Accelerating Regional Development of the Outer Islands: The Implementation of Special Economic Zones in Indonesia, 2011–18

**Executive Summary**

Economic development efforts in Indonesia have long focused on Java, home to more than half of Indonesia’s population, which has exacerbated disparities with the outer islands. To address the issue, the Indonesian government established a number of special economic zones (kawasan ekonomi khusus) in 2011. Efforts to promote business development within the zones faced two challenges: inadequate infrastructure and burdensome government rules and procedures. In response, the government established administrators as integrated one-stop service centers to manage all necessary business activities. Central and local governments also worked together with special economic zone operators to build critical infrastructure to connect local resources to global markets. These policies helped drive more economic activities in the special economic zones, though, as of 2020, further efforts were necessary to address unequal regional development across Indonesia.

**Introduction**

A major emerging market with massive growth potential, Indonesia has long struggled with domestic inequality in its economic development. As of 2009, the country had roughly 230 million inhabitants, who were spread across five main islands and thousands of smaller islands that had abundant natural resources. Approximately 57 percent of Indonesians lived in Java, the country’s fifth-largest island, which dominated the national economy.
Dutch colonial rulers had favored Java because of its strategic location and fertile land. After Indonesia won independence in 1949, development continued to focus on Java, the island where Indonesia’s capital city, Jakarta, and the country’s most advanced infrastructure and economy were located. A study in 1970 found that Java contributed 59 percent of the country’s gross domestic product, while Sumatra contributed 22.3 percent, Kalimantan 7.9 percent, Sulawesi 5.3 percent, and the other islands 5.7 percent (Esmara 1975, as cited in Baswir 1987).

Although the Indonesian government attempted to address the unequal development problem in the 1970s, the concentration of industries in Java increased from 74.8 percent in 1970 to 81.9 percent in 1982 (Statistics Indonesia 1985, as cited in Baswir 1987). By 1996, two islands near Java—Sumatra and Bali—had experienced vibrant growth, but investments lagged elsewhere.

After Indonesia’s economy recovered from the 2008 global financial crisis, Java’s economy grew by 6.4 percent, while the outer islands (including the four larger islands of Sumatra, Kalimantan, Sulawesi, and Papua) experienced average growth rates of only 4 to 5 percent.1 Java’s booming economy attracted more people to migrate there from other islands to live and work, which increased the imbalance.

Despite Indonesia’s economic growth, the unequal distribution of people and wealth among the islands caused severe problems. Population pressures on Java caused an increase in crime rates and in competition for limited job opportunities and public services such as education and health. Meanwhile, the relative neglect of the outer islands contributed to insecurity, lower social welfare, and the underdevelopment of resources.

To address this disparity, the Indonesian government established integrated economic development zones (kawasan pengembangan ekonomi terpadu, or KAPET) in 2000 to enhance the development of 13 regions, with a focus on agricultural sectors. However, the policy failed to provide investors with sufficient incentives and an attractive business climate. In addition, issues such as confusion over the economic zone borders deterred investors. “During the implementation of KAPET, there was not much maximization of incentives,” said Bambang Wijanarko, the head of the Development and Management Controlling Division of the National Council for Special Economic Zones. “The areas of implementation were also too broad. Not too much attention was given to the business sectors.”2

In late 2009, the Indonesian government tried to address those shortcomings by establishing special economic zones (kawasan ekonomi khusus, or SEZs). The government defined special economic zones as areas established within certain designated borders to maximize high-value industrial activities. Draft legislation to regulate SEZs was discussed by Minister of Finance Sri Mulyani, Minister of Trade Mari Elka Pangestu, Minister of Industry Fahmi Idris, and Minister of Law and Human Rights Andi Mattalatta, as well as other government ministers and the special committee for SEZs in the Indonesian legislature. According to the law, “the regions will be able to have industrial activities including export and import and boost the economic growth in the regions” to “prepare the regions in Indonesia with geo-economic and geostrategic advantages.”3

The Indonesian government benchmarked the policy against Chinese special economic zones but ultimately followed a different model that focused on developing areas with easy access to global markets. To attract investors, the government also regulated fiscal incentives for business activities in SEZs related to taxes, customs, and excise tax facilities, as well as nonfiscal incentives like streamlined regulations for investors.

Using the SEZs, the Indonesian government aimed to tackle economic growth inequality between Java and the outer islands in accordance with President Susilo Bambang Yudhoyono’s national master plan (the Masterplan Percepatan dan Perluasan Pembangunan Ekonomi Indonesia, or MP3EI). The plan accelerates economic growth in six corridors: Bali–Nusa Tenggara, Java, Kalimantan, Papua-Maluku, Sulawesi, and Sumatra (figure 1).4

The government planned to map out the special characteristic of each corridor. “The development of SEZs should highlight the main resources of each region,” said Wahyu Utomo, the deputy for coordination of infrastructure acceleration and regional development in the Coordinating Ministry for Economic Affairs.5 “Each

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2 Author interview with Bambang Wijanarko, Office of the National Council for Special Economic Zones, September 2019.
3 Indonesian Law on Special Economic Zones No. 39/2009.
5 Author interview with Wahyu Utomo, Office of the National Council for Special Economic Zones, September 2019.
accelerating regional development of the outer islands was designated based on its kinds of potential national resources and how transportation networks in each corridor were able to accommodate their development. sumatra, for instance, was designated the center of production for agricultural resources; java was the center of industry and services; and kalimantan was the center of production and mining. originally, the master plan focused on regional development, and then corridor development and the connectivity between each corridor, said utomo. “the government expected each economic zone to experience more economic growth from the development of sezs.”

delivery challenges
indonesia’s implementation of sezs faced two major delivery challenges: (a) complex bureaucratic procedures for handling investments discouraged potential investors, and (b) sezs lacked the basic infrastructure to support businesses and connect them with global markets.

unsupportive legal or regulatory processes
the sezs were designed to accommodate as many investment activities as possible within designated areas in order to maximize potential resources and increase regional economic growth. investment management in indonesia, though, involved many stakeholders and administrative requirements. the procedures for issuing a business license or an export-import permit, for instance, were expensive and time-consuming for business owners. in 2008, the world bank reported that indonesia ranked 123rd out of 175 countries in its annual assessment by the ease of doing business index. the index ranked indonesia 163rd out of 175 countries for starting a business and found that licensing a business could take up to 105 days—longer than any other country surveyed—and involved 12 procedures that required the securing of permission from both central and local government authorities (world bank 2008). lengthy bureaucratic processes also created corruption risks as businesses looked for shortcuts to expedite permits. sez promoters had to guard against potential resistance from those who benefited from those work-arounds.

to attract investors to the sezs, the indonesian government had to increase the efficiency and integrity of local permitting processes, starting with local government personnel. “one of the main challenges for sez implementation in the field was human resources,” said wijanarko. “it is important to increase the capacity of the people and protect integrity.”

basic infrastructure
the underdeveloped areas to which the indonesian government hoped to attract more investors lacked the
basic infrastructure necessary for business activities. In particular, Kalimantan, Papua, Sulawesi, and other eastern islands suffered from underinvestment in infrastructure. Between 2005 and 2010, the proportion of Indonesia's budget dedicated to infrastructure development financing ranged from 0.94 to 1.55 percent. In contrast, China spent 5.3 percent of the state budget on infrastructure (Maryaningsih, Hermansyah, and Savitri 2014).

The Indonesian government identified several challenges that hindered development in the east, including the lack of skilled labor, less favorable land conditions, and greater distances from global ports and manufacturing industries in Java. The eastern islands had higher construction and shipping costs because they were farther apart and had few transportation alternatives besides air and sea.

Java-centered development also hindered human capacity development in the other islands, worsened by labor migration to Java. The “brain drain” of educated and skilled workers to Java further encouraged investment in Java, resulting in less attention and less willingness to build infrastructure in eastern Indonesia. A manufacturing sector review by Bappenas and the Asian Development Bank (ADB) suggested that companies required trained laborers to improve productivity and adaptability to working environment and technology changes (ADB-Bappenas 2019). The labor force outside of Java was predominantly unskilled, and Indonesians scored lower on educational tests than did regional peers in countries like Thailand and Vietnam.6

Tracing the Implementation Process

SEZ implementation involved several steps. In 2010, the national government created a national council that implemented SEZ policies following the national master plan. Starting in 2011, the council worked with other stakeholders to choose SEZ locations, streamline administrative procedures, and create investment incentives.

Establishing the National Council and a Master Plan

After enacting the SEZ law in October 2009, the Coordinating Ministry of Economic Affairs formed a special committee in May 2010 to oversee all SEZ operations at the national level: the National Council for Special Economic Zones (or the SEZ National Council). Established under the presidency, the 10-member SEZ National Council was led by the coordinating minister of economic affairs and consisted of the ministers of finance, trade, industry, home affairs, public works, transportation, manpower, and development planning, as well as the head of the Indonesian Investment Coordinating Board (Badan Koordinasi Penanaman Modal, or BKPM).

The MP3EI established by President Susilo Bambang Yudhoyono in May 2011 created economic corridors to enhance Indonesian economic development outside Java, including the special economic zones. The central government planned to build and develop transportation and utility infrastructure to support connectivity among the corridors, such as airports and power lines (figure 2).

Utomo said the SEZs were established in 2009 in accordance with the economic corridor development plan, and so the SEZs incorporated MP3EI, which also specified the infrastructure necessary to support mobility and connectivity between and within each economic zone. He also said that the SEZs’ development reflected the power of Indonesian geography to shape its economic development. The SEZs would be at the front line of global connectivity because of Indonesia’s critical position near vital sea routes like the Strait of Malacca. Their infrastructure would thus support global supply chains, advancing President Yudhoyono’s vision—laid out in the MP3EI—of a “locally integrated and globally connected” Indonesia.

The MP3EI also identified infrastructure needed to support each corridor’s main economic activities. The central government, for instance, identified a need for more rails and roads on which to transport Sumatra’s key resources of palm oil and coal from source to port. For its part, Sulawesi needed irrigation, power plants, and power lines to increase the productivity and connectivity of its agricultural resources and fisheries.

Choosing the First SEZ Locations

SEZ implementation started in October 2011 at a meeting led by Coordinating Minister of Economic Affairs Hatta Rajasa. At the meeting, the SEZ National Council formulated the working road map for 2011–14 and decided to accept two proposals, from Sei Mangkei

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(in North Sumatra) and Tanjung Lesung (in West Java), to become the first SEZs. Sei Mangkei was accessible to ports and strategically located at a production center of raw materials (palm oil, rubber, and timber). Tanjung Lesung had tourism potential because of its proximity to Jakarta and two popular sites for visitors (Krakatau Mountain and Ujung Kulon National Park) (National Council for Special Economic Zones 2012).

After the two areas were designated as SEZs, the SEZ National Council required their proponents to make action plans in discussion with local governments to guide SEZ development over the next three years. The action plans set time frames for critical steps, including (a) establishing a regional council, (b) delegating authority from central to local governments, (c) developing infrastructure and related organizations, and (d) regulating business facilities and incentives.

The SEZ National Council conducted site visits and outreach to scout future SEZ locations. It also invited local government officials as well as private sector organizations to develop SEZ proposals. Each proposal consisted of information about six areas: proponents and location, local government support, location analysis, geospatial analysis, development plans, and investment potential.

In December 2011, the SEZ National Council received 66 proposals from local governments and enterprises in Indonesia. The SEZ National Council selected locations by considering several aspects of the proposals: administrative reviews, the commitment of the local government to support SEZ operations, distance from an international trade route, the potential of natural resources to attract investors, the development plan, available land for infrastructure development, site accessibility, analysis of environmental impact, a study of economic and financial feasibility, and infrastructure financing.

Streamlining Bureaucracy

To address the bureaucratic complexities that discouraged investment, the SEZ Council helped develop an integrated one-stop services program (Pelayanan Terpadu Satu Pintu, or PTSP). The PTSP provided simplified services to investors to help them manage investment applications and secure necessary approvals in one place. The BKPM managed the PTSP by handling investment processes among related government bodies, central and regional governments, and the central bank.

To reduce bureaucracy, the SEZ National Council established the position of administrator to assist the local governments with issues related to managing SEZs. The administrator was responsible for issuing business licenses and other necessary paperwork to investors. Ministries and local governments had to delegate their authority to issue licenses and other essential business documents to the SEZ administrator. BKPM and the Ministry of Trade delegated their SEZ-related authority—the power to issue mandatory business permits and the general importer identification numbers required for companies that imported goods—to the administrator.

Source: This illustration is adapted from the MP3EI document, February 2020.
GLOBAL DELIVERY INITIATIVE

in April and October 2014, respectively. In Sei Mangkei, the local government appointed the Integrated License and Capital Investment Agency in Simalungun as the administrator for Sei Mangkei (see box 1).

There were some concerns about the process of delegating the authority from the central government to local SEZ administrators, though, such as human resource and knowledge sharing. To build the capacity of the administrator, then, the related stakeholders from the Ministry of Trade and BKPM conducted several meetings and on-site trainings to introduce the new system.

By 2016, 526 out of 561 provinces, cities, and SEZs had implemented the PTSP program, according to BKPM.

Reorienting Special Economic Zones under a New National Vision and Infrastructure Institutional Reform

After his inauguration in October 2014, President Joko Widodo announced a new vision and mission for the country: Nawacita, which means “nine visions” in Classical Sanskrit. Of Nawacita’s nine development priorities, four emphasized making the labor force more productive and competitive, strengthening Indonesia’s rural areas, increasing high-value markets through industrialization, and developing infrastructure in the outer islands. The Widodo administration advanced SEZ development in Indonesia in line with Nawacita, which superseded the MP3EI vision laid out by the previous administration.

“MP3EI is different from Nawacita,” said Utomo. “However, there is a synergy between vision and mission of the previous and current presidents. There is around 90 percent of the project list that is in line with Nawacita.” Utomo said the Widodo administration was eager to develop SEZs outside Java to reduce regional inequality and share wealth nationwide.

Widodo also prioritized infrastructure development, mainly in the maritime, agricultural, and energy sectors. To promote institutional reform in the infrastructure sector, the president established the Committee for the Acceleration of Priority Infrastructure Development (Komisi Percepatan Penyediaan Infrastruktur Prioritas, or KPPIP).

KPPIP replaced the National Committee for the Acceleration of Infrastructure Provision (Komite Kebijakan Percepatan Penyediaan Infrastruktur, or KKPPiP), which had been established in 2005 to coordinate infrastructure development nationwide. The former committee had several weaknesses: a lack of decision-making authority, limited specific roles for each stage of project implementation, and a lack of incentive policies for accelerating project completion. To correct these issues, Presidential Regulation No. 75 of 2014 established KPPIP under the Coordinating Ministry for Economic Affairs to coordinate the decision-making process and improve cooperation among stakeholders responsible for infrastructure development.

According to KPPIP’s director of finance, Joseph Tobing, KPPIP was responsible for determining high-priority infrastructure projects from MP3EI. “There are around 1,600 projects,” said Tobing. “It is tough to construct everything. Therefore, we were mandated to determine which projects were to be prioritized. Priority projects were more difficult and provided more connectivity. We also looked at project bankability to attract the private sector. If it is an important infrastructure project and economically sound, then the government can provide viability gap funding.” The presidential regulation made KPPIP the focal point of coordination for the National Strategic Project (Proyek Strategis Nasional, or PSN).

“For SEZs, we need infrastructure connectivity,” Tobing said. “We support external infrastructure development to create quick access from the market and to the port and airport. Each SEZ has their specialized infrastructure to connect [to], like a train or toll road.” Sei Mangkei SEZ, for example, had projects that used Kuala Tanjung Port, a railroad, and a toll road; Mandalika SEZ had projects that used an airport and bypass toll road; Morotai SEZ had a ring road project; and Maloy Batuta Trans Kalimantan SEZ had projects equipped with road and port transport capabilities.

As of September 2019, there were about 81 ongoing National Strategic Project ventures out of 245 projects and two programs. KPPIP aimed for the private sector to handle 58 percent of the National Strategic Project enterprises. “They can do it faster,” Tobing said, “but there are remaining challenges: credibility, certainty, and lack of coordination within sectors.”

According to Tobing, project reviews would begin with an outline of the business case for infrastructure proposals, often made by ministries or regional governments, including “big-picture” details on regulation, the economy, the environment, social impact, and risk.

7 Author interview with Joseph Tobing, Office of the National Council for Special Economic Zones, September 2019.
The development of Sei Mangkei, one of Indonesia’s first special economic zones (SEZs), showed the policy’s implementation and impact. Sei Mangkei was originally a palm oil and rubber plantation area of roughly 2,000 hectares owned by a state-owned enterprise in palm oil and rubber production, PT Perkebunan Nusantara III (PTPN III). PTPN III had a long-term vision to develop an industrial cluster to produce and distribute palm oil and rubber and to process them into intermediate goods and finished products such as cooking oil and glycerol. With the support of the Simalungun Regency and the local government of North Sumatra, PTPN III proposed Sei Mangkei as an SEZ in 2011. The local government appointed PTPN III as the SEZ operator, responsible for managing the SEZ and developing infrastructure and facilities over the next three years.

PTPN III started the first stage of the SEZ infrastructure development in December 2012. As the operator, PTPN III had full authority over internal infrastructure within the SEZ, such as factories, roads, drainage structures, clean water, waste management, and dry ports. The government had responsibility for developing external infrastructure located outside Sei Mangkei that improved its connectivity, such as roads, railways, and electricity; examples included the government-improved roads and the 39.5-kilometer railway developed to connect Sei Mangkei with Kuala Tanjung and Belawan Port to reduce shipping costs for raw materials. The route had previously required a four-hour trip by road. After the railway development, it only required one hour to do the trip.

After the designation of Sei Mangkei as an SEZ in January 2015, PTPN III established a subsidiary called PT Kawasan Industri Nusantara (PT Kinra). PT Kinra became the operator, ensuring Sei Mangkei’s management and marketing services for investors. “We take care of the water management, electricity, waste management, safety, and cleanliness of the area,” said Wahyudi, the director of PT Kinra. “We also need to ensure the safety and comfort of not only business sectors but also local people.”

To improve internal infrastructure, the operator provided a high-volume waste management system, a large tank for palm oil storage, a 3.5-kilometer road, and a dry port. For external infrastructure, the central government provided 10 megawatts of electricity to the area.

Since green growth principles applied to all SEZs, companies had to use natural gas as their fuel. Sei Mangkei had to transport gas from the neighboring province of Aceh in Sumatra’s far north. In 2014, the central government committed to accelerating the construction of a 138-kilometer gas pipeline under construction since August 2011. The Committee for the Acceleration of Priority Infrastructure Development prioritized the construction of the gas pipeline, which was finished in 2016.

The operator secured a tender with PT Industri Nabati Lestari (PT INL), a company that produced intermediate products from palm oil, for a project expected to bring around Rp 850 billion (US$60 million) of investment to Sei Mangkei. In October 2016, PT INL started the construction of the company on 7.46 hectares of land. The company observed that operating in Sei Mangkei would benefit from investor incentives and facilities. Chairul Lubis, the director of PT INL, said there were at least five advantages of investing in Sei Mangkei: “First, PT INL received an exemption of value added tax of products that are in line with palm oil processing. Furthermore, the company is exempted from import duty on capital goods such as imported machines from Malaysia. Next, they can also receive a tax holiday or tax allowance since their investment value has fulfilled the minimum investment amount required by the SEZ law. Through the administrator, the company received investment permits in just one hour. Before, company officials had to travel to Jakarta to attain those permits. Lastly, SEZ comes with all the basic facilities and infrastructure such as dry ports, which helped the company save time by having their exported products cleared without going to the usual port.”

In February 2019, PT INL developed an oil refinery for palm oil intermediate products. The oil refinery produced refined, bleached, deodorized palm oil that could be processed into higher-value products for export to countries in Africa, Asia, and South America.

a. Author interview with Wahyudi, Office of PT Kinra Sei Mangkei, September 2019.
b. Green growth is a principle promoted by the Global Green Growth Institute, an international organization that encourages “strong, inclusive, and sustainable economic growth” in developing countries and emerging economies. Green growth principles are applied to ensure investment project development that reduces greenhouse gas emissions; promotes social, economic, and environmental resilience; sustains economic growth; and provides healthy, productive ecosystem services (GGGI 2018). GGGI and the Indonesian government collaborate to implement the principles in running the Sei Mangkei SEZ.
c. Author interview with Chairul Lubis, Office of PT INL Sei Mangkei, September 2019.
If the proposal did not meet its standards, KPPIP would work with the proponent to review or redo it to better fit KPPIP’s checklist of assessment criteria. “Therefore, we also provide capacity building,” Tobing said. For higher-budget items, such as toll roads, KPPIP conducted a more comprehensive review with demand studies and tried to encourage public-private partnerships.

“The problem is how to de-bottleneck the issues in infrastructure projects,” said Tobing. “There has to be coordination from the central and regional government... to see what kind of regulations we have and if we need any change of regulation. For instance, do we need to change the electricity tariff for waste power plants?”

**Finalizing Investor Incentives and Regulations**

The SEZ National Council also developed guidelines, regulations, and investment incentives through taxes, customs, and excise tax facilities.

The SEZ National Council had prioritized the issue of investment incentives early on and had even developed a draft government regulation on SEZ incentives in 2011. The council and related offices such as the BKPM and the ministries of finance, industry, and trade, however, disagreed on many substantive issues. Points of contention included the provision of tax holidays and tax allowances to investors and the percentage for each tax facility. In 2012, the tax facility had been given only to export- and tourism-oriented activities. Meanwhile, other stakeholders in the SEZ National Council expected more facilities and investor incentives such as a reduction in income tax and import duty. “There was a very long discussion,” Wijanarko said. “The negotiation on incentives also took a long time because the Ministry of Finance has its law that regulates tax issue[s].”

Widodo was determined to resolve the issue of overlapping regulations. The 2014 World Bank Ease of Doing Business Index had suggested that Indonesia still had to overcome several issues to enable a higher level of investment in the country. Therefore, Widodo initiated an economic stimulus package (Paket Kebijakan Ekonomi, or PKE) to remove some overlapping regulations, simplify bureaucracy, and improve law enforcement and the business environment.

Issued in November 2015, PKE No. 6 specifically regulated incentive provisions for SEZ investors. The stimulus package provided a tax holiday (to reduce income tax) and tax allowance (to reduce net income), eliminated charges on value added and luxury goods taxes, allowed foreign ownership of property, reduced taxes for entertainment and amusement purposes, and allowed the SEZ administrator to issue land permits and business licenses. The SEZ National Council supervised the implementation of this PKE and determined the procedures for investors to obtain the incentives.

The tax facilities included tax allowances and relief from import duties, as well as an income tax reduction or tax holiday, amounting to as much as 20 to 100 percent for 10 to 25 years for companies that invested more than Rp 1 trillion (US$70 million) and 20 to 100 percent for 5 to 12 years for companies that invested more than Rp 500 billion (US$35 million). Nonfiscal incentives included simplified regulations for foreign employment permits, property ownership rights for foreign workers, and PTSP through a delegated administrator. The Ministry of Finance also introduced a tax regulation for the SEZ.

The SEZ National Council involved private companies as well as local governments in SEZ site selection. “The new SEZ drive has a bottom-up approach, where business sectors will be more involved [than in the case of KAPET],” said Wijanarko. “For instance, business sectors will have more freedom to choose their preferred location in Indonesia, close to markets or raw materials that will support business activities they want to develop. After that, business sectors or local governments can propose to the central government whether their business is in line with the regional development plan. We hope this approach will attract more business sectors.”

The bottom-up approach also pushed the SEZ National Council to consider more private sector preferences. Because companies were most attracted to invest in countries with supportive business climates, the SEZ National Council identified challenges they could work on, such as unnecessary bureaucracy and gaps in basic infrastructure.

**Improving the Role of the SEZ Administrator**

In the early process of SEZ establishment, PT Industri Nabati Lestari (PT INL) had to go through a complex bureaucratic process as one of the investors in Sei Mangkei. The manager had to go all the way to Jakarta to handle business paperwork such as getting a taxpayer
identification number. After BKPM delegated its authority to the administrator, though, the company claimed to have had a better experience with the bureaucratic process. The administrator, for instance, was able to help the company issue work permits for foreign employees without having to go to Jakarta.

After being established in 2014, the administrator was not yet fully functional. To increase the administrator’s capacity and strengthen SEZ implementation, then, the SEZ National Council also provided training through the Ministry of Trade for local government officers attached to the administrator’s office. The training included how to issue an electronic certificate of origin (a mandatory letter for exporters detailing the origin of exported products) and how to use INATrade (Indonesia Trade), an online platform for trade activities registration created by the Ministry of Trade.8

Naomi Sigalingging, the subhead of programs for the Sei Mangkei administrator, said that the Indonesian government continued improving services for investors in regions through BKPM.9 In January 2016, BKPM launched an investment service that enabled companies that invested more than Rp 100 billion (US$7 million) to receive their business permits within three hours, while before it had taken 20 to 45 business days.

In 2018, the Indonesian government developed an electronic platform called the Online Single Submission (OSS), which enabled the administrator to expedite business license issuance in one to three hours. President Widodo said in August 2018, “Government should push the ease of doing business through structural reform, including reform in investment service. OSS expects to cut bureaucracy and help the business sectors effectively. Hopefully, through this reform, bureaucracy in the central and regional governments can be easier, faster, and integrated” (Jakarta Post 2018). OSS’s integration into the administrator’s operations enabled every SEZ investor to receive crucial business permits online, minimizing paperwork.

“[SEZ] administrators have a significant role in attracting investors,” said Wijanarko. “However, because each region has autonomy, sometimes central regulations have to compromise with local regulations. Therefore, we need a commitment from the local government to increase the capacity of their administrator.”

Outcomes

As of February 2020, Indonesia had 15 SEZs, of which 11 were operational and 4 were under development (see figure 3). Five were in Sumatra, three in Java, three in Sulawesi, and one each in Kalimantan, North Maluku, West Nusa Tenggara, and West Papua (see appendix A).

The urgency of increasing investments in SEZs moved the government to simplify the complicated bureaucracy. In fact, Indonesia’s rank in the World Bank’s Ease of Doing Business Index improved from 129th in 2011 to 72nd in 2018, which represented a potential boost to future investment. The digitalization of many business permit issuance processes reduced opportunities for corruption. The SEZs also contributed to human capital development by expanding job opportunities, especially outside Java. The number of employees in Sei Mangkei, for example, reached about 2,000, according to PT Kawasan Industri Nusantara (PT Kinra), and 60 percent of employees came from local areas.

The Indonesian government also attempted to boost investment through incentives and facilities. Still, Wijanarko cautioned that this was a long-term investment, the effects of which would take more time to assess. “The important thing now is the commitment from local government to support the activities, a growing working opportunity, and economic growth,” Wijanarko said.

Investment realization from 2013 until 2019 was still far below expectations, especially for SEZs in the eastern part of Indonesia.10 Indeed, most SEZ investment occurred in more developed areas with preexisting industry, tourism, or trade connections. Sei Mangkei and Galang Batang, which had more investment realization than other SEZs, are both in Sumatra and lie close to the global sea lane of the Strait of Malacca. SEZs in the western part of Indonesia tended to be in more settled areas that had already attracted investors. Furthermore, a Centre for Strategic and International Studies report said that investors were likely to choose locations with a larger potential workforce (Damuri, Christian, and Atje 2015). Meanwhile, for instance, Morotai SEZ, in the outer part

8 Author interview with Yuli Endah, Office of Indonesian Ministry of Trade, September 2019.
9 Author interview with Naomi Sigalingging, Office of Sei Mangkei SEZ Administrator, September 2019.
10 Author interview with Mulyoko, BKPM, September 2019.
of Northern Maluku, which only had 74,000 residents, required more workers to be economically viable, increasing investment costs. Regional government support, funding, and local human resources all contributed to the readiness of the area.

In the case of Sei Mangkei, underemployment continued to pose challenges. “Local people around Sei Mangkei sometimes conduct demonstrations about how unfair job recruitment is,” said Wahyudi, the director of PT Kinra. “Local people felt that companies in SEZs still mostly employed people from outside the region. Therefore, the local people have not necessarily felt the optimal result [of development].” He further explained that some companies recruited more people with specialized skills from other regions or islands. In response to the underemployment, PT Kinra engaged local representatives to resolve the issue. PT Kinra encouraged the local government, industries, and society to cooperate and provide proper capacity development.

Sigalingging said: “We hope they prioritize the local people to work. If the company needs certain skills, please do a training for them. PT INL has committed their 70 percent of job vacancy for local people. We need monitoring.”

Ultimately, the SEZs could be a stepping-stone toward growth and development in the outer islands. In Sei Mangkei, the minimum wage increased from Rp 2.4 million to Rp 2.5 million in 2019. Lubis said that the SEZ had helped local businesses. “Slowly but surely, there are more economic activities around the SEZ,” Lubis said. “The more companies, the more workers. Of course, workers need food and living. Therefore, their presence stimulates more local people to sell food in trucks, open convenience stores, and open boarding houses for workers.”

Wahyudi agreed. “There are more working opportunities,” he said. “There are also more economic activities around.”
The area around Sei Mangkei experienced economic growth, with more facilities such as hotels and dormitories for workers. The number of convenience stores had increased from 2 to 13 by 2019. The improved investments in Indonesia as a whole could also be a positive sign that the SEZs were contributing to the parallel development of all of Indonesia’s regions.

Sigalingging said there had been “no significant change yet” in the economic impact of Sei Mangkei because only two companies had joined the SEZ as of 2019, but she also noted additional developments like infrastructure, hotels, and restaurants. “It provides working opportunities,” she said, “but we have no official data yet about the impact, such as income per capita.”

As another example, the SEZ located in Mandalika, West Nusa Tenggara, sent some of its residents to Bali to study tourism so that they could be better equipped and ready to work in the SEZ.

**Lessons Learned**

**Sites with Strong Growth Potential Can Serve as Testing Grounds for SEZ Development**

Although the Indonesian government planned to establish multiple SEZs across the country to attract investment in underdeveloped areas, the SEZs that got off the ground first were in areas close to global markets such as Sei Mangkei and Galang Batang in Sumatra. As of 2020, the five SEZs in Sumatra and the three in Java attracted far more investment capital than the seven SEZs in the eastern islands. Although the SEZs in Sumatra and Java were outside business centers like Jakarta and Bali, they were better positioned for economic growth than sites in the eastern islands most affected by regional inequality.

Although such “low-hanging fruit” could serve as good testing grounds for SEZ development, SEZs in areas with greater needs may require additional government attention, resources, and investor incentives.

**Fiscal and Administrative Incentives Can Encourage Investment in SEZs**

Incentives played an important role in developing Indonesian SEZs. Lubis from PT INL said that investor incentives—especially tax incentives such as the value added tax, tax holidays, and tax allowances—attracted companies. Faster business permit issuance procedures from the administrator also benefited companies.

Wijanarko from the National Council said that SEZ incentives were quite generous compared with those in other countries, but he emphasized that companies received incentives only if they abided by procedures and laws related to document clearance, environmental assessment, and regular tax payment. Close monitoring and communication by central and local governments helped ensure compliance.

**SEZ Success Depends on the Commitment of All Stakeholders**

A combination of top-down and bottom-up approaches facilitated SEZ implementation in Indonesia. In the proposal stage, the National Council allowed local governments to propose the development of SEZs according to each region’s potential resources while also making its own suggestions to local governments that had the capacity and potential to become an SEZ. In each stage of SEZ development, the National Council coordinated with all stakeholders to understand local conditions and needs. Site visits, meetings, and focus group discussions increased the effectiveness of the decision-making process. The coordination also contributed to better infrastructure development and a more effective division of responsibility between central and local governments.

Better coordination at a local level could have smoothed the implementation process. Frequent rotations in the Sei Mangkei SEZ administrator’s office, for example, hindered proper task management and effective coordination with other stakeholders. “Since the local government has a crucial role, maybe it is important to consider providing incentives for local government (such as an administrator) to handle the SEZ implementation,” said Fakhrul Aufa of PT Sarana Multi Infrastruktur. Potential incentives for administrators could include bonuses, training, or capacity development.

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14 Author interview with Fakhrul Aufa, PT Sarana Multi Infrastruktur, September 2019.
References


## Appendix A

### SEZs in Indonesia as of February 2020

<table>
<thead>
<tr>
<th>Place</th>
<th>SEZ</th>
<th>Number of SEZs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sumatra</td>
<td>Sei Mangkei, Arun Lhokseumawe, Galang Batang, Tanjung Api-Api (development phase), and Tanjung Kelayang</td>
<td>5</td>
</tr>
<tr>
<td>Java</td>
<td>Tanjung Lesung, Kendal (development phase), Singasari (development phase)</td>
<td>3</td>
</tr>
<tr>
<td>Kalimantan</td>
<td>Maloy Batuta Trans Kalimantan</td>
<td>1</td>
</tr>
<tr>
<td>Sulawesi</td>
<td>Palu, Bitung, Likupang (development phase)</td>
<td>3</td>
</tr>
<tr>
<td>West Nusa Tenggara</td>
<td>Mandalika</td>
<td>1</td>
</tr>
<tr>
<td>North Maluku</td>
<td>Morotai</td>
<td>1</td>
</tr>
<tr>
<td>West Papua</td>
<td>Sorong</td>
<td>1</td>
</tr>
</tbody>
</table>

### Investment Plan in Indonesian SEZs (through June 2019)

<table>
<thead>
<tr>
<th>No.</th>
<th>SEZ</th>
<th>Investment needs* (trillion rupiah)</th>
<th>Investment plan (trillion rupiah)</th>
<th>Investment realization (trillion rupiah)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Sei Mangkei</td>
<td>128.10</td>
<td>4.88 (7 projects)</td>
<td>5.46 (5 projects)</td>
</tr>
<tr>
<td>2</td>
<td>Tanjung Lesung</td>
<td>96.60</td>
<td>0.95 (3 projects)</td>
<td>0.03 (1 projects)</td>
</tr>
<tr>
<td>3</td>
<td>Mandalika</td>
<td>30.83</td>
<td>57.57 (14 projects)</td>
<td>0.18 (11 projects)</td>
</tr>
<tr>
<td>4</td>
<td>Palu</td>
<td>94.10</td>
<td>5.67 (16 projects)</td>
<td>0.19 (16 projects)</td>
</tr>
<tr>
<td>5</td>
<td>Maloy Batuta Trans Kalimantan</td>
<td>37.71</td>
<td>0.67 (1 project)</td>
<td>0.00 (1 project)</td>
</tr>
<tr>
<td>6</td>
<td>Tanjung Api-Api</td>
<td>137.30</td>
<td>144.72 (2 projects)</td>
<td>0.23 (2 projects)</td>
</tr>
<tr>
<td>7</td>
<td>Galang Batang</td>
<td>43.05</td>
<td>12.00 (1 project)</td>
<td>9.29 (1 project)</td>
</tr>
<tr>
<td>8</td>
<td>Aron Lhokseumawe</td>
<td>55.10**</td>
<td>1.61 (2 projects)</td>
<td>0.20 (2 projects)</td>
</tr>
<tr>
<td>9</td>
<td>Tanjung Kelayang</td>
<td>21.50</td>
<td>0.43 (1 project)</td>
<td>0.20 (1 project)</td>
</tr>
<tr>
<td>10</td>
<td>Bitung</td>
<td>35.19</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>11</td>
<td>Morotai</td>
<td>37.24</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>12</td>
<td>Sorong</td>
<td>3.10</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td>719.82</td>
<td>228.50 (47 projects)</td>
<td>15.78 (40 projects)</td>
</tr>
</tbody>
</table>

*Source: Adapted from information provided by BKPM/SEZ National Council/SEZ administrator, September 2019.*

*Note: The investment needs were based on each SEZ master plan. The symbol * mainly refers to the investment need plan that projects figures through 2025. The symbol ** refers to the investment need plan that projects figures through 2030. Data are for domestic and foreign investment (not including investment from state-owned companies, oil and gas, and banking and finance).*

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