

**Withering of Patrimonial State-Business Relations  
in Indonesia  
following the 1997-8 Economic Crisis?  
Case Studies of the Electronics and Palm Oil Industries**

Riaty Raffiudin,  
Dra. (University of Indonesia), M.A. (Ohio University, USA)

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## Abstract

This study investigates the changes in patrimonial state–business relationships following the 1997–8 economic crisis and President Soeharto’s resignation. The main focus is to examine whether patrimonial state-business relations in Indonesia have withered away, persisted or developed into different patterns. Using a qualitative approach with a case study methodology, this study compares state-business relations in the electronics industry, considered to be among the most affected sector, and the palm oil industry, considered to be the least affected sector by the crisis. Applying this methodology has allowed the utilisation of multiple sources for an intensive and holistic study of state-business relations in the electronics and palm oil sectors of the Indonesian economy.

This study addresses two questions: first, to what extent and in what ways have state and business relations become more transparent, accountable and legal since the 1997–8 economic crisis?; and second, how have the economic crisis of 1997–8 and the *Reformasi* political changes modified and moderated patrimonial relationships between the state and business, particularly the electronics and palm oil industries. I argue that the patrimonial character of many of these relationships has persisted, but in more diverse forms and networks as a result of the dispersal of power at national and local levels, even though in general state-business relations have been more transparent and accountable. Comparing state-business relations in the palm oil and electronics industries, the former has been a more supportive environment for patrimonial relationships than the latter.

The contribution of this thesis is that in general it has demonstrated that patrimonial state-business relations in Indonesia, following the crisis and Soeharto’s resignation has remained but developed with different patterns, characteristics, and actors, which generated more complex relations and dependencies. This new understanding has confirmed Harold Crouch’s proposition (1979) regarding the persistence of these patrimonial relations. However, this research has also differed from Crouch by adding a new dimension to the complexity of such relations.

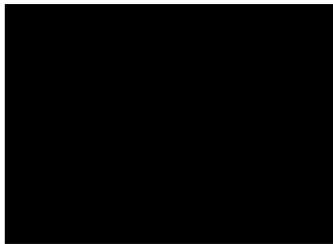
The findings of this study demonstrate that regulatory frameworks, global stakeholders and business associations have influenced patrimonial state-business relations in the palm oil industry, making them more complex, as this industry has become a more significant part of the domestic and global economy. In contrast, the same influences in relation to the electronics industry have suggested that the industry, relatively speaking, is not a supportive environment for patrimonial relationships to develop.

The major differences in the palm oil industry that depart from Harold Crouch's proposition are the increase in the number of government patrons; the involvement of local governments and conglomerates in exchange for concessions of land for plantations with material incentives; and the government, at both the national and regional level, are more dependent on conglomerates. The structure and dependency of technology on the international principal companies have made them more detached from the government. Patrimonial relationships between the government and these companies, therefore, can be considered as an impediment.

## **Student Declaration**

“I, Riaty Raffiudin, declare that the PhD thesis entitled “Withering of Patrimonial State-Business Relations in Indonesia following the 1997–8 Economic Crisis? Case Studies of the Electronics and Palm Oil Industries” is no more than 100,000 words in length including quotes and exclusive of tables, figures, appendices, bibliography, references and footnotes. This thesis contains no material that has been submitted previously, in whole or in part, for the award of any other academic degree or diploma. Except where otherwise indicated, this thesis is my own work”.

**Signature :**



**Date: 10 February 2015**

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## Glossary and Abbreviations

AFTA	ASEAN Free Trade Agreement
AILKI	<i>Asosiasi Industri Luminaires and Kelistrikan Indonesia</i> (Indonesia Electricity and Luminaires Industry Association)
AIMMI	<i>Asosiasi Industri Minyak Makan Indonesia</i> (Indonesian Cooking/Edible Oil Industry Association)
AIMRI	<i>Asosiasi Industri Media Rekam</i> (Indonesian Recording Media Industry Association)
‘Ali Baba’ relationships	Partnership of mutual dependents between Indonesian Chinese entrepreneurs who have capital and business skills with indigenous entrepreneurs who lack of capital and business skills but obtain licences and credits from the government. It occurred in the Parliamentary Democracy era when Fortress program was implemented.
AMDAL	<i>Analisis Mengenai Dampak Lingkungan</i> (Environmental Impact Statements)
APEMIN	<i>Asosiasi Pengusaha Oleochemical Indonesia</i> (Indonesian Oleochemical Association)
APKASINDO	<i>Asosiasi Petani Kelapa Sawit Indonesia</i> (Indonesian Palm Oil Farmers Association)
APKINDO	<i>Asosiasi Produsen Panel Kayu Indonesia</i> (Indonesian Wood Panel Producers’ Association)
APKOMINDO	<i>Asosiasi Komputer Indonesia</i> (Indonesian Computer Association)
APMN	<i>Asosiasi Pengusaha Minyak Makan</i> (Association of Edible Oil Producers)
APOLIN	<i>Asosiasi Pengusaha Oleochemical Indonesia</i> (Indonesian Oleochemical Association)
APROBI	<i>Asosiasi Produsen Biofuel Indonesia</i> (Indonesian Biofuel Producers Association)
ASEAN	Association of South East Asia Nations
ASPILUKI	<i>Asosiasi Piranti Lunak Telematika Indonesia</i> (Indonesia Telecommunication, Information and Software Association)
BAMUNAS	<i>Badan Musyawarah Nasional</i> (National Negotiation Agency)
<i>Bapak Pembangunan</i>	Father of Development
Bapedal	<i>Badan Pengendalian Dampak Lingkungan</i> (Environmental Impact Management Agency)
Bapedalda	<i>Badan Pengendalian Dampak Lingkungan Daerah</i> (Local Environmental Impact Management Agency)

BAPEPTI	<i>Badan Pengawasan Perdagangan Berjangka Komoditi</i> Commodity of Future Trading Regulatory Agency)
<i>Bea Masuk</i>	Incoming tariffs
<i>Benteng Program</i>	A program designed to encourage the growth of indigenous Indonesian entrepreneurs during the Parliamentary Democracy (1950-1957)
BHTV	Bandung High-tech Valley
BKPM	<i>Badan Koordinasi Penanaman Modal</i> (Indonesia Investment Coordinating Board)
BKPMD	<i>Badan Koordinasi Penanaman Modal Daerah</i> (Regional Indonesia Investment Coordinating Board)
BM DTP	<i>Bea Masuk Ditanggung Pemerintah</i> (Duty paid by the government)
BPN	<i>Badan Pertanahan Nasional</i> (National Land Agency)
BPS	<i>Biro Pusat Statistik</i> (Central Bureau of Statistics)
BSN	<i>Badan Standardisasi Nasional</i> (The National Standard Agency)
BUKOPIN	<i>Bank Umum Koperasi Indonesia</i> (Indonesian Cooperative Bank )
BULOG	<i>Badan Urusan Logistik</i> (State Logistic Agency)
BUMN	<i>Badan Usaha Milik Negara</i> (State Enterprises)
CAFTA	China – ASEAN Free Trade Agreement
CBU	Completely Built Up
CKD	Completely Knock Down
CPO	Crude Palm Oil
CRT	Cathode Ray Tubes
CUC	Control Union Certification
DBH	<i>Dana Bagi Hasil</i> (Revenue-sharing)
<i>Dewan Pembina KADIN</i>	Advisory council to the board of executives of KADIN
<i>Dinas Perkebunan</i>	Bureau of Plantations
DMO	Domestic Market Obligation
DMSI	<i>Dewan Minyak Sawit Indonesia</i> (Indonesian Palm Oil Board)
DPRD	<i>Dewan Perwakilan Rakyat Daerah</i> (Regional House of People’s Representatives)
EBB	European Biodiesel Board
ELSAM	<i>Lembaga Studi dan Advokasi Masyarakat</i> (Institute of Policy Reseach and Advocacy)
EOI	Export Oriented Industrialisation
EPTE	Entry port Production for Export
EU	European Union
EU RED	European Union Renewable Energy Directive
FDI	Foreign Direct Investment
FFB	Fresh Fruit Bunch ( <i>Tandan Buah Segar</i> )
FTA	Free Trade Agreement

GABEL	<i>Gabungan Pengusaha Elektronik</i> (Indonesia Electronics Producers Association)
GAKESLAB	<i>Gabungan Perusahaan Alat-Alat Kesehatan</i> (Federation of Medical Appliances' Companies)
GAPKI	<i>Gabungan Pengusaha Kelapa Sawit Indonesia</i> ( Indonesian Palm Oil Producers' Association)
GDP	Gross Domestic Product
GHG	Green House Gas
GIMNI	<i>Gabungan Industri Minyak Nabati Indonesia</i> (Indonesian Federation of Edible Oil Industries)
GOLKAR	<i>Golongan Karya</i> ( functional groups); the state party under the New Order)
<i>Golongan ekonomi lemah</i>	Small economic sector
HGU	<i>Hak Guna Usaha</i> (Cultivation Rights Title)
HIPMI	<i>Himpunan Pengusaha Muda Indonesia</i> (Indonesian Young Entrepreneurs Association)
HIPPI	<i>Himpunan Pengusaha Pribumi Indonesia</i> (Indonesian Indigenous Entrepreneurs Association)
HPH	<i>Hak Pengusahaan Hutan</i> (Right of Forest Exploitation)
HPK	<i>Hutan Produksi Konversi</i> (Forested areas that have been allocated for production purposes)
IBRA	Indonesian Bank Restructuring Agency
IDR	Indonesia Currency (Rupiah)
<i>Idul Fitri</i>	The Islamic celebration following the fasting month Ramadhan
IGGI	International Governmental Group on Indonesia
ILMEA	<i>Industri Logam Mesin Elektronik dan Aneka</i> (Directorate General of Metal, Machinery, Electronic and Multifarious Industries)
IMDIA	<i>Asosiasi Industri Mold dan Dies Indonesia</i> (Indonesian Mould and Dies Association)
IMF	International Monetary Fund
INHUTANI	<i>PT Eksploitasi dan Industri Hutan</i> (State owned Forestry Enterprises )
Inpres	<i>Instruksi Presiden</i> (Presidential Instruction)
IPB	<i>Institute Pertanian Bogor</i> (Bogor Institute of Agriculture)
IPOB (see DMSI)	Indonesian Palm Oil Board
IPOC (see KMSI)	Indonesian Palm Oil Commission
ISI	Import Substitution Industrialisation
ISPO	Indonesian Sustainable Palm Oil
IT	Information technology
IUP	<i>Izin Usaha Perkebunan</i> (Plantation Production Permit)
IVEX	Independent Verification Exercise
<i>Izin Usaha Produksi</i>	Production Operation Permit

KADIN	<i>Kamar Dagang dan Industri</i> (Indonesian Chamber of Trade and Industry)
KADINDA	<i>Kamar Dagang dan Industri Daerah</i> (Regional Chamber of Indonesian Trade and Industry)
KKN	<i>Korupsi, Kolusi dan Nepotisme</i> (Corruption, Colusion and Nepotism)
KMB	<i>Konperensi Meja Bundar</i> (Round Table Conference)
KMSI	<i>Komisi Minyak Sawit Indonesia</i> (Indonesian Palm Oil Commission)
<i>Komisi Ombudsman Nasional</i>	National Ombudsman Commission
Keppres	Keputusan Presiden (Presidential Decision)
<i>Koperasi</i>	Cooperatives
KOPKAMTIB	Commander of the Restoration of Security and Order Operation Command
KPKPN	<i>Komisi Pemeriksa Kekayaan Penyelenggara Negara</i> (Commission to Investigate the Assets of State Officials)
KPK	<i>Komisi Pemberantasan Korupsi</i> (Commission of Corruption Eradication)
KPO	Kernel Palm Oil
KPPU	<i>Komisi Pengawas Persaingan Usaha</i> (Supervisory Commission for Business Competition)
KSO	<i>Kerja Sama Operasi</i> (Joint Operation)
<i>Laboratorium Uji</i>	Laboratories for testing products
LC	Letter of Credit
LCD	Liquid Crystal Diode
<i>Lembaga Sertifikasi Produk</i>	Products Certification Agency
LHKPN	<i>Laporan Harta Kekayaan Penyelenggara Negara</i> (Report of State's Officials' assests)
LonSum	PT Perusahaan Perkebunan London Sumatra
MAKSI	<i>Masyarakat Kelapa Sawit</i> (Palm Oil Community)
Malari	<i>Malapetaka Lima Belas Januari</i> (the 15 January Disaster, the student demonstration and riot that occurred on 15-16 January 1974. The demonstrations protested the excess of foreign investment)
Masjumi	<i>Madjelis Sjuro Muslimin Indonesia</i> (Council of Indonesian Muslim Associations; one of the Indonesian Muslim parties in the Parliamentary Democracy)
MNC	Multi National Company
MoIT	Ministry of Industry and Trade (Since 2004, this ministry has been split into the Ministry of Trade and the Ministry of Industry)
MPI	<i>Masyarakat Per kayuan Indonesia</i> (Indonesian Timber Society)
NEA	Northeast Asia

NES	Nucleus Estate Smallholders
NGO	Non-governmental Organization
NICs	New Industrialised Countries
<i>Operasi pasar</i>	Domestic market operation to stabilise basic needs prices such as cooking oil prices
PBB	<i>Pajak Bumi dan Bangunan</i> (Land Value Tax)
PDBI	<i>Pusat Data Bisnis Indonesia</i> (The Indonesian Business Data Centre)
<i>Pengadilan Negeri Jakarta Pusat</i>	Central Jakarta Court of First Instance
PERTAMINA	<i>Perusahaan Tambang Minyak Nasional</i> (Indonesian state-owned oil and natural gas enterprises)
PET	<i>Pajak Ekspor Tambahan</i> (Added Export Tax)
PIR (see NES)	<i>Perkebunan Inti Rakyat</i> (Nucleus Estate Smallholders)
PIR-KKPA	<i>Perkebunan Inti Rakyat -Kredit Koperasi Primer untuk Anggotanya</i> (NES - Primary Cooperative Credit for members )
PMA	<i>Penanaman Modal Asing</i> (Foreign investment)
PMDN	<i>Penanaman Modal Dalam Negeri</i> (Domestic Investment)
PN TIMAH	<i>Perusahaan Negara TIMAH</i> (State-owned Tin Enterprises)
PNI	<i>Partai Nasional Indonesia</i> (Indonesian National Party)
PP	<i>Peraturan Pemerintah</i> (Government Regulation)
PPN	<i>Perusahaan Perkebunan Negara</i> (Plantation State Enterprises)
PPnBM	<i>Pajak Pertambahan Nilai Barang Mewah</i> (Sales Tax for Luxury Goods)
<i>Pribumi</i>	Indigenous Indonesians
PSI	<i>Partai Sosialis Indonesia</i> (Indonesian Socialist Party)
PTP	<i>Perusahaan Terbatas Perkebunan</i> (Plantation Limited Company)
PTPN	<i>Perusahaan Terbatas Perkebunan Negara</i> (State Plantation Limited Company)
RTRW	<i>Rencana Tata Ruang Wilayah</i> (Spatial Zoning Plan)
<i>Reformasi era</i>	The period after the resignation of President Soeharto
Repelita	<i>Rencana Pembangunan Lima Tahun</i> (Five Year Development Plan)
RSPO	Roundtable on Sustainable Palm Oil
RUP	<i>Rencana Urgensi Pembangunan</i> (Urgency Development Plan)
SAPs	Structural Adjustment Programs
SDA	Sole Distributor Agents
SDI	<i>Serikat Dagang Indonesia</i> (Indonesian Trade Union)
SEA	Southeast Asia
SEALPA	Southeast Asian Lumber Producers' association

SIPEF	A Belgian agro-industrial company established in 1919
SKD	Semi Knock Down
SMEs	Small and Medium Enterprises
SNI	<i>Standard Nasional Indonesia</i> (Indonesian National Standard)
Tapos	A large cattle ranch in Bogor that is owned by former
President	Soeharto
<i>Tandan buah segar</i>	Fresh Fruit Bunch
<i>Tata Niaga Impor</i>	Import Regulation
TE	Telecommunication
TEDI, PT	Tosummit Electronics Devices Indonesia, PT
TG	The Technical Group
UKM	<i>Usaha Kecil dan Menengah</i> (Small and Medium Enterprises)
USD	United States Currency (US Dollar)
WALHI	Wahana Lingkungan Hidup Indonesia (Indonesia Forum for the Environment)
WTO	World Trade Organisation
WWF	World Wide Fund for Nature
<i>Yayasan</i>	Foundations

# Chapter 1

## Introduction

### A. Background to the study

The collapse of the Thai currency (Bhat) on 2 July 1997 was the catalyst for the 1997 financial crisis.<sup>1</sup> The crisis spread across the Southeast Asia region and affected countries such as Indonesia, Malaysia, the Philippines and South Korea. Indonesia endured the longest financial crisis, which affected the entire economy and became a political crisis, leading to the resignation of Soeharto. In this research, the term economic crisis will be used as the crisis impacted on the Indonesian economy as a whole.

Scholars have argued that the various causes of the crisis in Northeast Asia and Southeast Asia regions were due to several factors. Stephan Haggard categorised these factors as follows:

...fundamentalists who emphasised macroeconomic and particularly exchange rate mismanagement, internationalists who focused on the inherent volatility of international financial markets; self-fulfilling speculative attacks and contagion; new fundamentalists who underlined regulatory and structural problems, particularly in the financial sector; and the IMF prescriptions and whether the adoption of overly restrictive monetary and fiscal policies and ambitious structural adjustment mitigated and compounded the crisis.<sup>2</sup>

Haggard's categorisation shows that scholars have analysed these factors from different economic perspectives when explaining the reasons for the crisis. As will be explained in greater detail in the literature review chapter, Haggard's categorisation is not mutually exclusive because scholars have argued across these categories.

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<sup>1</sup>Manuel F. Montes, *The Currency Crisis in Southeast Asia*, 2<sup>nd</sup> ed. (Singapore: Institute of Southeast Asian Studies, 1998), 7.

<sup>2</sup>Stephan Haggard, *The Political Economy of the Asian Financial Crisis* (Washington DC: Institute for International Economics, 2000).

One category not mentioned is that of moral hazard. Haggard as well as Haggard and MacIntyre<sup>3</sup>, define moral hazard as a misperception by business that government will guarantee and bail out any bad loans made by international and domestic lenders. Following Krugman<sup>4</sup>, Haggard agrees that moral hazard implies a more fundamental issue of business-government relations.<sup>5</sup> Haggard and MacIntyre as well as Eddy Lee also argue that moral hazard, as a consequence of close state-business relations, triggered the financial crisis in Northeast Asia (NEA) and Southeast Asia (SEA).<sup>6</sup> From a big picture viewpoint, these scholars argue that it is crony capitalism, which requires close state-business relations that characterises Asian capitalism, generated by moral hazard.

As will be explained in more detail in chapter two, the close state-business relations in NEA and SEA have different characteristics. In NEA, these relations are part of the developmental state model. For example, South Korea adopted this model to increase economic growth. This type of close state-business relations is more institutionalised and thus considered to be more of an asset for the economy. In SEA, for example, Indonesia, these relations are characterised by patrimonial relations, which are more personalised between the state and its clients.

The financial crisis in Indonesia demonstrated the weakness of patrimonial state-business relations. The former Director of the Indonesian Central Bank, Soedradjat Djiwandono and McLeod and Garnaut argue that the causes of the financial crisis in Indonesia developed from a combination of external shocks in currency markets as part

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<sup>3</sup> Haggard, *The Political Economy of the Asian Financial Crisis*, 7-9; Stephan Haggard and Andrew MacIntyre, "The Politics of Moral Hazard: The Origins of Financial Crisis in Indonesia, Korea and Thailand," in *Tigers in Distress: The Political Economy of the East Asian Crisis and Its Aftermath*, ed. Arvid Lukauskas and Francisco Rivera-Batiz (London: Edward Elgar, 2001), 85-109.

<sup>4</sup> Paul Krugman, "What Happened to Asia?" *Massachusetts Institute of Technology* (January 1998): 1-10, <http://web.mit.edu/krugman/www/DISINTER.html> (accessed 25 May 2013).

<sup>5</sup> Haggard, *ibid.*

<sup>6</sup> Eddy Lee, "The Debate on the Causes of the Asian Crisis: Crony Capitalism Versus International System Failure," 162-167, <http://library.fes.de/pdf-files/ipg/ipg-1999-2/artlee.pdf>, (accessed 25 May 2013).

of regional financial panic and weakness of financial and real estate sectors.<sup>7</sup> Djiwandono regretted that those countries affected in the crisis, including Indonesia, did not have a sound banking system for effective macro economic policies, prior to the crisis.<sup>8</sup> McLeod argued that the contagious effect of the crisis, in Indonesia in particular, was due to increasing apprehension of “an inadequate prudential supervision of the banking system and the speculative nature of property development projects”.<sup>9</sup> However, according to Haggard and Haggard and MacIntyre, “the quintessential case of crony capitalism” made the crisis in Indonesia even more severe.<sup>10</sup>

When the crisis occurred, entrenched relations between Soeharto and his cronies, the group that principally sought business opportunities, were at a peak. Soeharto’s patrimonial state-business relations were built on a pyramid network of patron-client relations developed from personal connections based on material incentives and rewards in exchange for favours, privileges and loyalties. As the key patron, Soeharto expanded his networks and managed to accumulate capital through his manipulation of his patrimonial relations with mostly Indonesian Chinese conglomerates, selected military officers in strategic state enterprises, foreign business players who had joint ventures with Soeharto’s relatives, Sukamdani Gitosardjono and Probusutedjo as well as his children.

The other group in Soeharto’s network consisted of ministers responsible for economic development strategies in his New Order cabinet. This group can be differentiated further, between the technocrats or market-oriented economists and nationalist industrialists led by B.J. Habibie. The competition between the technocrats and

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<sup>7</sup> Soedradjat Djiwandono, *Bank Indonesia and the Crisis: An Insider's View* (Singapore: Institute of Southeast Asian Studies, 2005); Ross H. McLeod and Ross Garnaut, eds. *East Asia in Crisis: From Being a Miracle to Needing One?* (London: Routledge, 1998).

<sup>8</sup> Djiwandono, *ibid.*, 29.

<sup>9</sup> Ross H. McLeod, “Indonesia,” in *East Asia in Crisis: From Being a Miracle to Needing One?* eds. Ross H. McLeod and Ross Garnaut ((London: Routledge, 1998), 37.

<sup>10</sup> Haggard, *The Political Economy of the Asian Financial Crisis*, 37 and Haggard and MacIntyre, “The Politics of Moral Hazard: The Origins of Financial Crisis in Indonesia, Korea and Thailand”, 101.

nationalist industrialists' over market economy strategies and state intervention approaches had been a tug of war.<sup>11</sup>

Since the beginning of the New Order, policy had focused on the market economy. However, Soeharto diverged and manipulated these policies for economic gain. Soeharto turned to the technocrats or market-oriented economists when the economy faced a significant downturn. He then turned to the nationalist industrialists when there was economic growth. In return, his business and bureaucratic cronies financed many of Soeharto's patronage activities and stood ready to provide emergency funds in crisis situations.

Despite the negative influence of entrenched patrimonial state-business relations during the financial crisis, scholars of Indonesian political economy and the World Bank acknowledged Indonesia's high Gross Domestic Product (GDP) and GDP per capita growth during much of Soeharto's New Order government, that is, until the financial crisis broke in mid 1997.<sup>12</sup> This impressive growth reflected Soeharto's ability to manage the tensions between a market economy approach and state intervention strategies. Even though these dual and sometimes contradictory approaches facilitated corruption as well as lack of accountability and transparency, the World Bank<sup>13</sup> and some scholars of the of the Indonesian political economy<sup>14</sup> seemed to accept these practices as the 'Indonesian way' of managing the economy, because Soeharto's government had sustained high rates of growth for more than twenty years.

The 1997-8 economic crisis revealed the contradiction between neo-liberal initiatives and the structure of patrimonial state-business relations of the Soeharto government. It

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<sup>11</sup> Harold Crouch, "Indonesia 'Strong' State," in *Weak and Strong States in Asia-Pacific Countries*, (ed) Peter Dauvergne (St. Leonards: Allen and Unwin and Canberra: Department of International Relations, RSPAS, 1998), 105-108; Ian Chalmers and Vedi R. Hadiz (eds), *The Politics of Economic Development in Indonesia: Contending Perspectives* (London: Routledge, 1997), Chapters 6 and 7.

<sup>12</sup> The World Bank, *Indonesia Dimensions of Growth*, (Washington D.C., 1996); Jomo K.S., "Introduction: Financial Governance, Liberalisation, and Crises in East Asia," in *Tigers in Trouble: Financial Governance, Liberalisation and Crises in East Asia*, ed. K. Jomo (New York: Zed Books, 1998), 1-32.

<sup>13</sup> The World Bank, 1996.

<sup>14</sup> "Government-Business Relations in Soeharto's Indonesia," in *Reform and Recovery in East Asia*, (ed) Peter Drysdale (London: Routledge, 2000), 148-170; Hal Hill (ed) *Indonesia's New Order: The Dynamics of Socio-Economic Transformation* (St Leonards: Allen and Unwin, 1994).

became evident that the banks and other financial institutions constituting a complex capitalist economy were merely utilised by Soeharto to support Habibie's strategy for high-tech development for his cronies', relatives' and children's businesses. Therefore, when the Indonesian government required international funding from the International Monetary Fund (IMF), the IMF demanded Soeharto cease his patrimonial and patronage practices.<sup>15</sup> This became a critical point as it turned the financial crisis into a political one. Soeharto did not agree immediately to cutting back his multi billion dollar linked projects, including Habibie's aircraft industry and Tommy Soeharto's national car project.<sup>16</sup> He eventually agreed to dismantle the foundations of his power structure: those favours, material incentives and facilities extended to his cronies and family members.

This research seeks to identify whether the patrimonial state-business relations in Indonesia have withered away, persisted or developed into different patterns following the crisis and Soeharto's resignation. It is interesting to explore this issue in light of domestic political changes brought about by democratisation at national and regional levels. It becomes more interesting because these changes coincided with the greater integration of the Indonesian economy into the global market. Thus any new forms of patrimonial state-business relations that occur in *Reformasi* governments will be affected by these circumstances.

The democratisation process at the national level has induced institutional changes in the form of new laws, regulations and institutions in all spheres as new foundations to become a more accountable government. Democratisation has also generated a dispersed system of power shared by president, political parties and parliament. Further, regional autonomy laws have changed the landscape of the decision-making process as governors, heads of districts and mayors have relatively more power. As the Indonesian economy has become part of the global economy, these changes will interact more intensively with the international community and professional business associations. Consequently, how will these changes affect patrimonial state-business relations?

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<sup>15</sup> Crouch, "Indonesia 'Strong' State" 1998, *Weak and Strong States in Asia-Pacific Countries*, 197.

<sup>16</sup> *Ibid.*

Almost sixteen years after Soeharto's resignation, little attention in research has focused on the transformation of patrimonial state-business relations. It is true that many corruption scandals involving politicians as well as bureaucrats and businesses has occurred. However, it is not yet clear whether they were caused by patrimonial relations between state and business. Jamie Mackie, in contextualising Crouch's article 'Patrimonialism and military rule in Indonesia', argued that "the several aspects of the New Order patrimonialism still persist, [but] it would be going too far to categorise the post 1998 political order as such".<sup>17</sup> What he and other scholars, such as Case, Webber, Robison and Hadiz<sup>18</sup>, have indicated is there have been new forms of patronage between bureaucrats – old and new – and their clients, involving different types of money politics<sup>19</sup>, and impeding the process of democratisation. This study will expand the research on patrimonial state-business relations through comparing case studies of the palm oil and electronics industries. The choice of these industries is mainly due to four reasons.

First, both industries have become the sectors relied on to boost non-oil export since deregulation was implemented in 1983. Despite the fact that since the 1997-8 economic crisis, Indonesia has experienced de-industrialisation, the palm oil industry, considered to be among the least affected by the crisis, has increased its productivity. The

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<sup>17</sup> Jamie Mackie, "Patrimonialism: The New Order and Beyond," in *Soeharto's New Order and Its Legacy: Essays in Honour of Harold Crouch*, (ed), Edward Aspinall and Greg Fealy (Canberra: ANU Press, 2010), 81-96.

<sup>18</sup> William Case, "Low Quality Democracy and Varied Authoritarianism: Elites and Regimes in Southeast Asia Today," *The Pacific Review* 22, no. 3 (2009), [www.informaworld.com/journals](http://www.informaworld.com/journals) (accessed 12 January 2011); Douglas Webber, "A Consolidated Patrimonial Democracy? Democratisation in Post-Soeharto Indonesia" (paper presented in *Joint Sessions of the European Consortium of Political Research*, Granada, 2005) 1-29, <http://www.casaasia.es/pdf/520551939PM1115047179830.pdf> (accessed 12 January 2012); Richard Robison and Vedi R. Hadiz, *Reorganizing Power in Indonesia; the Politics of Oligarchy in an Age of Markets* (London and New York: Routledge Curzon, 2004).

<sup>19</sup> Money politics used in the election context is a form of corruption. Corruption is a much broader concept than money politics because it can be found in business, government and legal system as well as in the electoral process. In the *Reformasi* era, money politics typically involved candidates and parties to paying people to vote for them or other politicians to support them. Money politics has increased significantly with the implementation of direct general elections at the regional level. Patrimonial relations refer to personal relationships between patrons in exchanging material rewards and clients for favours, protection, and loyalties. Corruption is an integral part of patrimonial relations between government and business figures. Money politics is a corrupt practice of open and competitive electoral politics of the sort that did not exist during the New Order. Patrimonial relationships are by the nature corrupt; however, corruption that occurs in patrimonial relationships is only one sort of corruption practice.

electronics industry, on the other hand, is considered to be the most affected by the crisis.

Second, the changes in the political system have led to the enactment of new laws, regulations and institutions. Even though the changes have been hindered by continuing patrimonial features,<sup>20</sup> how have the changes in laws, regulations and institutions impacted patrimonial state-business industries in the electronics and palm oil industries? State-business relations within these two industries are significantly different. The electronics industry in Indonesia represents a more global industry dominated by Multi National Corporations (MNCs) based in East Asia and North America. Companies in the palm oil industry however include state-owned, MNCs, national public and private enterprises as well as small plantation holdings. The intertwining position of the state, not only as the regulator but also as the owner, allows for the abuse of power and encourages patrimonial state-business relations. Further, the implementation of regional autonomy has meant that state-business relations in the palm oil industry functions at national and regional levels, which has produced a more complex network.

Third, the process of globalisation has also affected the changes in the political system in Indonesia. The increasing integration of the Indonesian market into the world market can be an important factor in influencing state and business to be more open and transparent. In this regard, Robison and Hadiz admit that globalisation "... ultimately constitutes an inexorable and progressive force for political and economic transformation."<sup>21</sup> However, as the old oligarchy of the *Reformasi* governments was able to make an alliance with the new oligarchy, the transformation did not occur; this is evidenced in the illiberal commercial system, and highly corrupt and poorly regulated markets.<sup>22</sup> Through the palm oil and electronics industries, this research investigates the extent of the ability of globalisation to moderate patrimonial state-business relations as both the palm oil and the electronics industries are part of the global industry, which must comply with international rules and standards.

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<sup>20</sup> Yuki Fukuoka, "Politics, Business and the State in Post-Soeharto Indonesia", *Contemporary Southeast Asia* 34, no. 1 (2012).

<sup>21</sup> Richard Robison and Vedi R. Hadiz, 34.

<sup>22</sup> Richard Robison, *ibid.*

Fourth, the political changes in the *Reformasi* era have allowed increased participation of business associations in influencing government policies including the palm oil and electronics industries. Business associations are groups that are organised under similar business interests and gradually have become influential in government policies based on their interests, as shown in one of MacIntyre's studies on the New Order.<sup>23</sup> With a more democratic political system and more integrated Indonesian economy in the global market, it is important to investigate the role of business associations in these two industries and how they influence patrimonial state-business relations.

## **B. Research questions**

The research questions posed in this study are:

1. To what extent and in what ways have state-business relations become more transparent, accountable and law-based since the 1997-8 economic crisis?
2. How have the economic crisis of 1997-8 and the *Reformasi* political changes modified and moderated patrimonial relationships between the state and private businesses, particularly in the electronics and palm oil industries?

## **C. Hypothesis**

The dispersal of power, as a result of the openness of the political system following the crisis and Soeharto's resignation, has changed the characteristics of patrimonial state-business relations in terms of numbers of actors involved and complexity of patrimonial networks.

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<sup>23</sup>Andrew MacIntyre, *Business and Politics in Indonesia* (North Sydney: Asian Studies Association of Australia in association with Allen and Unwin, 1991).

#### **D. Research aims**

1. To identify whether there have been changes structurally in the patrimonial state-business relationship in the Indonesian industrial sector as a result of the 1997-8 economic crisis and the *Reformasi* political changes.
2. To identify the effect on different sectors in the industry of the changes in the state-business relationship by comparing more and less affected industry sectors.
3. To identify factors that accelerated or impeded the changes by comparing the more and the less affected industry sectors
4. To investigate the role of business associations as one of the factors in accelerating (or impeding) transparent, accountable, and law-based state-business relations by comparing the most and least affected sectors in the industry.

#### **E. Contribution to knowledge**

This study is expected to contribute significantly to the Indonesian political economy in general and state-business relations following the 1997-8 economic crisis, in particular. Previous studies in state-business relations have emphasised their patrimonial nature, but the 1997-8 economic crisis and the *Reformasi* have opened up the possibility that they may develop in a different pattern, toward a more transparent, accountable, consultative and law-based relations. Within this context, this study will contribute to analysing whether the patrimonial system has actually changed or whether the patrons have changed but the system remains the same.

In a broader sense, this study will contribute to the debate on neo-liberal and statist perspectives regarding the nature of state and business classes in the industrial sector of the South-East Asian economy. The 1997-8 economic crisis has revived the thinking on state-business relations in the countries affected. This change allows business owners and managers, through business associations, to enhance their roles in accelerating the new pattern of state-business relations. This transformation has challenged the debate from neo-liberal and statist perspectives to determine appropriate and relevant roles for state and business actors in the economy.

## **F. Statement of significance**

Since the 1997-8 economic crisis, Indonesia has experienced de-industrialisation, which means industrial growth has fallen below economic growth levels for a prolonged period. For industrial growth to rise, an effective industrial policy initiative should be undertaken by government, as the regulator.

However, it is not only the responsibility of the government; the interconnection of state-business needs to develop in order to resume patterns of higher levels of growth. This study is useful for policy decision makers and analysts to make suggestions on the direction of industrial policy in general and, more specifically, in the electronics and palm oil industries. A study of state-business relations in both industries will therefore provide empirical input to the authorities formulating policy to promote higher levels of growth.

This study is also significant for business associations because it will examine their increasing roles in accelerating the new pattern of state-business relations. Identifying the extent to which these relations develop to form a different pattern is important because it will shed light on the extent of economic, social, and political reforms in the post-Soeharto era.

## **G. Organisation of the thesis**

This thesis comprises eight chapters. This chapter presented the background to the study, research questions, hypothesis, research aims, contribution of knowledge, statement of significance, and organisation of the thesis followed by methodology.

Chapter two will review the literature on state-business relations in Northeast Asia and Southeast Asia and, in particular, patrimonial state-business relations in Indonesia. The review will cover the crisis from neo liberalism, statism and institutional perspectives on patrimonial state-business relations during Soeharto's New Order, and on the Indonesian political economy and changes in state-business relations following the 1997-8 economic crisis.

Chapter three will analyse the expansion of Soeharto's patrimonial network during his thirty year tenure in the New Order. The paradox of expanding Soeharto's patrimonial network and achieving high economic growth in the Indonesian economy has been an interesting phenomenon. This chapter argues that Soeharto, towards the end of his power, established a more complex and highly personal patrimonial network and made this network an integral part of his economic development.

Chapter four will provide discussion on the progress and challenges faced by the electronics and palm oil industries from the beginning of their development in the Import Substitution Industrialisation (ISI) and Export Oriented Industrialisation (EOI), during and after the 1997-8 economic crisis. One of the points raised throughout this chapter is that changing government policies impacted the changing structure of these industries as well as state and business relations.

Chapters five, six and seven will discuss the findings of this research. Chapter five will discuss the influence of various regulatory frameworks on state-business relations in the palm oil and electronics industries. The argument of this chapter is that even though the regulatory frameworks have affected the interaction between state and business by providing circumstances to make patrimonial state-business relations more difficult to establish, the relationships remain especially in the palm oil industry.

Chapter six will discuss the influence of international stakeholders on state-business relations in Indonesia by using comparative case studies of the palm oil industry and the electronics industry. I argue the global stakeholders' campaign have scrutinised both business and the government in the global context and have revealed the complexity of the new patterns of patrimonial relationships. Unlike the palm oil industry, international stakeholders in the electronics industry have emphasised competition as their primary concern; therefore they have pressured their subsidiaries and the Indonesian government to provide supporting business environment or they relocated their companies to other countries. I argue that the involvement of the international stakeholders in this industry have pushed toward a more transparent and law-based relationships between business and the government.

Chapter seven will discuss state-business relations between business associations in the palm oil industry and the electronics industry and government. Among these three

business associations, I argue that business associations in the palm oil industry, which dominated by conglomerates, emerge as the association which maintain the patrimonial relationships between the government and business, but in the different form of power relations. In contrast, business associations in the electronics industry have pushed toward a more transparent and accountable state-business relations. Meanwhile, *Kamar Dagang dan Industri* (or the Indonesian Chamber of Trade and Industry, abbreviated as KADIN) has the potential to lessen the patrimonial relationships as showed in its transformation toward an autonomous and transparent business organisation. Chapter eight will conclude the thesis.

## **H. Methodology**

### **1. Rationale for adopting qualitative case study methodology**

This research takes a qualitative approach with case study methodology, which allows the use of multiple sources for the purpose of an intensive and holistic study of state-business relations in the natural setting of two sectors.<sup>24</sup> Yin emphasises that the distinctiveness of case study lays in the development of an in-depth understanding of events, relationships, experiences or processes from a single or small number of cases as unit analysis in a real world context.<sup>25</sup> More importantly, the holistic perspective in analysing the case provides a new understanding of the phenomenon because of its distinguishing characteristics.<sup>26</sup>

From a political economy perspective, this research examines whether patrimonial state-business relations in Indonesia following the 1997-8 economic crisis and Soeharto's resignation have withered away, persisted or transformed. As this is an ongoing phenomenon, I decided to analyse state-business relations in the palm oil and electronics industries as they were affected quite differently by the crisis. The objective of the analysis is to advance our understanding of how the dispersal of power, as a result

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<sup>24</sup> Robert K. Yin, *Case Study Research: Design and Methods*, 4th ed. (Thousand Oaks, California: Sage Publications, 2009); Martin Descombe, *The Good Research Guide: For Small Scale Social Research Project* (Maidenhead, McGraw-Hill Education, 2010); Norman Blaikie, *Designing Social Research* (Cambridge: Polity Press, 2000), 215-225.

<sup>25</sup> Yin, *ibid*, 18.

<sup>26</sup> Descombe, 53-54; Yin, *ibid*.

of the openness of the political system following the crisis and Soeharto's resignation, has changed the characteristics of patrimonial state-business relations in terms of numbers of actors involved and complexity of patrimonial networks.

## **2. Unit analysis**

In this research, the case or units of analysis are the palm oil and electronics industries least affected and most affected by the 1997-8 economic crisis. As the nature of these two industries is quite different, they are used to analyse the changes in patrimonial relations in Indonesia.

The 1997-8 economic crisis impacted differently across business sectors. Those affected strongly by the crisis were capital intensive industries which had previously focused on the domestic market. These sectors included banking, and construction and manufacturing industries such as electronics, textile and footwear industries. Labour intensive industries, previously export oriented, were not so negatively affected by the crisis; in fact, some of these industries grew. These sectors included agribusiness or the agriculture industry, and the mining industry, developed initially during Dutch colonisation.

The key characteristics of the electronics industry were that production was predominantly based on imported inputs and a significant percentage of production was sold into the domestic market, whereas the palm oil industry had predominantly domestic inputs and a significant percentage of the sector's production was exported.

In addition to these key characteristics mentioned above, state-business relations in both industries are significantly different. These differences relate to type of ownership. For example, the electronics industry is dominated by MNCs, joint ventures and private local companies including many Indonesian Chinese businesses, but they do not tend to be Soeharto's cronies. The palm oil industry however includes both state-owned enterprises and private companies – the latter represented by MNCs, local private companies – and small plantation holdings. Further, the majority private companies are conglomerates and some were Soeharto's cronies.

### 3. Data collection

I started collecting data for the electronics industry in 2003 when I began my PhD program at Curtin University, Perth, and continued collecting data for the palm oil industry in 2009 when I resumed my PhD program at Victoria University, Melbourne.

The scheduled fieldwork was completed in two phases during which I collected primary and secondary data. The first phase was from May to September 2003 in Jakarta and Surabaya, East Java, while the second phase was from June to August 2009 in Jakarta and Medan, North Sumatera. I interviewed a wide range of informants using in-depth interviews with open-ended questions.<sup>27</sup> This technique allowed me to gather facts, opinions and insights from informants on the issues raised.<sup>28</sup> In addition to interviews, I collected secondary data and attended seminars and workshops related to the development of the electronics and palm oil industries.

During the first phase of my fieldwork in 2003, I interviewed four types of informants: owners and/ or directors of Indonesian subsidiaries of Japanese and South Korean MNCs, joint ventures and local companies; chair and/or members of the electronics' business associations; bureaucrats in the Department of Trade and Industry; and policy makers and scholars.

The business informants included Adhi Sukmono, the Director of PT Toshiba Indonesia and Lee Kang Hyun, the Director of PT Samsung Indonesia; Uripto Widjaja, the owner of PT GALVA, a joint venture with the Japanese company, PT TOA; Ali Soebroto Oentaryo, owner and Director of PT Panggung, a medium scale domestic firm not affiliated with any MNC, located in Surabaya, East Java. These selected companies survived the economic crisis. From the Department of Trade and Industry, Ardiansyah, the Director of *Badan Pengawasan Perdagangan Berjangka Komoditi* (or the Commodity of Future Trading Regulatory Agency, abbreviated as BAPEPTI), who was the former Director of *Industri Logam Mesin Elektronika dan Aneka Industri* (or the Directorate General of Metal, Machinery, Electronic and Multifarious Industries, abbreviated as ILMEA). I also interviewed the then Coordinating Ministry of Economy and Industry in the first Cabinet of President Susilo Bambang Yudhoyono, Prof

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<sup>27</sup> Yin, *Case Study Research: Design and Methods*, 106-107.

<sup>28</sup> *Ibid.*

Dorodjatun Koentjoro-Jakti. I interviewed Dr Hadi Soesastro, a scholar from the Centre of Strategic and International Studies. I also conducted an interview with the Adhi Sukmono, the General Secretary of *Gabungan Pengusaha Elektronik* or Indonesia (or the Electronics Producers Association, abbreviated as GABEL). GABEL represents consumer electronics and home appliances companies in Indonesia and is one of the biggest interest groups in the electronic industry. In 2009, I also conducted interviews with Rahmat Gobel, Chair of GABEL and with Suhanda Wijaya, Chair of *Asosiasi Komputer Indonesia* (or the Indonesian Computer Association, abbreviated as APKOMINDO). From these interviews, I gathered information on interactions between the government and business, including business associations, on the policies that the government implemented to assist industry to recover from the crisis and to deal with the challenges from globalisation such as implementation of free trade agreements.

From June 2009 to August 2009 I undertook field work in Medan, North Sumatera to collect data about the palm oil industry. Unlike companies in the electronics industry mainly located around Jakarta and Surabaya, palm oil plantations have been developed in Sumatera, Kalimantan, Sulawesi and Papua. The larger palm oil companies have representative offices or their headquarters in Jakarta. For the purpose of this research, I decided to interview some of the informants in Medan, North Sumatera. The selection of North Sumatera was influenced by two factors. First, the history of palm oil plantations in this province dates from the Dutch colonial era. Second, North Sumatera has been the second largest producer of palm oil in Indonesia.

The informants in Medan, North Sumatera, were Balaman Tarigan, Director of PT Perusahaan Negara IV along with Marulam Angkat the corporate secretary and Abdul Ghanie, the head of Human Research and Development; Waras and Syamsul Bahri, Communication officers PT London Sumatera; Joner Napitulu, Vice Chair of *Kamar Dagang dan Industri Daerah* (or Regional Chamber of Indonesian Trade and Industry, abbreviated as KADINDA) North Sumatera Branch; Timbas Ginting, Secretary of *Gabungan Pengusaha Kelapa Sawit Indonesia* (or Indonesian Palm Oil Producers' Association, abbreviated as GAPKI) North Sumatera branch; Taufan Damanik, a lecturer at *Universitas Sumatera Utara* (or North Sumatera University) and an non-governmental organisation's (NGO) activist; and Sigit Pramono Asri, Chair of *Fraksi Partai Keadilan Sejahtera DPRD Kota Medan* (Prosperous Justice Party Faction,

Regional House of People's Representatives City of Medan), North Sumatera. In Jakarta, I conducted interviews with Maruli Gultom, the former director of PT Agro Lestari Tbk; Rosediana Soeharto, the Director of *Komisi Minyak Sawit Indonesia* (or Indonesian Palm Oil Commission, abbreviated as KMSI); Faisal Basri, an economist from the University of Indonesia; Joko Supriyono, Secretary General of GAPKI; and Fadhil Hassan, Executive Director of GAPKI.

As previously mentioned, I gathered information on the interaction between the government and business, including business associations, on the policies implemented by the government to further develop the palm oil industry. Unlike the electronics industry, this industry was among the least affected by the 1997-8 economic crisis. However, as the industry continues to develop, it has been affected by a more open political system (e.g. the implementation of the regional autonomy) and global concerns about climate change and environmental impacts. Therefore, questions on these issues were explored in the interviews to identify the different challenges faced by the palm oil industry.

Besides in-depth interviews, I also collected primary data relating to laws and regulations on corruption, regional autonomy, investment, trade and tax. Further, I also collected documents from the Roundtable for Sustainable Palm Oil, European Union Directives as well as ASEAN Free Trade (AFTA) and China-ASEAN Free Trade (CAFTA).

As mentioned, I also attended seminars and workshops that involved electronics and palm oil business associations to gather comprehensive secondary data to support primary source material. For example, I attended a seminar organised by the Ministry of Industry on “*Pengembangan industri elektronika sebagai basis pengembangan industri masa depan untuk memperkuat ekonomi nasional* (the development of the electronics industry as the foundation for the future industry to strengthen the national economy)”; a symposium on palm oil “*Menuju Ketahanan Pangan Dunia* (achieving global food security)”; and a workshop and Roundtable of the 2030 National Industry Vision and 2015 Roadmap on the electronics and palm oil industries, all organised by KADIN.

I also collected secondary data including company profiles and annual reports. From KADIN and KADINDA and business associations, I accessed minutes of meetings,

speeches, handbooks, memos and statutes of the associations. I also utilised local and national newspapers (e.g. *Harian Sumut Pos*, *Riau Pos* *Surabaya Pos* mostly retrieved online), economics magazines, journals and statistics such as value of production, export-import, investment and labour accessed from *Biro Pusat Statistik* (or the Central Bureau of Statistics, abbreviated as BPS) at national and regional levels.

The process of collecting data continued during analysis and writing, and in particular for accessing new laws and regulations pertaining to these two industries and/or incidents or issues experienced. I endeavoured to update most relevant data from secondary resources until 2012. These issues/incidents were partly covered by informants in interviews, but access to local, national and international newspapers, local and international NGO's reports, social media, business media and company websites enabled cross referencing of data and follow-up after fieldwork had been completed. And by cross referencing data from various sources, a process of triangulation occurred.<sup>29</sup>

#### **4. Data analysis**

Data from in-depth interview generated many themes, which allowed me to categorise informants' responses based on themes that emerged in each industry. In the palm oil industry, for example, there were seven themes: the anti palm oil campaign; global trade competition; lobbying against the export tax; problems arising from the implementation of regional autonomy; inconsistency of government policies; lack of government incentives; and the role of business associations in influencing government policy making. In the electronics industry, there were seven issues: recovery from the 1997-8 economic crisis; global trade competition; lobbying for reform of the tax system; inconsistency of government policies; lack of government incentives; power relations in the electronics industry; and the role of business associations in influencing government policy making.

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<sup>29</sup> Yin, *Case Study Research: Design and Methods*, 114-117; John W. Cresswell and Dana L. Miller, "Determining Validity in Qualitative Inquiry," in *Theory into Practice* 31, no.4 (2000): 571-587.

Using my hypothesis as a guide, I categorised the data into three themes: the regulatory framework, the influence of globalisation and the role of business associations.<sup>30</sup> These three themes informed the discussion in the findings chapters (see chapters five, six and seven).

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<sup>30</sup> Robert K.Yin, *Case Study Research: Design and Methods*, 5th ed. (Sage Publications, 2014), 130, [www.sagepub.com/upm-data/24737\\_Chapter\\_5.pdf](http://www.sagepub.com/upm-data/24737_Chapter_5.pdf)

## Chapter 2

### State-Business Relations in Developing Countries: Review of the Literature

The aim of this chapter is to review the literature on state-business relations following the 1997-8 economic crisis. Therefore, this chapter is divided into four sections. The first section reviews the literature on the effect of close state-business relations on the 1997 financial crisis, which sets the context for these changes. The second section compares three approaches to state-business relations: statist, neo-liberal and institutional approaches. The third section reviews the literature on patrimonialism and the patrimonial regime of Soeharto. The fourth section reviews the Indonesian political economy and changes in state-business relations following the 1997-8 economic crisis.

#### A. The effect of close state-business relations on the 1997 financial crisis

The 1997 financial crisis shattered most Northeast Asian (NEA) and South-East Asian (SEA) economies. Scholars agreed that numerous variables contributed to the crisis; in fact it was a combination of variables that initiated the crisis. The economic variables outweighed the political variables in explaining the causes of the crisis. Jomo, Montes, Laurids Lauridsen and Martin Hart-Landsberg are among the scholars who argued that financial liberalisation was the main cause.<sup>31</sup> These scholars pointed to the global financial system and the forces that supported the system that caused the collapse of the

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<sup>31</sup>Jomo KS, "Introduction: Financial Governance, Liberalisation and Crises in East Asia," in *Tigers in Troubles: Financial Governance, Liberalisation, and Crisis in East Asia*, ed. Jomo K. Sundaram (New York, Zed Books, 1998); Laurids S.Lauridsen, "Thailand: Causes, Conduct, Consequences," in *Tigers in Troubles: Financial Governance, Liberalisation, and Crisis in East Asia*, ed. Jomo K. Sundaram (New York Zed Books, 1998), 137-161; Manuel F. Montes, *The Currency Crisis in East Asia*, 2<sup>nd</sup> ed. (Singapore: Institute of Southeast Asian Studies, 1998); Martin Hart-Landsberg, "Causes and Crisis: Inside the Crisis," in *Solidarity* March/April, no. 73 (1998), <http://www.solidarity-us.org/site/node/1837> (accessed 10 October 2010).

financial system. According to these scholars, the crisis started when those countries affected implemented financial market reform as part of the neo-liberal agenda since the early 1990s. The policies (e.g. pegged currencies, excessive foreign capital investments and establishment of poorly regulated private sector banking), allowed the private sector to access short-term loans that led to a misallocation of resources, as well as speculation in real estate and the stock market.

Wade and Vaneroso, Henderson and Soesastro in explaining the crisis in South Korea, Thailand and Indonesia, emphasised regulatory failure with global financial market integration.<sup>32</sup> They argued that the banks, which had little experience managing foreign exchange, “risked being highly vulnerable to external shocks, particularly where liberalisation favoured short-term borrowing. The banks were inadequately supervised and prudential regulation of bank-dominated financial systems permitted high corporate leveraging and excessive risk taking.”<sup>33</sup> For the Indonesian case, Soesastro emphasised lack of prudent regulations and supervision from the central bank towards the new banks and lending practices by business and conglomerates, some of whom owned the banks.<sup>34</sup> In other words, the banking systems of these countries lacked the institutional foundations required to become more integrated with the international financial market.

However, Hill, McLeod and Sadli pointed to politics as one of the compounding factors that exacerbated the crisis in the region, particularly in Indonesia.<sup>35</sup> Haggard and MacIntyre, Winters and Robison and Rosser have argued that political causes were

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<sup>32</sup>Robert Wade and Vaneroso, “The Asian Crisis: The High Debt Model vs the Wall Street-Treasury-IMF Complex,” (1998), 3-22, <http://content.csbs.utah.edu/~mli/Economies%205430-6430/Wade-The%20Asian%20Crisis.pdf> (accessed 10 October 2010); ; Jeffrey Henderson, “Uneven Crisis: Institutional Foundation of East Asian Economic Turmoil,” *Economic Society* 28, no.3 (1999): 327-368; Hadi Soesastro, “The Financial crisis in Indonesia: Lessons and Challenges for Governance and Sustainable Development,” <http://www.pacific.net.id/pakar/hadisuastro/economic.html>, accessed 20 December 2009.

<sup>33</sup> Robert Wade and Vaneroso, “The Asian Financial Crisis”; Henderson, “Uneven Crisis”.

<sup>34</sup> Soesastro, “The Financial crisis in Indonesia”.

<sup>35</sup> Hill, *The Indonesian Economy in Crisis: Causes, Consequences and Lessons* (Singapore and United States of America: Institute of Southeast Asian Studies and St Martin's Press, 1999); Ross H. McLeod, “Indonesia”, in *East Asia in Crisis: From Being a Miracle to Needing One?* eds. Ross H. McLeod and Ross Garnaut (London: Routledge, 1998), 31-48; Mohammad Sadli, “The Indonesian Crisis,” in *Southeast Asia's Financial crisis: Origins, Lessons and the Way Forward*, eds. H.W. Arndt and Hal Hill (New South Wales: Allen and Unwin), 16-27.

more important compared to economic causes.<sup>36</sup> The similarity in these arguments is that they all saw Soeharto as a factor which exacerbated and complicated the crisis. Further, these scholars took the political perspective to explain the crisis and focused on the impact of close state-business relations in the region, which led to the practice of crony capitalism.<sup>37</sup> Their analyses revealed that crony relationships in the form of ‘patron-client’, ‘patrimonial’, or ‘close’ state business relations was a significant factor that worsened the crisis in the SEA region. According to these scholars, this factor is revealed as the cause that transformed the financial crisis into an economic as well as political crisis in Indonesia.<sup>38</sup>

Having a lack of prudent regulations and supervision in the banking system, close state-business relations emerged as the catalyst for causing moral hazard. In Haggard as well as in Haggard and MacIntyre, moral hazard is defined as the misperception by business that government will guarantee and bail out any bad loans made by international and domestic lenders.<sup>39</sup> According to Hill, government’s explicit or implicit over-guarantee under the regulated banking system triggered excessive and irresponsible lending behaviour.<sup>40</sup> More importantly, the connection of business and government, according to Robison and Rosser, exacerbated the moral hazard problem by creating a false sense of security among potential investors.<sup>41</sup> Unlike these scholars who tended to generalise that moral hazard occurred with most investors, MacIntyre and Haggard argued that

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<sup>36</sup> Stephen Haggard and Andrew MacIntyre, “The Political Economy of the Asian Financial crisis”, in *Review of International Political Economy*, 5, 3 (1998): 381-392, <http://www.jstor.org/stable/4177277> (accessed 5 May 2013); Jeffrey A. Winters, "The Financial Crisis in Southeast Asia," in *Politics and Markets in the Wake of the Asian Crisis*, ed. Richard Robison, Mark Beeson, Kanishka Jayasuriya and Hyuk-Rae Kim (London: Routledge, 2000), 34-52; Richard Robison and Andrew Rosser, “Surviving the Meltdown: Liberal Reform and Political Oligarchy in Indonesia,” in *Politics and Markets in the Wake of the Asian Crisis* eds. Richard Robison, Mark Beeson, Kanishka Jayasuriya, and Hyuk-Rae Kim (London: Routledge, 2000), 3-24.

<sup>37</sup> Haggard and MacIntyre, “The Political Economy of the Asian Financial crisis”; Winters, "The Financial Crisis in Southeast Asia"; Robison and Rosser, “Surviving the Meltdown: Liberal Reform and Political Oligarchy in Indonesia”.

<sup>38</sup> Haggard and MacIntyre, *ibid*; Winters, *ibid*; Robison and Rosser, *ibid*.

<sup>39</sup> Stephen Haggard, *The Political Economy of the Asian Financial Crisis* (Washington DC: Institute for International Economics, 2000), 24-30; Haggard and MacIntyre, “The Political Economy of the Asian Financial crisis.”

<sup>40</sup> Hill, *The Indonesian Economy in Crisis: Causes, Consequences and Lessons*.

<sup>41</sup> Robison and Rosser, “Surviving the Meltdown: Liberal Reform and Political Oligarchy in Indonesia”.

moral hazard only related to a small number of investors, who were mostly part of Soeharto's network of crony business relationships and obtained benefit from the industrial policies during the New Order.<sup>42</sup>

According to the World Bank and the IMF, crony capitalism caused the crisis. They both argued that crony capitalism has been the characteristic relationship between government and business in the affected countries.<sup>43</sup> In the NEA and SEA regions, the World Bank and IMF highly criticised excessive government intervention in the targeted industries, which created close, symbiotic but not transparent relationships with certain business groups and cronies. This generated widespread rent-seeking activity<sup>44</sup>, with high levels of corruption that distorted the economy.<sup>45</sup>

Further, Sadli, one of the technocrats in Soeharto's New Order, even though he did not use the term 'crony capitalism', admitted that the severity of the Indonesian crisis was related to the lack of "political fundamentals" of the regime.<sup>46</sup> These fundamentals constituted a "lack of good governance or rampant corruption, lack of transparency and democracy perceived political instability surrounding impending succession".<sup>47</sup> Compounded by the weakness of market fundamentals, these political factors led to an abrupt decline in market confidence.

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<sup>42</sup> Haggard and MacIntyre, "The Political Economy of the Asian Financial Crisis."

<sup>43</sup> The World Bank, *Indonesia in Crisis: A Macroeconomic Update* (Washington DC, 1998).

<sup>44</sup> Rent-seeking activity can be associated with any unproductive activity to obtain subsidies from government to business. In the political sense, subsidies and rents are understood as any policy induced gain beyond what would be expected from a competitive market. Having rent-seeking activity in place will reduce the optimum productivity that market economy can achieve. In the long run, it will affect the overall growth of the economy because it will reduce the rate of investment to come because this activity only favours particular groups or firms, see Mancur Olson, *The Rise and Decline in Nations* (New Haven and London: Yale University Press, 1982); Mustaq H. Khan and Jomo K. Sundaram, eds. *Rents, Rent Seeking and Economic Development: Theory and Evidence in Asia* (Oakleigh, Melbourne: Cambridge University Press, 2000).

<sup>45</sup> Stanley Fisher, "The Asian Crisis: A View from IMF" (1998), <http://www.imf.org/external/np/speeches/1998/012298.htm> (accessed 24 March 2013).

<sup>46</sup> Mohammad Sadli, "The Indonesian Crisis", 18.

<sup>47</sup> *Ibid.*

Sadli, MacIntyre and Haggard<sup>48</sup> also see this decline as a consequence of Soeharto being the highest executive authority with no effective institutional constraints. With no institutions that would challenge him, he was vulnerable to the credibility issue. More importantly, concerns about Soeharto's health increased uncertainty about political succession, and served to challenge the confidence in his leadership, creating an uncertain political and economic situation, which not only affected business confidence, but also worsened the severity of the crisis.<sup>49</sup>

Soeharto's close relations with his cronies and families, as an example of how politics and business intertwine, according to Winters was the representation of how political power holders in Southeast Asia engaged through personal relationships with families, military groups and favoured individuals and transformed them into conglomerates for the power holders' purposes.<sup>50</sup> Since the 1980s, these patron-client relationships, however, became much more problematic because more private capital was involved and decisions about capital flow were much more fragmented and competitive.<sup>51</sup> Winters argued the crisis occurred because the conflicts between the patron-client groups, that controlled the state and capital flow, were challenged by the "highly mobile domestic economic actors" who did not control the state.<sup>52</sup>

In the bigger picture, Beeson and Rosser argued that the unregulated and volatile nature of global financial markets, in terms of the shift in power from the states to mobile forms of capital, occurred as a result of globalisation.<sup>53</sup> Relating to this shift, Robison and Rosser observed the emergence of powerful politico-business coalitions within these countries since the 1980s and early 1990s, responsible for generating poor economic fundamentals in many countries within the region.<sup>54</sup> More importantly, the

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<sup>48</sup> Stephan Haggard and Andrew MacIntyre, "The Political Economy of the Asian Financial Crisis."

<sup>49</sup> *Ibid.*

<sup>50</sup> Jeffrey Winters, "The financial crisis in Southeast Asia," 34-52.

<sup>51</sup> *Ibid.*, 37.

<sup>52</sup> *Ibid.*

<sup>53</sup> Mark Beeson and Andrew Rosser, "The East Asian Financial crisis: A Brief Overview of the Facts, Issues and the Future," *Working Paper* no. 86, (June 1998): 1-16.

<sup>54</sup> Robison and Rosser, "Surviving the Meltdown: Liberal Reform and Political Oligarchy in Indonesia".

dominance of these coalitions prevented the adoption of reform measures to resolve the crisis.<sup>55</sup>

Close state-business relations in the affected countries emerged as the underlying cause, particularly in Indonesia. Haggard argued that among the four countries he analysed – Indonesia, Malaysia, Thailand and South Korea – the concentration of private economic power was situated in the hands of big conglomerates.<sup>56</sup> These conglomerates became the significant actors who exploited the weaknesses of the regulations, especially in the banking sector. However, the concentration of private economic power in Indonesia occurred in the form of quintessential relations between Soeharto and his cronies, which exacerbated the financial crisis and eventually transformed the crisis into a political one.<sup>57</sup>

Stephan Haggard argued that close state-business relations had beneficial aspects in the era of economic growth but these relationships became problematic when the crisis occurred.<sup>58</sup> As will be explained at greater length in the second section, the close relations between state and business in the developmental state model, or even in the patrimonial state model, were compatible with achieving high economic growth from the 1970s to 1990s or until the crisis occurred in 1997.

## **B. Debate on state-business relations in the political economy of Northeast Asia and Southeast Asia: statist, neo-liberalist and institutionalist approaches**

The scholars in the previous section have demonstrated that close state-business relations had a negative impact in the period of the financial crisis. In fact, these relations were significant factors in igniting the crisis. The subsection 1 of this section, however, demonstrates a body of literature that accommodated scholars who argued that close state-business relations had proven to be an asset before the financial crisis occurred.

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<sup>55</sup> *Ibid.*

<sup>56</sup> Haggard, *The Political Economy of the Asian Financial Crisis*, 101.

<sup>57</sup> *Ibid.*

<sup>58</sup> *Ibid.*, 2.

The discussion here involves a comparison of two different development models of the first tier of the New Industrialised Countries (NICs) of NEA and the second tier of NICs of SEA plus the transformation of a developmental state model following the crisis and how this model impacted state-business relations, both in NEA and SEA.

The debate in the first subsection focused on the implementation of developmental state model in the first tier of the NICs of NEA and the implementation of the non-developmental state model of the second tier of NICs of SEA. Even though NEA and SEA apply different models, the NICs of NEA reached a miracle of high economic growth for almost thirty years before the crisis occurred. Their counterparts in SEA also reached a considerably high economic growth during the same period. In the second subsection, the focus of the debate will shift to the transformation developmental state model following the crisis and its effect on state-business relations, both in NEA and SEA. The dismantling of some features of this model, particularly close state-business relations and strong state intervention features, became a lesson learned. Both statist and neo-liberal proponents have identified these factors and accommodated them in alternative state-business arrangements after the crisis.

### **1. Implementation of the developmental state model in NEA and SEA**

Before the 1997 financial crisis, the literature analysed the miracle growth reached by the the NICs of NEA, which applied the developmental state model. Using statism as the approach, the proponents, such as Peter Evans, Robert Wade and Alice Amsden, believed in strong state capacity to pursue high economic goals.<sup>59</sup> To catch up with advanced industrialised countries, Amsden and Wade argued that since the beginning of

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<sup>59</sup>Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton: Princeton University Press, 1995); Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asia Industrialization*, 2nd ed. (New Jersey: Princeton University Press, 1990); Alice Amsden, "Why Isn't the Whole World Experimenting with the East Asian Model to Develop?: Review of the East Asian Miracle," *World Development* 22, no. 4 (1994): 627-633.

their development, the NICs have adopted strong states<sup>60</sup> as captured in Johnson's developmental state model.<sup>61</sup>

This model relies on state intervention in guiding, leading and shaping economic development through industrialisation: to formulate the industrial policy, to set economic development as the primary priority, to set the institutional arrangements to support this priority, and to prepare for the consequences caused by the rigidity and strictness of implementing the industrial policy.<sup>62</sup> In other words, the state's role in the economy is in contrast with World Bank expectations and other international financial institutions' premises: a minimised role for states in the economy.

This state intervention proceeds on the basis of power: it has its own structural arrangements to pursue its own interests. The first structure is a strong, insulated and autonomous set of economic agencies run by educated, well-paid bureaucrats with a high capacity to implement economic policies and programmes.<sup>63</sup> Second, the state creates an activist industry policy that develops competitive export oriented global industries. Johnson and Wade argued that to accelerate economic growth, the state mobilises and allocates resources to selected industrial sectors and business groups, as well as sets up the target to be achieved. In other words, the state chooses the sector and business groups to be "the national champion", to carry industrialisation.<sup>64</sup> Third, as a consequence of the state choosing the "winner", the relationship between states and business groups becomes subordinate. In sum, the state builds strong institutional foundations that embrace economic agencies, banks and specific business groups, under state patronage. Amsden, Wade and Woo-Cummings, therefore, argued that the miracle growth achieved by the NICs for almost three decades (from the mid 1970s until 1997 when the financial crisis occurred) was the result of activist industrial policies that

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<sup>60</sup> Amsden, *ibid*; Wade, *ibid*.

<sup>61</sup> Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford: Stanford University Press, 1982); Chalmers Johnson, "Studies of Japanese Political Economy: A Crisis in Theory," *The Japan Foundation Newsletter* XVI, no. 3 (1988): 1-11.

<sup>62</sup> Johnson, *MITI and the Japanese Miracle*, *ibid*; Wade, *Governing the Market*, *ibid*; Evans, *Embedded Autonomy*.

<sup>63</sup> Johnson, *ibid*; Wade, *ibid*; Evans, *ibid*.

<sup>64</sup> Johnson, *ibid*.

targeted selected industries in the architecture of the developmental state within the export oriented global economy.<sup>65</sup>

In responding to the miracle growth of NEA countries, the neoliberal proponents, the World Bank, Choudary and Islam, argued that this growth was the outcome of applying fundamental market prescriptions, such as supply-side economics, monetarism and minimal government, instead of applying industrial policy, directed credit and import protection.<sup>66</sup> Given the World Bank analysis on this extraordinary growth, the NEA countries applied policies that favoured a free trade regime, which allowed the private sector to innovate and pursue its natural comparative advantage: financial sector liberalisation, privatisation of state-owned enterprise, fiscal and trade discipline, exchange rates and foreign investment regulations.<sup>67</sup> Apart from these policies, the World Bank also argued that East Asian countries have pursued effective export oriented industrial strategies rather than broadening and deepening their import substitution industrial activities, which contribute to high economic growth.<sup>68</sup>

In terms of the state's intervention role, the World Bank has argued that the role of the state is limited to stabilising the macro economy, meeting the basic needs of its people, maintaining law and order, providing infrastructure, and enforcing property rights to induce the market to operate more efficiently. According to the World Bank, by limiting the state to these roles, the East Asian market was stimulated, competitiveness occurred, and high economic growth was obtained.<sup>69</sup> However, in its 1993 "The East Asian Miracle" Report, the World Bank also acknowledged that the East Asian developmental states intervened significantly in the economy, especially in directing credit and allocating funds to specific firms. Even though some of these interventions violated the

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<sup>65</sup> Amsden, "Why Isn't the Whole World Experimenting with the East Asian Model to Develop?"; Wade, *Governing the Market*; Meredith Woo-Cummings, ed. *The Developmental State* (Ithaca and London: Cornell University Press, 1999).

<sup>66</sup> The World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (New York: The World Bank, 1993); Anis Chowdury and Iyanatul Islam, ed. *The Newly Industrialising Economies of East Asia* (London: Routledge, 1993); William E. James, Seiji Naya and Gerald M. Meier, *Asian Development: Economic Success and Policy Development* (Madison: University of Wisconsin Press, 1989).

<sup>67</sup> The World Bank, *ibid.*

<sup>68</sup> *Ibid.*

<sup>69</sup> *Ibid.*

operation of the free market, the World Bank argued that their intervention, to a certain extent, promoted the industrial development of these East Asian countries.<sup>70</sup>

Even though SEA countries have different features from NEA countries, SEA countries experienced considerable economic success before the 1997 financial crisis. Unlike their counterparts in Northeast Asia, according to Henderson, the state's structure did not follow the developmental state model.<sup>71</sup> In Henderson's assessment of the institutional arrangement of these Southeast Asian countries, he argued that some of the SEA states, for example Indonesia, have not yet developed the institutions as required in the developmental states model. In other countries, such as Malaysia and Thailand, even though they have begun to develop developmental state characteristics, their institutions are still weak.<sup>72</sup> In other words, the characteristics of these countries have encompassed weaker bureaucracies, more or less corrupt and unskilled officials, and economies dominated by rent-seeking behaviour, providing conditions for a patrimonial and clientelistic relationship between state and business to flourish.

The considerable high growth reached by these SEA countries is due to import substitution industrial policies as part of the nationalistic approach to the development in the early 1970s, followed by export oriented industrialisation. Hart-Landsberg and Hill argued that the massive inflow of Foreign Direct Investment (FDI) began in the mid 1980s to the early 1990s from Japan. South Korean and Taiwanese manufacturing companies had also made these countries major exporters of manufacturing products, largely to the United States.<sup>73</sup> Within the time frame, economic growth reached more than 10 percent per annum.

The neo-liberal view of SEA development was not as critical as its view of the NICs developmental state model. The lack of criticism was due to the fact that SEA seemed to choose the path prescribed by neo-liberals, which limits state involvement and, at the

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<sup>70</sup> *Ibid*, 9.

<sup>71</sup> Jeffery Henderson, "Uneven Crises: Institutional Foundations of East Asian Economic Turmoil", *Economics and Society*, 28, no.3 (1999): 227-368.

<sup>72</sup> Henderson has labelled Indonesia as an "unborn developmental state", whereas Malaysia and Thailand were labelled as "still-born developmental states".

<sup>73</sup> Hart-Landsberg, "Causes and Consequences: Inside the Asian Crisis" in Hal Hill, ed. *Indonesia's Industrial Transformation* (Singapore: ISEAS and St Leonards, NSW: Allen and Unwin 1998).

same time, maintains a free-market economy with the private sector as the main engine of growth. Specifically, the considerable high growth of SEA economies was achieved after they shifted to Export Oriented Industrialisation (EOI) and implemented deregulation policies, namely trade, investment and capital liberalisation.

Unlike the neo-liberal view, the institutional perspective saw Southeast Asian states as weaker states compared to their NEA counterparts, which reached its high economic growth due to interdependency between state policy and the private sector. Richard Doner, one of the institutional proponents, argued that interdependency between both institutions was understandable because any policies implemented should reflect the interests of a coalition of state and the private sector.<sup>74</sup> Underlying his argument was his assumption that “development requires the consent, indeed, the active participation of diverse economic actors”<sup>75</sup>, therefore, taking into account that coalition interests could become a good foundation in such arrangements between state policy and the private sector.

## **2. Debates on the role of states and business among statist, neoliberal and institutional proponents**

Following the 1997 financial crisis, the salient features of developmental states, including strong state intervention and close state-business relationships were strongly questioned. This section focuses on the debate in revisiting state and business relationships in the economy following the 1997 financial crisis among statist, neoliberal and institutional proponents.

The main argument of statist proponents is that they defend the role of states in managing their economy; therefore, the state determines its relationships with business. Different statist scholars, however, have different conceptualisations of the

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<sup>74</sup> Richard F. Doner, "Approaches to the Politics of Economic Growth in Southeast Asia." *The Journal of Asian Studies* 50, no. 4 (1991): 818-849, <http://www.jstor.org/stable/2058543> (accessed 24 October 2009).

<sup>75</sup> Richard F. Doner, "Limits of State Strength: Toward an Institutional View of Economic." *World Politics* 44, no. 3 (1992): 398-431, <http://0-www.jstor.org.library.vu.edu.au/stable/10.2307/2010544?origin=api> (accessed 24 October 2009)

transformation of the developmental state and how this transformation affects the new arrangement of state-business relations. As will be discussed in this subsection, the idea of regulatory states, argued by a statist proponent, Kanishka Jayasuriya, almost has the same features as the World Bank's notion of capacity building of countries affected by the crisis.<sup>76</sup> The difference is that the former has the objective to insulate from political influences whereas the latter has the objective to include political factors in order to reduce the negative access of its earlier policies such as the Structural Adjustment policies. Further, Linda Weiss, another statist proponent, accepts the idea that the state should determine relations with business; however, her idea of the state following the crisis is different from the original strong state, but it is a synergy between the minimalist state and the strong developmental state.<sup>77</sup> In other words, she rejects this idea of state and society relationship in state corporatism circumstance.

With the demise of developmental state model, Kanishka Jayasuriya suggested that it transform into a strong regulatory state.<sup>78</sup> This regulatory state strengthened by a form of economic constitutionalism which "refers to the attempt to treat the market as a constitutional order with its own rules, procedures, and institutions operating to protect the market order from political interference."<sup>79</sup>

Jayasuriya's concept of a regulatory state embraces almost all of the regulative capacities. The regulatory state has the capacity to guard the market from the oligarchy of the private sector with its legal system, and to establish financial and corporate accountability, judicial independence, and transparent regulatory structures.<sup>80</sup> In his

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<sup>76</sup> Kanishka Jayasuriya, "Authoritarian Liberalism, Governance and the Emergence of the Regulatory State in Post-Crisis East Asia," in *Politics and Markets in the Wake of the Asian Crisis*, eds., Richard Robison, Mark Beeson, Kanishka Jayasuriya and Hyuk Rhe Kim (New York: Routledge, 2000).

<sup>77</sup> Linda Weiss, *The Myth of Powerless State: Governing the Economy in a Global Era*, 1st ed. (Ithaca: Cornell University Press, 1998).

<sup>78</sup> Kanishka Jayasuriya, "Authoritarian Liberalism, Governance and the Emergence of the Regulatory State in Post-Crisis East Asia," *ibid*, 329.

<sup>79</sup> Kanishka Jayasuriya, "Governance, Post Washington Concensus, and the New Anti Politics," *Working Paper Series* no. 2 (Southeast Asia Research Centre: City University of Hong Kong, 2001), 7; Kanishka Jayasuriya, "The Rule of Law and Regime of Exception in East Asia," *Working Paper*, (Asian Research Centre: Murdoch University, 2000), 14.

<sup>80</sup> Jayasuriya, "Authoritarian Liberalism, Governance and the Emergence of the Regulatory State in Post-Crisis East Asia", *ibid*; Jayasuriya, "The Rule of Law and Regime of Exception in East Asia", *ibid*.

argument, he makes it explicit that the task of the regulatory state is to be the “safeguard of the market”; therefore businesses are subordinated, regulated and guarded by the regulatory state.<sup>81</sup>

Unlike Jayasuriya’s regulatory state, the World Bank, from the neo-liberal point of view, and in response to the countries affected, has modified the policies to emphasise rebuilding the institutional capacity. The World Bank has accepted that its previous policy implemented in the countries affected by the crisis did not consider political factors such as governance, civil society and safety nets. The inclusion of these political factors is considered significant for a stable market system.<sup>82</sup> The adoption of new policies by the World Bank does not mean that it departs from its previous policy of the open market, deregulation and less government intervention with the private sector at the centre of policies. This adoption needs to be understood as “a political counterpart to the earlier economic emphasis on structural reform.”<sup>83</sup>

In its report “Road to Recovery”, particularly aimed at reviving the success story of the affected countries, the World Bank found it necessary to add ‘extra economic’ determinants of economic performance to its previous policies: open markets, deregulation, liberalisation and structural adjustments.<sup>84</sup> Of the extra economic determinants, governance becomes the foundation for re-building the institutional capacity of these affected countries, because it consists of policy frameworks, rules and institutions that regulate the conduct of private and public activity, which includes an adequate legal system, a financial and corporate accountability system, judicial independence, and transparent regulatory structures.<sup>85</sup>

The other statist scholar, Linda Weiss, has used the model of governed-interdependence to define how the state has the capacity to respond to economic globalisation.<sup>86</sup>

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<sup>81</sup> Jayasuriya, *ibid*; Jayasuriya,” *ibid*.

<sup>82</sup> The World Bank, *East Asia: The Road to Recovery* (Washington DC, 1998).

<sup>83</sup> Kanishka Jayasuriya and Andrew Rosser, "Economic Orthodoxy and the East Asian Crisis," *Working Paper No. 94* (1999): 15.

<sup>84</sup> The World Bank, *East Asia: The Road to Recovery*.

<sup>85</sup> *Ibid*.

<sup>86</sup> Linda Weiss, *The Myth of Powerless State: Governing the Economy in a Global Era*, 1st ed. (Ithaca:

According to her, state capacity itself is a complex institutionalisation which involves a power network between state and society, whereby both state and society can be in the same strong position.<sup>87</sup> As a concept, governed-interdependence refers to “a negotiated relationship in which public and private participants maintain their autonomy, yet which is nevertheless governed by broader goals set and monitored by the state.”<sup>88</sup> Therefore, relations between the state and the private sector are formally recognised as an institutionalised cooperation. In other words, Weiss makes it explicit when she argues that states are not restricted to authoritarian-types.

Unlike Jayasuriya, Weiss’s type of state seems to be a synergy between the minimalist state and the strong developmental state which provides infrastructures, socialises risks, coordinates the participation of the various public and private participants, and sets the broader goals for society by drawing firms and associations into negotiating relationships in pursuit of the state’s own policies and projects for development.<sup>89</sup> However, actors in the private sector or business sector must be strong enough to take initiatives, provide useful information, and assist the state in targeting its resources and activities.<sup>90</sup> And under governed interdependence, the mutual dependence and interactions between state and private or business sectors develop formal recognition through opportunities for institutionalised cooperation.<sup>91</sup>

Weiss is closer to the institutionalist argument which incorporates other actors (in this case business groups) in a transactional relationship with the state to solve problems that emerge during policy implementation. The underlying assumption of this concept is that interests vary in both public and private sectors, and a successful policy reflects these complex interests. At the same time, this approach can be seen as a reaction to the statist approach, which may allow coercive action to solve problems caused by business groups that disobey government policy.

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Cornell University Press, 1998).

<sup>87</sup> *Ibid.*, 38.

<sup>88</sup> *Ibid.*, 38.

<sup>89</sup> *Ibid.*, 37-39.

<sup>90</sup> *Ibid.*

<sup>91</sup> *Ibid.*

From the institutionalist approach, the changing structure caused by the 1997 financial crisis needs to be explained by the state and the private sector because both institutions have changed. In the early 1990s, Richard Doner, one of the institutionalist proponents, seemingly saw the disadvantages of domination of the strong states applied in developmental models. In his article "Limits the state strength", he argued that industrial transformation to increase economic growth in weaker states, such as in Southeast Asian countries, depended not only on the state as policy makers but also on the private sector.<sup>92</sup> The interdependency between both institutions was understandable because any policies decided and implemented should reflect the coalition interests of the state and private sector.<sup>93</sup> Underlying his argument were his assumptions that "development requires the consent, indeed the active participation of diverse economic actors",<sup>94</sup> therefore, taking these interests into account could become a solid foundation between the state and the private sector.

Unlike statist arguments, the institutionalist scholars' perceived state and business in a more or less equal relationship, where state still has the capacity to monitor, discipline and regulate the business sector.<sup>95</sup> In this type of relationship, according to Schneider and Maxfield, four factors – information exchange, reciprocity, credibility and trust -- need to be provided by both sides that could avoid rent-seeking activities, and at the same time, "encourage business to make productive use of government assistance rather than squandering it and investing in seeking more."<sup>96</sup>

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<sup>92</sup> Doner, "Limits of State Strength: Toward an Institutional View of Economic,"

<sup>93</sup> Doner, "Approaches to the Politics of Economic Growth in South-East Asia."

<sup>94</sup> Richard F. Doner, "Limits of State Strength," *ibid.*

<sup>95</sup> Sylvia Maxfield and Ben Ross Schneider, eds. *Business and the State in the Developing Countries*, Cornell Studies in Political Economy (Ithaca: Cornell University Press, 1997); Doner, "Approaches to the Politics of Economic Growth in South-East Asia"; Doner, "Limits of State Strength: Toward an Institutional View of Economic."

<sup>96</sup> Schneider and Maxfield, *Business and the State in the Developing Countries* 7-15.

## **C. Patrimonialism and patrimonial state-business relations in Soeharto's New Order**

This section reviews the concept of patrimonialism coined by Weber and the development of this concept as applied to a “catch all concept” in the developing countries, such as Southeast Asia, Africa and South America, in referring to the structure of society, states or regimes, bureaucracies and capitalism. The concept of patrimonial state and how scholars have used this concept in analysing Indonesian political economy, especially during Soeharto's New Order, will also be reviewed.

### **1. What is patrimonialism?**

The concept of patrimonialism relates to authority as outlined by Weber. Weber defines authority as:

Domination (“authority”) in this sense may be based on the most diverse motives of compliance all the ways from simple habituation to the most purely rational calculation of advantages. Hence every genuine form of domination implies a minimum of voluntary compliance, that is, an *interest* (based on ulterior motives or genuine acceptance) in obedience.<sup>97</sup>

Weber's definition indicates that authority can range from non-rational compliance to purely rational compliance. Based on this definition, Weber categorised three types of authority: traditional, charismatic and legal-rational authority. These represent the continuum from non-rational compliance to purely rational compliance.

Traditional authority is based on the acceptance that the traditional rights of a powerful and dominant individual or group are accepted, or at least not challenged, by subordinate individuals. Different types of traditional authority are (i) gerontocracy or rule by elders; (ii) patriarchy where positions are inherited; (iii) patrimonialism where rule is by an administration or military force that are purely personal instruments of the master; and (iv) feudalism.

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<sup>97</sup>Max Weber, Max Weber, *Economic and Society Volume 1*, ed. Guenther Roth and Claus Wittich (Berkeley: University of California Press, 1978), 212.

Charismatic authority relies on "devotion to the exceptional sanctity, heroism or exemplary character of an individual person, and of the normative patterns or order revealed or ordained by him."<sup>98</sup> The sole basis of charismatic authority is the recognition or acceptance of the claims of the leader by the followers. Legal-rational authority relies on "a belief in the legality of enacted rules and the right of those elevated to authority under such rules to issues commands."<sup>99</sup>

Weber's categorisation of authority is frequently related to the study of bureaucracy, which differentiates the legal-rational type of bureaucracy in modern society and the patrimonial type of bureaucracy in traditional society. As exemplified in the second section of this chapter, the proponents of the developmental state model applied in Northeast Asia relied on the legal-rational economic bureaucracy and argued that this type of bureaucracy could support the role of strong state intervention in the economy. In comparison, scholars such as Doner and Henderson pointed to the absence of legal-rational type of bureaucracy in the weaker states of Southeast Asian countries where patrimonial bureaucracy prevails.<sup>100</sup>

In addition to the study of bureaucracy, a considerable amount of literature has been published on the applicability of the concept of patrimonialism (sometimes it is used interchangeably with neo-patrimonialism). Based on Weber's definition of patrimonialism, the concept is expanded to:

A true neopatrimonial, we argue, would have to include, the reciprocities [personal, densely interwoven, often lopsided, and based on intangible and symbolic dynamic of status, loyalty, deference as much as on material exchange] that Weber discusses along with the personal dimensions of power, governance, and compliance that feature in most contemporary accounts. It would have to recognize the mutual, socially constructed obligations he delineated, along with the inequalities. It must allow for the possibility that such a complex, multistranded set of ties and obligations is too complex and diverse to predetermine any one regime type, dysfunctional or otherwise.<sup>101</sup>

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<sup>98</sup> Weber, *ibid.*, 215

<sup>99</sup> *Ibid.*

<sup>100</sup> Doner, "Approaches to the Politics of Economic Growth in South-East Asia."

<sup>101</sup> Anne Pitcher, Mary H. Moran, Michael Johnston, "Rethinking Patrimonialism and Neopatrimonialism in Africa," *African Studies Review* 52, no. 1 (April 2009): 127, <http://muse.jhu.edu/journals/arw/summary/v052/52.1.pitcher.html>. (accessed 21 April 2010).

Thus the definition and its usage in analysis are expanded to:<sup>102</sup>

1. a set of social relations at either the community or nation-state level, mediated by personal loyalty and governed by bonds of dependence and subordination.
2. rent-seeking behaviour and personal patterns of authority practised by African leaders in selected country settings.
3. an economic logic distinguished by the continual blurring of public service and private gain, with serious implications for economic development.
4. a characteristic regime type associated with most African countries, not only during the period of one-party rule, but also in the present period of democratisation.

Relating to its usage in economic and development spheres, Theobald<sup>103</sup> observed that a lack of development tends to produce a patrimonial public administration and Pierre Engelbert<sup>104</sup> asserts that neopatrimonialism hinders development and economic growth. Eric Budd<sup>105</sup> reinforces the claims made by Theobald and Engelbert regarding the relationship between neopatrimonialism and poor economic developmental outcomes. Like Theobald, Budd indicates that patrimonialism is a structural feature of many states but it is not an institution; he states that, “patrimonialism mitigates institutionalisation.”<sup>106</sup> He claims that all states are patrimonial but “some states are clearly more patrimonial than others.”<sup>107</sup>

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<sup>102</sup> *Ibid*, 131.

<sup>103</sup> Robin Theobald, "Patrimonialism, " in *World Politics* 34, no. 4 (1982): 548-559, <http://www.jstor.org/stable/2010334> (accessed 18 November 2009).

<sup>104</sup> Engelbert 2000 quoted by Pitcher, Moran and Johnston, “Rethinking Patrimonialism and Neopatrimonialism in Africa”, 133.

<sup>105</sup> Eric Budd, *Democratization, Development, and the Patrimonial State in the Age of Globalization* (Lanham, Maryland: Lexington Books, 2004).

<sup>106</sup> *Ibid*, 6.

<sup>107</sup> *Ibid*,139.

Pitcher, Moran and Johnston<sup>108</sup>, drawing from African experience, criticise the negative interpretation of the concept of patrimonialism (or neo-patrimonialism). According to these authors, western scholars have claimed that dictatorial governments in Africa (both at local and national levels) have failed to implement development, increasing economic growth and eradicating corruption as a result of the values of patrimonialism or neo-patrimonialism.<sup>109</sup> They argued that western scholars have misread Weber, particularly with respect to Weber's ideal types of authority. According to these scholars<sup>110</sup>, all three types of authority were ideals. Weber did not argue that one ideal type of authority evolved into another. Further, they argued each of the types of authority related to different cultures and beliefs and were created in different social and political settings.<sup>111</sup>

## 2. Patrimonial state

The term 'patrimonial state' was introduced early in the nineteenth century by Carl Ludwig von Haller and adopted by Weber with a slightly different meaning.<sup>112</sup> Weber defined patrimonial state as:

the political domination of a ruler with the help of his personal apparatus (consisting of slaves, retainers and ministeriales), upon the attitude toward the concrete applicant and his concrete requests and upon purely personal connections, favours, promises, and privileges.<sup>113</sup>

In Guenther Roth's words, it is a "personal rulership on the basis of loyalties that do not require any belief in the ruler's unique personal qualification, but are inextricably linked

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<sup>108</sup> Pitcher, Moran, Johnston, "Rethinking Patrimonialism and Neopatrimonialism in Africa," 125-156.

<sup>109</sup> Pitcher, Moran, Johnston, "Rethinking Patrimonialism and Neopatrimonialism in Africa," *ibid.*

<sup>110</sup> *Ibid.*

<sup>111</sup> *Ibid.*

<sup>112</sup> Weber, *Economy and Society*.

<sup>113</sup> *Ibid.*

to material incentives and rewards.”<sup>114</sup> From these two definitions it can be implied that the patrimonial state belongs to the ruler, where all the relations are developed from personal connections based on material incentives and rewards in exchange for favours, privileges and loyalty.

In running a patrimonial state, the ruler implements what Eisenstadt<sup>115</sup> and Callagy<sup>116</sup> labelled as the essential features of this type of state, which range from: 1) the exchange of resources political officials to their associates (i.e. their cronies); 2) policies tend to be particularistic, rather than universalistic, in nature; 3) the rule of law is secondary to the “rule of man”; and 4) political officials tend to blur the boundaries between public and private realms.

In the same vein, Harold Crouch, in his seminal work “Patrimonialism and Military Rule in Indonesia” explained that patrimonial states rely on personal relations between senior figures in government and society, built on a pyramid-like network of patron-client relations by dispensing material rewards and opportunities to leading members and the elite, who struggle for the patronage and generosity of the government, particularly the head of state/government.<sup>117</sup>

What is implied from the definitions and arguments above is that the ruler of a patrimonial state has generated a personal and authoritarian regime with a centralised system that provides benefit for the ruler and his or her clients in the form of exchanging material rewards for loyalties and privileges. It would be interesting to see how this type of state engaged in the global economy and what its relations with business would be. This issue becomes the subject of review in the next subsection.

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<sup>114</sup> Guenther Roth. "Personal Rulership, Patrimonialism, and Empire-Building in the New States," *World Politics* 20, no. 2 (1968): 196, <http://www.jstor.org.library.vu.edu.au/stable/2009795> (accessed 20 November 2009).

<sup>115</sup> Thomas M. Callagy, *State-society struggle: Zaire in comparative perspective* (New York: Columbia Press, 1984).

<sup>116</sup> S.N. Eisenstadt, *Traditional patrimonialism*, (Beverly Hills, California: Sage Publication, 1973).

<sup>117</sup> Harold Crouch, "Patrimonialism and Military Rule in Indonesia," *World Politics* 31, no.4 (1979), <http://www.jstor.org/stable/2009910> (accessed 21 November 2009): 571-587; Harold Crouch, "Indonesia 'Strong' State," in *Weak and Strong States in Asia-Pacific Societies*, ed. Peter Dauvergne (Sydney: Allen & Unwin Pty Ltd, 1998), 93-113.

### 3. Patrimonial state-business relations in Soeharto's New Order

Studies on state-business relations in Indonesia demonstrate that patrimonial relationships have been entrenched since the early 1950s in the period of Parliamentary Democracy (1950-1957). Herbert Feith argued that the patrimonial relationship between state and business in Indonesia has been entrenched since this period, when politicians or indigenous entrepreneurs had the licence to do business but not the capabilities.<sup>118</sup> Therefore, the link of patronage was between the politicians or indigenous entrepreneurs, who became the patrons, and the Chinese entrepreneurs, who became the clients. The term *Ali-Baba* was the reflection of this type of patrimonial relationship. Soekarno, the first President of Indonesia, nationalised Dutch enterprises in 1957. His contentious action resulted in altering the ownership structure of economy, but what he could not change was the fact that Indonesian Chinese entrepreneurs remained key players in the economy.

From a structural approach, Farchan Bulkin<sup>119</sup> views this phenomenon as an attempt to establish a middle-class group but this attempt was defeated because of the dismantling of what he called the 'peripheral capitalism structure'. Sukarno's nationalisation of the Dutch-owned enterprises helped create a class of civilian and military bureaucratic managers of state-owned enterprises, who became and remain important actors in state-business relations.

The failure of the emergence of a capitalist class in Indonesia, especially in the New Order, has also become the focus of Yoon Hwan Shin's and Richard Robison's studies. Yoon Hwan Shin, using the structural approach, argued that the failure of the capitalists to form a class in the New Order, despite their high involvement in the Indonesian economy, was because they had been defeated by factional politics and bureaucrats' interests.<sup>120</sup> In other words, the state established a patronage network through the bureaucracy and made the business sector subordinate and "led the rising new capitalists

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<sup>118</sup> Herbert Feith, *The Decline in Constitutional Democracy in Indonesia* (Ithaca: Cornell University Press, 1962).

<sup>119</sup> Farchan Bulkin, "State and Society: Indonesian Politics under the New Order (1966-1978)". *PhD dissertation* (University of Washington, 1988).

<sup>120</sup> Yoon Hwan Shin, "Demistifying the Capitalist State: Political Patronage, Bureaucratic Interests and Capitalists-in-Formation in Soeharto's Indonesia," *PhD Dissertation* (Yale University, 1991), chapter 7.

to resort to non-economic, primitive or pre-modern modes of accumulation”.<sup>121</sup> He also highlighted how the state co-opted and patronised upper and middle classes in society and “maintained a monopoly on violence and symbolism to defy and pre-empt any societal challenges”.<sup>122</sup>

Similar to Shin’s approach, Robison’s study focused on analysing the interaction between state and capital during the period of growth in the Indonesian economy. His study on the rise of capital of the New Order demonstrated a different approach to studying Indonesian politics, which had mainly concentrated on the military and bureaucracy.<sup>123</sup> He argued that capital had emerged in the past two decades as a major influence upon the state, its official and policies in Soeharto’s New Order. Further, he examined in great detail the emergence of the so-called capitalist class in Indonesia and its division into state and private, Chinese and indigenous and emphasised the weakness of this class, not only because of the pressure of international influences, but also the subordinated position under the politico bureaucrat class and Soeharto’s patronage.<sup>124</sup>

In his other study, Robison emphasised the significant tensions occurring between the interests of the regime and its officials, on the one hand, and the interests of various elements of the capital-owning classes, on the other hand, in response to broader structural pressure for economic change.<sup>125</sup> The important contribution of his study lies in demonstrating, then theorising, the impact of the pressure for economic change on restructuring the alliances between the regime and its officials with the various elements of the capitalist classes as well as their economic strategies.<sup>126</sup>

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<sup>121</sup> *Ibid.*, 426 and Yoon Hwan Shin, “The role of elites in creating capitalist hegemony in post-oil boom Indonesia,” *Indonesia* 51, (1991):127-143, <http://www.jstor.org/stable/3351259> (accessed 19 February 2010).

<sup>122</sup> Yoon Hwan Shin, “Demistifying the Capitalist State: Political Patronage, Bureaucratic Interests and Capitalists-in-Formation in Soeharto’s Indonesia”, 430.

<sup>123</sup> Richard Robison, *The Rise of Capital* (Sydney: Allen and Unwin, 1986).

<sup>124</sup> *Ibid.*

<sup>125</sup> Richard Robison, “Authoritarian States, Capital-owning Classes, and the Politics of Newly Industrializing Countries: the Case of Indonesia,” *World Politics* 41, no. 1 (October, 1988): 52-74.

<sup>126</sup> *Ibid.*

The importance of Bulkin's, Shin's and Robison's studies, which used the structural approach to state-business relations in Indonesia, is that they have enabled the analysis to focus more broadly on the structural political economy that related to the domestic situation including the emergence of the capitalist class. However, these studies have limited the ability to explain the particular personal rulership that Soeharto established during his thirty years in power.

In his work on "The Military Rule in Indonesia", Harold Crouch argued that as a state that had been through a dire straits economy, Indonesia under Soeharto, had emerged as a relatively stable nation, since Soeharto used the military bureaucracy as his instrument: first, to maintain his authority by preserving the balance of power among competing clients, and second, to obtain loyalty and to enforce acceptance of his rule by using material interests and coercion. According to Crouch, Soeharto generated a personal and authoritarian regime with a centralised system that provided benefits for himself and his clients in the form of exchanging material rewards for loyalties and privileges.<sup>127</sup> As will be elaborated in chapter three, Soeharto managed to accumulate capital through manipulation of his patrimonial relations with conglomerates, the selected military officers in strategic state-owned enterprises, and foreign business players who had joint ventures with Soeharto's children.

Patrimonial arrangement in the modern era requires a more personal relationship, not an institutional one; therefore, several aspects of development depend on the leaders' interests. These include the operation of modern institutions depends more on the leaders' interests, the development of planning, and the establishment of effective, efficient and transparent bureaucracies as well as establishing the rule of law. It further depends on the leader allowing rent-seeking by business, for example Soeharto's cronies, to gain excessive profit through patrimonial relations. As argued by Crouch and Budd as well as Resosudarmo and Kuncoro<sup>128</sup> this situation is harmful for

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<sup>127</sup> Harold Crouch, *The Army and Politics in Indonesia*, revised ed. (Ithaca: Cornell University Press, 1988).

<sup>128</sup> Crouch, "Patrimonialism and Military Rule in Indonesia"; Crouch, "Indonesia: 'Strong' State"; Eric Budd, *Democratization, Development, and the Patrimonial State in the Age of Globalization*; Budi P. Resosudarmo and Arie Kuncoro, "The Political Economy of the Indonesian Economic Reforms: 1983-2000," *Oxford Development Studies* 34, no. 3 (September 2006): 342-355, <http://dx.doi.org/10.1080/13600810600921893> (accessed 20 November 2009).

maintaining economic development, particularly if the economies are dependent on foreign investors who need certainty of law, which reflects consistent and coherent policies and regulations. Scholars such as Ross McLeod, Richard Robison and Jomo K. Sundaram<sup>129</sup> focus on the practice of rent-seeking because it generates corruption as a negative impact of patrimonial relations.

Crouch, following Weber, more than thirty years ago warned that the integration of the Indonesian economy into the global economy requires bureaucratisation and regularisation.<sup>130</sup> It is because the more mature capitalist economy, as Weber argues "... must be able to count on the continuity, trustworthiness and objectivity of the legal order, and on the rational predictable functioning of legal administrative agencies."<sup>131</sup>

The incompatibility of patrimonial state-business relations is also argued by Resosudarmo and Kuncoro in their studies of economic reform in Indonesia in the period 1983-2000.<sup>132</sup> The findings of their study demonstrated that in the initial state of development of market economy, there was compatibility between market-oriented policies and patrimonialism. However, in the latter stage, market-oriented policy became incompatible with patrimonialism because it slowed reforms.

In addition to the issue of incompatibility with market economy, scholars also indicate the negative impacts from patrimonial state-business relations, such as corruption, as the manifestation of business rent-seeking activity. Ross McLeod argues that Soeharto built his relations with his business cronies through rent-seeking activity. This rent-seeking activity was reflected in all aspects of the economy that benefitted from their relations. Some examples were:

protection from imports, awarding contracts without bidding, providing access to cheap loans, granting rights to explore natural resources, designation as

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<sup>129</sup> Ross H. McLeod, "Government-Business Relations in Soeharto's Indonesia," in *Reform and Recovery in East Asia*, ed., Peter Drysdale (London: Routledge, 2000); Robison, *The Rise of Capital*; Mustaq H. Khan and Jomo K. Sundaram, eds. *Rents, Rent-Seeking and Economic Development: Theory and Evidence in Asia*. (Oakleigh, Melbourne: Cambridge University Press, 2000).

<sup>130</sup> Crouch, "Patrimonialism and Military Rule in Indonesia", 580.

<sup>131</sup> Max Weber, *Economic and Society Volume 2*, ed. Guenther Roth and Claus Wittich (Berkeley: University of California Press, 1978), 1095..

<sup>132</sup> Resosudarmo and Arie Kuncoro, "The Political Economy of the Indonesian Economic Reforms: 1983-2000".

mandatory partners in foreign joint ventures, rights to take over land, purchase low input at artificially low prices, favourable treatment by tax office, rights to collect taxes.<sup>133</sup>

MacIntyre<sup>134</sup>, in his study on the relations between business and politics in Indonesia, acknowledged the negative impact of state-business relations; however, his research reveals the possibility of the increasing role of business associations in a strong authoritarian state. His research on comparing three sectors of the industry: textiles, insurance, and pharmaceuticals revealed the rise of more independent business groups. Even though they are still in an early phase, business associations were strengthened and gradually became more independent in influencing the policy making process.<sup>135</sup> The possibility for business groups to become more independent was allowed, because in the era of export-led industrialisation, the business sector was able to give different inputs, not only in stimulating the process of industrialisation, but also in the decision-making process.

This section has reviewed the literature on the concept of patrimonialism and the patrimonial state as well as on Soeharto's patrimonial state-business relations: how they were developed, the negative impact of these relations and the possibility for business to be more independent through their business associations within the personal, authoritarian and centralised regime of the New Order.

Following the 1997-8 economic crisis and the political crisis, Soeharto resigned as president and the largest patron of the regime. The change in the patrimonial regime and its impact on the state-business relations will be the subject of review in the next section.

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<sup>133</sup> Ross H. McLeod, "Government-Business Relations in Soeharto's Indonesia," in *Reform and Recovery in East Asia*, ed. Peter Drysdale (London: Routledge, 2000), 157-158.

<sup>134</sup> Andrew MacIntyre, *Business and Politics in Indonesia* (North Sydney: Asian Studies Association of Australia with Allen and Unwin, 1991).

<sup>135</sup> *Ibid.*

#### **D. Indonesian political economy and changes in state-business relations**

Among the extensive works on change following the 1997-8 economic crisis and Soeharto's resignation, there is literature that provides general explanations and overviews of the impact of transition from an authoritarian regime towards a more democratic one with regard to politics, economics and society.<sup>136</sup>

On more particular aspects of these changes, scholars' arguments have fallen into three types: democracy; oligarchy; and institution arguments.<sup>137</sup> Democracy focuses on the change in democratic institutions and the role of civil society in transforming the authoritarian rule of the New Order into a more institutional democratic transformation in the *Reformasi* government. Oligarchy embraces the idea of the re-emergence and domination of the New Order's oligarchs, which created alliances with the new elites as a consequence of the failure of institutional democratic reform. The third argument, which is the least popular, embraces the idea that institutions matter in building a coalition of interests between state and business. Interestingly, in explicating their arguments, the scholars also make both direct and indirect connections with patrimonial relations between state and business. This demonstrates that patrimonial relations, entrenched in the New Order, still appear as a significant phenomenon in the Reformasi government. Therefore, debates among these scholars have importantly influenced the change in patrimonial state-business relations.

The scholars who have examined democratisation and democratic transition argue that society has a big role to play in transforming the authoritarian regime of Soeharto into a liberal democratic one.<sup>138</sup> Aspinall observed a growth of variegated and energetic Non-

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<sup>136</sup> Edward Aspinall, Herb Feith, and Gerry Van Klinken, eds. *The Last Days of President Soeharto* (Clayton, Monash Asia Institute, Monash University, 1999); John Bresnan, ed. *Indonesia: The Great Transition* (Lanham, Maryland: Rowman and Littlefield Publishers, 2005); Donald K. Emmerson, ed. *Indonesia Beyond Soeharto: Polity, Economy, Society Transition* (New York: M.E.Sharpe Inc. in cooperation with the Asia Society, 1999); Harold Crouch, *Political Reform in Indonesia after Soeharto* (Singapore: ISEAS Publishing, 2010); Kees van Dijk, *A Country in Despair: Indonesia between 1997 and 2000* (Leiden, The Netherlands: KITLV Press, 2001).

<sup>137</sup> Richard Robison, "Introduction", in *Routledge Handbook of Southeast Asian Politics*, ed. Richard Robison (New York: Routledge, 2012), 5-22.

<sup>138</sup> Edward Aspinall, "Indonesia: Transformation of Civil Society and Democratic Breakthrough," in *Civil Society and Political Change in Asia: Expanding and Contracting Democratic Space*, ed., M. Alagappa (Stanford, CA: Stanford University Press, 2004), 61-96.

Government Organisations (NGOs) as well as groups of industrial workers and peasants repressed in the New Order, that were seen as part of a larger civil society, intellectuals and professionals, who could undermine Soeharto's authoritarianism.<sup>139</sup> Further, Case emphasised that "new middle working class grievance appeared finding expression through Islamic resurgence, student activism, labour militancy and opposition politics" that contributed to the process of democratisation, but also he sees the importance of the unity of elites in consolidating democracy.<sup>140</sup>

As the *Reformasi* governments progressed, other scholars from a democratic perspective, such as Webber, Case and Eklof, argue that one of the factors that hinder the democratisation process is the persistence of patrimonialism or patronage relationships.<sup>141</sup> Webber admits that the strength and pervasiveness of patrimonial norms and practices are still intact and have survived the transition from authoritarian to democratic politics.<sup>142</sup> Case argues there is an indication in *Reformasi* governments that the traditional elites in the military and bureaucracy have made attempts to accommodate the interests of the wider and more varied new elites in the political parties and legislative body through patronage and patrimonial relationships.<sup>143</sup> Eklof<sup>144</sup> emphasised the close and intimate links between state and business, for example, where money politics has become the means for businesses to exchange their funds to influence the political process, as politicians need funds for their political activities. According to Eklof, the quality of democracy will be jeopardised as representative

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<sup>139</sup> Aspinall, *ibid.*

<sup>140</sup> William Case, *Politics in Southeast Asia* (London and New York: Routledge Curzon, 2002); William Case, "Low Quality Democracy and Varied Authoritarianism: Elites and Regimes," in *Southeast Asia Today*, 22, no. 3 (2009), [www.informaworld.com/journals](http://www.informaworld.com/journals) (accessed 12 January 2012).

<sup>141</sup> Douglas Webber, "A Consolidated Patrimonial Democracy? Democratisation in Post-Soeharto Indonesia" (paper presented at the workshop, 'Post-Cold War Democratisation in the Moslem World: Domestic, Regional and Global trends', Joint Session of the European Consortium of Political Research, Granada, 14-19 April, 2012): 1-29, <http://www.casaasia.es/pdf/520551939PM1115047179830.pdf> (12 January 2011); Case, *ibid.*; Stefan Eklof, "Politics, Business and Democratisation in Indonesia", in *Political Business in East Asia*, ed. Edmund Gomez (London: Routledge, 2001), 216-249.

<sup>142</sup> Webber, *ibid.*

<sup>143</sup> Case, "Low Quality Democracy and Varied Authoritarianism: Elites and Regimes."

<sup>144</sup> Eklof. "Politics, Business, and Democratization in Indonesia."

bodies, such as political parties and the parliament, become more susceptible to money politics.<sup>145</sup>

As democratisation progressed, scholars, such as Webber, Case and Eklof, are in agreement about the widespread practice of money politics as a consequence of the changing election system and decentralisation. This practice of money politics has expanded between state and business and among politicians and power holders in local governments. Decentralisation as a consequence of democratisation offers an interesting example of money politics involved in development assistance. One of the examples is the field research by Blunt, Turner and Lindroth, on governance conditions and human resource management practices in Indonesia post-Soeharto, which revealed that the practice of development assistance, and patronage relationships between officers of the development agency and local government, have contributed to create what they called the 'patronage democracy'.<sup>146</sup>

As mentioned in the third section of this chapter, Crouch argued that patrimonialism was the cohesive factor in Soeharto's regime, not only as the foundation of his legitimacy, but as a means for exchanging material rewards for favours, protection and loyalties to Soeharto's clients.<sup>147</sup> In contextualising Crouch's idea on patrimonialism as a tool of analysis, Jamie Mackie argued that "several aspects of the New Order patrimonialism still persist, [but] it would be going too far to categorise the post 1998 political order as such."<sup>148</sup> Observing the more pluralistic characteristics of the *Reformasi* governments, Mackie differentiated the patrimonialism that refers to the whole system of Soeharto's regime from those patronage relations between officials who hold bureaucratic positions with their clients. According to Mackie, the *Reformasi* governments cannot be entirely categorised like the patrimonial regime; however, the continuity of using patronage relationships, which refer to a particular kind of "mutual

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<sup>145</sup> *Ibid.*

<sup>146</sup> Peter Blunt, Mark Turner and Hendrik Lindroth, "Patronage's Progress in Post-Soeharto Indonesia," *Public Administration and Development* 32 (2012): 64-81.

<sup>147</sup> Harold Crouch, "Patrimonialism and Military Rule in Indonesia".

<sup>148</sup> Jamie Mackie, "Patrimonialism: The New Order and Beyond," in *Soeharto's New Order and Its Legacy: Essays in Honour of Harold Crouch*, ed. Edward Aspinall and Greg Fealy (Canberra, Australia: ANU Press, 2010), 81-96.

relationship usually between a relatively wealthy patron and a needy of dependent client”, persists.<sup>149</sup> The other significant difference that he observed is the use of “the new and very different phenomenon of money politics”<sup>150</sup> which follows the texture of a more plural and decentralised political system.<sup>151</sup>

Not all scholars agree with Mackie’s suggestion to differentiate patrimonialism and patronage to explain the changes in power relations in the *Reformasi* governments. Webber, for example, in analysing the Indonesian democratic progress retains patrimonial relations as a term<sup>152</sup>, but Aspinall uses both patronage and clientelism. Webber strongly argued that the patrimonial norms and practices entrenched in Indonesian politics and society has survived the transition from authoritarian to more democratic governance. As he analysed, in relation to the change in the whole system towards democratisation, is the importance of using patrimonial instead of patronage, which refers to a relatively limited number of relationships. Aspinall, however, combines patronage and clientelism. He defines patronage as “a material resource disbursed for particularistic purposes and for political benefit typically distributed via clientelist networks”, and clientelism as a “personalistic relationship of power.”<sup>153</sup> Further, Case, uses patronage relationships to indicate the way the traditional elites in the military and bureaucracy have made attempts to accommodate the interests of wider and more varied new elites in political parties and the legislative body through patronage relationships.<sup>154</sup>

Scholars from the oligarchy perspective argue there has not yet been change in the structure of power in Indonesia following the crisis and Soeharto’s resignation. What

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<sup>149</sup> *Ibid.*

<sup>150</sup> *Ibid.*

<sup>151</sup> *Ibid.*

<sup>152</sup> Webber, “A Consolidated Patrimonial Democracy? Democratisation in Post-Soeharto Indonesia”.

<sup>153</sup> Edward Aspinall, “A Nation in Fragments,” in *Critical Asian Studies* 45, no.1 (2013): 28, <http://dx.doi.org/10.1080/14672715.2013.758820> (accessed 28 February 2013).

<sup>154</sup> Case, “Low Quality Democracy and Varied Authoritarianism: Elites and Regimes.”

has been occurring is “reorganising the old power”<sup>155</sup>, “modification in the hegemonic of the ruling class”<sup>156</sup>, “transformation to patrimonial oligarchic state from patrimonial administrative state”<sup>157</sup> and “enhancement [of] the power of indigenous (*pribumi*) oligarchs”.<sup>158</sup> All of these scholars agree that the fall of Soeharto has provided the possibility for change towards democratisation in political and economic spheres, but they have their own emphasis in explaining some of the changes in the structure of power as the outcome of Soeharto’s resignation.

Among those scholars in this group, Jeffrey Winters, for instance, gives a clear definition of oligarchs: “actors who command and control massive concentrations of material resources that can be deployed to defend or enhance their personal wealth and exclusive social position.”<sup>159</sup> Further, Winters emphasised that wealth, as a material form of power obtained by a minority of persons, can be used for their personal interests, although material wealth does not personally belong to them.<sup>160</sup>

Looking more closely at Winters’ definition of oligarchs, particularly on massive personal wealth which does not have to belong to them, and how he applied it to the Soeharto’s sultanistic oligarchy, there is a similarity between his definition and Crouch’s, Eisenstadt’s and Callagy’s definitions of material resources that patrons distribute to their clients.<sup>161</sup> According to these scholars, what patrons dispensed to their cronies were public resources.

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<sup>155</sup> Richard Robison, “Neoliberalism and the Future World: Markets and the End of Politics,” *Critical Asian Studies* 36, no.3 (2004); Richard Robison and Vedi R. Hadiz, *Reorganising Power in Indonesia: The Politics of Oligarchy in the Age of markets* (London and New York: Routledge Curzon, 2004).

<sup>156</sup> Christian Chua, *Chinese Big Business in Indonesia, The State of Capital* (London and New York: Routledge, 2008); Christian Chua, “The Conglomerates in Crisis: Indonesia, 1997-1998,” *Journal of the Asia Pacific Economy* 13, no. 1 (2008): 107-127.

<sup>157</sup> Yuki Fukuoka, “Politics, Business and the State in Post-Soeharto Indonesia,” *Contemporary Southeast Asia* 34, no. 1 (2012): 80-100.

<sup>158</sup> Jeffrey A. Winters, *Oligarchy* (Cambridge: Cambridge University Press, 2011).

<sup>159</sup> *Ibid.*

<sup>160</sup> *Ibid.*

<sup>161</sup> Crouch, “Patrimonialism and Military Rule in Indonesia”; Eisenstadt, *Traditional Patrimonialism and modern Neo-Patrimonialism*; Callagy, *State-Society Struggle: Zaire in Comparative Perspectives*.

Richard Robison has identified the roots of oligarchy in Indonesia in the 1970s in the growing cooperation between politico-bureaucrats, who controlled rent allocation, and Chinese business conglomerates.<sup>162</sup> Their cooperation created monopolies in every aspect of the economy, which made them powerful enough to hijack the deregulation process in the 1980s. In politics, they made sure that Golongan Karya (GOLKAR) channelled their interests. In the post Soeharto era, these politico-bureaucrats survived and managed to establish alliances with politicians from other political parties including GOLKAR.

There is a difference in focus between Robison's and Winters' definitions of oligarchy. Winters attempts to build a theory of oligarchy; thus his theory is more abstract, and can be applied to three categories: warring, sultanistic and civil oligarchies.<sup>163</sup> In contrast, Robison and Hadiz demonstrate the continuation of the oligarchic pattern from the New Order in the Reformasi governments, even though the crisis had passed. Eventually, the old oligarchy was able to seize the new political and market institutions.<sup>164</sup> The intertwining interests have made use of money politics more than ever before, particularly in the new arenas of political parties and parliaments; and they have failed to generate transparent, accountable and legal management. What has occurred seems to be a repeat of the previous pattern, when the oligarchy hijacked deregulation policies back in the 1980s.

Unlike Robison and Hadiz, who identified the continuity of the oligarchy of politico-bureaucrats and business from the New Order to the Reformasi governments, Chua<sup>165</sup> and Fukuoka<sup>166</sup> note a change in the hierarchy in the Reformasi governments. According to Chua, politico-bureaucrats were seen as the only ruling oligarchy in the New Order because they subjugated the Chinese conglomerates, marginalised them

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<sup>162</sup> Richard Robison, *Indonesia: The Rise of Capital*.

<sup>163</sup> Winters, *Oligarchy*.

<sup>164</sup> Robison and Hadiz, *Reorganising Power in Indonesia: the Politics of Oligarchy in an Age of Markets*.

<sup>165</sup> Chua, *Chinese Big Business in Indonesia, The State of Capital*; Chua, "The Conglomerates in Crisis: Indonesia."

<sup>166</sup> Fukuoka, "Politics, Business and the State in Post-Soeharto Indonesia."

politically and co-opted them financially.<sup>167</sup> The institutional reforms, such as in the electoral political system and in decentralisation to empower local government, have facilitated the increase in assertiveness in these Chinese conglomerates in providing capital for the reformist agenda. As a consequence, the Chinese conglomerates gained power and the politico-bureaucrats lost their hold.

Fukuoka shares the same argument with Chua in terms of the ascendancy of business as one of the outcomes of democratisation.<sup>168</sup> However, he disagrees with Chua regarding the emergence of Chinese conglomerates.<sup>169</sup> Instead, he argues that indigenous business has emerged more assertively in the political arena. Fukuoka acknowledged that Chinese conglomerates currently have more freedom compared to what they experienced in the New Order, however, but they remain in the background.

The difference in Chua and Fukuoka's arguments originated from their respective interpretations of Hutchcroft's typology of capitalism. Hutchcroft categorises different capitalist states based on Weber's ideal types of rational-legalism and patrimonialism.<sup>170</sup> Further, he differentiates between relatively stronger and weaker state apparatuses in comparison with business interests. In Hutchcroft's application, western states fall within the category of more rational-legal states and non-Western states, including South-East Asia, fall in the category of patrimonial states, where politico-bureaucrats' interests are stronger than business interests and patrimonial oligarchy states where state's interests are weaker than business interests.

Chua interprets Hutchcroft's scheme for the starting point of his argument; for the future of the Indonesian state, he does not see Indonesia transforming into the abovementioned states post-Soeharto's resignation. Instead he argues:

The new regime will be based in a plutocratic state where power is mainly derived from capital... In [the] years after the crisis, there might still be an equivalence of power inside the oligarchy that was forced to reorganise itself in

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<sup>167</sup> Chua, *Chinese Big Business in Indonesia*, , *ibid.*

<sup>168</sup> Fukuoka, *ibid.*

<sup>169</sup> *Ibid.*

<sup>170</sup> Paul Hutchcroft, *Booty Capitalism in the Politics of Banking in the Philippines* (Ithaca: Cornell University Press, 1998).

1998. The trend, however, is moving in favour of the Chinese capitalist class that decreasingly needs the politicians at the levers of formal power.<sup>171</sup>

Chua's finding indicates that the Chinese conglomerates obtained much benefit from the institutional reform as the consequence of democratisation and the decentralisation process. In the immediate after the crisis years, the Chinese conglomerates still needed their state patrons to provide social protection for their own survival. As the state continuously needed capital – domestic and foreign – conglomerates would be able to extricate themselves from the former patron as well as to escape and protect themselves from the reform initiatives.<sup>172</sup> Therefore, the form of collusion in post-Soeharto Indonesia is the reverse; Chua observes “a modified form of collusion where the traditional patron client relations have been turned upside down. It became the job of the politicians to seek new partners although they had nothing much to offer in return.”<sup>173</sup>

One last aspect from Chua's research that has not been emphasised by other scholars is that the diffused system of power, as a consequence of the democratisation process, has created different networks for state and business to establish patronage relationships. In Chua's case, even within the diffused system of power, conglomerates managed to leverage their position ahead of the state.<sup>174</sup>

In contrast, Fukuoka interprets Hutchcroft's typology of capitalism differently. He argues that institutional reforms have enabled businessmen to access power by becoming members of parliament, or even being appointed as cabinet ministers in the *Reformasi* governments. According to Fukuoka, the empowerment of the parliament has shifted the principal direction of rent extraction: not to a small number of politico-bureaucrats but to the parliament occupied by an increasing number of *pribumi* elites.<sup>175</sup> More importantly, two prominent *pribumi* entrepreneurs, Jusuf Kalla and Aburizal

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<sup>171</sup> Chua, *Chinese Big Business in Indonesia: The State of Capital*, 27.

<sup>172</sup> *Ibid.*

<sup>173</sup> *Ibid.*, 126-127.

<sup>174</sup> *Ibid.*

<sup>175</sup> Fukuoka, “Politics, Business and the State in Post-Soeharto Indonesia.”

Bakrie, emerged as vice-president and coordinating economic minister respectively in Yudhoyono's first term cabinet. At the conceptual level, according to Fukuoka, this presents a shift from a patrimonial administrative state to a patrimonial oligarchic state.<sup>176</sup>

On the political ascendancy of indigenous businesses, Fukuoka shares Winters' argument. Based on how they can utilise their material power, Winters argues that "the inclusion of indigenous *pribumi* oligarchs from high state and party offices presents evidence that the indigenous oligarchs have more unlimited access and far wider range of use of their funds compared to the Chinese oligarchs."<sup>177</sup> In other words, he saw Chinese oligarchs as more constrained in how they positioned their material wealth and power due to the potential for *pribumi* entrepreneurs to compete in electoral politics.

The common thread from the literature using the structural approach is its ability to analyse whether the structure of power has changed or remains the same. Paradoxically, this strength is also a weakness. While this approach is a good generalisation, sometimes it generalises too much. Moreover, its ability for micro level analysis is relatively limited.

The institutional approach can be used for micro level analysis. Unfortunately, in analysing state-business relations in Indonesia, following the crisis and Soeharto's resignation, there are only a few scholars that have taken this approach. Unlike the structural approach, the institutional approach allows the incorporation of both state and business in a consultative coalition of shared interests.

One of the few scholars to have applied the institutional approach to the new roles of business and business associations in Indonesia since 1998 is Natasha Hamilton-Hart.<sup>178</sup> Hamilton-Hart saw the problem of government and business relationships in Indonesia as low level formal organisation, which impeded businesses in lobbying their collective

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<sup>176</sup> *Ibid*, 95.

<sup>177</sup> Winters, *Oligarchy*, 195.

<sup>178</sup> Natasha Hamilton-Hart, "Government and Private Business: Rents, Representation and Collective Action," in *Indonesia: Democracy and the Promise of Good Governance*, ed. Ross H. McLeod and Andrew MacIntyre (Singapore: Institute of Southeast Asian Studies, 2007): 93-114.

demands more openly to government.<sup>179</sup> She has come to this argument by taking up Maxfield and Schneider's, Lucas and Doner and Schneider's arguments. They perceive that collective organisation and lobbying have some advantages over individual deal making, because not only do they bring a degree of transparency but they also avoid lobbying for illegal privileges.<sup>180</sup>

Analysing KADIN's (the Indonesian Chamber of Trade and Industry) demands to government, Hamilton-Hart found that some of their demands, such as reduced bureaucratic red tape, secure property rights and transparent, consistently implemented taxation policies, did not reduce rent-seeking activities.<sup>181</sup> She disclosed that many business actors are practising rent seeking through personalising their business deals with *Reformasi* governments at the expense of the public. Although business associations are relatively new and weak institutions, they have developed a capacity to represent collective, transparent business interests.<sup>182</sup> Hamilton-Hart argued that while governments have contributed to generating rent through government policies, various political mechanisms (for example government bureaucracy, parliament and judiciary) have not as yet been successful in eradicating corruption in state institutions.<sup>183</sup>

Hamilton-Hart's findings are similar to MacIntyre's regarding the increasing role of business and business associations in the policy making process during the New Order<sup>184</sup> and, to a certain extent, confirm Hartono's study on the efforts of KADIN to become a more important player in shaping economic policy in the period 1999-2003.<sup>185</sup>

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<sup>179</sup> *Ibid.*

<sup>180</sup> Sylvia Maxfield and Ben Ross Schneider, eds. *Business and the State in the Developing Countries* (Ithaca: Cornell University Press, 1997); John Lucas, "The Politics of the Developing World," *The Journal of Developing Areas*, 32, no 1 (1997), [www.jstor.org/stable/4192733](http://www.jstor.org/stable/4192733) (accessed 26 November 2009); Richard F. Doner and Ben Ross Schneider, "Why Some Associations Contribute More Than Others," *Business and Politics* 2, no 3 (2000).

<sup>181</sup> Hamilton-Hart, "Government and Private Business: Rents, Representation and Collective Action."

<sup>182</sup> *Ibid.*

<sup>183</sup> *Ibid.*

<sup>184</sup> Andrew MacIntyre, *Business and Politics in Indonesia*; Andrew MacIntyre, ed. *Business and Government in Industrialising Asia* (St Leonards: Allen and Unwin, 1994).

<sup>185</sup> AIJ Hartono, "State-business Relations in Post 1998 Indonesia: The Role of Kadin," *PhD Thesis* (The University of Groningen, 2011).

Hamilton-Hart agreed that business associations were more vocal in demanding their interests as well as influencing policy making, yet their level of formal organisation was extremely low. From a different viewpoint, MacIntyre observed that different sectoral industries contributed to the level of business associations' assertiveness in voicing their interests.<sup>186</sup> For example, in describing and analysing state-business relations in three different sectoral industries – textile, insurance and pharmaceutical – MacIntyre found that the textile industry was the most assertive in voicing business association's conflicting interests, which enabled them to compete regarding government policy considerations.<sup>187</sup> Thus, the nature of industry sectors could generate different dynamics of state-business relations, even under a coopted New Order regime.

Hartono's analysis of state-business relations in post 1998 was through a case study of the role of KADIN. Hartono argued that KADIN's efforts to become a more important player in the policy making process was only marginally successful. This was due to the fact that in the post-Soeharto era KADIN was not the only organisation in Indonesian society that represented specific interests.<sup>188</sup> According to Hartono, economic and political reforms allowed for many other representatives of societal interests to raise their voices.

Comparing these different arguments, scholars agree that in state-business relations, to a certain extent, patrimonialism or patronage or clientelism remains. The scholars of democratisation still hold the view that this is part of the consolidation of democracy. The institution proponents, however, hold out more hope for state-business relations to become more transparent, facilitated by business associations. From these three perspectives, scholars arguing from the oligarchic perspective are the most pessimistic: they do not believe that state-business relations can be accountable and transparent, given the fact that they have become illiberal bourgeoisie, meaning they do not support liberal reform.

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<sup>186</sup> Andrew MacIntyre, *Business and Politics in Indonesia*.

<sup>187</sup> *Ibid.*

<sup>188</sup> Hartono, *ibid.*

However, the reviewed literature has not yet discussed the possibility of the integration of Indonesia into the global market, influencing state-business relations in Indonesia, even though the Indonesian market has had greater integration with the global economy. The level of involvement of MNCs through FDI as well as Indonesia's participation in free trade agreement, for example ASEAN Free Trade Agreement (AFTA) and China - ASEAN Free Trade Agreement (CAFTA) has demonstrated the intensity of global influence in Indonesia. In fact, the Indonesian political economy has been affected by the emergence of local and international non-governmental organisations, which add to the complexity of players that influence state-business relations as well as the ways in which patrimonial relations still exist. Despite the fact that globalisation has had negative impacts on the Indonesian political economy, according to Juwono Sudarsono, "the global market will force upon us business practices and disciplines that we cannot generate internally."<sup>189</sup> If this eventuates, it would have a potentially significant influence on state-business relations in Indonesia following the economic crisis and Soeharto's resignation.<sup>190</sup>

Robison and Hadiz note that globalisation ultimately constitutes an inexorable and progressive force for political economy transformation, even though they still suspect that globalisation spreads neoliberal ideas.<sup>191</sup> According to these scholars, neoliberalism advocates the Indonesian state as an empty political entity with weak institutions; therefore, the market remains inefficient, despite deregulation and an interventionist state.<sup>192</sup> They argue that neoliberal policies implemented in Indonesia, do not have the roots to transform into good governance defined by transparency and accountability in economic management and by legally constituted systems of market regulation.<sup>193</sup> However, Robison and Hadiz do not explain the relations between globalisation and neoliberalism. Instead, from what they have proposed, globalisation has the potential to

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<sup>189</sup> Juwono Sudarsono interviewed by Thomas Friedman, see Thomas Friedman, *The Lexus and the Olive Tree* (London: Harper Collins, 1999), 143.

<sup>190</sup> Thomas Friedman, *The Lexus and the Olive Tree*.

<sup>191</sup> Robison and Hadiz, *Reorganising Power in Indonesia: the Politics of Oligarchy in an Age of Markets*.

<sup>192</sup> *Ibid.*

<sup>193</sup> *Ibid.*

become a powerful force to transform the constellation of power in the Indonesian political economy. Globalisation could assert pressure on the oligarchy to follow global norms, but the domestic political dynamics during the *Reformasi* era have tended to obstruct this type of transformation.

Unlike Robison and Hadiz, Harvey relates globalisation with neo-liberalism, but Scholte does not agree.<sup>194</sup> Harvey argues that globalisation is inseparable from neoliberalism, which has been overwhelmingly dominated by ideology that influences economic and political systems worldwide. These systems have been imposed by the World Bank, IMF and the American government. According to Harvey, globalisation is responsible for spreading this dominant ideology. In contrast, Scholte argued that globalisation is a process of rethinking the global social sphere as an interconnected entity; thus globalisation adds more complexity to the nation state due to the extended culture, ecology, economics, history, politics and social psychology it brings. Using this definition also allows understanding of globalisation as a process in channelling the implementation of “transworld law, regional arrangements, as well as national regulation and relations with provincial and local authorities.”<sup>195</sup>

Much research on globalisation in Indonesia is related to the causes of the 1997-8 economic crisis. Further research on globalisation following Soeharto’s resignation emphasises the impact of globalisation in the manufacturing sector on the greater openness of the Indonesian market in engaging in free trade through AFTA and

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<sup>194</sup> David Harvey, *A Brief History of Neo-Liberalism* (Oxford: Oxford University Press, 2005); Jan A.Scholte, “Defining Globalisation,” *The World Economy* 31, no. 11 (2008): 1471-1502, DOI: 10.1111/j.1467-9701.2007.010119.x (accessed 25 May 2013)

<sup>195</sup> *Ibid*, 1494.

CAFTA.<sup>196</sup> More recently, research has focused on how NGOs in Indonesia respond to negative impacts of globalisation.<sup>197</sup>

From the three perspectives discussed earlier, the pluralist perspective has influenced this study in informing the research question: that the change toward democratisation has taken place and will affect new patrimonial state-business relations in the *Reformasi* governments. Democratisation contributes to the dispersal of power and this will generate more diverse networks in patrimonial state-business relations. Simultaneously, the structural approach has also informed this study in that the power structure of *Reformasi* governments has not yet changed. Scholars from this school of thought have pointed out the continuity of the old oligarchs, originating in the New Order, that still hold political and economic power. The continuation of economic supremacy among the business oligarchs, in particular, has been more noticeable. The issue of change in the ascendancy between Chinese and indigenous businesses, not only in the economic sphere but also in the political arena, has been identified by scholars as an important one. These issues are relevant, particularly to see how these businesses have connected to new political elites. Finally, the institutional approach has informed this study in relation to the possibility of business associations representing business players and establishing partnerships with government. A further implication is the extent to which business associations have affected patrimonial relationships with the state.

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<sup>196</sup> Peter Gammeltoft, "Globalisation and State Intervention in Indonesia," in *Changing Forms of State Policies for Industrial Development in the Age of Globalisation* (1997); Ari Kuncoro, "Globalisation and Innovation in Indonesia: Evidence from Micro Data on Medium and Large Manufacturing Establishments," *Eria Discussion Paper Series* (2012) (accessed 25 May 2013); Hadi Soesastro and M.Chatib Basri, "The Political Economy of Trade Policy in Indonesia," *CSIS Economic Working Paper Series* (2005).

<sup>197</sup> Yanuar Nugroho, "Spreading the Word, Broadening Perspectives: Internet, NGOs and Globalisation Discourse in Indonesia," *Manchester Business School Working Paper*, <http://www.mbs.ac.uk/research/workingpapers/> (accessed 23 May 2013).

## Chapter 3

### Expansion of Soeharto's Patrimonial Network in the New Order

In the literature on patrimonial regimes in developing countries, Soeharto's patrimonial regime has been widely discussed<sup>198</sup> because it demonstrated strong and sustainable characteristics during his thirty-two years in power. By 1997, before the financial crisis occurred, Soeharto had built an empire: his patrimonial networks comprised military officers, who managed some of the state enterprises, his *yayasan* (foundations), Indonesian Chinese conglomerates, and businesses run by his relatives and children, who became his cronies and indigenous business players.

Parallel to the expansion of his patrimonial network, Soeharto awarded himself the title of *Bapak Pembangunan* (Father of Development)<sup>199</sup> for his achievement in transforming Indonesia from experiencing a hyperinflation economy in 1966 into sustainable high rates of growth for more than twenty years.

The paradox of this expansion and economic growth in the Indonesian economy has been an interesting phenomenon. This chapter argues that Soeharto, towards the end of his power, had established a more complex and highly personal patrimonial network and made it an integral part of his economic development strategies.

This chapter is divided into three sections. The first section discusses the expansion of patrimonial state-business relations through the establishment of the indigenous entrepreneurs' class in the *Benteng* program during the Parliamentary Democracy (1950-1957), and the nationalisation process, which created a new military bureaucrats' class during the transition period to Guided Democracy (1957-1959). As the second

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<sup>198</sup> Anne Pitcher, Mary H. Moran, and Michael Johnston, "Rethinking Patrimonialism and Neopatrimonialism in Africa," *African Studies Review*, no. 1 (April 2009), 125-156, <http://muse.jhu.edu/journals/arw/summary/v052/52.1.pitcher.html> (accessed 21 April 2010); Douglas Webber, "A Consolidated Patrimonial Democracy? Democratization In Post-Soeharto Indonesia", paper presented at the workshop, *Post-Cold War Democratization in the Muslim World: Domestic, Regional and Global Trends*, Joint Sessions of the European Consortium of Political Research (Granada, 14-19 April 2005); Eric Budd, *Democratization, Development, and the Patrimonial State in the Age of Globalization* (Maryland: Lexington Books, 2004).

<sup>199</sup> *Majelis Permusyawaratan Rakyat* (People's Consultative Assembly) named Soeharto 'Father of Development' on 10 March 1983, see R.E. Elson, *Soeharto: a Political Biography* (Cambridge: Cambridge University Press, 2001), xvii.

section discusses the expansion of Soeharto's patrimonial networks, the end of this section introduces Soeharto's position during these two periods and his acquaintance with his first cronies – Liem Sioe Liong and Bob Hasan.

The second section discusses the expansion of Soeharto's patrimonial networks during his thirty-two years in power. The first subsection discusses the expansion in the Import Substitution Industrialisation (ISI) period through three state enterprises: *Perusahaan Tambang Minyak Nasional* (or State-owned Oil and Natural Gas Enterprises, abbreviated as PERTAMINA), *Perusahaan Eksploitasi dan Industri Hutan* (or State-owned Forestry Enterprises, abbreviated as INHUTANI and *Badan Urusan Logistic* (or State Logistic Agency, abbreviated BULOG). The second subsection discusses the continuation of the expansion of Soeharto's patrimonial networks during the deregulation in the Export Oriented Industrialisation (EOI) period, which began in the early 1980s until his resignation in 1998. The complex but highly personalised nature of these networks became the characteristics of this period. The third section concludes the chapter.

#### **A. Patrimonial state-business relations in the Indonesian political economy post independence**

Soekarno and Hatta assumed political and bureaucratic power in 1945 after independence, but they did not have much control over economic ownership of the means of production. This means that even though Indonesia had become politically independent, the structure of a colonial economy remained with Dutch private enterprise dominating the modern sector of the economy. This was followed by the Chinese dominating retailers and the small manufacturing sector, while indigenous Indonesians were involved in the traditional sector.

The continuity of the economic colonial structure was formally and legally sanctioned in the *Perjanjian Konperensi Meja Bundar* or Round Table Conference Agreement in late 1949. One of the agreements laid down was the modern economy of the *Republik Indonesia Serikat* (e.g. plantation agriculture, exporting, importing, banking, shipping

and aviation), dominated by foreign, mostly Dutch-owned enterprises.<sup>200</sup> In addition, this agreement had the obligation “to consult the Netherlands government in matters affecting the economy until the debt of the former colony to the metropolitan had been repaid in full.”<sup>201</sup>

Responding to the Round Table Conference in preserving the dominance of the colonial economic structure, the Natsir cabinet (September 1950 to March 1951)<sup>202</sup> as the first cabinet in the Parliamentary Democracy period (1950-1957), designed *Rencana Urgensi Pembangunan* (the Urgency Development Plan, abbreviated as RUP), with *Benteng* programs as its integral part, to restructure into a national economy and to establish an indigenous entrepreneurs’ class. All cabinets during this prioritised this program.

Unfortunately, the implementation of the *Benteng* program failed. The program was highly politicised by the politicians to establish patronage relationships with indigenous entrepreneurs who had the same political affiliations. However, many of these indigenous entrepreneurs were novices who lacked skill and went on to create symbiotic relations with Chinese partners. These relations were referred to as “Ali-Baba relations”. In other words, instead of establishing an indigenous entrepreneur class, the program facilitated the foundation of patrimonial relationships between politicians and indigenous entrepreneurs and did little to change the colonial economic structure.

The RUP was initiated by Soemitro Djojohadikoesoemo, the Trade Minister from *Partai Sosialis Indonesia* (or Indonesian Socialist Party, abbreviated as PSI). According to Glassburner, the RUP involved highly nationalistic efforts from the Natsir cabinet, at reducing Indonesian economic dependency from foreign economic domination.<sup>203</sup> There were several ways to reduce the dependency as stated by the RUP:

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<sup>200</sup> Herbert Feith, *The Decline in Constitutional Democracy in Indonesia* (Ithaca: Cornell University Press, 1962), 36; Jamie Mackie and C.A. Coppel, “A preliminary survey,” in Mackie and Coppel, eds, *The Chinese in Indonesia: five essays* (Melbourne: Thomas Nelson and The Australian Institute of International Affairs, 1976), 13.

<sup>201</sup> Feith, *ibid*, 15; J. Thomas Lindblad, "The Economic Decolonialisation of Indonesia: A Bird's-Eye View." *Journal of Indonesian Social Sciences and Humanities* 4, (2011), 1.

<sup>202</sup> The cabinet was named after the Prime Minister Mohammad Natsir from *Masjumi* who formed the government with *Partai Sosialis Indonesia* (Indonesia Socialist Party), see Feith, *ibid*, 146-176.

<sup>203</sup> Bruce Glassburner, “Economic Policy Making in Indonesia 1950-1957,” in Bruce Glassburner (ed), *The Economy of Indonesia*, (Ithaca and London: Cornell University Press, 1971), 85.

... by developing small national industry to produce import substitutes in the hope of reducing dependence of foreign trade; by means of capital assistance to indigenous enterprise; by restricting certain markets to indigenous sellers. The latter aspect of the program is often referred to the *Benteng* program.<sup>204</sup>

In its implementation, *Benteng* focused on providing privileges to indigenous importers to import commodities needed by devising credit and licensing policies. Focusing on the import trade, which required minimal amounts of capital and corporate resources<sup>205</sup>, enabled the *Benteng* importers to accumulate sufficient capital to move into other sectors. More importantly, the ruling government strongly intervened in deciding which importers would be *Benteng* importers and the type of commodities imported. After this decision, the government ensured import licenses were allocated to these importers. It was hoped that through this import trade, indigenous Indonesia entrepreneurs would be able to accumulate sufficient capital to move into other sectors.<sup>206</sup>

The short-term period of each coalition government during the Parliamentary Democracy period increased the number of political patrons providing import licenses to the *Benteng* importers. Even though this practice had begun since the early stage of the *Benteng* program, it reached its peak when the first Ali Sastroamidjojo Cabinet, dominated by *Partai Nasional Indonesia* (or Indonesian Nationalist Party, abbreviated as PNI), was in power. In general, the ministers from each cabinet allocated import licenses and credit schemes to business groups that were not based on their entrepreneurial skills and qualifications, but rather their party affiliation, favouritism and 'cliques'.<sup>207</sup>

The minister of economic affairs, Mr Iskaq Tjokrohadisurjo in the first Ali Sastroamidjojo's government, utilised the issuing of licenses as primarily a means of financial support for the Nationalist party, which distorted the *Benteng* program

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<sup>204</sup> *Ibid.*

<sup>205</sup> J. Thomas Lindblad, *Bridges to New Business* (Leiden, KITVL Press, 2008), 127.

<sup>206</sup> Richard Robison, *Indonesia: The Rise of Capital* Sydney (Allen and Unwin, 1986), 44.

<sup>207</sup> Yahya A. Muhaimin, *Bisnis dan Politik: Kebijakan ekonomi Indonesia 1950-1980* (Jakarta:LP3ES, 1990), 82-83.

significantly.<sup>208</sup> Further, the numbers of *Benteng* firms grew exponentially: from 250 firms in 1950 to approximately 2,211 to 4,000 to 5,000 when Iskaq resigned as the Trade Minister in November 1954.<sup>209</sup> The relations between the politicians, later known as the political bureaucrats' class, and the indigenous business groups grew during this stage. The widespread patronage between the incumbent political parties with particular *Benteng* groups firms undoubtedly led to corruption and cronyism.

The exponential numbers of *Benteng* firms unfortunately did not represent the skilled entrepreneurship of indigenous businesses. Besides the accumulative patronage relations with the politicians in government, the *Benteng* importers who lacked the entrepreneurial skills formed firms in an Ali-Baba relationship to take advantage of governments' easy licensing and credits policies.<sup>210</sup> This was a partnership of mutual dependence from which both parties could benefit.

The "Ali" or *pribumi* partner obtained import licenses whereas the "Baba" or Chinese partner had the capital and managed the firm. Sometimes the indigenous business players were called "briefcase importers" or importer *aktentas* because all they needed was a briefcase and approved import licenses.<sup>211</sup> It also can be seen that most of the indigenous importers were brokers instead of genuine importers.

Even though the original objective to establish an indigenous entrepreneur class as an important part of creating the national economy was not accomplished, according to Lindblad there were approximately thirteen indigenous entrepreneurs that became the old-timers of indigenous conglomerates; two of them were Achmad Bakrie (the father of Aburizal Bakrie) and Haji Kalla (the father of Jusuf Kalla).<sup>212</sup> Among these indigenous entrepreneurs mentioned above, only Bakrie as a group became part of

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<sup>208</sup> Glassburner, "Economic Policy Making in Indonesia 1950-1957", 88; Muhaimin, *Bisnis dan Politik*, 68-7.

<sup>209</sup> Feith, "The Decline in Constitutional Democracy in Indonesia", 375; Muhaimin, *ibid.*

<sup>210</sup> Feith, *ibid.*; Muhaimin, *ibid.*, 157-159; Lindblad, *Bridges to New Business*, 132.

<sup>211</sup> Feith, *ibid.*; Muhaimin, *ibid.*; Lindblad, *ibid.*

<sup>212</sup> The other eleven indigenous entrepreneurs were: Bumiputera 12, Hasjim Ning, Burhanuddin M. Diah, Wartono, Kentjana Widjaja, Soedarpo Sastrosatomo, TD Pardede, Julius Tahija, Muhammad Thayeb Gobel, Indrapura Paul Hamid Njoto Kusumo and Hans Mahendra (Pioneer Trading) and Arnold Baramuli (Poleko Trading), see Lindblad, *ibid.*, 92-98.

Soeharto's patrimonial networks. Interestingly, the "positive discrimination"<sup>213</sup> through indigenous entrepreneurs during the Benteng program also benefitted the Chinese and therefore encouraged the emergence of the Indonesian Chinese conglomerates during the 1950s. In fact, several of them became part of Soeharto's network: Liem Sioe Liong (Salim Group), William Soeradjaja (Astra International) and Sjamsul Nursalim (Gajah Tunggal Group).<sup>214</sup>

When Soekarno resumed his executive presidential power in 1957, he ended the Parliamentary Democracy and the Benteng programs ended as well. The potential program to establish an independent indigenous entrepreneurs' class, unfortunately, failed. Despite the fact that the *Benteng* program failed, according to Lindblad, the supportive environment during the Soekarno's Guided Democracy period made the old-timers of the indigenous conglomerates expand their businesses even more.<sup>215</sup> This situation was quite different compared to what had occurred during the Soeharto period where Soeharto preferred to expand his patrimonial networks with Indonesian Chinese conglomerates.<sup>216</sup>

The relations between Indonesian and Dutch governments had worsened after the mid-1950s on the West Irian issue. In November 1957, the *Konferensi Meja Bundar* (Round Table Conference, hereafter KMB) did not produce the expected result for the Indonesian government: its attempt to persuade the United Nations General Assembly to adopt a resolution requiring the Dutch government to give up West Irian to Indonesia was not successful. The deteriorating relations between the Dutch and Indonesian governments led to some drastic economic consequences, which led to the nationalisation of all Dutch enterprises such as the Dutch inter-island shipping company, Dutch trading, estate enterprises, banking and industrial enterprises.<sup>217</sup> In

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<sup>213</sup> Lindblad, *ibid*, 99.

<sup>214</sup> Relating to the success of the Indonesian Chinese conglomerates during the New Order, Lindblad believes that "the seeds of success had in several cases been planted during the 1950s," see *ibid*, 99-100.

<sup>215</sup> Lindblad, *ibid*, 93.

<sup>216</sup> *Ibid*.

<sup>217</sup> Ruth McVey, "The post-revolutionary transformation of the Indonesian Army Part 2", in *Indonesia* 13 (April 1972): 147-182; Thee Kian Wie, "Understanding Indonesia: the Role of Economic Nationalism",

December 1957, General Nasution ordered all Dutch property to be placed under military management. In 1958, the nationalisation was formally endorsed by Parliament; therefore, these Dutch firms were transformed into Indonesian state enterprises mostly under military management.<sup>218</sup>

Two important trends emerged from nationalisation. First, nationalisation did not change the colonial economic structure; it only changed ownership and management of companies. Since nationalisation, the owner was the state and managed by the military. By allocating state owned enterprises under military management and making the officers managers, Soekarno created a new political bureaucrats' class which had never existed before.<sup>219</sup> This structure and this new class become Soekarno's legacy for Soeharto, which Soeharto transformed into the foundation of his patrimonial networks.

Second, nationalisation of Dutch enterprises also facilitated a flourishing continuity of patrimonial relations, particularly between the military officers, the Chinese and indigenous entrepreneurs, such as Achmad Bakrie and Haji Kalla, as the outcome of the Benteng program. The ownership was now in the hands of the state through its military officers, who became managers of the state enterprises and had direct control over economic resources.<sup>220</sup> They were assigned to those positions because they had high ranking military positions. The officers may not have had business skills or experience, although some developed them, but they were in a position to control economic resources as well as acquire personal wealth. The control of Dutch enterprises provided an opportunity for capital accumulation.<sup>221</sup>

Patronage and corruption again became common practice among this new class and the old clients: Chinese business players and a small number of indigenous entrepreneurs who emerged from the Benteng program. These old clients gathered around military

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*Journal of Indonesian Social Sciences and Humanities* 3 (2010), 64; Harold Crouch (revised edn), *The Army and Politics in Indonesia* (Ithaca: Cornell University Press, 1988), 54-57.

<sup>218</sup> UU no 86 tahun 1958 tentang Nasionalisasi Perusahaan-Perusahaan Milik Belanda (Law no 86/ 1958 on Nationalisation of Dutch-owned companies).

<sup>219</sup> Robison, *Indonesia: The Rise of Capital*, 94-98.

<sup>220</sup> *Ibid*, 79.

<sup>221</sup> McVey, "The Post Revolutionary", 147-182; Thee, "Understanding Indonesia", 64.

managers of state enterprises who provided the only means of access to obtaining import licenses. They also assisted in the dispensing of low credit interest from banks and other finance facilities. Among the military's managers, allocating the enterprises' profits for military means and personal gain was common, instead of allocating these profits to government revenue.

Unfortunately, the mismanagement by Soekarno and his state-enterprise managers led to the gradual collapse of the economy. As will be explained in greater length in the next section, Soeharto, who became his successor, inherited state-owned enterprises (SOEs) and a political bureaucrat's class, which he utilised as the bases for his patrimonial networks. In addition to utilising these state enterprises and military officers, Soeharto also formed patrimonial networks with his two core cronies, Liem Sioe Liong and The Kian Seng (known as Bob Hasan). These networks were developed separately until Soeharto became president.

Liem Sioe Liong's first acquaintance with Soeharto was in 1956-1957 when he became Colonel Soeharto's logistic supplier for the military's Diponegoro Division in Central Java.<sup>222</sup> At that time Colonel Soeharto was a Commander in that Division. However, according to Elson, the patron-client relationships between Soeharto and Liem started in Jakarta, at the beginning of the New Order.<sup>223</sup>

Bob Hasan, a foster son of General Gatot Soebroto, intensified his relations with Soeharto when Soeharto became Commander of Diponegoro Division in 1950. Bob Hasan then worked for Soeharto to develop a wide range of sideline businesses, controlled by the military, providing much of the funding for the Division as well as extra income for its officers.<sup>224</sup>

As the expanding patrimonial network became an integral part of Soeharto's development strategy, Soeharto connected these selected state enterprises and managers with his business cronies, such as Chinese conglomerates, especially Liem Sioe Liong and Bob Hasan, and later with his relatives' and children's businesses. Soeharto's

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<sup>222</sup> Elson, *Soeharto: A Political Biography*, 64.

<sup>223</sup> *Ibid*, 192.

<sup>224</sup> Christopher Barr, "[Bob Hasan, the Rise of Apkindo, and the Shifting Dynamics of Control in Indonesia's Timber Sector](http://www.jstor.org/stable/3351402)". *Indonesia* 65 (1998):1-36. <http://www.jstor.org/stable/3351402> (accessed 15 August 2012).

relations with Chinese conglomerates seemed to continue the pattern of “Ali-Baba” that occurred in the business relationships between indigenous and Chinese business players during the Benteng program in the Parliamentary Democracy. Soeharto took advantage of these conglomerates’ capital, business skills and even their networks to expand his business in much the same way as the Benteng entrepreneurs. In other words, Soeharto became the centre of the patrimonial network and used state enterprises as the vehicles to relate to his other cronies and to fulfil his ‘development goals’.

### **B. Political bureaucrats and cronies at the core of Soeharto’s patrimonial network**

At the beginning of his tenure, Soeharto inherited hyperinflation as the result of Soekarno’s mismanagement of the economy. To resolve this issue, he followed the prescription of his economic technocrat ministers with assistance from foreign donors (the IMF and the World Bank) and a consortium of several countries unified under the International Governmental Group on Indonesia (IGGI), implementing a liberalised economy and leaving behind a direct state control economy. Regulating Foreign Investment Law no 1/1967 and Domestic Investment Law no 1/1968 to attract investors were indicators of the direction of the economy.

Having an abundance of revenue generated from oil exports, however, Soeharto diverted his market economy strategy to his Import Industrialisation Strategy (ISI) with state-owned enterprises as its prime movers. As briefly mentioned in the previous section, Soeharto utilised state-owned enterprises as a means to expand his patrimonial networks. The period of revenue abundance from oil exports was followed by the abrupt decline in the international oil price in 1983, which forced the government to move to EOI to push for non-oil exports.

This section discusses the expansion of Soeharto’s patrimonial network during both periods until Soeharto resigned. The first subsection discusses the expansion in the ISI period through three state enterprises: PERTAMINA, INHUTANI and BULOG. Even though the ISI period began in 1973, heavy state-led intervention occurred between 1975 and 1983.<sup>225</sup> Soeharto took full advantage of state enterprises in terms of

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<sup>225</sup> Thee Kian Wie, “Policies Affecting Indonesia’s Industrial Technology Development,” *ASEAN Economic Bulletin* 23, no. 3 (2006), 341-59.

generating funding for his patrimonial networks as well as cultivating loyalties and funding from military bureaucrats in exchange for creating positions. PERTAMINA, an oil company originating from the Old Order, was one of the state enterprises from the resources sector, which showed how Soeharto manipulated this state enterprise through its then director, General Ibnu Sutowo. INHUTANI and BULOG showed the expansion and intricacy of Soeharto's patrimonial networks through integration of state enterprises, including the military bureaucrats, with Soeharto's first cronies, Liem Sioe Liong and Bob Hasan.

The second subsection is the continuation of the expansion of Soeharto's patrimonial network during the deregulation period, which began in the early 1980s until his resignation in 1998. The highly personalised nature of Soeharto's authority was reflected in a more complex patrimonial network and interestingly, this expansion, to a certain extent, could intertwine with the implementation of deregulation policies, which made it integral to Soeharto's economic development.

### **1. State enterprises as part of Soeharto's patrimonial network**

PERTAMINA is one of the most important state enterprises in the resource sector which became the source of major foreign exchange earnings and state revenue. This status made the bureaucrat managers become powerful players because it broadened their responsibilities from setting up agreements with foreign companies or other parties that were interested in investing as well as regulating the collection of taxes and royalties, concession and contracts and the supervision of domestic supplies.

PERTAMINA was a good example of how Soeharto, since the beginning of his presidency, allowed Ibnu Sutowo to manipulate PERTAMINA in exchange for providing revenue for Soeharto's patrimonial networks. During the peak of PERTAMINA, General Ibnu Sutowo, the President Director of PERTAMINA, not only invested in oil-related projects, but non oil-related ones including fertilisers, steel plants, rice, industrial estates and hotels.<sup>226</sup> One of the examples of what PERTAMINA built

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<sup>226</sup> Bruce Glassburner, "In the Wake of General Ibnu: Crisis in the Indonesian Oil industry", *Asian Survey* 16, no. 12 (December 1976): 1099-1112. <http://www.jstor.org/stable/2643447> (accessed 4 September 2012).

was PT Krakatau Steel, to build major extensions for oil refining capacity and new refineries, new petrochemicals plants and new investments in heavy engineering.<sup>227</sup> To finance these projects, PERTAMINA borrowed heavily from international credit markets, including many short-term investment loans.<sup>228</sup> The expansion to both oil and non-oil-related projects saw PERTAMINA emerge as a conglomerate in private sector terms.

When PERTAMINA faced bankruptcy, many scholars and analysts argued that Ibnu Sutowo mismanaged the enterprise.<sup>229</sup> In early 1975, PERTAMINA's debt had reached USD10.5 billion and it fell behind with repayments.<sup>230</sup> One of the factors of this mismanagement was Ibnu Sutowo's practice of blatant corruption, which seemed to be allowed by Soeharto. He apparently not only allowed the practice of corruption, but he also obtained advantages from Ibnu Sutowo's corruption. In other words, Soeharto through Ibnu Sutowo virtually made PERTAMINA his own private property.<sup>231</sup> Therefore, when Soeharto announced Ibnu Sutowo's replacement as PERTAMINA's President Director with Mayor General Piet Haryono on 3 March 1976, he did not highlight the corruption in that SOE, which made it bankrupt; on the contrary, Soeharto said that Ibnu Sutowo was being "dismissed with honour".<sup>232</sup>

As the largest patron, Soeharto had used SOEs as the locus for connecting to his closest business partners, Liem Sioe Liong and Bob Hasan, by providing them with concessions and monopolies that benefitted all parties. In exchange, through their companies, they shared their profits mostly with Soeharto's *yayasans*, but most importantly, they expanded their businesses through Soeharto's children from the 1980s onwards.

Soeharto, who inherited SOEs from the Soekarno period, had taken advantage of selected state enterprises and positioned his loyal military officers to manage them. To

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<sup>227</sup> Robison, *The Rise of Capital*, 217-220.

<sup>228</sup> Glassburner, "In the Wake of General Ibnu," 1104-1105.

<sup>229</sup> See Glassburner, Robison, John Colmey and David Liebhold, "The Family Firm", *TIME*, 24 May 1999 <http://edition.cnn.com/ASIANOW/time/asia/magazine/1999/990524/cover5.html> (accessed 15 August 2012).

<sup>230</sup> Glassburner, "In the Wake of General Ibnu," 1104-1105; Elson, *Soeharto: a Political Biography*, 151.

<sup>231</sup> Elson, *Soeharto: a Political Biography*, *ibid*.

<sup>232</sup> Glassburner, "In the Wake of General Ibnu," 1099.

expand these patrimonial relationships, he connected these officers to his Chinese clients (Liem Sioe Liong and Bob Hasan), and provided them with facilities and privileges to obtain contracts, concessions and credits in any sector of the economy. Through this distribution of patronage, Soeharto successfully maintained loyalties and created relatively high dependency.

INHUTANI, the other SOE in the resource sector, was used by Soeharto as one of his bases for expanding his patrimonial network. Similar to oil exports by PERTAMINA, timber was a natural resource that foreign investors were interested in at the beginning of the New Order. INHUTANI along with INHUTANI II and INHUTANI III were supposed to administratively regulate contracts and concessions between government and foreign investors. However, this was not the case for state enterprises; they were only executors because all contracts and concessions were handled by the Department of Agriculture, especially the Director of Forestry, Soedjarwo.

Under Soedjarwo, a civilian with family ties to Mrs. Soeharto, the government introduced *Hak Pengusahaan Hutan* (a Right for Forest Exploitation, abbreviated as HPH) to SOEs and to private timber companies. The HPH is a “contract that provides the concession-holder with non-transferable exploitation rights to a discrete area of Production Forest for a period of up to twenty years.”<sup>233</sup> Between 1967 and 1980 the INHUTANI, INHUTANI II and III were assigned logging rights to over four million hectares in East Kalimantan and other parts of the outer islands.

The roles of INHUTANI became marginalised when Bob Hasan used his personal network with Soeharto to be appointed as the local partner for the American timber corporation, Georgia Pacific in 1970.<sup>234</sup> He then became Soeharto’s powerful partner in INHUTANI. Investors from Japan and other East Asian countries had to deal with INHUTANI for exporting timber from Kalimantan.<sup>235</sup> Further, he positioned himself as

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<sup>233</sup> Peraturan Pemerintah no. 21/1970 tentang *Hak Penguasaan Hutan dan Hak Pemungutan Hasil Hutan* (Government Regulations no. 21/ 1970 on a Right for Forest Exploitation and Forest Cultivation), <http://sipruu.ditjenpum.go.id/1970/1970/1970pp21.htm> (accessed 14 October 2012).

<sup>234</sup> Barr, “Bob Hasan, the Rise of Apkindo,” 7.

<sup>235</sup> As he emerged as a powerful decision maker in timber trading, Bob Hasan became known as ‘the Shadow Minister of Forestry’, see Kees van Dijk, *A Country in Despair: Indonesia between 1997 and 2000* (Leiden: KITLV Press, 2001), 77.

“the primary advocate and spokesperson for the nation’s timber industry”<sup>236</sup> after he established the *Masyarakat Perkayuan Indonesia* (the Indonesian Timber Society) and played a significant role in international timber associations such as the Southeast Asian Lumber Producers’ Association (SEALPA).<sup>237</sup>

When the government banned the export of raw timber in 1981, many of the foreign partners sold their Indonesian operations to their domestic partners, including George Pacific, because they were not interested in establishing downstream industries. When George Pacific left Indonesia in 1983, Bob Hasan became the sole owner and expanded his business to include processed timber. Taking advantage of deregulation policies in the mid-1980s, he built his business holding “Kalimanis” and expanded into financial, insurance, automotive and other industries.<sup>238</sup>

Bob Hasan was appointed as the Chairman of *Asosiasi Panel Kayu Indonesia Indonesian* (or the Wood Panel Producers Association, abbreviated as APKINDO) in the 1984. As the chairman of APKINDO, he was given the monopoly to determine the price, marketing and export of Indonesian plywood. Even though he succeeded in assisting the Indonesian government to gain approximately three-quarters of the worldwide plywood export market, he obtained large profits for himself by marking up prices and obtaining government facilities.<sup>239</sup>

BULOG was the state enterprise built during the New Order by Soeharto. The task of BULOG was primarily to mediate crises arising from shortages and price rises in basic staples, through purchasing and pricing policies including subsidies. In doing this task, BULOG had a monopoly on the purchase and distribution of certain corps.

In 1972 Soeharto replaced General Achmad Tirtosudiro with Mayor General Bustanil Arifin as the head of BULOG. He became one of the closest and most trusted clients of Soeharto. From 1972 to 1993 he remained head of BULOG and was appointed Junior Cooperative Minister (1978-83) and Cooperative Minister from 1983 to 1993 while he

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<sup>236</sup> Barr, “Bob Hasan, the Rise of Apkindo,” 8.

<sup>237</sup> *Ibid.*

<sup>238</sup> Manuel Saragosa, “Indonesian Tycoon Plays Influential Role,” *Financial Times* (13 February 1997): 6.

<sup>239</sup> Barr, “Bob Hasan, the Rise of Apkindo.”

was occupying the position as head of BULOG. Soeharto allowed him to manage *Bank Umum Koperasi Indonesia* (the Indonesian Cooperative Bank, addressed as Bank BUKOPIN) while he maintained political positions such as the head of BULOG and the Cooperative Minister until that bank was taken over by Bob Hasan in 1989. He still however remained Commissioner. More importantly, he could still use his influence to assist Bank BUKOPIN financially because of his political position as a minister.

From 1967 to 1998, BULOG distributed basic commodities such as rice, sugar, flour soybean and cooking oil. However, these basic commodities were imported and distributed through six of Liem Sioe Liong's companies. He was also rewarded with the flour monopoly. In 1969 he was granted a license to trade flour by BULOG. In the early 1970s, he set up Bogasari Flour Mills which then monopolised the importing, milling and distribution of flour in the country. The company expanded significantly and by 1991 this flour mill was the world's largest commercial buyer of wheat.<sup>240</sup> In addition, Liem also obtained BULOG's facilities for soy bean and sugar mills.

Soeharto had expanded state enterprises through installing military managers so they could provide funds for both Soeharto and the managers. During the Guided Democracy, most state enterprises were utilised by military officers to obtain their salaries because of the limitation of government funding for the military. This practice continued but expanded to fit with Soeharto's needs to utilise them as the bases of his patrimonial network. More importantly, by connecting selected enterprises with his other cronies, Soeharto cultivated solid and loyal relationships among military officers and his close Chinese cronies.

The expansion of Soeharto's patrimonial network faced serious challenges from wide ranging elements in society, especially at the beginning of the New Order. Further, the criticism also related to the absence of the indigenous entrepreneurs' class as the result of the implementation of a market strategy which gave too much toleration for foreign ownership.

As a consequence of the implementation of the Foreign Investment Law, the openness of the economy attracted foreign investors, especially from Japan, and some from the

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<sup>240</sup> "Obituary: Liem Sioe Liong, New Order Tycoon, Soeharto Crony Dies", *The Jakarta Post*, 11 June 2012.

United States as well as European countries. This thriving circumstance for foreign investment also encouraged joint ventures between, for example, Japanese investors and mostly Indonesian Chinese companies.<sup>241</sup> According to the critics, the market strategy signified that the government was not in favour of establishing an indigenous business class by allowing too many foreign investors and joint venture companies.<sup>242</sup>

The critics obtained momentum when Prime Minister Kakue Tanaka paid a state visit to Indonesia on 14 January 1974. The demonstration turned into violence and riots. Because of the number of casualties this demonstration was later known as *Malapetaka Lima Belas Januari* (the 15 of January disaster, abbreviated as *Malari*).<sup>243</sup> *Malari* became a riot that represented a conflict of interest. First, the students who opposed Soeharto's development strategy were not in favour of establishing an indigenous business class. Second, there was internal military conflict towards Soeharto, who was too tolerant of the spreading corruption of army loyalists, and of the way in which they exploited state enterprises.<sup>244</sup>

After *Malari*, Soeharto made some adjustments in political and economic spheres to reinforce his power. In the army, for example, Soeharto dismissed both General Soemitro and General Ali Moertopo from their positions. In economic policy, he addressed the critics on the absence of the indigenous business class by implementing, for example, Presidential Decree no.14/1979 and Presidential Decree no. 14a/1980 to assist the small economic sector (*golongan ekonomi lemah*) to make them independent economically. In other words, those two decrees seemed to address the issue of

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<sup>241</sup> Muhaimin, *Bisnis dan Politik*, 82-83; Mochtar Mas'oeed, *Ekonomi dan Struktur Politik: Orde Baru 1966-1971*, (Jakarta: LP3ES, 1989); Jamie Mackie and Andrew MacIntyre, "Politics," in Hal Hill, ed. *Indonesia New Order* (St Leonards: Allen and Unwin, 1994): 1-53; Robison, *The Rise of Capital*, 164-168.

<sup>242</sup> Mackie and MacIntyre, "Politics", *ibid.*

<sup>243</sup> *Ibid.*

<sup>244</sup> *Ibid.* The students and Islamic NGOs that led the Malari, were supported by the reformist army officers who one of whom was the head of the Commander of the Restoration of Security and Order Operation Command (KOPKAMTIB), General Soemitro, see Harold Crouch, "Patrimonialism and Military Rule in Indonesia," *World Politics* 31, no. 4 (July, 1979). 571-87, <http://www.jstor.org/stable/2009910> (accessed 21 November 2009).

promoting the indigenous business class<sup>245</sup> but unfortunately, it was merely Soeharto's rhetoric to encourage entrepreneurship through small and medium enterprises (SMEs) and *koperasi* because, in reality, this scheme was not sustainable.

## **2. Soeharto's highly personalised patrimonial network during the deregulation period**

Beginning in the early 1980s, for a little less than twenty years, Indonesia's development strategy shifted to Export Oriented Industrialization (EOI) as the response to the abrupt decline in international oil prices. The technocratic ministers developed deregulation policies to increase revenue from the non-oil export sector. It was also expected that the private sector would play a more significant role to enhance revenue.

While there was evidence that a quite significant increase in non-oil exports occurred; the deregulation policies, to a certain extent, supported the expansion of Soeharto's patrimonial network. During the deregulation period, the fact that Soeharto's financial resources increased enormously and were put under his direct control, made his political authority highly personalised. The sudden expansion of Soeharto's children's businesses combined with the increased dependence on Chinese conglomerates and a small number of dependent indigenous businesses, made Soeharto's patrimonial network more complex, but still personal. Soeharto gradually decreased the role of state enterprises but kept his loyal military officers.<sup>246</sup>

Groups of conglomerates, predominantly led by ethnic Chinese, had already been established in Indonesia since the colonisation period as well as in the Old Order. As seen in Table 3.1, two of the largest conglomerates in 1996 (before the economic crisis occurred) – Sampoerna and Bakrie – were established during the colonisation period and five of them – Djarum, Gudang Garam, Argo Manunggal, Pembangunan Jaya and Metropolitan – were established during the Old Order. Their existence, at least until 1996, demonstrated their ability to adjust to different patrons in different political systems.

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<sup>245</sup> Thee Kian Wie, "Understanding Indonesia: the Role of Economic Nationalism," 70-71.

<sup>246</sup> Yasmin Sungkar, "Indonesia's State Enterprises: from State Leadership to International Concensus", *Journal of Indonesian Social Sciences and Humanities* 1 (2008), 95-120.

Table 3. 1: The thirty largest conglomerates in Indonesia before the crisis (1996)

<b>Period of establishment</b>	<b>Conglomerate and year established</b>	<b>Founder and/or current owner and their Chinese names</b>
Colonisation Period	Sampoerna (1913) Bakrie (1942)	Putera Sampoerna/ Liem Tien Pao (Liem Seng Tee) Aburizal Bakrie (Achmad Bakrie)
Old Order	Djarum (1951) Astra International (1954) Salim (1957)  Gudang Garam (1958) Sinar Mas (1959) Roda Mas (1959) Ometraco (1959) Gajah Tunggal (1950s) Argo Manunggal (1961) Pembangunan Jaya (1961) Metropolitan (1962)	Budi Hartono William Soeriadjaja/Tjia Kian Liong Anthony Salim (Sudono Salim/ Liem Sioe Liong) Rachman Halim/Tjoa To Hing Eka Tjipta Widjaya / Oey Ek Thjong Tan Siong Kie Ferry Teguh Santosa/Kang Som Tjhiang Sjamsu Nursalim The Ning King Local Government of Jakarta and Ciputra Ciputra and Budi Brasali/ Tjie Tjin Hoan and Lie Tjoan Hong
The beginning of the New Order 1966 – 1968	Kalbe (1966) Panin (1968) Jan Darmadi (1968)	F. Bing Aryanto/Khouw Lip Bing Mu'min Ali Gunawan/Lie Mo Ming Jan Darmadi/Fuk Jo Jan
First <i>Repelita</i> of the New Order 1969 – 1974	Dharmala (1970) Cipta Cakra Murdaya (1970) Texmaco (1970) Ongko (1971) Maspion (1971) Matahari (1972) Raja Garuda Mas (1973) Gemala (1973)	Soehargo Gondokusumo/ Go Ka Him Murdaya Poo/ Poo Tjie Gwan Marimutu Sinivasan Kaharuddin Ongko/ Ong Ka Hwa Aliem Husein/ Lim Wen Kwang Mochtar Riady/ Lee Mo Tie Sukanto Tanoto/ Tan Kang Ho Sofjan Wanandi/ Liem Bian Khoen
Second <i>Repelita</i> of the New Order 1974 – 1979	Barito Pacific (1975) Lippo (1976) Danamon (1976)	Prajogo Pangestu/ Phang Djoen Poen Mochtar Riady/ Lee Mo Tie Usman Admadjaya/ Njauw Jauw Woo
Third <i>Repelita</i> of the New Order 1979-1982	Bimantara (1981) Nusamba (1981) Humpuss (1984)	Bambang Trihatmojo Bob Hasan/ The Kian Seng Hutomo Mandala Putra

Source: Christian Chua, *Chinese Big Business in Indonesia: the State of Capital*, London: Routledge, 2008, Table A.1 based on data from Warta Economy 24 November 1997, 32; Data Consult 1998, 44-46; Yuri Sato, "The decline of conglomerates in post Soeharto Indonesia: the case of Salim Group," *Taiwan Journal of Southeast Asian Studies* I, no. 1 (2004), 25.

The conglomerates which then became the first rank in terms of their annual sales (see table 3.2) – Salim, Astra International and Sinar Mas – were established in the 1950s when the *Benteng* program was implemented. Their expansion was closely related to their patronage from Soeharto. It is interesting to notice that in addition to Bakrie, the other two indigenous conglomerates belong to Soeharto's sons: Bimantara owned by Bambang Trihatmojo and Humpuss owned by Hutomo Mandala Putra. Bimantara and Humpuss were established in the third year of the Five Year Development Plan (*Rencana Pembangunan Lima Tahun, 1979-1984*).

As seen in Table 3.2, in terms of annual sales, the Salim Group, owned by Sudono Salim and/or Liem Sioe Liong had the highest annual sales (USD 22.3 billion) and was not comparable with other conglomerates, even with the other two conglomerates—Astra International and Sinar Mas—annual sales were USD 8.5 billion and USD 8.5 billion respectively. Among the indigenous conglomerates, Bimantara had the highest annual sales (USD 1.8 billion) compared to Bakrie (USD1.0 billion) and Humpuss (USD1.0 billion), but these three conglomerates fell in the middle ranking of annual sales along with the other fourteen conglomerates. The other ten conglomerates were ranked in the low category of annual sales (below USD 1 billion).

The massive expansion of these big corporate groups, especially the businesses of Soeharto's closest cronies and his children's was facilitated by the deregulation policies. On the one hand, the simplification of the establishment of new banks<sup>247</sup> facilitated this largest group of conglomerates to expand their businesses to any sector without implementing prudent business calculations. Instead they expanded their businesses financed by debt from their own banks as well as borrowing massively from foreign

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<sup>247</sup> One of the first deregulation policies undertaken by the government was to liberalise the banking sector. Deregulation policies were implemented after the Rupiah was devalued. The first deregulation policy in 1983 was targeted to relax banking regulations. It was to reduce the role of the Central Bank in regulating credit limit. This policy allowed private banks to determine credit interests, savings and deposits. In the initial stage, the 1983 deregulation policies created a competitive environment among, especially, private banks in attracting consumers. In 1988, the government took a further step in liberalising the banking sector, which was a controversial one, by giving permission for the establishment of new private banks. This policy was known as Pakto 88 (Paket Kebijakan Deregulasi Perbankan 1988). Two aspects made this policy controversial: the New Order government had forbade the establishment of new banks since 1971 and minimum assets that a new bank should possess was (only) IDR 100 million (approximately AUD 10,000), see <http://www.bi.go.id/NR/rdonlyres/A6011CBA-1B4E-49B1-9DDC-CB01AB6C60D0/19386/SejarahPerbankanPeriode19831997.pdf> (accessed 12 September 2012).

creditors. Because they owned the banks, they could force the bank to ignore the principal procedure for borrowing.

Table 3. 2: The thirty largest conglomerates before the crisis (1996) and their annual sales

No.	Rank	Annual Sales tril.Rp/bil. US\$	Conglomerates
1 2 3	First	53.12 / 22.3 20.20 / 8.5 20.19 / 8.5	Salim Group Astra International Sinar Mas
4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20	Middle	9.44 / 3.9 9.30 / 3.8 4.29 / 1.8 4.20 / 1.8 4.18 / 1.8 4.03 / 1.07 3.97 / 1.7 3.89 / 1.6 3.66 / 1.6 3.43 / 1.4 3.36 / 1.4 2.87 / 1.2 2.46 / 1.0 2.45 / 1.0 2.32 / 1.0 2.32 / 1.0 2.25 / 1.0	Gudang Garam Lippo Bimantara Gajah Tunggal Ongko Djarum Roda Mas Nusamba Kalbe Dharmala Argo Manunggal Barito Pacific Maspion Bakrie Humpuss Danamon Cipta Cakra Murdaya
21 22 23 24 25 26 27 28 29 30	Low	2.24 / 0.9 2.23 / 0.9 2.12 / 0.9 2.09 / 0.9 1.97 / 0.8 1.78 / 0.8 1.71 / 0.7 1.69 / 0.7 1.64 / 0.7 1.63 / 0.7	Panin Jan Darmadi Pembangunan Jaya Sampoerna Raja Garuda Mas Texmaco Metropolitan Matahari Ometraco Gemala

Source: Christian Chua, *Chinese Big Business in Indonesia: the State of Capital* (London: Routledge, 2008), Table A.1 based on data from *Warta Ekonomi*, 24 November 1997, 32; Data Consult (1998), 44-46; Sato "The Decline of Conglomerates in post Soeharto Indonesia: the Case of Salim Group," 25, with modification.

On the other hand, these Chinese conglomerates needed to partner with numerous, high military and civilian bureaucrats<sup>248</sup> in order to obtain the principal source of capital, which was credit from state banks, often at subsidised rates.<sup>249</sup> It was estimated that three-fourths of government bank loans were going to Chinese business firms.<sup>250</sup>



Figure 3. 1: President Soeharto along with the Indonesian Chinese conglomerates at his cattle ranch at Tapos, Bogor, 4 January 1990

Source: Liem Sioe Ling, Prajogo Pangestu, Eka Tjipta Widjaja, Soeharto and Ir Ciputra.

Courtesy: Bambang Harymurti, copyright Tempo.

[http://berita.plasa.msn.com/photoviewer\\_editor.aspx?cp-documentid=250245848&page=9](http://berita.plasa.msn.com/photoviewer_editor.aspx?cp-documentid=250245848&page=9)

(Accessed 29 September 2012)

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<sup>248</sup>The development of these large family concerns in the late 1960s and early 1970s was made possible, at least in part, by alliances with foreign partners in fields where technology was crucial, mainly textiles, chemicals, paper products, electrical appliances and transportation equipment. See John Bresnan, *Managing Indonesia: The Modern Political Economy* (New York: Columbia University Press, 1993), 255-256; van Dijk, *A Country in Despair*, 78-82; Elson, *Soeharto: A Political Biography*, 248-258.

<sup>249</sup> Bresnan, *Managing Indonesia*, 269.

<sup>250</sup> *Ibid.*

While it was openly known that Soeharto took full advantage of his patrimonial relations with conglomerates, he made efforts to lessen the critics by instructing the conglomerates to assist the welfare of the small economy sector through *koperasi*. Therefore, as seen in Figure 3.1, on 4 January 1990, Soeharto invited thirty one conglomerates—some of them were Liem Sioe Liong (Salim Group), Prajogo Pangestu (Barito Pacific), Eka Tjipta Widjaja (Sinar Mas) and Ir Tjiptura (Pembangunan Jaya)—to his cattle ranch at Tapos, Bogor. These conglomerates were instructed to set aside 5 to 25 per cent of their share to be donated to cooperatives (*koperasi*). Even though there had been no transparency about this flow to the *koperasi*, inviting the conglomerates to Tapos signified the personal relationships between them.<sup>251</sup>

The deregulation period was also the time where Soeharto's children's businesses expanded massively in all sectors of the economy. Soeharto's indulgence of his children along with his cronies' enterprises was an integral part of his government's development policies. Especially regarding his children's business involvement in the economy, Soeharto did not see that the process was flawed because his children's businesses contributed to the development of Indonesia.<sup>252</sup> Elson quoted McBeth, a *Far Eastern Economic Review* reporter, who viewed that "Soeharto genuinely seems to see his children as opportune instruments of his development policy."<sup>253</sup> As a consequence, Soeharto perceived his children's involvement in business as not corrupt but as business development.<sup>254</sup> Further, in early 1998, Soeharto declared: "There is no problem if the enterprises [of his children] are useful to the Indonesian people."<sup>255</sup> In other words, the success of his children's businesses was perceived by Soeharto as their achievements because of their business skills. In fact, having them involved significantly in the

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<sup>251</sup> Thee Kian Wie, "Understanding Indonesia: the Role of Economic Nationalism," *Journal of Indonesian Social Sciences and Humanities* 3 (2010): 55-79.

<sup>252</sup> Elson, *Soeharto: A Political Biography*, 248-258.

<sup>253</sup> John McBeth, 'Succession talk recedes', *Far Eastern Economic Review*, 18 May 1995, 48 as quoted by Elson, *Soeharto: A Political Biography*, 278.

<sup>254</sup> Elson, *ibid.*

<sup>255</sup> Soeharto, 'Watashi no rirekisho' ['My personal history'], *Nihon Keizai Shimbun*, 1-31 January 1998 (daily articles) as quoted by Elson, *Soeharto: A Political Biography*, 278.

Indonesian economy would balance the excessive roles played by the Indonesian Chinese conglomerates, the criticism frequently directed at Soeharto.<sup>256</sup>

The massive expansion of Soeharto's children's businesses in a relatively short period were the result of two factors: first, Soeharto positioned his children as brokers and gave them monopoly in any of the trades for government purposes; and second, Soeharto involved his children with his closest business partners, Liem Sioe Liong and Bob Hasan, which made the network even more complex.

Soeharto's children, as brokers of trades for government purposes, were also given monopoly over distributing and importing any commodities which were significant for the national economy including banking, oil market, clove trade, flour milling, cement, logging, hotels, textiles, cars, toll roads and fertiliser distributors.<sup>257</sup>

Some examples were the businesses of Soeharto's eldest daughters, Siti Herdiyanti Rukmana, Hutomo Mandala Putra and Bambang Trihatmojo. Siti Herdiyanti Rukmana, Soeharto's eldest daughter, through her holding company, Citra Lamtoro Gung, had a wide range of businesses from forestry, flour milling, construction and telecommunications. But her first and largest business was developing toll roads in Indonesia. Two state banks and her father's yayasans became the main funding for the project. In the oil market for example, for export and import oil in PERTAMINA in the mid-1980s, two companies—Perta Oil Marketing and Permindo Oil Trading—in which Hutomo Mandala Putra and Bambang Trihatmojo acquired significant stakes were established. PERTAMINA imported and exported much of its oil and had to share a commission with these two companies of USD 0.30 to USD 0.35 a barrel until Soeharto's resignation.<sup>258</sup>

Positioned as brokers, Soeharto's children were also approached by foreign investors who were interested in investing in Indonesia. As brokers they requested a high service charge for 'consultation' to secure these investments. Several foreign companies that approached Siti Herdiyanti Rukmana, for example, were foreign multinational

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<sup>256</sup> Elson, *Soeharto: A Political Biography*, 250.

<sup>257</sup> Bresnan, *Managing Indonesia*, 269; van Dijk, *A Country in Despair*, 78-82; Elson, *Soeharto: A Political Biography*, 248-258.

<sup>258</sup> John Colmey and David Liebhold, "The family firm."

companies such as an American telecommunication company, AT and T, and a Canadian mining company, Barric Gold.<sup>259</sup>

The second method by which Soeharto assisted his children to develop and expand their businesses was by involving them with his close business partners, Liem Sio Liong and Bob Hasan. As they also had widespread businesses in many sectors, Soeharto's children could be significant partners for them and it would smooth their own business paths. The benefits these partnerships would obtain were, for example, obtaining credits without or with very low interest, not having the obligation to pay back their loan, and even proceeding without following any regulations including international regulations.

The involvement of Soeharto's children's businesses in the Salim Group began when Liem Sioe Liong granted a 32 per cent share of his Bank of Central Asia (BCA) to Siti Hardijanti Rukmana dan Sigit Harjojudanto. After that, their "partnerships" continued in BULOG as well as in the timber industry. Since Soeharto was in power, the expansion of Liem Sioe Liong's conglomeracy was unavoidable: domestically and internationally. His businesses spread from the banking sector to: establishing BCA; cloves importers with Hutomo Mandala Putra, Soeharto's youngest son; cement manufacturing by establishing PT Indocement Tunggal Perkasa with Sudwikatmono (Soeharto's cousin); granting monopoly for importing flour and flour distribution in BULOG through PT Bogasari; acquiring the sole agency for the assembly, and distribution of Suzuki, Volvo, Nissan and Mazda cars, Hino trucks and Suzuki motorcycles in the 1980s, to name a few.<sup>260</sup>

In BULOG, Liem shared the business with Soeharto's children, especially rice, soybean and sugar. At least three of Soeharto's children benefitted: Bambang Triatmojo for sugar imports and distribution, Siti Hutami Endang Adiningsih for rice imports and distribution and Hutomo Mandala Putra (Tommy) for soybean imports and distribution.<sup>261</sup>

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<sup>259</sup> *Ibid*, van Dijk, *A Country in Despair*, 78-82; Elson, *Soeharto: A Political Biography*, 248-258.

<sup>260</sup> van Dijk, *A Country in Despair*, 78-82; Yuri Sato, "The Salim Group in Indonesia: the Development and Behavior of the Largest Conglomerate in Southeast Asia," *The Developing Economies* XXXI, 4 (December 1993), 408-441.

<sup>261</sup> John Colmey and David Liebhold, "Soeharto INC."

Expanding their businesses without following any regulations also signified Soeharto's strong intention to involve his children in the economy.

First, it turned out that Tommy, and who held the monopoly for importing and distributing soy beans in BULOG, had violated the implementation of trade reform.<sup>262</sup> Second, when Soeharto endorsed the Indonesian national car in 1996, he deliberately dismissed the Minister of Trade because he had reminded him that his endorsement would breach World Trade Organisation (WTO) regulations. When Soeharto granted the Timor car contract to Tommy, as the partner for KIA, the Korean car, Soeharto decreed that under the terms of agreement with Korea's KIA Car Co, the Timor cars would be assembled in Korea and imported without payment of duties or luxury tax, enabling the "national" car to undercut any competitor's price. This practice was challenged by Mari'e Muhammad, the Minister of Finance, and Satrio Budihardjo Joedjono, the Minister of Trade. Their arguments were related to the source of state funding and that agreement would breach the WTO's regulations. Soeharto did not see anything wrong with what he wanted and instructed the Minister of Finance to look for funding and dismissed the Minister of Trade from the cabinet.<sup>263</sup>

Soeharto's children's involvement with Bob Hasan's businesses began with Sigit Harjoyudanto (Soeharto's eldest son). Along with three of Soeharto's yayasans (Dakab, Dharmais dan Supersemar and Sigit), Bob Hasan established PT Nusantara Ampera Bhakti (Nusamba) in 1981. Under Bob Hasan's management, PT Nusamba comprised thirty companies ranging from finance, energy, pulp and plywood, steel, automotives, tea plantations and metal products.<sup>264</sup> The profit was estimated at USD 5 billion, which became one of the financial sources of Soeharto's yayasans as well as being credited to Sigit's account.<sup>265</sup>

In addition to the expansion of Chinese conglomerates and Soeharto's children, indigenous businesses also developed along the same lines: they had to have patronage

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<sup>262</sup> Until the trade reform bill was implemented six months later, the monopoly of soybean imports remained in Tommy's hands. See Adam Schwarz, *A Nation in Waiting: Indonesia's Search for Stability* (St. Leonards: Allen and Unwin, 1999), 133-134.

<sup>263</sup> Elson, *Soeharto*; van Dijk, *A Country in Despair*, 78-82.

<sup>264</sup> Swa, 30 January to 19 February 1997, 24.

<sup>265</sup> *Business Week*, 17 February 1997, 16.

from military and civilian bureaucrats and/ or Soeharto's children. One of the largest conglomerates in this category was the Bakrie group, owned by Aburizal Bakrie.

Aburizal Bakrie was one of the indigenous entrepreneurs, who initially Soeharto did not consider as one of his close business partners. In fact, Soeharto did not give his blessing when he, as the first indigenous entrepreneur, was elected as Chairman of KADIN in 1994.<sup>266</sup> For Soeharto, Aburizal Bakrie's victory was seen as a rebellion, since Soeharto had used KADIN as one of his vehicles for expanding his patrimonial network.<sup>267</sup> Aburizal Bakrie's acquaintance with Soeharto's family business began in the middle of his tenure as KADIN's Chairman. He began to be involved with Soeharto's family businesses, such as with Soeharto's son, Bambang Triatmodjo and Sudwikatmono in a rubber plantation in Sumatera, with Soeharto's daughter Titi Prabowo in a steam power plant in Tanjung Jati, and with Soeharto's youngest son, Hutomo Mandala Putra in Goro and Gelael retail businesses.<sup>268</sup> Further, Bakrie became a donor to *Yayasan Harapan Kita*. On the fifty-third anniversary of the Bakrie Group, Aburizal Bakrie contributed IDR 1 billion to the *yayasan*. Since then, his business has flourished with his two companies, Bakrie Capital Indonesia and Bakrie Investindo.<sup>269</sup> Before Soeharto's resignation, Soeharto requested Bakrie and the Minister of Finance, Mari'e Muhammad, to negotiate with the IMF to request alleviation for Indonesia's debt instalment.<sup>270</sup>

Fifteen years after Soeharto's resignation, it is interesting to observe the ongoing development of his cronies and family businesses. Based on the thirty conglomerates in 1996 (see Table 3.2), most have survived the economic crisis. From the 2011 Rich List

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<sup>266</sup> More detailed discussion will be presented in Chapter 7.

<sup>267</sup> Further analysis on how Soeharto had used KADIN for expanding his patrimonial network and Aburizal Bakrie's chairmanship in Kadin will be presented in Chapter 7.

<sup>268</sup> George J. Aditjondro, *Tuntut pertanggungjawaban 100-an Yayasannya!* (Kelompok Studi Reformasi CPK without year), 48.

<sup>269</sup> Abraham Runga Mali, "Jejak Soeharto di Lantai Bursa" (Soeharto's Traces in the Stock Market), <http://www.bisnis.com/servlet/page?pageid=127&dad=portal30&schema=PORTAL> (accessed 13 May 2012).

<sup>270</sup> "Aburizal Bakrie: Pelobi dan Pengusaha (Aburizal Bakrie: Lobbyist and Businessman), *Tempo*, 10 January 2000, <http://majalah.tempointeraktif.com/id/arsip/2000/01/10/EB/mbm.20000110.EB111061.id.html> (accessed 13 May 2012).

compiled by *Globe Asia*, some of Soeharto's cronies such as Eka Tjipta Widjaja (the wealthiest conglomerate in Indonesia with USD12 billion of wealth), Salim, Prajogo Pangestu and Ciputra remain among the wealthiest in Indonesia. Among the indigenous conglomerates, Aburizal Bakrie has become one of the wealthiest conglomerates since the economic crisis and has prospered significantly in comparison to Soeharto's children.<sup>271</sup>

Significantly, they survived the Indonesian Bank Restructuring Agency (IBRA) to restructure and repay their immense domestic and foreign debts as well as dealings which took over the management of some of these conglomerates' poorly administered banks.<sup>272</sup> The amount of some conglomerates' immense debts were as follows: Eka Tjipta Widjaja USD4.6 billion; Liem Sioe Liong USD 3.2 billion; Astra USD 2.5 billion; Bakrie Brothers USD 2.3 billion; Bambang Triatmojo USD 839 million; Bob Hasan USD 704 million; Siti Hardijanti Rukmana USD 491 million; and Hutomo Mandala Putra USD 162 million.<sup>273</sup> In addition to the debt issue, some of these conglomerates had to deal with Bank Umum Nasional (BUN) owned by Bob Hasan, Bank Danamon, BCA and Bank Modern.<sup>274</sup>

Six out of thirty conglomerates in 1996 (see Table 3.2) have not existed since the economic crisis including Nusamba, Dharmala, Danamon, Texmaco, Metropolitan and Matahari. They all went bankrupt as a result of the crisis.<sup>275</sup> Astra International, on the

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<sup>271</sup> SK Zainuddin, "Going behind the number and headlines: the 2011 Globe Asia 150 Rich List", *Globe Asia*, June 2011, 44-50.

<sup>272</sup> Kees van Dijk, *A Country in Despair*, 209, 402.

<sup>273</sup> van Dijk described in 1998 various lists of massive amounts of conglomerates' debts which were circulated in the Indonesian and foreign media. He quoted one of them that appeared in *Panji Masyarakat*, 24 June 1998. The list also included Hasjim Djojohadikusumo (US\$ 1.8 billion), Arifin Panigoro (US\$ 413 million), the Ning King (US\$ 351 million), Abdul Latief (US\$ 257 million), and Timmy Habibie (US\$ 220 million). See van Dijk, *A Country in Despair*, 209 as quoted from *Panji Masyarakat*, 24 June 1998, 69.

<sup>274</sup> van Dijk, *ibid*, 402.

<sup>275</sup> "Sebuah Panggung tanpa Pemain Baru", *Tempo*, 12 May 2008, <http://ip52-214.cbn.net.id/id/arsip/2008/05/12/LU/mbm.20080512.LU127128.id.html> (accessed 1 September 2012).

other hand, was acquired by Jardine Cycle and Carriage of Singapore in 2000, before they became part of Jardine Matheson in 2004.<sup>276</sup>

In summary, towards the end of his power, Soeharto had established a more complex and highly personal patrimonial network and made it integral to his political and economic development. It became a highly personalised regime because Soeharto exploited natural resources through his personal relations with the Chinese conglomerates, his children, his loyalist military officers in state enterprises and his dependent indigeneous business groups to acquire personal wealth. With the retreat of state enterprises in the economy as a consequence of the shift of economy strategy to EOI, Soeharto maintained relationships with his loyalist military generals and positioned some of them as ministers in his Development cabinet and/or bank commissioners or to become silent business partners of his cronies.

### **C. Conclusion**

Soeharto's meeting with Chinese cronies at his cattle ranch in Tapos in 1990 justified his support as part of national economic development. Moreover, the massive expansion of Soeharto's children's businesses in the last decade of his power was declared by Soeharto as the appropriate instruments for his development policy.

Soeharto's patrimonial network was in part based on the state-owned enterprises (SOEs) his government inherited from Soekarno. Soeharto appointed loyal military officers as managers of these SOEs then connected them to his Indonesian Chinese business partners, Liem Sioe Liong and Bob Hasan, in order to accumulate more wealth for all

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<sup>276</sup> William Soerijadja, the owner, acquired Astra International in 1992 with his seven fellow conglomerates such as Prajogo Pangestu, Bob Hasan and Anthony Salim, to assist Edward Soerijadja, his son, with Bank Summa's debt problems. In 1999, these conglomerates failed to repay Astra Internal's debt through BPPN; as a consequence it was acquired by Jardine Cycle and Carriage in 2000. See "Oom William, Pengusaha yang Menjaga Martabat", *Kompas*, 18 December 2012, <http://sosok.kompasiana.com/2012/12/18/pengusaha-yang-menjaga-martabat-511871.html> (accessed 18 July 2013); van Dijk, *A Country in Despair*, 77; [www.astra.co.id](http://www.astra.co.id)

parties. During the deregulation period, Soeharto expanded his patrimonial networks by establishing connection with other Indonesian Chinese conglomerates, also close to Liem Sioe Liong and Bob Hasan.

Even though Soeharto did not have a deliberate intention to establish indigenous entrepreneurs, the emergence of Soeharto's children's businesses and dependent indigenous business groups in the economy potentially could have established independent indigenous business groups as intended by the *Benteng* program during Parliamentary Democracy. Furthermore, nationalisation also created a dependent indigenous entrepreneurial class. Ibnu Sutowo or Bustanil Arifin had expanded their own businesses once they retired from their duties as directors of PERTAMINA and BULOG respectively. In fact, their businesses were continued by their children and families.

As a characteristic of his patrimonial network, Soeharto became the largest patron for dependent business groups ranging from his cronies, conglomerates other than his cronies, indigenous conglomerates and military bureaucrats with different levels of dependency. Through providing privileges and exercising coercion in exchange for material incentives and loyalties, Soeharto dealt with the different types of clients successfully until the 1997-8 economic crisis occurred.

As will be discussed in the subsequent findings (chapters five, six and seven), the democratisation process, which generated transparency and dispersal of power in the political system, inevitably changed and developed Soeharto's patrimonial networks. Following Soeharto's resignation, there is no patron as centralised as Soeharto, who was able to control the elaborate and complex pyramid of different clients. Even though the patrimonial network continues, actors and other stakeholders have changed. These changes have forced Soeharto's cronies to look for new patrons and methods in establishing and continuing these patrimonial networks.

## Chapter 4

### Four Developmental Phases in the Electronics and Palm Oil Industries

Chapter three discussed the background of patrimonial relations in Indonesia since the Old Order to its expansion in Soeharto's New Order. As mentioned in the conclusion of the chapter, towards the end of his tenure, Soeharto established highly personalised patrimonial relations comprising military officers, Chinese and indigenous conglomerates, his relatives and his children. It has also been contended that most aspects of the economy were dominated by Soeharto's cronies and family. Moreover, Soeharto successfully integrated his own business expansion as part of Indonesia's economic development.

Within this political economy context, this chapter outlines the development of the electronics and palm oil industries from the New Order to *Reformasi* era. The tug of war between the implementation of protectionism in the Import Substitution Period (ISI) and the half-hearted liberal market schemes in the Export Oriented Industrialisation (EOI) period generated many policies which affected the development of these two industries in terms of nature, scale and ownership. The discussion reveals that government policies have influenced and shaped the development of these two industries including state-business relations.

The chapter is divided into five sections, comparing the electronics and palm oil industries in four different developmental phases: the ISI, the EOI, the 1997-8 economic crisis, following the crisis and the conclusion. In the first section, the comparison of these two industries demonstrates different outcomes from the implementation of the ISI strategy. For the electronics industry, the protection scheme during the ISI period (1973-1983) failed to develop this industry into a strong producer in substituting imported products for domestic consumption. On the other hand, the protection scheme was an appropriate strategy for the development of the palm oil industry because state enterprises assisted its expansion.

The second section discusses the impact of the shift to the EOI strategy in the mid-1980s on the development of the electronics and palm oil industries. The abrupt decline

in the revenue from oil export from 1982 forced the government, through deregulation policies, to promote the role of the private sector to boost non-oil exports and discourage the role of state enterprises in the economy. The comparison of these industries demonstrates different patterns of development due to the different nature of these two sectors. The electronics industry, for example, demonstrates its dependency toward Multi National Corporations (MNCs) as the dominant players in the industry, whereas the palm oil industry began to attract local conglomerates (some of them were Soeharto's cronies) as their dominant players and the subsequent withdrawal of state-owned enterprises (SOEs).

The third section demonstrates the opposite effects of the 1997-8 economic crisis on the electronics and palm oil industries as the nature of these industries is different. The former was among the most affected, whereas the latter was among the least affected by this crisis.

Engaged in a more globalised economy, the *Reformasi* governments continue to adopt the strategy of EOI, which brings different consequences for each industry. The fourth section compares these different consequences. The electronics industry seems to have encountered more challenges than the palm oil industry. The challenges faced by the former industry are: the result of the electronics industry's technological and skilled dependency on MNCs and foreign suppliers; and the lack of comprehensive government policies to anticipate the shift to digital technology, as a response to the realisation of ASEAN Free Trade Agreement (AFTA) and China-ASEAN Free Trade Agreement (CAFTA). The palm oil industry, however, has relatively accomplished more in developing its downstream industries compared to the electronics industry, even though it has encountered countervailing pressures, especially environmental issues. Finally, the fifth section concludes the chapter.

#### **A. Effects of ISI strategy (1973-1983) during the New Order era**

At the beginning of the New Order in the early 1970s, the Indonesian economy underwent liberalisation policies as part of its EOI strategy, especially trade and investment policies. When oil prices boomed in 1973 and continued until approximately the early 1980s, the industrialisation strategy shifted towards ISI but retained certain

sectors driven by export strategy such as oil and gas. As will be explained in the subsection 1 of this section a small part of the components electronics industry in the 1970s was also targeted for export. However, for most of the manufacturing sector, the strategy swung towards ISI. As a result, rapid industrialisation growth was achieved.

In contrast with liberalisation policies which emphasised exporting the manufactured product, the implementation of ISI was aimed to replace foreign imports with domestic production. According to Thee Kian Wie<sup>277</sup> there were two phases of ISI that were implemented in the New Order: the easy phase (1973-1975) and heavy state-led intervention in the industry (1975-1983). It was in the latter phase that the New Order government established various upstream, state-owned and basic industries without considering on “efficiency, comparisons of the costs with border prices and the exportability of the products of the products of these basic industries.”<sup>278</sup>

The development of the electronics and palm oil industries reflected the swing of these two industrialisation strategies towards ISI. As these two industries differ in their nature, the effects of ISI policies on their development were different as well. In the electronics industry, for example, the government intervened with the process of import substitution through highly protected policies and regulations but not as an actor; whereas, in the palm oil industry, the government became a major actor, through state enterprises, in addition to highly protected policies and regulations. The following is a comparison of the two industries which elaborates the different effects of ISI strategy on their development.

## **1. Electronics industry**

As mentioned above, in the electronics industry, the government intervened through highly protected policies and regulations, but not as a major actor. The aim of the government, through its Ministry of Trade, was to develop this simple structure in order

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<sup>277</sup> Thee Kian Wie, “Policies Affecting Indonesia's Industrial Technology Development,” *ASEAN Economic Bulletin* 23, no. 3, (2006), 341-59.

<sup>278</sup> Clive S. Gray, "Survey of Recent Developments". *Bulletin of Indonesian Economic Studies* XVIII, 3 (November 1982): 41 as quoted by Thee Kian Wie, “Policies Affecting Indonesia's Industrial Technology Development,” 342.

to build simple consumer electronics and home appliances using imported components.<sup>279</sup> It was also the government's intention to transform the structure of simple domestic electronics repairers and assemblers into competitive domestic electronics manufacturers.

Parallel to this structure, there were two American companies that manufactured components – Fairchild and National Semiconductors – that exported all their output. Some joint venture existed between local and Japanese companies (Sanyo, National and Sharp) as well as local and European companies (Grundig, ITT, Philips).<sup>280</sup>

From 1973 to 1982, as part of government intervention, the government released several policies and regulations to encourage simple assembly and manage negative implications resulting from these regulations. The 1973 decree regulated to ban Completely Built Up (CBU) consumer electronics as well as lower taxes and tariffs for Completely Knocked Down (CKD) and Semi Knocked Down (SKD) consumer electronics.<sup>281</sup> This decree was directed to promote domestic assembly and to fulfil the domestic needs of consumer electronic products, such as televisions and tape recorders, and home appliances including refrigerators, air conditioners, fans and irons.

Further, the Minister of Industry regulated two other quantitative restrictions in 1978 and 1982 respectively: the Deletion Program and Trade Order for Import (*Tata Niaga Impor*). The 1978 Deletion Program was aimed to strengthen the structure of the industry by developing component electronics and to encourage the usage of local content. This program was a guideline for the automotive and electronics industry to use a certain percentage until the products of these two industries used 100% local content. The seriousness of the government in enforcing these two regulations was reflected in a Negative List of banned imported consumer and component electronics.

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<sup>279</sup> Interview with Uripto Wijaya, the owner of GALVA Group in Jakarta, 25 and 28 August 2003.

<sup>280</sup> Agus Santoso and Teddy Lesmana, "Analisis Kebijakan dan Dinamika Industrialisasi di Indonesia: Kasus Industri Elektronika," *Warta Kebijakan IPTEK dan Manajemen Litbang*, (LIPI, without year), 80. [www.jurnal.pdii.lipi.go.id/index.php](http://www.jurnal.pdii.lipi.go.id/index.php) (accessed 11 August 2011).

<sup>281</sup> When companies needed to import CBU consumer electronic products, they were able to do so but tariffs were imposed (20 per cent to 50 per cent) for products other than televisions and radios and 5 per cent to 50 per cent for professional electronics goods. In addition, the tariffs and import duties of CKD and/or SKD kits (consumer electronics products) were set lower than tariffs of the CBU. Their tariffs were from 0 per cent to 30 per cent.

The 1982 Trade Order for Import was implemented to deal with the negative consequences of the 1973 decree. Through the 1982 Trade Order for Import, the government then regulated a new system of Sole Distributor Agent (hereafter SDA)<sup>282</sup> in order to register all domestic assemblers that had links to foreign principals that imported electronics goods and electrical appliances. The low tariffs and low import duties of CKD and/or SKD kits regulated in the 1973 decree were manipulated by some companies to establish “fake companies”: to assemble and sell products without taking advantage of foreign technology and manufacturing for domestic purposes. These “pseudo-assemblers” emerged as one of the problems in the industry during the ISI period.

The implication of the implementation of the new SDA system was significant because it provided stages for local consumer electronics companies before they could manufacture independently. Establishing agency agreements between local companies and their foreign principal emerged as the first step before independence. Some of these domestic companies that began as SDA were PT Yasonta, PT Panggung Electric Corporation and PT Topjaya.<sup>283</sup> During this period, more local companies preferred to be simple assemblers and SDAs rather than establish joint ventures.<sup>284</sup> As a result, the number of joint venture companies was fewer than domestic companies.

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<sup>282</sup> Sole distributor agents (SDA) for consumer electronics products applied based on Agency Agreement between local companies and the principals. Problems emerged because the principals which already had relations with the specific company to be the SDA suddenly gave breach the agreement and gave the SDA to other party. One of the reasons the principals did this because they “divide et impera” the local companies and there were not yet regulations on this matter, see *Laporan Perkembangan GABEL 1982-1985*.

<sup>283</sup> Data from the field shows most of the established consumer electronics companies in Indonesia started as sole distributor agents. PT YASONTA and PT Panggung Electric Corp. (PT Panggung), PT Topjaya Antariksa (PT Topjaya) are good examples. These three local, PMDN companies started as sole distributor agents. PT YASONTA was sole distributor agent for SHARP Corp, PT Panggung was the sole distributor of more than one brand and one principal (Japan and the US), namely JVC, MAXELL, TEAC, JBL, whereas PT Topjaya was the sole distributor agent of TOSHIBA. SHARP Corp. had used PT YASONTA since 1970 to assemble televisions, audio-videos, and home appliances especially refrigerators for local demand. All these consumer electronics products were designed for and sold in the Indonesian market only. SHARP Corp., as the principal, did not produce of consumer products anymore. TOSHIBA Corp., since 1978, had PT Topjaya assemble televisions and home-appliances (especially refrigerators) under the TOSHIBA brand but for local demand only.

<sup>284</sup> There was a significant different between SDAs and joint ventures schemes. The idea behind this scheme was that local companies had the ability to learn the know-how and to secure networks with principal companies. Having developed these networks, they had secured their position to obtain components for their on-going assembling process. This principal network could be used as a marketing

Even though joint ventures were fewer in number than SDAs, established joint venture companies during that period were as follows: PT National Gobel (joint venture between Matsushita Corp. and PT National Gobel), PT Sanyo Industries Indonesia (joint venture between Sanyo Corp. and the Wongsowidjaja family), PT TOA Galva Industries (joint venture between TOA Corp and Galva Corp). Examining only a few joint venture companies established in the ISI period, Ardiansjah Parman, the Director of the Electronics Industry at *Direktorat Industri Logam, Mesin, Elektronika dan Aneka* (the Directorate of Metal, Machinery, Electronics and Multifarious Industries, abbreviated as ILMEA) 1984-1996, argued that the policies to ban CBU and lower the import duty of CKD and SKD failed to train local assemblers to be competitive players.<sup>285</sup> According to Ardiansjah Parman<sup>286</sup>, these policies, apparently, only provided trade protection, not industry development, let alone generate competitive domestic players.

## 2. Palm oil industry

In contrast with the electronics industry, government became the major actor, through state enterprises in the palm oil industry, in addition to highly protected policies and regulations.

At the beginning of the New Order, the government had not yet established palm oil as an industry for cooking oil; Indonesia instead imported from Malaysia. As the demand for cooking oil increased, there were tremendous parallels with population growth in Indonesia. Thus the government through Keputusan Presiden (or Presidential Decision, abbreviated as Keppres) no 1/ 1974 , instructed SOEs in the plantation sector to develop palm oil plantations to provide Crude Palm Oil (CPO)S for cooking oil.<sup>287</sup> The scheme regulated by the Keppres was called Perkebunan Inti Rakyat (or Nucleus Estate

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network as well. The joint venture scheme, on the other hand, had broader activities and responsibilities: they functioned not only as traders and as simple assemblers, but also they expected to manufacture the products to develop the industry.

<sup>285</sup> Interview Ardiansjah Parman in Jakarta, 24 September 2003.

<sup>286</sup> *Ibid.*

<sup>287</sup> Dewan Minyak Sawit Indonesia, *Industri dan Perdagangan Minyak Sawit Indonesia*, (Jakarta: Ministry of Agriculture, without year), 11.

Smallholders, abbreviated as hereafter PIR-BUN/NES). Under this scheme, the state enterprises, which developed the plantations, became the nucleus, obliged to provide up to 2.25 hectares for cultivation by about 500-2000 farmers; of the 2.25 hectares, 2 hectares were already planted.<sup>288</sup> This scheme was part of a redistribution scheme and to build farmers' capability in managing palm oil plantations in which they could own the land under a credit scheme and pay back in 15 to 20 years.<sup>289</sup>

This scheme was the first generation of PIR and was established in North Sumatra and Riau which then spread to other provinces of Sumatera, Kalimantan and Papua.<sup>290</sup> The second generation PIR regulated by Instruksi Presiden (Inpres or Presidential Instruction) no. 1/1986 instructed SOEs in the transmigration area to develop palm oil plantations. Transmigrated farmers from Java, Sumatera, Kalimantan and Sulawesi cultivated and owned these areas of the plantations. Since this project became successful, the government borrowed from the World Bank to develop extensive state enterprise plantations under the PIR-TRANS scheme.<sup>291</sup>

From the 1970s to 1985 (see Tables 4.1 and 4.2), the expansion of state enterprise plantations and production grew exponentially. The government enterprise plantations covered 60 per cent of the whole plantation area (641,140 hectares out of 1,045,030 hectares) and their CPO production was almost 70 per cent out of the total CPO production in 1985 (1,243,430 tonnes).

The increased areas and CPO production from small plantation holdings were generated through the PIR BUN/NES. Further, the increased areas and CPO production from private estate plantations, generated by non-Dutch affiliation companies, were therefore not nationalised. Some of them were under the SIPEF group (a Belgian agro-industrial

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<sup>288</sup> Iskandarini "Sistem Agribisnis Kelapa Sawit Di Indonesia,"(Universitas Sumatra Utara: Fakultas Pertanian, 2002), 12, <http://library.usu.ac.id/download/fp/sosek-iskandarini.pdf> (accessed 2 June 2011).

<sup>289</sup> *Ibid.*

<sup>290</sup> Dewan Minyak Sawit Indonesia, *Industri dan Perdagangan Minyak Sawit Indonesia*, *ibid*; Interview Rosediana Soeharto, Director of Indonesian Palm Oil Commission (KMSI), in Jakarta, 25 June 2009.

<sup>291</sup> Inpres no 1/1986 "Pengembangan Perkebunan dengan Pola Perusahaan Inti Rakyat yang dikaitkan dengan Program Transmigrasi", 3 Maret 1986; Interview Balaman Tarigan, Director PTPN IV in Medan, North Sumatera, 10 August 2009; Interview Rosediana Soeharto.

company established in 1919)<sup>292</sup> and PT Perusahaan Perkebunan Sumatera Indonesia (London-based Harrison and Crossfield Plc, a general trading and plantation management services firm).<sup>293</sup>

Table 4. 1: Area of CPO plantations, 1970, 1980 and 1985 (in thousand hectares)

<b>Year</b>	<b>SP</b>	<b>GPE</b>	<b>PPE</b>	<b>TOTAL</b>
<b>1970</b>	0	86.4	46.7	<b>133.1</b>
<b>1980</b>	6.18	199.54	88.85	<b>294.57</b>
<b>1985</b>	118.56	355.20	143.60	<b>617.36</b>
<b>TOTAL</b>	<b>124.74</b>	<b>641.14</b>	<b>279.15</b>	<b>1045.03</b>

Notes: SP= Smallholder Plantations, GPE=Government Plantation Estates, PPE= Private Plantation

Source: Ditjenbun and GAPKI, 2006.

Table 4. 2: Production of CPO and KPO, 1970, 1980 and 1985 (in thousand tonnes)

<b>Year</b>	<b>SP</b>		<b>GPE</b>		<b>PPE</b>		<b>TOTAL</b>	
	<b>CPO</b>	<b>PKO</b>	<b>CPO</b>	<b>PKO</b>	<b>CPO</b>	<b>PKO</b>	<b>CPO</b>	<b>PKO</b>
1970	0	0	147	33.34	60.24	15.42	207.24	48.76
1980	0.77	0	498.86	89.73	221.54	38.22	721.17	127.95
1985	43.02	8.82	861.17	178.68	339.24	70.97	1,243.43	258.47
<b>TOTAL</b>	<b>43.79</b>	<b>8.82</b>	<b>1,507.03</b>	<b>301.75</b>	<b>621.02</b>	<b>124.61</b>	<b>2,171.84</b>	<b>386.42</b>

Notes: SP= Smallholders' Plantations, GPE=Government Plantations' Estates, PPE= Private Plantations' Estates, CPO = Crude Palm Oil and PKO=Palm Kernel Oil

Source: Ditjenbun and GAPKI 2006.

In addition to being an actor through state enterprises, the government implemented highly protected industry regulations. Similar to what occurred in the electronics industry, the Trade Order implemented by the government in 1978 affected the palm oil industry. The main aim of this trade order was to secure CPO supply for domestic cooking oil production and to stabilise the cooking oil price. The other aim of the Trade Order was to regulate CPO export. This Trade Order was implemented through *Surat*

<sup>292</sup> SIPEF PT Tolan Tiga, *A Company Profile*, January 2009; see also PT Tolan Tiga Indonesia. "Our Company," <http://www.tolantiga.co.id/v1/> (accessed 1 September 2011).

<sup>293</sup> Interview Waras, Communication Officer of PT London Sumatra, in Medan, North Sumatra, 10 August 2009. See also [www.londonsumatera.com](http://www.londonsumatera.com), (accessed 12 January 2011).

*Keputusan Bersama Tiga Menteri* (Collaborative Decisions among three ministers: Minister of Trade and *Koperasi*, Minister of Agriculture and Minister of Industry).<sup>294</sup>

## **B. Expansion of private companies during the EOI period (1985-1996)**

The shift to EOI through implementing deregulation policies had changed the structure of both industries, especially in terms of ownership. As the strategy swung to export orientation, the New Order government began to allow private companies, including foreign and MNCs to play major roles in the electronics industry. In the palm oil industry, this period witnessed a gradual withdrawal of state enterprises.

In 1983 the oil price plunged for the first time, which forced the Indonesian government to shift from the ISI strategy to the EOI strategy. In implementing the EOI strategy, the New Order government had to replace its protection scheme with deregulation policies in all aspects of the economy to bring production in line with market economy. Since then, systematic deregulation measures in finance, trade, investment and privatisation were implemented.<sup>295</sup> According to Hill<sup>296</sup> from 1987 to 1991 the surge in manufacturing exports can be considered an important milestone in Indonesia's modern economic history. It was the first broad-based expansion of manufactured exports. Indonesia's manufacturing sector, therefore, emerged not only as the major source of foreign exchange earnings, replacing oil and gas, but also as the country's major engine of economic growth.

There were three important deregulation measures which had a direct influence on the "boom" stage of this industry: customs, ownership in foreign investment, and trade

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<sup>294</sup> SK Bersama Tiga Menteri: Menteri Perdagangan dan Koperasi No 275/KPB/XII/78, Menteri Pertanian No 284/KPTS/12/78, Menteri Perindustrian No 282/KP/XII/78, see Table 3 Matriks Kebijakan Pemerintah untuk Produksi Kelapa Sawit, in Arisman. "Analisis Kebijakan: Daya Saing CPO Indonesia," *Jurnal Universitas Paramadina* 2, no. 1 (2002): 80, Table 3 *Matriks Kebijakan Pemerintah untuk Produksi Kelapa Sawit*.

<sup>295</sup> Mari Pangestu, *Economic Reform, Deregulation, and Privatization: The Indonesia Experience* (Jakarta: Centre for Strategic and International Studies, 1996).

<sup>296</sup> Hal Hill, "Indonesian Industrialization: An Overview," in *Indonesia's Industrial Transformation* ed., Hal Hill *Indonesia's Industrial Transformation*. Singapore and St Leonards, (NSW: ISEAS and Allen and Unwin 1998), 22-54.

occurred in 1985, 1986, 1990, 1994 and 1996. The ‘revolutionary’ reform of customs in 1985 was a good start because it improved the custom’s administration including the implementation of duty exemption facility for exporters. A year later in 1986, there was the possibility of having majority foreign ownership for the exporting companies. The deregulation of foreign ownership peaked in 1994 when most restrictions on foreign investment were removed, meaning the government allowed 100% ownership. These deregulation policies were intended to boost the value of non-oil exports.

### **1. Electronics industry**

Taking advantage of the deregulation policies in the period between 1986 and 1996, both Japanese and South Korean electronics companies expanded and relocated their world-class consumer and component electronics subsidiaries. As described in section 1, in establishing cooperation with foreign companies, more local companies preferred to establish SDA compared to joint ventures. However, during the EOI period, these joint venture companies expanded significantly: not only their orientation towards export but also principal foreign companies established sister companies to manufacture consumer and component electronics.

Matsushita National Gobel, which had joint ventures with Panasonic during this period, expanded its domestic oriented joint venture company to an export oriented company by establishing six sister companies to manufacture consumer and component electronics. SANYO also expanded in the same manner with Matsushita by establishing three other sister companies in consumer and component electronics. The South Korean companies, Samsung Electronics and the Lucky Goldstar (LG) group, also relocated their companies to Indonesia.

Further, in 1994 under Government Regulation no 20/1994, the world-class companies established their subsidiaries in Indonesia: they were PT Sharp Indonesia, PT SONY Electronics Indonesia, PT Samsung Electronics Indonesia and PT LG Indonesia. More importantly, this period also witnessed Toshiba Corp make Indonesia its production base for colour televisions for the Southeast Asia market. These subsidiaries mostly manufactured consumer electronics. The other milestone also occurring in component electronics was the establishment of two Cathode Ray Tube (CRT) plants, a core

component of television and computer monitors, a collaboration between PT Tosummit Electronics Devices Indonesia (PT TEDI)<sup>297</sup> and PT LG Electronics Devices. In addition to these world-class companies, significant numbers of medium sized companies were also established to assemble consumer electronic parts.

Local companies also contributed to this expanded structure. Initially, the local companies only sold consumer electronics products for the domestic market, but since the export oriented MNC companies in Entrepot Production for Export (EPTE) were allowed to sell 25 per cent of their products in the domestic market, local companies repositioned their orientation, not only to the domestic market, but also export. For them, it was quite a challenge, offering their local brands in competition with international brands in the domestic market. They therefore diversified within their core business to be accepted in the export market. They also took advantage of some deregulation measures. Some examples of local companies were PT Hartono Istana Teknologi, which carries the POLYTRON brand, and PT Panggung Electronics Corp, which carries the AKARI and PANAREC brands.

As a result, the industry started to show exponential growth within ten years. Unfortunately, while these export oriented companies expanded, the local companies, which sold most of their products in the domestic market, appeared to be the second priority in government policies.

The exponential growth can be seen in foreign investment in consumer electronics as well as in component and parts electronics, which increased by five and six times respectively, compared to foreign investment in 1994 (see Table 4.3). The exponential increase in foreign investment in consumer, component and parts electronics was because through the 1994 June Package, the government allowed 100 per cent foreign ownership in most sectors in the economy, except nine sectors that were essential for the welfare of people at large, for example, telecommunications.<sup>298</sup>

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<sup>297</sup> PT Tosummit Electronics Devices Indonesia (PT TEDI) was a joint venture between PT Tabung Gambar Indonesia (a consortium of four domestic-owned companies: PT National Gobel, PT Hartono Istana Teknologi, PT Panggung Electronics and PT Topjaya Antariksa), Toshiba Corp., Sumitomo and Orion Electric Co. Ltd (a South Korean company).

<sup>298</sup> The relaxing of foreign investment regulations began with the 1986 May Package, which allowed foreign companies for export to have majority ownership (5 per cent share for an Indonesian partner). Foreign investment started to boom when the government released the 1989 May Package. This allowed

Table 4. 3: Investment in the main segments of electronics, 1994-1996

<b>Segment</b>	<b>Status</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>
<b>Consumer electronics</b>	PMA (USD Million)	107	107	559
	PMDN (IDR Billion)	18	0	96
	Non-Fac*(IDR Billion)	33	58	173
<b>Business and industrial electronics</b>	PMA (USD Million)	10	8	28
	PMDN (IDR Billion)	80	0	0
	Non-Fac*(IDR Billion)	61	30	30
<b>Component and parts electronics</b>	PMA (USD Million)	208	470	1,402
	PMDN (IDR Billion)	129	0	172
	Non-Fac*(IDR Billion)	115	91	209

Notes: Non-Fac denotes Non-Facility investment status, neither PMA nor PMDN.

Source: Directorate of Industry Electronics (2000), as quoted by Idris F. Sulaiman, *Indonesian Electronics Industry: Building International Competitiveness through Trade Policy Reform, IT-Based Inter-Firm Linkages and New Institutions* (USAID) and the Government of Indonesia, 2001), 105, Table 1.

In the period between 1986 and 1996, there were many expansions of subsidiaries but most invested more in consumer electronics compared to component electronics manufacturing. Data in Table 4.4 shows that the value of component and parts production almost doubled from the period 1994 to 1996. This increased value, however, contributed less than 25 per cent of total production in that period. The dominant consumer, business and industrial electronics segment with the relatively small component and parts electronics segment indicated that the policies had not yet

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the establishment of 100 per cent foreign ownership of companies in the Batam Economic Zone and introduced a major investment licensing reform, i.e. the replacement of Daftar Skala Prioritas (DSP) by the Negative List (investment licensing), which specifies areas closed to foreign investment. The establishment of Export Processing Zones (EPZs) and Entrepot Production for Export (EPTE) were other important export promotion instruments.

been targeted to establish the downstream industry for a more technological based electronics industry. Building the downstream industry was also significant to lessen dependency on foreign principal companies. As will be analysed in the third section, this dependency had contributed to the severe effects of the 1997-8 crisis for this industry.

Table 4. 4: Electronics and Electric Appliance Production in Indonesia, 1994-1996 (in billions)

Segment	1994		1995		1996	
	USD	%	USD	%	USD	%
Consumer electronics	5,005	57	7,734	56	8,564	54
business and industrial electronics	1,836	21	2,951	21	3,591	23
Component and parts electronics	1,979	22	3,241	23	3,597	23
<b>TOTAL</b>	<b>8,820</b>	<b>100</b>	<b>13,926</b>	<b>100</b>	<b>15,722</b>	<b>100</b>

Source: Ministry of Industry and Trade based on BPS (2000), as quoted by Sulaiman, *Indonesian Electronics Industry* 105, Table 2.

## 2. Palm oil industry

The shift to EOI strategy influenced and shaped the development of the palm oil industry including state-business relations. The dominance of state enterprises was replaced by private companies in terms of plantation areas and CPO production. This means there had been a gradual withdrawal of state enterprises during this period. However, unlike the electronics industry, the government maintained its intervention through implementing export tax, Negative Investment List and empowering BULOG to secure the supply of CPO for cooking oil production as well as to stabilise the cooking oil price.

Table 4.5 shows that from 1985 to 1997, Private Plantation Estates (PPE) grew exponentially compared to Government Plantation Estates (GPE) and Smallholders' Plantations (SP). Data from the table indicates that the growth of PEP occurred in 1990, approximately seven years after the first deregulation was implemented in 1983. Its rapid growth occurred in 1997. Extrapolating from Table 4.5, in 1997, out of the total

area of 2,922,300 hectares, the compared percentages among PEP, SP and GEP were as follows: 54.48 per cent, 27.83 per cent and 17.69 per cent respectively. Based on these percentages, in 1997 the growth of the government plantations' estate (GPE) was less compared to small holders' plantations (SP) growth.

Table 4. 5: Area of palm oil oil plantations in 1985, 1990, 1997 (in thousand hectares)

<b>Year</b>	<b>SP</b>	<b>GPE</b>	<b>PPE</b>	<b>TOTAL</b>
<b>1985</b>	--	335.20	143.60	<b>597.37</b>
	118.57			
<b>1990</b>	291.34	372.25	463.09	<b>1,126.68</b>
<b>1997</b>	813.18	517.06	1592.06	<b>2,922.3</b>
<b>TOTAL</b>	<b>1,223.09</b>	<b>1,224.51</b>	<b>2,198.75</b>	<b>4,646.35</b>

Note: SP=Smallholders' Plantations, GPE=Government Plantation Estates, PPE=Private Plantation Estates.

Source: Ditjenbun and GAPKI 2006.

In terms of CPO production, Table 4.6 shows that in 1985 and 1990, GEP was still dominated CPO production compared to PPE and smallholders' plantations. CPO production from private plantation estates almost doubled (2,578,810 tonnes) compared to the GPE (1,586,880 tonnes). Even though smallholders' plantations had increased significantly in 1997, CPO production had not yet exceeded GPE production.

Table 4. 6: Production of CPO and KPO 1985,1990 and 1997 (in thousand tonnes)

Year	SP		GEP		PEP		TOTAL	
	CPO	PKO	CPO	PKO	CPO	PKO	CPO	PKO
1985	43.02	8.82	861.17	178.68	339.24	70.97	<b>721.17</b>	<b>127.95</b>
1990	376.95	75.39	1247.16	249.43	788.51	178.98	<b>2,412.62</b>	<b>503.8</b>
1997	1,282.82	256.57	1,586.88	322.95	2,578.81	515.76	<b>5,448.51</b>	<b>1095.28</b>
<b>TOTAL</b>	<b>1,702.79</b>	<b>340.78</b>	<b>3,695.21</b>	<b>751.06</b>	<b>3,706.56</b>	<b>765.71</b>	<b>8,582.30</b>	<b>1,727.03</b>

Note: SP= Smallholders' Plantations, GPE=Government Plantation Estates, PPE= Private Plantation Estates, CPO= Crude Palm Oil; PKO=Palm Kernel Oil  
Source: Ditjenbun and GAPKI 2006.

The gradual withdrawal of state enterprises during this period was a consequence of the implementation of deregulation policies. The internal consolidation began in 1974 when *Perusahaan Perkebunan Negara* (PPN) was merged with forty *Perseroan Terbatas Perkebunan* (PTP). From their legal status, the merger in 1974 began to transform these state enterprises into more business-like enterprises for profit. In 1994, in line with deregulation policies, another merger occurred among these PTPs which had different commodities. The objective of this merger was to transform them into business-like enterprises for growing profit. The 1994 merger transformed the forty PTPs into only fourteen *Perusahaan Terbatas Perkebunan Negara* (PTPN) or State Plantation Limited Company (hereafter PTPN).<sup>299</sup> In terms of numbers and ownership of areas, the government deliberately reduced PTPs. Thus the scale of production gradually decreased.

On the other hand, the expansion of smallholders' plantations in terms of areas and ownership was encouraged by other PIR schemes, that is, *PIR-Kredit Koperasi Primer untuk Anggotanya* (NES Primary Cooperative Credit for members, abbreviated as PIR-KKPA). This scheme was a collaboration between the cooperatives of farmers and private companies and/or state enterprises. In addition to the scheme, there were independent farmers (*petani swadaya*) who began to own their plantations. Thus the

<sup>299</sup> PTPN, which has palm oil as their commodities, are PTPN I to PTPN VIII, PTPN XIII and PTPN XIV. PTPN I to PTPN VIII are located in Sumatera (only North Sumatera has three PTPNs which indicated that this province has many plantations of different commodities, especially palm oil and rubber). PTPN XIII covered the area of Kalimantan and PTPN XIV, which covered Sulawesi and the eastern part of Indonesia. Interview with Muhammad Abdul Ghani PTPN IV, Medan, 10 August 2009.

expansion of smallholders' plantations had become integral to the development of both state enterprises and private companies.

As occurred in the electronics industry, from January 1995 to December 1997 there was big investment in palm oil plantations. During that period, data from *Pusat Data Bisnis Indonesia* shows there were nine projects of foreign investment with the total amount being USD 961.7 million and 316 local investments worth IDR 48.85 billion.<sup>300</sup> Most foreign investors came from Malaysia and local investors were groups of conglomerates such as the Salim Group, Sinar Mas Group, Raja Garuda Mas Group and Wilmar Group and companies such as PT Asian Agri and PT London Sumatera.<sup>301</sup> Groups of conglomerates, which expanded to the palm oil business, were some of Soeharto's cronies. As will be explained in the third section of this chapter, when the 1997-8 economic crisis occurred, the *Reformasi* governments relied on these groups and state enterprises for domestic cooking oil supply.

Even though in the 1990s the economy was directed to export, unlike in the electronics industry, the government significantly intervened through three instruments: re-applying the export tax, applying the Negative Investment List and authorising BULOG to stabilise CPO supply and the price of cooking oil in the domestic market. The government intervened in this sector due to its responsibility to provide sufficient CPO supply for domestic cooking oil production. Without government intervention, there was a tendency for manufacturers to export all the CPO produced.

After abolishing the Trade Order and Export Tax on 3 June 1991, the government re-applied the Export Tax due to the increase in the international CPO price. In 1994, the international CPO price steadily increased and reached its peak (USD 720) in August 1994. To discourage manufacturers from exporting CPO, the government increased the Export Tax from 40 per cent to 75 per cent.

The other two instruments were the Negative Investment List and authorising BULOG to stabilise the price and supply of cooking oil to the domestic market. The Negative

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<sup>300</sup> *Pusat Data Bisnis Indonesia*, 1998, as quoted by Iskandarini (2002), p. 13. In general, these investors established plantations integrated with factories to manufacture CPO and its derivatives.

<sup>301</sup> Until 2007, the number of private companies that operated their business in the palm oil industry were 814 companies with 1006 plantations, see *Dewan Minyak Sawit Indonesia, Industri dan Perdagangan Minyak Sawit Indonesia*, 9.

Investment List was an instrument to limit new investment for both local and foreign investors who attracted to open new investment in expanding CPO plantations and manufacturing cooking oil.<sup>302</sup> In line with these policies, BULOG was authorised to be the buffer stock for CPO from state enterprise plantations and to carry out *operasi pasar* together with private cooking oil producers, especially prior to Idul Fitri (the Islamic celebration following *Ramadhan*, the fasting month) and the New Year. All this suggests significant government intervention in the sector.

### **C. Effects on both industries of the 1997-8 economic crisis**

The 1997-8 economic crisis which evolved into an political and social crisis, affected all sectors in the economy, but it affected them differently. As mentioned earlier, the electronics industry was among the most affected whereas the palm oil industry was among the least affected.

#### **1. Electronics industry**

In the electronics industry, the effect of the crisis meant that local companies were more severely compromised compared to joint venture companies and subsidiaries. When the crisis started, one IDR devalued almost 900 per cent to one USD, which afflicted both subsidiaries of the MNCs and local companies because all trading, including importing raw materials and components, were in US currency; however, it affected local companies even more. As for domestic consumers, devaluation lowered their purchasing power due to the rocketing price of electronics products.

Devaluation of the Rupiah affected local electronic companies in two ways. First, local manufacturers had difficulties in obtaining access to loans to finance production. On the one hand, many of the banks they dealt with were liquidated. On the other hand, Letter of Credit (L/C) from Indonesia's accredited banks was not accepted by overseas suppliers. It is important to remember here that even though most local products had more than 65 per cent of local content, major components and raw materials were still

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<sup>302</sup> In March 1997, however, the government relaxed the Negative Investment List by allowing foreign investors to establish CPO's downstream industry and allowing local investors to invest in CPO plantations.

imported. Lack of access for loans made local manufacturers reduce their production capacities by up to 70 per cent. Some of them, at least thirty-five local companies, terminated their production and laid off thousands of workers because they ran out of capital.<sup>303</sup> Second, and more importantly, they faced problems in lowering purchasing power of the domestic market due to the fact that prices of their products became too expensive for buyers in the domestic market, especially for the poorer people in society.

Subsidiaries of the MNCs and joint venture companies, which exported most of their products, survived better, because even though they had to deal with a sudden rise in production costs, their principals maintained giving orders, supplying raw materials and components to their subsidiaries for ongoing production. Apparently, they relied on export activities during the crisis period. Still, however, they had to restructure some of their production lines to adjust to lowering the purchasing power of the domestic market. The restructuring of subsidiaries of the MNCs took the form of a merger, shifting and even closing their domestic production lines.

SONY, which has three subsidiaries in Indonesia, merged its television and audiotape production of PT Sony Manufacturing Indonesia for the domestic market to PT Sony Electronics Indonesia. Unlike their Japanese counterpart that merged its subsidiaries, two South Korean subsidiaries took a different path. PT LG Electronics Indonesia, for example, diverted its production lines of televisions and fridges from domestic to export markets. More radical restructuring was taken by PT Samsung Electronics Indonesia; from 1997 to 1998, this company closed its production lines for domestic televisions and home appliances.<sup>304</sup>

The transformation of the financial crisis into a economic, political and social crises had brought brutal riots and looters to Jakarta who burned down consumer electronics retail trading centres in Jakarta. These accounted for 70 per cent of national trading. In addition, there was illegal trade in the form of smuggling, parallel imports and under invoicing. From 1998-1999 approximately 50 per cent to 70 per cent of illegal products were traded in the local market.<sup>305</sup> The lower income customers preferred these products

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<sup>303</sup> Interview with Ali Soebroto, Director of GABEL, Surabaya, East Java, 30 September 2003.

<sup>304</sup> Interview with Lee Kang Hyun, Director of PT Samsung Indonesia in Jakarta, 4 August 2003.

<sup>305</sup> Interview with Ali Subroto.

because the price of legal products rocketed as the Rupiah devalued almost ten times that of the USD.

Due to security reasons, the subsidiaries of the MNCs, mostly export oriented companies, were more concerned with economic and security issues. Some Japanese and South Korean principals shifted their orders from their subsidiaries in Indonesia to their subsidiaries in other countries. It is understandable that the unstable political situation and social unrest had affected the quality and volume of products produced in Indonesia. This unpredicted situation also generated the possibility that principal companies would relocate their subsidiaries to other countries. As a further consequence of restructuring and relocation, there was a significant decline in foreign investments in consumer electronics, business and industrial electronics, and component and parts electronics as seen in table 4.7.

Table 4. 7: Investment in the main segments of electronics, 1996-1999

<b>Segment</b>	<b>Status</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>
<b>Consumer electronics</b>	PMA (USD Million)	559	37	16	0
	PMDN (IDR Billion)	96	9	1	0
	Non-Fac*(IDR Billion)	173	53	21	25
<b>Business &amp; industrial electronics</b>	PMA (USD Million)	28	14	0	5
	PMDN (IDR Billion)	0	0	12	0
	Non-Fac*(IDR Billion)	30	72	16	99
<b>Component &amp; parts electronics</b>	PMA (USD Million)	1,402	332	96	111
	PMDN (IDR Billion)	172	313	0	1
	Non-Fac*(IDR Billion)	209	129	11	3.5

Notes: Non-Fac denotes the Non-Facility investment status, neither PMA or PMDN  
Source: Directorate of Industry Electronics (2000), as quoted by Idris F. Sulaiman, *Indonesian Electronics Industry* 105, Table 1.

The significant decrease not only showed in investment but also in export value. For consumer electronics, in 1997 and 1998 for example, the export value decreased by 28 per cent and 23 per cent respectively (see Table 4.8). For component and parts electronics, there had been a steady growth from 1997 to 1998 as these products were mostly manufactured by subsidiaries.

Table 4. 8: Electronics and Electric Appliances Export 1996-1999 (USD Billion)

<b>Segment</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>
<b>Consumer electronics</b>	1.704	1.330	1.080	1.096
<b>Business &amp; industrial electronics</b>	0.890	0.804	0.515	0.631
<b>Component and parts electronics</b>	1.318	1.458	1.464	2.076
<b>TOTAL</b>	<b>3.911</b>	<b>3.898</b>	<b>3.363</b>	<b>3.896</b>

Source: Ministry of Industry and Trade based on BPS (2000), as quoted by Idris F. Sulaiman, *Indonesian Electronics Industry*, 106, Table 3.

## 2. Palm oil industry

The opposite situation occurred in the palm oil industry. As mentioned in the previous section, the international price of CPO in Rotterdam reached its peak (USD 720) per metric ton in 1994. Even during the crisis the price was not as high as in 1994, when it reached a considerably high price of USD 672 per metric ton. Needless to say, the manufacturers took advantage of the high international price and exported most of their CPO products without the consent of the government.

In securing CPO supply for domestic cooking oil production, the government continued to intervene by implementing a high percentage of the export tax without considering the high international price and market demand. The progressively high export tax succeeded in decreasing the volume and value of CPO exports in 1998.

The increased tendency of export in 1997 (see table 4.9) made the government pre-empt export by using Export Tax and forbidding CPO production for export as the instruments. The Export Tax was first applied in 1994, but on 17 December 1997, the

government, through the Minister of Finance's decree applied the 'Added Export Tax' (*Pajak Ekspor Tambahan*) by 40 per cent to 70 per cent.<sup>306</sup> This Added Export Tax applied to 17 groups of CPO companies appointed by the Minister of Industry and Trade and to PTPN; they obliged and allocated 80 per cent of their CPO products for domestic cooking oil production.<sup>307</sup> In addition to Export Tax, on 24 December 1997, *Dirjen Perdagangan Dalam Negeri* (or the General Director of Domestic Trade) released a decree instructed to prohibit CPO production for export.<sup>308</sup> On 7 July 1998, through the Minister of Finance, the Export Tax was increased from 40 per cent to 60 per cent.<sup>309</sup> In terms of export, the government allowed CPO production from the private companies to be exported, with the exception of state enterprises' CPO production.<sup>310</sup> These regulations affected CPO export significantly. As seen in Table 4.9, there was a steep decline in CPO export value from USD 1.45 billion in 1997 to USD 0.75 million in 1998.

Table 4. 9: Export Volume (in thousand tonnes) and Value (in million USD), 1980, 1990, 1997-8.

Year	CPO	
	Volume	Value
1980	503	255
1990	816	204
1997*	2,891.7	1,446
1998*	1,479.4	745.2

Source: For 1980 and 1990 figures see BPS and Department of Trade, as quoted by Achmad Mangga Barani, "Pengembangan Kelapa Sawit Nasional: Mewujudkan Visi 2020," (paper presented In *Simposium Kelapa Sawit Indonesia: Menunjang Ketahanan Pangan Dunia*, Jakarta, 30 June 2009).

\*For 1997 and 1998: Thee Kian Wee, "The Impact of the Economic Crisis on Indonesia's Manufacturing Sector," *The Developing Economies* XXXVIII,4 (December ,2000): 446, Table XVI.

<sup>306</sup> Arisman, "Analisis Kebijakan: Daya Saing CPO Indonesia," 79.

<sup>307</sup> *Ibid.*

<sup>308</sup> SK Dirjen Perdagangan Dalam Negeri no. 420/DJPDN/97 on prohibiting the CPO export, 24 December 2007.

<sup>309</sup> Arisman, *ibid.*

<sup>310</sup> The intervention of the International Monetary Fund (IMF) during the crisis ignited these export activities, see Arisman, *ibid.* 79.

Because the international demand was so high at that time, some CPO producers did not comply with government regulations on the Export Tax but chose instead to smuggle their products to be exported for the international market. According to Iskandarini<sup>311</sup>, CPO producers who smuggled their products in 1998 obtained more profit compared to legal exports. Even though the government increased the Export Tax to as high as 60 per cent on 7 July 1998,<sup>312</sup> the volume of the smuggling of CPO reached 1 million tonnes (the official CPO export was 1.4 million tonnes in 1998 (see Table 4.9).

The government faced the paradox of its EOI strategy. On the one hand, the opening up of investment and trade policies increased the number of local and foreign companies in this industry, which in turn increased the value of their exports. On the other hand, the government could not control local private companies in taking advantage of the profitable international market. The same thing occurred with state enterprises. During the EOI state enterprises were transformed into more business oriented enterprises in order to obtain more profit. Nevertheless, during the crisis, it seemed that the government expected them to play their previous roles as buffers, as they were needed to be seen as part of the national interest.

#### **D. Progress and challenges of the electronics and the palm oil industries following the 1997-8 economic crisis**

##### **1. Recovery of the Indonesian economy**

Following the crisis, the *Reformasi* governments have continued to implement liberal market economy and maintain the EOI. Even though the National Industrial Policy that regulates all industries was formulated in 2001, the recovery from the crisis had already taken place. In 2000, economic growth increased to a little over 3 per cent from its contraction in 1998. In general, the growth of non-tradable sectors contributed to this

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<sup>311</sup> Iskandarini, "Sistem Agribisnis Kelapa Sawit Di Indonesia."

<sup>312</sup> See SK MenKeu no 334/KMK.017/1998 on the increase of CPO export tax from 40 per cent to 60 per cent, RBD Olein from 35 per cent to 55 per cent and prohibiting the CPO export produced by state enterprises.

increase such as services; the tradable sectors, such as manufacturing and agriculture, still showed low growth.

Relating to the tendency of both agriculture and manufacturing to contribute to GDP from 2001 to 2009, observing data in table 4.10 more closely, the contribution of plantations in the agricultural sector had adversely increased in the same period. As will be demonstrated in the next section of this chapter, one of the factors responsible for this increase was the production and export of palm oil.

Table 4. 10: GDP of agriculture, livestock, forestry, fishery and manufacturing sectors (in trillion IDR), 2001-2009 and the sectors contribution to GDP (in per cent), 2001-2009

Sector	2001	2002	2003	2004	2005	2006	2007	2008*	2009**
<b>Agriculture, livestock, forestry &amp; fishery</b>	225.7	232.97	240.39	284.22	254.39	262.40	133.89	142.00	148.69
%	17.62	17.31	16.91	16.48	15.86	15.40	7.35	7.32	7.31
<b>- Plantation</b>	34.85	36.59	38.69	39.55	40.43	41.41	43.12	44.76	45.89
%	2.72	2.72	2.72	2.62	2.52	2.43	2.37	2.31	2.25
<b>Manufacturing</b>	398.32	419.39	441.75	469.95	491.56	514.10	538.08	557.76	569.55
%	31.10	31.16	31.08	31.19	30.65	30.17	29.54	28.76	27.99
<b>GDP (minus oil &amp; gas)</b>	1,280.64	1,345.81	1,421.54	1,506.61	1,604.22	1,703.42	1,821.76	1,939.48	2,035.13
%	100	100	100	100	100	100	100	100	100
<b>GDP (minus oil &amp; gas) %</b>	<b>5.11</b>	<b>5.09</b>	<b>5.62</b>	<b>5.99</b>	<b>6.48</b>	<b>6.11</b>	<b>6.87</b>	-	-

Notes: \*provisional figure, \*\*very provisional figure.

Source: For 2001-2005 figures see, Badan Pusat Statistik Republik Indonesia 2006, as quoted by Fadhil M. Hassan et.al, *Strategi Pengembangan Industri Hilir Kelapa Sawit*, (Jakarta: INDEF Report,2007); for 2006-2009 figures, see Badan Pusat Statistik Republik Indonesia (Statistics Indonesia) 2009, [www.bps.go.id](http://www.bps.go.id)

## 2. Electronics industry

Even though products of the Indonesian electronics and the palm oil industries are considered global commodities, the significant differences between them are that Indonesia is the biggest CPO producer in the world, whereas Indonesia is among the smaller electronics producers, even in the ASEAN-5 countries. The other difference is that this industry was hit twice: first by the 1997-8 economic crisis and second, by the global financial crisis approximately ten years on. The first crisis affected mostly products for domestic need, whereas the second crisis affected products for export. The situation has become more complex for the electronics industry, because the nature of the industry is more dependent on the international export market as well as foreign technology and foreign investment for industry development. This situation occurred

because the policies during the ISI period, to both manufacture substitution for imported products and broaden technology capability, failed.

Following the crisis, the structure of the electronics industry remains a continuum as in the New Order.<sup>313</sup> In general, it consists of MNCs, joint ventures and local companies. Six MNCs – mostly Japanese and South Korean MNCs – have become significant players since 2005.<sup>314</sup> They are Matsushita, Epson, Sanyo, Toshiba, Samsung and LG. These MNCs have generated 51 per cent out of the total Indonesian electronics export.<sup>315</sup> In addition to the main players, there are Shimizu, Kenwood, JVC and Daikin. Large joint ventures are also occurring between Matsushita and PT National Gobel. Local companies are also involved in production, mostly for domestic consumption and a small part for export. Most manufacture low technology consumer electronics products. Only a few companies, such as PT Hartono Istana Teknologi, PT Pangung and GALVA, have manufactured high-tech products.

Table 4. 11: Profile of Indonesian electronics industry

Description	Year			
	2001	2002	2003	
<b>Total of companies</b>	1,291	1,351	1,389	
<b>Investment value (in billion IDR)</b>	2,713	3,517	3,809	
<b>Production capacity** (in thousand tonnes)</b>	829.5	2,626.0	2,518.7	
<b>Total labour (people)</b>	256,898	278,211	291,034	
<b>Production</b>	<i>Value (in billion IDR)</i>	55,068	149,081	138,520
<b>Export</b>	<i>Value (in million USD)</i>	5,914.8	6,061.8	6,120.7
<b>Import</b>	<i>Value (in million USD)</i>	1,317.6	1,432.6	1,632.1
<b>Net Export***</b>	<i>Value (in million USD)</i>	<b>4,597.2</b>	<b>4,629.2</b>	<b>4,488.6</b>

Sources: Badan Pusat Statistik Republik Indonesia 2003 for large and medium manufacturing establishments and for Exports of Electronics by Major Country Destination 1999-2003, as quoted by KADIN in “2030 Vision and 2010 Road Map: National Industry -- Electronics Industry and component electronics.”

<sup>313</sup> Gabungan Elektronika, “Strategi Industri Elektronika Konsumsi,” (paper presented in Round Table Discussion to prepare the 2030 Vision and 2015 National Industry Road Map, Jakarta, 14 July 2009).

<sup>314</sup> *Ibid.*

<sup>315</sup> *Ibid.*

From 2001-2003, the electronics industry in general grew by 61.67 per cent annually (see Table 4.11) and the growth of radio, television and communication apparatus reached 50.3 per cent on average from 2006-2008 (see Table 4.12).

As mentioned earlier, the electronics industry was hit significantly by the global financial crisis in 2008. Table 4.12 shows there was a steep decline in the production of radio, television and communication apparatus from 2007 to 2009. A report by Siwage Dharma Negara shows that Indonesia electronics exports experienced a trade deficit of US\$ 6 billion.<sup>316</sup> Table 4.12 also shows the negative growth of radio, television and communication apparatus in the first quarter of 2009 (-0.1 per cent) with a slight increase in the second quarter of 2009 (0.2 per cent).

Table 4. 12: Growth of large and medium manufacturing (expressed in percentages)

<b>KLB</b>	<b>Description</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009-1</b>	<b>2009-2</b>
<b>I</b>						
<b>15</b>	Food, beverages	11.9	5.2	2.6	5.2	16.8
<b>16</b>	Tobacco processing	-0.9	15.9	14.6	30.9	28.0
<b>17</b>	Textile	6.0	11.2	3.4	-8.2	-6.5
<b>18</b>	Clothing	67.3	-23.0	-28.7	-9.4	-11.7
<b>20</b>	Wood & wood products	-41.0	-16.4	-5.6	0.0	-6.0
<b>24</b>	Chemicals	25.8	35.8	-6.8	4.4	3.8
<b>26</b>	Non Metallic Minerals	11.8	0.3	-9.5	-13.7	-4.4
<b>27</b>	Metal ores ( <i>logam dasar</i> )	22.1	12.1	6.3	-13.0	-8.6
<b>29</b>	Machinery and apparatus	-2.9	43.0	-9.3	-18.0	-5.2
<b>31</b>	Electric machinery and apparatus	-1.3	-22.1	1.6	7.4	-2.0
<b>32</b>	Radio, TV and communication apparatus	87.1	50.5	13.3	-0.1	0.2
<b>34</b>	Motorised vehicles (4 wheels)	-46.5	29.6	22.4	-0.4	-10.7
<b>35</b>	Transportation (except 4 wheels)	-36.6	-8.9	35.4	7.4	-10.7
<b>36</b>	Furniture and its manufacturing	-1.9	-14.1	33.6	0.6	-6.7
	<b><i>Total manufacturing industry</i></b>	<b>-1.6</b>	<b>5.6</b>	<b>3.0</b>	<b>0.2</b>	<b>0.4</b>

Source: BPS as quoted by Faisal Basri , Industri Elektronika sebagai Pilar Utama Penguatan Ekonomi Nasional”(paper presented in seminar on the Development of the Electronics Industry, Ministry of Industry, 13 August 2009)

<sup>316</sup> Siwage Dhama Negara, “Fragmentation of Electronics and Textiles Industries from Indonesia to CMLV Countries”, in *A study on upgrading industrial structure of CLMV Countries* (Jakarta: ERIA Research Project Report, 2010): 173 -174.

The steep decline in consumer electronics in 2009 reveals the fundamental issues that originated from the establishment of this industry including low technology capability, lack of foreign investments due to restructuring and relocation of some MNCs during the 1997-8 economic crisis, and lack of comprehensive government policies. In addition to these issues Thee Kian Wie and Sulaiman Idris argued that the Indonesian electronics industry's lack of a highly skilled labour force made the shift to advanced technology even more difficult.<sup>317</sup> These fundamental issues have lowered the industry's competitiveness in the ASEAN region.

Regardless of these fundamental issues the electronics industry has been experiencing, one of the challenges Indonesian electronics has encountered is to redirect its target to aim for shifting from analogue to digital technology. Since 1998, global market trends have shifted to digital consumer electronics, information technology and telecommunication products. Therefore, more foreign investments are needed to shift from analogue to digital technology. In response to this need, the government made it compulsory for foreign investment in high-tech electronics products. It was predicted that USD 2 billion of new investment was needed, so the industry could provide 170,000 extra jobs and increase its exports by USD 15 billion in 2010.<sup>318</sup> Unfortunately, this target has not yet been achieved; one of the reasons was the global financial crisis in 2008.

Most of the investment in 2010 onwards was made by other Chinese electronics manufacturers and existing main players. Chinese producers included Changhong (entered the market on 28 December 2008) and the Haier Group from Shandong through its subsidiary PT Haier Sales Indonesia, which acquired Sanyo Electric Co Ltd units in Southeast Asia and in Indonesia (PT Sanyo Sales Indonesia and PT Sanyo

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<sup>317</sup> Thee Kian Wie, "The Impact of the Economic Crisis on Indonesia's Manufacturing Sector", 42-53; Sulaiman Idris, "Indonesian Electronics Industry."

<sup>318</sup> Gabungan Elektronika, "Strategi Industri Elektronika Konsumsi," (paper presented in Round Table Discussion to prepare the 2030 Vision and 2015 National Industry Road Map, Jakarta, 14 July 2009).

Indonesia) at a price of USD 100 million. The other Chinese manufacturer which also invested in 2012 was PT Midea Electronic Indonesia.<sup>319</sup>

The existing Japanese MNCs, such as Toshiba and Panasonic, have increased investment in their operations in Indonesia to take advantage of the huge domestic market.<sup>320</sup> Sanyo invested USD 38 million to establish a factory in Cibitung outside Jakarta that produces components for compact disc readers. PT Panasonic Gobel Energy Indonesia, which produces lithium batteries, plans to invest an additional USD 60 million to increase manufacturing. And Toshiba has relocated its DVD factory from Vietnam to Indonesia. The Industry Ministry expects USD 2 billion investment in the electronics sector in 2013 and has set an annual 9 per cent to 10 per cent growth target for the industry.

As illustrated above, the dependency on foreign technology and investment continues. More importantly, because expansion during the EOI did not allow for the transfer of technology from MNCs to local companies to occur, most new investment was expected to begin in 2013 to take advantage of the huge domestic market. This is unfortunate because, as will explained in more detail in subsequent chapters, Indonesian manufacturers faced serious disadvantage when the global trend for electronics products shifted from analog to digital technology.

The other challenge is that the government has not yet regulated comprehensive policies to make the business climate more supportive for global competition. Therefore, when free trade zones, such as AFTA and CAFTA, implemented in 2002 and 2010 respectively, the Indonesian electronics industry has been struggling to protect its domestic market from imported products (i.e. smuggling, illegal products and below

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<sup>319</sup> “Produsen Elektronik Investasi Rp 1,2 Triliun, Serap 3.773 Tenaga Kerja Baru,” *Dunia Industri*, Juni 2012, <http://duniaindustri.com/produsen-elektronik-investasi-rp-12-triliun-serap-3-773-tenaga-kerja-baru/> (accessed 2 September 2012).

<sup>320</sup> Rizqon Bilhuda, “More Electronics Giants Expanding Domestic Production as Sales Climb”, in *Jakarta Globe*, July 13, 2010, <http://www.thejakartaglobe.com/consumers/more-electronics-giants-expanding-domestic-production-as-sales-climb/385653>

standard products mostly from China) because the industry had not conformed to national standards (i.e. Standard Nasional Indonesia).

### **3. Palm oil industry**

Following the crisis, the development of the palm oil industry in Indonesia has become more significant because this industry is expected not only to export CPO, but also to expand its downstream industries such as cooking oil, oleochemical and biofuel. During this period, therefore, the industry has been targeted in this direction. Some requirements to satisfy this development is that the industry needs high amounts of CPO production, to expand the areas for palm oil plantations, as well as technology capability and a respected amount of local and foreign investment. By expanding in this direction, employment and export values have increased; however, government and business players in this industry have faced the countervailing pressure which relates to environmental issues.

The structure of the industry remains on a continuum from the deregulation period, which consisted of private companies' plantations as the largest ownership, followed by smallholders' plantations and state enterprises' plantations. As discussed in the first and second section of this chapter, the increased ownerships of smallholders was encouraged by the government through PIR-BUN/NES PIR TRANS, PIR-KKPA as well as independent farmers (*petani swadaya*) who followed their counterparts. In addition to these schemes and independent farmers, which have been continued during the *Reformasi* governments, the increase in smallholders' plantations has been supported by private companies and state enterprises as part of their Corporate Social Responsibility programs. As mentioned in the second section of this chapter, foreign investors from Malaysia began to invest in CPO production in Indonesia, which began in the late 1990s. The increasing number of foreign investors from Malaysia was more noticeable during this period.

Table 4. 13: Areas of palm oil by category of producers in Indonesia, 2001-2009

Year	CPO Production (thousand ha)			TOTAL
	SP*	GPE*	PPE*	
2001	1562.03	609.94	2542.46	4713.43
2002	1808.42	631.57	2627.07	5067.06
2003	1854.39	662.80	2766.36	5283.56
2004	2120.34	664.78	2781.52	5566.64
2005	2356.86	677.79	2915.66	5950.35
2006	2536.51	692.20	3056.25	6284.96
2007	2752.17	606.248	3408.42	6766.84
2008	2903.33	607.419	3497.13	7007.88
2009	3204.02	617.169	3500.71	7321.90

Notes: SP=Smallholder Plantations, GPE=Government Plantations, PPE=Private Plantations Estates.

Source: BPS-Statistics Indonesia Tree Crop Estate Statistics for Palm oil by Directorate General of Estates 2007-2009, Ministry of Agriculture.

Extrapolating from the data in Table 4.13, the total area of plantations increased significantly by 55.34 per cent from 2001 to 2009. In the same period, the production increased exponentially by 131.52 per cent (this percentage was generated after extrapolating the data in table 4.14). In terms of exported value, the exponential increased of export value occurred in 2008 where the value was USD 12,402 million but in 2001 the value had only reached USD 1,081 million (see table 4.15). According to Siwage, there was a worldwide rise in commodity prices in 2007-2008, particularly in the price of CPO.<sup>321</sup> During this period, exports of CPO emerged as the country's major export revenue earner and changed the structure of Indonesia's exports because it surpassed the textile industry.<sup>322</sup> More importantly, by generating this total of production and earning revenues, according to Rosediana Soeharto, Director of KMSI<sup>323</sup>, this industry has been providing raw material from the domestic industry and

<sup>321</sup> Negara, "Fragmentation of Electronics and Textile Industries from Indonesia to CLMV Countries."

<sup>322</sup> Negara, *ibid.*

<sup>323</sup> Interview Rosediana Soeharto in Jakarta, 25 June 2009. See also DMSI, *Industri dan Perdagangan Minyak Sawit Indonesia*, , 2.

employment for more than 4.5 million people, creating economic growth in the regions where there are extensive plantations.

Table 4. 14: Production of palm oil by category of producers in Indonesia, 2001-2009

Year	CPO Production (thousands tonnes)			
	SP*	GPE*	PPE*	TOTAL national production
2001	2798.03	1519.3	4079.15	8396.47
2002	3426.74	1607.73	4587.87	9622.35
2003	3517.32	1750.65	5172.86	10440.83
2004	3745.26	1988.43	6358.91	11806.55
2005	4500.77	2236.82	7883.23	14620.82
2006	5608.17	2376.87	8584.88	16569.62
2007	6358.39	2117.04	9189.3	17844.73
2008	6683.02	2124.36	9282.13	18089.51
2009	7209.07	2253.36	9977.87	19440.30

Notes: SP= Smallholder Plantations, GPE=Government Plantations, PPE= Private Plantations Estates

Source: BPS-Statistics Indonesia and Tree Crop Estate Statistics for Palm oil by Directorate General of Estates 2007-2009, Ministry of Agriculture.

Table 4. 15: Export volume (thousand tonnes) and value of palm oil and its derivatives (USD million), 2001-2008

Year	CPO		CPO derivatives*		Total	
	Volume	Value	Volume	Value	Volume	Value
2001	1,849	406	3,054	674	4,903	1,081
2002	2,805	892	3,529	1,200	6,334	2,092
2003	2,892	1,062	3,494	1,393	6,386	2,455
2004	3,820	1,444	4,842	1,998	8,662	3,442
2005	4,565	1,593	5,811	2,164	10,376	3,757
2006	4,840	1,791	7,261	3,027	12,101	4,818
2007	5,701	3,739	6,174	4,130	11,875	7,869
2008	7,904	6,557	6,387	5,845	14,291	12,402
<i>Annual Growth %</i>	<i>8.4</i>	<i>10.9</i>	<i>13.6</i>	<i>28.6</i>	<i>11.7</i>	<i>13.8</i>

Sources: Badan Pusat Statistik (BPS) And Ministry of Trade

\* RBD-Olein, RBD-Stearin and its derivatives

Examining the exponential growth of Indonesian CPO production and export reveals there are some contributions from Malaysian plantation companies which started to invest in the late 1990s. One of the Malaysian conglomerates which expanded to Indonesia is a merger of two Malaysian plantation companies – Sime Darby and Golden Hope – and a trade company, Guthrie Berhad. They acquired twenty-three of the Salim Group’s plantations (256, 000 hectares) in Sumatera, Kalimantan and Sulawesi, and confiscated by the Indonesian Bank Restructuring Agency (IBRA).<sup>324</sup> By 2012, the Malaysians had taken over approximately 25 per cent of the total area of Indonesian palm oil plantations. There has been increasing apprehension among local manufacturers that Malaysian investors could expand and control these areas.<sup>325</sup>

<sup>324</sup> “Sebuah Panggung Tanpa Pemain Baru,” *Tempo* (2008).

<http://majalah.tempo.co/konten/2008/05/12/LU/127160/Sebuah-Panggung-tanpa-Pemain-Baru/12/37> (accessed 1 September 2012).

<sup>325</sup> Investor Malaysia kuasai 2 juta hektar lahan kelapa sawit, *Suara Pembaruan*, 17 February 2012, <http://www.suarapembaruan.com/ekonomidanbisnis/investor-malaysia-kuasai-2-juta-hektare-lahan-kelapa-sawit/17223> (accessed 2 March 2012).

As mentioned in the third section of this chapter, the palm oil industry is among the least affected sectors from the 1997-8 economic crisis. The confiscation of Salim's plantations demonstrates that the expansion of Salim's business to this industry closely relates to privileges he had as one of Soeharto's cronies. Without Soeharto's patronage, Salim had to forfeit his plantations to pay off debts. Unfortunately, the plantations were acquired by Malaysian conglomerates that have deterred many of the local CPO producers.

As the palm oil industry becomes more significant for the Indonesian economy, the government will continue to intervene. During this period, the intervention of government has taken the form of making biofuel mandatory as an alternative energy in the industry. The manufacturing of biofuels is part of downstream industry manufacturing. Many private companies and state enterprises have manufactured largely stearin (the solid part of CPO) and olein (the liquid part of CPO). For manufacturing biofuel and oleochemical, both state enterprises and private companies not only need high-tech capability but also comprehensive government policies, to fund the establishment of these downstream industries.

The private companies involved in this period were almost the same group as in the EOI period, which maintained the oligopoly structure of this industry. Wilmar Bioenergy, Asian Agro, Sinarmas Group and Bakrie Sumarekin invested in the biofuel industry.<sup>326</sup> Further, PT Musim Mas, PT Flora Sawita Chemindo, PT Sinar Oleochemical International, PT Cisadane Raya Chemical and PT Sumiasih and PT Ecogreen Oleochemical invested in the oleochemical industry. Some of these companies originated from those conglomerates that had close relations with Soeharto during the New Order.

The expansion of plantations, which to a certain extent alleviated poverty levels and absorbed labour plus the broader objective to develop palm oil's downstream industry, generated local and international criticism. The countervailing pressures on the government and industry related to environmental issues and the welfare of native

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<sup>326</sup> DMSI, *Industri dan Perdagangan Minyak Sawit Indonesia*, 37-41.

people. These criticisms have influenced the government to regulate policies on sustainable CPO. However, the criticisms affected CPO trade, especially the European Union, which has set a high standard for greenhouse emissions for Indonesian CPO.

## **E. Conclusion**

This chapter provided background on the development of the electronics and palm oil industries during the New Order and following the 1997-8 economic crisis. Further, the discussion for each period demonstrates that governments, both the New Order and *Reformasi*, have shaped the development of these two industries, including state-business relations.

The pendulum swing from the ISI and the EOI had the consequence of establishing an unbalanced structure in the electronics industry, which became apparent in the economic crisis. As the nature of this industry is more dependent on global technology supplies in order to match state-of-the-art technology products, the general development in the *Reformasi* era has shown that its backwards technology, which positioned the Indonesian electronics industry at the bottom in Southeast Asia with lack of competitiveness in free trade. This situation also discussed the impact on relations between business players and government. The dependency on foreign companies to supply technologies has made business players even more concerned about how to create a supportive business environment, compared to established patrimonial relations between business and state, even though some Chinese Indonesian conglomerates are involved in this industry.

As analysed in this chapter, the swing from the ISI to the EOI did affect the development of the palm oil industry, however, in a positive way. The structure of this industry was first dominated by state enterprises (in the ISI period) which performed as pioneers in producing CPO. Their roles were replaced by local business players – the conglomerates who previously dominated the logging industry – which then expanded the industry, not only in producing CPO, but also in the downstream industries such as cooking oil, biofuel and oleochemical. More importantly, the government's initiative for using biofuel as mandatory, in every aspect of the industry, has pushed development even more.

Unlike the electronics industry, the structure of the palm oil industry, dominated by the conglomerates, has created an oligopoly. This structure is conducive for patrimonial relations between state and business to occur. As will be analysed in the subsequent findings chapters, patrimonial relations between state and business in this industry have become more complex with the openness of the political system, due to the democratisation process within the *Reformasi* governments. Further, the globalised economy, which involved international actors in the global chain of the industry, affected the complex nature of patrimonial relations in this industry.

The three subsequent chapters report the findings of the research and examine the extent to which more transparent and accountable relations between state and business in the two industries have been created during the *Reformasi* governments. The three possible factors are: the increasing regulatory function of the state, the scrutiny from global actors and the increasing roles of business associations in the electronics and palm oil industries.

## Chapter 5

### Regulatory Frameworks of the *Reformasi* State

Chapters three and four provided the political and economic background, which allowed the reader to understand how patrimonial relations in the Indonesian political economy were established during the New Order and discussed the development of the palm oil and electronics industries from the New Order until *Reformasi* governments.

Following the crisis, one of the International Monetary Fund (IMF) requirements for *Reformasi* was to improve its governance in the political economy sphere. In regards to complying with IMF requirements, the *Reformasi* governments established regulatory frameworks emphasising bank restructuring and legislation regulations to create an accountable government, and therefore to eradicate the practices of corruption, collusion and nepotism in the political economy. Simultaneously, all these laws and regulations, which encouraged transparency and a law-based environment, are necessary for revitalising industry's global competitiveness. However, during the sixteen years of *Reformasi*, the revival of old political actors in both business and government challenged the implementation of regulatory frameworks, which contributed to the success or otherwise of expected outcomes.

This chapter comprising four sections discusses the first finding: the influence of regulatory frameworks on patrimonial state-business relations in the palm oil and electronics industries. I argue that even though these regulatory frameworks affected patrimonial state-business relations and made them more difficult to establish, these relations remained evident, especially in the palm oil industry.

This chapter analyses seven pieces of legislation and the National Industrial Policies. The legislation includes: *Undang-Undang Penyelenggaraan Negara yang bersih dan bebas dari korupsi, kolusi dan nepotisme* no 28/1999 or “Clean and anti corruption, collusion and nepotism for state's administrators” (hereafter addressed as Good Governance Law); *Undang-Undang* no 31/1999 on *Pemberantasan Tindak Pidana*

*Korupsi* (hereafter addressed as Corruption Eradication Law)<sup>327</sup>; Undang-Undang no 30/2002 on *Komisi Pemberantasan Tindak Pidana Korupsi* (hereafter addressed as Commission on Corruption Eradication Law); *Undang-Undang Anti Monopoli dan Persaingan Usaha Tidak Sehat* no 5/1999 or “Prohibition of monopolistic practices and unfair business competition” (hereafter addressed as Competition Law); *Undang-Undang Pemerintah Daerah* no 22/1999 and no 32/2004 (hereafter addressed as Regional Autonomy Laws); *Undang-Undang Investasi* no 25/2007 (hereafter addressed as Investment Law); and the 2001 Trade and Industrial Policies and 2008 National Industrial Policy (hereafter addressed as National Industrial Policies).

The first section discusses Good Governance Law, Corruption Eradication Law, Commission on Corruption Eradication Law and Competition Law. Good Governance Law no 28/1999 was intended to overcome corruption, collusion and nepotism as the characteristics of patrimonial state-business relations. The Corruption Eradication Law no 31/1999 and Commission on Corruption Eradication no 30/2002 targeted wider corruption. The Anti Monopoly Law no 5/1999 was intended to promote competition and fairness in politics and the economy. The discussion of these laws here will examine the extent to which they influenced patrimonial state-business relations in the palm oil and electronics industries.

The second section discusses Regional Autonomy Laws no 22/1999 and no 32/2004. The implementation of regional autonomy is the essence of these laws, which have empowered heads of districts/mayors to implement more authority, which has enabled patrimonial relationships between local government and business to strengthen.

The third section discusses the Investment Law and the National Industrial Policies. They were both designed to encourage transparency and a law-based environment for doing business in Indonesia and achieving industry targets following the 1997-8 economic crisis. It is interesting to analyse the extent of this law and policy in moderating patrimonial relations in both industries. The fourth section concludes the chapter.

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<sup>327</sup> Some articles of the Law on Corruption Eradication no 31/1999 were amended to Law No. 20/2001 when Megawati was in power.

## **A. Regulatory frameworks and their impact on patrimonial state-business relations**

### **1. Good Governance, Corruption Eradication, Commission on Corruption Eradication Laws**

Patrimonial relationships between Soeharto and his cronies were the benchmark of how institutionalised corruption, collusion and nepotism became the foundations for these relationships. Throughout Soeharto's long tenure, he and his cronies exchanged privileges, protection and loyalties with material incentives. The extraordinary widespread corruption following Soeharto's resignation encouraged *Reformasi* governments to legislate new laws to overcome corruption, collusion and nepotism.

The *Reformasi* governments adopted two approaches to combating corruption. The first was the Good Governance Law no 28/1999, which had not existed in the New Order. This was legislated to prohibit government officials (*pejabat negara*) in executive, legislative and judicative branches from being involved in corruption, collusion and nepotism practices. The Corruption Eradication Law no 31/1999<sup>328</sup> and Commission on Corruption Eradication Law no 30/2002 had more scope to deal with corruption in state-business relations.

It clearly states in the Explanation Section of the Good Governance Law that Soeharto, who had centralised power for more than thirty years, was able to direct privileges to his cronies and their families. These patrimonial relations contributed to the dysfunction of the Indonesian economy and made Indonesia particularly vulnerable during the 1997-8 economic crisis.<sup>329</sup> The direct association between Soeharto's practices and the destructive outcome in the Indonesian political economy reflected the urgency of this law to regulate patrimonial relationships between government officials and their cronies by preventing corruption, collusion and nepotism. Despite the distinct feature of this law, it has a relatively limited scope as it only targets the examination, investigation and prosecution of government officials (*pejabat negara*).

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<sup>328</sup> Some articles of Law on Corruption Eradication no 31/ 1999 were amended into Law No. 20/2001 when Megawati was in power.

<sup>329</sup> See the Explanation Section of Good Governance Law part I.1 General, 15.

The legislation of Law no 31/1999 and Law no 30/2002 was intended to regulate the significantly increasing number of corrupt practices among civil servants and private actors. Therefore, these two laws have extended the scope of targeted investigation, examination and prosecution to civil servants and private actors, in addition to the government officials (*pejabat negara*) in executive, legislative and judicative branches. Further, more assertive and systemic countermeasures were put in place, such as applying specified sanctions, and a new method that allows suspects to prove themselves not guilty upon allegations of corruption, which is known as shifting the burden of proof (*pembuktian terbalik*).

More importantly, Commission on Corruption Eradication Law no 30/2002 on the establishment of *Komisi Pemberantasan Korupsi* (or Commission on Corruption Eradication, hereafter KPK) has systemised and simplified the investigation, examination and prosecution of corruption cases. Before the establishment of KPK, institutions such as the police, the attorney general's office, as well as other bodies, separately conducted the eradication of corruption. With the establishment of KPK, the process of eradication can be more structured as KPK can establish strong networks between institutions and, if necessary, KPK can take over the processes of investigation, examination and prosecution previously conducted by other institutions. Further, in preventing corruption, *Komisi Pemeriksa Kekayaan Penyelenggara Negara* (KPKN) which was established by Law no 28/1999), is absorbed into one of the KPK tasks, which is prevention. The KPKPN is a supervisory commission and one of its authorities, at the beginning, was to investigate the wealth of senior political appointees, elected officials and senior government officials, as stated in articles 2 and 7 and article 7 of Law no 28/1999 respectively, before, during and after their tenures.<sup>330</sup>

By expanding these targets and implementing new methods, both laws make it more difficult for civil servants and non-government actors to perform corruption, especially

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<sup>330</sup> Senior political appointees, elected officials and senior government officials were identified in the articles 2 and 7 and also stated in the explanation on the section of article 7 of the Good Governance Law no 28/1999 as follows: elected members of *Majelis Permusyawaratan Rakyat* (People's Consultative Assembly), elected members of *Dewan Perwakilan Rakyat* (House of Representative) as well as the appointed members of *Mahkamah Agung* (the Supreme Court) and *Mahkamah Konstitusi* (the Constitutional Court), ministers, governors, judges, other government officials regulated by laws, other government officials which have specific positions such as Directors of Bank Indonesia as well as head of public universities.

institutionalised corruption, which occurred in the Soeharto era. It was expected that with the implementation of legislation in accordance with the objectives of these laws, criminal investigation of corruption would lead to disclosure of the systemic and institutionalised corruption that had characterised patrimonial relationships. This expectation has not yet been realised, because corruption between government officials and business, as part of patrimonial relationships, continues with the ongoing establishment of networks. However, as will be explained further, with increased corruption cases and targeted prosecuted actors demonstrates a systematic action by KPK to overcome patrimonial state-business relations.

With the implementation of Good Governance, Corruption Eradication and the Commission of Corruption Eradication Laws, the data in table 5.1 below shows a significant increase in cases of corruption prosecuted. Further, targeted prosecuted actors increased from government officials in upper echelons to heads of local government (governors, heads of districts and/of mayors), ministers and former ministers, prosecutors and judges, as well as private actors.

Data from Indonesian Corruption Watch showed that, beginning in 2008, the emphasis of KPK was to prosecute corrupt actors who were in middle management positions as project leaders (22 actors) and heads of local government (13 actors).<sup>331</sup> The focus of investigation spread in 2009-2010 to prosecute political corruption conducted by ministers and/or former ministers such as Bachtiar Chamsyah (former Social Welfare Minister), Achmad Suyudi (former Health Minister), Paskah Suzetta (former Bappenas Minister) and Hari Sabarno (former Interior Minister).<sup>332</sup> For the same period, KPK was consistent in prosecution with massive corruption inquiries among members and/or former members of parliament. In 2011, the corruption cases targeted another 43

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<sup>331</sup>Adnan Topan Husodo, *Evaluasi dan Roadmap Penegakkan Hukum KPK 2012-2015: Save KPK Save Indonesia* (Indonesian Corruption Watch supported by The Asia Foundation, 2011), 5-6, <http://www.antikorupsi.org/sites/antikorupsi.org/files/doc/Umum/evaluasiandroadmappenegakanhukumkpk.pdf> (Accessed 2 October 2013).

<sup>332</sup>Wijayanto and Ridwan Zachrie, *Korupsi Mengkorupsi Indonesia: Sebab, Akibat dan Prospek Pemberantasan* (Jakarta: PT Gramedia Pustaka Utama, 2009).

members. In the period 2009-2011, KPK also prosecuted two prosecutors and three judges for bribery and blackmail.<sup>333</sup>

Elaboration of data for the first semester of 2010 (1 January to 31 July) released by Indonesia Corruption Watch, demonstrated a 50 per cent increase for the same period in 2009 (see table 5.1) in terms of suspects and financial losses the state had to bear.

Table 5. 1: Corruption comparison, first semester (January to July) 2009 and 2010

Year	2009	2010
Number of cases	86	176
Financial losses	Rp 1.7 trillion	Rp 2.102 trillion
Suspects	217 personnel	441 personnel
Highest number of suspects	Members of national and local parliament 38 personnel	Private actors (Commissioners and Managing Directors) 61 personnel
Regional financial corruption	23 cases (Rp 410.857 billion)	38 cases (Rp 596.232 billion)

Sources: Indonesia Corruption Watch, released 4 August 2010, quoted from Arry Anggadha, “Jumlah Kasus Korupsi Meningkat 50 persen dimata ICW ini pertanda buruk, menurut KPK ini sinyal positif”, *VIVA News*, <http://us.fokus.news.viva.co.id/news/read/168991-korupsi-meningkat-50-persen> (accessed 2 October 2013).

The increasing trend of corruption cases investigated along with private actors becoming the highest number of suspects in 2010 implied that the largest proportion of corruption cases involved patrimonial relationships between government officials and business.

The prosecution of heads of local government has been the focus of KPK and this trend has increased significantly. Among these corruption cases, according to KPK, most alleged corruption of heads of local government was to do with the misuse of local budgets.<sup>334</sup> Further, alleged cases of corruption specifically related to palm oil were relatively few; however, these corruption cases demonstrated patrimonial relationships between heads of local government and the plantation companies involved.

<sup>333</sup> *Ibid.*

<sup>334</sup> Komisi Pemberantasan Korupsi, *Laporan Tahunan 2012*, <http://www.kpk.go.id/id/publikasi/laporan-tahunan/955-laporan-tahunan-kpk-2012> (Accessed 1 October 2013).

The number of heads of local government who were prosecuted has increased significantly since 2008. In two years, until 2010, 19 heads of local government were prosecuted. In 2011, based on the KPK investigation, 155 heads of local government consisting of 17 governors and 138 heads of districts/mayors were investigated on corruption allegations.<sup>335</sup> These numbers increased in 2013 by 62 per cent (or a total of 251 heads of local government).<sup>336</sup>

Some corruption involving governors as well as heads of district/mayors indicated ongoing patrimonial relationships with business. Two examples, the former Governor of East Kalimantan, Suwarna Abdullah Fatah and the former Buol Head District, Central Sulawesi, Amran Batalipu were both found guilty by KPK in 2006 and 2012 respectively due to their corruption activities related to palm oil plantations.

Suwarna Abdul Fatah was sentenced to a further four years along with IDR 200 million penalty, for discharging a permit for a million hectares of land for clearing for palm oil plantations in North Penajam, Berau, East Kalimantan.<sup>337</sup> Suwarna was found guilty because he issued the permit to his business partner Martias (or Pung Kian Hwa), the owner of Surya Dumai, which forms part of the oligopoly that dominates the palm industry.<sup>338</sup> Despite replanting the land, his companies executed logging activities, which generated 697 thousand cubic meter logs from the forest area (equivalent to IDR

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<sup>335</sup> “Ini Daftar Kepala Daerah Tersandung Korupsi,” *Tempo*, 9 February 2012, <http://www.tempo.co/read/news/2013/02/09/063460207>(accessed 8 August 2013); “138 Bupati/walikota dan 17 Gubernur Tersangka Korupsi Fantastik,” *Kompas*, 18 January 2011, <http://sosbud.kompasiana.com/2011/01/18/138-bupatiwalikota-17-gubernur-tersangka-korupsi-fantastik-334028.html>(accessed 8 August 2013).

<sup>336</sup> *Tempo*, *ibid*; *Kompas*, *ibid*.

<sup>337</sup> “Gubernur Kaltim Masuk Penjara”, *Jawa Pos*, 20 Juni 2006, <http://www.antikorupsi.org/id/content/gubernur-kaltim-masuk-penjara>, (accessed 8 August 2013); Emerson Yuntho, *Investigasi dan Penerapan Undang-Undang Tindak Pidana Korupsi terhadap Kejahatan Kehutanan*, (Jakarta: Indonesian Corruption Watch bekerjasama dengan Koalisi Anti Mafia Kehutanan dan didukung oleh Kemitraan, 2012);, 76-82, [http://www.kemitraan.or.id/uploads\\_file/20130131073239.Panduan%20Investigasi%20dan%20Penerapan%20UU%20Tipikor%20sektor%20kehutanan.pdf](http://www.kemitraan.or.id/uploads_file/20130131073239.Panduan%20Investigasi%20dan%20Penerapan%20UU%20Tipikor%20sektor%20kehutanan.pdf) (accessed 17 October 2013).

<sup>338</sup> “Gubernur Kaltim Masuk Penjara”, *ibid*.

346.823 billion).<sup>339</sup> Suwarna's business partner, Martias, was also sentenced for 18 months and had to return IDR 346.823 billion from state losses.<sup>340</sup>

The ongoing relationship between the former Governor of East Kalimantan began in the New Order when rampant illegal logging occurred. Surya Dumai Group, at that time, was well-known for forestry and timber processing, manufacturing plywood and other wood-based products before expanding to palm oil plantation. Suwarna Fatah had been proven guilty by the KPK court because he issued three interconnecting permits from 1999 to 2002 to eleven companies under this group, which allowed them to collect the revenue from logging without replanting the land for palm oil.<sup>341</sup>

The other corruption case involving heads of local government was the former Head of Buol District, Central Sulawesi, Amran Batalipu. The KPK court found him guilty for continued corruption as he abused his power as head of district to grant a recommendation letter for PT Hardaya Inti Perkasa the extension of *Hak Guna Usaha* (Cultivation Rights Title, hereafter HGU) and was sentenced to seven years and six months.<sup>342</sup> As a reward, he received bribes (as much as IDR 3 billion) from Hartati Murdaya. This enabled Amran Batalipu to utilise these funds for his preparation to be re-elected for a second term. His efforts to be re-elected were strongly supported by

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<sup>339</sup> "Rekanan Suwarna Kembalikan Rp 346,8 Miliar kepada Negara", *Antara News*, 12 March 2008, <http://www.antaraneews.com/print/96383/rekanan-suwarna-kembalikan-rp3468-miliar-kepada-negara> (accessed 8 August 2013).

<sup>340</sup> *Ibid.*

<sup>341</sup> The three interconnected permits were: first, a letter of recommendation from Suwarna Fatah for the approval release of forest land for palm oil plantations in eleven companies; second, he granted securities clearance and approved the principle permit for the utilisation of timber in PT Berau Perkasa Mandiri, PT Sebuku Oil Perkasa and PT Bumi Indah Simanggaris; third, he issued a bank guarantee exemption for PT Tirta Honey Oil Jaya, PT Citra Marsam Adi Perkasa, PT Bulungan Green Perkasa, PT Berau Perkasa Mandiri, PT Sebuku Oil Perkasa, PT Bumi Indah Simanggaris, and PT Kaltim Bakti Welfare. These company was under Surya Dumai Group which owned by Martias, see Yuntho, *Panduan Investigasi dan Penerapan Undang-Undang Tindak Pidana Korupsi terhadap Kejahatan Kehutanan*, 2012, p. 76 and Indah Nurmasari, "Mahkamah Agung Tolak Kasasi Suwarna", 13 Desember 2007, <http://www.vhrmedia.com/vhr-news/berita-detail.php?.e=1111&.g=news&.s=berita> (accessed 17 October 2013).

<sup>342</sup> "Bekas Bupati Buol Amran Divonis 7,5 Tahun Penjara", *Tempo*, 11 February, 2013, <http://www.tempo.co/read/news/2013/02/11/063460607/Bekas-Bupati-Buol-Amran-Divonis-75-Tahun-Penjara> (accessed 8 August 2013); "Jaksa Tolak Pleidoi Bupati Buol" *Tempo*, 23 January 2013, <http://www.tempo.co/read/news/2013/01/28/078457406/Jaksa-Tolak-Pleidoi-Bupati-Buol> (accessed 8 August 2013); "KPK Tangkap dan Tahan Bupati Buol", <http://www.kpk.go.id/id/berita/berita-sub/536-kpk-tangkap-dan-tahan-bupati-buol> (accessed 8 August 2013).

Hartati Murdaya, who employed and paid a Jakarta-based polling agency<sup>343</sup> to measure Amran's election prospects. The strong support from Hartati Murdaya implied her efforts to maintain a close relationship with Amran as former Head of Buol District. Further, the existence of Murdaya's palm oil plantations in Buol District since 1995 implied that patrimonial relationships with former heads of Buol District, before Amran Batalipu, had been established.

In conclusion, all three laws have been implemented more than expected. There has been a significant increase in corruption cases involving government officials (as shown in table 5.1). This can be considered as a continuing step in the right direction in investigating and prosecuting more systemic cases of corruption, which is characteristic of patrimonial relationships. Two prosecuted cases in the palm oil industry, between former East Kalimantan Governor with conglomerates of PT Surya Dumai and between Buol head of district and Hartati Murdaya demonstrate that the KPK has prosecuted successfully corruption that has occurred in patrimonial state-business relations. If these prosecutions continue in a sustained manner, it will reduce significantly the practice in patrimonial state-business relationships.

## **2. Competition Law**

Competition Law acknowledges the urgency to overcome monopoly which creates unfairness in business competition. The Explanation Section of the Competition Law stated that during the New Order the private sector was mostly dominated by conglomerates with close relations with policy makers. Even though the law does not refer directly to the monopoly structures and practices that were often associated with relationships between Soeharto and his cronies, its objective is to abolish these practices, because they distorted the market and increased unfairness in business competition, but the law did not seek to change the structure of any sector of the economy.<sup>344</sup> Competition Law, therefore, is expected to be the turning point towards a fair and competitive private sector because it prohibits any conduct of businesses that

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<sup>343</sup> Tempo, 11 February 2013, *ibid.*; Tempo, 23 January 2013, *ibid.*; "KPK Tangkap dan Tahan Bupati Buol," *ibid.*

<sup>344</sup>The Competition Law no. 5/1999, 31.

involve prohibited contracts or agreements, prohibited activities and/or dominating the economy. In practice, this law determines that monopoly practices and unfair business competition among businesses will be not tolerated, even though the law does not seek to change the monopoly or oligopoly structures in various sectors of the economy.<sup>345</sup>

Commissions as supervisory bodies for the private and public sector have also been established. *Komisi Pengawas Persaingan Usaha* (or the Supervisory Commission for Business Competition (hereafter KPPU), for example, emphasised conducting supervision in the business community to ensure that all activities are based on fair competition. This institution was given the authority to impose administrative sanctions to business people or business organisations who do not comply with the law. Even though KPPU is not as powerful as KPK, it also supervises and sanctions any unfair and uncompetitive business activities that involve multinational, national and regional companies. Since it was established in 2000, it has received many reports (as many as 2094), consisting of written reports and presumed litigation cases since established in 2000.<sup>346</sup> Some of the examples of KPPU verdicts in 2007, 2009 and 2010 are shown in Table 5.2.

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<sup>345</sup>The objective of the Competition Law no. 5/1999, 32-33.

<sup>346</sup>Komisi Persaingan dan Pengawasan Usaha, “Menuju Babak Baru Implementasi Persaingan Usaha,” *2008 Report*, (Jakarta: KPPU, 2008), 16.

Table 5. 2: Examples of KPPU verdicts in 2007, 2009 and 2010

No	KPPU Verdicts	Subject	Parties subject to sanctions
1	Putusan No. 7/KPPU-L/2007	Temasek's cross-ownership in the telecommunications industry in Indonesia	Singapore Technologies Telemedia Pte Ltd (Temasek subsidiary) and PT Telkomsel
2	Putusan KPPU No. 26/KPPU-L/2007	SMS tariffs cartel	PT Excelkomindo Pratama, Tbk., PT Telkomsel, PT Telkom, PT Bakrie Telecom, PT Mobile-8 Telecom, Tbk., PT Smart Telecom
3	Putusan KPPU No.24/KPPU-I/2009	Cooking oil	Twenty cooking oil companies (for details of company names, (see footnote no 345 below)
4	Putusan No. 25/KPPU-I/2009	Price fixing for fuel surcharge in the domestic airlines industry	Nine airlines
5	Putusan No. 17/KPPU-I/2010	Pharmaceutical industry for Amlodipine therapy	Pfizer Group dan PT Dexa Medica

Source: Sudaryatmo (Ketua Harian YLKI), “Menelaah Perlindungan Konsumen melalui Kebijakan Kompetisi”, *Warta Konsumsi*, (12 September 2011), <http://www.ylki.or.id/menelaah-perlindungan-konsumen-melalui-kebijakan-kompetisi.html> (accessed 8 August 2013)

KPPU has been investigating the palm oil industry on the grounds that the structure of this industry is an oligopoly. In the palm oil industry, the KPPU reports published in 2007 show that ten groups dominated almost 30 per cent of total private plantation estates. These were the Raja Garuda Mas Group, Wilmar Group, Guthrie Bhd Group, Sinar Mas Group and Astra Agro Lestari Group, Cilandra Perkasa Group, Socfindo Group, Kurnia Group, Lonsum Group and Bakrie Group.<sup>347</sup> The fact that these players exercised limited domination (upstream to downstream industry), also opened up the possibility to determine prices, especially in the cooking oil industry. Therefore, investigating price cartels has been the target of KPPU as well.

<sup>347</sup> Komisi Persaingan dan Pengawasan Usaha, “Evaluasi Kebijakan Perkebunan Kelapa Sawit,” *2007 Report*, (Jakarta: KPPU, 2007), 25.

As listed in table 5.1 based on Putusan KPPU No.24/KPPU-I/2009, KPPU sanctioned twenty cooking oil companies<sup>348</sup> (as much as IDR 299 billion). According to KPPU these companies violated Article 5 (making agreements with competitors to set the price of cooking oil products) and Article 11 (making agreements with competitors in order to influence prices by adjusting production and or marketing of goods, which may result in monopolistic practices or unfair business competition) of the Competition Law. The violation caused a loss to consumers (as much as IDR 1.2 trillion for branded cooking oil and as much as Rp 374 billion for non-branded cooking oil) from April to December 2008.<sup>349</sup>

The legal struggle between these twenty companies and KPPU began immediately after the verdict from KPPU took place. While the legal process occurred, some companies objected to KPPU sanctions.<sup>350</sup> In February 2011, the sanctions were annulled by *Pengadilan Negeri Jakarta Pusat* (Jakarta Pusat First Instance Court).<sup>351</sup> The legal process continued to the Supreme Court as KPPU appealed on the same grounds: that these companies engaged in price cartels which generated a loss for consumers. In December 2012, the Supreme Court declined the KPPU appeal<sup>352</sup>, which means these

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<sup>348</sup> They were: PT Multimas Nabati Asahan, PT Sinar Alam Permai, PT Wilmar Nabati Indonesia, PT Multi Nabati Sulawesi, dan PT Agrindo Indah Persada, PT Musim Mas, PT Intibenua Perkasatama, PT Megasurya Mas, PT Agro Makmur Raya, PT Miko Oleo Nabati Industri, PT Indo Karya Internusa, PT Permata Hijau Sawit, PT Nubika Jaya, PT Smart Tbk, PT Tunas Baru Lampung, PT Berlian Eka Sakti Tangguh, PT Pasific Palmindo Industri, dan PT Asian Agro Agung Jaya.

<sup>349</sup> “Putusan Perkara No 24/KPPU-I/2009”, *Komisi Pengawas Persaingan Usaha Republik Indonesia* (2009), [http://www.kppu.go.id/docs/Putusan/putusan\\_24\\_2009\\_upload\\_16\\_juni\\_2010.pdf](http://www.kppu.go.id/docs/Putusan/putusan_24_2009_upload_16_juni_2010.pdf) (accessed 8 August 2013).

<sup>350</sup> “PT SMART Tbk Raises Its Objection on the Decision of the Business Competition Supervisory Commission (“KPPU”) to No. 24/Kppu-I/2009 Regarding Presumption of a Breach to Articles 4, 5 and 11 of the Law No. 5/1999 for Palm-Based Cooking Oil Industry in Indonesia, *SMART Agribusiness and Food* (2010), <http://www.goldenagri.com.sg/pdfs/News%20Releases/2010/100506%20Press%20Release-SMART%20KPPU%20english.pdf> (accessed 8 August 2013).

<sup>351</sup> “Bertarung Melawan Kartel: KPPU Periode 2006-2012”, *Kompetisi*, Edisi 32 (Jakarta, 2012): 6 <http://www.kppu.go.id/id/wp-content/uploads/2012/02/Edisi-31.pdf> (accessed 8 August 2013); “Pengadilan batalkan putusan KPPU terkait Kartel Minyak”, *Antara News*, 23 February 2011, <http://www.antaraneews.com/news/247378/pengadilan-batalkan-putusan-kppu-terkait-kartel-minyak> (accessed 8 August 2013).

<sup>352</sup> Putusan MA nomor 582 K/PDT.SUS/2011, *Direktori Putusan Mahkamah Agung*, (2011), <http://putusan.mahkamahagung.go.id/putusan/downloadpdf/03b669c230a521c40e37051bfe021560/pdf> (accessed 8 August 2013).

cooking oil companies were found not guilty of engaging price cartels and did not have to pay sanctions (as much as IDR 299 billion).<sup>353</sup>

The victory of these companies against KPPU demonstrated that promoting competition within an oligopoly structure was not an easy task. The Jakarta Pusat First Instance Court and the Supreme Court declined KPPU sanctions and appealed because KPPU did not have enough evidence that these companies had arranged meetings with competitors to fix the price, and determine the production capacity and cost structure which created unhealthy business competition.<sup>354</sup> More importantly, these companies are conglomerates and had strong support from government as government relied on them for domestic cooking oil supply. In other words, the intricacy of government and business interests which created mutual dependency, in reality, significantly impeded KPPU's ability to promote competition, anti monopoly, and fairness among businesses.

## **B. Regional Autonomy Laws**

The first section discussed Good Governance Law, Corruption Eradication and Commission on Corruption Laws, which expedited the prosecution of many corruption cases among government officials (*pejabat negara*) at national and local levels as well as the private actor, which occurred since the *Reformasi* governments. It is also demonstrated that most of the corruption investigated and prosecuted by these Laws did not necessarily entail systemic collusion and nepotism as characteristics of ongoing long-term patrimonial state-business relations.

The impact of Regional Autonomy Laws on relations between local government and business is broad and complex. This is because businesses should interact not only with heads of districts/mayors but also with members of parliament and NGOs as a consequence of the democratisation process since the *Reformasi* era. In other words, the unintended consequences of the implementation of these laws are that they not only

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<sup>353</sup> M. Rizky Maulana MA, "Tolak Kasasi KPPU Tentang Kartel Minyak Goreng", *detikfinance*, 2 December 2011, <http://finance.detik.com/read/2011/12/02/102800/1780840/1036/ma-tolak-kasasi-kppu-tentang-kartel-minyak-goreng> (accessed 1 October 2013).

<sup>354</sup> Noverius Laoli, "MA tolak putusan KPPU atas kartel minyak goreng", *Kontan*, 2 December 2011, see <http://nasional.kontan.co.id/news/ma-tolak-putusan-kppu-atas-kartel-minyak-goreng> (accessed 1 October 2013).

identify the possibility of patrimonial relationships, but they can also identify how business interacts with local government and society.

The implementation of local autonomy has mainly impacted on the palm oil industry. One of the reasons for this is that the location of palm oil plantations and their factories are mostly in the districts and/or municipalities, which means they are affected by all regulations implemented at the local level including the implementation of local autonomy. The laws do not affect state-business relations in the electronics industry. As a consequence, this section focuses on the impact of Regional Autonomy Laws and the implementation of local autonomy in the palm oil industry.

### **1. Regional Autonomy Law no 22/1999**

Regional Autonomy Law no 22/1999 was first legislated when Habibie was in power. This law was amended to Regional Autonomy Law no 32/2004 in Megawati's government. Law no 22/1999 had given greater authority to both heads of districts and/or mayors as well as heads of district parliament, consequently devolving local autonomy at the district level.

In the early years of the implementation of the Regional Autonomy no 22/1999, business in the palm oil industry pointed to the negative effects of implementation of local autonomy as the industry had to deal with heads of districts/or mayors that had transformed into "*raja-raja kecil* (small kings)" instead of transforming into democratic leaders. One of the issues revealed in interview was the arbitrary regulations, including illegal taxes, issued by some heads of districts in the provinces such as in Jambi, North Sumatera, South, Central and West Kalimantan. Even though most of these illegal taxes had been revoked between the Ministry of Finance and Ministry of Interior after plantation companies had appealed to the province government<sup>355</sup>, this incident demonstrated that greater authority obtained by these heads of districts/municipalities

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<sup>355</sup>Interviews Timbas Ginting, Secretary of GAPKI North Sumatera Branch and Joner Napitupulu, Vice Chair of KADIN North Sumatera Branch, in Medan, 12 August 2009. The result of this effort was shown in the amendment of Regional Government Law no 32/ 2004, which stated explicitly that "local governments are prohibited to collect taxes or retributions unless they are regulated in the law", see article no 158.2 of Regional Autonomy Law no 32/2004.

affected their relations with business, by increasing uncertainty in doing business in those areas.

Thus these arbitrary regulations can be interpreted as: power escalation from the heads of district after more than thirty years only became the prolongation of the central government. Further, these arbitrary regulations affected business in the provinces where timber and palm oil plantations were the main extractive sources for Soeharto and his business partners. In other words, because of the highly centralised nature of forest management under the New Order, the local government was overshadowed by Soeharto's interests. Therefore, the implementation of Regional Autonomy Law no 22/1999 opened the access for heads of districts to escalate their power towards business in pursuit of increasing local revenue.

The wider impact, however, of the implementation of Regional Autonomy Law no 22/1999 can be suggested as strengthening patrimonial relationships between local government and palm oil companies. The palm oil plantations in the provinces of Sumatera have been established since Dutch colonisation. Especially in North Sumatera, according to Taufan Damanik, close relationships between companies and local governments, which involved an exchange of *upeti* for security, has been a common practice.<sup>356</sup> Therefore, extrapolating from Damanik's observation, the arbitrary regulations prohibited CPO from accessing: plantations in Jambi for manufacturing cooking oil outside Jambi<sup>357</sup>; levies on generator set procurement, on fresh fruits bunch, on production, and on using main roads to transport CPO as well as voluntary financial contributions, of which the amount decided by heads of district in North Sumatera<sup>358</sup> were considered part of the exchange as the heads of district provided security.

Despite the fact that business was against arbitrary regulations implemented by the local government, interestingly business shared the same interests with local government in requesting revenue from palm oil plantations that could be accommodated as part of

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<sup>356</sup> Interview Taufan Damanik, lecturer at Universitas Sumatera Utara in Medan, North Sumatera, 12 August 2009.

<sup>357</sup> Interview Joko Supriyono, Secretary General of GAPKI in Jakarta, 15 July 2009.

<sup>358</sup> Interviews Timbas Ginting and Joner Napitupulu, 12 August 2009. Interviews with Waras and Syamsul Bahri, Communication Officers of PT London Sumatera in Medan, 10 August 2009.

local revenue sharing. According to Timbas Ginting, Joner Napitulu, Balaman Tarigan and Fadhil Hassan, whose main commodity is palm oil oil, they were entitled to receive shared revenue from plantations as part of their local revenue.<sup>359</sup> Therefore, both business and local government strongly supported the amendment of Regional Law no 22/1999. The same shared interests between local government and business on this possible material advantage indicates they could utilise funds for strengthening their relationships.

## **2. Amended Regional Autonomy Law no 32/2004**

Law no 22/1999 was amended in 2004 to Regional Autonomy Law no 32/2004. One of the criticisms of the previous law was that the practice of local autonomy was too broad, which generated instability at the local level as executive and legislative were frequently in disagreement. In resolving this issue, the amended law explicitly stated that the relations between executives (governors and heads of districts/mayors) and their legislative counterparts (local representative body or DPRD, both in provincial and districts/municipalities) are as partners<sup>360</sup> in order to create more stability. Further, Law no 32/2004 does not state explicitly that regional autonomy devolved at the districts level; however, the law has regulated for the heads of local government to be directly elected. Having local leaders directly elected by voters at the local level is a way of empowering not only provincial municipalities but also districts.

With the implementation of Regional Autonomy Law no 32/2004, the greater authority obtained by the heads of local government increased even further. This was because, for coordination purposes, all national regulations needed to include local government as part of national regulations. For example, in SK Menteri Kehutanan no 282/2004 and 2007 Investment Law, the involvement of local government has been acknowledged as part of the decision making. With the implementation of SK Menteri Kehutanan no 282/2004, governors as well as heads of districts/mayors were given the authority to

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<sup>359</sup>Interviews Timbas Ginting and Joner Napitupulu; interview with Director of PTPN IV North Sumatera, Balaman Tarigan in Medan, North Sumatera, 10 August 2009; interview Joko Supriyono, "Pengembangan Kelapa Sawit Nasional: Mewujudkan Visi 2020" (paper presented in Simposium Kelapa Sawit Indonesia: Menuju Ketahanan Pangan Dunia, Jakarta, 30 June 2009).

<sup>360</sup>Didik G Soeharto, "Tarik Ulur Kewenangan dalam UU No 32/2004", *Suara Merdeka*, 6 December 2004, <http://www.suaramerdeka.com/harian/0412/06/opi04.htm> (accessed 4 April 2011). See also the Law no 32/2004 on Regional Autonomy, articles no 10-14 and articles no 15-18.

issue land clearing permits to companies wishing to establish agricultural plantations such as palm oil. In addition, the heads of local governments were also able to issue felling permits for forested land allocated for conversion (*Hutan Produksi Konversi*).<sup>361</sup> These permits allow companies to begin the process of acquiring HGU from the Biro *Pertanahan Nasional* (National Land Agency, abbreviated as BPN). In the 2007 Investment Law, it is stated that each level has its own authority to deal with foreign investors, which intend to expand into their regions.

Using the cases of PT London Sumatra Tbk and Syamsul Arifin, the former Langkat District demonstrated that the implementation of the amended Regional Autonomy Law no 32/2004 increased the possibility to further strengthen patrimonial relationships between heads of local government (governors, heads of districts/mayors) with business.

#### **a. The case of PT Perusahaan Perkebunan London Sumatra**

PT Perusahaan Perkebunan London Sumatra (hereafter LonSum) founded in 1906 is a listed plantation company incorporated and operating in Indonesia.<sup>362</sup> The London Sumatera Group was established by Harrison and Crossfields, a British general trading plantation management and services firm, which began its plantation in North Sumatera.<sup>363</sup> In July 1994, Harrison and Crosfield sold the holding company, LonSum to the Napan Group and Risjadson Group for USD 273 million.<sup>364</sup> Andry Pribadi of the Napan Group and Ibrahim Risjad of the Risyadson Group with Henry Liem then

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<sup>361</sup> Anne Casson, *The Hesitant Boom: Indonesia's Palm oil Sub-Sector in an Era of Financial Crisis and Political Change* (Bogor: Centre for International Forestry Research, 1999).

<sup>362</sup> The principal business of LonSum is cultivating, harvesting, processing and marketing principally palm oil and rubber and, to a lesser extent, cocoa and tea. Lonsum's 38 plantations comprise both nucleus and plasma estates in Sumatra, Java and Sulawesi and Kalimantan. PT PP London Sumatra Tbk, "About Us – History", <http://www.londonsumatra.com/content.aspx?mid=5> (accessed 30 March 2010).

<sup>363</sup> *Ibid.*

<sup>364</sup> Walhi, 'Profil PT Perusahaan Perkebunan London Sumatra Indonesia (PT PP London Sumatera Indonesia), 2003', quoted by ELSAM, "Pelanggaran Hak Asasi Manusia di Kawasan Perkebunan Kelapa Sawit PT PP LonSum Tbk. Sumatera Utara", *Position Paper* no. 1, (Jakarta, 2010): 8, [http://www.elsam.or.id/downloads/1372924048\\_Pelanggaran\\_HAM\\_di\\_Kawasan\\_Perkebunan\\_Kelapa\\_Sawit\\_PT\\_PP\\_Lonsum\\_Sumatera\\_Utara.pdf](http://www.elsam.or.id/downloads/1372924048_Pelanggaran_HAM_di_Kawasan_Perkebunan_Kelapa_Sawit_PT_PP_Lonsum_Sumatera_Utara.pdf) (accessed 15 October 2013).

established the PT Pan London Sumatra Plantation and Happy Cheer.<sup>365</sup> They dominated LonSum with a combined shareholding of 49.93 per cent (47.23 per cent and 2.7 per cent respectively). When the 1997-8 economic crisis occurred, LonSum collapsed financially and both Andry Pribadi and Ibrahim Risjad were categorised as the most troubled debtors in Indonesian Bank Restructuring Agency (IBRA).<sup>366</sup> After debt restructuring in 2004, three years later in 2007, PT Salim Invomas Pratama and Indofood Agri Resources Ltd (subsidiary of Indofood Sukses Makmur) acquired a 64.4 per cent stake in LonSum.<sup>367</sup>

This company benefitted from the New Order in 1968 when Harrison Crossfield, the owners, reclaimed their plantations after fleeing in the 1950s when the nationalisation process occurred. The military assisted the reclaiming process by taking the land by force from labourers and farmers. Those who refused to cooperate were alleged as members of the Indonesian Communist Party and arrested. The first HGU was issued on 1 April 1968 and lasted for thirty years. Since then, the plantations have expanded significantly, not only in North Sumatera, but also in other provinces in Sumatera, Java, Sulawesi and Kalimantan. In the North Sumatera Province, in particular, the plantations expanded from 5,403 hectares during 1968-1999 to 39,360 hectares in 2012.<sup>368</sup> In the 2012 Annual Report, LonSum achieved a gross profit of Rp 1.68 trillion from all commodities this company produced, representing a 28.8 per cent decrease from 2011.<sup>369</sup>

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<sup>365</sup> Jan Willem van Gelder, "Swiss banks and palm oil and pulp and paper in Indonesia", *A research paper prepared for WWF International*, (The Netherlands: December, 2001): 41-44, <http://www.google.com.au/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CC0QFjAA&url=http%3A%2F%2Fassets.panda.org%2Fdownloads%2Fswissbankswwf011220.pdf&ei=rrF1Uo3gO8r9IAXPIYHgDw&usq=AFOjCNFjyXuginNVohgYu36i4pU0BvvPUg&bvm=bv.55819444.d.dGI> (accessed 15 October 2013).

<sup>366</sup> *Ibid.*

<sup>367</sup> PT PP London Sumatra Tbk, "About Us – History", <http://www.londonsumatra.com/content.aspx?mid=5> (accessed 30 March 2010).

<sup>368</sup> "Persevering Amidst Challenges", *2012 Annual Report PT PP London Sumatera Tbk*, 20 [www.londonsumatra.com/uploads/download/dl\\_47\\_enAnnual\\_Report\\_2012.pdf](http://www.londonsumatra.com/uploads/download/dl_47_enAnnual_Report_2012.pdf) (accessed 1 October 2013).

<sup>369</sup> This is the gross profit for all commodities produced by LonSum, *ibid.*, 33.

During the *Reformasi* era, LonSum faced challenges from the implementation of local autonomy which related to land disputes and new districts development (*pemekaran*). There is no direct evidence that LonSum have had ongoing patrimonial relationships with heads of districts where their plantations and companies are located. However, extrapolating from the significant expansion of these plantations, profits obtained as well as minimum losses (because of land disputes), LonSum has at least established good relationships with heads of districts.

According to ELSAM, problems faced by LonSum in North Sumatera since it was established were mostly land disputes.<sup>370</sup> Several reports and position papers on ongoing land disputes between residents and palm oil plantations companies in North Sumatera and in LonSum<sup>371</sup> have demonstrated that these problems are yet to be resolved.

One of the land disputes covered by the media with a focus on non-governmental organisations was the Pergulaan case. Pergulaan is a village located in Serdang Bedagai District where the villagers have been in conflict with LonSum since 1960. Since 1998, villagers repeatedly tried to reclaim their 165.6 hectares used by PT LonSum for the new expansion of its palm oil plantations. Instead of reclaiming their land, villagers mostly gained accidents and injuries due to rubber bullets as they were accused of trespassing.

Communities have been seeking to resolve the dispute by lobbying the government at the district, provincial and national level including several ministers and members of the national parliament. In October 2006, before LonSum was acquired by PT Salim Invomas Pratama and Indofood Agri Resources Ltd., one of the national members of

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<sup>370</sup> Elsam, “Pelanggaran Hak Asasi Manusia di Kawasan Perkebunan Kelapa Sawit PT PP LonSum Tbk. Sumatera Utara”, *Position Paper* no. 1, (Jakarta, 2010), 8. [http://www.elsam.or.id/downloads/1372924048\\_Pelanggaran\\_HAM\\_di\\_Kawasan\\_Perkebunan\\_Kelapa\\_Sawit\\_PT\\_PP\\_Lonsum\\_Sumatera\\_Utara.pdf](http://www.elsam.or.id/downloads/1372924048_Pelanggaran_HAM_di_Kawasan_Perkebunan_Kelapa_Sawit_PT_PP_Lonsum_Sumatera_Utara.pdf) (accessed 15 October 2013).

<sup>371</sup> “Dampak Ekspansi Perkebunan Kelapa Sawit Terhadap Hak Asasi Manusia Di Indonesia”, *Laporan*, (Jakarta: Friends of the Earth, LifeMosaic and Sawit Watch, 2008), <http://www.lifemosaic.net/images/uploads/Resources/Docs%20BI/BahasaLosingGround.pdf> (accessed 15 October 2013) Bakumsu, “Tabel Kasus Tanah di Sumut”, [http://bakumsu.or.id/news/images/stories/tabel\\_kasus\\_tanah\\_di\\_sumut.pdf](http://bakumsu.or.id/news/images/stories/tabel_kasus_tanah_di_sumut.pdf) (accessed 15 October 2013); Elsam, “Pelanggaran Hak Asasi Manusia di Kawasan Perkebunan Kelapa Sawit PT PP LonSum Tbk. Sumatera Utara”.

parliament, Nasril Bahri, called for goodwill from LonSum to resolve the land dispute, as a new start with the new management.<sup>372</sup> He echoed the communities' demand because, since March 2006, the conflict had heated up and resulted in eleven villagers being arrested on charges that they had occupied and damaged land and the plantation of PT LonSum. Unfortunately, Bahri's concerns were not heard by LonSum as the conflict has continued.

In addition to Nasri Bahri, many non-government organisations, such as *Badan Perjuangan Masyarakat Pergulaan* (Organisation for *Pergulaan* Community Struggle), *Konsorsium Pembaruan Agraria* (Agrarian Reform Consortium), Walhi North Sumatera Branch and ELSAM, strongly criticised LonSum, for not being aware of human rights issues. In fact, these NGOs were surprised and infuriated when LonSum was awarded the RSPO Certificate in 2009.<sup>373</sup> One of the criteria to obtain this certificate is that a company should not enter into conflict or occupy native people's land for their plantations. It was ironic, because RSPO failed to gather information on the land dispute thus far unresolved.

In addition to the land dispute, LonSum was also approached to release some of its plantation areas for the establishment of new districts. According to Waras and Syamsul Bahri, Community Relations Officers of LonSum, the company was twice requested by two different districts to release some of its plantations for establishing new districts.<sup>374</sup> The first instance was in 2001, when the Head and DPRD of Simalungun District reached an agreement and LonSum agreed to release 200 hectares of its plantation. This agreement was reached after LonSum discovered that the HGU of the plantation had expired; therefore, instead of pursuing the renewal of the HGU, the company decided to release the land as a centre for the new district government. After the plantation was

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<sup>372</sup>“PT Lonsum Diminta DPR Menunjukkan Etiket Baik”, *Waspada*, 27 October 2007.  
[http://www.waspada.co.id/index.php?option=com\\_content&view=article&id=252507:bpn-sergai-diminta-tuntaskan-sengketa-lahan&catid=15:sumut&Itemid=28](http://www.waspada.co.id/index.php?option=com_content&view=article&id=252507:bpn-sergai-diminta-tuntaskan-sengketa-lahan&catid=15:sumut&Itemid=28) (accessed 15 October 2013).

<sup>373</sup> Roundtable of Sustainable Palm Oil (RSPO) certificate is a certification awarded by an accreditation agency acknowledged by the RSPO. This certificate shows that the whole process of planting, harvesting and marketing of LonSum has followed the rules of sustainability. “Tanah Warga dicaplok Tolak Sertifikasi RSPO”, <http://brita.or.id/2012/2009/07/05/tanah-warga-dicaplok-tolak-sertifikasi-rspo.htm> (accessed 15 October 2013).

<sup>374</sup>Interviews with Syamsul Bahry and Waras, Community Relations Officers PT PP London Sumatra, in Medan, North Sumatera, 10 August 2009.

released, the plan to establish a separate district from Simalungun District, North Sumatera, was delayed, and it was due to occur in 2013.<sup>375</sup>

In 2008 when it was planned to develop Labuan Batu District into Labuan Batu Utara and Labuan Batu Selatan Districts, LonSum was asked to release some of the plantations for the purpose of the new administrative centre of the new district. In this second instance, LonSum did not release its plantation area because the HGU of its plantations, which are located in Labuan Batu District, are still in effect for twenty to thirty years. It would be wasted income, not only for the company but also for its workers, if the valid HGU plantations were released for that purpose.<sup>376</sup>

When reflecting on what they experienced on releasing some of the company's plantations in relation to establishment of the new district, Waras dan Syamsul Bahri regretted the fact that there was a lack of information at the provincial level, on planning to develop for new districts that should be shared with companies.<sup>377</sup> Having not been well informed on this issue, this increased the uncertainty among businesses as to whether their plantations could be requested for continuing new districts development in North Sumatera.

The land disputes and new districts development issues faced by LonSum were the consequences from the implementation of local autonomy. On the one hand, they perceived these disturbances as counter productive for contributing to the North Sumatera economy. On the other hand, LonSum realised that the losses due to land disputes and proliferation issues were insignificant and it seemed that the heads of district provided 'security' for the company. In terms of land disputes in Serdang Bedagai, the head of district did not take sides or mediate the disputes. However, since the land disputes are still happening, the Director of LonSum, Joe fly J. Bahroeny and the companies' Corporate Social Responsibility (CSR) team regularly visit some heads

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<sup>375</sup>“Pemekaran Kabupaten Simalungun didukung Daerah Tetangga”, *Medan Bisnis Daily News*, 31 July 2013, see [http://www.medanbisnisdaily.com/news/read/2013/07/31/43379/pemekaran\\_kabupaten\\_simalungun\\_didukung\\_daerah\\_tetangga](http://www.medanbisnisdaily.com/news/read/2013/07/31/43379/pemekaran_kabupaten_simalungun_didukung_daerah_tetangga) (accessed 1 September 2013).

<sup>376</sup> Unlike PT Lonsum, PTPN III released some of its plantations to support the establishment of the new district. Interviews with Timbas Ginting and Joner Napitupulu in Medan, North Sumatera, 10 August 2009.

<sup>377</sup> Interviews with Syamsul Bahry and Waras.

of districts, such as Simalungun and Langkat Districts where some of their palm oil plantations are located, as well as LonSum providing a library for the community in Batubara District and establishing two junior high schools in Deli Serdang District.<sup>378</sup>

As mentioned at the beginning of this subsection, there is no direct evidence that proves patrimonial relations between LonSum and the heads of district are where their plantations are located. However, indirect evidence demonstrates that both parties obtained advantages from these relations. The subsequent subsection discusses the Syamsul Arifin case as an example of how Regional Autonomy Laws have enabled the establishment of patrimonial relationships.

#### **b. The case of Syamsul Arifin**

The implementation of Good Governance and Local Government Laws has provided a legal boundary for heads of local government. However, with the popularity of the candidates, the same person might be elected for a maximum of two terms as heads of district/mayor in the same district or municipality, and continue as a governor for another two terms at the provincial level. In other words, a candidate might have the possibility of being in power for twenty years and might establish a patrimonial relationship between local government and business.

Since the implementation of Regional Autonomy Laws, there has been no data to inform the situation, whereby the same person may be twice elected as head of district and/or mayor, as well as twice elected as governor and could therefore serve for twenty years as head of local government. In fact, indirectly, the limitation period for the heads

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<sup>378</sup> “PT PP Lonsum Audiensi Dengan Bupati Langkat”, *Berita Sore*, 15 July 2009, <http://beritasore.com/2009/07/15/pt-pp-lonsum-audiensi-dengan-bupati-langkat>; “Bupati Simalungun Bersama Tokoh Masyarakat Silaturahmi Ke PT PP Lonsum”, *Berita Sore*, 16 June 2010 <http://beritasore.com/2010/06/16/bupati-simalungun-bersama-tokoh-masyarakat-silaturahmi-ke-pt-pp-lonsum>; “Bupati Batubara Resmikan Rumah Pintar PT.PP Lonsum”, *Analisa*, 19 April 2013, <http://analisadaily.com/news/2013/10479/bupati-batubara-resmikan-rumah-pintar-pt-pp-lonsum/?year=2013&id=10479&title=bupati-batubara-resmikan-rumah-pintar-pt-pp-lonsum>; “Bupati Deli Serdang Letakkan Batu Pertama Pembangunan SMPN 4 dan 5”, [http://www.google.com.au/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCsQFjAA&url=http%3A%2F%2Fharianandalas.com%2FSumatera-Utara%2FBupati-Deli-Serdang-Letakkan-Batu-Pertama-Pembangunan-SMPN-4-dan-5-Tamora&ei=FJCNUuq5KOPJiAfl2YHgAQ&usg=AFQjCNFxn\\_VBzSSrVg1NvAbqqCqK5TWVkg&bvm=bv.56988011.d.aGc](http://www.google.com.au/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCsQFjAA&url=http%3A%2F%2Fharianandalas.com%2FSumatera-Utara%2FBupati-Deli-Serdang-Letakkan-Batu-Pertama-Pembangunan-SMPN-4-dan-5-Tamora&ei=FJCNUuq5KOPJiAfl2YHgAQ&usg=AFQjCNFxn_VBzSSrVg1NvAbqqCqK5TWVkg&bvm=bv.56988011.d.aGc). All these articles were accessed on 15 October 2013.

of local government is a legal boundary to lessen the possibility of expanding the patrimonial relationships.

Syamsul Arifin almost reached the benchmark by having the position of head of Langkat District for two periods (1999-2004 and 2004-2008) and continued as North Sumatera Governor from 2008 to 2013. In 2009, he was accused by KPK of misusing Langkat District's budget. And in 2011 he was prosecuted and proven guilty for misusing the budget during his tenure as head of Langkat District.<sup>379</sup> In 2012, President Soesilo Bambang Yudhoyono, based on Presidential Decision no 95 /P/ 2012, terminated Arifin's position as North Sumatera Governor.<sup>380</sup>

In the case of local government and business relationships in the palm oil industry, the significance of Syamsul Arifin emerging as head of district was that he was known to be a leader who was informal and easy to approach by members of society. For Langkat District, palm oil has become the region's main commodity. Thus state enterprises, such as PTPN II which managed palm oil plantations in Langkat, had been one of the major contributors to the region.

As the power broker in the Langkat District, Syamsul Arifin was also aware that PTPN II had been one of the state enterprises that faced continuing financial problems since the merger between PTP II and PTP IX in 1996.<sup>381</sup> The legacy of debt from the old management resulted in continuing losses in its business operation. In 2004 PTPN II restructured its debt<sup>382</sup> and did not generate gross profit until 2008.<sup>383</sup>

In an effort to manage the debt and remain in operation, the Head of Langkat District, Syamsul Arifin had assisted the board directors of PTPN II in several ways. PTPN II

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<sup>379</sup> Moksa Hutasoit, "Korupsi APBD Langkat, Syamsul Arifin dituntut 5 tahun Penjara", *detik news*, 26 July 2011, <http://news.detik.com/read/2011/07/26/162315/1689830/10/syamsul-arifin-dituntut-5-tahun-penjara?nd771108bcj> (accessed 19 September 2013). Syamsul Arifin was proven guilty violated article 2 verse 1 jo Article 18 Law on Corruption Eradication no. 31/1999. However, Syamsul Arifin then filed an appeal to the Supreme Court to declare his innocence. By making an appeal, he obtained a higher sanctions of 5 years imprisonment and should return the money of IDR 8 billion to Langkat's budget.

<sup>380</sup> Based on the Supreme Court decision no 472 / K / Pid.Sus/2012 dated May 3, 2012, President Yudhoyono issued a Presidential Decree No. 95 / P / 2012 dated October 12, 2012 on the termination of Syamsul Arifin as Governor of North Sumatra 2008-2013 over corruption allegations.

<sup>381</sup> The merger was established based on Peraturan Pemerintah (PP) Nomor 7 Tahun 1996 14 Februari 1996.

<sup>382</sup> "Utang PTPN II direstrukturisasi", *Bisnis Indonesia*, 17 June 2005, <http://www.bumn.go.id/19410/publikasi/berita/utang-ptpn-ii-direstrukturisasi/> (accessed 9 September 2013).

<sup>383</sup> *Ibid.*

sold some of its plantations in Langkat District to Syamsul Arifin, which he transformed into an area for transportation hubs. Further, Syamsul Arifin assisted in the process of obtaining HGU, especially for palm oil plantations located in the District Rayon Tengah in Langkat District, which later became the areas that were leased to the Malaysian company, Kepong Berhad.<sup>384</sup>

Syamsul Arifin also allowed PTPN II to have IDR 41,159,507,728 as arrears for its *Pajak Bumi dan Bangunan* (Land Value Tax) in November 2009. When Syamsul Arifin became the North Sumatera Governor, PTPN II through its Managing Director, Bhatara Moeda Nusantara, also expedited the transfer of the land that was used as a governor's office and central administration office owned by the North Sumatera Province. Closer relations between Syamsul Arifin and the board of directors had been gradually established with both sides gaining advantages.

These relations became more obvious when Arifin and the directors were requested by *Kejaksaan Tinggi Sumatera Utara* (the office of the high prosecutor general of North Sumatera) to provide information on the alleged corruption of *Kerjasama Operasi* (or the Joint Operation) between PTPN II and the Malaysian palm oil company, Kepong Berhad. According to Alimuddin AG, *Ketua Umum Forum Rakyat Bersatu* (Chair of United People Forum), Arifin was the one who recommended the diversion of the plantation areas of PTPN II to be located in Langkat District for the Joint Operation.<sup>385</sup> According to Alimuddin, in addition to this recommendation, Arifin and the board of directors of PTPN II received IDR 100 billion commission from the joint venture company, PT Langkat Nusantara Kepong, for transferring these assets.<sup>386</sup>

While the Joint Operation between PTPN II and Kuala Lumpur Kepong Berhad did not violate any regulations, they were considered controversial because they involved the allegations of corruption conducted by Syamsul Arifin and the board of PTPN II

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<sup>384</sup> Later in the discussion, Arifin's assistance in the process of obtaining HGU in this area, gave more evidence to the possibility of closer relationships between Arifin and the Managing Director of PTPN II, Bhatara Moeda Nasution.

<sup>385</sup> "Mantan Gubsu dan Dirut Diduga Terlibat: Soal Pengusaha Malaysia 'Kuasai' lahan PTPN II", *Harian Orbit* 20 December 2011, see [www.harianorbit.com/mantan-gubsu-dan-dirut-diduga-terlibat/](http://www.harianorbit.com/mantan-gubsu-dan-dirut-diduga-terlibat/) (accessed 19 September 2013); "Gubsu Bantah Terlibat di PTPN II", *Sumut Pos*, 30 July 2009 <http://www.hariansumut.pos.com/arsip/?p=5103> (accessed 19 September 2013).

<sup>386</sup> *Ibid.*

directors. The Joint Operation was coordinated by PTPN II directly with the State Ministry for State Enterprises. Therefore, the acquisition of some of the PTPN II plantations has become the jurisdiction of the central government, not the North Sumatera Government. As a consequence, the North Sumatera Government, as an institution, was not coordinated and businesses<sup>387</sup> in the palm oil industry in North Sumatera were not informed by PTPN II of its plan to lease its plantations in the Rayon Tengah District to Kuala Lumpur Kepong Plantations Holdings Sdn Bhd.

Before the Memorandum of Understanding (hereafter MOU) was signed, PTPN II and Kuala Lumpur Kepong (KLK) (as the parent companies) had agreed to establish a joint venture company called PT Langkat Nusantara Kepong (hereafter addressed as LNK) to lease, operate and manage five plantations consisting of mature and immature palm oil (13,189.89 hectares) and rubber (6,815.73 hectares) plantations, factories and other fixed assets in Rayon Tengah in Langkat District.<sup>388</sup> The main objective of the establishment of PT LNK was to utilise the technology and management skills of its holding company, KLK, to revitalise the plantations. It was to increase the production of fresh fruit bunches (FFB) from low yields to levels comparable with international agribusiness standards. Furthermore, it also involved the short-term objective (to replant at least 40 percent of estates) and the long-term objective (to build two new palm oil mills).

The MOU of Joint Operations between PTPN II and PT LNK was signed on 9 June 2009 and was to be effective for thirty years. It was conducted formally in the State Ministry office of BUMN by the President Director of PTPN II, Bharata Moeda Nasution, and the President Director of PT LNK, Liem Hoong Joon.<sup>389</sup> This official

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<sup>387</sup>Timbas Ginting and Joner Napitulu in the interview demonstrated their disagreement on PTPN II decision to lease the twenty thousand hectares plantations to a Malaysian investor. On the one hand, they were aware that PTPN II had a severe financial problem before the Joint Operations with the Malaysian investor began. On the other hand, they thought it would be wiser to request financial assistance or subcontract the plantation to local private companies given the fact that there have been gradual increased of Malaysian investors in the Indonesian palm industry.

<sup>388</sup> *Annual Report 2011 PTPN II*, 128, see [ptpn2.com/AnnualReport2011.pdf](http://ptpn2.com/AnnualReport2011.pdf) (accessed 19 September 2013).

<sup>389</sup>“PTPN II Melakukan Kerja Sama Operasi”, 25 June 2009, <http://www.bumn.go.id/ptpn2/publikasi/berita/ptpn-ii-melakukan-kerja-sama-operasi/>; See also “PTPN II Menjalinkan Kerjasama Operasi dengan PT LNK”,

ceremony was attended by the Malaysian Ambassador for Indonesia, the State Minister of BUMN, the Minister of Agriculture, the North Sumatera Governor, Syamsul Arifin, the head of Langkat District, the Board of Commissioners of PTPN II, the Chairman and Directors of Kepong Berhad, as well as the President Director of PTPN I to IX.<sup>390</sup> PT LNK had 60 per cent shares whereas PTPN II had 40 percent shares.<sup>391</sup> It was also agreed that PT LNK invest IDR 800 billion to achieve its objective. Further, because Joint Operations between PTPN II and Kepong Berhad had been prolonged, it was decided to establish a new company, PT AAR Nusantara, in the area of palm oil seedlings, two years after the ratification of MOU by the State Minister of State Enterprises in December 2011.<sup>392</sup>

Joint Operations did not violate any rules by any means acceptable in palm oil industries and civil society in North Sumatra. This incident prompted parties such as the high prosecutors' officials in North Sumatra and KPK to investigate the case. By the end of July 2009, these officials had investigated Syamsul Arifin and the board of PTPN II directors in relation to the possibility of corruption in the establishing of Joint Operations.<sup>393</sup> Unfortunately, these officials could not press any charges because of lack of evidence; therefore, the involvement of Syamsul Arifin, as Head of Langkat District as well as the board of directors of PTPN II could not be proven.<sup>394</sup> KPK, on the other hand, in order to prevent the possibility of financial state losses, suggested

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[ptpn2.com/index2.php?option=com\\_content@do\\_pdf=1&id=92](http://ptpn2.com/index2.php?option=com_content@do_pdf=1&id=92), accessed 1 September 2011; "Corporate Information, Milestones 2009-2006", <http://www.klk.com.my/corporate-information/milestones/2009-2006/>; "Kuala Lumpur Kepong in Indonesian palm oil, rubber pact", [www.palmoilhq.com/PalmOilNews/kuala-lumpur-kepong-in-indonesian-palm-oil-rubber-pact/](http://www.palmoilhq.com/PalmOilNews/kuala-lumpur-kepong-in-indonesian-palm-oil-rubber-pact/)(all articles accessed 15 October 2013).

<sup>390</sup>"PTPN II Melakukan Kerja Sama Operasi, 25 June 2009.

<sup>391</sup> *Ibid.*

<sup>392</sup> Angga Aliya, "PTPN II Gandeng Investor Malaysia Bentuk Perusahaan Sawit," *Detik Finance*, 15 December 2011, <http://finance.detik.com/read/2011/12/15/110742/1791744/1036/ptpn-ii-gandeng-investor-malaysia-bentuk-perusahaan-sawit> (accessed 9 September 2013).

<sup>393</sup> *Ibid.*

<sup>394</sup> *Ibid.*

reviewing the contract to prevent future state financial losses as a result of ramifications of Joint Operations.<sup>395</sup>

In conclusion, the case of Syamsul Arifin and the case of Joint Operations between PTPN II and Malaysia were two different cases. The relationship between Syamsul Arifin and the director of PTPN II prior to the Joint Operation could open up possibilities for patrimonial relationships, where both parties would mutually benefit. The Joint Operations between PTPN II and the Malaysian company, likely facilitated by Syamsul Arifin, had to do with PTPN II efforts to rescue itself by leasing its assets to foreign companies.

### **C. Investment Law and the National Industry Policies**

Investment Law and the National Industrial Policy are among laws and regulations with the objective to improve industry's global competitiveness following the 1997-8 economic crisis. The law and policy provide general guidelines to generate a supportive investment climate and business certainty for potential investors. This law and policy are designed to encourage transparency and a law-based environment, doing business in Indonesia as well as achieving industry targets. They are applied to all sectors including the electronics and palm oil industries.

The *Reformasi* governments, which to a certain extent have adopted the economic liberal view, demonstrate this view within the Investment Law and the National Industrial Policy. The Investment Law offers generous facilities, a transparent process and a law-based environment which are expected to generate certainty, both in politics and the economy, to potential investors. The National Industrial Policies also demonstrate their consistency with the Investment Law by outlining road maps and targets for each priority of the cluster based industry. The necessary conditions in both law and policy as outlined by governments, has indicated strong government support for revitalising the industry. Furthermore, in implementation, the side effects of this law and policy are to encourage business to become more competitive rather than relying on government protection.

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<sup>395</sup> "KPK Sarankan Revisi KSO di PTPN II", *Arsip Harian Sumut Pos*, 3 August 2013, <http://www.hariansumutpos.com/arsip/?p=5486> (accessed 15 October 2013).

The different impact of both the Investment Law and the National Industrial Policies in revitalising industry competitiveness can be assessed from business responses in the electronics and palm oil industries. In regards to Investment Law, business players in both industries have similar opinions in assessing that the government has not done enough to improve the investment climate as outlined in the Investment Law. This includes lack of coordination among institutions at the national and local level, and inefficiency in bureaucracy which has created a high cost economy. Further, the ultimate authority to provide permits and licences has become relatively more dispersed, especially after the implementation of the Regional Autonomy Laws. The former condition has impacted the electronics industry, whereas the latter impacted the palm oil industry.

In relation to the implementation of the National Industrial Policies, according to businesses in the palm oil and electronics industry, the government has not yet provided the necessary conditions for the priority cluster based industry to proceed as targeted. Even though these industries are similar in how they perceive policy, the government has its own interests in the palm oil industry, but not in the electronics industry, which would differentiate the direction of change in state-business relations across these two sectors.

Business players in the electronics industry highlighted that the lack of coordination among institutions is one of the significant problems to be solved. The importance of foreign investment seems to be inevitable for the electronics industry, especially in the era of digital technology. According to Rahmat Gobel, the owner of Panasonic Gobel Indonesia and Deputy Head of Research and Technology KADIN, following the 1997-8 economic crisis, the trend towards digital electronics products is a must.<sup>396</sup> Among the ASEAN countries, Indonesia has been left behind in attracting investors as a result of lack of coordination among institutions and inefficiency in bureaucracy, which has created a high cost economy. Compared to Indonesia, other ASEAN countries can not only offer better fiscal incentives and non-tariff barriers, but the length of time for obtaining licences is reduced. This situation led Indonesia's reduced competitiveness in

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<sup>396</sup> Interview Rahmat Gobel in Jakarta, 13 August 2009. See also Rahmat Gobel, "Tantangan Industri Elektronika Nasional: Mengembangkan Produk berbasis Teknologi Digital dan Ramah Lingkungan" (paper presented at the Electronics Industry Seminar, Department of Industry, Jakarta, 13 August 2009).

the ASEAN region. Further, Gobel argued that this reduced competitiveness in the Indonesian electronics industry was also a result of lack of component electronics manufacturing. Even though the National Industrial Policy has outlined road maps to resolve this issue, it could not provide too much guidance because in its implementation, the manufacturing of component electronics is highly dependent on other factors, particularly foreign investment, taxes and tariffs.<sup>397</sup>

In addition, Himawan, the Corporate Secretary of Panasonic, argued that following the crisis, Indonesian electronics products were not competitive because of local products experiencing problems with taxes.<sup>398</sup> And therefore: imported products were less expensive compared to locally manufactured ones; there was no SNI to protect against illegal imported products traded in the domestic market; and no comprehensive policy for shifting to advanced digital technology.

Himawan agreed with Rahmat Gobel that the government needed to provide more concrete action, apart from outlining the 2008 National Industrial Policy.<sup>399</sup> He argued that if the government coordinated the policy with other laws and regulations, such as taxes and customs' regulations, harmonising the tariffs and regulations to protect the domestic market from illegal imported products, deregulating the tax and banking system as well as simplifying the process of obtaining licenses, permits and export, there would be a possibility for the industry to gradually build up its component electronics as outlined in the long-term objectives of the 2008 National Industrial Policy.<sup>400</sup> Further coordinated action from government was also needed to increase industry competitiveness in the free trade era of AFTA and CAFTA.

Further, the ultimate authority to provide permits and licences has currently become relatively more dispersed, especially after the implementation of Local Government Laws. According to Tulus Tambunan dan Mudrajad Kuncoro, the implementation of

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<sup>397</sup> Interview Rahmat Gobel.

<sup>398</sup> Interview Himawan, Corporate Secretary of Panasonic, in Jakarta, 25 June 2009.

<sup>399</sup> Interview Himawan.

<sup>400</sup> Interview Himawan.

local autonomy has made the process of obtaining investment permits more complex.<sup>401</sup> Before local autonomy was implemented, *Badan Koordinasi Penanaman Modal* (the Investment Coordinating Board, hereafter BKPM) was the highest authority to process investment permits at the national level, whereas *Badan Koordinasi Penanaman Modal Daerah* (the Regional Investment Coordinating Board, hereafter BKPMMD) was the highest authority to process investment permits at the local level. Since the implementation of local autonomy, some local governments established other institutions to manage the investment process in addition BKPMMD. Therefore, there has been a tug of war of interests between BKPMMD and these institutions as well as between BKPMMD and BKPM.

Fadhil Hassan, Executive Director of GAPKI, agreed with Tulus Tambunan and Mudrajad Kuncoro, in referring to the complexity of obtaining permits in the palm oil industry with local autonomy in place.<sup>402</sup> According to Fadhil Hassan, foreign investors interested in opening up new palm oil companies and plantations described the process as very complex. This complexity is because the process of obtaining permits begins at the local level and continues at the national level. At the local level, heads of districts/municipalities and governors are significant authorities as part of determining permits to business or investors, as stated in Investment Law article 30 (5) and (6):

The approval process for investments involving more than one district/city government are managed by the provincial government, while investments that occur within one district/city are managed by the government of that district/city).<sup>403</sup>

Unlike the electronics industry, business in the palm oil industry perceived the Investment Law as a threat for Indonesian domination as a CPO producer in the world.

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<sup>401</sup> Tulus Tambunan, “Kendala Perijinan Dalam Kegiatan Penanaman Modal Di Indonesia Dan Upaya Perbaikan Yang Perlu Dilakukan Pemerintah”, <http://www.kadin-indonesia.or.id/enm/images/dokumen/KADIN-98-2496-06022008.pdf>. (accessed 6 September 2011); Mudrajad Kuncoro, “Doing Business in Indonesia 2010”, <http://www.mudrajad.com/upload/Doing%20Business%20in%20Indonesia%202010.pdf> (accessed 6 September 2011).

<sup>402</sup> Interview with Fadhil Hassan, Executive Director of GAPKI in Jakarta, 6 August 2009.

<sup>403</sup> Investment Law no 25/2007 article 30 (5) and (6).

Business has requested that government limit the Malaysian investors because the expansion of Malaysian investors only previously occurred in plantations for CPO production, whereas business expected their expansion in downstream industries such as oleochemical and biodiesel industries.

Ahmad Mangga Barani, General Director of Plantation, Department of Agriculture and Maruli Gultom, former Director of PT Astra Agri Tbk, have criticised the Investment Law because this law has made it easier for foreign companies to own palm oil plantations as well as to establish plantation companies in Indonesia.<sup>404</sup> Further, Maruli Gultom emphasised that this means that Malaysia may have taken advantage of the Investment Law to expand its palm oil plantations even further, due to their limited existing plantation areas.<sup>405</sup>

In addition to business, which required protection from the government, the government itself has intervened in this industry because it has had a high stake, not only for maintaining Indonesia as the largest global CPO producer, but also for maintaining the domestic cooking oil supply and establishing the biofuel industry. Rosediana Soeharto, the Director of Indonesian Palm Oil Commission (*Komisi Minyak Sawit Indonesia*, hereafter KMSI)<sup>406</sup> argued that the current policy had not yet outlined priorities and how government would develop them. Both in the 2001 Trade and Industrial Policies and in the 2008 National Industrial Policy, the government prioritised the expansion of the palm oil industry, not only for producing CPO for export but as the raw material for the domestic cooking oil industry. More importantly, as stated in the 2008 National Industry Policy, CPO should be utilised for domestic palm oil derivatives and biofuel.

Furthermore, the biodiesel industry, determined by President Yudhoyono as the main part of his renewable energy policy<sup>407</sup>, can be considered as a big project to be

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<sup>404</sup>Ahmad Mangga Barani, “Pengembangan Kelapa Sawit Nasional: Mewujudkan Visi 2020” (paper presented at the Symposium of Perkelapa Sawitan Indonesia Menunjang Ketahanan Pangan Dunia, Jakarta, 30 June 2009).

<sup>405</sup>Interview Maruli Gultom in Jakarta, 24 June 2009.

<sup>406</sup>Interview Rosediana Soeharto in Jakarta, 25 June 2009.

<sup>407</sup>The seriousness of Yudhoyono’s administration was demonstrated in a series of government regulations to support the biodiesel industry. To name a few of those regulations: Government Regulation no 5/2006 on National Energy Policy, President Decree no 1/2006 on Biofuel Development Program, President Decree no 10/2006 on National Biofuel Development Team, Government Regulation

accomplished, which needs to be supported by investment, infrastructure, government incentives in taxes, research and development as well as physical infrastructure. Lacking these facilities means expansion towards the upstream industry would fail.<sup>408</sup> Unfortunately, according to Rosediana Soeharto<sup>409</sup>, since 2008 most of the companies that have manufactured oleochemical and biofuels have not yet maximised their operations because of the significant increase in CPO price and lack of government support.

#### **D. Conclusion**

Regulatory frameworks, in the form of laws and policies related to overcoming corruption and contributing to good governance, anti monopoly, competitiveness at the regional level, revitalising the industry and attracting more investment, has been established by the *Reformasi* governments. These regulations were not legislated at the same time. Among those discussed, the earliest laws were Good Governance and Corruption Eradication as well as Competition Laws, legislated in 1999, and the latest regulations were the Investment Law and the National Industrial Policy, legislated in 2007. Good Governance and Corruption Laws were among the laws which were legislated as early as *Reformasi*, demonstrating the urgency of overcoming corruption, especially among government officials (*pejabat negara*).

Of the seven regulations outlined above, which constitute part of the regulatory frameworks discussed in this chapter, only one regulation is designated to overcome corruption, collusion and nepotism among government officials (Good Governance Law no 28/1999). The rest do not have that direct objective. However, based on this framework, transparent and law-based relationships between state and business are expected to be established in order to support the further integration of the Indonesian

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no 1/2007 on Biofuel Tax Incentives, Agriculture Minister's Decree 2007 on Plantation Allocation, Government Regulation no 8/2007 on Biofuel Fund, see *Asosiasi Produsen Biofuel Indonesia* or AROBI or Associations of Indonesia Biofuels Producers, as quoted by *Dewan Minyak Sawit Indonesia, Industri dan Perdagangan Minyak Sawit Indonesia*, 40.

<sup>408</sup>Interview with Rosediana Soeharto in Jakarta, 25 June 2009. See also, *Dewan Minyak Sawit Indonesia, Industri dan Perdagangan Minyak Sawit Indonesia*, 38 and 42.

<sup>409</sup> *Ibid.*

economy with the global market. In the fifteen years of *Reformasi*, these regulations have interacted with the resurrection of some actors, both in business and government.

Despite the implementation of these regulations, patrimonial structure between state and business, which had presumably formed since the New Order, are not easily overcome. They still persist although in modified relationships. This is in contrast to the electronics industry, in which the structure of patrimonial relationships between state and business do not occur. In fact, business has used these regulations to make relationships become more transparent and law-based.

In the palm oil industry, patrimonial relations are possible because both governments at the centre and at the local level have maintained considerable interest in the palm oil industry, with conglomerates (some have begun their businesses in timber as well as pulp and paper during the New Order era) as the dominant players. The implementation of Regional Autonomy Laws, which bestowed governors as well as heads of district and mayors with greater authority in a strict two-term tenure, enabled them to maintain their relationships. The oligopoly structure of this industry has strengthened relationships by targeting different heads of local government to become their patrons, explaining why business has been intensely involved in local election. In other words, business has become more active to find new patrons. Investment and Competition Laws, which aim to create a more competitive and supportive business environment, are not favoured by conglomerates because their implementation threatens oligopoly structure as well as patrimonial relations.

In contrast, state-business relations in the electronics industry do not engage in patrimonial relationships, and therefore perceives the combined legislation of the Competition Law, the Investment Law and the National Policies as necessary for enhancing competitiveness at the global level. Business, however, was disappointed because these regulations have not yet been fully implemented; therefore, the improvement in this industry has not yet optimally been achieved. With the urge for competition in the era of free trade, these regulations have not yet been able to respond to, for example, the price dumping problem caused by imported electronics products from China, which has lowered Indonesian competitiveness and the Indonesian domestic market has deteriorated.

Finally, the regulations discussed in this chapter aim to enforce laws, good governance anti monopoly, competitiveness that enables the further integration of the Indonesian economy to the global market; therefore, it is expected the relationship between business and government will become more transparent and law-based. Although this is not the case in the electronics industry, the patrimonial structure between state and business in the palm oil industry has demonstrated continuity for some New Order actors both in government and business to survive. In the subsequent chapter, the focus shifts to a discussion on the influence of foreign stakeholders towards patrimonial state-business relations to explore whether they have overcome patrimonial state-business relations.

## **Chapter 6**

### **Influence of Global Stakeholders on State-business Relations: Two Case Studies**

The previous chapter discussed the regulations legislated by government to address patrimonial relationships between state and business, either directly or indirectly. This chapter comprising three sections discusses the extent to which international stakeholders have influenced state-business relations in Indonesia, by comparing the palm oil industry and electronics industry as case studies.

In the palm oil industry, criticisms and campaigns on environmental issues from non-state actors, such as global Non-Government Organisations (hereafter NGOs) and Indonesian NGOs that have affiliated with the international NGOs and state actors such as the European Union (hereafter EU), have targeted palm oil companies as well as government. I argue that their criticisms and campaigns have scrutinised both business and government in the global context and have revealed the complexity of new patterns of patrimonial relationships. Unlike the palm oil industry, international stakeholders in the electronics industry have emphasised competition as their primary concern; therefore they have pressured their subsidiaries and the Indonesian government to provide a supportive business environment or they threaten to relocate. I argue that the involvement of international stakeholders in this industry has pushed toward a more transparent and law-based relationship between business and government.

Unlike chapter five, the findings in this chapter are categorised under each sector: the first section discusses the palm oil industry, the second section discusses the electronics industry and the third section concludes the chapter. The first section, comprising three subsections, discusses the influence of global stakeholders on state-business relations in the palm oil industry through three issues: the NGO campaigns against conglomerates, the conflict between Greenpeace and Sinar Mas, and PT SMART Tbk and the biofuel dilemma. The second section, comprising two subsections, discusses the influence of global stakeholders on state-business relations in the electronics industry through the issue of ASEAN Free Trade Agreement (hereafter addressed as AFTA) and China – ASEAN Free Trade Agreement (hereafter addressed as CAFTA).

## **A. Palm oil industry**

Environmental issues have been raised as significant ones, especially in relation to the production of sustainable CPO. Global and local NGOs, as non-state actors, and the EU, as state actor, have addressed these issues with regard to specific conglomerates as the major component of the oligopoly structure. In this section I argue that these persistent criticisms have not yet succeeded to make the Indonesian government enforce a moratorium on the targeted conglomerate, PT SMART Tbk, as will be discussed in subsection 2. As will be discussed in subsection 3, on the one hand, the campaigns have influenced the government to implement a moratorium on “Postponement of granting new permits and improvement of the primary forests’ and peatland’ management” since 2011. On the other hand, the EU restrictions have not yet succeeded to limit the expansion of palm oil plantations, which has been massive since 2006, when the government decided to use biofuels<sup>410</sup> as part of the National Energy Policy. This suggests global criticisms have scrutinised both government and business and revealed the complexity of the new pattern of patrimonial relationships.

### **1. NGOs’ campaigns against conglomerates**

The objective of this subsection is to demonstrate that NGOs’ campaigns on environmental destruction as the cause of forest fires in Indonesia has occurred since the Soeharto era. However, the campaigns did not reach the global media because of the ability of Soeharto to confine the protest to Malaysian and Singapore governments. The NGOs’ campaigns have found momentum in the *Reformasi* government. With the expansion of palm oil plantations, according to the NGOs, environmental destructions and deforestation have become more widespread and critical. These allegations have been denied by palm oil producers and the government as the expansion was legal because it did not violate Indonesian law.

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<sup>410</sup> Biofuel is a general term that refers to biodiesel or ethanol, and shows the fuel made from biological sources, see “Biofuel: Perkembangan Generasi Etanol dan Biodiesel,” <http://www.indoenergi.com/2012/04/biofuel-perkembangan-generasi-etanol.html>, (accessed 5 January 2014). This definition is used throughout the dissertation..

Campaigns on environmental issues by international and local NGOs targeted Indonesian companies and the Indonesian government and they began when Soeharto was in power. Before Soeharto resigned, the recurrent forest fires, as a result of timber companies using fire for land clearing, sparked controversies with Malaysia and Singapore because of smoke haze that enveloped these two countries. The NGO's criticisms on the recurrence of forest fires in 2013, which again Malaysia and Singapore protested against, have suggested that the *Reformasi* governments have not been overly successful in controlling the activities of palm oil plantations and timber companies, and some of them were Soeharto's cronies.

Since the *Reformasi* governments, criticisms and campaigns by local and international NGOs on environmental destruction due to the expansion of palm oil plantations have intensified and targeted conglomerates that dominate the industry. The NGOs argued that the government had not enforced sufficient regulations to limit conglomerates' environmental destruction while they expanded their palm oil plantations.

According to the NGOs, at least, two types of destructive activities relate to the expansion of palm oil plantations: the use of illegal fire to clear land had released high carbon emissions, and clearance of primary forests and peat lands were highly valued conservation areas. The local and international campaigners wanted the government to prevent plantation expansion.

The World Wide Fund for Nature (WWF) Indonesia, Greenpeace Indonesia and Sawit Watch, that have global networks with NGOs in America and Europe, are among the NGOs which have been strongly criticising the government and business players in relation to environmental destruction. The long list of criticisms levelled at environmental destruction due to the expansion of palm oil plantations occurred especially in Sumatera, Kalimantan and more recently in Papua. Their allegations were about the burning techniques used to clear forests for new plantations, insufficient data on which forests can be converted to *Hutan Produksi Konversi* (or Conversion Production Forests)<sup>411</sup>, and the high rate of carbon dioxide caused by burning peat land to plant palm oil on those three islands.

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<sup>411</sup> Based on Peraturan Menteri no 33/Menhut II/2010, "*Hutan produksi yang dapat dikonversi yang selanjutnya disebut HPK adalah kawasan hutan yang secara ruang dicadangkan untuk digunakan bagi*

According to the WWF, the change of the political system has not yet provided significant policy to limit environmental destruction caused by the use of fire to clear the land. Data showed that since 1997 the fire that spread in Sumatera and Kalimantan was man made. For a comparison of how the fire was ignited in the forest, the WWF showed that the pattern before 2002 had been repeated in that year, as well as in 2013. The logging and estate companies were clearing land by setting fire to natural forest after removing valuable timber and leaving fire-prone debris. Therefore, the NGOs have alleged the *Reformasi* government has not yet enough political will to control the business players who have dominated Indonesia's palm oil industry.<sup>412</sup>

Comparing data from Cassons, the Department of Agriculture and Rai<sup>413</sup>, seven conglomerates were consistently cited as big players in this industry. They are Astra Group through PT Astra Agro Lestari, Bakrie Group through PT Bakrie Sumatra Plantation, Raja Garuda Mas through PT Asian Agri, Salim Group through PT Indofood Sukses Makmur and Sinar Mas Group through PT Sinar Mas Tbk. Of these conglomerates, the Sinar Mas and Raja Garuda Mas Groups had been involved in the pulp and paper industry from the Soeharto era to the present.<sup>414</sup> However there were several conglomerates not consistently cited as major players in the palm oil industry that began their businesses in pulp and paper in the 1970s before expanding to the palm oil industry; they were Surya Dumai Group and the Barito Pacific Group.<sup>415</sup>

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*pembangunan di luar kegiatan hutan.* In other words, based on this regulation the government has set some of the area in the forest to be allocated for production purposes. Further, this insufficient data was closely related to the lack of local *Rencana Tata Ruang Wilayah* or Spatial Zoning Plan (hereafter RTRW) at some of districts and municipalities as well as at national level.

<sup>412</sup> WWF Germany in collaboration with WWF Indonesia and WF, Switzerland, "Palm Oil Plantations and Deforestation in Indonesia: What Role do Europe and Germany play? *A Report* (November 2002), 5.

<sup>413</sup> Anne Casson, "The Hesitant Boom: Indonesia's Palm Oil Sub-Sector in an Era of Financial Crisis and Political Change" (Bogor: Centre for International Forestry Research, November 1999); Ministry of Agriculture, 2007, and Shunsuke Rai, "Agribusiness Development and Palm Oil Sector in Indonesia," *Economia* 61, no 1 (May 2010): 45-59.

<sup>414</sup> "Perkebunan Kelapa Sawit Terbesar Milik Sang Garuda Mas: Biografi Pengusaha Sukses Sukanto Tanoto" <http://biografi-pengusaha.blogspot.com.au/2013/10/perkebunan-kelapa-sawit-terbesar-milik.html> (accessed 10 December 2013).

<sup>415</sup> "Boss Surya Dumai Grup Dituntut 9 Tahun Penjara," *Tempo* 17 April 2007, <http://www.tempo.co/read/news/2007/04/17/06398143/Bos-Surya-Dumai-Grup-Dituntut-9-Tahun-Penjara> (accessed 10 December 2013); "Berburu Kayu di Kebun Sawit," <http://fwi.or.id/berburu-kayu-di-kebun-sawit/> (accessed 10 December 2013); "Profil Prayogo Pangestu: Taipan Kayu Terbesar di

In addition to using fire to clear the land, the NGOs have addressed the issue of expansion of palm oil plantations by conglomerates to primary forests and to peatlands.

These allegations are critical because practices that convert forest to plantations are illegal unless the land for plantations has been designated as Conversion Forest by law. Further, according to Indonesian Law, it is also illegal to expand palm oil plantations in peat land as it creates high carbon emissions and destroys the biodiversity. Keppres (Presidential Decision) no. 32/1990 on *Pengelolaan Kawasan Lindung* (or Management on Conservatory Land) and Peraturan Menteri Pertanian (Minister of Agriculture Decree) no 14/Permentan/PL.1102/2/2009 are some of the regulations which state that natural forests on peat soil of three metres or more must be protected.

To demonstrate how massive the expansion of the palm oil plantations is, Cassons<sup>416</sup> compared the areas already planted with the land bank – the land that has been cleared but has not yet been planted – from each of the big companies. Before the financial crisis, these conglomerates owned land banks totalling approximately 2.1 million hectares. However, only around 821,369 hectares of the total land bank acquired by these companies had been planted by the end of 1997, as shown in table 6.1.

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Indonesia,” <http://www.orangterkayaindonesia.com/profil-prajogo-pangestu-taipan-kayu-terbesar-di-indonesia/>

<sup>416</sup> Cassons, “The Hesitant Boom: Indonesia’s Palm Oil Sub-Sector in an Era of Financial Crisis and Political Change,” *Ibid.*

Table 6. 1: Conglomerates, holding companies, land bank and plantations in 1997

<b>Conglomerates</b>	<b>Holding companies</b>	<b>Land bank (in hectares)</b>	<b>Total area planted (in hectares)</b>
Sinar Mas Group	PT SMART Tbk	582,208	211,713
Bakrie and Brothers	PT Bakrie Sumatera Plantations	376,041	34,392
Astra Group	PT Astra Agro Lestari Tbk	280,000	177,976
Salim Group	PT Salim Plantation (PT Indofood Tbk)	275,000	125,000
Napan Group	PT Perusahaan Perkebunan Sumatera London	245,629	78,944
Raja Garuda Mas Group	PT Asian Agri Tbk	200,000	110,000
SIPEF Group	PT Tolan Tiga	52,869	36,312
Socfin Group	PT Socfindo	47,777	37,180
<b>Total</b>		<b>1,982,242</b>	<b>821,369</b>

Source: Anne Casson, "The Hesitant Boom: Indonesia's Palm Oil Sub-Sector in an Era of Financial Crisis and Political Change" (Bogor: Centre for International Forestry Research, November 1999), 15, Table 2.

Ten years later, it became even more difficult to find accurate and complete data on which forests had been converted legally or illegally. However, the expansion of private company plantations owned by conglomerates was extraordinary. In 2009, there was a huge increase of land expansion for private companies to 3,501,000 hectares from 1,982,242 hectares in 1997. This was an increase in 56.6 per cent from the land bank in 1997. This expansion also involved significant investment from big foreign companies including big companies from Malaysia.

Unlike the NGOs, business and government argued that criticism and the campaign were used to disadvantage Indonesian palm oil products as part of trade competition, especially among oil seed producers. Rosediana Soeharto, the Director KMSI (the Indonesian Palm Oil Commission) accepted the fact that some of the plantation companies continued to use fire to clear the land, however, the number of companies which used fire had gradually decreased.<sup>417</sup> Joko Supriyono, the Secretary General of GAPKI (the Indonesian Palm Oil Producers' Associations) agreed with her argument

<sup>417</sup> Interview Rosediana Soeharto in Jakarta, 25 June 2009; interview with Joko Supriyono in Jakarta, 15 July 2009.

and further explained that the NGOs had generalised that all plantation companies acted as logging companies and used fire to clear the land.<sup>418</sup> Rosediana Soeharto and Joko Supriyono argued that all the NGOs' criticisms were negative campaigns against Indonesian palm oil products and had partly been used by the EU to impede the importation of Indonesian CPO and biofuel for the European market.<sup>419</sup> As competition among the seed oil producers was high, therefore, the EU imposed restrictions, which made it even more difficult for Indonesia's palm oil products to meet the requirements and to be traded in European markets. As will be discussed in more detail in subsection three of this chapter, despite the NGOs' campaigns and EU restrictions, the export of Indonesian CPO has increased steadily and biofuel export has increased significantly to the EU.

The discussion in this subsection has demonstrated that NGO campaigns succeeded to scrutinise the conglomerates and *Reformasi* governments on a global scale about their responsibility for alleged environmental destruction and deforestation due to the expansion of palm oil plantations. The companies rejected most of the NGO criticisms and asserted that the expansion of plantations was legal. In a more elaborate manner, the next subsection discusses the conflict between Greenpeace and PT SMART Tbk of the Sinar Mas group (hereafter addressed as SMART), on Greenpeace's allegation that this conglomerate violated domestic and international law when it expanded its palm oil plantations. As will be discussed, the allegation that SMART violated the domestic laws was because this conglomerate interpreted some regulations to meet its needs and interests. Further, discussing this conflict in detail reveals the complexity of the new pattern of patrimonial relations between conglomerates and local government.

## **2. Conflict between Greenpeace and SMART**

Conflict between Greenpeace and Sinar Mas began after Greenpeace released its December 2009 Report "Illegal Forest Clearance and RSPO Greenwash" in regard to

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<sup>418</sup> Interview Joko Surpiyono.

<sup>419</sup> Interview Joko Supriyono. In addition, Joko Supriyono pointed out the same argument in his presentation, "Arah Pembangunan Industri Kelapa Sawit Indonesia" (paper presented at Simposium Kelapa Sawit, Kamar Dagang dan Industri Indonesia, Jakarta, 30 June 2009); interview with Rosediana Soeharto.

how Sinar Mas breached national and international laws when they cleared their new palm oil plantations in several concessions in West Kalimantan Province.<sup>420</sup> Following this report there was a series of reports including “New evidence: Sinar Mas – rainforest and peatland destruction”, and “How Sinar Mas is expanding its empires of destruction”.<sup>421</sup> Greenpeace alleged that Sinar Mas had masked their companies destructive environmental activities under its image of the RSPO membership, although, on December 2009 when Greenpeace made its allegations, only two companies, PT SMART Tbk and PT Ivo Mas Tunggal, had RSPO certification.

The Reports contain allegations about the Sinar Mas Group (SMART) as follows:<sup>422</sup>

1. For five concessions in Central Kalimantan province and two concessions in West Kalimantan Province, SMART had cleared and planted on peatland with a depth of more than three meters and have violated Indonesian Law.
2. For six concessions in Central Kalimantan Province and two concessions in West Kalimantan Province, SMART had destroyed primary forests and Orangutan habitat.
3. For six concessions in Central Kalimantan Province and two concessions in West Kalimantan Province, SMART had performed forest land clearance/logging without obtaining Timber Utilisation Permit (IPK) or prior to obtaining approval of Environment Impact Statements (AMDAL) for two concessions in West Kalimantan Province.
4. In five concessions in Central Kalimantan Province and one concession in West Kalimantan Province, SMART had use burning methods to clear and prepare the land.
5. Through plantation expansion, SMART had caused social conflicts, including land rights and resource conflicts.

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<sup>420</sup> Greenpeace, “Illegal Forest Clearance and RSPO Greenwash: Case Studies of Sinar Mas,” *Report* (London, 2009), [www.greenpeace.org/](http://www.greenpeace.org/) (accessed 7 September 2011).

<sup>421</sup> Greenpeace International, "How Sinar Mas Is Expanding Its Empires of Destruction" *Report* (Amsterdam, 2010); Greenpeace International, new evidence on Sinar Mas rainforest and peatland destruction," *Report* (Amsterdam, 2010), <http://www.greenpeace.org/international/en/publications/reports/New-Evidence-Sinar-Mas-Rainforest-and-Peatland-destruction/> (accessed 7 September 2011).

<sup>422</sup> “BSI-CUC Verifying Greenpeace Claimes Case: PT SMART Tbk,” *Report*, August 2010.

According to Greenpeace, all these allegations breached Indonesian Law as well as RSPO Code and Criteria. Therefore, principally Greenpeace demanded the implementation of a moratorium on forest and peatland clearance to consumers and producers as well as to governments and investors. In order to support the moratorium, consumers had to cancel contracts with any Sinar Mas company, producers had to stop purchasing palm oil from any Sinar Mas company, and governments and investors had to stop financing the Sinar Mas group of companies until they implemented a moratorium on further forest clearance for plantations.<sup>423</sup>

Following the Greenpeace December Report, SMART, as the division of agriculture and food in the Sinar Mas group, responded immediately because Unilever, one of its important corporate customers, had temporarily discontinued purchasing CPO from Sinar Mas after the Report was released.<sup>424</sup> SMART's letter to the Jakarta Stock Exchange was its first public response towards Greenpeace allegations, confirming and explaining its position regarding the allegations, which resulted in Nestle's temporary discontinuation.<sup>425</sup> Further, in his official response to SMART partners published on its website, Daud Dharsono, the President Director of SMART, strongly disagreed with the allegations and accusations because "they are either exaggerated or are not scientifically grounded or are not based on facts."<sup>426</sup> In the announcement, he also acknowledged the possibility that mistakes in executing the company strategy might happen; however, he requested stakeholders' understanding that the implementation of environmental

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<sup>423</sup> Greenpeace, "Illegal Forest Clearance and RSPO Greenwash: Case studies of Sinar Mas," *Report*, 9.

<sup>424</sup> Jenny Wiggins, "Unilever Cuts Palm Oil Ties over Environment Fears", *Financial Times*, 11 December 2009, <http://www.ft.com/cms/s/0/6e3bb462-e655-11de-bcbe-00144feab49a.html#axzz2dWR9N4xZ> (accessed 7 September 2011); see also Nurul Qomariyah, "Unilever Putuskan Kontrak dengan Sinar Mas", 11 December 2009, <http://finance.detik.com/read/2009/12/11/153607/1258618/6/unilever-putuskan-kontrak-dengan-sinar-mas> (accessed 7 September 2011).

<sup>425</sup> Golden Agri-Resources Ltd., "Clarification Announcements by PT Sinar Mas Agro Resources and Technology Tbk," 15 December 2009, see <http://www.goldenagri.com.sg/pdfs/SGX%20Filings/2009/GAR15-12-2009-ClarificationAnnouncementsbyPTSinarMasAgroResourcesandTechnologyTbk.pdf> (accessed 7 September 2011).

<sup>426</sup> PT SMART Tbk., "Letter to Partners of PT SMART Tbk.", *An Announcement* [http://www.smart-tbk.com/pdfs/Announcements/letter\\_to\\_partners.pdf](http://www.smart-tbk.com/pdfs/Announcements/letter_to_partners.pdf) (accessed 7 September 2011).

policies could be interpreted differently and thus assured shareholders that SMART would review its environmental policy.<sup>427</sup>

There has been a principal difference between Greenpeace and responses by SMART toward Greenpeace allegations and demands. Based on these allegations and demands, SMART ceased its activities in clearing the land for plantation expansion. Following the government suggestion, SMART responded by requesting an Independent Verification Exercise (hereafter IVEX) – a thorough legal and RSPO criteria verification – for assessing Greenpeace allegations. SMART appointed two leading certification bodies, approved by RSPO, BSI Group (BSI) and Control Union Certification (CUC).<sup>428</sup> In addition, in consultation with RSPO, SMART requested expert assistance from the Bogor Institute of Agriculture (IPB) for independent advice, technical expertise and objectivity to support the IVEX verification of Greenpeace reports.<sup>429</sup>

While the investigation took place, Greenpeace continued its campaign to SMART corporate consumers to discontinue purchasing CPO from SMART or terminate their financial support to SMART. This campaign successfully affected some of these corporate consumers. In March 2010, Nestle discontinued supplies of palm oil from SMART after a very controversial Greenpeace campaign against “Kit Kat”.<sup>430</sup>

As part of its campaign, Greenpeace produced two YouTube videos that showed horrifying Kit Kat’s chocolates which transformed into orangutan’s fingers because

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<sup>427</sup> *Ibid.*

<sup>428</sup> “SMART Appoints Control Union Certification and BSI Group to Verify Greenpeace Reports”, [http://www.smart-tbk.com/pdfs/Announcements/letter\\_20100401.pdf](http://www.smart-tbk.com/pdfs/Announcements/letter_20100401.pdf) (accessed 7 September 2011).

<sup>429</sup> Two leading experts from Indonesia’s Bogor Agricultural Institute (IPB), will provide independent expert assistance over verification of the claims in recent Greenpeace reports. Prof. Dr. Bambang Hero Saharjo and Dr. Ir. H. Yanto Santosa were requested to aid the independent verification to be conducted by two Roundtable on Sustainable Palm Oil (RSPO) approved certified bodies, Control Union Certification (CUC) and BSI Group (BSI). The two experts are senior academicians and forestry conservation researchers at IPB’s Faculty of Forestry, see Press Release PT SMART Tbk, “Two Leading Experts to Assist SMART’s Verification of Greenpeace Reports”, 15 April 2010, [http://www.smart-tbk.com/pdfs/Announcements/20100408\\_SMDO\\_CCPR\\_Press\\_Release.pdf](http://www.smart-tbk.com/pdfs/Announcements/20100408_SMDO_CCPR_Press_Release.pdf) (accessed 7 September 2011).

<sup>430</sup> Stuart Washington, “Greenpeace Claims Sweet Victory over Nestle,” *Sydney Morning Herald*, 17 May 2010, <http://www.smh.com.au/environment/conservation/greenpeace-claims-sweet-victory-over-nestle-20100517-v8i1.html#ixzz2dXBsKp6c> (accessed 7 September 2011). The Kit Kat campaign was directed not only against Indonesian palm oil producers but also Malaysian palm oil producers.

Nestle utilised palm oil from plantations which destroyed orangutan habitat.<sup>431</sup> The YouTube videos went viral and successfully brought to SMART's corporate customers attention the message on how palm oil has been destructing the rain forest and its biodiversity including the *orangutan*. This strong message had made several corporate customers of SMART come to the decision to discontinue their contracts in purchasing CPO and its derivatives such as Kraft<sup>432</sup>, HSBC<sup>433</sup> and Burger King.<sup>434</sup>

The Indonesian government stood behind SMART, in fact, SMART had taken the government's advice to verify Greenpeace allegations by the independent certified bodies. Further, the government also supported SMART by pointing out that it was the lack of coordination in the implementation of national and local government regulations which ignited the conflict between Greenpeace and SMART.

After five months, in August 2010, the findings of the IVEX team were published. The report found that many aspects alleged by Greenpeace were not entirely correct. This result satisfied SMART.<sup>435</sup> However, the report also found that SMART breached the principles of responsibility to environment and conservation of national resources and biodiversity as well as enforcing laws and regulations, which supported one of the

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<sup>431</sup> "Greenpeace – Kitkat – ask Nestle CEO to Stop Buying Palm Oil from Destroyed Rainforest," [www.youtube.com/watch?v=IBCA8dQfGi0](http://www.youtube.com/watch?v=IBCA8dQfGi0), 17 March 2010 (accessed 7 September 2011); see also [www.youtube.com/watch?v=VaJjPRwExO8](http://www.youtube.com/watch?v=VaJjPRwExO8) (accessed 7 September 2011); see also <http://www.greenpeace.org/kitkat> (accessed 7 September 2011).

<sup>432</sup> Ashley Schaeffer, "Krafting a New Story on Palm Oil, Rainforest Action Network," Blog.htm (accessed 7 September 2011).

<sup>433</sup> HSBC has sold its shares in Sinar Mas due to Greenpeace campaign to Sinar Mas, see Zara Maung, "HSBC Pulls Investment from Sinar Mas after Greenpeace Protest", *The Guardian*, 9 July 2010, <http://www.theguardian.com/sustainable-business/hsbc-sinar-mas-greenpeace-protest> (accessed 7 September 2011).

<sup>434</sup> "Burger King Dumps Indonesian Palm Oil Company", *ABC News* 2 September 2010 <http://www.abc.net.au/news/2010-09-02/burger-king-dumps-indonesian-palm-oil-company/2246350>, (accessed 7 September 2011). Bill Di Benedetto, "HSBC Drops Indonesian Palm Oil After Illegal Deforestation Report", 13 July 2010 in <http://www.triplepundit.com/2010/07/hsbc-indonesia-palm-oil/> (accessed 7 September 2011).

<sup>435</sup> "SMART stands firm in its belief that the independent verification exercise clearly demonstrates the Claims Made by Greenpeace were exaggerated or wrong," *Press Release*, Jakarta, 19 August 2010, <http://www.smart-tbk.com/pdfs/Announcements/20100819%20-%20Press%20Release.pdf> (accessed 7 September 2011).

Greenpeace allegations.<sup>436</sup> However, according to the report, SMART breached this principle due to the overlapping national and local regulations.

The findings of the IVEX Report on the Greenpeace allegations about SMART demonstrated lack of evidence for allegations on planting on peat lands and deep peat, destroying primary forests and Orangutan habitat, and on destroying primary forests and Orangutan habitat. Planting on the peat lands and deep peat were found, but not as extensive as claimed in the Greenpeace Report. On destroying primary forests and Orangutan habitat, SMART was found not responsible because all the land in the eleven concessions investigated were not primary forests anymore before SMART began to clear the land for planting. On the use of burning methods to prepare and clear land, the IVEX investigation could not find evidence to support this allegation.

On Greenpeace allegations on two concessions in Ketapang District, West Kalimantan and six concessions in Central Kalimantan, it was proven that they did not have AMDAL prior approval for land clearance. Highlighting these findings, the Minister of Agriculture, Suswono, acknowledged that these eight companies have operated based only on *Izin Usaha Produksi* (or Production Operation Permit) while AMDAL or (Environmental Impact Statements) were in process.<sup>437</sup> Suswono admitted that two companies in the Ketapang District were allowed, by the Head of Ketapang District, for land clearing before AMDAL approval for all these companies in this district.

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<sup>436</sup> This criteria is part of the 8 principles and 39 criteria as a set of regulations to comply in producing sustainable palm oil which were accepted by the members. All of the 8 principles and criteria are as follows: commitment to transparency (2 criteria), enforcing laws and regulations (3 criteria), long-term commitment to expedient economic and financial situation (1 criteria), plantation and factories use the best and the accurate practices (8 criteria), responsibility to environment and conservation of national resources and biodiversity (11 criteria), responsible new plantation development (7 criteria) and commitment to continuing improvement in the most active areas, [http://www.rspo.org/sites/default/files/Indonesia%20NI%20of%20RSPO%20P&C\\_May2008.pdf](http://www.rspo.org/sites/default/files/Indonesia%20NI%20of%20RSPO%20P&C_May2008.pdf) (accessed 7 September 2011).

<sup>437</sup> See Diena Lestari, "Konflik SMART-Greenpeace Akibat Tumpang Tindih Peraturan," *Bisnis Indonesia*, 12 October 2010, [http://koran/bisnis/2010-10-12/bisnis\\_2010-10-12\\_142.pdf](http://koran/bisnis/2010-10-12/bisnis_2010-10-12_142.pdf) (accessed 7 September 2011).

only on the Production Operation Permit while AMDAL were in process.<sup>438</sup> Suswono admitted that two companies in the Ketapang District were allowed, by the Head of Ketapang District, West Kalimantan for land clearing before AMDAL approval for all these companies in his district.<sup>439</sup>

For the concessions in Ketapang District and West Kalimantan, SMART took advantage of the intervention of the Head of Ketapang, District, Morkes Effendi, who had allowed the company to clear land before the companies were assessed for their AMDAL.<sup>440</sup> As mentioned in the Greenpeace Report<sup>441</sup>, the Head of Ketapang attended the inauguration ceremony for clearance and land preparation in the area. Since the implementation of local autonomy in 1999, local government has been given more power to determine what can be done in their region including permits for land clearance and new plantations. Governors, heads of districts or *Badan Pengendalian Dampak Lingkungan Daerah* (Local Environmental Impact Management Agency, hereafter Bappedalda) constitute the legal authority for the provision of permits. In this case, there was a possibility for SMART to establish patrimonial relations with the Head of Ketapang District who was in the position for two terms (2001-2005 and 2005-2010) while expanding its palm oil plantations. Due to their symbiotic interests, the Head of Ketapang utilised his power to provide support to SMART.<sup>442</sup>

In Central Kalimantan, all concessions examined were found to have carried out land clearance before the AMDAL was approved. As stated in the IVEX Report, SMART explained they had interpreted the Ministry of Agriculture Regulation no 229/Kpts/KB.550/4/91 dated 25 April 1991 and 753/Kpts/KB.550/12/93 dated 6 December 1993, that a plantation company can develop the plantation before

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<sup>438</sup> *Ibid.*

<sup>439</sup> *Ibid.*

<sup>440</sup> See “Buka Lahan”, *Pontianak Post*, 13 September 2005, <http://arsip.pontianakpost.com/berita/index.asp?Berita=Ketapang&id=98352> (accessed on 2 August 2011); “BSI-CUC, Verifying Greenpeace Claims Case: PT SMART Tbk,” *A Report*, August 2010, point 3.3.

<sup>441</sup> Greenpeace, “Illegal Forest Clearance and RSPO Greenwash: Case Studies of Sinar Mas”, 5.

<sup>442</sup> In 2012, Morkes Effendi, the former Head of Ketapang District, West Kalimantan, was one of the heads of local government in Indonesia accused of corruption. However, the allegation was withdrawn because of insufficient evidence, see “Dugaan Korupsi Pejabat Tuntas”, *Pontianak Post*, 19 April 2012, [http://epaper.pontianakpost.com/document/5842\\_286057443/assets/basic-html/index.htmlu#1](http://epaper.pontianakpost.com/document/5842_286057443/assets/basic-html/index.htmlu#1) (accessed 23 December 2013).

AMDAL.<sup>443</sup> SMART also interpreted Ministry of Agriculture Regulation no 786/Kpts/KB.120/10/96 dated 22 October 1996, that a plantation company can develop the plantation simultaneously while AMDAL and Cultivation Rights Title (HGU) were being processed before the company obtained a permanent plantation permit.<sup>444</sup> In other words, SMART was able to benefit from the inconsistencies of policies and lack of coordination within government to pursue its own interests.

In conclusion, even though Greenpeace could not accept the fact that the result was assessed mostly on legal and Roundtable Sustainable Palm Oil (RSPO) code and criteria rather than addressing the moratorium, Greenpeace was able to scrutinise the actions and decisions of SMART and the Indonesian government. In fact, observing the process of restoring the purchasing contract to Nestle, it took almost two years before Nestle resumed its CPO purchases from SMART on 15 September 2011.<sup>445</sup> Further, the temporary discontinuity of the corporate consumers to purchase CPO from SMART showed the effectiveness of the Greenpeace campaigns against GAPKI.<sup>446</sup> However, these campaigns have not yet succeeded in limiting the expansion of SMART plantations or made the Indonesian government enforce a moratorium on SMART expansion activities. It would seem that international campaigns are able to embarrass and inflict short-term pain, but not change long-term processes.

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<sup>443</sup> BSI-CUC Verifying Greenpeace Claims Case: PT SMART Tbk., 8.

<sup>444</sup> *Ibid.*

<sup>445</sup> The process involved many stakeholders, such as RSPO, international NGO (the Forest of Trust), international auditor (TUV Rheinland Group), in addition to Golden-Agri-Resources (PT SMART's parent company) and PT SMART Tbk. They developed a joint action plan with the Forest of Trust in late 2010, and together with Nestle, announced Responsible Sourcing Guidelines (RSG), a set of critical requirements to guide the Nestle procurement process and to ensure compliance with the Nestle Supplier Code. TFT then assessed the plantations supplying Nestle to ensure they met the RSG requirements. For quality supply chain control, Nestle appointed an international auditing agency, TUV Rheinland Group, to ensure the delivered palm oil was fully traceable from the supply plantations, through processing and transportation to the Nestle factory in Indonesia, "Unilever Returns to SMART," <http://www.smart-tbk.com/pdfs/Announcements/20111017%20-%20Press%20Release%20-%20Unilever%20Returns%20to%20SMART.pdf> (accessed 10 January 2012).

<sup>446</sup> Femi Adi Soempemo, "Greenpeace: Verifikasi SMART Benarkan Temuan Greenpeace," <http://industri.kontan.co.id/news/greenpeace-verifikasi-smart-benarkan-temuan-greenpeace-1/2010/08/10> (accessed 8 September 2011).

### 3. Biofuels dilemma

The European Union Renewable Energy Directive 2009/28/EC on the Promotion of the Use of Energy from Renewable Sources (hereafter EU RED), adopted on 23 April 2009, was an ambitious plan to increase the share of renewable energy in the EU energy consumption to 20 per cent by 2020.<sup>447</sup> The EU RED requires two criteria: greenhouse gas (GHG) emission savings rate threshold of renewable sources at 35 per cent and land use requirements for the sources must not be planted on land with high carbon content.<sup>448</sup> The promotion of the EU RED and its criteria sought to protect the environment. However, as will be discussed in this subsection, the high demand for biofuel to meet EU targets conflicted with the objective to prevent the environmental destruction of tropical forests, due to the expansion of palm oil plantations in Indonesia and Malaysia. Further, the high demand for biofuel to meet EU targets conflicted with the long-term NGO campaign to prevent deforestation. This in fact reduced the effectiveness of NGO campaigns against the Indonesian government and palm oil producers.

The ambitious plan of the EU RED not only demonstrates an increased share in renewable energy from EU energy consumption to 20 per cent by 2020, but also an increase in 10 percent for renewable energy in transport alone.<sup>449</sup> The EU RED was in force on 25 June 2009 with a mandate for implementation by EU member states by 5 December 2010.<sup>450</sup> Renewable energy can come from a variety of sources, but for transport the main source is biofuel.<sup>451</sup> Therefore, the goal set by the EU RED has initiated a significant increase in the consumption of biofuel in the EU and EU demand for palm oil biofuels from Indonesia and Malaysia.

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<sup>447</sup> Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the Promotion of the Use of Energy from Renewable Sources and Amending and Subsequently Repealing Directives 2001/77/EC and 2003/30/EC, articles 15 and 16.

<sup>448</sup> *Ibid*, article 17.

<sup>449</sup> Andreas Lendle and Malorie Schaus, "Sustainability Criteria in the EU Renewable Energy Directive: Consistent with WTO Rules?" in International Centre for Trade and Sustainable Development Information, no. 2 (September 2010).

<sup>450</sup> *Ibid*.

<sup>451</sup> *Ibid*.

As shown in Figure 6.1, the increase in the export of Crude Palm Oil (CPO) and its derivatives began in 2000. From 2000 to 2010, export increased exponentially to 308 per cent. Since then, export growth has continued to rise with an average annual growth of 15.4 per cent.

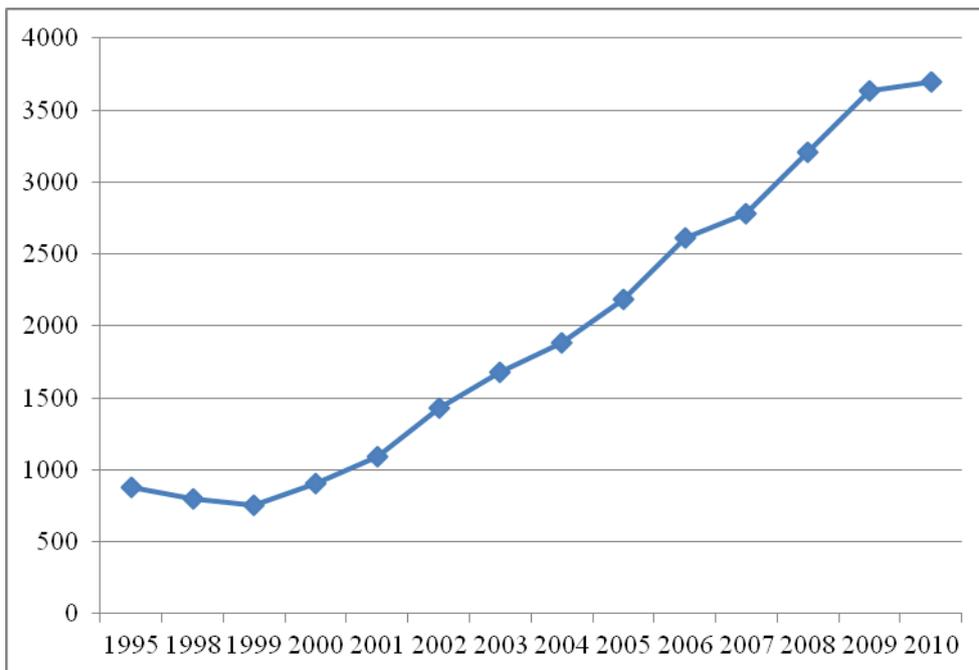


Figure 6. 1: Export CPO and its derivatives to European Union (in thousand tonnes)

Source: From 1995-2002: see [http://www.foe.co.uk/sites/default/files/downloads/greasy\\_palms\\_buyers.pdf](http://www.foe.co.uk/sites/default/files/downloads/greasy_palms_buyers.pdf) From 2003-2009: Dirjen Bina Produksi perkebunan Departemen Pertanian 2010: 2010: GAPKI: Ekspor CPO 2010 capai 15,6 juta ton, see: <http://economy.com/read/2011/01/25/320/4177/large>

As can be seen in Figure 6.2 below, the significant increase in biofuel export from Indonesia to meet the EU mandate occurred in 2011 and 2012 respectively (Indonesian total biofuel production plus export in general plus export to the EU).

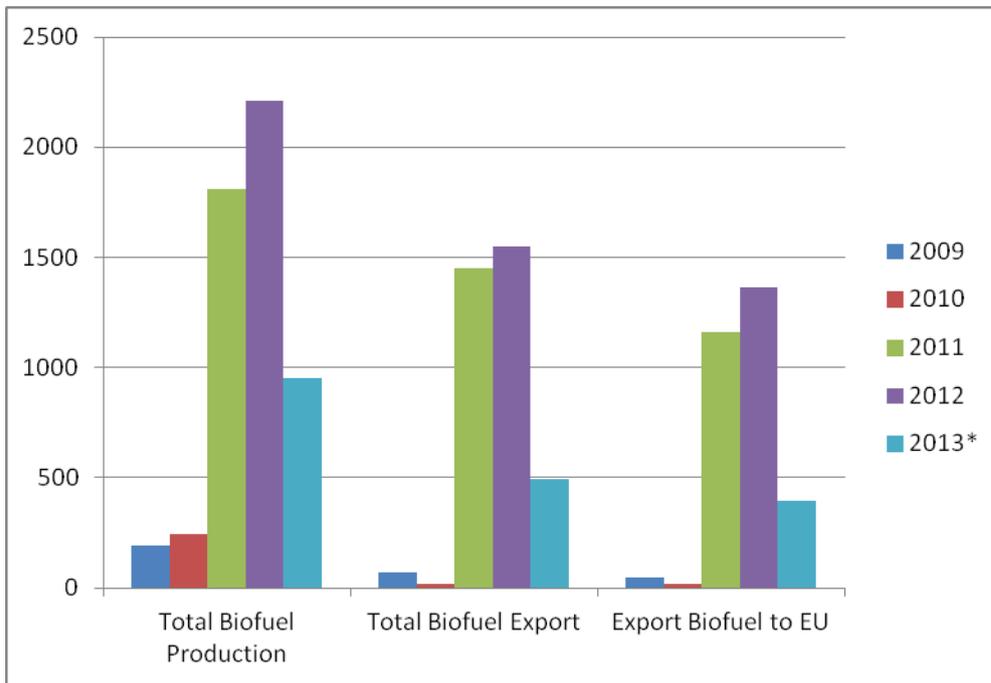


Figure 6. 2: Indonesian biofuel production and export from Indonesia to the EU, 2009-2013 (in kilolitres)

Source: Dadan Kusdiana, Director of Bioenergy, Ministry of Energy and Mineral Resources, “Existing and new Bio Energy Policies Needed and Implementation Target (paper presented at Indonesia EBTKE Conference and Exhibition, Jakarta, 22 August 2013), 11 <http://energy-indonesia.com/03dge/0130905bio.pdf>

\*Data until August 2013

Indonesian CPO export to EU counted for 20 percent to 30 percent, with the Netherlands and Germany becoming the biggest importers of CPO.<sup>452</sup> India is the biggest market for Indonesian CPO, followed by the EU and the People’s Republic of China.<sup>453</sup>

Figure 6.2 shows that a significant increase in total biofuel production occurred in 2011 and 2012, reaching 1,821 kilolitres and 2,211 kilolitres respectively. Out of the total production, the total export was also increased from 20,000 kilolitres in 2010 to 1,453,000 kilolitres in 2011. The increasing trend was also seen in 2012 where the total

<sup>452</sup> Dewan Minyak Sawit Indonesia, *Industri dan Perdagangan Minyak Sawit Indonesia* (Jakarta: without year), 54-55.

<sup>453</sup> *Ibid.*

export reached 1,552,000 kilolitres. The export to EU remained constant at the level of 80 per cent of the total biofuel exports since 2009.<sup>454</sup> However, the volume of export increased exponentially from 16,000 kilolitres in 2010 to 1,162,000 kilolitres in 2011 to 1,365,000 kilo litres in 2012. According to the European Biodiesel Board, out of the total EU biofuel imports, Indonesian biofuel to the EU has increased from 9 percent in 2008 to 21 percent in 2010<sup>455</sup> with a sharp rise to 39 per cent of total European biofuel imports in 2011.<sup>456</sup>

The steady increase in CPO and derivatives exports to the EU and the significant increase in biofuel export from Indonesia to the EU show that both EU RED and NGOs' campaigns to protect the environment have become less effective. Due to the high demand for biofuel, EU restrictions to meet 35 percent GHG emissions fully applied in 23 April 2013. From 25 June 2009 to 23 April 2013, it was a 'grace' period for palm oil installations in operation before 23 January 2008. This period was an opportunity for Indonesian biofuel producers to increase exports because many of their installations were in operation before 23 January 2008. Moreover, the mandated usage of biofuel has still required the EU to import from other countries such as Indonesia. Even though the EU is known as the largest rapeseed biofuel producer in the world, the high demand for biofuel cannot be met by domestic production.

The EU demand for biofuel has overturned NGOs campaigns against Indonesian conglomerates over time, as palm oil producers. It is evident that the NGOs disagree with the fact that the implementation of the biofuel mandatory policy has impeded the

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<sup>454</sup> USDA Foreign Agricultural Service, "Indonesia Biofuels Annual 2010", *Global Agricultural Information Network (GAIN) Report*, no. ID 1033 (20 December 2010); USDA Foreign Agricultural Service, "Indonesia Biofuels Annual 2013," *Global Agricultural Information Network (GAIN) Report*, no.ID 1337 (7 January 2013).

<sup>455</sup> EBB Press Release 2010-2-11: EU biodiesel industry production forecasts show first decrease in 2011 since data is gathered, Bruxelles, 18 October 2011.

<sup>456</sup> USDA Foreign Agricultural Service, "Indonesia Biofuels Annual 2012", *Global Agricultural Information Network (GAIN) Report*, no. ID 1222 (14 August 2012); USDA Foreign Agricultural Service, "Indonesia Biofuels Annual 2013," *Global Agricultural Information Network (GAIN) Report*, no.ID 1337 (7 January 2013).

import of palm-oil based biofuel from Indonesia to the EU; instead, it has allowed further expansion of Indonesian palm oil plantations.<sup>457</sup>

Significantly, the Indonesian government policy to export palm-oil based biofuel to the EU occurred after the government implemented the National Energy Policy in 2006.

The policy targeted a biofuel mixture of 2 percent for national energy consumption, especially for transportation, industries and electricity power plants by 2010 and increasing to 5 per cent by 2025.<sup>458</sup> This ambitious program in terms of scale, stakeholders and targets has its initial objective to meet the national needs in reducing fossil fuel and converting to renewable energy. Further, the government plans to impose an obligation that biofuel companies (twenty-two companies existed at the outset) have their own palm oil plantations in order to supply the biofuel industry. To meet the projected targets for palm oil for blending biofuel, the government targeted approximately 1.5 million hectares by 2010 and 4 million hectares by 2025.<sup>459</sup> Since only 80 per cent of the total plantation area is located in Sumatera, other large plantation areas are allocated in Kalimantan, Sulawesi and Papua.<sup>460</sup> The plan for furthering palm oil expansion has proved the NGOs' campaigns to be mostly ineffective.

Unfortunately, the implementation of this ambitious program did not proceed on target.<sup>461</sup> In addition to the lack of coordination and inconsistency of regulations, business began to face increasing serious problems when the global CPO price significantly increased from May 2007 to August 2008.<sup>462</sup> This price rise made biofuel too costly to produce, given only 6 per cent of total CPO produced is used in the biofuel

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<sup>457</sup> Friends of the Earth, LifeMosaic and Sawit Watch, "Losing Ground: the Human Rights Impact of Palm Oil Plantation Expansion in Indonesia," *A Report*, February 2008.

<sup>458</sup> Wisnu Caroko W, et al, "Policy and institutional framework for the development of palm-oil-based biodiesel in Indonesia," *Working Paper* no. 62 (Bogor: CIFOR, 2011): 1-30. <http://www.cifor.org/online-library/browse/view-publication/publication/3660.html> (accessed 29 November 2013)

<sup>459</sup> Caroko et.al, *ibid*, Tables no 3, 4 and 5.

<sup>460</sup> *Ibid.*; The Bisnis Watch Indonesia, "Biofuel Industry in Indonesia," 16, <http://www.fair-biz.org/admin-bwi/file/publikasi/20070828100425.pdf> (accessed 29 November 2013).

<sup>461</sup> This issue will be discussed at greater length in Chapter 7.

<sup>462</sup> <http://www.indexmundi.com/commodities/?commodity=palm-oil> (accessed 5 January 2014).

industry.<sup>463</sup> However, when the international CPO price stabilised in September 2008, biofuel producers increased their CPO production. However, with low domestic biofuel uptake, biofuel producers took the opportunity to export to the EU and export has increased to 2013.

Biofuel companies that have exported to the EU are PT Indo Biofuels Energy (subsidiary of a British Company), PT Ciliandra Perkasa (Subsidiary of First Resources Group), PT Pelita Agung (Permata Hijau Group), Wilmar Group (PT Wilmar BioEnergi Indonesia), Sinar Mas Group (PT SMART), Raja Garuda Mas Group (PT Asian Agro Agung Jaya), Astra Group (PT Astra Agro Lestari), Bakrie Group (PT Bakrie Sumarekin), Duta Palma Group (PT. Darmex Agro), PT Sumi Asih, Eterindo Group which consisted of PT Eterindo and PT. Multi Kimia.

Apart from the ineffectiveness of the EU RED scheme and NGOs' campaigns, another aspect that contributed to the increase in Indonesian biofuel export was diplomacy by the government towards the EU which intensified from 2006 to 2011. This made business dependent on government as their EU representative. From 2006 to 2011, the Indonesian government took this approach with the EU to moderate differences, with both the implementation of 35 percent reduction of GHG emissions as the threshold and land use requirements with their EU counterparts.

The Indonesian government, represented by KMSI<sup>464</sup>, the Ministry of Agriculture, Ministry of Trade and Ministry of Industry utilised seminars, political lobbying and diplomacy with their EU counterparts instead of filing a complaint to the World Trade Organisation (WTO) as suggested by business. Their objectives were to negotiate the possibility of establishing a team with the EU to settle differences in applying the EU RED scheme to the Indonesian CPO and its derivatives including biofuels. In its capacity, KMSI organised seminars in Brussels, Amsterdam and London to promote Indonesian sustainable palm oil in 2006 and 2007.

One of the issues that emerged as a fundamental problem for biofuel export to the EU is that renewable resources (i.e. Indonesian CPO), must meet the above mentioned 35 per

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<sup>463</sup> 25.7 per cent is consumed as cooking oil and other edible fats, while 73 per cent of all CPO produced is exported, Caroko, *et al*, "Policy and institutional framework for the development of palm-oil-based biodiesel in Indonesia," 17.

<sup>464</sup> Interview Rosediana Soeharto in Jakarta, 25 June 2009.

cent minimal threshold for export. This percentage will increase to 50 per cent in 2017 and 60 per cent in 2018. Rosediana Soeharto, Executive Director of KMSI and a member of the Indonesian Minister of Agriculture delegation to the EU, argued that high percentage targets to reduce GHG emissions was set for political rather than scientific reasons.<sup>465</sup>

Business argued that the EU threshold was used as a technical trade barrier for palm oil products, including biofuels, from Indonesia. In fact, business interpreted this restriction as discriminatory and strongly suggested this point of view to both government and the WTO. Business became more convinced that this restriction violated WTO regulations after a long discussion on the legal aspects of the EU RED scheme among business representatives, and Indonesian and Malaysian governments. They found there was inconsistency between the EU RED scheme and WTO regulations, especially those that related to General Agreements on Tariffs and Trade as well as the Agreement on Technical and Trade Barriers.<sup>466</sup>

The Ministries of Agriculture, Trade and Industry organised seminars and workshops as well as political lobbying both in Europe and Indonesia. The political lobbying by the Indonesian Minister of Agriculture and his counterparts in Spain and France that took place in April 2011, demonstrated that the effort by the Indonesian government to convince Spain and France that progress towards sustainability in palm oil development in Indonesia was well advanced was successful.<sup>467</sup> Therefore, he urged his counterparts to reconsider the EU RED scheme regarding Indonesian biofuels. In May 2011, the Ministry of Trade and Ministry of Industry also organised the first EU-ASEAN Business Summit in Jakarta to discuss the possibility of establishing a team to settle differences between the EU and Indonesia (e.g. instruments and certification).

The political lobbying, to a certain extent, succeeded. The Indonesian government established a bilateral approach to non-rapeseed producing countries such as Italy, the

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<sup>465</sup> Interview Rosediana Soeharto.

<sup>466</sup> [http://agribisnis.deptan.go.id/disp\\_informasi/1/5/54/1884/pertemuan\\_the\\_13\\_th\\_sub\\_working.html](http://agribisnis.deptan.go.id/disp_informasi/1/5/54/1884/pertemuan_the_13_th_sub_working.html), (accessed 7 September 2011). As the two biggest producers of CPO in the world, Indonesia and Malaysia have concerns that the WTO revisits the EU RED scheme because it is discriminatory compared to other oil seeds' GHG.

<sup>467</sup> [http://agribisnis.deptan.go.id/disp\\_informasi/1/5/54/1232/spanyol\\_dan\\_perancis\\_mendukung.html](http://agribisnis.deptan.go.id/disp_informasi/1/5/54/1232/spanyol_dan_perancis_mendukung.html), (accessed 7 September 2011).

Netherlands and Spain, to gain export market access in these countries. More importantly, the Netherlands government, for example, offered assistance to Indonesia to understand the EU RED as well as to meet the criteria stipulated.<sup>468</sup> The Netherlands government has offered aid for capacity building program and pledged to support Indonesia by investing more than USD 40 million in renewable energy projects between 2010 and 2013.<sup>469</sup> The underlying implication is the partnership between both governments to support an Indonesian commitment towards “a total ban on the production of non-sustainable palm oil.”<sup>470</sup>

The Indonesia government also obtained funding assistance for addressing forest degradation from the government of Norway in April 2011.<sup>471</sup> A month after endorsing the agreement, the government decided to implement a two-year moratorium *Pemberian Izin Baru dan Penyempurnaan Tata Kelola Hutan Alam Primer dan Lahan Gambut* (or Postponement of granting new permits and improvement of the primary forests’ and peatland’ management”) regulated in Inpres (Presidential Instruction) no. 10/2011 on 19 May 2011. The moratorium has been continued for another two years, as regulated in Inpres 6/2013.<sup>472</sup>

Even though these diplomatic measures were relatively successful, increasing Indonesian biofuel exports continues to be the object of scrutiny by NGOs and

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<sup>468</sup> “Netherlands helped to promote Indonesia’s CPO Export”, see Jakarta Post, 5 March 2010, <http://www.thejakartapost.com/news/2010/03/05/netherlands-help-promote-indonesia039s-cpo-exports.html>

<sup>469</sup> Ibid.

<sup>470</sup> “Netherlands and Indonesia join hands for sustainable palm oil”, (Government of the Netherlands, 22 November 2013) <http://www.government.nl/ministries/bz/news/2013/11/22/netherlands-and-indonesia-join-hands-for-sustainable-palm-oil.html> (accessed 30 November 2013).

<sup>471</sup> “Kurangi Emisi Indonesia dapat Bantuan 1 Miliar dari Norwegia,” *Tempo*, 27 May 2010, see <http://www.tempo.co/read/news/2010/05/27/118250769/Kurangi-Emisi-Indonesia-Dapat-Bantuan-US-1-Miliar-dari-Norwegia> (accessed on 2 September 2011); WALHI Ragukan Komitmen Pemerintah, *BBC Indonesia*, 27 May 2010, [http://www.bbc.co.uk/indonesia/berita\\_indonesia/2010/05/100527\\_indowalhireaction.shtml?print=1](http://www.bbc.co.uk/indonesia/berita_indonesia/2010/05/100527_indowalhireaction.shtml?print=1) (accessed 2 September 2011).

<sup>472</sup>“ Penundaan Pemberian Izin Baru dan Penyempurnaan Tata Kelola Hutan Alam Primer dan Lahan Gambut,” (INPRES No 10/2011) and (INPRES no 6/2013). See also Nur R.Fajar, “Memperpanjang Moratorium Hutan, Memperpanjang Kehidupan”, *Antara*, 15 May 2013, <http://www.antaranews.com/berita/374828/memperpanjang-moratorium-hutan-memperpanjang-kehidupan>, (accessed 10 December 2013).

European biofuel producers. The notion that the export of Indonesian biofuel posed a threat to the European domestic market became more apparent when the EBB found evidence in 2012 that some Indonesian biofuel companies had the potential to trade biofuel at a dumping price to the EU market. Since 29 May 2013, some companies have faced dumping allegations for trading biofuel lower than international prices due to the different application of export tax system.<sup>473</sup> These allegations were proven correct in 26 November 2013. Indonesian biofuel is subject to imported tariffs between 1 per cent and 23.3 per cent. Some companies that had to pay anti-dumping duty were PT Ciliandra Perkasa (8.8 per cent), PT Musim Mas (18.3 per cent), PT Pelita Agung (16.8 per cent) and PT Wilmar (23.3 per cent).<sup>474</sup>

This event has escalated criticisms about imported Indonesian biofuel to the EU from industry represented by the European Biodiesel Board (EBB) and NGOs, but for different reasons. The EBB argued that the EU needed to terminate its biofuel import arrangement with Indonesia because the impact of the biofuel dumping price had the potential to ruin the European biofuel industry as well as compromise biofuel farmers because around 400,000 jobs would be lost.<sup>475</sup> This strong argument from the EBB reflected how EU biofuel producers prioritised to protect their industry and its agriculture products. More importantly, the EBB strongly supported the EU decision to implement the anti-dumping duty on imported Indonesian biofuel. This decision also showed that the EU was highly motivated in protecting its domestic market compared to its concerns about environment destruction and deforestation in Indonesia as a result of palm oil expansion.

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<sup>473</sup> “The EU Biodiesel Industry Welcomes the Publication of Definitive Anti-Dumping Measures against Unfair Biodiesel Exports from Indonesia and Argentina”, *EBB Press Release*, Brussels, 26 November 2013, see <http://www.ebb-eu.org/EBBpressreleases/EBB%20PR%20Regulation%20AD%20Ind%20Arg20131126.pdf> (accessed 2 December 2013); Jonathan Sterns, “Argentina, Indonesia Hit EU Tariffs,” *Bloomberg*, 19 November 2013, see <http://www.bloomberg.com/news/2013-11-19/argentina-indonesia-hit-with-eu-tariffs-on-biodiesel.html> (accessed 2 December 2013); “Pemerintah akan Ajukan `Dispute Settlement` Terkait Biofuel,” *Antara*, 27 November 2013, see <http://www.antaraneews.com/berita/407002/pemerintah-akan-ajukan-dispute-settlement-terkait-biofuel> (accessed 2 December 2013).

<sup>474</sup> “Pemerintah akan Ajukan `Dispute Settlement` Terkait Biofuel,” *Antara*, 27 November 2013.

<sup>475</sup> EBB Press Release, 26 November 2013.

The NGOs consisted of Indonesian NGOs represented by Sawit Watch and Walhi which collaborated with international NGOs such as “Friends of Earth”, for different reasons, supported by the EBB’s suggestion to the EU.<sup>476</sup> What concerned these NGOs was the usage of palm oil for biofuel. Their demand to the EU was to cease using palm oil as a renewable resource for biofuel. Even though the NGOs did not directly suggest to the EU to stop importing Indonesian biofuel, their intention was clear as Indonesia is one of the largest exporters of palm-oil based biofuel to the EU.

Indeed although the EU has strict requirements regarding renewable energy resources, this issue confirmed that environmental concerns were weighed down by EU protectionism policies for industry and the agricultural sector. This is the challenge for Indonesian biofuel producers and government, if they decide to maintain their export to the EU market. Certainly, the total volume of biofuel exports is expected to decline from 2014 onwards as Indonesian producers have to honour anti-dumping penalties.

In conclusion, the influence of global stakeholders has subjected state-business relations to increasing global scrutiny. However, the increase in biofuel export in response to the high demand, as mandatory for all members of the EU, appears to have made the restrictions plus the NGOs’ campaigns ineffective and this allows the relationship between government and business in Indonesia to strengthen, especially in providing land for palm oil plantations for Indonesian conglomerates to produce biofuel. Indeed, in the biofuel case, government and business are mutually dependent. It is true that business has not always supported the government’s argument or policies. For example, since the moratorium was implemented in May 2011, as a response to the NGOs’ campaigns, business has strongly disagreed with government policies. However, business also depended on diplomatic measures taken by the government to protect the industry from environmental issues.

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<sup>476</sup> Friends of the Earth, LifeMosaic and Sawit Watch, “Losing Ground”.

## **B. Electronics industry**

### **1. Factors that prevented patrimonial state-business relations from flourishing**

Initially Soeharto was not interested in choosing the electronics industry to expand patrimonial relationships with business players for two reasons. First, the electronics industry was developed by following global standards and regulations, which made it difficult for Soeharto to interfere. And second, there were not many conglomerates involved in this industry.

Thus the structure of the electronics industry was not conducive to state-business relations, even though the political system of the New Order was patrimonial. Actually, the New Order government established patrimonial relationships with business players when the Import Substitution Industrialisation (ISI) was in place (from the mid- 1970s to the mid-1980s). The government protected this industry from imports of Complete Built-in Unit (CBU) and Complete Knocked Down (CKD) consumer electronics products to encourage the industry to manufacture from spare parts and components. Furthermore, the government took control of both regulations and companies that existed during that period. Consequently, patronage from the government to business players in this industry did occur. However, due to the fact that this industry was still in the early stages of development, the New Order government did not see much profit being generated from patrimonial relationships.

The aim of the New Order in establishing a modern electronics industry was to increase its non-oil revenue when oil exports decreased abruptly from the mid-1980s. At that time, the structure of the industry began to develop after the government shifted to Export Oriented Industrialization (EOI). Most players were local companies that existed in their own right or through joint venture companies (i.e. local companies that established Sole Distributor Agents (SDA) with principal foreign companies). The MNCs did not exist until 1994 when deregulation policies peaked.

Some conglomerates were involved in this industry including the Maspion Group owned by Alim Markus<sup>477</sup> and PT Hartono Istana Technology owned by the Hartono

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<sup>477</sup> According to the 2011 Globe Asia 150 Rich List, Alim Markus, with USD 195 million, was the 97<sup>th</sup> richest person in Indonesia, see SK Zainuddin, "Going Behind the Numbers and Headlines", *Globe Asia*, June 2011, 44-50.

Family (Djarum Group).<sup>478</sup> Among the established conglomerates only the Humpuss Group was interested at that time in expanding into the electronics industry. It had a joint venture with NEC (a Japanese semiconductor company) for a short period only.

The Maspion Group had become a conglomerate by manufacturing home and electrical appliances with “Maspion” as its brand. From the electronics industry, Alim Markus expanded its business into areas such as banking and property. The other example is PT Hartono Istana Teknologi owned by the Djarum Group. Since 1975, it had produced white goods under “Polytron and Digitec” brands. However, this company, since its establishment, did not have a foreign principal company. The transfer of technology was obtained from Philips-MBLE Belgium.<sup>479</sup> The strength of these groups was their focus of interest and relative independence lie in manufacturing and trading electronic products.

Local companies with joint ventures with partners had established their connections in the Old Order including PT National Gobel (now PT Panasonic Gobel) and PT Galva. Before PT National Gobel entered into a joint venture with Matsuhita Corp. it had manufactured transistor radios as PT Tjawang Radio Mfg, owned by Thayeb Mohammad Gobel. Together with a state enterprise, PT RALIN, Thayeb’s company was appointed by Soekarno to manufacture black and white televisions in 1962 when the Asian Games was held in Indonesia.<sup>480</sup> Not long afterwards, Thayeb partnered with Matsushita Corp. Before he passed away, the local leadership was passed on to his son, Rachmat Gobel. During the deregulation period (1986-1999), Matsushita National Gobel<sup>481</sup> expanded both domestic and export consumer electronics products. There were

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<sup>478</sup> According to the 2011 Globe Asia 150 Rich List, Budi Hartono and Michael Hartono, with USD 11.5 billion, was the 2<sup>nd</sup> of the richest person in Indonesia, *ibid*.

<sup>479</sup> “Imperium Bisnis Keluarga Hartono,” <http://www.indonesiamedia.com/2011/04/20/imperium-bisnis-keluarga-hartono> (accessed 8 December 2011).

<sup>480</sup> Ramadhan Kartahadimadja, *Gobel: Pelopor Industri Elektronika Indonesia Dengan Falsafah Usaha Pohon Pisang* (Jakarta: Pustaka Sinar Harapan, 1994).

<sup>481</sup>In 2004, the name changed to the Panasonic Gobel Group and its joint venture changed the name again to PT Panasonic Gobel Indonesia. The changing of names was in line with Matsushita global policy to change its global brand into “Panasonic” from 2003 while retaining the “National” brand for Japan, see <http://panasonic.net/> and Indoconsult. In January 2008, Matsushita Electric Industrial Co., Ltd. announced it would change its company name to 'Panasonic Corporation', effective as of October 1, 2008. The company unified its corporate brands to 'Panasonic' worldwide.

six other Multi National Corporations (MNCs) established to manufacture and export consumer and component electronics.

PT Galva Radio in Jakarta was first owned by Chinese entrepreneur, Uripto Widjaya, who established this company in 1946 with two other business partners. This company is another example which began as a transistor radio manufacturer before establishing a joint venture with TOA Corp, specialising in speakers and LCD monitor computers.

After the mid 1980s, the abrupt decline in international oil prices significantly affected Indonesian revenue. The New Order government was gradually opened up and in 1994 total foreign ownership could be obtained in all sectors of the industry including electronics. Under Government Regulation no 20/1994, world branded companies established their fully owned subsidiaries in Indonesia: they were PT Sharp Indonesia, PT SONY Electronics Indonesia, PT Samsung Electronics Indonesia and PT LG Indonesia. More importantly, this period also witnessed Toshiba Corp. make Indonesia its production base for colour televisions for the Southeast Asia market. These subsidiaries mostly manufactured consumer electronics. The milestone in component electronics was the establishment of two Cathode Ray Tubes (CRT) plants, a core component of television and computer monitors, under PT Tosummit Electronics Devices Indonesia (PT TEDI)<sup>482</sup> and PT LG Electronics Devices.<sup>483</sup>

## **2. Global stakeholders and state-business relations**

Following the 1997-8 economic crisis, global stakeholders in the electronics industry, represented by the MNCs and parent companies, were confronted with severe global competition; they pressured their subsidiaries and the Indonesian government to provide a supportive business environment or they threatened to relocate their companies.

In the Indonesian electronics industry, Japanese companies which dominated the industry along with South Korea, channeled their demands to the Indonesian

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<sup>482</sup> PT Tosummit Electronics Devices Indonesia (PT TEDI) was a joint venture between PT Tabung Gambar Indonesia (a consortium of four domestic-owned companies: PT National Gobel, PT Hartono Istana Teknologi, PT Panggung Electronics and PT Topjaya Antariksa), Toshiba Corp., Sumitomo and Orion Electric Co. Ltd (a South Korean company).

<sup>483</sup> For more detail on the expansion of MNCs during 1986-1994, see chapter four.

government through their subsidiaries to minimise the cost of production and provide incentives to upgrade technology, so their products manufactured in Indonesia could compete with other global players. Responding to these pressures, business players of subsidiaries of the MNCs and joint venture companies established mutual relationships with the Indonesian government. To a certain extent, they succeeded in influencing the government to respond to regulation pressures. Nevertheless, the significant decrease of foreign investment following the crisis indicated there were more serious systemic problems in the industry. Apart from inconsistencies that failed to implement new regulations; the old regulations had been responsible for establishing a weak industry.

The relations between business and government changed from cooptation during the ISI period to becoming more equal during the EOI period. These changes in relations, however, could not establish policies to develop a supportive industry that included strong component electronics. Since 1985, the industry was expected to compensate for the revenue lost from the abrupt decline of oil exports instead of developing a strong national electronics industry. Even though there were several lengthy discussions between business players, including MNCs' subsidiaries and joint venture companies and government to establish a strong national electronics industry, the government declined because it preferred to attract foreign investment in consumer electronics so electronics products could be exported. It was also part of the government strategy to take advantage of cheap and plentiful Indonesian labour.

In relation to establishing a strong national electronics industry, business and government continued to have different views. In 1986, for example, the government was strongly criticised by business because it had requested two American semiconductor companies – Fairchild and National – to cease production because it did not agree with these companies' decisions to use automation, replacing labour in assembly lines. Even though the government at that time backed up its argument to defend the interests of labour over automation, business perceived this as a disadvantage. According to business, the government's decision to discontinue networks with world-class companies to assist in the expansion of component electronics structure damaged the global image of the Indonesian electronics industry.

Another business proposition for establishing a supportive industry opposed by government was to establish a components Industrial Park. In 1993 business players in the electronics industry had submitted a similar proposal to government: a one-stop industrial park would consist of small and medium size component electronics from Taiwan and Japan, which also offered facilities for export and import. Nevertheless, after lengthy ongoing discussions until 1996, the government refused to implement this proposal because, apparently, it conflicted with Soeharto's ambitious plan for the Nusantara-21 Superhighway, which was delayed due to the 1997-8 economic crisis.

The N-21 Superhighway was a technological master plan and a sophisticated strategy for the electronics industry entering the 21st century, which involved Information Technology (IT) and telecommunications (TE). It started with industrial corridors that would link Jakarta, Cikampek, Cipularang and Bandung. Bandung High-tech Valley (BHTV) would be developed as a Research and Development centre for IT and TE industries and transform Bandung into a multimedia city. Although the Superhighway did not go ahead due to the economic crisis, as mentioned above, some of the foundations for this ambitious plan were laid out and, apparently, benefitted the electronics industry. One benefit was the establishment of industrial corridors in Cilegon-Jakarta and Jakarta-Cikampek. These corridors were appropriate for electronic super sites because they were located in strategic areas (close to airports and seaports). And close to factories from local and foreign manufacturing companies including electronics companies. Soeharto instructed the Lippo Group, Manunggal Group, Sinar Mas Group, Sudwikatmono Group and Salim Group to establish their manufacturing companies in these industrial corridors and the government would fund their development.

As the electronics industry has not developed a strong support industry, Japanese Multi National Corporations (MNCs) perceived their business in Indonesia as significant for trading high-tech but not for manufacturing high-tech products. Japan also changed its strategy to become competitive globally, which has jeopardised the existence of foreign investment in Indonesia.

To compete globally, Japanese MNCs have decreased Foreign Direct Investment (FDI) in Southeast Asia and invested more in Northeast Asia, particularly Hong Kong and

China, because these two countries have developed a sophisticated world-class sites supplier for the global electronics industry. For Southeast Asia, Japan adopted two new strategies to obtain more profit, improve quality and reduce costs: economic block strategy and outsourcing through subcontracting strategy. The first strategy manifested in integrating ASEAN and China as an economic block in production networks in their finished and component products assembly, while maintaining a substantial amount of investment to upgrade facilities such as Research and Development which requires high-technology. This strategy has benefitted ASEAN-5 (Association of South East Asian Nations) countries, such as Malaysia and Singapore, which already had the infrastructure capability.<sup>484</sup> The second strategy, outsourcing through subcontracting, was adopted by Japanese MNCs to target an ultimate profit by outsourcing from global suppliers.<sup>485</sup> These global suppliers were chosen based on their capabilities to provide new global sourcing requirements of lead firms in order to reduce costs. Following the 1997-8 economic crisis, Japanese MNCs have shifted their component electronics production lines from Indonesia to Singapore and Malaysia.

In addition to global competition, which needs to be responded to by government policy in the electronics industry, changes in the Indonesian political system due to the *Reformasi* movement gave more freedom to civil society to express their interests. In 1999, when Habibie was in power, the electronics industry was challenged by labour movements due to regulation in outsourcing workers introduced by his administration. This regulation was amended by Abdurrahman Wahid, which imposed more burdens on business players, especially foreign investors.

The closure of PT Sony Electronics Indonesia (SEI) in March 2003 is a good example to describe the complexity of the situation.<sup>486</sup> For efficiency in Southeast Asia, SEI restructured its operational plants due to labour disputes and transferred its product lines to Malaysia. As a result around 1,000 workers were laid off. According to some

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<sup>484</sup> Tomo Kinoshita, "Strategies of Japanese manufacturers in ASEAN and China in the light of emerging FTA Initiatives" (Nomura Securities, November 2004), 1-53, [www.tcf.or.jp/data/20041108-09\\_Tomo\\_Kinoshita.pdf](http://www.tcf.or.jp/data/20041108-09_Tomo_Kinoshita.pdf) (accessed 7 December 2005).

<sup>485</sup> *Ibid.*

<sup>486</sup> "Sony akhirnya hengkang dari Indonesia," *Suara Merdeka*, 4 June 2003, <http://www.suaramerdeka.com/harian/0306/04/nas8.htm> (accessed 7 December 2005).

business players, such as Uripto Widjaja and Adhi Sukmono,<sup>487</sup> restructuring for efficiency was only part of the reason for SONY to close its manufacturing subsidiary in Indonesia. PT SEI had been engaged in prolonged conflict with its workers (due to amended regulation) which had cost the company millions of dollars.<sup>488</sup> In other words, cheap labour which added value to this industry did not exist anymore, partly due to openness of the political system.

The decrease in levels of competitiveness in the Indonesian domestic market had also become a concern for global stakeholders. This situation was exacerbated by both the implementation of ASEAN Free Trade Area (AFTA) in January 2002, followed by China-ASEAN Free Trade Agreement (CAFTA) eight years later in January 2010.<sup>489</sup> In these free trade zones, all countries involved were required to remove tariffs and non-tariffs for member countries. Both AFTA and CAFTA aimed to increase competition among the countries involved. For the Indonesian electronics industry, one of the consequences of the implementation of AFTA and CAFTA is that the domestic market has been flooded with imported manufactured electronics products. And unfortunately, not all of these products are legal. This situation occurred because the Indonesian government has not fully applied the compulsory Standar Nasional Indonesia (SNI) to domestic and imported manufactured products.

In responding to global stakeholders' concerns, business players, through *Gabungan Pengusaha Elektronika* (Indonesia Electronics Producers Association, hereafter GABEL), asked the government to implement the compulsory Standar Nasional Indonesia (the Indonesian National Standard, hereafter SNI)<sup>490</sup> from the time the crisis

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<sup>487</sup> Interview Uripto Widjaja in Jakarta, 28 August 2003. Interview Adhi Sukmono, General Secretary of GABEL in Jakarta, 13 August 2003.

<sup>488</sup> Due to the labor disagreement, Sony was forced to reduce its product lines from 12 to two, causing the giant million dollars of losses and resulted in almost a thousand of workers being laid off, see The Jakarta Post, 2002.

<sup>489</sup> Genap SNI, [http://www.bsn.go.id/files/1704711/genapsnibuku/BAB\\_1.pdf](http://www.bsn.go.id/files/1704711/genapsnibuku/BAB_1.pdf), retrieved 29 September 2011.

<sup>490</sup> This standard is one of the measures applied to advanced countries. The SNI is a technical specification and criteria need to be applied consistently in the classification of materials, in the manufacture and supply of products, in testing and analysis and provision of services. This standard is a consensus determined by stakeholders based on product safety, security, and moral hazard when they are used by human beings and their effects on the environment. The main objective of the standard is to control the quality of manufactured or imported products. More importantly, the SNI is meant to protect

occurred. According to Ali Subroto, the government has not given an appropriate response to the issue of SNI.<sup>491</sup> And, as mentioned above, as a result, the domestic market has been inundated with low quality imported products, illegal products in the form of black market products, parallel import products and low quality products. For the MNCs and joint ventures which trade 20 per cent of their consumer electronics products in the domestic market, the market is perceived as not profitable because of competition with black market products and low quality products.

Data from GABEL showed that from 1998 to 1999 approximately 50 per cent to 70 per cent illegal products were traded in the local market.<sup>492</sup> Ten years later, in 2010, the value of illegal imports was USD10.43 billion out of USD19.73 billion, the total value of imported products.<sup>493</sup> In other words, comparing percentages of illegal imports (52.86 per cent) to legal imports (47.14 per cent), the former is higher and most illegal products were imported from China.

In conclusion, global stakeholders represented by the MNCs and parent companies, have pressured their subsidiaries and the Indonesian government to provide a supportive business environment, or they would have no alternative but to relocate their companies to other countries. As discussed in this section, subsidiaries of the MNCs and joint venture companies have entered into discussions with government to increase investments for components and spare parts. This is in order to strengthen the industry, to combat illegal products, and to provide a non-technical barrier (i.e. SNI) to protect the domestic market. To increase global competitiveness in the free trade area, foreign investment in Indonesia has been decreasing. This situation relates to the fact that the

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consumers and producers in order to establish fair and competitive trade. To export or import products, the standards determined by the destination country must be met. With global trade, advanced countries have adopted the International Organisation for Standardisation (ISO)/the International Electrotechnical Commission (IEC). This standard has also been adopted by the WTO.

<sup>491</sup> “Menghadang Impor dengan standarisasi”, see [http://republika.co.id:8080/koran/126/110937/Menghadang Impor dengan Standarisasi](http://republika.co.id:8080/koran/126/110937/Menghadang_Impor_dengan_Standarisasi) (accessed 29 September 2011). Among the products traded in the domestic market to 2010, only 78 products applied compulsory SNI. Consumer electronic products to 2010 have applied the compulsory SNI including water pumps, irons, audio videos, televisions, washing machines, refrigerators air-conditioners. A good example of compulsory SNI application was batteries.

<sup>492</sup> Interview with Ali Subroto, Director of GABEL in Surabaya, East Java, 30 September 2003.

<sup>493</sup> “Kemendag amankan Produk Elektronika Ilegal,” *Okezone* 27 April 2010, <http://news.okezone.com/read/2010/04/27/320/326593/kemendag-amankan-produk-elektronika-ilegal> (accessed 29 September 2011).

Indonesian electronics industry has emerged as relatively costly for the manufacturing of low technology products, due to high labour costs, however, the industry is not well-equipped with high-tech infrastructure to manufacture advanced digital technology products. More importantly, because of the mobility of this industry, the government appears not to have provided incentives for manufacturing, but instead provided incentives for trading.

### **C. Conclusion**

Global context in the palm oil and electronics industries has been increasingly important, even though it has affected these two industries differently. While there are several Malaysian companies, national conglomerates, some were Soeharto's cronies and these companies were mostly involved in the palm oil industry. This situation departs from what occurs in the electronics industry. Even though conglomerates are involved, they were not Soeharto's cronies. Most importantly, their existence as business players are more dependent to their parents' companies compared to the government. According to Robison and Hadiz, "globalisation could have a powerful force to make the transformation in the constellation of power in the Indonesian political economy."<sup>494</sup> In other words, the internal political constellation determines whether the oligarchy follows globalised norms or vice versa.

Globalised norms in the form of international standards and regulations determined by the Roundtable of Sustainable Palm Oil (RSPO) and the European Union's RED restrictions are the foundations for NGO campaigns to pressure GAPKI and government to comply with global sustainable criteria. From the discussion in this chapter, on the one hand, NGO campaigns and sustainable criteria succeeded in scrutinising and boycotting specific conglomerates, such as PT SMART Tbk, and caused the global chain of MNCs and retailers, which used Indonesian CPO, to temporarily withdraw their contracts to procure Indonesian CPO and its derivatives.

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<sup>494</sup> Robison and Hadiz, *Reorganising Power in Indonesia; the Politics of Oligarchy in an Age of Markets* (London and New York: Routledge Curzon, 2004), 34.

On the other hand, it seemed that local and global NGOs have provided some new scrutiny, but they have limited effectiveness compared with increased EU and other international demands for CPO and biofuel. Especially in meeting the high demand of biofuel as the consequence of EU mandatory policy, the ineffectiveness of the NGOs' campaigns has revealed the difference in interests between the EU and NGOs in terms of protecting Indonesian forests from palm oil expansion. In other words, biofuel production has been stimulated by EU targets for biofuel use, which seems to be a more important influence than EU regulations to protect tropical forests.

However, the increase in CPO and biofuel exports to meet the high demand in the EU market has served to undermine the effectiveness of the EU restrictions and the NGOs' campaigns. The increase in EU demand has also strengthened the relationship between government and business facilitating the provision of land for the further expansion of palm oil plantations to meet this demand. For example, in Greenpeace's campaign against Sinar Mas and other biofuel producers the government defended the companies and provided diplomatic support. However, there were issues where the oil palm industry did not support the government's policies and regulations, as in the case of the moratorium on the expansion of plantations announced in May 2011 and instigated as a response to the NGOs' campaigns. The strong and cooperative relations between the government and the palm oil companies are reflected in the inconsistencies of government policies. New plantations permits continued to be issued, the government's moratorium notwithstanding.

In the electronics industry, global stakeholders' influence on state- business relations is different from that of the palm oil industry. Following the 1997-8 economic crisis, these stakeholders represented by the MNCs and parent companies have pushed business in this industry to be transparent and law based. Global stakeholders have also pushed their subsidiaries to influence the Indonesian government to provide a supportive investment climate in order to reach profitability and sustain their businesses in Indonesia. They have perceived their business in Indonesia as not profitable, partly because of the democratic system has enabled labours to challenge companies and because the government has not provided consistent policies to: support an investment climate, provide adequate infrastructure, shorten the length of time it takes to obtain permits and minimise labour costs. Therefore, they perceived Indonesia as significant

for manufacturing low technology products but not significant for trading high-tech products.

Finally, to a certain extent, the discussion in this chapter has confirmed Robison and Hadiz's argument that globalisation pressures conglomerates to follow globalised norms. However, this argument is limited in explaining more complex and evolving state-business relations. At the national level, it would seem that conglomerates and government are mutually dependent, as required, to deal with global campaigns and restrictions. At the local level, the intertwining process of globalisation and democratisation revealed the new pattern of patrimonial relationships between conglomerates and local government to sustain their palm oil plantations. Further, what occurred in state-business relations in the electronics industry demonstrated a more direct influence of globalisation which pushed the government towards implementing all regulations necessary to keep the MNCs manufacturing in Indonesia.

## Chapter 7

### Business Associations and their Impact on Patrimonial State-Business Relations

The previous chapter discussed the influence of global stakeholders on patrimonial state-business relations in the palm oil and electronics industries. This chapter discusses the impact of business associations with regard to patrimonial state-business relations in these industries.

MacIntyre and Hamilton-Hart's research on the role of business associations in the New Order demonstrated the increasing role of business associations in the policy making process.<sup>495</sup> However, the nature of the sector affects the varying capabilities of business associations and complexities in the sectors they represent.<sup>496</sup> There are two types of business associations discussed in this chapter: (1) Indonesian Chamber of Trade and Industry or KADIN as the peak national business association, and (2) business associations in the palm oil and electronics industries.

Among these associations, I argue that business associations in the palm oil industry, dominated by conglomerates, maintain patrimonial relationships between government and business, but they are different with regard to power relations. In contrast, business associations in the electronics industry have pushed toward more transparent and accountable state-business relations. Meanwhile, KADIN has the potential to lessen patrimonial relationships as evidenced in its transformation towards an autonomous and transparent business organisation.

This chapter is divided into four sections. The first section discusses the transformation of KADIN into a transparent and independent business association in different eras (Soeharto, New Order and *Reformasi*). The second section discusses the policy

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<sup>495</sup> Andrew MacIntyre, *Business and Politics in Indonesia*, (Sydney: Asian Studies Association of Australia with Allen & Unwin, 1991); *Business and Politics in Indonesia* "Government and Private Business: Rents, Representation and Collective Action," in *Indonesia: Democracy and the Promise of Good Governance*, ed. Ross H. McLeod and Andrew MacIntyre (Singapore: Institute of Southeast Asian Studies, 2007), 93-114.

<sup>496</sup> MacIntyre, *Business and Politics in Indonesia*.

influence of business associations' lobbying efforts in the palm oil industry and their impact on state-business relations. The third section discusses the long and intensive lobbying of business associations in the electronics industry and their impact on state-business relations with regard to technology levels and power relations. The fourth section concludes the chapter.

## **A. KADIN as the peak business association: transformation into a transparent and independent business association**

### **1. KADIN under Soeharto's patronage**

Historically, the establishment of business associations in Indonesia has been related closely with politics. In the colonial period, one of the examples was the establishment of *Serikat Dagang Indonesia* (the Indonesian Trade Union). During the Parliamentary Democracy, the establishment of business organisations reflected political affiliations or *politik aliran*; these were mass organisations of specific political parties, which reflected their political affiliation.

During Guided Democracy, the government took charge in establishing business organisations. The centralised political system generated no autonomous business organisations. Business organisations established *Badan Musyawarah Nasional* (the National Negotiation Agency or BAMUNAS), which was supposed to be the representative of business. However, according to Richard Robison, BAMUNAS was established to be a government fundraiser.<sup>497</sup>

The close relationships between business and politics continued when Soeharto was in power. The diversity of business players in the Indonesian business sector was reflected in their different interests. As the largest patron, Soeharto had his own interest in co-opting this diversity under his patronage. Business players and their organisations were co-opted by Soeharto.

Business players established KADIN in Jakarta before the national KADIN was established. On the initiative of Ali Sadikin, the Governor of Jakarta, in 1968, KADIN was expanded into a national peak business association with Soeharto's blessing. In

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<sup>497</sup> Richard Robison, *Indonesia: The Rise of Capital* (Sydney: Allen and Unwin, 1986).

other words, it functions as the umbrella organisation for all business associations existing in Indonesia.

KADIN's structural organisation comprises three strands: regional KADIN branches (KADIN Daerah hereafter KADINDA), aspirational or entrepreneurial groups such as Himpunan Pengusaha Muda Indonesia (or the Indonesian Young Entrepreneurs Association, hereafter HIPMI) and Himpunan Pengusaha Pribumi Indonesia HIPPI (*Indonesian Indigenous Entrepreneurs Association*, hereafter HIPPI), and sectoral and sub-sectoral industry associations. With government acknowledgement under the 1987 Law no. 1 on KADIN, the government instructed KADIN to expand its membership to include state enterprises, small and medium business players, individual business players and individual companies to become members of KADIN. Even though this expansion seemed out of context for business associations which represented the private sector in contrast with the public sector, substantially, the members of KADIN are entrepreneurs' associations and sectoral (and sub sectoral) industry associations.<sup>498</sup> These associations would later be called business associations.

As an interest group, the main goal in establishing KADIN is to represent business players' interests and to influence government policies which affect business. Unfortunately, since its establishment, this main goal was barely achieved because, as part of his corporatist strategy, Soeharto utilised KADIN to control the business sector and at the same time, give his loyalists the highest positions in KADIN, so they gained advantages over business players in KADIN.

One way Soeharto controlled the business sector through KADIN was to position his loyal military figures, senior bureaucrats and business cronies to obtain advantage over business players. In the first ten years (1968-1978), three military figures – Brigadir

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<sup>498</sup> Andrew MacIntyre, *Business and Politics in Indonesia*; A.I. J. Hartono, "State-Business Relations in Post-1998 Indonesia: The Role of Kadin," *PhD Thesis* (The University of Groningen, 2011).

General Usman Ismail, Brigadir General Sofyan and Air Marshall Suwoto Sukendar – were chairmen of KADIN. In the second decade, two business players – Hasyim Ning (1979-1982) and Sukamdani Gitosardjono (1982-1987) – presided over KADIN. Even though these two were business players, they identified with Soeharto as close business partners. Following the oil boom period, Soeharto instructed KADIN to expand its membership to include state-enterprise players. In 1988, Soeharto appointed Sotion Ardjanggi, a senior bureaucrat, to preside over KADIN (until 1993).

During the New Order, according to Hartono, chairman of KADIN, had to deal with the issue of credibility so that it could be accepted as an independent business association, by policy makers, Indonesian Chinese business players as well as among KADIN's own members.<sup>499</sup> The policy makers and ministers of Soeharto's government were reluctant to treat KADIN as a serious contributor to policy making, as they were aware that KADIN was a creation of the government and they did not necessarily represent the independent interests of its members.

Further, KADIN was also undermined by Indonesian Chinese conglomerates and they were not willing to join KADIN because they did not see the benefits for them. They preferred to maintain bilateral and direct relationships with Soeharto to gain concessions, contracts and other advantages.<sup>500</sup> They also viewed KADIN as an indigenous business association, which could not represent their interests.

In addition to external challenges, internally KADIN was also challenged by the rivalry between KADINDA and the sectoral industry associations, which forced KADIN's leaders to give less opportunity to the sectoral industry associations. This was particularly evident in the first decade of KADIN's operations (1968-1978), as vocal sectoral industry associations viewed KADIN as no longer their representative, but rather an arm of government. The sectoral industry associations demanded better representation from KADIN's leaders because they suspected these leaders did not

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<sup>499</sup> Hartono, "State-Business Relations in Post-1998 Indonesia: The Role of Kadin".

<sup>500</sup> MacIntyre, *Business and Politics in Indonesia*.

represent their interests as effectively as those of KADINDA, even though they had the same rights.<sup>501</sup>

The issue of obtaining credibility and professional acceptance turned out to be an internal problem in KADIN. The continuing conflicting membership between KADINDA and the sectoral industry associations forced KADIN's leaders to give less opportunity to the latter associations.

The hesitancy of KADIN's chairmen to support sectoral industry associations was partly caused by the intertwining relations between KADINDA and Golkar at the local level. Therefore, taking the stance to support KADINDA was a necessity. Further, among KADIN's leaders, they were not in favour of sectoral industry associations gaining too much influence in KADIN.

Instead of obtaining better representation in KADIN, sectoral industry associations were disadvantaged by the change of KADIN's statute which granted limited voting rights to sectoral industry associations. When Sortion Ardjanggi became the president of KADIN (1989-1993), he made radical changes to KADIN's statute. First, he changed the status of memberships of KADINDA from distinctive membership and sectoral industry associations to ordinary membership of KADIN. This was closely related to their ability to vote. By applying this change, he made it impossible for sectoral industry associations to influence KADIN's decision making with their votes, because only the distinctive members had influence. Further, the sectoral industry association was given more limited voting rights where "the number of votes by business associations could not exceed 20 per cent of the number of votes by the KADINDA".<sup>502</sup> The limited vote also reflected the efforts from KADIN's leaders to close down the possibility of influence from sectoral industry associations in the election of the chairman or executive directors. Even though the business associations opposed this decision, the limiting of their influence within KADIN was the outcome.

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<sup>501</sup> Hartono, "State-Business Relations in Post-1998 Indonesia: The Role of Kadin."

<sup>502</sup> *Ibid*, 74.

## 2. KADIN under Aburizal Bakrie's leadership during the New Order era

The setting up of close patrimonial relationships between Soeharto and KADIN as the peak business association became less so when deregulation reached its peak in 1994. Even though Soeharto had his favoured candidate to be the successor of Sotion Ardjanggi, the election was won by Aburizal Bakrie. He was a successful, indigenous business player, who came from one of the entrepreneurs' associations, which MacIntyre called the 'aspiration group', named HIPMI. Bakrie, who led KADIN as president from 1994 to 1999 and from 1999 to 2004, demonstrated the success of the private sector faction. But in general, Bakrie's victory was perceived as dominance by the private sector faction as opposed to other factions such as the state enterprises. For Soeharto, Bakrie's victory (not one of his closest business partners), demonstrated a sort of "private sector rebellion", thus Bakrie did not receive Soeharto's full blessing.<sup>503</sup>

The first period of Bakrie's leadership coincided with the time when Soeharto's patrimonial New Order regime interacted more openly with the global economy. The government's continuing policies of deregulation, privatisation and de-bureaucratisation from the 1990s increased the role of the private sector. The dynamics of the Indonesian economy became more complex with the implementation of a foreign investment policy. Therefore, there were high expectations that Bakrie, as the new president of KADIN, could strengthen KADIN's credibility and legitimacy to emerge as a professional, peak business association that would play a significant role in influencing government policies.

The election of Aburizal Bakrie as the fifth president of KADIN not only demonstrated the victory of the private sector faction (especially from the indigenous entrepreneur faction), but also his leadership created the possibility of a new direction for KADIN to

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<sup>503</sup> "Kami sungguh bahagia dengan kemenangan Bang Ical saat itu. Namun, sekaligus khawatir karena kepengurusan Kadin tidak mendapat dukungan Pak Harto. Bagaimana tidak, saat kamar datang menghadap ke Istana, Pak Harto hanya mengangguk-angguk dan salaman. Bahkan, Pak Harto tak bersedia berfoto bersama kami, para pengurus Kadin yang baru" ("We were so grateful with Brother Ical's victory. However, we were worried because the new KADIN's committee did not have President Soeharto's blessing. When we made a formal visit to the President at the Palace, he only nodded and shook our hands but he was not willing to take picture [sic] with us as the new KADIN's committee") Dewi Motik Pramono, "Cerita Tak Terlupakan Saat Bang Ical Memimpin Kadin", <http://icalbakrie.com/?paged=16> (accessed 12 August 2011). Ical is Aburizal Bakrie's nickname. The word "Bang" can loosely be translated as "Bung". In the Indonesian culture, it is common to address an older person with that greeting, to show respect and familiarity.

become more transparent, not exclusively for indigenous business players, but also reaching out to business groups that were not involved in KADIN, especially Indonesian Chinese conglomerates as well as providing a greater role to sectoral industry associations in KADIN.

More importantly, Bakrie set a new pattern for business players who wanted to be involved in politics. He began his leadership in KADIN in 1994 when Soeharto was still in power. At that time, business players could not have a government position immediately unless the person was in a military or bureaucratic position. In contrast, business players could have an immediate position or career in government when the *Reformasi* regime was in place. Bakrie was one of the business players appointed as the Coordinating Economic Minister (then Coordinating Welfare Minister) in the first term of Susilo Bambang Yudhoyono's administration. With his ministerial appointment, Bakrie broke the previous pattern for being involved in party politics. However, the Golkar party supported Bakrie's appointment as a minister in Yudhoyono's administration.<sup>504</sup> In fact, this factor has become more significant in the *Reformasi* era, as competition between political parties differentiates the characteristic of this regime compared to Soeharto's regime. The support of political parties with representation in the national parliament became the basis of government; Golkar was one of a coalition of political parties that supported Susilo Bambang Yudhoyono.<sup>505</sup>

When Aburizal Bakrie began his tenure as KADIN's Chairman in 1994, his first challenge was to make KADIN a more open and professional business organisation to differentiate it from its previous characteristics as an exclusive business organisation dealing in patronage. This means that he had to reach out to business elements that were not involved in KADIN to increase its credibility. One of the first things Bakrie did was to incorporate many prominent business players to be seated on KADIN's executive board and advisory board. He accommodated business players from HIPMI (Adi Putra

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<sup>504</sup> In the first Susilo Bambang Yudhoyono government, the President established a new practice of businessmen assuming cabinet positions, with Aburizal Bakrie's appointment as Coordinating Minister of Economy (2004-2005) then as Coordinating Minister of Welfare (2005-2009). In 2009, he was elected as the Chairman of GOLKAR and was controversially re-elected in 2014.

<sup>505</sup> Jusuf Kalla, was another prominent businessman represented in the first SBY government in the position of Vice President. He was also a candidate for President in the 2009 election. He held no position in KADIN.

Taher) and HIPPI (Iman Taufik) as deputy chairmen on the executive board. HIPMI and HIPPI were two entrepreneur associations that strongly supported Bakrie. In addition, he also involved business players successful in their areas, such as Mooryati Soedibjo, to become head of the department.<sup>506</sup>

His efforts to make KADIN more representative were through the involvement of Indonesian Chinese conglomerates. Even though they did not become members of the executive board, Bakrie appointed them to KADIN's advisory board. One of them was Liem Soe Liong who was appointed as a member of the *Dewan Pembina Kadin*, an advisory council to the board of executives of KADIN on economic matters. Other Indonesian Chinese business players, such as Prayogo Pangestu (Barito Pacific group), The Ning King (Daya Manunggal group) and Syamsul Nursalim (Gajah Tunggal group), also held advisory positions. James Riady (son of Muchtar Riady, head of the Lippo Group) became involved in KADIN as a member of the Committee of Investment, which is also an advisory council to the board of executives.<sup>507</sup> Many other individuals assisted KADIN financially, even though they did not hold formal positions.

Involving sectoral industry associations in the department sections under the responsibility of deputy chairman was the other strategy employed by Aburizal Bakrie to make KADIN more credible and for its voice to be heard. Even though he took the risk of dealing with the big powers of sectoral industry associations, their involvement was necessary because KADIN needed their expertise in solving the problems of industry and recommending solutions to the government. More importantly, as KADIN was entering a free trade era and was integrated more into the global economy, global pressures on Indonesian industry increased, therefore, cooperation with sectoral industry associations was a necessity.

It can be said that in his first term, Bakrie made efforts to improve KADIN's credibility and legitimacy by involving credible business players that become organisers in KADIN. However, at the same time, he began to be involved with Soeharto's family businesses, such as with Soeharto's son, Bambang Triatmodjo and Sudwikatmono in a rubber plantation in Sumatera, with Soeharto's daughter Titi Prabowo in *Pembangkit*

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<sup>506</sup> Indria Samego, "KADIN dan Pembangunan Nasional", in [elib.pdii.lipi.go.id/catalog/index.php/search/catalog/.../531/531.pdf](http://elib.pdii.lipi.go.id/catalog/index.php/search/catalog/.../531/531.pdf) (accessed 24 January 2012).

<sup>507</sup> Hartono, "State-Business Relations in Post-1998 Indonesia: The Role of Kadin", 81.

*Listrik Tenaga Uap* (or Steam Power Plant) Tanjung Jati project in Jepara, Central Java, and with Soeharto's youngest son, Hutomo Mandala Putra on 'Goro' and 'Gelael' retail businesses.<sup>508</sup> Further, Bakrie became a donor to one of Soeharto's foundations, the *Harapan Kita* Foundation. On the fifty-third anniversary of the Bakrie Group, Aburizal Bakrie, donated IDR 1 billion to the foundation. Since then, his business has flourished with his two companies, Bakrie Capital Indonesia and Bakrie Investindo.<sup>509</sup> In other words, while he made efforts to improve KADIN, at the same time, he used his connections to the inner circle of power to develop his own businesses. Bakrie's personal relationships with Soeharto became closer when Soeharto asked him and the Minister of Finance, Mari'e Muhammad, to negotiate with the IMF to request alleviation for Indonesia debt instalments before Soeharto's resignation.<sup>510</sup>

### **3. KADIN in the *Reformasi* era**

As will be discussed in this section, during the *Reformasi*, KADIN evolved into a more independent peak business association, which emphasised that its main task was to represent business interests in order to be accepted professionally by its members. More importantly, during this period KADIN demonstrated its capacity to influence the government policy making process, representing member interests. Interestingly, the process of influencing governmental policy occurred when there was a different political relationship between KADIN and the government. Even though it was not as obvious as in the New Order, GOLKAR has been the political organisation for whom many of the KADIN's committee are affiliated. It is interesting to discuss whether political distance as a consequence of having different political affiliations, enabled KADIN to influence the government.

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<sup>508</sup> George J. Aditjondro, *Tuntut pertanggungjawaban 100-an Yayasannya!* (Kelompok Studi Reformasi CPK,n.d.), 48.

<sup>509</sup> Abraham Runga Mali, "Jejak Soeharto di Lantai Bursa", <http://www.bisnis.com/servlet/page?pageid=127&dad=portal30&schema=PORTAL> (accessed 13 May 2012).

<sup>510</sup> "Aburizal Bakrie: Pelobi dan Pengusaha", *Tempo*, 10 January 2000, <http://majalah.tempointeraktif.com/id/arsip/2000/01/10/EB/mbm.20000110.EB111061.id.html> (accessed 13 May 2012).

The other changes worth noting is that Aburizal Bakrie, who presided over KADIN for a second term (1999-2004), broke the pattern of business obtaining ministerial cabinet positions without having prior bureaucratic or military positions. Before his second term finished in 2004, he was appointed Coordinating Minister of Economy, then Coordinating Minister of Welfare in President Yudhoyono's first cabinet. His successor, MS Hidayat who presided over KADIN for two terms (2004-2009 and 2009-2015) had to resign in 2010 as he was appointed, by President Yudhoyono, as Minister of Industry in his second cabinet term. This new pattern demonstrates that the position of chairman in KADIN increased its significance, as it was a stepping stone to becoming a cabinet minister.

During Aburizal Bakrie's and MS Hidayat's terms as chairmen of KADIN, it was the period when the *Reformasi* governments enacted many new laws and regulations that sought to regulate business, including the Competition Law, the Investment Law as well as the 2010-2015 National Industry Road Map and the 2030 Vision of National Industry. In assessing the influence of KADIN on these laws and regulations, one needs to consider that KADIN has a wide range of interests as its members comprise conglomerates, state-owned enterprises and small to medium companies in cooperatives (*Koperasi*).

The Competition Law was one of the first important laws formulated in 1999 when Habibie was in power. In the discussion of this law, there was strong resentment from parliament and society arguing that conglomerates were partly responsible for the 1997-8 economic crisis. There was a desire to impose strict regulations on monopoly as well as corruption, collusion and nepotism. Issues such as domination, price fixing, cartels and market share became the crucial points to be discussed. During discussions about formulating the Anti Monopoly Law, eventually KADIN came up with a moderate opinion, which could be accepted by most members of parliament. In market share, as one of the crucial points, KADIN half-heartedly agreed to support the maximum of 50 percent of market share.

KADIN lobbied and made submissions to the *Dewan Perwakilan Rakyat* (or House of Representative, hereafter DPR) on the government's draft legislation, including anti monopoly legislation and the issue of market share. As members of KADIN included

both conglomerates and small to medium companies, the ability of KADIN to determine its own standpoint was complicated. Aburizal Bakrie's personal opinion on this matter was mixed because he was in favour of reducing monopoly, oligopoly and cartel practices. However, he did not criticise the practice of Soeharto's family conglomerates, even after the resignation of Soeharto as President. Further, he was in favour of giving preferential treatment to indigenous business people and Small and Medium Enterprises (SMEs), even though his own businesses were a conglomerate in proportion. However, KADIN strongly opposed the government's intention to limit the market share of any corporation by no more than 30 per cent because it contradicted the principle of free market competition. Although there was an internal debate, KADIN argued there should be no limit on the market share of a corporation. When the government suggested 50 percent as the permissible market share, KADIN accepted the compromise.

Aburizal Bakrie, in his second term of leadership (1999-2004) faced a serious challenge from his internal organisation as well as business players from small to medium company factions, who felt they were underrepresented in the organisation. One of the examples is the challenge that Bakrie faced due to the fact that KADIN members comprised a wide range of businesses: from conglomerates to state enterprises, from small to medium companies to cooperatives (*Koperasi*). Each had different interests and in specific issue their interests were often in conflict. One example to illustrate this point is that of problems between KADIN and small to medium companies. This faction wanted to establish KADIN UKM as their peak organisation and they took this issue to court. However, the endeavour was rejected by the court because legally, as mentioned in UU no. 1/1987, KADIN is the only peak association for existing business associations in Indonesia.

The relationships with ministries continued and more frequent discussions between KADIN and the government occurred when Bakrie's successor, MS Hidayat, also chaired KADIN for two terms (2004-2009 and 2009-2015 respectively). However, he did not finish his tenure as chair because he was appointed by Susilo Bambang Yudhoyono as Minister of Industry in the second term of his administration. In other words, he also followed his predecessor, Aburizal Bakrie's career path.

Under MS Hidayat, at least KADIN participated in the drafting of the Investment Law and formulated the 2010-2015 National Industry Road Map and the 2030 Vision of National Industry. In a hearing with the DPR, MS Hidayat, as chair of KADIN at that time, presented KADIN's view of the Investment Law.<sup>511</sup> In summary, KADIN provided two recommendations for the Investment Law draft. First, with the implementation of regional autonomy, the government could increase coordination among authorities and institutions at the national and local level in granting permits and licenses to increase investment. Second, as competition increased in the global economy, KADIN strongly recommended that the government establish an investment committee comprising all stakeholders to improve the business investment climate, to reinforce the legal system and increase transparency in order to achieve efficiency and attract a significant number of investments to Indonesia.<sup>512</sup> This view was emphasised by KADIN because coordination had become the most challenging task for government. The 2010-2015 National Industry Road Map and 2030 Vision of the National Industry was formulated with the assistance of its research institution, the think-tank KADIN. This policy statement was later adopted by government as the National Industry Road Map and Vision.<sup>513</sup>

The informal relations between Golkar and Kadin have always been close. Before 1998, most influential leaders in KADIN were Golkar members. Several vice presidents, such as Sukamdani, and previous chairmen, such as Bakrie and MS Hidayat, were also members of and/or had a close connection with Golkar.<sup>514</sup> The openness of the political system also influenced KADIN's relations with political parties. As Golkar has become the dominant political party in KADIN, in the *Reformasi* era KADIN was occasionally invited to hearings in parliament. However, informal, indirect relations with Golkar

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<sup>511</sup> MS Hidayat, "Posisi KADIN Indonesia mengenai RUU Penanaman Modal" (presented in the hearing to the House of Representatives, 1 June 2006).

<sup>512</sup> *Ibid.*

<sup>513</sup> KADIN Indonesia. *Visi 2030 dan Roadmap 2010 Industri Nasional*, 2007

<sup>514</sup> Hartono, "State-Business Relations in Post-1998 Indonesia: The Role of Kadin, 77.

remain. In fact, when MS Hidayat was chair of KADIN, he did not withdraw from his treasurer position in GOLKAR.<sup>515</sup>

The position of chairman becomes more significant, apparently, when it affects government policy makers and parliamentarians who thought about KADIN not only as an interest group but also as a political vehicle. The argument for and against KADIN to be the political vehicle again, as occurred in Soeharto's era, has divided members.

The increasing significance of KADIN's chair position has a tendency to return KADIN to a political vehicle instead of an independent, transparent and professional peak business association. One of the indicators was revealed in the election of Suryo Bambang Sulistio, as KADIN's chairman after MS Hidayat.

The competition for the chairman's position was fierce and involved money politics.<sup>516</sup> There were several candidates in the election but Sulistio, who has a HIPMI background and is one of the directors in Bakrie's Group, was the favoured candidate. Not only did he have the same background as his predecessor, Aburizal Bakrie, but he also had Bakrie's blessing as chair of Golkar. In other words, Bakrie supported him at all costs to become KADIN's chairman for 2010-2015.

Despite the fact that Bakrie was the first chair of KADIN and who transformed this organisation into an independent, transparent and professional peak business association, apparently, he reinstated patrimonial linkage between himself and Sulistio. More importantly, Bakrie wanted Sulistio to win because he could control Sulistio and KADIN to become one of his political vehicles for Bakrie's 2014 Presidential election campaign.

The intersections between KADIN and politics and KADIN and GOLKAR could not be easily changed. Discussions among KADIN's members, particularly non HIPMI members and sectoral industry association members had the intention to disconnect KADIN from politics and GOLKAR, even though their efforts have not succeeded. On the contrary, Sulistio as the new Chair of KADIN (2010-2015) demonstrated the

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<sup>515</sup>“*Mohammad Sulaiman Hidayat KETUM KADIN 2004-2009*”, <http://news.liputan6.com/read/72655/mohamad-sulaiman-hidayat-ketum-kadin-2004-2009> (accessed 3 September 2011).

<sup>516</sup>*Hiruk Pikuk di “Rumah” Pengusaha, 26 September 2010*”, <http://www.seputar-indonesia.com/ediscetak/content/view/353137> (accessed 3 September 2011).

consistency of GOLKAR as being politically affiliated with most of KADIN's members. The downside of being affiliated with GOLKAR is that KADIN could be politicised again and used as a political vehicle.<sup>517</sup>

To conclude, after more than a decade since the *Reformasi* era commenced in May 1998, KADIN as the peak business association seems to have transformed into a relatively more independent, transparent and professionally accepted body, not only by government but also among Indonesian Chinese conglomerates. This transformation has also demonstrated that KADIN is no longer Soeharto's creation, as it has evolved into a business interest that represents its members and can have different interests to government.

The influence could be no more apparent than when MS Hidayat was the chairman of KADIN. The government acknowledged KADIN's participation in the Investment Law and in assisting government by formulating the "2010-2015 Road Map of the National Industry" and "the 2030 Vision of the National Industry" which were adopted by government.

KADIN as an institution has been transformed into an independent and professional business interest group. However, members of KADIN consisted of many business groups in all sectors of the economy, including the electronics and the palm oil industries. Based on observations documented during the field research, when the researcher attended three workshops organised by KADIN in Jakarta from June to August 2009, there were several members of KADIN present at these workshops, who made efforts to approach senior business figures, including some KADIN leaders, as brokers. This suggests that within the transformed KADIN, the norms and practices of rent-seeking and brokering among some of the membership still persists.

The selection of the previous KADIN chairmen as cabinet ministers also demonstrates that business players can become political actors without having careers in the military or bureaucracy, which never occurred in the New Order. Aburizal Bakrie broke the pattern. He and his successor, MS Hidayat, were appointed as ministers in Soesilo Bambang Yudhoyono's cabinets.

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<sup>517</sup>Faisal Basri, "Bahaya Politisasi KADIN", *Kompas*, 3 May 2010, <http://cetak.kompas.com.read.xml/2010/05/03/03104876/bahaya.politisasi.kadin> (accessed 3 September 2011).

Interestingly, both men were supported by Golkar, a political party used by Soeharto in the New Order. In this new pattern, there is a tendency for business players to envision themselves as obtaining more profit by entering politics. As a result, it allowed them to use KADIN as their political vehicle.

## **B. Business associations in the palm oil industry: lobbying and impact**

### **1. Business associations in the palm oil industry**

There are several business associations in the palm oil industry which represent the interests of companies that produce different products from palm oil's upstream and downstream industries. Crude Palm Oil (CPO), for example, has become the major industry export.

Indonesian Palm Oil Producers' Association (hereafter GAPKI) is an association that represents the interests of producers with at least 200 hectares of palm oil plantations and produce CPO as a product of the upstream industry. GAPKI can be considered as the overarching business association because most of the companies involved in the downstream industry have become GAPKI members due to their palm oil plantations and manufacturing plants.<sup>518</sup>

The downstream manufacturing of Crude Palm Oil (CPO) and Palm Kernel Oil (PKO) is used in both the food and non-food industry. These industries produce cooking oil (a blend of solid and liquid CPO and PKO), oleochemical and biofuel industries. The oleochemical industry generates intermediate products such as fatty acid, fatty alcohol, methyl ester, glycerine, biscuits and soup noodles, used for personal care to pharmaceutical industries to food industries such as biscuits and noodles. Further, CPO can also be used as the base of the biofuel industry. Because of differences in interests and emphasis, business players in this downstream industry have also established

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<sup>518</sup> According to Chapter IV, article 6, Anggaran Dasar (hereafter AD) GAPKI, there are two types of GAPKI members: regular members consisting of individuals, companies, foundations, cooperatives and other form business; and affiliated members consisting of businesses related to palm oil production. The criteria for GAPKI membership is described in Chapter II, article 2, Anggaran Rumah Tangga (hereafter ART). GAPKI stated that regular members must own a minimum of 200 hectares of palm oil plantation. Based on GAPKI AD/ART, even though it allows individuals to be members, it clearly stated in the AD/ART that farmers, with less than 200 hectares of plantations, are not members of GAPKI and their interests are not represented by GAPKI.

business associations including *Asosiasi Industri Minyak Makan Indonesia* (or Indonesian Cooking/Edible Oil Industry Association, hereafter AIMMI), *Gabungan Industri Minyak Nabati Indonesia* (Indonesian Federation of Edible Oil Industries, hereafter, GIMNI), *Asosiasi Produsen Biofuel Indonesia* (Indonesian Biofuel Producers Association, hereafter APROBI), *Asosiasi Pengusaha Oleochemical Indonesia* (Indonesian Oleochemical Association, hereafter APOLIN) and the Indonesian Palm Oil Board (DMSI), of which all business associations are members.<sup>519</sup>

## **2. Business associations' influence on the implementation of Export Tax**

From the government's view, there are two objectives in implementing the Export Tax: to secure CPO for domestic supply and to develop value added CPO. Business associations, such as GAPKI, APOLIN, AIMMI and APROBI, have disagreed with the implementation of the Export Tax based on the argument that this tax reduces the competitiveness of Indonesian CPO compared to Malaysian CPO. Even though to a certain extent this argument is true, what business associations really meant was that the Export Tax reduces their profits in exporting product.

The members of business associations in the palm oil industry are dominated by big companies and conglomerates involved in both upstream and downstream industries. In other words, the associations do not include all stakeholders in the industry such as farmers from small plantation holdings.

GAPKI, AIMMI, GIMNI, APOLIN and APROBI represent the big companies' interests, and they have lobbied government on many occasions, directly or indirectly, through seminars and discussions. However, they could not influence government in moderating the Export Tax.

With the implementation of the Export Tax, they argued they had to purchase the fresh fruit bunch (FFB) from farmers under the normal price in order to maintain their profit margins. According to GAPKI, this means that Export Tax as a policy made farmers in

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<sup>519</sup> Some other business associations in this industry are the Association of Edible Oil Producers (APMN) and *Asosiasi Pengusaha Oleochemical Indonesia* (APEMIN). Other associations, such as the Palm Oil Community (*Masyarakat Kelapa Sawit* or MAKSI) represent wider interests including NGOs, academicians/researchers, and retailers. Meanwhile, the Indonesian Palm Oil Farmers Association (*Asosiasi Petani Kelapa Sawit Indonesia* or APKASINDO) exclusively represent farmers' interests.

the palm oil industry suffer even further. This argument about the government making the farmers suffer is actually true, according to big business.<sup>520</sup> Especially big companies and conglomerates, which have companies and factories upstream and downstream, and they can be compensated for their reduced profit by their value chains. In other words, they are in a much more influential position vis-a-vis the government compared to farmers.

The other disagreement between GAPKI, AIMMI, GIMNI and the government was about utilising the Export Tax to secure the domestic consumption of CPO, especially for cooking oil production. According to Fadhil Hassan, the Executive Director of GAPKI, the ineffectiveness of the Export Tax as the instrument for limiting CPO export could be seen during the 1997-8 economic crisis.<sup>521</sup> The government applied a high percentage of Export Tax, 40 per cent to 70 per cent. At this time the domestic cooking oil price was significantly high while there was a lack of CPO. The government ran the risk of applying such a high tax at the cost of almost a million tonnes of CPO illegally smuggled through Belawan Sea Port, North Sumatera.<sup>522</sup> As there was no compliance from the business side, the government then arbitrarily instructed 17 companies to allocate 80% of their CPO production for domestic supply<sup>523</sup> and prohibited CPO export by state enterprises.<sup>524</sup>

The ineffectiveness of the high Export Tax was again evident in 2007-2008 when the cooking oil price increased significantly, from IDR 6,000 per kilogram to IDR 7,350 to

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<sup>520</sup>Joko Supriyono, the Secretary of GAPKI, has addressed this issue on several occasions. The first occasion was when he presented GAPKI's paper on "*Arah Pembangunan Industri Kelapa Sawit Indonesia*, (presented at the Palm Oil Symposium held by KADIN in Jakarta, 30 June 2009). The other occasion was when I interviewed him in his office, PT Astra Agro Lestari, Jakarta, 15 July 2009.

<sup>521</sup> Interview Fadhil Hasan in Jakarta,, 6 August 2009.

<sup>522</sup> Iskandarini "Sistem Agribisnis Kelapa Sawit Di Indonesia," (Universitas Sumatera Utara: Fakultas Pertanian, 2002), 12, <http://library.usu.ac.id/download/fp/sosek-iskandarini.pdf> (accessed 2 June 2011).

<sup>523</sup> Minister of Finance's Decree no. 622/KMK 01/1997 on 17 December 1997, Minister of Trade and Industry's Decree no 456/MPP/12/97 on 24 December 2007 and Domestic Trade Director General's Decree no 420/DJPDN/XI/91 quoted from Arisman, "Analisis Kebijakan: Daya Saing CPO Indonesia, *Jurnal Universitas Paramadina*, 2, no. 1 (September 2002), 80-81.

<sup>524</sup> SK Menteri Kehutanan dan Perkebunan on 22 April 1998 and Minister of Finance's Decree no. 334/KMK.07/1998.

IDR 10,000 in traditional markets.<sup>525</sup> Both business associations and the government could not impose compliance even though they had been committed to the Domestic Market Obligation (DMO) from the beginning.

During this period, the government requested business associations, coordinated by GAPKI, to supply more CPO and cooking oil for the domestic market.<sup>526</sup> By supplying more cooking oil through DMO, the government expected to lower the price. GAPKI, GIMNI, AIMMI and other associations, agreed to assist the government to secure CPO domestic consumption, especially for the production of cooking oil; however, they criticised the government for making the associations responsible for lowering the price because this was the government's task.<sup>527</sup>

It was true that all business associations in the palm oil industry could not influence the implementation of the Export Tax; however, government could not enforce business compliance even though it had increased the Export Tax significantly. The following discussion shows, given the sustained high price of CPO in the world market, these conglomerates have tended to export their CPO production as the profits were greater, notwithstanding the high export tax. At the beginning of the DMO program, business associations involved in the DMO, were confident that DMO could decrease the cooking oil price. However, they had to admit that by mid June 2007, when the price was still around IDR 7800, that a reduction in price could not be achieved. According to GAPKI and GIMNI, the unsuccessful DMO program was due to the lack of commitment by companies in each group. In May 2007, the realisation of CPO supply was 59 per cent out of 97,525 tonnes. Until 12 June 2007, CPO supply for the DMO program was only 10 per cent from June and May's carryover, which was 142,781

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<sup>525</sup> "Wapres Ancam Kenakan Pajak Ekspor CPO, Sindo, 14 May 2007, <http://antara.co.id> (accessed 3 September 2011); Bambang Drajat, "Stabilisasi Harga Minyak Goreng," *Warta Penelitian dan Pengembangan Pertanian*, 29, no. 6, (2007). In traditional markets, cooking oil is sometimes sold by weight rather than by volume.

<sup>526</sup> "Menperin dan 3 Asosiasi Akan Bahas Evaluasi Pasok Minyak Goreng. Komitmen Pasok CPO Relatif Lemah" , <http://www.kpbn.co.ic/news-1484-0-menperin-3-asosiasi-akan-bahas-evaluasi-pasok-minyak-goreng-komitment-pasok-cpo-relatif-lemah.html#/xzzz1r33ZBqvH> (accessed 3 September 2011).

<sup>527</sup> Joko Supriyono, "Arah Pembangunan Industri Kelapa Sawit Indonesia (paper presented at the Palm Oil Symposium held by KADIN in Jakarta, 30 June 2009); interview Joko Supriyono in Jakarta, 15 July 2009; interview Fadhil Hassanin in Jakarta, 6 August 2009.

tonnes.<sup>528</sup> To make companies comply, the government increased the Export Tax, which did not significantly increase compliance.

The Secretary General of GAPKI, Joko Supriyono, defended companies non-compliance by explaining that despite the low commitment from CPO producers, the problem was an oversupply of CPO that could not be absorbed by the cooking oil industry. With the CPO price still high, producers then exported their surplus, which explains why CPO exports in May increased by 41 percent compared to January 2007. When the DMO program ended in mid June 2007, the government was disappointed that the targeted lower price of cooking oil was not achieved.

A KPPU investigation confirmed that the twenty cooking oil producers raised domestic oil prices when international CPO prices increased. However, they did not lower the price when the international CPO price declined. During its investigation from January 2006 to December 2008, the KPPU found a steep decrease in the international CPO price during the latter half of 2008 which was not reflected in a reduction in the price of domestic cooking oil. The KPPU investigation found that the producers manipulated the price information so that they could avoid lowering the domestic cooking oil price.<sup>529</sup> They were proven guilty of violating Articles 4, 5 and 11 of the Competition Law (Law No. 5 1999). The KPPU reported the violation to Pengadilan Jakarta and the allegation was ruled correct by the court. These companies (see Table 7.1) had to pay out IDR 229 billion.

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<sup>528</sup> Minister of Agriculture Decree no 339/Kpts/PD.300/5/2007 instructed that plantation companies supply 97,525 tonnes CPO in May 2007 and 102,800 tonnes CPO in June 2007 respectively.

<sup>529</sup> “KPPU Selidiki Kartel Minyak Goreng”, <http://industri.kontan.co.id/news/kppu-selidiki-kartel-minyak-goreng> (accessed 3 September 2011).

Table 7. 1: Companies reported by KPPU on price cartel allegation

No	Group reported	Group companies reported
1.	Wilmar Group	1. PT Multi Mas Vegetable Shavings
		2. PT Sinar Alam Permai
		3. PT Wilmar Bio Indonesia
		4. PT Wilmar Bio Sulawesi
		5. PT Indah Persada Agrindo
2.	Musim Mas Group	1. PT Musim Mas
		2. PT Inti Benua Perkasa Utama
		3. PT Megasurya Mas
		4. PT Agro Raya Makmur
		5. PT Mikie Oleo Vegetable Industry
		6. PT Indo Karya Internusa
3.	Permata Hijau Group	1. PT Permata Hijau Sawit
		2. PT Nubika Jaya
4.	Sinar Mas Group	1. PT SMART Tbk
5.	Salim Group	1. PT Salim Ivomas
6.	Sungai Budi Group	1. PT Tunas New Lampung Tbk
7.	BEST Group	1. PT Berlian Eka Sakti Tangguh
8.	HSA Group	1. PT Pacific Palmindo Industry
		2. PT Asian Agro Agung Jaya
		3. PT Bina Karya Prima

Source: Palm Oil Cartel Case [Wilmar, Musim Mas, SMART, Salim] <http://eng.kppu.go.id/palm-oil-cartel-case/>

GAPKI, GIMNI and AIMMI supported the cooking oil companies' attempt to convince the government there was no price cartel that had set the cooking oil price. The associations argued that the imposition of the Export Tax for all palm oil products, including cooking oil, became one of the important reasons for the high price.<sup>530</sup> In other words, according to Joko Supriyono, it was a combination of the world CPO price and inadequate government regulation which created the price rise. In 2011, the Supreme Court decided to overrule the 2009 court's decision to penalise these companies on the basis there was insufficient evidence to prove these companies had set the cartel price. The rejection of the KPPU allegation by the Supreme Court demonstrated that these conglomerates had used the Indonesian law system to articulate their interests.

<sup>530</sup> "Lima Produsen CPO Diduga Kartel", 22 June 2007, [http://www.lpp.ac.id/berita\\_detail.php?id=127](http://www.lpp.ac.id/berita_detail.php?id=127), (accessed 3 September 2011); "KPPU selidiki Kartel Minyak Goreng", <http://industri.kontan.co.id/news/kppu-selidiki-kartel-minyak-goreng> (accessed 3 September 2011).

In relation to the second objective of the implementation of the Export Tax, business associations argued that government because did not act fairly government had not returned a percentage of the significant revenue it had received from the Export Tax since 1994.<sup>531</sup> It would be much fairer, according to business associations, if the government not only made demands on industry but also provided incentives and more comprehensive regulations to accelerate the development of downstream industries.<sup>532</sup> It would be more reasonable for government to return some revenue from the Export Tax so industry could use this revenue to fund research, and promote the Indonesian palm oil industry as well as increase farmers' welfare.<sup>533</sup> The highest revenue from the Export Duty occurred from 2008 to 2011, when the CPO price in the international market exceeded USD1,200 per metric ton.<sup>534</sup> In 2010, for example, the revenue from CPO Export Duty increased IDR 45 trillion or AUD 12.8 billion.<sup>535</sup>

GAPKI, APROBI, GIMNI, AIMMI and APOLIN in their regular meetings also argued that the government contradicted its own objective in implementing the Export Tax because government levied the Export Tax on CPO derivatives for export.<sup>536</sup> This

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<sup>531</sup> The criticism about government not returning some portion of revenue generated by the Export Tax has been ongoing from business associations. This criticism was expressed not only by informants but also in discussion at the Palm Oil Symposium in Jakarta, 30 June 2009. The informants who expressed this criticism included Joko Supriyono (interviewed in Jakarta, 15 July 2009), Fadhil Hassan (interviewed in Jakarta, 6 August 2009), Maruli Gultom (Former Director of PT Astra Agro Lestari Tbk, interviewed in Jakarta, 22 July 2009), Joner Napitupulu and Timbas Ginting (Secretary of General of KADINDA and Secretary of GAPKI North Sumatera Branch, interviewed in Medan, 10 August 2009) and Balaman Tarigan (Director of PTPN IV and the Chair of GAPKI North Sumatera Branch, interviewed in Medan, 10 August 2009). At the Palm Oil Symposium in Jakarta, 30 June 2009 the critics included several business associations, including GAPKI, APROBI, DMSI and APKASINDO, as well as the government, represented by Ahmad Mangga Barani, Director General of Plantations, Ministry of Agriculture.

<sup>532</sup> *Ibid.*

<sup>533</sup> *Ibid.*

<sup>534</sup> “*Harga CPO Melandai, Pendapatan Bea Keluar Diperkirakan Turun 17.1%*”, *IPOPNEWS*, 18 August 2013, [https://www.ipotnews.com/index.php?jdl=Harga CPO Melandai Pendapatan Bea Keluar Diperkirakan Turun 17.1%25&level2=newsandopinion&id=2353404&img=level1\\_topnews\\_1#.UvWinKBkOSo](https://www.ipotnews.com/index.php?jdl=Harga+CPO+Melandai+Pendapatan+Bea+Keluar+Diperkirakan+Turun+17.1%25&level2=newsandopinion&id=2353404&img=level1_topnews_1#.UvWinKBkOSo) (accessed 20 January 2014).

<sup>535</sup> Bustanul Arifin, “*Menggugat Manfaat Bea Keluar Ekspor CPO*”, Metro TV News, 19 January 2009, <http://www.metrotvnews.com/read/analisdetail/2011/01/17/130/Menggugat-Manfaat-Bea-Keluar-Ekspor-CPO> (accessed 15 September 2011).

<sup>536</sup> Minutes of Meeting between GAPKI and business associations represented the palm oil downstream industry, 14 October 2008; “*APROBI Tolak Pengenaan Pungutan Ekspor Biofuel*”, 23 November 2007, <http://www.bumn.go.id/ptpn13/id/publikasi/berita/APROBI-tolak-pengenaan-pungutan-ekspor-biofuel>,

indicated that government had taken advantage of the export of CPO and its derivatives to generate more revenue.

In analysing the influence of business associations on moderating the implementation of the Export Tax, the data shows that GAPKI, APROBI, AIMMI and GIMNI were unable to influence the government on this matter. Illegal smuggling by some conglomerates or exporting CPO instead of trading CPO for local consumption, when the price of cooking oil was high, could not entirely be blamed on the conglomerates. It was partly due to the government's lack of ability to enforce its own regulations including the Export Tax. The implication was that the government was dependent on conglomerates. This situation reflected the fundamental change in patrimonial relations between government and business, where government looked to the conglomerates to solve problems in the cooking oil industry.

### **3. GAPKI's and APROBI's influence on government policies related to environmental issues**

In addition to the Export Tax issue, business associations also faced the NGOs' campaigns and EU restrictions on environmental issues. As discussed in chapter six, these campaigns and restrictions affected the industry in the short term, but not for the longer term as exports of Indonesian CPO and biofuel increased.

GAPKI's and APROBI's concerns were that CPO and biofuel exports, palm oil plantations' expansion and consumption of domestic biofuel would be greater if the government had provided comprehensive policies in combating these campaigns by lobbying against the EU and other restrictions.

The disagreement among GAPKI, APROBI and the government on environmental issues was closely related to the consistency of the Yudhoyono government to implement a National Energy Policy. APROBI was highly critical of government relating to its mandatory policy for using biofuel, including bioethanol and biodiesel, stated in the National Energy Policy (Presidential Regulation no 5/2006) followed up by the Ministry of Energy Decree no 32/2008 (effective January 2009), which had not been

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(accessed 3 September 2011); "*Pengusaha Sangsikan Pengenaan PE*", <http://www.suaramerdeka.com/harian/0802/04/eko06.htm> (accessed 3 September 2011).

implemented as planned. It was true that the government provided about 1.5 million hectares of land by 2010 and 4 million hectares by 2025.<sup>537</sup> Apart from this concession, the implementation of other regulations did not happen and the incentives promised were not provided. More importantly, APROBI criticised the government for being behind schedule in establishing institutions to enforce industry, transportation, electric power plants and PERTAMINA to commit to targets and become regular purchasers of biofuel from domestic production.<sup>538</sup>

In relation to government's intention to expand palm oil plantations for biofuel production, according to Joko Supriyono of GAPKI, this was a contradiction in terms because the government implemented the second moratorium on *Penundaan Pemberian Izin Baru dan Penyempurnaan Tata Kelola Hutan Alam Primer dan Lahan Gambut* (INPRES 6/2013) as a continuation of the first moratorium, which ended in May 2013.<sup>539</sup> GAPKI strongly disagreed with this decision because, principally, it impeded the further expansion of palm oil plantations.<sup>540</sup>

Further, Joko Supriyono, the Secretary General of GAPKI, was also critical of what he called the imposition of western standards such as RSPO and EU RED.<sup>541</sup> Therefore, when RSPO decided to involve the EU RED restrictions to reduce GHG emissions, GAPKI opposed it and withdrew its membership from RSPO in 2011. This was the time when GAPKI strongly urged the government to apply Indonesian Sustainable Palm Oil (ISPO): a compulsory Indonesian standard for developing sustainable palm oil that not

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<sup>537</sup> Caroko et al, *Policy And Institutional Frameworks For The Development Of Palm Oil-Based Biodiesel In Indonesia*, (2011), 5, Tables 3 and 4.

<sup>538</sup> “*Industri Biofuel Rugi US\$2 Miliar*”, <http://www.bumn.go.id/ptpn13/polls/berita/industri-biofuel-rugi-us2-miliar/> (accessed 15 September 2011).

<sup>539</sup> See INPRES no 10/2011 and INPRES no 6/2013 on *Penundaan Pemberian Izin Baru dan Penyempurnaan Tata Kelola Hutan Alam Primer dan Lahan Gambut*.

<sup>540</sup> Anggi M. Lubis, “GAPKI Says 'No' to Moratorium Extension” , *The Jakarta Post*, 24 April 2013, <http://www.thejakartapost.com/news/2013/04/24/gapki-says-no-moratorium-extension.html>; see also <http://www.gapki.or.id/Page/NewsDetail?guid=76920aa3-d87e-4f7b-a0f2-f82febe6edf4> (accessed 25 May 2013).

<sup>541</sup> GAPKI, “*Ironi Industri yang Penuh Cobaan:Dunia Bakal Tergantung pada Komoditas Sawit*”, <http://www.gapki.or.id/news/detail/23/0> (accessed 5 June 2012).

only strictly follows the RSPO requirements, but also Indonesian laws and regulations.<sup>542</sup>

The Indonesian government has supported GAPKI initiative to implement ISPO. Internal discussions inside government as well as between government and business players took two years before the government implemented ISPO on 29 March 2011, as regulated in the Ministry of Agriculture's Regulation no 19/2011<sup>543</sup>, even though the government could not overturn GAPKI's decision to withdraw its RSPO membership on 30 September 2011.<sup>544</sup> ISPO Certification<sup>545</sup> is compulsory for all stakeholders in the Indonesian palm oil industry including Nucleus Estate Smallholders (NES) and plantations owned by individual farmers. It is a certification that expires every five years, based on compliances regarding legal, economic, social and environmental aspects of palm oil plantations.

According to Joko Supriyono of GAPKI, the added value of having ISPO Certification is that it is compulsory as opposed to voluntary certification of RSPO.<sup>546</sup> Further, he argued that having ISPO Certification also shows the compliance of Indonesian palm oil

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<sup>542</sup> GAPKI does not oppose companies, including its members, from obtaining RSPO Certification, even though GAPKI is no longer a RSPO member. RSPO Indonesia data shows an increase in the number of companies in Indonesia that have obtained RSPO certification. Until 2012, there were only 100 companies with RSPO Certification, see "600 perusahaan sawit kantong sertifikat RSPO", *Kontan*, 21 March 2012, <http://industri.kontan.co.id/news/600-perusahaan-sawit-kantongi-sertifikat-rspo> (accessed 3 January 2014).

<sup>543</sup> Greenpeace highlighted the implementation of ISPO as the way for Indonesia to avoid implementing strict international environmental regulations, see Josh Franken, "Indonesia: Reforming palm oil production (analysis)", *Jakarta Post*, 23 October 2011, <http://www.thejakartapost.com/news/2011/10/03/indonesia-reforming-palm-oil-production-analysis.html> (accessed 23 October 2011).

<sup>544</sup> Statement on GAPKI's official letter to Withdraw Membership from RSPO, see [www.rspo.org/sites/default/files/GAPKI.docx](http://www.rspo.org/sites/default/files/GAPKI.docx) (accessed 5 October 2011).

<sup>545</sup> Minister of Agriculture Decree no 19/Permentan/OT.140/3/2011 Tentang Pedoman Perkebunan Kelapa Sawit Berkelanjutan Indonesia (Indonesian Sustainable Palm Oil/ISPO). Similar to RSPO, ISPO has seven criteria which have to be followed: 1) permit system and plantations management; 2) implementation of technical guidelines of palm oil cultivation and production; 3) environmental management and monitoring; 4) worker's safety; 5) community and social responsibility; 6) empowerment on economic community; and 7) sustainable peningkatan usaha, see Section II Certification System, article 2 Certification Requirements. The only difference is that in Indonesia this standard is compulsory and RSPO is voluntary. Before its implementation, the Ministry of Agriculture must notify the WTO. Through the Indonesian Accreditation Committee multilateral arrangement with accreditation bodies in countries of destination, ISPO will be approved and purchasers will be notified.

<sup>546</sup> GAPKI, "Ironi Industri yang Penuh Cobaan: Dunia Bakal Tergantung pada Komoditas Sawit", <http://www.gapki.or.id/news/detail/23/0> (accessed on 5 June 2012).

stakeholders, both to Indonesian and global regulations, of developing sustainable palm oil; therefore, it will remove doubts from import countries about the product sustainability including the EU countries.<sup>547</sup>

GAPKI, as the business association of the upstream industry, cooperated with downstream industry business associations to persuade the government to revise the impost of the Export Tax on CPO and biofuel. In relation to biofuel production, GAPKI supported APROBI's argument that the Export Tax not be applied to biofuel. Moreover, GAPKI also urged the government to encourage domestic consumption of biofuel, irrespective of whether the government imposed an export tax. GAPKI and APROBI based their argument on the fact that the biofuel industry experienced accumulated investment losses of up to USD 2 billion with a shortfall in domestic consumption in 2008.<sup>548</sup> More importantly, PERTAMINA decided not to purchase biofuel to produce blended petrol as the price of biofuel was too expensive. As a result of this lobbying, the government decided to permit the export of biofuel, but nevertheless imposed the Export Tax.

Similar to GAPKI, AIMMI and GIMNI, members of APROBI, mostly the big companies, were conglomerates. Because the biofuel industry is an advanced industry which needs high-tech, therefore only big conglomerates can establish biofuel companies. Some of these conglomerates are: PT Musim Mas, PT Darmex Biofuel (Duta Palma Group), PT Wilmar Bioenergi (Wilma Group), Multikimia Inti Pelangi (Eterindo Group), PT Pelita Agung Industries (Permata Hijau Group) and PT Ciliandra Perkasa (First Resource Group).

According to Paulus Tjakrawan, the Director of APROBI, the companies that exported biofuel product to EU, mentioned above, also have expressed concerns on reducing GHG emissions<sup>549</sup> to fulfill the EU regulation: a 35 percent minimum threshold to fulfil

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<sup>547</sup> *Ibid.*

<sup>548</sup> "Industri Biofuel Rugi US\$2 Miliar", *Bisnis Indonesia*, 12 May 2009.

<sup>549</sup> Greenhouse gases (GHGs) are atmospheric compounds that store energy, thus influencing the climate. Each GHG has a different global warming potential that takes into account the effectiveness of each gas in trapping heat radiation and its longevity in the atmosphere. Some of the gases are methane (CH<sub>4</sub>), carbon dioxide (CO<sub>2</sub>) and nitrous oxide (N<sub>2</sub>O). The rationale for the use of biofuels is that they can lower GHG emissions and they are 'renewable'. However, the production and processing of biofuel [(1) extraction and cultivation of raw materials, (2) land-use change, (3) processing and (4) transport and

land use requirements. These companies have integrated upstream and downstream industries and have employed advanced technology to increase GHG emission saving product. In addition, Paulus Tjakrawan quoted research conducted by the Ministry of Agriculture and IPOB that show promising results for GHG emission reduction for future Indonesian palm oil-based biofuel: 56.7 per cent to 59.8 per cent and 56 per cent respectively.<sup>550</sup>

As explained in chapter six in relation to the EU RED restrictions, APROBI along with GAPKI requested the government to establish a “Government to Government” diplomatic dialogue with its EU counterparts to explain that the Indonesian palm oil industry has employed sustainability indicators in its development. In the interim, biofuel exports have escalated, since 2011, to the EU as Indonesia’s main global market, despite the implementation of the EU RED scheme (see chapter six).

With respect to the EU dumping allegation against Indonesian biofuel companies, the response demonstrated cooperation between the government and APROBI on what was a matter of shared interest. The government, through the Ministry of Trade, and APROBI worked together to refute the dumping allegation. Despite joint lobbying, the EU determined on 26 November 2013 that Indonesian companies had attempted to sell biofuel into the European market at prices below market value.<sup>551</sup> The EU applied anti-dumping duties to all companies involved including PT Ciliandra Perkasa (8.8 per cent),

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distribution)] is not emission-free and emissions could reach levels similar to those associated with the use of fossil fuel. To fulfil sustainability criteria, the percentage reduction of GHG emissions generated through the use of a specific biofuel instead of a fossil fuel has to be above a certain threshold. A minimum savings rate of 35% applies initially, see *Directive 2009/28/EC* of The European Parliament and of the Council 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC.

<sup>550</sup> Paulus Tjakrawan, “Biofuel Industry Development: Shifting of Fossil Fuel Energy Subsidies to Renewable Energy and Energy Conservation Experiences in Project Development, Constraint and Expectation” (paper presented at the EBTKE Conference and Exhibition (Conex) 2013, Jakarta Convention Center, 21-23 August 2013).

<sup>551</sup> “EU to impose definitive anti-dumping duties on biodiesel from Argentina and Indonesia”, *Press Release*, [http://europa.eu/rapid/press-release\\_IP-13-1140\\_en.html](http://europa.eu/rapid/press-release_IP-13-1140_en.html) (accessed 30 November 2013).

PT Musim Mas (18.3 per cent), PT Pelita Agung (16.8 per cent) and PT Wilmar (23.3 per cent).<sup>552</sup>

Even though these companies were required to pay the anti dumping fine for five years, APROBI urged these companies to prove that they had not sold biofuel to Europe at below the market price. Further, APROBI and the government have prepared an appeal to the European court and plan to take the case to the WTO for resolution. Together with APROBI, the government has anticipated that the appeal might not be successful, in which case the government has made a commitment to boost domestic biofuel consumption.

To conclude, as members of business associations in the palm oil industry are dominated by conglomerates which have plantations, companies and factories from upstream and downstream industries, it is interesting that these business associations could not influence regulations such as the Export Tax. As discussed, the government did not accept the business associations' arguments. However, this does not mean that conglomerates entirely complied with government. On the contrary, especially when the international price of CPO reached significantly high prices during the 1997-8 economic crisis and/or in 2007-2008, both the government and business associations (GAPKI, GIMNI, and AIMMI) could not discipline conglomerate members when they exported or smuggled CPO, even with a high Export Tax.

In responding to environmental issues, GAPKI with its strong position, was not pressured under western standards, and influenced the government to implement ISPO. Further, GAPKI strongly disagreed with the government decision to continue the moratorium as it has impeded new palm oil plantation expansion, including for biofuel. With the inconsistency of the National Energy Policy and EU restrictions, GAPKI supported APROBI to convince the government to export biofuel to compensate for domestic losses. The government agreement was not without cost, because government imposed a tax on exported biofuel.

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<sup>552</sup>“Uni Eropa Naikkan Biaya Anti Dumping Biodiesel Indonesia” (“*European Union Increased Anti Dumping Duties for Indonesian Biofuel*”), *Kompas*, Sabtu, 30 November 2013.

<http://bisniskeuangan.kompas.com/read/2013/11/30/1216168/Uni.Eropa.Naikkan.Biaya.Anti.Dumping.Biodiesel.Indonesia> (accessed 30 November 2013).

### **C. Business associations in the electronics industry: long and intensive lobbying**

In the initial period of the New Order, Soeharto's economic development strategy was strongly influenced by the technocrats' neoclassical economic approach indicated by the formulation of the 1967 Foreign Investment Law and the 1968 Domestic Investment Law. Not long afterwards, as he began to build his patrimonial structure, he changed the strategy by implementing the Import Substitution Industrialisation (ISI) which protected the industry. The ISI period took place from 1973 to around 1983; during that time, he exploited oil and natural resources as the major income earnings and financed several capital intensive industries. In 1985, two years after the global oil price first decreased abruptly, the strategy had to change to Export Industrialisation Orientation (EOI) because of the lack of financial resources to fund the industry. Since then, the strategy has been directed to integrate the Indonesian economy into the global economy.

The electronics industry, as part of the manufacturing industry, has been affected positively by the shift to the EOI strategy because it is more dependent on large MNCs to invest in the industry. With the expansion of MNCs, unfortunately, the industry has not yet strengthened its structure because most of the subsidiaries were focused on making Indonesia their base for exporting consumer electronics products.

During this deregulation period, the economy was further integrated with the global economy with its inclusion in the Free Trade Agreement (FTA). The implementation of AFTA was accelerated on 1 January 2003 (instead of the planned starting date in 2008) to respond to China's emergence as a sophisticated world-class supplier for the global electronics industry since 1990. More importantly, the buildup of China's electronics industry capability was a real threat for Indonesia, when the CAFTA was implemented on 1 January 2010.

Unfortunately, the Indonesian electronics industry was severely affected by the 1997-8 economic crisis, which weakened the fragile structure of the Indonesian electronics industry even more. Business associations in this industry have become aware of two immediate impacts. The first impact was the dumping of legal and illegal imported products into the domestic market as a consequence of the implementation of free trade agreements (AFTA and CAFTA). Further, with the changing global trend toward high-tech products, the business associations have also realised that in the global production

network, Indonesia's position has become smaller; it is necessary for the industry to increase the level of technology of Indonesian electronics products. Business associations, therefore, emphasised these two issues as their agenda.

Business associations in the electronics industry have pushed relations between business and government to be more transparent and institutional so the government can meet its own target, that is, to make Indonesia a leading country in high-tech industry, both in electronics and information communication technology by 2020. The business associations have argued that their agendas are in line with and support that target; however, the incomprehensiveness of government policies and regulations has impeded this target.

### **1. Business associations in the electronics industry**

Business associations in the electronics industry represent the interests of upstream and downstream industries. The upstream industry consists of companies that manufacture components, create molds and dye and provide raw materials; the downstream industries comprise companies that manufacture a wide range of electronics products from consumer electronics, lighting, batteries, computers, information technology and communications products to business and medical electronics products.

In the initial stages of the development of the Indonesian electronics industry, not many business associations were established. *Gabungan Pengusaha Elektronik* (Indonesia Electronics Producers Association, hereafter GABEL) was the first business association to be established in 1985 to cater for business players' interests in consumer electronics and home appliances. The members of GABEL, in the initial period, were mostly local and Indonesian partners in SDA and joint venture schemes. As the electronics industry developed, members of GABEL have expanded and comprise subsidiary companies in consumer and home appliance companies as well as component electronics.

As manufacturing progressed and companies in these areas became well established, business associations in these sectors followed. Mold and dye activities – as a supporting sector of the core industry – began to develop in the late 1980s. In addition, manufacturing of computers and lighting was also progressing. Therefore, in the 1990s many business associations were established, for example, Indonesian Mold and Dies

Association (IMDIA), *Asosiasi Komputer Indonesia* (or Indonesian Computer Association, hereafter APKOMINDO)<sup>553</sup> and or *Asosiasi Industri Luminaires and Kelistrikan Indonesia* (Indonesian Electricity and Luminaires Industry Association, hereafter AILKI).<sup>554</sup> In the late 1990s, other business associations, such as *Asosiasi Piranti Lunak Telematika Indonesia* (or Indonesia Telecommunication, Information, Telecommunication and Software Association, hereafter ASPILUKI)<sup>555</sup> and *Asosiasi Industri Media Rekam* (or Indonesian Recording Media Industry Association, hereafter AIMRI) were established.

These six business associations along with *Gabungan Perusahaan Alat-Alat Kesehatan* (the Federation of Medical Appliances' Companies, hereafter GAKESLAB<sup>556</sup> in 2010 united under one federation. During 2009, they had had intensive discussions to form a federation to advance their position towards government. Even though each business association has different specific interests and challenges, they encounter the same policies and regulations in response to the government's current approach in integrating electronics as well as information technology industries. The Federation of the Associations is based on the Electronics and Telematics Industries.<sup>557</sup>

The structure of ownership in the electronics industry comprises MNCs, joint ventures and local companies. Not all of these companies, however, are members of business associations. Under IMDIA, for example, members of 238 companies comprise 87 subsidiaries from Japan and Korea and 145 local companies.<sup>558</sup>

Business associations here are analysed as a whole because, as mentioned before, even though they have specific interests, they have to face similar government regulations

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<sup>553</sup> APKOMINDO is a business association that organised the interests of companies that manufacture and or import any kind of computer (desktop, laptop and notebook), i-pad (including tablets). This association is closely related with ASPILUKI which is the interested organiser of software and information technology and telecommunications equipment. The latter is also closely related with telecommunications providers such as Telkom and Satelindo.

<sup>554</sup> AILKI is the other business association in the electronics industry which organised the interest of companies that manufacture lightning, luminair, electrical instruments and fluorescent light fittings.

<sup>555</sup> See [www.aspiluki.or.id](http://www.aspiluki.or.id)

<sup>556</sup> See <http://gakeslabindonesia.or.id/>

<sup>557</sup> Interview with Himawan, Corporate Secretary of Panasonic Gobel, Jakarta, 25 June 2009.

<sup>558</sup> Djajadi Wikara, "Visi 2030 dan Roadmap 2015 Industri Mold and Dies Indonesia (IMDIA) (presented in Round Table Discussion KADIN, Jakarta, 14 July 2009).

and policies, and have to respond and lobby in accordance to their interests. The policies and regulations that will be elaborated relate to the implementation of free trade agreements and to the increasing level of technology and repositioning of the Indonesian electronics industry in the global production network.

## **2. Lobbying between business associations and government: the impact of free trade agreements (AFTA and CAFTA)**

The implementation of AFTA and CAFTA has integrated the Indonesian economy into the global economy even more. The Indonesian market has become part of the larger market in ASEAN and China. The implementation of AFTA was accelerated, as stated earlier, from 1 January 2008 to 1 January 2003, to respond to China's electronics industry, which supplies the global electronics industry, especially Japanese companies.<sup>559</sup> Because the electronics industry is highly sensitive to assembly costs, China has emerged as the principal supplier in the export market for electronics products, particularly in telecommunications equipment, computers and disk drives<sup>560</sup>, while the ASEAN region has slowly lost its comparative advantage in this segment of the production chain. Therefore, for the ASEAN market, imported Chinese products could be a 'threat'. However, countries involved in free trade agreements will obtain benefits if the infrastructure of the economy is efficient and well prepared. Without these requirements, imported products will invade the market of the products in destination countries because the prices are cheaper.

In mid 2010, approximately 70 per cent of the domestic market was dominated by global players, some of whom are subsidiaries that manufacture in Indonesia.<sup>561</sup> This means that only 30 per cent of the market has been the domain of local manufacturers. It is interesting to note that imported products are value added electronics products such as

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<sup>559</sup> According to Ernst 2004 China is not only a provider of cheap labour but its recent attraction to global production network is attributed to other factors such as: (1) a booming market for information technology products and services; (ii) an unlimited supply of low-cost information technology skills who are involved in R&D; (iii) abundant land and a rapidly improving infrastructure; and (iv) support policies by the government to rely on FDI for industrial upgrading.

<sup>560</sup> Wilson et. Al, 2003.

<sup>561</sup> Ali Soebroto Oentaryo, the Executive Director of GABEL was interviewed by Tempo,, see "Satu Semester CAFTA, Pasar Elektronik Didominasi Impor", *Tempo*, 5 July 2012.

mobile cellular phones, smart phone<sup>562</sup> notebooks, personal computers, digital recorders and digital cameras<sup>563</sup>, whereas local products traded in the domestic market are mostly white goods (especially washing machines) as well as plasma and LCD televisions.<sup>564</sup>

As part of making the domestic market more transparent, the business associations have requested to the government to apply Indonesia National Standard (*Standar Nasional Indonesia*, thereafter SNI) that protects the domestic market especially from legal, legal but non standard and counterfeit products. SNI functions as a technical barrier in trade to enhance Indonesian products' competitiveness, increase efficient and transparent markets and protect consumers' from hazards generated by electronics products that can be harmful to humans and their wellbeing and the environment.<sup>565</sup>

The negotiations and discussions between the business associations and the government have been lengthy and intense beginning with the 1997-8 economic crisis between business associations; nevertheless, the government has just begun the systematic execution of the SNI in the electronics industry in 2009, a year before CAFTA was implemented.

Three business associations that have intensely lobbied government to set up the SNI and to execute it among the Indonesian electronics products are GABEL, AILKI and APKOMINDO. Their products, such as consumer electronics, lighting and luminaries as well as computers and mobile cellular phones, apparently, have mostly been affected by the same imported products from China.

Data from GABEL has shown that high tech imported products comprise mobile cellular phones, notebooks, personal computers and home appliances.<sup>566</sup> According to

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<sup>562</sup>“10 Perusahaan elektronika terbesar di Indonesia perebutkan pasar Rp 83 triliun” (“Ten biggest companies battling over IDR 83 trillion market”), 19 February 2012, see <http://www.duniaindustri.com/berita-industri-elektronik-indonesia/817-10-perusahaan-elektronik-terbesar-di-indonesia-perebutkan-pasar-rp-83-triliun.html> (accessed 23 March 2012).

<sup>563</sup> Adrian Lubis, “Analisis Kinerja perdagangan Sektor Elektronik sebelum dan setelah Pelaksanaan CAFTA”, *Bullietin Ilmiah Litbang Perdagangan*, 4, no. 2 (November 2010), 226-239. Data was quoted from Table 4, 235.

<sup>564</sup> “Industri Televisi Nasional di tengah Krisis Global, Indonesian Commercial Newsletter: A Report of Market Intelligence (October 2008).

<sup>565</sup> GENAP SNI see [http://www.bsn.go.id/files/1704711/genapsnibuku/BAB\\_3.pdf](http://www.bsn.go.id/files/1704711/genapsnibuku/BAB_3.pdf)

<sup>566</sup> “Gempuran Produk Impor Terus Berlanjut”, *Kontan*, Maret 2010, see <http://www.kontan.co.id>, 29

Suhanda Wijaya, chair of APKOMINDO, except for home appliances, the high rate of import of ICT products was due to the fact that there were no manufacturers for these products in Indonesia.<sup>567</sup>

The concerns of business associations were that along with these legal imported products, similar, illegal products were also traded. The fact that the domestic market was not yet protected by SNI, allowed 45 per cent of illegal and non-standard products to be traded in the domestic market in 2010.<sup>568</sup>

Following the 1997-8 economic crisis, GABEL was one of the business associations which intensively and continuously lobbied government to set up SNI for local electronics products, and at the same time, providing the domestic market with a standard for imported electronics products. In other words, SNI creates transparency and fairness for all traded electronics products in the market.<sup>569</sup>

Because the process for requiring SNI involves many parties, including the World Trade Organisation (WTO), and would therefore take a long time, for temporary protection after the crisis, GABEL suggested applying the Warranty Card in the Indonesia language for all imported electronics consumer products as well as manufactured products.<sup>570</sup>

The push to make government set up SNI for the industry was again affected by the 2008 global crisis, two years before the implementation of CAFTA on 1 January 2010. In the 2008 global financial crisis, the export line was particularly affected either by subsidiaries, joint ventures or local companies which exported to the USA and EU countries. China's export market was also badly affected. To compensate, China used

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See also [http://bbtppi.org/isiberita\\_id.php?idb=28](http://bbtppi.org/isiberita_id.php?idb=28) (accessed 17 July 2011).

<sup>567</sup> Interview Suhanda Wijaya in Jakarta, 7 August 2009.

<sup>568</sup> *Bisnis Indonesia*, 12 July 2010, see [http://www.bsn.go.id/news\\_detail.php?news\\_id=2144](http://www.bsn.go.id/news_detail.php?news_id=2144), accessed 30 September 2011.

<sup>569</sup> *Menghadang Impor dengan Standardisasi*, see [http://republika.co.id:8080/koran/126/110937/Menghadang\\_Impor\\_dengan\\_Standardisasi](http://republika.co.id:8080/koran/126/110937/Menghadang_Impor_dengan_Standardisasi)

<sup>570</sup> Interview Adhi Sukmono in Jakarta, 13 July 2003 and 20 August 2003, In addition to the SNI, GABEL also had lobbied the government to reform the corrupted Custom and decreasing Luxury Tax (*Pajak Pertambahan Nilai Barang Mewah*).

the Indonesian market as an alternative which saw the beginning of Indonesia's trade deficit with China.

A little over ten years following the 1997-8 economic crisis, SNI was systematically set up in 2009, the year before CAFTA was implemented. *Badan Standardisasi Nasional* (the National Standard Agency, hereafter BSN), the authority to formulate the SNI, admitted that the number of SNI set ups was actually too many; for example, there were 6,839 SNIs formulated for the manufacturing industry prior to the implementation of CAFTA.<sup>571</sup> Of this number, 164 SNIs were for electronics and ICT products.<sup>572</sup> According to business associations, this number was low because important infrastructure, such as laboratories for testing products (*Laboratorium Uji*) and products certification agencies (*Lembaga Sertifikasi produk*), were limited in number and their equipment was not comprehensive.<sup>573</sup>

Business associations convinced the government of the significance of establishing SNIs before AFTA or CAFTA were implemented. It is evident that starting a systematic execution of SNI one year before CAFTA, was not sufficient time. As a consequence, sectors affected by CAFTA have requested that government delay its implementation.<sup>574</sup> However, since it cannot be delayed, business associations along with KADIN have lobbied the government to keep renegotiating with the government of China regarding 228 tariffs of 14 sectors (including the electronics industry).

The progress to set up SNI for electronics products then accelerated in terms of numbers. Not only that, but the GABEL chairman admitted that the implementation of SNI had encouraged several new foreign and local manufacturers to open up their

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<sup>571</sup> GENAP SNI, 42.

<sup>572</sup> *Ibid.*

<sup>573</sup> *Ibid.*

<sup>574</sup> “*Renegosiasi ACFTA Diminta terus Dilakukan*”, <http://www.kotasatelit.com/forums/showthread.php?28067-Keputusan-Pemerintah-Renegosiasi-AFTA-dengan-China/page 7> (accessed 20 June 2012).

production in Indonesia, even though they are low tech industries such as home appliances (e.g. refrigerators and washing machine ).<sup>575</sup>

### **3. Lobbying to increase the level of technology used in Indonesian electronics industry**

All business associations are aware of the implementation of both AFTA and CAFTA, which they support. However, they have acknowledged that the government has provided insufficient comprehensive policies and regulations in order for the industry to be competitive and to enable it to take advantage of the FTAs. These comprehensive policies should comprise industrial, trade, fiscal and labour as well as infrastructure policies.

The business associations have lobbied government to synchronise duties and tariffs in products, components/parts and raw materials as part of the government's trade policy. Many incoming tariffs (*bea masuk*), apparently, have not yet balanced the advantages of imported products to inundate the domestic market, because these tariffs are lower than components/parts and raw materials.

To make Indonesian electronics products more competitive in the both ASEAN and China markets, business associations have realised that the industry has to have a strong, hi-tech structure to manufacture high-tech products. To generate such a structure, raw materials for spare parts is essential; therefore, GABEL and IMDIA, for example, have requested that government decrease tariffs on imported raw materials, spare parts and components in order to enhance manufacturing products. The reverse situation has occurred currently: those tariffs have been high, which has driven local assemblers to import products rather than manufacture them locally.

With counter productive tariffs which do not assist the structure to become stronger, the government has requested all sub-sectors in the electronics to industry to either enhance their use of Indonesian made products or increase local content by up to 40 per cent of

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<sup>575</sup>“*Pengamat: Ekonomi RI bergerak naik*, Antara, 11 Februari 2011, <http://www.antaraneews.com/berita/245737/pengamat-ekonomi-ri-bergerak-naik>, accessed 30 September 2011.

assembled products. For business associations, particularly APKOMINDO, dominated by imported notebooks, laptops and mobile cellular phones, the government's request is difficult to implement. Even in domestic manufactured laptops, such as the Zyrex brand, local content only reached 10 per cent.<sup>576</sup> Examples of industrial and trade policies are given to demonstrate that not only has the government not yet provided comprehensive policies, but also some of its policies are contradictory.

These policies will not help to increase the competitiveness of the Indonesian electronics industry in both ASEAN and China. Moreover, with only a small number of tariff barriers that can be applied to imported products, the domestic market is currently flooded with legal imports, legal but not standard products and illegal electronics products, especially from China. This has become the concern of business associations because this inundation of imported products distorts the domestic market. All business associations are concerned about trade deficits in the electronics industry that has been dominated by China since 2007.<sup>577</sup>

Further, business associations have lobbied the government to provide fiscal stimulus for the industry to shift from analogue to digital technology as well as special fiscal stimulus and tax incentives to develop a network between large companies (local, joint ventures and foreign conglomerates) and small to medium enterprises (*Unit Kerja Masyarakat – UKM*). The latter supports mold and dies, electric components and devices as well as manufacturing basic consumer electronics.

Despite the fact that negotiations on fiscal stimulus for shifting to analogue technology is not yet in place, when the global crisis occurred, the government provided three tax incentives for the industry, especially for manufacturing televisions, because of the importance of Indonesia as a global base for ten subsidiaries.<sup>578</sup> The fiscal incentives comprised three aspects: first, eradicating the Sales Tax on Luxury Goods (*Pajak Pertambahan Nilai Barang Mewah*) for particular electronics products; second, reducing 30 per cent of the income tax for investment in the industry in a certain area

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<sup>576</sup>Interview Suhanda Wijaya in Jakarta, 7 August 2009.

<sup>577</sup>Adrian, "Analisis Kinerja perdagangan Sektor Elektronik sebelum dan setelah Pelaksanaan CAFTA".

<sup>578</sup>"Industri televisi nasional di tengah krisis global" ("National television industry amid the global crisis), in Indonesian Commercial Newsletter: A Report of Market Intelligence, Oktober 2008.

for three years; third, *bea masuk ditanggung pemerintah (BM DTP)* for imported spare parts and raw materials for component electronics manufacturing. Without fiscal stimulus, the government was concerned that these companies would relocate their subsidiaries to other countries. In addition, providing such stimulus has ensured television production and export.

Especially the eradication of the implementation of *Pajak Penjualan untuk Barang Mewah* (Sales Tax on Luxury Goods hereafter PPnBM)<sup>579</sup> on electronics home appliances, white goods and televisions, discussions on PPnBM between GABEL and the government began in 1998. Lobbying between GABEL and the Ministry of Finance, to a certain extent, has succeeded in influencing the government to revisit the implementation of PPnBM periodically. For example, on 15 April 2002 the government issued a decree to reduce the number of electronics products subject to the Sales Tax on Luxury Goods<sup>580</sup>, and the second decree on 13 January 2003 removed the imposition of Sales Tax on Luxury Goods on 23 items.<sup>581</sup> With the development of digital home appliances and televisions, the government revisited the regulations periodically as part of its fiscal incentives in 2008 and 2013.<sup>582</sup>

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<sup>579</sup> The imposition of many taxes such as Value Added Taxes on Luxury Good (*Pajak Pertambahan Nilai untuk Barang Mewah*), Sales Tax on Luxury Goods (*Pajak Penjualan untuk Barang Mewah*), Income Tax (*Pajak Penghasilan*) have been the part of deregulation policies which began in 1985, when Soeharto was in power. Chronologically, these first two taxes replaced the 1951 Sales Tax, then amended into Law no 8/1983, and finally amended into Law no 18/2000 in *Reformasi* governments. In other words, this law has become the legal foundation for government to tax luxury items which are consumed by high income class in domestic as well as imported products. In order words, from the government side, this tax has two objectives: first, to control luxury items consumption, and second, to increase state's income.

<sup>580</sup>SK Menkeu no.141/KKM.03/2002 tentang "Perubahan kedua atas SK Menkeu 570/2000 tentang Jenis Barang Kena PPnBM".

<sup>581</sup>a. Peraturan Pemerintah no. 6/2003 ttg Perubahan Ketiga atas Peraturan Pemerintah no. 145/2000 ttg Kelompok Barang Kena Pajak yang Tergolong Mewah yang dikenakan Pajak Penjualan atas Barang Mewah (Perubahan pertama PP no. 6/2001, perubahan kedua PP no. 7/2002);

b. Keputusan Menteri Keuangan no. 39/KMK.03/2003 tentang Perubahan Ketiga Atas Keputusan Menteri Keuangan no. 570/KMK.04/2000 tentang Jenis Barang Kena Pajak yang tergolong mewah selain Kendaraan Bermotor yang dikenakan Pajak Penjualan Atas Barang Mewah (Perubahan kedua SK Menkeu no. 141/2002) dan;

c.Keputusan Dirjend Pajak Nomor Kep-21/PJ./2003 tentang Pengenaan Pajak Penjualan atas Barang Mewah atas impor dan atau Penyerahan Barang Kena Pajak yang tergolong mewah selain kendaraan bermotor.

<sup>582</sup>Penghapusan PPnBM elektronik dorong produk local, <http://www.kemenperin.go.id/artikel/1947/kode-etik>; Inilah 6 Barang Mewah yang Kini Tidak Kena PPnBM, *Kompas*, 28 August 2013, see

However, lobbying between business associations and government to shift from analogue to digital technology is still a long way off. To formulate and implement comprehensive policies that comprise industrial, trade, fiscal and labour as well as infrastructure policies are not an easy task for any government. One of their inputs to government was the 2010 to 2015 Road Map as well as their 2030 Vision, where they made explicit their support for the government's target.

#### **4. Power relations in the electronics industry**

The suggestions and demands from business associations to government to provide incentives and comprehensive regulations to allow a fair playing field for both local and imported products is understandable, because until currently the industry still relied on imported products, components/parts and raw materials as well as mold and dies. Data showed that the supply of local products was 34 per cent, which is quite low, and the supply of local components was 40 per cent. This means that shortages in supply were complemented by imported goods.

As discussed in chapter six, especially after the occurrence of the 1997-8 economic crisis, only a small number of foreign investors in this industry invested in Indonesia, even though the government had already regulated the new law of investment, which allows more flexibility for foreign investors in terms of ownership. This means that foreign investors seem to not see Indonesia as a beneficial relocation base for the electronics industry, as it used to be during the 1990s. At the same time, the Indonesian domestic market is unfortunately inundated with imported ICT and consumer electronic products, both legal and illegal. On the one hand, the government has exerted a lot of

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<http://bisniskeuangan.kompas.com/read/2013/08/28/1258326/Inilah.6.Barang.Mewah.yang.Kini.Tidak.Kena.PPnBM>; Ini Jenis Barang yang Tidak Dikenakan PPnBM, *Tempo*, 28 August 2013.

<http://www.tempo.co/read/news/2013/08/28/090508134/Ini-Jenis-Barang-yang-Tidak-Dikenakan-PPnBM>; Dilema PPnBM, 1 September 2013, see <http://www.investor.co.id/home/dilema-ppnbnm/67888>.

pressure on this industry to become a leading high-tech industry by 2020; on the other hand, the government does not provide comprehensive regulations to support achieving that target.

The roles of business associations in the electronics industry are limited to issues that are technically related to them, but not to issues perceived as the government's domain. For example, business associations' suggestions for government to provide comprehensive regulations to create a fair playing field for both local and imported products, which includes regulations on tax and tariffs, technical barriers to implement SNI and a warranty card for protecting both the domestic market and consumers. Other issues such as how these regulations are being enforced in customs or in seaports are the government's domain and business associations cannot interfere. Given that the subsidiaries in Indonesia are dependent on their parent companies, the business associations endeavour to convince the government to create economic condition that will attract further investment from the parent companies.

An interesting aspect of the players in the Indonesian electronics industry is that they are dominated by Indonesian Chinese business leaders. They are owners who started out as entrepreneurs in local companies, who now hold important positions as subsidiaries representatives and partners in joint venture companies. Significantly, only a small number are indigenous business players. One of these players is Rahmat Gobel, the Chairman of Panasonic Gobel Group, a subsidiary of Panasonic Corporation, one of the leading and most prestigious electronics companies in Japan.

As Rahmat Gobel was the sole significant Indonesian businessman in the electronics industry, he was appointed as the representative of the electronics industry in KADIN from 2004. When Aburizal Bakrie was the Chairman of KADIN for a second term, Rachmat Gobel was appointed head of the Metal, Machinery and Electronics Department. When MS Hidayat replaced Bakrie as the Chairman of KADIN in 2004, Rahmat Gobel was promoted to Deputy Chairman of KADIN for the industry sector. His involvement in KADIN continued in the second term of MS Hidayat, when he was appointed Deputy Chairman of KADIN for industry, research and technology. In addition, from 1999 to 2003, he was the Chairman of GABEL. And he was appointed

Chairman of the Federation of Associations of Electronics, Telecommunication and Informatics Industries from 2010 to 2014.

The success of indigeneous players, such as Rahmat Gobel in an industry like the electronics industry, is quite rare. More importantly, his role as the representative of a Chinese dominated industry in KADIN, a more or less indigeneous peak business association, attracted government attention on the significance of this industry.

The nature of the electronics industry requires intensive capital, a principal and follows the trend of a principal's values and products. Further, the products manufactured have to be able to compete in the global market, or if they are traded in the domestic market, they have to compete with imported products. These requirements – having high-tech, principals and massive investment – are not a conducive environment for establishing patrimonial relationships. Therefore, since the New Order, this industry has not attracted big conglomerates, who were Soeharto's partners, to invest, and has only attracted a small number of indigenious players. In other words, the level of difficulty and uncertainty to succeed in this industry means it depends on entrepreneurships and networking with foreign partners. This could be one of the reasons why indigenious business players and conglomerates (inside Soeharto's circle) did not want to be involved in this industry.

Yet, the discussion on business associations' functions as interest and pressure groups in the electronics industry has indicated their efforts to establish transparent and legally responsible relationships with government. In other words, their roles in influencing government policies and their interaction with government mean there is a slight possibility that patrimonial relationships could be established.

#### **D. Conclusion**

This chapter has discussed KADIN as the peak business association and sectoral industry associations in the palm oil and electronics industries, which are members of KADIN. The main role of business associations is to represent their members' interests in influencing the process of government policy making. From the business associations' historical background, among these associations, in the *Reformasi* era, KADIN has evolved from an association established by Soeharto and largely

representing Soeharto's interests to an independent, transparent business association that can represent its members' interests in its own right, lobbying the government on laws, regulations and international relations that impact industry. Following MacIntyre and Hamilton-Hart, sectoral industry associations have a history of being vocal and they have maintained their critical position towards the *Reformasi* governments.

Aburizal Bakrie, who became the chairman of KADIN for two terms, both in the Soeharto era (1994-1999) and the *Reformasi* era (1999-2004), was able to expand the membership of KADIN to reach out not only to indigenous business players but also Indonesian Chinese conglomerates, and transform KADIN over time. During his tenure prior to the election of the Yudhoyono's government, he was able to negotiate his members' interests with government on several crucial issues (e.g. market share in relation to the application of market economy in Indonesia, as part of the KADIN's negotiation with the government on the Competition Law). Even though KADIN had limited influence on the final formulation of this law, these negotiations showed that KADIN could take its own position on issues that impacted members' interests.

Aburizal Bakrie also established a new pattern for business involvement in the national politics. He was appointed as Coordinating Minister of Economy, then Coordinating Minister of Welfare in the first term of President Yudhoyono's administration; therefore, he had to resign from his position with KADIN. This pattern did not occur during the Soeharto era, when many leading politicians came to national politics from military or bureaucratic careers.

The transformation of KADIN as a more independent organisation and the new political career paths of its leaders were continued by Bakrie's successor, MS Hidayat, who became the chairman of KADIN for two terms (2004-2009 and 2009-2014). The assessment of economist, Faisal Basri during this period was that KADIN attained its highest achievements in influencing government policy such as in the Investment Law as well as enacting the 2010-2015 Industry Road Maps and 2030 Industry National Vision. Further, Hidayat was also appointed as Minister of Industry in President Yudhoyono's second term in cabinet in 2009, therefore he also had to resign as KADIN's chairman. With the resignation of Hidayat, there was an attempt by Bakrie's faction to make KADIN not only a political vehicle for Bakrie's presidential ambitions,

but also to continue the patrimonial relations between Bakrie and his protégé, Suryo Bambang Sulistio, who succeeded Hidayat for 2010-2015.

Unlike KADIN, sectoral business associations, critical of government since the New Order, increased their efforts to influence governmental policies.

Given the different nature of both the palm oil and electronics industries, lobbying by business associations demonstrated a capability to represent the collective interests of their members to influence government policies. However, there were differences in the lobbying dynamics conducted by business associations in the palm oil and electronics industries during this period.

Business associations in the palm oil industry, dominated by conglomerates, were able to influence government policies in relation to international campaigns on environmental issues, whereas they have not been able to influence the government in adjusting the implementation of the Export Tax. These different outcomes reflect the shared interests of business associations and government in facing international criticism on environmental issues. As discussed, both business associations and government are committed to producing CPO and its derivatives, including biofuel, on a sustainable basis. The implementation of the ISPO standard and the export of biofuel, when the implementation of the National Energy Policy was behind schedule, were examples of how business associations' lobbying was successful, when there are sufficient shared interests.

Business associations did not share the same interests however with government in the implementation of the Export Tax. Even though interests were conflicting, business associations had to cooperate with government when the domestic price of cooking oil rose significantly when the international CPO price was also high. Lobbying to revoke the Export Tax of CPO and its derivatives without returning a percentage of revenue did not succeed. As a result, some companies exported CPO by smuggling it out of the country to avoid payment of the Export Tax that they regarded as excessive.

Examining the complex interaction between business associations in the palm oil industry and government, even though they have different interests, the government has come to rely on these conglomerates. However, the power in patrimonial relations has changed as the government has come to depend more on conglomerates. As the

oligopolistic structure of the industry limits the number of players in the industry, maintaining CPO supply for domestic consumption, earning foreign exchange as well as to alleviate poverty, the government needs the cooperation of palm oil conglomerates. In exchange for this cooperation, the government has allowed the expansion of new palm oil plantations almost indefinitely, which contradicts the government's former commitment (e.g. to implement the moratorium).

Unlike business associations in the palm oil industry, in the electronics industry they have succeeded in accommodating the competing interests of local companies and the MNCs in their membership, as well as convincing the government of the importance to apply SNI and safety standards for any electronics products manufactured locally or imported into the Indonesian market. In addition, they have lobbied the government successfully to support them in the more competitive market created by free trade agreements, particularly CAFTA. The business associations in the electronics industry have developed more transparent state-business relations compared to those in the palm oil industry.

The increasing roles of business associations in influencing government policy making in a more transparent and independent manner have the possibility to moderate the patrimonial relationships between the government and business. However, each sector has different characteristics, which affect how business associations have influenced state-business relations. Business associations in the palm oil industry, dominated by conglomerates, have emerged as those that maintain patrimonial relationships with government, but with different forms of power relations. As discussed in this chapter, the domination by conglomerates as well as the demand for CPO and its derivatives in the domestic and international market have made the government dependent on conglomerates. In contrast, business associations in the electronics industry have pushed toward more transparent and accountable state-business relations. Meanwhile, KADIN has the potential to lessen patrimonial relationships as evidenced in its transformation towards an autonomous and transparent business organisation. However, conflicts between internal factions in KADIN are a crucial factor for this organisation to return to its patrimonial relationship with government.

Findings in this chapter have confirmed MacIntyre's and Hamilton-Hart's proposition that business associations have played an increasing role in influencing government in policy making. However, their research does not include the intricacies of domestic and international factors in the way business associations once lobbied government as they now operate in a more open and democratic political system.

## Chapter 8

### Conclusion

Following the 1997-8 economic crisis and *Reformasi* movement, the Indonesian political economy has been through many changes in a complex process of democratisation. On the one hand, the process has created a more transparent political system and has pushed the state to lessening its interventionist role as the Indonesian economy has become more integrated with the global market. On the other hand, as power has dispersed, the democratisation process has involved corruption, collusion, and nepotism generated by senior government officials, who are in many cases figures from the New Order government. This complex process of political and economic change suggests that many of the aspirations of the *Reformasi* movement have not yet been realised.

This thesis has analysed the process of change in patrimonial state-business relations following the 1997-8 economic crisis and Soeharto's resignation through case studies of the palm oil and electronics industries. It has addressed the research questions: 1) to what extent and in what ways have state and business relations become more transparent, accountable, consultative and law-based since the 1997-8 economic crisis? and 2) how have the economic crisis of 1997-8 and *Reformasi* political changes modified and moderated patrimonial relationships between the state and businesses, particularly in the electronics and palm oil industries?

The hypothesis examined in this study is that the dispersal system of power, as a result of the openness of the political system following the crisis and Soeharto's resignation, has changed the characteristics of patrimonial state-business relations in terms of numbers of actors involved and complexity of patrimonial networks.

This research has shown that even though, in general, state-business relations have been more transparent and accountable, their patrimonial character has persisted, but in more diverse forms and networks as a result of the dispersal of power at national and local levels. Comparing state-business relations in the palm oil and electronics industries, the former has shown a more supportive environment for patrimonial relationships than the latter.

By the end of his tenure, Soeharto had established a complex and highly personal patrimonial network and made it integral to his political and economic development strategies. The absence of a Soeharto-like dominant figure in the *Reformasi* governments has meant there has been no one government lynchpin at the centre of patrimonial networks, as the foundation of the regime. The competitive and relatively free elections, however, have empowered parliaments as well as directly elected heads of local governments to emerge as new sources of power. However, the authority of the directly elected President and heads of local government is somewhat constrained by the limit of two five-year terms for executive positions. More importantly, the reverberation of this more dispersed system of power has been reinforced by the acceleration of globalisation, which facilitates more open access from state and non-state global actors to influence state-business relations in both industries, even though global influences have not automatically promoted less patrimonial state-business relations.

The first finding of this thesis dealt with the consequences of having a more dispersed system of power. As a consequence, the *Reformasi* governments have significantly increased the regulatory function of government, such as legislating and implementing the Competition Law, the Good Governance Law, the Corruption Eradication Law, the Investment Law and Regional Autonomy Laws, to provide more transparent, accountable and law-based state-business relations. Even though the main objective of the regulatory frameworks is to increase the economic and industrial performance, the implementation of these new laws and regulations has gradually transformed patrimonial state-business relations into more transparent, accountable and law-based relationships. However, the research has demonstrated that there were many unintended consequences from the implementation of these laws and regulations. They have led to the formation of new patrimonial state-business relations, particularly in the palm oil industry. In the electronics industry, in contrast, government regulations in this industry have tended to advantage MNCs, as the dominant players, compared to local businesses.

The contradictory outcomes in both industries have reflected the different structures of the two sectors. The oligopoly of the palm oil industry dominated by approximately ten local players, most of them conglomerates, has made the implementation of new laws and regulations more difficult. The implementation of Regional Autonomy Laws, for example, has enabled the head of local government to have more power and has created

patrimonial relationships between local governments and national and international businesses. These relations have created new forms of patrimonial relationships, where national business players have tended to dominate local governments, which was very different from the ones established by Soeharto. To a certain extent, this finding has confirmed Christian Chua's argument that the democratisation process has been turned upside down regarding traditional patronage relationships between state and business.<sup>583</sup> In his research on Indonesian Chinese conglomerates in the *Reformasi* governments, he found that these big businesses that survived the crisis have successfully transformed the traditional patronages relationships. In other words, these businesses are now often the dominant partners.

Asymmetrical power relations between local government and conglomerates in the palm oil industry have fostered corrupt practices. With the implementation of the Good Governance and Corruption Eradication Laws, these practices can be limited by the prosecutions of governors and heads of districts and cities as well as conglomerates involved in these practices. In other words, the regulatory framework for eradicating corruption has gradually exposed patrimonial relations and the magnitude of corruption.

Dominated by a limited number of big businesses with a common interest to maintain Indonesia as the number one CPO producer in the world, these conglomerates did not feel secure with the implementation of Investment and Competition Laws. The increasing number of Malaysian companies operating in Indonesia, according to Indonesian conglomerates, could jeopardise Indonesia's national interest as the largest producer in the world. Further, it was revealed the KPPU (Supervisory Commission for Business Competition), the institution that supervises competition, in several of its reports, that the oligopoly structure negatively impacted business competition in the sector.<sup>584</sup>

The difficulty of the implementation of new laws and regulations, to a certain extent, has confirmed the research by Richard Robison and Vedi R.Hadiz<sup>585</sup> as well as Yuki

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<sup>583</sup> Christian Chua, *Chinese Big Business in Indonesia: The State of Capital* (London and New York: Routledge, 2008).

<sup>584</sup> *Komisi Pengawas Persaingan Usaha Republik Indonesia*, "Evaluasi Kebijakan Perkebunan Kelapa Sawit", *Position Paper* (2006).

<sup>585</sup> Richard Robison and Vedi R. Hadiz, *Reorganising Power in Indonesia: the Politics of Oligarchy in an Age of Markets* (London and New York: Routledge Curzon, 2004).

Fukuoka.<sup>586</sup> Robison and Hadiz argued strongly that the democratisation process could not transform business to become more politically independent from the governing elites. According to these scholars, this occurred because the governing elites were secure in patronage relations with their old business alliances; therefore these businesses remained predatory and market forces were constrained.<sup>587</sup> Fukuoka, following Robison and Hadiz's argument, agreed that the process of democratisation did not have the intended effect, either in transforming patrimonial state-business relations or transforming Indonesia into a regulatory state because patrimonialism has inhibited this transformation.<sup>588</sup>

While it might be true that the existence of illiberal politics and predatory markets at the national level has impeded transformation to a regulatory state, the electronics industry, however, has negated these scholars' arguments. The majority of electronics players are MNCs, who are in a stronger position vis-a-vis the government to press for a regulatory regime more consistently in favour of their interests. The local companies were aware of the need for attracting foreign investment in this industry so that Indonesia could compete in the ASEAN region. Nevertheless, the efforts to lure foreign investment were not enough to provide incentives for local companies. As a result, MNCs and joint venture companies obtained more benefits from this law compared to local companies, which weakens the structure of the local industry.

Further, the electronics industry has demonstrated that dispersed systems of power have a limited impact on state-business relations, let alone patrimonial relations, given the fact that the majority of electronics players are MNCs, which makes the dependency between subsidiaries and parent companies greater than dependency on government. Even though the local players (most of them were Indonesian Chinese entrepreneurs and some conglomerates), were independent entrepreneurs, they were not part of Soeharto's crony network. In other words, the case study of the electronics industry has shown that it does not provide such a supportive environment for patrimonial relationships to develop, even in the New Order era. According to business players, personal

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<sup>586</sup> Yuki Fukuoka, "Politics, business and the state in post-Soeharto Indonesia," *Contemporary Southeast Asia* 34, no. 1 (2012).

<sup>587</sup> Robison and Hadiz, *ibid.*

<sup>588</sup> Fukuoka, *ibid.*

relationships, between government and companies were considered an impediment to state-business relations.

The second finding relates to the influence of accelerated globalisation and its impact on patrimonial state-business relations in the palm oil and electronics industries. Given the role of globalisation in the power constellation in the *Reformasi* era political economy, Robison and Hadiz argued that globalisation could support the oligarchic character of the elite as it would press the oligarchy to follow globalised norms.<sup>589</sup> In the palm oil industry, this research showed that the influence of globalisation was reflected in the intensification of global NGOs' campaigns on environmental destruction, resulting from the massive expansion of palm oil plantations, and the pressure on Indonesia to comply with global standards for the production of sustainable palm oil, which have scrutinised state-business relations. Even though, to a certain extent, the scrutiny succeeded in making both the state and conglomerates comply with global norms, it was not sufficient enough to support the Indonesian government's own moratorium on the expansion of plantations. The production of Crude Palm Oil (CPO) and its derivatives have continued to grow.

On the contrary, the high demand for CPO and biofuels from the international market, especially with the European Union's mandatory targets for the use of renewable energy, have increased government support for the conglomerates to produce and export CPO and its derivatives, including biofuels, to meet this high demand. In this sense, this finding has diverged from Robison and Hadiz's arguments, as this research showed that globalisation has made relations between state and business more complex and, more importantly, advantaged the conglomerates in their relations with government. As a consequence, government has become more dependent on conglomerates to produce CPO and its derivatives, including biofuels, both for domestic consumption and export income. The dependency of government on the conglomerates is more obvious at the local government level, given their enhanced authority under decentralisation.

These complex relations between state and business have not only been influenced by globalisation, but the palm oil industry has grown rapidly and contributes significantly to the whole economy in terms of foreign exchange, job creation and poverty

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<sup>589</sup> Robison and Hadiz, *Reorganising Power in Indonesia: the Politics of Oligarchy in an Age of Markets*.

alleviation. The government requires the conglomerates' assistance to meet the increasing domestic demand for cooking oil and biofuels. The inconsistency of the government's policies in granting licences for new palm oil plantations, despite its own moratorium, indicated its twofold concern for domestic palm oil consumption and export income.

The electronics industry, however, has demonstrated that globalisation has driven local business players, joint ventures and subsidiaries of the MNCs, their competing interests notwithstanding, to push the government to develop its regulatory function, although the regulatory regime has mostly favoured the MNCs. The Indonesian electronics industry was among the smaller producers with strong reach in medium technology capability of consumer electronics products, but with a big domestic market. This situation required a commitment from the government to follow through on laws and regulations, to enforce standards, to control illegal imported products infiltrating the market in an era of free trade and to prolong the existence of the MNCs. Compared to what occurred during the New Order, the MNCs have the capability to reallocate their subsidiaries relatively quickly, if the host country fails to provide the requirements they need. Given the broader picture, this finding contradicts with Robison and Hadiz's argument; they have warned that globalisation will be weighed down by neo-liberal interests in safeguarding private companies' interests. However, in this sense, the interests of the MNCs have pushed the government to increase its regulatory scrutiny.

The third finding relates to the roles played by business associations as new players in state-business relations. Business associations are interest groups whose role has been to represent the interests of their members' sector in the economy. These associations sought to influence the New Order government's policies, particularly since the implementation of deregulation policies in the mid 1980s. The findings of this research have shown that as democratisation evolved, the roles of business associations – KADIN and sectoral industry associations – in influencing the *Reformasi* governments' policies have not only increased, but also their activities have been conducted in a more transparent and institutionalised manner, even though more public lobbying has not automatically meant a withering away of patrimonial relations with government.

MacIntyre's study on sectoral industry associations during the New Order era revealed that they could influence the government's policy makers, even though their roles were still limited.<sup>590</sup> Another study by Natasha Hamilton-Hart and Hartono<sup>591</sup> during the period of *Reformasi* governments has observed the increasing role of KADIN as part of the policy making process. But Hamilton-Hart has warned that business associations need to be aware of competing interests as a consequence of the transparent political system.

As interest groups, business associations' main task is to promote their own interests, whether or not their sectional interests are consistent with government or national interests. In a more transparent political system, lobbying the government to promote their interests has become an accountable and public practice; however, findings from this study have shown that in an era of globalisation, both KADIN and business associations in the palm oil industry continue to engage in patrimonial state-business relations. In contrast, accelerated globalisation has strengthened the role of business associations in the electronics industry vis-a-vis government.

KADIN has developed into a relatively professional and credible peak business association during the first ten years of *Reformasi* governments (1999 to early 2010) and has effectively coordinated its activities with business associations in the palm oil and electronics industries. Prior to 1994, KADIN was used by Soeharto as one means of controlling the business community through the appointment of military officers and senior government officials to leadership positions in KADIN. Since the New Order, KADIN and the associations have sought to influence the government's policy process in a more institutionalised and transparent manner. The lobbying by business associations in these industries with government has been around such issues as cooking oil, export tax and biofuel as well as the issues of Luxury Tax, *Standard National Indonesia* (the Indonesian National Standard) and how to protect the domestic market in an era of free trade. More importantly, the government has acknowledged the input of

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<sup>590</sup> Andrew MacIntyre, *Business and Politics in Indonesia* (North Sydney: Asian Studies Association of Australia with Allen & Unwin, 1991).

<sup>591</sup> Natasha Hamilton-Hart, "Government and Private Business: Rents, Representation and Collective Action," in *Indonesia; Democracy and the Promise of Good Governance*, eds. Ross H. McLeod and Andrew MacIntyre (Singapore: Institute of Southeast Asian Studies, 2007), 93-114; Adelbertus I.J. Hartono, "State-Business Relations in Post-1998 Indonesia: The Role of KADIN", *PhD thesis* (The University of Groningen, 2011).

KADIN and these associations in the development of policies and new laws, including the Competition Law and the government regulation for the National Industry Policies.

The influence of globalisation on business associations' stance in the palm oil industry is more complex. Facing boycotts on Indonesia's biofuel export to the EU and scrutiny from global stakeholders on environmental issues, business associations sought protection from the government.

However, the government could not give protection in the same way as it had in the Soeharto era. More importantly, the government also needed to secure national interests, in the case of cooking oil and the biofuels, for domestic consumption. Even though the government had its own limitations in providing protection to specific conglomerates as members of business associations, through its Trade and Industry Ministers, the government intensified its diplomatic lobbying with some EU countries, not only to inform the progress achieved by business associations in this industry to comply with international standards and regulations to produce sustainable palm oil, but also to challenge regulations that favoured developed countries. This diplomatic support might not be the same as the protection in the Soeharto era; but what the government has demonstrated is a more transparency and accountability in responding to business associations' interests and the countervailing pressures of the international community.

Even though business associations lobbied the government to promote their interests, some issues are more difficult than others. The nature of these issues has made business associations' lobbying complex, sometimes using public advocacy while at other times relying on patrimonial relationships. In maximising their profits in producing CPO and its derivatives, the associations lobbied the government to revoke the Export Tax. Nevertheless, the government perceived these issues as a matter of national interest as they were intertwined with the government's strategy to grow export income, alleviate poverty and secure sufficient CPO production for domestic needs. These national interest considerations limited the effectiveness of business association lobbying. However, the lobbying of business associations was more successful when the government shared the same interests, as reflected in its support of the Indonesian Sustainable Palm Oil (ISPO) standard implementation as well as to counter the EU dumping allegation against Indonesian biofuel companies. The government's support of

the palm oil conglomerates reflected, in part, its responsibility to protect Indonesia's reputation as a responsible global citizen on environmental and climate change issues.

In contrast, the influence of globalisation on business associations in the electronics industry has strengthened their position in relations with government. Globalisation has intensified competition to keep subsidiaries of the MNCs in Indonesia and to protect the Indonesian market from negative impacts, particularly from AFTA and CAFTA. The convincing lobbying from business associations has had the support from stakeholders, including the local companies, to follow through with laws and regulations and to enforce them in order for the electronics industry to survive in the face of global competition.

The evolution of KADIN, from being one of Soeharto's political vehicles to control business groups to becoming a more independent and credible peak business association, partly relates to the role of Aburizal Bakrie. The emergence of Bakrie as KADIN'S first president, from a private business faction, presided over KADIN from 1994 to 2004 for two consecutive terms. Bakrie developed KADIN as a relatively credible and professional business association along with good cooperation from the sectoral industry associations. Alongside modernising KADIN, he used the networks he developed in KADIN to engage with Soeharto's family businesses for his own companies' benefit. As the chair of KADIN, he managed to maintain his professionalism. In 2004 he transferred his leadership to his successor, when he was appointed as the Coordinating Economic Minister (then as the Coordinating Welfare Minister) in the first term of Susilo Bambang Yudhoyono's administration.

Following his ministerial position, he became a major politician and was elected as the chair of GOLKAR. His achievement was to institutionalise KADIN internally and to transform KADIN into a respected player in state-business relations. Bakrie also established a precedent and a new pattern for the involvement of business players in national politics. He showed that business players could hold a ministerial position without having had a military or bureaucratic career.

Analysing this personal dimension, Aburizal Bakrie's role, both in politics and business, has demonstrated a new phenomenon in Indonesia's political economy. While he modernised KADIN, at the same time, he developed his own patrimonial relations

inside KADIN and used KADIN as one of the means to promote his future political career. As an emerging figure, he could be compared to Soeharto as a central figure in patrimonial networks, linking business and government. After Aburizal Bakrie became chair of Golkar in 2009, he was able to reassert his influence in KADIN through the election of protégées to senior positions.

Analysing the influence of the regulatory framework, global stakeholders and business associations in the palm oil industry, this research demonstrates that patrimonial state-business relations remain but they have changed in nature. The major different characteristics are that the number of government patrons involved has increased as a result of key dominant patrons no longer existing; the involvement of local governments and conglomerates, who owned national palm oil companies at the district level, in exchange for concessions of land for plantations with material incentives; and the government at the national level was indirectly targeted by global campaigners because of its limited ability and willingness to control conglomerates in this industry.

Globalisation has assisted to make patrimonial relationships in this industry more visible and, accordingly, this has enabled global stakeholders to scrutinise the new pattern of patrimonial relationships and any contraventions of international norms facilitated by these relationships. In fact, the government has become more dependent on the conglomerates to produce CPO and its derivatives to fulfil its own objectives.

In contrast, the findings demonstrated by the case study of the electronics industry have suggested that this sector relatively is not a supportive environment for patrimonial relationships to develop, even during the New Order. That is, different industry sectors brought different accounts of the existence of patrimonial relationships following the crisis and Soeharto's resignation. The structure and the dependency of technology on international principal companies, which were the majority of players, have made them more detached from government. Patrimonial relationships between the government and these companies, therefore, can be considered as an impediment.

Further, the findings also emphasise the differential influence of globalisation as responsible for the different existence of patrimonial relationships between industries as well as the increased role of business associations in the palm oil and electronics industry. The electronics industry, since the New Order, has been highly dependent on

and integrated with advanced global electronics countries. Even for local companies, they have had to network through their connections with global suppliers in order to be competitive players. The relations between state and business in this industry have been based on laws and regulations as expected in the market economy.

This situation is different from what occurred in the palm oil industry. From the beginning of its development in the 1970s, the state was the key player. Much environmental destruction occurred during the Soeharto era; even though neighbouring countries, such as Singapore and Malaysia, were affected by forest clearing and fires, the government took little or no action against the conglomerates responsible, some of whom were government cronies. From the 1990s, as part of globalisation the environmental destruction by conglomerates in the palm oil and timber industries has been the focus of international and NGOs' campaigns. It reached its peak during the *Reformasi* governments and created tension among business and global stakeholders in this industry; nevertheless, globalisation has assisted to make patrimonial relationships in this industry more visible and, accordingly, it enabled global stakeholders to scrutinise the new pattern of patrimonial relationships and any contraventions of international norms facilitated by these relationships.

Comparing the influence of globalisation to state and conglomerates relationships in South Korea and Malaysia, it seems that what occurred in South Korea is more similar to Indonesia. Before the 1997 financial crisis, some administrations in South Korea agreed to allow *chaebols* to largely manage themselves, with their large and diversified structures.<sup>592</sup> However, following the 1997 financial crisis, starting with Kim Dae Jung administrations were less tolerant of what *chaebols* did. Kim Dae Jung and the successor administrations worked with international financial institutions, such as IMF and OECD, as well as local NGOs to regulate the behaviour of the *chaebols* and established an independent body to supervise the *chaebols*. Unlike what occurred in South Korea following the 1997 financial crisis, Malaysian conglomerates relations with their government has not demonstrated changes towards a more open and

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<sup>592</sup> Jiho Jang, Sunhyuk Kim, and Chonghee Han, "Advocacy Coalitions in Regulating Big Business in South Korea: Change of *Chaebol*'s Holding Company Policy," *Korea Observer* 41, no. 2 (The Institute of Korean Studies, 2010), 161-188.

independent relationship.<sup>593</sup> The process of democratisation in Malaysia has not yet progressed as in South Korea and in Indonesia. Malaysian conglomerates still enjoy close and protected relationships with the government.

Finally, business associations in both the palm oil and electronics industries have developed a greater variety of relationships with governments, both national and regional. The national business association has established more institutionalised relations with government. They have been consistently reminding the *Reformasi* governments of the importance of providing supportive business environments to enable them to compete in domestic and global markets. This can be seen in their lobbying, for example, to promote efficiency, to discuss laws and regulations, and to propose blueprints for industries. However, their lobbying was not an automatic indication of a withering in patrimonial relationships, particularly with business associations in the palm oil industry. Globalisation, conversely, has strengthened the role of business associations in the electronics industry vis-a-vis government.

The contribution of this thesis is that it has demonstrated in general, that patrimonial state-business relations in Indonesia, following the crisis and Soeharto's resignation, has remained but has developed with different patterns, characteristics and actors, which in turn generated even more complex relations and dependencies. The new form of patrimonial relations has confirmed Harold Crouch's proposition about the persistence of these relations<sup>594</sup>; however, this research has differed from Crouch's proposition by adding a new dimension to the complexity of these relations. These differences, more importantly, are more visible when different sectors of the industry are compared. Two case studies in the palm oil and electronics industries have exposed these differences; in fact, due to the nature of the electronics industry, patrimonial relationships hardly existed.

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<sup>593</sup> Mhinder Bhopal and Chris Rowley, "The State in Employment: The Case of Malaysian Electronics," *The International Journal of Human Resource Management* 13, no.8 (Taylor and Francis, December 2002), 1166-1185.

<sup>594</sup> Harold Crouch, "Patrimonialism and Military Rule in Indonesia," *World Politics* 31, no. 4 (1979), <http://www.jstor.org/stable/2009910> (accessed 21 November 2009): 571-587.

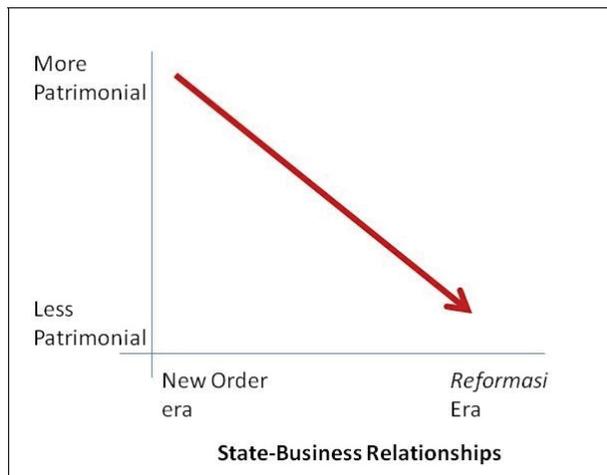


Figure 8.1: State Business Relationships Comparison Between New Order and Reformasi Eras

Not only was the democratisation process responsible for these changes; more importantly, globalisation has emerged as an influential factor to differentiate patrimonial relationships following the 1997-8 economic crisis and Soeharto's resignation. During Soeharto's New Order, the emphasis on development occurred domestically with Soeharto as the key patron. The impact of globalisation was starting to take hold with the deregulation of the economy and greater engagement with the global market. Soeharto's government had the capacity to marginalise and suppress its domestic critics and ignore foreigners, at least until the economic crisis. Following Soeharto's resignation, these two factors have completely changed.

The dispersed system of power as a consequence of democratisation and decentralisation processes has meant that the *Reformasi* governments have been weaker than Soeharto's government. Coinciding with this change, globalisation has accelerated considerably and made the Indonesian political economy more exposed as it has been integrated with the global economy. Unavoidably, this greater transparency has exposed the new pattern of patrimonial relationships to greater scrutiny. The palm oil industry is a good example, but not the electronics industry. Despite revealing the negative impacts of globalisation, the greater involvement of the Indonesian economy in global markets has also increased considerably the ability of its regulatory function to respond to international requirements. It is the influence of the greater integration of Indonesia with

the global economy that has brought about some moderation and transformation of patrimonial relationships between state and business.

In a broader sense, this research has contributed to making sense of the impact of globalisation on patrimonial state-business relations, following the 1997-8 economic crisis and Soeharto's resignation. On the one hand, globalisation has positively influenced to assist the state to develop its regulatory function, and therefore, to moderate patrimonial relationships. On the other hand, globalisation has also provided a different context for patrimonial state-business relations to operate in *Reformasi* governments. The fact that the patrimonial system remains, despite but the scrutiny of global actors, means that its operation has to take on a new pattern of relations which involve different networks and actors.

In the debate about patrimonialism, the contribution of this research is to demonstrate the complexity of relations between state and business, and as such has tended to confirm the arguments of Jamie Mackie, Edward Aspinall and William Case in terms of the number of actors involved as patrons and clients.<sup>595</sup> What makes this research different from that of other scholars is that this research has indicated an increase in the number of actors, but also this research has examined the dynamics and complexity of relations. The government's interest in the palm oil industry has made government more dependent on business, both at national and local levels.

The Joko Widodo – Jusuf Kalla government was inaugurated on 20 October 2014 and the new cabinet was announced on 26 October 2014. Although it is too early to identify the approach of the new government and how it might develop, President Joko Widodo has said that he wants to reduce the red-tape in the bureaucracy as this effects the conduct of business and would support the KPK's programs to eradicate corruption. The President has also identified the need for greater transparency in government contracts,

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<sup>595</sup> Jamie Mackie, "Patrimonialism: The New Order and Beyond," in *Soeharto's New Order and Its Legacy: Essay in Honour of Harold Crouch*, eds. Edward Aspinall and Greg Fealy (Canberra: ANU Press, 2010), 81-96; Edward Aspinall, "A Nation in Fragments," in *Critical Asian Studies*, 45, no.1 (2013): 27-54, <http://dx.doi.org/10.1080/14672715.2013.758820> (accessed 25 May 2013); William Case, *Politics in Southeast Asia* (London and New York: Routledge Curzon, 2002); William Case, "Low Quality Democracy and Varied Authoritarianism: Elites and Regimes," in *Southeast Asia Today*, 22, no. 3 (2009), [www.informaworld.com/journals](http://www.informaworld.com/journals) (accessed 12 January 2012).

especially in the sensitive gas and fossil fuel sectors.<sup>596</sup> These early signs suggest that the new government has established new benchmark to combat corruption, including the systemic corruption which is often involved in patrimonial relationships between state and business figures.

The research of the abovementioned scholars also emphasised decentralisation as one of the significant aspects of the democratisation process which facilitated a new pattern of patrimonial relationships. The usage of ‘patronage relationships’ and ‘clientelism’ instead of ‘patrimonial relationships’ has the implication that the relations between patrons and clients are limited and exclusive in number, but dispersed sets of relationships follow the dynamics of decentralisation. This includes the widespread exchange of money politics that has characterised these relationships. Even though my research does not focus specifically on decentralisation, it suggests, particularly in the palm oil sector, that local governments have become dependent on businesses, even though local governments have the authority to issue permits for plantations.

Decentralisation and the empowerment of district governments has meant that further research is necessary to explore how district governments have developed relations with business. There has been a significant expansion of palm oil plantations in Kalimantan, Sulawesi and Papua where local governments have the authority to make decisions that influence the business opportunities of companies, but have little experience and limited capacity to negotiate with companies and monitor business activities. Thus state-business relations in a decentralised Indonesia constitute an important arena for further research.

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<sup>596</sup> “Jalan Perubahan untuk Indonesia yang Berdaulat, Mandiri dan Berkepribadian, Jokowi dan Jusuf Kalla 2014, (Jakarta, May 2014), [kpu.go.id/koleksigambar/VISI\\_MISI\\_Jokowi-JK.pdf](http://kpu.go.id/koleksigambar/VISI_MISI_Jokowi-JK.pdf)

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