was minimal. This provided further impetus that financially the district government of Gianyar paid little attention to small businesses. It is important to note that the implementation of decentralisation policy had minimal impact on small businesses in terms of financial assistance. The following discussion will examine the perception of small business owners on financial assistance from the district government.

The study surveyed 100 small business owners. According to 29 percent of respondents, the district government was supportive to small businesses and 10 percent said the district government was very supportive of small businesses. However, the majority of respondents, 61 percent said that the district government of Gianyar did not do anything for small businesses (Table 5.5). In general, respondents

did not know that local government provided money to LPDs. The responses reflect that small business owners rarely had contact with local bureaucrats and further they failed to read the local newspaper which detailed activities.

**Table 5.5**  
**The Perception of Small Business Owners on**  
**Financial Assistance**

What do you think about the local government's financial support (Financial aid, subsidies, favourable business taxes, and low interest loan) for local small business?	Frequency	Percent
Very supportive	10	10.0
Supportive	29	29.0
Not at all	61	61.0
Total	100	100.0

Source: Data obtained from survey questionnaire, 2009

According to small businesses of Gianyar, financial assistance from the district government was small and not the main determinant for success of their businesses. As mentioned above, based on the experiences of small business owners they were able to survive without receiving financial assistance from the district government. The next section will discuss training for small businesses.

### **5.3.2. Training for Small Business Owners**

This section will examine: How far does the Gianyar district government allocate public resources to provide training programs. Does the central government play an important role in providing training for small business owners? To what extent did small business owners provide response to training programs?

As discussed in Chapter One, local government provided training for small business owners to improve the skills of workers and quality products. In 2006, the district government of Gianyar established the UPTD<sup>131</sup> with an aim to provide training for small businesses. The location of this office building was far from the main road and far from central office building of the Gianyar district government. The building next to the office of UPTD was a primary school. Thus, the environment of the UPTD

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<sup>131</sup>UPTD is *Unit Pelaksana Teknis Dinas* (Technical Service Unit of Local Agency for Industry, Trade and Cooperative) regulated by district head's decree No. 10/2006, 20 February 2006.



office was quite noisy, particularly during the school recess. In short the surrounding was not ideal as a training location.

Some of staff members appeared jobless and were left to converse with each other. The majority of the computers could not be used for the previous 6 months and had yet to be repaired. The boss was aware that the computers require repair, however a staff member commented that there was no local budget for this purpose. This phenomenon showed that the Gianyar district government paid less serious attention in implementing its functions in term of training.

The Gianyar district government provided training for small businesses to increase their skills. For instance, in 2003 the local government of Gianyar provided training for 380 small business owners across seven sub-districts. However, in 2007 the Gianyar district government provided training only for 140 small business owners across seven sub-districts (Table 5.4). All training programs were financed by the central government. It is interesting to note that although the district government of Gianyar adopted a decentralisation policy, the central government still played an important role in providing funds training for small businesses (Table 5.6).

**Table 5.6**  
**Training Program for Small Business Owners**  
**2003 – 2007**

No.	Year	Location of Training	Source of Finance	Number of Participants
1.	2003	7 Sub-districts	Central government grant	380
1.	2004	7 Sub-districts	Central government grant	110
2.	2005	7 Sub-districts	Central government grant	380
3.	2006	7 Sub-districts	Central government grant	80
4.	2007	7 Sub-district	Central government grant	140

Source: *Diperindagkop* (2003, 2004, 2005, 2006, 2007)

At the same time, the local government of Gianyar through the *Diperindag* (local agency for industry and trade) provided training for small business owners with the aim to increase their skills. During 2004-2007, this training involved 710 participants (Table 5.7). The training was fully funded from the local government budget.

**Table 5.7**  
**The Number of Training Programs and District Budget, 2004-2007**

No.	Year	The number of Training Sessions	Total Budget
1.	2004	7	Rp 40,878,000
2.	2005	18	Rp 62,060,000
3.	2006	4	Rp 28,305,000
4.	2007	8	n.a.
	Total	37	Rp131,243,000

Source: *Diperindagkop* (2004, 2005, 2006, 2007).

This is evidence that under decentralisation policy, the central government was still involved in promoting small businesses by providing grants for training programs. At the same time, the local government of Gianyar were actively involved in facilitating funds for training program. The important question is, whether the training program can promote small businesses. We need to look at the perception of small business owners on the training program, as to whether this program is useful for them.

Data obtained by survey research indicated that 10 percent and 6 percent of respondents had the opinion that the Gianyar district government was supportive and very supportive in providing training for them. But, most of respondents (84 percent) did not have opinion about the training held by the local government (Table 5.8). In the other words, they ignored the training programs. There was the possibility that the training program was not useful for them. The limited financial capacity of Gianyar may have allowed poor training programs as well as negative perceptions of the training.

**Table 5.8**  
**The Perception of Small Business Owners on Training Program**

What do you think about the local government's training support (Support for in-house education, government job training) for local small business?	Frequency	Percent
Very supportive	6	6.0
Supportive	10	10.0
Not at all	84	84.0
Total	100	100.0

Source: Data obtained from survey questionnaire, 2009.

In short, the district government of Gianyar did not have sufficient financial resources to implement administrative decentralisation particularly in providing training programs for small businesses. The UPTD had poor financial resources and physical infrastructures to implement training programs.

The district government of Gianyar did not actively facilitate training for small businesses because there was no political pressure to do so from local parliament members. As described on Chapter Three, the district head was supported by *Golkar* party and several small parties, such as the PPIB party, Democrat party, *Patriot Pancasila* party, PDK party, *Pelopor* party, PKPI party, PNBK party, PNI *Marhenisme* party and PKPB party that had occupied 21 seats at of 40 seats of parliament member. Thus, the majority of local parliament members did not criticize the district head policy.

### **5.3.3. Material Assistance for Small Businesses**

One of factors that influence the sustainability of small businesses is the availability of material input. My research took a case of woodcraft in the sub-district of Tegallalang. Wood is the main material for 450 small businesses in the sub-district of Tegallalang in 2009. According to small business owners, they can buy wood from the locality of Tegallalang and from other sub-districts.

During 2007-2008, small woodcraft businesses faced a lack of wood supply due to a major investor having established a plywood factory in Bangli district located 30 km east of Gianyar district. The new plywood factory needed a lot of wood from many regions including wood from Gianyar district. As a result, the small businesses of Gianyar faced supply problems and were forced to buy from other regions at a higher cost. In addition, illegal wood was sold from Gianyar to other districts, further exacerbating the problem. This caused Gianyar to have a lack of wood and small businesses had more difficulty in buying wood. The problem encouraged *Kadinda* (the Chamber of Commerce and Industry of Gianyar) to assist small business owners and communicate with the local government.

The chairman of *Kadinda* met with the district head of Gianyar to discuss the problem, however the district head did not take a decision to resolve the problem.

The *Kadinda* of Gianyar responded to the problem with a tree planting program. The program was managed by Consortium under the *Kadinda* of Gianyar. The first step involved *Kadinda* rent land around 6 *ha* to plant *abesia* trees. The process is expected to take three years.<sup>132</sup>

It was clear that the district government of Gianyar did not do anything to help small businesses in overcoming the lack of materials despite the district head being a businessman. Cok Ace, the district head and businessmen, failed to rectify the situation, furthermore the problem was not related to his business. As discussed on Chapter Three, Cok Ace operated within the hotel and restaurant sector. In contrast, *Kadinda* played an important role in overcoming the lack of material inputs.

The local government of Gianyar did not intervene to help small businesses source raw materials. In my opinion there are three possible reasons for this. Firstly, the local government of Gianyar did not help with the procurement of raw material due to a possible absence of political will to stop the trade in wood out of Gianyar to other regions. Both district head and local parliament members did not have strong commitments to help small business because they were not sensitive to needs of small businesses. Secondly, the district government was reluctant to help small business owners regarding raw materials due to a lack of funding to facilitate it. However, I argue that to solve this problem did not require much funding but rather political will to make regulation. The district government should have developed regulations on trade of wood. For instance, the local government should have decided on a quota for traders in selling raw materials for woodcraft to other regions. However, the local government did not do this. Thirdly, the local government was believed that market mechanism could overcome the problems faced by small businesses. It could be interpreted that local government tended to adopt a market economy model. Market economy is one in which goods are bought and sold at prices determined by a free market, with a minimum of external government control. It is also an economy in which decisions regarding production and distribution are based on supply and demand. This study found that the absence of local government

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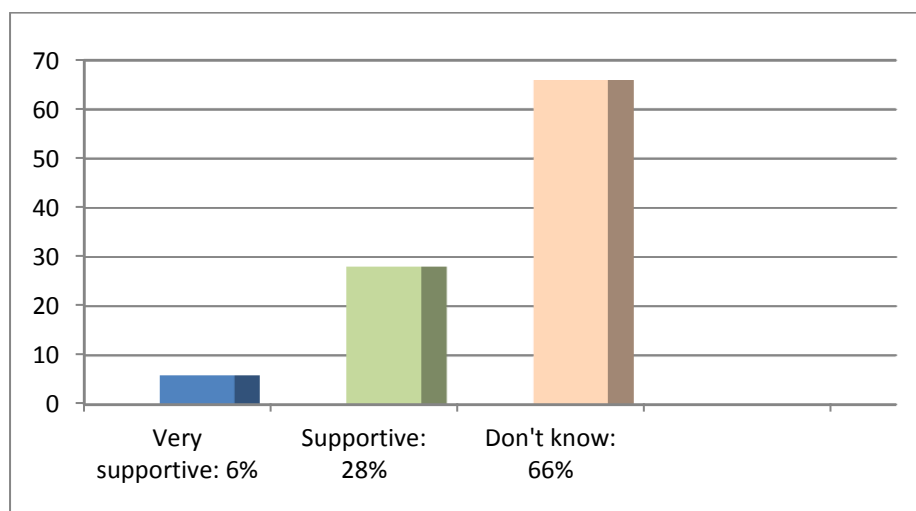
<sup>132</sup> Interview with Mr. A.A., Chairman of Kadinda, 24 April 2009.

help to small businesses in the procurement of raw materials has led the Gianyar district to adopt a market economy model.

To understand the perception of small business owners on material assistance from local government, small business owners were questioned: What do you think about the local government's material support such as raw materials, investment guidance, favourable supply of gas and electricity for local small business? Three alternative answers were provided: (A) Very supportive; (B) Supportive; and (C) Not at all.

Data obtained by survey research showed that 6 percent of respondents perceived that the local government of Gianyar was very supportive in providing material assistance for small businesses, and 28 percent said that local government of Gianyar was supportive. About 66 percent respondents said that they did not know about material assistant from the Gianyar district government (Chart 5.3).

**Chart 5.3**  
**The Perception of Small Business Owners on Material Assistance**  
(N=100)



Source: Data obtained from survey questionnaire, 2009.

Based on the data obtained survey research, it was clear that most small business perceived that local government did not do anything (66 percent). The results infer that the local government of Gianyar was not responsive to provide materials assistance for small businesses. The results of survey research were consistent with data obtained by interview with the Chairman of *Kadinda* as discussed above. Data obtained by interview with small businesses also showed that the Gianyar district did

not improve road and facilitate parking areas for small businesses in Tegallalang sub-district.

Although in 2008 the Gianyar district has already established *Diskop dan UKM* (Local Agency for Cooperative, Small and Medium Businesses), substantially, the *Diskop dan UKM* had not yet provided sufficient material assistance for small businesses. I argue that the establishing the *Diskop dan UKM* was more driven by need of the distribution of power and authority among local bureaucrats rather than to help small businesses. Before the decentralisation policy, besides *Dinas* (local agencies) there were also deconcentrated functions from the central government located in district of Gianyar called *Kandep*.<sup>133</sup> Since the implementation of the decentralisation policy, these functions of *Kandep* were transferred to *Dinas* which carry out functions of decentralisation. Public servants of *Kandep* were transferred to *Dinas*. The increased number of public servants in the *Dinas* could drive district government to create new local agencies with the aim to distribute power and authority to them.

If we make a comparison of Bantul and Gianyar, the Bantul district played a more important role in allocating public resources by providing material assistance for small businesses than the Gianyar district.

#### **5.3.4. Physical Infrastructure Facilities**

Physical infrastructure facilities such as roads, banks, electricity, telephone networks and market buildings are important for supporting small businesses. These infrastructure facilities will be discussed as follows:

##### **5.3.4.1. Roads**

As discussed in the Introduction, the majority of small businesses of Gianyar are concentrated in Tegallalang sub-district. This sub-district is located on north of the city of Gianyar (see Map of Gianyar, Figure 3.1). There are no exact numbers on how many small businesses exist in sub-district of Tegallalang. According to *Diperindag*, the number of small businesses was approximately 450. Nearly all of

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<sup>133</sup>*Kandep* (*Kantor Departemen*) is local office of the central government minister located in district area.

them were concentrated on woodcraft such as statues, wall decorations and toy animals.

However, the district government of Gianyar has not improved asphalt roads in the location of Tegallalang sub-district. The road was narrow with no parking areas, tourists had difficulty in shopping for woodcraft in Tegallalang. The Tegallalang road has not yet been improved since decentralisation policy was implemented in 2001.<sup>134</sup>

In relation to the quality of roads throughout the region of Gianyar, during 2005 - 2007 the number of good roads decreased from 419.83 km to 175.18 km, while the moderate roads increased from 139.99 km to 238.76 km. In 2007, there were still 139.87 km of damaged roads. Further, in 2005 there were 124.90 km of seriously damaged roads (Table 5.9). As a result, transportation was difficult and expensive. Small business owners had difficulty in bringing their products to markets. Buyers also had difficulty visiting the handicraft villages such as Tegallalang and Ubud.

**Table 5.9**  
**Length of Roads by Conditions (Km)**

No.	Condition of Road	2004	2005	2006	2007
	Good	280.64	419.83	194.28	175.18
	Moderate	141.79	139.99	200.00	238.76
	Damage	262.30	-	159.53	139.87
	Serious damage	-	124.90	-	-

Source: *Pemerintah Kabupaten Gianyar* (2008a, p. 192)

#### 5.3.4.2. Banks

In 2003 the state banks had 22 *Kantor* (offices)<sup>135</sup> in the region of Gianyar, and increased to 25 offices in 2007. However, the number of offices of commercial/private bank decreased from 21 in 2003 to 19 in 2007. The Institution for People's Credit (LPD) increased from 255 in 2003 to 266 in 2007 (Table 5.10).

<sup>134</sup> Interview with Mr. A.W., Small Business Owner and *Kelian Dinas*, Banjar Bonjaka, Desa Sebatu, Tegallalang, 23 May 2009.

<sup>135</sup> *Kantor* or Office is under control of Gianyar Branch of State Bank.

The LPD operated at *Banjar* level (Association of Local Customary Community). As discussed before, small business owners preferred to borrow money from the LPDs because the administrative requirement was simple whereas the state and the private banks had complicated administrative requirements for borrowing money from them.

**Table 5.10**  
**Types of Financial Institutions**

Type of Banks	2003	2004	2005	2006	2007
State Bank	22	24	25	25	25
Private Bank	21	19	19	19	19
District government's Bank	1	1	1		1
BPR <sup>136</sup>	31	31	31	31	31
LPD	255	255	266	266	266

Source: *Pemerintah Kabupaten Gianyar* (2008b, p. 67).

#### 5.3.4.3. Electricity

Electricity is another important element of infrastructure for developing the industrial sector because this sector uses electricity in the process of production. The state owned enterprise for electricity (PT PLN) has installed electricity in the Gianyar regions. However, during 2003-2007, the number of installed capacity did not significantly change and the number of customers only increased 9 percent from 77,776 to 84,966 (Table 5.11). In 2007, 28 percent of electricity in Gianyar was used in business sector.

**Table 5.11**  
**The Number of Electricity Installed Capacity and Costumers, 2003-2007**

No.	Year	Total Number of Installed Capacity (MWH)	Total number of Sold (MWH)	Total Number of Customers
	2003	180,465.00	135,769.00	77,776
	2004	150,537.00	142,263.00	75,342
	2005	186,108.00	167,769.00	82,910
	2006	190,468.18	154,388.59	83,896
	2007	190,468.18	154,388,59	84,966

Source: *Pemerintah Kabupaten Gianyar* (2008b, p. 46)

<sup>136</sup> BPR is smallholder credit bank at village level.



#### 5.3.4.4. Telephone Networks

During 2003-2007 telephone networks in Gianyar did not change significantly. The number of customers as well as the number of installed capacity and the number of using capacity decreased slightly during 2003 - 2007. The data suggests that the district government provided less telephone network facilities for local communities including small business owners (Table 5.12). The total number of customers decreased due to an increase in mobile phone usage.

**Table 5.12**  
**Telephone Networks, 2003-2007**

No.	Year	Total number of Installed Capacity	Total number of Using Capacity	Total number of Customers
1.	2003	25,466	21,647	21,583
2.	2004	25,647	21,960	21,835
3.	2005	25,674	21,999	21,903
4.	2006	25,206	21,796	21,762
5.	2007	25,206	21,257	21,361

Source: *Pemerintah Kabupaten Gianyar* (2008b, p. 62).

#### 5.3.4.5. Market Buildings

Gianyar has many art market buildings such as, Sukawati, Ubud, Gelulung and Guwang market. The district government encouraged small business owners to open stalls at these markets or open art shops along street toward a tourism destination. However, the district government did not improve the roads towards these tourism destinations and did not improve infrastructure in local public art markets.

The physical infrastructure in Sukowati Art Market, for instance, is poor. Many small businesses sold their products along walkways as market was overcapacity. In addition, the parking area in Sukawati and Ubud market were narrow. As a result, many tourists' cars were parked beyond the parking area, along a narrow street. This indicates that the district government did not improve the market infrastructure and provide assistance to small businesses.

It is seen that local government of Gianyar was less responsive in promoting market infrastructure for small businesses. There was evidence that many local public

market buildings lack infrastructure facilities including a lack of planning for stalls in the markets and the limited parking areas in the local public market. Beyond market infrastructure, the district government could develop markets by facilitating business exhibitions and network with buyers as will be discussed in the following section.

### **5.3.5. Market Development for Small Businesses**

The local government of Gianyar has undertaken two ways to develop markets: Firstly the business exhibition; secondly by developing cooperation with other institutions with the aim to promote product of small businesses. All market development programs were financed by the central government: the Ministry of Cooperatives and Small and Medium Enterprise (Ministry of Cooperative and SMEs). The two developments will be discussed in the following section.

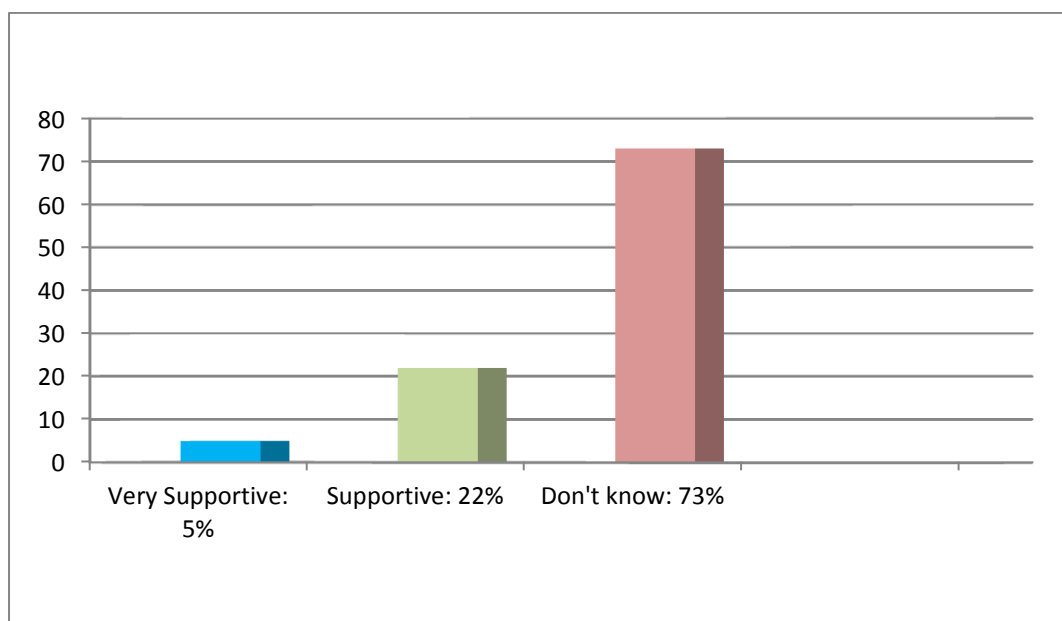
Firstly, the Ministry of Cooperatives and SMEs provided funds to the Gianyar district government to finance small business owners who participated in business exhibitions. For instance, in 2007 the Gianyar district received 548.45 million rupiah from the Ministry of Cooperatives and SMEs to finance 62 small business owners who were involved in business exhibitions in Jakarta and Bali. Unfortunately, the district government of Gianyar did not allocate local budget to support the business exhibitions. This indicated that although Gianyar district adopted a decentralisation policy, the central government still played an important role in developing small businesses on a local level.

Secondly, the district government of Gianyar developed cooperation with other institutions such as hotels and the central government with the aim to promote small businesses. For instance, the Gianyar district developed cooperation with many hotels to facilitate small businesses to open art shops in these hotels. The aim of the program was to promote products of small businesses. Moreover, the district government developed cooperation with the Ministry of Cooperatives and SMEs to establish a centre for Business Development Services (BDS) with the aim to improve products of small businesses. In 2007 there were five BDSs in Gianyar. The BDS could provide financial assistance and facilitate training for small businesses. The Gianyar district also established cooperation with the Foundation of *Dharma Bakti*

*Astra* with aim to establish the BDS. The next question is whether small businesses reap benefit from the district government's support.

Survey data shows that majority of small business owners did not know about district government's support for developing market (73 percent). Only 27 percent recognized that the district government provided assistance for developing markets (Chart 5.4). This indicates that small business owners rarely communicated with local government bureaucrats and vice versa. The local government also provided less information to small businesses about assistance in developing markets such as access to business exhibitions.

**Chart 5.4**  
**The Perception of Small Business Owners on Market Development**  
(N=100)



Source: Data obtained by survey research, 2009.

Based on interviews with small business owners, several small business owners noted that local government has not yet facilitated them to be involved in business exhibitions both in Bali and other cities outside of Bali. They paid for themselves when involved in business exhibitions. To date the local government has not facilitated the *Kadinda* to organize business exhibitions in Gianyar.

Based on the discussion above, it appears that the district government of Gianyar allocates only small financial assistance for supporting small business owners' capital and training program. Additionally, the district government provides less support for the physical infrastructure facilities for small businesses such as roads, banks, telephone networks and market buildings. However, small business owners can survive without local government support. Thus, small businesses are relatively independent of the district government policies.

#### **5.4. Political Influence**

This section will answer the questions as proposed in Introduction: Firstly: can political parties help small businesses? Secondly: in what ways local politicians approach small business owners with the aim to obtain votes in election of district head and local legislative member? Thirdly: have business associations and small business owners involved themselves in the process of decision making or political parties as well as political activities?

As discussed in Chapter One, political decentralisation can cause elected public officials to approach local communities with the aim to obtain political support. Further, political decentralisation opens an opportunity for local communities to participate in electing district head and local legislature members as well as participate in the process of decision making at district level.

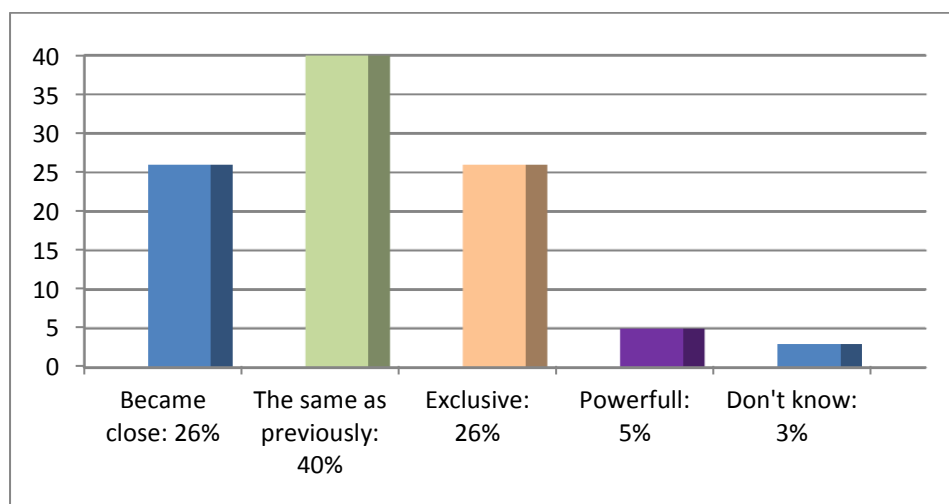
##### **5.4.1. Political Influence of Politicians over Small Businesses**

Political decentralisation provides an opportunity for political party members to compete in obtaining political positions both in the executive body and local legislature. The political positions will provide benefit for local politicians and political parties. Thus, political party members need political support from local citizen and small businesses. The important question is then in what ways political parties approach small business owners to obtain political support. Are they capable of being close to the small businesses?

Survey data showed that only 26 percent of respondents recognized that political decentralisation caused political parties to be closer to small business owners. In contrast, the majority of them, 40 percent said that political parties operated the same

fashion or that political parties were not close to small business owners. A further, 26 percent of respondents viewed that political parties were exclusive in terms of voters. Five percent revealed that political parties exercise more power than before (Chart 5.5). This data interprets that in Gianyar, decentralisation policy could not encourage political parties to become close to small business owners. Although political parties had become more powerful, they communicated less with their constituents.

**Chart 5.5**  
**The Perception of Small Business Owners on Political Parties**  
(N-100)



Source: Data obtained by survey questionnaire, 2009.

The next important question concerns the extent to which political parties can help small businesses. Data obtained by survey research indicates that according to most small business owners, political parties did not do anything for small businesses. Small business owners had the view that political parties never helped small business owners in developing network with financial institutions (90 percent); political parties never helped small business owners in developing networks with markets (as much as 89 percent); political parties had never helped small business owners in facilitating trainings (91 percent); and 92 percent of respondents said that political parties never helped small businesses in providing legal aid (Table 5.13).

**Table 5.13**  
**The Support of Political Parties for Small Businesses**

No.	Various Kinds of Support	Answer			
		Always	Sometimes	Not at all	Total
1.	Developing network with financial institutions	2 (2.0%)	8 (8.0%)	90 (90.0%)	100 (100.0%)
2.	Developing network with the markets	2 (2.0%)	9 (9.0%)	89 (89.0%)	100 (100.0%)
3.	Facilitating trainings	1 (1.0%)	8 (8.0%)	91 (91.0%)	100 (100.0%)
4.	Facilitating legal aids	1 (1.0%)	7 (7.0%)	92 (92.0%)	100 (100.0%)

Source: Data obtained from survey questionnaire, 2009.

Nearly all political parties had no affiliation with local communities and they only approached local communities before the legislator elections for soliciting votes. After election, political parties did not interact with small business owners and local communities.<sup>137</sup> According to a scholar from Bali Institute of Tourism Management, political parties never side with small businesses. The political parties have not done much for small businesses. They approached small businesses only before the election for local legislator members by providing money or material for the poor local communities. Political parties did not have sustainable programs for the empowerment of small businesses.<sup>138</sup>

In general, the degree of political party support to small business was low. Majority of small business owners perceived that political parties did not do anything for them (68.0 percent) as presented in Table 5.14. Only 12 percent of respondents noted that political parties were responsive to needs of small business owners. It can be concluded that political parties have not yet assisted small businesses. Further question is whether or not local legislative members help small businesses.

Most local legislators were not idealist politicians struggling to meet local people's preferences; rather they struggled for their individual needs. The majority of legislators try to regain the money they spent during the campaigns. In contrast, most

<sup>137</sup> Summary from data obtained by interview: Interview with W.S., *Kelian Dinas, Banjar Glagah*, 14 May 2009; Interview with K.K., *Kelian Dinas*, 14 May 2009; Interview with K.G., *Bedesa of DesaPakraman Kliki*, 22 May 2009.

<sup>138</sup> Interview with D.A., Head of Bali Institute of Tourism Management, 4 May 2009.

local communities thought pragmatically in electing local legislator based on the money they earned.

**Table 5.14**  
**The Degree of Political Parties' Support**  
**to Small Business Owners**

No.	Degree of Political Party's Support	Frequency	Percentage
1.	Very supportive	1	1.0
2.	Supportive	12	12.0
3.	Somewhat supportive	19	19.0
4.	Not at all	68	68.0
	Total	100	100

Source: Data obtained from survey questionnaire, 2009.

Data obtained by interviews indicates local politicians generally influenced small business owners by providing money during political campaign for local legislature members (Case 5.3). Political parties did not have roots in local communities nor did they have an emotional connection with local communities. They did not use programs to influence local communities but used money and material as rewards. In the relationship between political parties and small business owners, it indicates that role of the personal was more dominant than the role of political parties in influencing voters.

### **Case 5.3: Money Politics in Local legislature Member Election**

According to A.W., *Kelian Dinas* and *Kelian Adat of Banjar* of Bonjaka, during a political campaign there were seven candidates for local legislator who visited the *Banjar*. Each candidate attended *Banjar* meetings and provided financial assistance of about one million rupiah. For instance, the candidate from the PDI-P party provided one million rupiah, whereas the candidate from the *Golkar* party also provided one million rupiah.<sup>139</sup>

Other cases show that the candidate for local legislator member provided money for *Banjar* of approximately one- two million rupiah. However, the candidate also provided money to individuals of about twenty five thousand rupiah to gain sympathy from constituents.<sup>140</sup> Two candidates for local legislator visited the *Banjar Gagah* to provide financial assistance of about one million *rupiah*.<sup>141</sup>

<sup>139</sup> Interview with Mr. A.W., *Kelian Dinas* and *Kelian Adat*, 23 May 2009.

<sup>140</sup> Interview with Mr. P.D., *Banjar* of Jasan, 23 May 2009.

<sup>141</sup> Interview with Mr. W.S., *Kelian Dinas, Banjar Gagah*, 14 May 2009.

Money politics is further evidence that political parties are not close to local communities and did not have affiliations to local communities. They bought votes from small business owners and local communities. In contrast, they were controlled by the headquarters of political parties using a centralised system. Local politicians also provided money to the central headquarters to obtain political position at local level.

The Case of money politics indicates that political party members who will be candidates for local legislature need a lot of money to cover political campaign costs as political parties do not have enough funds. As a result, political parties preferred to recruit big business owners rather than small business owners as party cadres. Further, candidates for legislative members influenced voter behaviour by providing money or material.

How do small business owners influence political parties to articulate their interest? This study indicate that about 21 percent of small business owners used funds to influence behaviour of political parties; about 17 percent used personal network relations with politicians to influence political parties. 21 percent commented that they used both funds and personal networks with politicians to influence political parties and only 12 percent used it for business associations (Table 5. 15).

**Table 5.15**  
**The Influence of Small Business to Political Party**

No.	Form of Influences	Frequency	Percentage
1.	Providing funds	21	21.0
2.	Creating personal networks	17	17.0
3.	Using small business associations to influence political party	12	12.0
4.	Developing opinion in mass media	7	7.0
5.	Mass mobilization	1	1.0
6.	Combined between no. 1 and 2	21	21.0
7.	Combined between 1 and 4	1	1.0
8.	Combined between no 2 and 4	7	7.0
9.	Combined among no. 1, 2 and 4	1	1.0
10.	Other	12	12.0
	Total	100	100.0

Source: Data obtained from survey questionnaire, 2009.



Based on the discussion above, it may be concluded that political decentralisation was not able to strengthen the relationships between political parties and small business owners. Most of small business owners perceived that political parties are not able to help them such as facilitating legal aids, developing network with financial institutions and markets. Politicians approached small business owners by providing money or material when they need political support in electing local legislative members and district head.

#### **5.4.2. Participation of Small Businesses**

Political decentralisation creates an opportunity for business associations and small business owners to participate in the process of decision-making as well as political activities. Political decentralisation also opens access for small business owners to participate in electing public officials. This section will discuss two aspects. Firstly, it discusses the participation of business association in the process of decision making at the district level. Secondly, it examines the participation of small business owners in political activities.

##### **5.4.2.1. Participation of Business Association**

As discussed in Chapter One, business associations have voices and potential power to influential local government policy (Pyke, 1992). In Chapter Three it was discussed that in Gianyar there are four business associations: the Business Association for Wood (*Asosiasi Pengusaha Kayu*), the Business Association for Silver (*Asosiasi Pengusaha Perak*), the Business Association for Fabric (*Asosiasi Pengusaha Kain*) and the Gianyar Chamber of Commerce and Industry (*Kadinda*). However, only *Kadinda* was active in supporting the business sector than other business associations. The important question is whether *Kadinda* was involved in the process of decision making at the district level and to what extent *Kadinda* can influence local policy.

The *Kadinda* of Gianyar is headed by Ari Arsana since 2007, who is businessman and non-participant in politics. He is also the chairman of the Business Association for Wood (*Asosiasi Pengusaha Kayu*) and is not affiliated with local bureaucrats. The local government seldom invites him to discuss the business sector in Gianyar. According to the chairman of the *Kadinda*, if the local government had political will,

the local government could provide more opportunities for the *Kadinda* to be involved in the discussing business affairs at the district level. He argues that *Kadinda* is able to provide valuable inputs for local government in the decision making process. However, the local government never invited the *Kadinda* to discuss the trade and industry sector.

As an example, in 2008 *Kadinda* informed the local government regarding a lack of wood supplies by small business owners of Gianyar but the local government never acted to solve this problem. In another case, since the decentralisation policy was implemented in 2001, small business owners of Gianyar now require complicated documents to purchase wood from other districts due to varying district regulations.<sup>142</sup> The *Kadinda* suggested the district head of Gianyar to develop cooperation with other district governments to resolve this problem. However, the local government never responded to the input from the *Kadinda*.

The Gianyar legislature also never invited the chairman of *Kadinda* to discuss draft local regulations on various business permits such as permits for business location, industry business permits, registration identification permits and trade business permits.<sup>143</sup> The vice chairman of the local legislature also commented that until now there has been no public hearing with local citizens and business associations such as *Kadinda* to discuss draft local regulations.<sup>144</sup>

Based on the discussion above, it is clear that *Kadinda* is not involved in the decision-making at the executive body and local legislature levels. Both executive and legislature of Gianyar have not opened the opportunities for business associations to participate in decision-making despite the district adopting a decentralisation policy. In the case of Gianyar, decentralisation could not increase popular participation and *Kadinda* has difficulty in influencing policy making at the local level. This suggests that political parties have not developed networking with business associations. As a result, business association have difficulty to lobby with political parties. This means that small business associations are not able to bargain

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<sup>142</sup> Interview with Mr. A.A., Chairman of *Kadinda* of Gianyar, 24 April 2009.

<sup>143</sup> Interview with Mr. A.A., Chairman of *Kadinda* of Gianyar, 24 April 2009.

<sup>144</sup> Interview with Mr. R.K., Vice chairman of local legislature and chairman of *Golkar* party of Gianyar, 28 April 2009

with local authorities in local decision making. This is different from Bantul where business associations have opportunities to be involved in the process of decision-making because political parties developed networks with business associations.

#### **5.4.2.2. Participation of Small Business Owners**

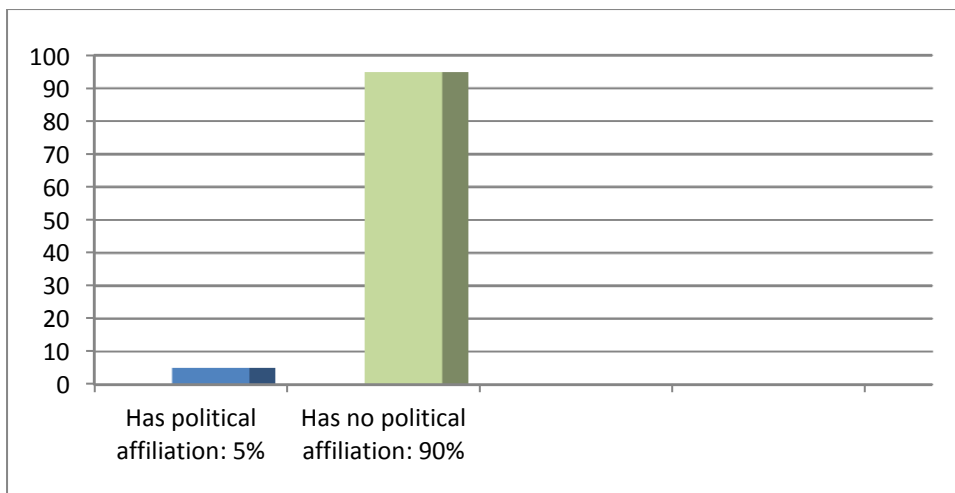
As discussed in the previous section, business associations had difficulty to participate in the process of decision-making. The next important question is, the extent to which small business owners can individually participate in decision-making and political activities.

The degree of political participation can be measured by indicators:

- (1) Become a member of political party;
- (2) Participate in political campaign;
- (3) Attend regular political party meetings;
- (4) Become a member of an executive committee of political party;
- (5) Provide a political donation or funds; and
- (6) Become candidate or member for local parliament.

The survey data indicates that most small businesses (95.0 percent) are not members of political parties. There are only 5 percent of respondents said that they were affiliated to political parties (Chart 5.6). According to respondents, they could not benefit from any political party's membership. Despite many political parties appearing since 2001, small business owners generally remain uninterested. Data from interviews with small business owners substantiated this opinion (Case 5.4 and Case 5.5).

**Chart 5.6**  
**Participation of Small Business Owners on Political Parties**  
**(N=100)**



Source: Data obtained by survey questionnaire, 2009

#### **Case 5.4: Small Business Owners are not interested in Political Party membership**

Mr. P.D. is a business owner in woodcraft since 1993. He lives in *Banjar Jasan*, sub-district of Tegallalang. He employs 16 workers. Most of his products are exported for foreign markets, some for the domestic market. He said that he is not member of a political party and he would not become a member of political party as political parties do not do anything for his business. He also never provides funds to political parties.<sup>145</sup>

Political decentralisation failed to encourage local small business owners to be political party membership. A small business owner said that he was not interested in political party (Case 5.5.).

#### **Case 5.5: Small Business was not Interest to be Political party Member**

Mr. N.S. was a small businessman and *Kelian dinas*. He started his business 15 years ago and he was elected as *kelian dinas* in 2003. Most of his products were exported. He was also a dancer and gave performances in foreign countries. He was not a political party member although was previously aligned with PDI P party in the past.<sup>146</sup>

During 2009 political campaign season, 72 percent of small business owners never participated in political campaign held by political parties; 90 percent of respondents

<sup>145</sup> Interview with Mr. P.D, 23 May 2010.

<sup>146</sup> Interview with Mr. N.S., 23 May 2009.

never participated in a political party meeting and 97 percent also never became members of the executive committee of a political party; 97 percent of respondents never provided political donations to a political party (Table 5.16). It may be concluded that the degree of political participation of small business owners was low. The research findings was in accordance with data in Chart 5.6 above that most small businesses were not party members and that political parties failed to draw closer to local communities.

**Table 5.16**  
**Political Participation of Small Businesses**

No.	Indicator of Political Participation	Answer			
		Always	Sometimes	Never	Total
1.	Participating in local election campaigns	4 (4.0%)	24 (24.0%)	72 (72.0%)	100 (100.0%)
2.	Regular participants in political party meetings	3 (3.0%)	7 (7.0%)	90 (90.0%)	100 (100.0%)
3.	Member of an executive committee in a political party	0 (0.0%)	3 (3.0%)	97 (97.0%)	100 (100.0%)
4	Providing a political donation or funds	0 (0.0%)	3 (3.0%)	97 (97.0%)	100 (100.0%)
5.	Candidate or member for local parliament	1 (1.0%)	3 (3.0%)	96 (96.0%)	100 (100.0%)

Source: Data obtained from survey questionnaire, 2009

Data obtained from surveys and interviews showed that political participation of small business owners in political party was low. Most small business owners were of the opinion that political parties could not provide assistance for their business. Therefore, they were not interested to be involved in political parties. As a result, small businesses had difficulty to use political parties in articulating their preferences in the process of decision-making. Decentralisation policy did not impact on increased political participation of small business in political parties.

### **5.5. Conclusion**

Based on the discussion above, it may be concluded that although local government supported reform of local regulation on small businesses, that regulation did not have much impact because majority of small business owners did not obey those regulations. The regulations on business permits are not effectively implemented because of economic and political reasons. As a result, although the number of small businesses increased, the district government's revenue from small businesses did

not increase significantly. In the other words, district government could not use local regulation on levies to control small business owners.

From the aspect of promotion policy for small businesses, the research finding shows that the district governments provided small financial and material assistance yet less of physical infrastructure for small business owners. This means, in promotion policy for small businesses, the relationship between local government and small business is characterised as an unsupportive relationship.

However, facts show that small business owners could prosper as they are not only influenced by the district government but also influenced by markets. The majority of products of small businesses are exported to many countries. As a result, any increase in demand for small business products in countries such as Australia, the United States and European countries will increase the product of small businesses of Gianyar.

The research finding in Bantul is like the previous studies conducted by scholars such as Trigilia (1986), Best (1990), Wilson (1995) and Patterson (1994), who argue that decentralisation policy could improve the relationship between political parties and local businessmen. However, the research findings in Gianyar suggest otherwise. In Bantul, political parties played an important role in business associations. The Chairman of the Bantul Handicraft Board comes from PDIP party, while the chairman of the chamber of commerce and industry come from the Golkar party members. However, in Gianyar, political decentralisation did not encourage political parties to be closer to small businessmen because politicians were not able to identify the interests of local small business and failed to articulate the small businesses' interests. In addition, political parties did not use business associations to support their interests.

In respect to political decentralisation, the district government and local legislature opened less an opportunity for small business owners and business associations to participate in the process of decision-making. As a result, political decentralisation failed to involve small business owners and business associations in the process of decision making at the district level because business association have not yet

developed links with political parties. Thus, politically small businesses were not able to bargain with local authorities in local decision making.

On one hand, political decentralisation was not able encourage political parties to be close to small business owners. On the other hand, political decentralisation also did not encourage small business owners to be involved in political activities. As political parties were not close to small business owners, local legislature candidates approached small business owners by providing money and materials with the aim to obtain political support. By providing money and materials they tried to buy votes through the head of local customary associations such as *Bendesa* (head of *Desa Pakraman*) and *Kelian* (head of *Banjar*). This suggests that both *Bendesa* and *Kelian* had power to make bargaining with local politicians with aim to obtain benefits for small businesses and citizens. Politically, local politicians used small businesses to support their interests, but they could not provide benefit for small businesses. This may be called an exploitative relationship.

The next chapter examines comparison of the impact of decentralisation on the relationship between local government and small businesses in Bantul and Gianyar. By comparing the two different regions, this project will assess their similarities and differences of the impact of decentralisation policy.

## CHAPTER SIX

### CONCLUSIONS

#### 6.1. Conclusion

This thesis has assessed the impact of decentralisation policy on the relationship between local governments and small businesses in Bantul and Gianyar, Indonesia. This study began with the critical review of some literature on local government and decentralisation, noting that decentralisation policy can give local governments more power in administrative functions and fiscal policy, as well as in politics. Administrative decentralisation provides local governments with more discretionary functions to improve public service for small businesses. With fiscal decentralisation, local governments can have discretion to develop types of local taxes/levies and tax/levy rates for small businesses. Political decentralisation can enable small business owners to participate in the process of decision making and political activities as well as electing the district head and local legislature members. Political decentralisation, therefore, usually causes change of the relationship between politicians and local citizens. If so, local government can wield more or less power.

The main issue of this research concern how the decentralisation policy changes the relationship between district government and small businesses. The impact of decentralisation on the relationship between local government and small businesses may be different between regions because of differences in social, economic and political conditions. The social factors such as high density population below the poverty line can be constraints for the local government in providing public service for small businesses. In contrast, local government with rich natural resources and a high income from the local taxes/levies could have financial capacity to provide public services for small businesses. Political decentralisation can provide an opportunity for small business to participate in the elections for district head and local legislative member as well as participate in the process of decision making. A large number of small business owners in Bantul and Gianyar can play an important role in implementing political decentralisation.



The research finding found that there are three variables which local officials actually determine priorities for local policy programs. Firstly is commitment of local government to small businesses. Secondly, market condition for small business. The market condition for small businesses in Gianyar is better than in Bantul. Therefore, the district government of Gianyar provide less assistance in developing small businesses. In contrast, the district government of Bantul strongly support small businesses. Thirdly is the process of determining annual local budget. If local business associations are involved in the process of determining annual budget, local government will provide financial assistance for small businesses such as in Bantul.

The following briefly summarises key findings as discussed in the previous chapters. Brief comparison of these findings will be presented to demonstrate the core arguments.

The analyses of the social, economic and political setting of Bantul and Gianyar shows that in some aspects such as the size of areas, the total population and potential natural resources are similar (Table 6.1. no.1). However, in other aspects such as economic structure, style of district head leadership, behaviour of local bureaucrats and social structure are different. Both Bantul and Gianyar have small areas with high density populations, which may provide positive contributions in implementing decentralisation policy. However, a large number of poor among the population (below poverty line) may cause financial burden for local governments because they have to allocate part of the district budget to help this disadvantaged group.

**Table 6.1**  
**Comparison of Social, Economic and Political Background between**  
**Bantul and Gianyar**

No.	Aspect	Bantul	Gianyar
1.	Geographic and Demographic setting		
	1.1. Size of area	Small area. The district head easily provides public services for local populations in each sub-district. This contributes in implementing decentralisation policy.	Small area. District head easily provides public services for populations in each sub-district in implementing decentralisation policy.
	1.2. Natural Resources	Poor natural resources. The natural resources provide small benefit for the district government and less support in the implementation of decentralisation.	Poor natural resources. The natural resources provide small benefit for the district government and less support in the implementation of decentralisation.
	1.3. The size of Population	Small population. The district government easily provides public services.	Small population. The district government easily provides public services.
2.	Structure of Economics		
	2.1. GDRP	Concentration on agricultural sector (24 percent).	Concentration on services: trade, hotel & restaurant sector (30 percent).
	2.2. The capacity of locally derived revenue (the PAD income)	Average of 7 percent of total district government's revenue	Average of 14 percent of total district government's revenue
	2.3. Relations to the central government	Bantul highly dependent on the central government grants	Gianyar dependent on the central government grants
	2.4. Industrial sector	Growth rate of industrial sector is low	Growth rate of industrial sector is low
3.	Political Institutions		
	3.1. Local Legislature	Local legislative members consist of nationalist and religion parties.	Local legislative members consist of nationalist parties.

		Largest number of seats in local legislature is occupied by PDI-P party (24 percent).	Largest number of seats in local legislature is occupied by PDI-P party (40 percent).
		Performance of legislature has not yet changed since the implementation of decentralisation.	Performance of legislature has not yet changed since the implementation of decentralisation.
	3.2. Political parties	The PDI-P party and <i>Golkar</i> party develop networks with business associations.	Political parties do not develop networks with business associations.
4.	Local Bureaucracy		
	4.1. Local bureaucrats	Behaviour of local bureaucrats has changed to be responsive in providing public services for small businesses.	Behaviour of local bureaucrats has not yet changed in providing public services for small businesses.
	4.2. District head	The relationship between district head and small businesses is harmonious in term of district head is responsive to the needs of small business owners.  District head strongly promote small businesses.	District head is not responsive to the needs of small business owners  District head offers less promotion of small businesses.
5.	Community Structure		
	5.1. Business associations	Business associations develop link with political parties	Business associations have no link with political parties
	5.2. Neighbour associations	Politicians influence small business owners through hamlet or local community associations or and neighbourhood associations (RT).	Politicians influence small business owners through <i>Bendesa</i> (head of <i>Desa Pakraman</i> and <i>Kelian</i> (head of <i>Banjar</i> ).

Bantul and Gianyar have poor natural resources that provide small financial capacity. Further, the small financial capacity reduced support of the implementation of the decentralisation policy and they faced difficulties to improve public services such as

providing physical infrastructures, training and market development for small businesses (Table 6.1. no.1).

The economic structure between Bantul and Gianyar is different. Bantul is supported by agricultural sector, while Gianyar is supported by trades, hotels and restaurant sectors. Locally derived revenue (*Pendapatan Asli Daerah, PAD*) is very small, 7 percent in Bantul and 14 percent in Gianyar because both local tax and levy incomes are small (Table 6.1. no.2). As a result, they have difficulty to implement decentralised functions and increase financial and technological assistance for small businesses. Furthermore, these regions are dependent on the central government grants. Without central government grants, these regions have difficulty in implementing decentralisation policy. In addition, the growth rate of the industrial sector in these districts is very slow, thus this sector is unlikely to increase district government revenues. I argue that both Bantul and Gianyar have financial constraints in implementing decentralisation policy. The flow on effect is their difficulty improving public services for small businesses such as providing financial and technological assistances as well as facilitating market development. Therefore, both Bantul and Gianyar faced difficulty to implement administrative decentralisation.

Furthermore, the implementation of political decentralisation in both the districts did not improve the performance of political parties and local legislature. Although decentralisation policy has driven the emergence of political parties in local legislature, the performance of this legislature did not increase because of low performance of local legislature members. There is difference in composition of local legislature members between Bantul and Gianyar. Local legislature members of Bantul consist of nationalist and Islamic parties, but in Gianyar, only nationalist parties exist (Table 6.1. no.3). Although there are many factions in the Bantul legislature, the district head is able to control them. In Bantul, decentralisation has driven small business associations to be involved in local decision-making. In contrast, decentralisation policy has not yet driven the local legislature of Gianyar to open opportunities for business associations to be involved in the process of decision making. As a result, business associations in Bantul are able to bargain with local government in local decision-making, but not in Gianyar (Table 6.3).

Political decentralisation causes local politicians to (highly) compete in pursuing public positions both in executive and legislature. As a result, they use many ways to approach small business owners as well as local citizens such as by providing money and materials through local community associations. In Bantul they used the head of hamlets (*Dukuh*) and the head of neighbourhood associations (*Ketua Rukun Tetangga* or RT), while in Gianyar they used notable persons such as the *Bendesa* or the head of *Desa Pakraman* (customary village) and the *Kelian* or the head of *Banjar* (association of local customary community) (Table 6.1. no.5). Additionally, local politicians directly distributed the money to constituents individually with the aim to influence voter behaviour. Research findings show that most of small business owners commented that political parties are not able to help them. This suggests that the relationship between politicians and small business is characterised by an exploitative relationship because local politicians use small businesses to support their political positions, but they do not respond the needs and interests of small businesses (Table 6.3).

It is important to note that political decentralisation has caused the relationship between the district head of Bantul and small businesses to significantly change. The behaviour of the district head changed from authoritarian leadership to democratic leadership. In addition, the district head is closer to small business owners compared to previous arrangements (1974-2000). Following the change in the district head leadership, the behaviour of local bureaucrats has shifted by being more responsive to the needs of small businesses. In other words, the relationship between district head and small business is characterised by a supportive relationship (Table 6.3).

However, in Gianyar, the behaviour of local bureaucrats did not change in providing public services because the district head was not able to drive the changes. Most of small business owners commented that style of district head leadership has not significantly changed under the decentralisation era and was not responsive to the interests of small businesses (Table 6.1. no. 4).

In Chapter Four and Five, it was shown that local governments have limited authority to issue business permits because the central government still held authority for issuing some business licenses. In general, throughout the

decentralisation era, types of business permits that were held by local governments are the same as previously, such as building location licenses, building establishment licenses, industry business licenses, company registration location, advertisement licenses and disturbance licenses. However, district governments have tried to improve the system of business permits.

Decentralisation has driven local governments to carry out local institutional and regulation reforms to improve public service for the business sector. For institutional reform, local government of Bantul and Gianyar has developed local institutions for integrated permits services with the aim to improve public services for business sector. In relation to local regulation, both local governments improved local regulation on the business sector so as to become transparent and accountable. This suggests that the Bantul and Gianyar district are responsive to promotes small businesses. Based on the regulation and institutional aspect, the relationship between local governments and small businesses is characterised by a supportive relationship.

In the case of Bantul and Gianyar, small businesses are relatively independent from the local government regulations in terms of tax and levy regulations. The district governments are not able to control small businesses by using the local regulations. The local regulation on local levies could not be effectively implemented by local governments because of political and social reasons as discussed in Chapter Four and Five. It could be interpreted that politically, small businesses were used by local authorities, as a large number of small business owners and workers could be a potential source for political votes. The politicization of small businesses also occurred in many countries such Japan (Patterson, 1994), Italy (Trigilia, 1986) and Germany (Schmitz & Musyck, 1994). In Japan, as an example, politicians were able to influence bureaucrats in providing financial assistance to small businesses based on political support obtained from them. In Germany, Christian Democrat party influenced the local government in policy making on industrial districts.

Bantul differs from Gianyar in terms of protection policy for small businesses. The district government of Bantul developed a policy to protect small businesses from big capitalists by enacting district head decree no. 503/5439, in 2008. The protection policy is driven by small businesses having the power to bargain with district head

and the style of district head leadership. According to this policy, supermarkets were not allowed to operate in Bantul regions. In contrast, the Gianyar district did not have a policy to protect small businesses because business associations and small businesses are not able to make a bargain with district government (Table 6.2. no.1). Thus, the Bantul district strongly supports small businesses but the Gianyar district does not.

In relation to promotion policy for small businesses, the findings of the thesis shows that Bantul has given much help to small businesses through providing financial assistance and material. In the case of Gianyar, the local government provided a small financial and material assistance to small business owners, but their businesses could develop well because their businesses were more influenced by markets than local government assistance (Table 6.2. no.2). This suggests that, unlike Gianyar, the district government of Bantul strongly promotes small businesses such as to protect traditional market and develop Centre for Employment Training.

Another aspect of promotion policy for small businesses is market development. The Bantul district was more active in developing markets for small businesses than Gianyar. The Bantul district, for example, built local public market buildings to replace the old with the aim to promote small businesses. The district government also developed the Gabusan Art Market building as centre for selling small business products and as a place for small business exhibitions. By improving market buildings, local people are interested to shop at these markets, thus small businesses could develop. Local government and small business also share the cost of business exhibition. Further, the important issue in developing small businesses is whether political decentralisation could create opportunities for small businesses and business associations to participate in the process of decision making.

**Table 6.2**  
**Regulation, Promotion Policy and Political Influence to Small Business**  
**In Bantul and Gianyar**

No.	Aspect	Proposed Policy Objectives	Bantul	Gianyar
1.	Regulation			
	1.1. Business License	To provide more power to local governments in business licenses	Limited discretionary policy	Limited discretionary policy
	1.2. Local tax and levy on small business	1. Increased district revenue	Levy cannot increase district revenue	Levy cannot increase district revenue
		2. Increased control of district government over small businesses	Local tax/levy cannot be used to control small businesses	Local tax/levy cannot be used to control small businesses
		3. Increased allocation of public resources to small businesses	Yes	No
1.3. Protection	To protect and develop small businesses	Yes, district head's decree to protect small businesses	No	
2.	Promotion Policy			
	2.1. Financial assistance	To increase capital for small businesses	Yes, district government provides financial assistance and subsidy	Yes, district government provides small financial assistance
	2.2. Training	To increase skill and management of small business owners	Yes. Using district government budget & grants from the central government	Yes, using the central government grants



	2.3. Material assistance	To facilitate material input and improve quality of products	Yes, district government facilitates raw materials.	No
	2.4. Physical infrastructure facilities	To facilitate the process of production and develop market	Yes, district government improves road and market buildings	No
3.	Political Influence			
	3.1. Political influence of politicians over small business owners	To obtain political support in election for district head and local legislature members	Yes, through <i>Dukuh</i> (head of hamlet and <i>Ketua RT</i> (head of neighbourhood associations).	Yes, through <i>Bendesa</i> (head of customary village) and <i>Kelian</i> (head of association of local customary community).
	3.2. Participation of small businesses			
	3.2.1. Participation of business associations in the process of decision making.	Decisions are in accordance with the needs and interests of business sector	Limited opportunity because only <i>Dekranas</i> was involved because this association has links with district government.	No, local government did not provide opportunity for business associations to participate
	3.2.2. Participation of small business owners in political activities and in the process of decision making	Increased the dynamics of local politics and political representative	Low. Small business owners were not interested in political activities.	Low. Small business owners were not interested in political activities
		Decisions at district level are in accordance with interests and needs of small business owners	Middle. Small business owners asked the district head to protect them.	Low. Small business owners fail to ask assistances to district government when they face lack of raw material input.

Under political decentralisation, on one hand, political parties are not able to be closely aligned to small business owners. On the other hand, small business owners are not interested in being political party members. Thus, politicians had difficulty for obtaining political support from small business owners. In general, they tried to influence a voter's behaviour typically small businesses owners by providing money or material such as foods, T-shirts and fertilizers. Small business owners were politicised by politicians in both Bantul and Gianyar. However, there is a different way in influencing voter behaviour between Bantul and Gianyar. In Bantul, politicians use official local community associations such as the hamlet (*Pedukuhan*) and *RT* to influence voter behaviour. In Gianyar, they use local customary associations such as *Desa Pakraman* and *Banjar* to do so (Table 6.2. no.3). It indicates that political decentralisation could not increase political participation of small business owners in political activities because political parties do not provide benefit small businesses.

In the case of Bantul, political decentralisation has caused political parties to develop networks with business associations such as the PDI-P party developed a network with *Dekranas* (Bantul National Handcrafts Board), whereas the *Golkar* party with *Kadinda* (Gianyar Chamber of Industry and Trade). Therefore, in Bantul politicians can use business associations to support their political interests. In contrast, in Gianyar business associations do not have networks with political parties, thus they have difficulties in articulating their interests (Table 6.1. no.5). Business associations have no opportunities to be involved in the process of decision-making at the district level. As a result they have no opportunity bargain with district government in local decision-making (Table 6.3).

Based on the discussion above and Table 6.2, the relationship between local government and small business will be summarised in Table 6.3. There are three types of possibility of the relationship as discussed in Chapter One such as supportive, bargaining and exploitative relationship. In short, based on the regulation aspect, in both Bantul and Gianyar the relationship between local government and small business is characterised as a supportive and bargaining relationship. From aspect of policy to promote small businesses, in Bantul the characteristic of the relationship is strong supportive and bargaining, but in Gianyar is less supportive

with no bargaining. Finally, based on the political aspect, in Bantul the relationship between local government and small business is called a supportive, bargaining and exploitative relationship. However, in Gianyar it is a less supportive, weak bargaining and exploitative relationship (Table 6.3).

**Table 6.3**  
**Typology of Relationship between Local Government and Small Business**  
**in Bantul and Gianyar**

	Bantul			Gianyar		
	Type of Relationship			Type of Relationship		
Aspect	Supportive	Bargaining	Exploitative	Supportive	Bargaining	Exploitative
Regulation	<p>Yes, Strong supportive:</p> <ol style="list-style-type: none"> <li>Simple procedure for obtaining business licenses</li> <li>Light tax/levy on small businesses</li> <li>District head's decree to protect small businesses.</li> </ol>	<p>Yes,</p> <p>Local government does not fines to small business which have no business licenses</p>	<p>No,</p> <p>Most of small business owners perceive that local levies are not heavy.</p>	<p>Yes, moderate supportive:</p> <ol style="list-style-type: none"> <li>Simple procedure for obtaining business licenses</li> <li>Light tax/levy on small businesses</li> </ol>	<p>Yes,</p> <p>Local government does not fines to local business who have no business licenses</p>	<p>No,</p> <p>Most of small business owners perceive that local levies are not heavy.</p>
Promotion	<p>Yes,</p> <p>Local government provides:</p> <ul style="list-style-type: none"> <li>Financial assistance,</li> <li>Training and technological assistances</li> <li>Infrastructure facilities to small businesses.</li> </ul>	<p>Yes,</p> <p>There is a sharing of the cost of organizing the exhibition business between small business owners and local government.</p>	<p>No,</p> <p>Local government gives loan with low interest.</p>	<p>Less supportive,</p> <p>Local government provides less financial assistance, training &amp; technological assistance and infrastructure facilities.</p>	<p>No,</p> <p>Business associations are not involved in financing business exhibition</p>	<p>No,</p> <ol style="list-style-type: none"> <li>Local government gives small loan with low interest.</li> <li>Local government gives small financial assistance to Institution for People's Credit (LPDs).</li> </ol>
Politics	<p>Yes,</p> <p>District head and local bureaucrats are able to respond the needs and interests of small business owners</p>	<p>Yes,</p> <p>Business associations have a network with political parties and can influence policy makers to produce policy in accordance with the interests of small businesses.</p>	<p>Yes,</p> <p>Politicians use small business owners to support their political positions, but they less respond the needs and interests of small businesses.</p>	<p>Less supportive,</p> <p>District head and local bureaucrats less respond the needs and interests of small businesses</p>	<p>Weak,</p> <p>Business associations have no link with political parties and are not involved in local decision making</p>	<p>Yes,</p> <p>Politicians use small business owners to support their political positions, but they less respond the needs and interests of small businesses.</p>

## **6.2. Implications**

Based on the discussion above, this thesis makes two major contributions, one practical and one theoretical. On a practical level, it provides three important findings. Firstly, the findings imply that the implementation of decentralisation is not based on the real capacity of local governments. Regions with poor resources and low incomes from local taxes and levies such as Bantul and Gianyar have difficulty in implementing decentralisation policy. The district governments that adopt decentralisation policy are still dependent on central government grants. I suggest that degree of administrative decentralisation among regions should be based on the capacity of each local government. The number of decentralised functions that are given to the local governments may be different among regions, refers to an asymmetric administrative decentralisation as discussed in Chapter One (Bird, 2003, p. 9). This is important consideration due to the differences in capacity of natural resources and social culture among regions in Indonesia. Besides asymmetric administrative decentralisation, there are also asymmetric fiscal decentralisation (Garcia-Mila & McGuire, 2002) and asymmetric political decentralisation (Chien, 2008; 2010).

In practice, asymmetric decentralisation has been adopted in many countries such as Canada (Ladduwahetty, 1995), India (Pandid, 1997), China (Chien, 2008, 2010), and Spain (Garcia-Mila & McGuire, 2002). For instance, Canada as unitary federation provides special decentralisation to Quebec in order to use French language as official language although other states in Canada use English language (Ladduwahetty, 1995). Quebec also has status as a self-governing political community (Chevrier, 1996). Based on the experience of the implementation of decentralisation in Quebec, the Indonesian government could also adopt asymmetric decentralisation to solve conflict between the central government and local government.

In other cases, Jammu and Kashmir in India also obtain special decentralisation from India with the aim to overcome conflict with the federal government. Both Jammu and Kashmir were given authority to develop their constitution. The Indian government provided particular decentralisation to these regions because of political and religious reasons. The third case is China where sub-national governments

economically have been granted greater autonomy with huge decentralised fiscal and administrative power, but politically, it is still a state under Communist Party domination. Local officials are not elected locally but are assigned by the party in its asymmetric political decentralisation (Chien, 2008, 2010). In Indonesia, I have shown that political decentralisation causes money politics in election for district heads. As an alternative way to overcome money politics, district heads may not be elected by local people but are assigned by central government.

Another form of asymmetric decentralisation is asymmetric fiscal decentralisation, as adopted in Spain and discussed in Chapter One. In Spain, fiscal authority is devolved to local governments based on their different capacities. As an example, Basque and Navarre regions in Spain are given authority to raise taxes locally. The major taxes such as income, corporate, wealth, inheritance and wealth transfer are fully administered by the local governments (Garcia-Mila & McGuire, 2002).

The cases of Canada and India are examples of decentralisation driven by compromises between national and sub-national government to resolve conflict. The capacity of local government is not a major consideration in delegating power from the national government to sub-national governments. It is important to note that political consideration is the main variable in implementing decentralisation policy both in India and Canada. In my opinion, this has two implications. Firstly, if the sub-national government has financial resources, it could well implement decentralisation policy. Secondly, if the sub-national government does not have enough financial resources, it will constrain implementing decentralisation policy.

Decentralisation policy driven by compromises between national and sub-national government to resolve conflict was not only occurs in Canada and India, but also in Indonesia. For instance, the Indonesian central government provided special decentralisation to the provinces of Papua in 2001 and Aceh in 2006 with the aim to resolve conflict between the central government and local communities. By enacting Law No. 21/2001 the central government provided special autonomy to Papua, while based on Law No. 11/2006 Aceh obtained special autonomy from the central government.

Based on the Law 32/2004, however, the main purpose of decentralisation policy in Indonesia is to develop local democracy and to empower sub-national governments. Yet the local resource capacity of each local government is different. The local governments in Indonesia generally face lack of financial resources to implement decentralisation policy. Therefore, the central government delivers subsidies in form of special grants (DAK) and general grants (DAU). I suggest that the implementation of decentralisation should be based on the real capacity of each local government. The scope and type of decentralised function to each region is not the same. This may be called asymmetric decentralisation with the aim to both develop local democracy and empower local government.

Based on the development experience of many countries with asymmetric decentralisation, the Indonesian government should not provide the same decentralised functions to a variety of sub-national governments whose capacity differs. The scope and type of decentralised functions should be based on the capacity of each sub-national government. The same scope and type of decentralised functions could create financial burdens for poor local governments if they are not able to implement them. Therefore, asymmetric decentralisation is a reasonable alternative to be adopted in the implementation of decentralisation policy in Indonesia.

The second practical, finding of this thesis show that local governments have limited support to help small businesses due to the local governments' financial constraints. The finding also indicates that the central government (The Ministry of Cooperatives and SMEs <sup>147</sup>) provides a variety of assistance such as financial assistance, technological assistance and training programs to small businesses through district governments. Therefore, it is important to develop coordination between the central and local governments in providing public services. For an example, central government formulates policy and initiates programs, whereas local governments, based on receiving direction from the central government, respond by designing locally based programs which vary between different local governments (Aoyama, 2000, p. 55). Additionally, the central government should question the district

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<sup>147</sup> SMEs are small and medium Enterprises.

government on the type of assistances provided by the central government. The district governments are closer to small businesses and better understand the needs of small businesses than the central government. At local level, coordination is needed among local agencies such as *Dinas Koperasi* and *UKM* (Local Agency for Cooperative and Small & Medium Businesses), *Diperindag* (Local Agency for Industry and Trade) and *Badan Perijinan Terpadu* (Local Board for Integrated Permit Services). Thereby, local government can provide better services for small businesses. One type of services for small businesses is training program.

The third practical finding of the thesis show that training programs for small business owners has not been effectively implemented by local governments in Bantul and Gianyar due to a lack of facilities. Although there are UPTs (*Unit Pelayanan Teknis* or Unit for Technical Services), the UPTs do not work effectively. It is presumed that local governments can encourage the UPTs to provide more training programs to small businesses with the aim to increase the managerial skills of small businesses owners and workers. As discussed in Chapter One, small businesses conduct less training for employees and managers than large businesses because they faced financial constraints (Bannock, 2005, p. 147), thus local governments are obliged to fill the gap.

As with the practical findings, this thesis has also made three important contributions on the theoretical level. Firstly, administrative decentralisation theoretically can encourage the capacity building of local bureaucracy as discussed in Chapter One. However, findings have shown that administrative decentralisation did not always maintain local capacity building at district level. The case of Bantul has shown that creating a local capacity building of local bureaucracy was influenced by the style of district head leadership. The district head of Bantul was able to encourage local capacity building, whereas the district head of Gianyar failed in developing a local capacity building. The style of district head leadership in Bantul was democratic and close to local small businesses. The district head of Bantul developed a policy to protect small businesses against large capitalists. In addition, the district head introduced a scheme to protect farmers by buying agricultural products (rice, chilli, shallot, corn) during the harvest season when the prices of these products dropped. Then, the district government sold these products when the prices became normal.



From these examples, the district head intended to develop capacity of local bureaucrats in providing services for local citizens. In contrast, the district head of Gianyar was not close to small businesses and able to increase capacity of local bureaucrats. Therefore, local bureaucrats of Gianyar have not yet significantly changed during the decentralisation era. It can be concluded that administrative decentralisation could drive a local capacity building if it is supported by strong local leader.

Secondly, the thesis finding has shown that political decentralisation could not automatically increase participation of local citizens as discussed in Chapter One. The participation of local citizens could increase if local government and local legislature provide an opportunity for them and develop institutional mechanisms for local citizens to be involved in the process of governance (Hentic & Bernier, 1999). In the case of Bantul, the district head opened greater opportunities for local citizens to articulate their interests. The local government also developed an institutional mechanism for local citizens to participate through “*plengkung gading*” program.<sup>148</sup> In contrast, the district head of Gianyar could not develop the mechanism for local citizens to articulate their interests.

Thirdly, political decentralisation may lead political parties to become aligned with local citizens as politicians tried to obtain political support. However, the findings show, political decentralisation fails to encourage political parties to be closer to small business owners and local citizens because of the low quality of party cadres. In addition, small business owners are not interested to be political party members and involved in political parties. This thesis argues that political parties have not yet provided benefit to small business owners such as developing networking with financial institutions and markets as well as facilitating training and legal aids. Political decentralisation cannot increase political participation of small business owners unless political parties are able to provide some benefits for small business owners. The case of small businesses in Germany, as an example, small business owners are close to a Christian Democrat party as this party assists them through

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<sup>148</sup>*Plengkung gading* is television program with the aim to increase participation local citizen in local development. In this program, the district head introduced variety of programs to local citizens with the hope to receive inputs and criticism from local citizens.

their influence in policy making on the industrial district (Schmitz & Musyck, 1994). Thus, if political parties are able to carry out their functions, such as to identify the interests of local small business owners in policy making, they may obtain political support.

### **6.3. Concluding Remarks**

Based on the study in Bantul and Gianyar, I suggest the devolution of power from central government to local governments should be revisited based on the capacity of each local government. Asymmetric administrative decentralisation may be the reasonable alternative in implementing decentralisation in Indonesia. In fiscal terms, asymmetric decentralisation may be manifested in differential central taxation, in differential revenue responsibilities and differential central government grants. Uniformity of functions and discretionary fiscal policy among different regions can create poorly managed public services for small businesses.

Although local governments have carried out local institutional reform in responding to increased functions and responsibilities as a result of decentralisation, they only have been able to provide small financial assistance to small businesses due to the limited financial resources. Therefore, the implementation of decentralisation is accompanied by the central government grants. Additionally, the local governments do not effectively implement local regulation on levies and cannot control small businesses. They are relatively independent from the local government regulations. This research is limited to two local governments. However, findings from Bantul and Gianyar should be developed in order to conduct research in other places of Indonesia.

In Bantul decentralisation policy has generated a positive relationship between political parties and local business, while in Gianyar decentralisation did not improve the unfriendly relationship between political parties and local businessmen. It may have been due to differences of the degree and nature of patrimonialism in local politics of two regions. The political patrimonialism system in Bantul is characterised by strong leader of local government head, while in Gianyar, local government leader is characterised by moderate leader. This is an important issue for further research.

This thesis highlights the impact of decentralisation from local governments and small business owners' viewpoint. To date there are few studies focus on the politics behind small businesses in Indonesia. This study can enrich our understanding of small businesses.

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**APPENDIX 1****INTERVIEW GUIDE****Content:**

- 1. Interview guide for local bureaucrats**
- 2. Interview guide for local parliament members**
- 3. Interview guide for political parties' elite**
- 4. Interview guide for owner of small business**
- 5. Interview guide for scholars**
- 6. Interview guide journalists**

**The questions will be translated into Indonesia Language (*Bahasa Indonesia*)**

## INTERVIEW GUIDE FOR LOCAL BUREAUCRATS

1. How do local bureaucrats view small business: Do they view small business as an economic source for local government, or do they view small business as partner in local economic development?
2. If the local bureaucrats view small business as economic source, what kind of policies will be created by local government?
3. If the local bureaucrats view small business as partners in local development, what kind of policies will be developed by local government?
4. To what extent has the behaviour of local bureaucrats changed during the decentralisation period?
5. To what extent have the local policies on small business changed during decentralisation era compared the previous period?
6. If the local policies have changed, please explain what kind of new policies have been introduced?
7. Do these policies on small business give more benefit for small business or have they created constraints for developing small business?
8. Please explain what kind of benefit for local bureaucrats in implementing decentralisation?
9. Please explain what kind of constraints are faced by the local bureaucrats in implementing decentralisation?
10. What kind of political, social and economic support has been given by the local government to small businesses?
11. To what extent were the owners of small business involved in local decision-making process?
12. In what ways were the owners of small business involved in the decision-making process?
13. How did the owners of small businesses respond to the opportunity to participate in the decision-making process?
14. Have the behaviour of small business owners change during decentralisation period compared to the previous period?



15. If they have changed, what are the new behaviours of small business owners?

How did the local bureaucrats respond to it?

===Finish===

## **INTERVIEW GUIDE FOR LOCAL PARLIAMENT MEMBERS**

1. How many of the local parliament members have business backgrounds?
2. In the committee on trade and industry in the local parliament, how many of them have business backgrounds?
3. How does the local parliament view small business in the decentralisation era? : Do they view small business as an economic source for local government or do they view small business as partners in local economic development?
4. How many regulations on small business have been introduced during the decentralisation era?
5. To what extent do the small business owners obtain benefit from the new regulations? What kind of benefits do they obtain?
6. How did the members of local parliament respond to small business people's interests?
7. Has the local parliament provided more access for small business owners to participate in the decision-making process? If they have, to what extent were small business owners involved in the decision-making process?
8. How did the small business owners respond to it?
9. What kinds of constraints are faced by small business owners to participate in the decision-making process?
10. How did local parliaments facilitate development of small business owners?
11. Have small business owners reported their problems to the local parliament?

===Finish===

**INTERVIEW GUIDE FOR POLITICAL PARTIES' ELITE**

1. To what extent have political parties influenced constituents at the grassroots level?
2. Do political parties view small business people as potential voters? If the answer is yes, how did political parties' elite respond to it?
3. Do political parties have data and information about small business people?
4. Do political parties have programs to support small business people? If the answer yes, what kind of programs do they have?
5. To what extent did political parties facilitate small business people to network with bank institutions and or markets?
6. To what extent have political parties develop networks with small business associations or small business cooperatives? What kind of networks did they develop?
7. Have small business owners asked political parties to solve their problems? If the answer yes, please explain.
8. To what extent have small business owners been involved in political parties' activities? Please give examples.
9. How did small business owners respond to it?
10. To what extent did political parties influence small business owners in general elections and elections for heads of districts?
11. How many small business owners have been involved with the boards of political parties?
12. Have political parties received financial support from small business owners? Did they receive it regularly or only occasionally?

===Finish===

## INTERVIEW GUIDE FOR OWNER OF SMALL BUSINESS

1. When did you start to operate your business?
2. How many workers support your business?
3. Have you been involved in small business associations or small business cooperatives?
4. Are you a member of a board of a small business association or a small business cooperative?
5. Are you a member of a political party? If yes, what party are you involved with?
6. Do you think that local government policies on small business are fair and just? Would you like to explain it?
7. Who received more benefit from decentralisation politics in Indonesia? Please chose one from: small business owners, bureaucrats, or politicians. Explain why they received more benefit compared with others?
8. To what extent does local government respond to small businesses' interest?
9. If the small business owners have problems, to whom can they ask for help? Would you like to explain it?
10. Have small business people been involved in local decision-making? In what ways have they been involved in the decision-making process?
11. Have small business owners been involved in activities held by political parties? What kind of activities?
12. According to you, to what extent do small business owners use political parties in articulate their interests?
13. How do small business owners develop networks with local bureaucracy to influence local decision making process?
14. Who are the main actors among small business owners who play an important role in negotiating with local government or political parties? Please explain what their roles are?
15. What extent do small business associations or small business cooperatives become mediators in relationships between small business owners and local government?

## INTERVIEW GUIDE FOR SCHOLARS

1. Who gets more benefit in implementing decentralisation in Indonesia: local bureaucrats, the elite of political parties or small business owners
2. According to you, to what extent has the business climate changed during decentralisation in Indonesia?
3. Does the new business climate give advantages to small business? Or does it give more advantages for local bureaucracies or politicians?
4. According to you, to what extent does local government respond to small business's interest?
5. To what extent has the behaviour of local bureaucrats changed during the decentralisation era?
6. To what extent and in what ways do political parties influence small business people in general elections and elections for head of district?
7. To what extent and in what ways do small business owners use political parties to further their interests?

===Finish===

## INTERVIEW GUIDE FOR JOURNALISTS

1. Who got more benefit among local bureaucrats, elite of political parties and small business owners in implementing decentralisation in Indonesia?
2. According to you, to what extent has the business climate changed during decentralisation in Indonesia?
3. Does the new business climate give advantages for small business? Or does it more advantages for local bureaucracies or politicians?
4. According to you, to what extent does local government respond to small business's interest?
5. To what extent did behaviour of local bureaucrats change during the decentralisation era?
6. To what extent and in what ways do political parties influence small business people in general elections and elections for head of district?
7. To what extent and in what ways do small business owners use political parties to articulate their interest?

===Finish===

**APPENDIX 2****SURVEY OF SMALL BUSINESS**

**These questions will be addressed to the owner of small businesses**

**These questions will be translated into Indonesian (*Bahasa Indonesia*)**

**PART 1**  
**Respondents Identity**

No. :  
Name of respondent :  
Address :  
Phone number :

**PART 2**  
**Characteristic of Small Business**

1. How many employees work for your business?
  - (A) 1 – 5 workers
  - (B) 6 – 10 workers
  - (C) 11 – 15 workers
  - (D) 16 – 19 workers
  - (E) More than 19 workers
  
2. What is your business's net assets worth? (Excluding land and buildings).
  - (A) < 50 million rupiah
  - (B) 51 – 100 million rupiah
  - (C) 101 -150 million rupiah
  - (D) 151 – 200 million rupiah
  - (E) > 200 million rupiah
  
3. How long have you been operating your business?
  - (A) less than 1 year
  - (B) Between 12 months and 23 months
  - (C) Between 24 months and 35 months
  - (D) Between 36 months and 47 months
  - (E) More than 47 months
  
4. Are you a member of a small business association or small business cooperative?
  - (A) Yes
  - (B) No
  
5. Do you have any political affiliation?
  - (A) Yes
  - (B) No
  
6. If you answer yes to questions 5, please mention, which party you are affiliated with .....



**PART 3**  
**The Views of Local Small Businesses toward**  
**Local government bureaucrats**

7. Do you know about your local government policies on small business?
  - (A) Yes
  - (B) No
  
8. If you answer yes to question 7, please provide examples of these policies:
  - (A) .....
  - (B) .....
  - (C) .....
  - (D) .....
  - (E) .....
  
9. What do you think is the impact of decentralisation on local business climate?
  - (A) Local business climate has become better
  - (B) Local business climate is the same as it was before
  - (C) Local business climate has become worse
  - (D) I don't know
  
10. What do you think about local regulations, for instance: the procedures for obtaining business licenses or industry licenses during decentralisation era?
  - (A) Generally, local regulations tend to be simple
  - (B) Local regulations are the same as in previous periods
  - (C) Local regulations tend to be complex
  - (D) I don't know
  
11.               What do you think about local taxes or fees on small business?
  - (A) Generally, the local tax is relatively cheaper
  - (B) The local tax is reasonable
  - (C) The local tax is expensive
  - (D) The local tax is very expensive
  
12.               What do you think about the impact of decentralisation on local bureaucrats?
  - (A) Local bureaucrats are improving
  - (B) No impact
  - (C) Local bureaucrats are getting the worse
  - (D) I don't know
  
13. What do you think about impact of elections of the heads of district by the local people?
  - (A) The head of district is more responsive to the needs of small business
  - (B) Behaviour of the head of district is the same as when they were not elected directly
  - (C) The head of district is less responsive
  - (D) The head of district is increasingly powerful

14. To what extent do local public services support small business during decentralisation era?
- (A) Local public services are more responsive to the needs of small business
  - (B) Local public services are the same as it was before
  - (C) Local public services are less responsive compared to before
  - (D) I don't know
15. In what ways were small business people able to influence local bureaucracies? (it is possible to choose more than one answer)
- (A) By providing funds
  - (B) By creating personal network
  - (C) By facilitating a small business association
  - (D) By communicating opinions in mass media
  - (E) By supporting mass mobilization
16. What do you think about the local government's support for local small business?

No.	Various kinds of Support	Answer		
		Very supportive	Supportive	Not at all
16.1.	Financial support (Financial aid, subsidies, favourable business taxes, low interest loan, and government contracts)			
16.2.	Facilitating material for operation (Facilitating the supply/allocation of raw materials, investment guidance, favourable supply of gas and electricity, building infrastructures - road, bridge, port facilities)			
16.3.	Facilitating training (Support for in-house education, government job training)			
16.4	Market promotion (Information of marketing opportunities, promotion of local business, and facilitating market entry)			
16.5.	Other.....			

17. What do you think about the support of small business associations or small business cooperatives in promoting business, negotiating with the local government, and developing networks with financial institutions and market?

No.	Various Kinds of Activities	Answer			
		Very supportive	Supportive	Less supportive	Not at all
17.1.	Promoting business				
17.2.	Negotiating with the local government				
17.3.	Developing network with financial institutions				
17.4	Developing network with the market				
17.5.	Other .....				

18. To what extent have small business people been involved in local decision-making processes?

- (A) They have never been involved
- (B) Sometimes they have been involved in the decision making-processes
- (C) They have always been involved in the decision-making processes

**PART 4**  
**The Views of local small business toward**  
**Political party**

19. What do you think about the impact of decentralisation on political parties?

- (A) Political parties are closer to the grass roots level, including to small businesses
- (B) The behaviour of political parties are the same as in previous periods
- (C) Political parties are more exclusive and far from grass roots level
- (D) Political parties have become increasing powerful

20. To what extent have small business people been involved in political activities?

No.	Various Kinds of Activities	Answer		
		Always	Sometimes	Never
20.1.	Participating in local election campaigns			
20.2.	Regular participants in political party meetings			
20.3.	Member of a political party			
20.4.	Member of an executive committee in a political party			
20.5	Providing a political donation or funds			
20.6.	Candidate or member for local parliament			
20.7.	Other .....			

21. In your opinion, what form has the support of political parties for small business taken?

No.	Various Kinds of Facilities	Answer		
		Always	Sometimes	Not at all
21.1.	Developing networks with financial institutions			
21.2.	Developing networks with the markets			
21.3.	Facilitating training			
21.4.	Facilitating legal aid			
21.5.	Other.....			

22. Generally, do you think that political parties are supportive of your business?

- (A) Very supportive
- (B) Supportive
- (C) Less supportive or somewhat supportive
- (D) Not at all

23. How have small business people been able to influence political parties so that they will support their business? (it is possible to have more than one choice)

- (A) By providing funds
- (B) By creating personal networks
- (C) By supporting small business associations to influence political parties
- (D) By developing opinion in mass media
- (E) By mass mobilization

24. How do political parties influence small business people in elections for district heads? (it is possible to have more than one choice)

- (A) By providing funds
- (B) By creating personal network
- (C) By facilitating for individual small businesses
- (D) By facilitating for small business associations
- (E) LessBy mass mobilization

25. How are political parties able to influence small business people in the elections for local parliament members? (It is possible to choose more than one answer)

- (A) By providing funds
- (B) By creating personal networks
- (C) By facilitating on behalf of individual small business people
- (D) By facilitating on behalf of small business associations or small business cooperatives
- (E) By mass mobilization

26. To what extent have political parties created more access for small business people to be involved since decentralisation has been implemented?

- (A) Political parties have increased their access
- (B) Not all political parties have more access
- (C) All political parties are the same as previous period
- (D) Political parties tend to be more closed
- (E) Political parties have become increasingly powerful

27. If your business has problems, to whom do you usually go to ask for help?

- (A) Political parties
- (B) Local bureaucrats
- (C) Local business associations or local business cooperatives
- (D) Non government organisations
- (E) Mass media
- (F) Other .....

====End of questions====

## APPENDIX 3

## LIST OF NAME OF INTERVIEWEES OF BANTUL

No	Abbreviation	Position	Date of Interview
1.	I.S.	District head	25 June 2009
2.		Vice district head	
3.	G.R.	Secretary of Local Government	15 June 2009
4.	Y	Head of <i>Diperindagkop</i>	3 June 2009
5.	T.S.	Secretary of <i>Bappeda</i>	2 June 2009
6.	H	Head of <i>Dinas Perijinan</i>	9 July 2009
7.	A.D.	Head of <i>Dinas Keuangan dan Aset Daerah</i>	17 June 2009
8.	S.S.	Head of <i>Dinas Tenaga Kerja</i>	13 June 2009
9.	S	Head of Department of Law	
10.	J.P	Chairman of Local Legislature and Chairman of Bantul branch PDI-P party	24 June 2009
11.	A	Secretary of PDI-P Party	26 June 2009
12.	A.S.	Chairman of Bantul branch, Golkar party	10 June 2009
13.	S.B.	Chairman of <i>Kadinda</i> , Local legislative member and Golkar party member	15 June 2009
14.	G.S.	Chairman of Bantul branch, Democratic Party	20 June 2009
15.	H	Chairman of Bantul branch, PAN party	10 June 2009
16.	Sm	Head of B Committee of Local Legislature	15 June 2009
17.	A.R.	Chairman of Bantul branch, PKB party	24 June 2009
18.	A.Sr.	Head of Research and Development of PKS party and local legislative member	10 June 2009
19.	W.U.	Expert in Local Autonomy and Senior Lecturer of Faculty of Social and Political Sciences, GadjahMada University.	18 June 2009
20.	P	Expert in District Government Affairs and the Dean of Faculty of Social and Political Sciences,	13 July 2009

		GadjahMada University	
21.	Sy.	Chairman of <i>Dekranas</i>	11 June 2009
22.	T	Chairman of Gabusan Art Market	11 June 2009
23.	S.A	Chairman of Bantul Craft Association	16 June 2009
24.	A.T	Chairman of ASMINDO (Furniture Industry and Handicraft Association)	19 June 2009
25.	T.R.	Chairman of Satya Bawana Small Business Cooperative	11 June 2009
26.	E.R.	Head of ASEPHI (Exporter and Handicraft Association)	19 June 2009
27.	Y.K.	Chairman of APIKRI (Foundation of Indonesian People's Handicraft Development)	16 June 2009
28.	B.S.	Journalist of Daily <i>Kompas</i>	7 June 2009
29.	N.H.	Journalist of Daily <i>Kedaulatan Rakyat</i>	8 June 2009
30.	Slm.	Head of RT	9 July 2009
31.	S.H.	Small business owner and Candidate for Local legislature member	9 July 2009
32.	Pm	Small business owner	1 July 2009
33.	Pj	Small business owner	7 July 2009
34.	E.R.	Small business owner	23 June 2009
35.	Sh.	Head of Hamlet of Tirto	7 July 2009
36.	MU	Small business owner	23 June 2009
37.	W	Small business owner	14 July 2009
38.	N	Head Hamlet of Kasongan	9 July 2009
39.	S.W.	Small business owner	7 July 2009
40.	E.S.	Small business owner	
41.	Pm.	Head of Hamlet of Karangasem	9 July 2009
42.	Sn	Small business owner	9 July 2009
43.	Sg.	Chairman of Karya Sejahtera Mandiri Business Association	7 July 2009
44.	Ar.	Chairman of Manding UPT	7 July 2009

## APPENDIX 4

## LIST OF NAME OF INTERVIEWEES OF GIANYAR

No	Abbreviation	Position	Date of Interview
1.	A.S.	District head of Gianyar	23 April 2009
2.	D.S.	Vice District head	28 April 2009
3.	B.N.	Head of <i>Bappeda</i>	30 April 2009
4.	B.M.	Local legislature member	23 May 2009
5.	R.K.	Vice Chairman of Local legislature	28 April 2009
6.	A.B.	Former of District head and Chairman of Gianyar PDI-P party	
7.	C.B.	Head of <i>Diskop</i> and <i>UKM</i>	29 April 2009
8.	S	Head of Diperindag	23 April 2009
9.	D.M.	Secretary of <i>Dispenda</i>	29 April 2009
10.	D.J.	Head of Department of Law	28 April 2009
11.	P.S.	Head of Section of Economic Affairs, Bappeda	22 April 2009
12.	S.E.	Staff of <i>Badan Pelayanan Perijinan Terpadu</i>	28 April 2009
13.	W.St.	Head of Diskop and UKM, Province of Bali	11 May 2009
14.	A.A.	Chairman of Gianyar Chamber of Industry and Trade and Chairman of Business Association for Wood	24 April 2009
15.	D.A.	Director of Bali International Institute of Tourism Management	4 May 2009
16.	S	Editor of Daily Bisnis Bali	1 May 2009
17.	S.A.	Editor Pelaksana, Daily Bisnis Bali	1 May 2009
18.	W.M.	Senior Lecturer in Faculty of Economic, University of Udayana	1 May 2009
19.	A.P.	Small Business owner and <i>Kelian Adat</i> of Banjar Kendran	23 May 2009
20.	M.A.	Head of Section of Business Development, <i>Diskop</i> and <i>UKM</i>	30 April 2009



21.	A.W.	Small business owner and <i>Kelian Dinas</i> and <i>Kelian Adat</i> of Banjar Bonjaka	23 May 2009
22.	M.R.	UPTD staff	22 April 2009
23.	K.K.	<i>Kelian Dinas</i> of Banjar Sapat	14 May 2009
24.	N.S.	Small business owner, <i>Kelian Dinas</i> and <i>Kelian Adat</i> , Banjar Pujung Kaja	23 May 2009
25.	P.D	Small business owner and <i>Bendesa</i> , Banjar Jasan	23 May 2009
26.	W.S.	<i>Kelian Dinas</i> , Banjar Glagah	14 May 2009
27.			
28.	K.G.	<i>Bendesa</i> of <i>Desa</i> Pakraman Kliki	22 May 2009
29.	S	Secretary of B Committee, Local legislature	4 May 2009
30.	W.P.	<i>Bendesa</i> of Tegallalang	22 May 2009

## APPENDIX 5

## LIST OF NAME OF RESPONDENTS OF BANTUL

No.	Acronym	Telephone/Mobile Phone Number
1.	Sury	0818260171
2.	Tg	081328749722
3.	Pyt	0274-7370517
4.	I.W	0274-7112524
5.	Ro	0274-370968 / 08122791377
6.	Y.A.P	0274-6463645
7.	C.Pt.	08882518937
8.	Kik	-
9.	E.R	0274-7408189
10.	E,D	0274-78522440 / 0811286172
11.	Srtm	081392183383
12.	Utg	0274-7485966
13.	A,M	08562920504
14.	Pnd	0274-370516
15.	T.A.K.	0274-370523
16.	T.E.S.	0274-7408612
17.	A.S	0274-370517
18.	Tri	-
19.	El	-
20.	T.M	0274-6461410
21.	Cah.P	-
22.	Pu	08122952241
23.	Bog	081802638722
24.	Pwt	-
25.	Srj	0274-6461408
26.	Pj	0274-370514
27.	N. A.	08164228292
28.	M.W.	-
29.	M. M.	085743728586
30.	R.Set	08122706823
31.	A.H.	085643406522
32.	Um	-
33.	Muh. Is	08562865296
34.	Str	0274-6466419
35.	A.I.	0818262046
36.	D. Utm	0274-6462585

37.	C.L.	0274-6462579/0816689013
38.	D.E.	0274-7489372/08122964542
39.	Mus	081328349340
40.	Ner No.	0274-445689 / 0818293178
41.	Mar	08122753492
42.	A.S. Y.	081578637399
43.	T.W.	081578755533
44.	Wir.	7113577
45.	E.S.	0274-414910
46.	Ro.Y.	08122780848
47.	Sjn	-
48.	S.R.	0274-6460956
49.	Sn.	0274-6460916
50.	Srj	-
51.	Str	-
52.	D.T.	-
53.	Bj	0274-7440317
54.	Barm	-
55.	Rus	0274-368453
56.	A.P.	0274-6462787 / 081578628900
57.	J.Sb	0274-368462
58.	Swd	0274-368437
59.	Sby	0274-368438
60.	Jok Sud	-

## APPENDIX 6

## LIST OF NAME OF RESPONDENTS OF GIANYAR

No.	Acronym	Telephone/Mobile Phone Number
1.	Ra Ud	08123981564
2.	Mad Sm	081558331137
3.	Ke Su	0361-976280
4	Ay Pi	0361-977894
5	Mad Ad	0361-7454927
6	Way Gal	0361-978833
7	Way Ag Wa	0361-970123
8	Mad Kel	0361-973037
9	Way Suw.	0361-980808
10	Mad Pit	0361-7400294
11	N Way M.	0361-901953
12	N Way S Jay	0361-901253
13	Ny Nai	0361-901943
14	Mad Reg	0816574370
15	Put In	0361-901732
16	Kom Ar	0361-974249
17	Wun Wir	0361-901069
18	Jro Mang I J	0361-901581
19	N Ra	0361-976272
20	Kt. Wi	0361-980874
21	I Way Kar	0361-980784
22	Gus Ay R A.	08123960357
23	L Yoh Sut	08133422664
24	J. Ny Sik	0361-8512394
25	Ge Ar	0817552470
26	Mad Bud	081338225115
27	Ny Wik	0361-901353
28	A. A. Pu	081338030437
29	Way Sab	0361-942374
30	Pu Suk	0361-901184
31	Way Bud	0361-901011
32	Mad Ta	0361-901733
33	D.W. Kom	0361-902232
34	Mad Sur	081338517713
35	Wyn Me	0361-901771
36.	Mad Mul	0361-901766
37.	Kad As	085238729990

38.	Wid As	0361-901903
39.	In Suk	08123942091
40.	Ni Mad Mang	0361-901446
41.	Ket Mer	0361-981070
42.	Way Rup Sug	0361-901606
43.	I Way Sub	0361-901010
44.	I Mad Sud	0361-901831
45.	I Way Mus	085237190035
46.	Ni Way Mo	0361-901011
47.	Wik	0361-901131
48.	Ay S.Rat	0361-901692
49.	Mad Sut	085237042877
50.	A Aut	08123923004
51.	I Kom Rat Kus	081236000349
52.	I Mad Dan	08123804504
54.	Tik	0361-978135
55.	Put Rad	0361-976046
56	Ni Way Sun	0361-976646
57	I Kom Mud	081566526
58	Dwi	0361-901567
59	Nyom Bun	081338718313
60	I Mad Pas	0361-901965
61	I Way Raj	-
62	Ni Nyom Lu	0361-7895297
63	I Ay Prad	0361-7981254
64	Dew Put Rat	0361-980980
65	I WayMas	0361-901132
66	I Way Sud	081916691140
67	I Mad Sak	-
68	I Ket Sup	081338760902
69	I Mad Blon	0361-901122
70	Rud	0361-902117
71	Way Sua	0361-901121
72	Way Gan	0361-901022
73	I Way Dam	0361-901123
74	I Put Sud	0361-901186
75	Ni Made Murni	0361-980946
76	Ni Way Rus	0361-980898
77	I Way Si	085237316556
78	Dew K. A.	0361-980720
79	Ni Lu Sut	081337551122
80	Cah	0361-7901384
81	Ni N. Mun	0361-980881
82	I Way Sue	0361-980884
83	I Mad Suk	081337810089

84	I Nyo Su	08123639361
85	Dew Put A.	085237530902
86	Way Ar	08155757690
87	Mad Su	081338440457
88	I Way Par	0361-901137
89	Ni Mad Mar	081337696859
90	Cok Bag T.	0361-976433
91	I Nyo Kar	081558142481
92	I K. Mud	085737032823
93	I Nyo Sar	08124626429
94	I Mad Ag Win	085238118110
95	Wayn Ba	081337197091
96	Way Sum	-
97	I Mad Sua	081338710228
98	Nyo Mur	-
99	Komg	0361-7469090
100.	P.Wayn Sem	-