

**Research Report  
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Year 2009**



**Cluster Industry Policy in a Decentralised Government:  
A Case Study of the Leather Goods Cluster of Tanggulangin, Sidoarjo,  
Indonesia**

**Prof. Kacung Marijan, Drs., MA., Ph.D.**

**Funded By Directorate General for Higher Education, Department of  
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Competition for International Publication Number:  
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**Airlangga University  
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A Case Study of the Leather Goods Cluster of Tanggulangin,  
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## SUMMARY

The Indonesian government has been concerned with supporting cluster industries for more than four decades. However, as the nature of central-local relations was centralised, most policies were formulated and implemented by central government. This paper aims to explore the role of local government in supporting clusters through the case of the ways the District of Sidoarjo government has supported the leather goods cluster industry of Tanggulangin. Based on a comparative perspectives, that is under centralisation era and decentralisation era, this paper argues that despite the remain low of budget allocated for the industrial affairs under the decentralisation era, the initiatives of local government in supporting cluster is bigger compared to under centralisation era. However, the extent to which the policies are useful for the cluster there is no particular different between before and after implementing the decentralisation policy.

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## Chapter One

### INTRODUCTION

#### 1.1. Research Background

As Hill (2001:248) has pointed out that 'SMEs are clear and consistently enunciated Indonesian government priority.' The government has introduced particular policies, such as through the provision of financial and technical assistances, and the Foster-Father program. This has been done because SMEs have been the majority of establishments and been able to absorb more labour forces. In addition, as happened in late industrialising countries (Amsden 1989; Gerschenkron 1962; Johnson 1982; Kohli 2004; Wade 1990), the government seems to posit itself as supporting the industrial sector as the way to catch up the industrialised countries.

Among strategies in supporting SMEs is a cluster approach, through providing assistance to the particular sector in certain areas. Cluster industry is commonly understood as the 'sectoral and spatial concentration of firms' (Schmitz and Nadvi 1999:1503). As Broadway *et al.* (2004:623) argue that 'economic activities tend to cluster' because a firm tend to gain more benefits when it closer to other firms. This corresponds with findings that the benefits of clustered SMEs in Indonesia are higher than the dispersed SMEs (Berry *et al.* 2001; Klapwijk 1997; Sandee 1995; Smyth 1992; Weijland 1999). Thus, the Indonesian government has preferred to pay attention more to the clustered SMEs rather than to the dispersed firms (Marijan 2006; Tambunan 2000; Thee 1993). This is indicated by the increasing number of clusters gained support from government, from 8329 in 1992 (Tambunan 2000:116-17) to 12162 in 1998 (Deperindag 2000:79).

Considering clusters are decentralised businesses (Brusco 1982) and they are associated with local economy development, the sub-national government supposed to be more active in supporting clusters (Brusco 1989; Rabellotti 1997; Trigilia 1989). However, most policies in supporting cluster industries in Indonesia were formulated and implemented by central government (Marijan 2005; Tambunan 2000; Turner

2003). This happened because between the end of the 1950s and the end of the 1990s the nature of Indonesian government were centralised.

The collapse of the New Order has brought about the change such nature. As enacted under Law No 22 and 25 of 1999, the government introduced a more comprehensive decentralisation policy that covers administrative, fiscal and political decentralisation,<sup>1</sup> where most government affairs were transferred to sub-national government. As a consequence, from the viewpoint of central - local relations, the ways the government in supporting SMEs to some extent have changed as well.

### **1.2. Research Question**

Does local government play more roles in supporting cluster industries after it gain more authorities? If yes, in what ways, and how they induces a positive impact to cluster industries?

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<sup>1</sup> These laws were revised and changed into Law No 32/2004 and Law No 33/2004. Among the significant change of this revision is that the provincial government has more authority.

## Chapter Two

### Literature Review

The literature on cluster industries conceives of decentralisation in two different ways, and each concept has different implications for the existence of cluster industries. The first way looks at decentralisation as part of relationship among firms. Decentralisation may happen when the central headquarters of large firms delegate management to their branches. This kind of decentralisation is based on the argument that the small firm is more effective and efficient than the large one. This can be seen in the thinking of Piore and Sabel (1984) about flexible specialisation, which is referred to as 'a strategy of permanent innovation: accommodation to ceaseless change, rather than an effort to control it'. Moreover, they explain, 'this strategy is based on flexible equipment; skilled workers; and the creation, through politics, of an industrial community that restricts the forms of competition to those favouring innovation' (1984:17).<sup>2</sup>

The second concept is that decentralisation is put in the context of the relationship between central and local government. The degree of centralisation or decentralization in the national administrative system is assumed to contribute to the extent and nature of government intervention into local, urban, or metropolitan

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<sup>2</sup> Flexible specialisation is considered to be an alternative for industrial systems of mass production. Piore and Sabel argue that mass production failed in facing the crisis in the 1970s and 1980s, due to its rigidity. The existence of large organisations, centralised and with hierarchical management, dependent on specialised machinery and workers, contributes to the rigidity of mass production in facing the dynamics of the market. In contrast, industrial systems of flexible specialisation are regarded as more flexible for the processes of production and market. The machinery in flexible specialisation, for example, can be used to fulfil the needs of the market because of its multi use. Other characteristics of flexible specialisation such as labour and management also make industrial systems more flexible compared to mass production. Piore and Sabel acknowledge industrial systems within cluster industries as flexible specialisation because of their three mutually dependent characteristics. First is the relationship of district to the market. Due to the fact that the production of the district involves a wide range of products for various markets, both domestic and overseas, its production becomes more flexible. It is relatively easier for the district to fulfil the demands of the market. Second, the technology which is used is not specialised machinery. Therefore, when the district needs to produce various styles of products, for example, it is less of a problem. The last characteristic which leads the cluster industries to flexibility is its ability to create regional institutions that make possible the balancing of cooperation and competition among firms (Piore and Sabel 1984).



economies (Lever 1989:219). Thus, the degree of decentralisation is linked to the ability of local government to encourage the growth of local economic development.

The literature that discusses the nature of central-local government relationships in industrial policy consists mainly of studies on local economic development, particularly in the industrial sector. These studies examine the contribution of local government to local economic development where local industrial strategies are given priority (Blakely 1989; Branley *et al.* 1981; Meyer 1993; Moulaert and Demaziere 1995; Wilson 1996). The three major trends of renewal industrial strategy in local level that occurred in 1980s are relevant (Zeitlin 1989:367). First is the success story of interdependent networks of small industries, which are called industrial districts or cluster industries in Italy, West Germany, Scandinavian countries, the USA and Japan. The second trend is the decentralisation of large firms into smaller operating units in order to pursue more specialised products and more flexible production methods. The last trend is the increasingly active role of local government in promoting local economic development, such as through the provision of industrial services. The last trend is partly in response to the first two trends and partly due to the decline of effectiveness of macroeconomic management in many countries. Most studies on industrial districts or cluster industries (Costa-Campi and Viladecans-Marsal 1999b; Edgington 1999; Gordon and McCann 2000; Llobrera *et al.* 2000; Park and Markusen 1995; Pyke and Sengenberger 1992; Schmitz and Musyck 1994; Sengenberger *et al.* 1990) discuss these three trends.

Studies, which look at the role of local government in promoting cluster industries, however, resulted in different conclusions. On one hand, some studies consider that local government plays an important role in supporting cluster industries (Brusco 1982; Brusco 1989; Brusco 1992; Brusco and Righi 1989; Costa-Campi and Viladecans-Marsal 1999a; Lever 1989). On the other hand, other studies consider the role played by local government in promoting cluster industries to be less important (Meyer-Stamer 1998; Park and Markusen 1995; Schmitz 1995a; Schmitz and Musyck 1994). Obviously, these different conclusions reflect the debates in the literature about the role of government in general in the economy.

Nevertheless, in line with the promotion of the decentralisation policy, the role of local government in fostering local economic development, including the promotion of cluster industries, has been given attention in recent studies. In case of British, Lever (1993:71) argues that the main reason for the strengthening of local government in economic development was the failure of central government to provide appropriate schemes to the local people. This is also related to a country's political structure: a country that applies federalism or the decentralisation policy tends to involve local government more in the formulation and implementation of local economic development.

The bottom-up development model that considers the importance of autonomous development planning (Stohr and Taylor 1981) seems to be the basic argument of the first point of view. Ettliger (1994:145) points out that the presumption of this development strategy is that 'national policy and aid to localities have lost significance in the global economy'. This presumption suggested that decentralising industrial policy was crucial in fostering local economy to be able to compete in the global market.

Furthermore, social and political configurations also contribute to the importance of local government in formulating and implementing industrial policy. Industrial districts or cluster industries are often socially and territorially integrated within the community (Becattinni 1990, cited in Schmitz 1995b:10). The emergence and the growth of industrial districts are not merely associated with economic activities but are also socially and culturally embedded within communities. In Italy, for example, most industrial districts are part of a process of transformation from rural to industrial areas (Rabellotti 1997). In this sense, the values of rural society, such as the importance of family and community ties, contributed to the development of those districts. Those values facilitated the relationships among workers and employees and also between firms. Furthermore, Rabellotti argues that the relationships within the industrial districts are supported by 'high social mobility which makes it possible to move easily from one job to the other or to an independent entrepreneurial position,

creating new firms as well as shutting them down and going back to work as employee' (1997:25).

Moreover, the rapid growth of small enterprises in Italy in the 1970s was a result of the process of adjustment to economic and social tensions (Rabellotti 1997; Trigilia 1989). Political parties and interest groups played an important role in that process. According to Trigilia, this process actually occurred a long time before, about the end of the nineteenth century where socialist party and Catholic political party established roots in Italy. In responding to the development of capitalism and the creation of the nation-state, these parties developed the idea of socialism and Catholicism in local areas. They tried to defend what they called local society from these developments. In the areas where socialist party was predominant, this process involved 'unions, labour organizations, friendly societies, cooperatives and communes', while in the areas where the influence of Catholic party was predominant, it involved 'a network of rural savings and other banks, agricultural organizations, cooperatives, friendly societies and charities' (Trigilia 1989:180). The involvement of similar political forces in the development of industrial districts also occurred in Germany (Benfer 1995; Hennings and Kunzmann 1993; Herrigel 1996), where the decentralised political structure in Germany significantly influenced the process of industrialisation in local areas.

Furthermore, Begg and Mayes (2000:151-153) highlight three reasons why government should decentralise industrial policy. The first relates to motivation, that is, to formulate industrial policy based on the tastes and the interest of local industrialists or on local needs (Zeitlin and Totterdill 1989:183). The second reason is to achieve efficiency. Decentralisation of industrial policy is believed to overcome the complexities of the public sector, as well as to make policy more responsive. The third reason is to produce industrial policies that are concentrated and focused on particular aspects. For instance, decentralising industrial policies encourages local government to assist cluster industries.

The problem is, what should the local government do when given more authority in industrial policy? Begg and Mayes (2000:150) points out that 'a primary aim of industrial policy is to counteract market failure by providing the necessary infrastructure and other services that private agents, for one reason or another, do not'. For example, the government 'can help to create the rights conditions for the development of industrial districts' (van Dijk 1995:23) by providing a better environment for business and establishing common services.

However, in practice, the extent to which industrial policy provides infrastructure and other services to the private sector and its forms may vary among local governments. In Germany, for instance, Herrigel (1996:278) concludes that in the decentralisation context, local governments paid more attention to the local industrial sector by increasing the level of financial subsidies to industrial firms (Herrigel 1996:278). In England, some local governments support the industrial sector, particularly small industry, by providing direct assistance such as financial support, and providing collective services such as machinery beyond the capacity of individual firms (Zeitlin and Totterdill 1989:180-181). In Modena, Italy, local government supports cluster industries through three kinds of intervention: provision of land for firm construction, financial assistance and the supply information and technology (Brusco and Righi 1989). Loveman and Sengenberger (1990:49) point out, local governments 'attribute special rights or privileges, or supply resources and subsidies' and other policies.

The policy of local government in promoting local economy, in particular cluster industries, basically consists of two kinds of formulation (Trigilia 1989:189; Zeitlin and Totterdill 1989:180-193). Firstly, policy relates to government providing financial assistance and technical assistance to cluster industries or what Brusco calls 'real service' (Brusco 1992:186). Secondly, policy deals with the provision of both physical and non-physical infrastructure. The latter policy is not always directly aimed at supporting cluster industries but contribute to its existence.

While there is variation in decentralised industrial policies, implementation is not easy. Zeitlin and Totterdill (1989:183) point out that decentralisation of industrial policy may create problems of coordination between local initiatives and national policies. The efforts of local government to develop a strategic intervention for sectoral intervention are often contradicted by the uncoordinated and fragmented policies of central government agencies. The problem of coordination occurs because central government usually does not lose all of its authority regarding industrial affairs, even though most aspects of industrial affairs have been devolved to the local level.

The fact that central government still plays a strategic role in formulating and implementing industrial policy is the basis of the argument for those who say that local government plays a less important role in supporting cluster industries. In South Korea, for example, decentralisation of industrial policy has been implemented. This can be seen from the fact that many districts in South Korea have been successful in decentralising manufacturing employment away from the capital city of Seoul. However, as Park and Markusen (1995:100) point out, central government still functions as 'the developer and locator of business activities within the confines of the districts'. They (1995) identify some contributing factors. They are the extraordinary specialisation of the districts, the tight control of the state over the entry of firms and the limits of natural resources.

The two arguments above actually need not oppose each other if we consider the relationship of central and local government relation to be dynamic and situated on a continuum. Both central and local governments may formulate and implement industrial policies that are suitable in supporting cluster industries. In Japan, for example, central government is active in strengthening the manufacturing capacity of cluster industries through its arrangement of infrastructure plans and projects (Edgington 1999:325). At the same time, local governments in Japan also have a history of supporting small and medium enterprises (SMEs) (Best 1990; Whittaker 1997). In this sense, central and local governments provide synergistic policies to support SMEs.

Government's involvement, whether central or local, is not always present in the early stages of the development of cluster industries. Based on their observation of the growth of cluster industries in *Third Italy*, Baden-Wuttemberg, West Jutland and Southwest Flanders, Schmitz and Musyck (1994:902) conclude 'none of the industrial districts are the result of planned action, of a local or regional industrial strategy. They all developed spontaneously'. However, Schmitz and Musyck do acknowledge that government, both local and central, plays a crucial role in the growth of those cluster industries. Furthermore, Brusco (1990) points out that the role of government depends on the type of cluster industries. In the type of traditional small firms, where cluster industry has grown spontaneously, the role of government is less important. The obvious role of government in supporting a cluster industry that occurs in the type of dependent sub-supplier, where cluster industry is in the process of growth.

In addition, the success or failure of the efforts of government in promoting cluster industries also depends on the support of the private sector. Thus, some authors emphasise the importance of public-private partnership in promoting cluster industries (Ettliger 1994; Helmsing 2001). The spirit behind this concept actually is to close the gap between market failure and government failure. Government intervention may be necessary to overcome the problem of market failure; while free market mechanisms may be the way to minimise government failure (Batley 1997; Chang 2002; Walsh 1995). In fact, in some cases, it is necessary to establish joint mechanisms between government and the private sector to support cluster industries. Furthermore, Ettliger (1994:148) argues 'neither central (national-scale) nor local governments have the resources to solve problems that fundamentally are long-term and integrally related to economic restructuring'. Thus, establishing a partnership between government and the private sector may help overcome the problems faced by cluster industries.

The idea of public-private partnership in supporting cluster industries seems to be an effort to integrate developmental state thinking and neo-liberal thinking in industrial strategy,<sup>3</sup> where the roles of government and the private sector are posited as

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<sup>3</sup> Development state thinking considers that intervention of state in economy, somehow, is needed to achieve better economic performance and to avoid market failure (Chibber 1999; 2002; Johnson 1982;

being complementary to each other. This partnership may function as institutional modalities in providing services for cluster industries. Helmsing illustrates how public-private partnership may work: 'government, for example (co)finances service centres but leaves it to the private sector to run them (trade representation, sector specific innovation centres)' (Helmsing 2001:297).

Furthermore, in such partnership, local government is more important compared to central government. As Helmsing (2001:300) argues 'the national level is too high to cope with complexity and detail, while the regional level allows for an appropriate incorporation of local diversity and specificity'. The reasoning is in line with the trend of decentralisation in the vast majority of developing countries, where many public responsibilities have been transferred to the local level. This process has forced local governments to be interested in the economic development of their jurisdiction in order to generate more local revenues.

From this point of view it can be concluded that decentralisation policy might be exercised more effectively in promoting cluster industries when local government is able to collaborate with private sector. However, the extent to which local government is able to explore and exploit its resources, including its responsibility for government affairs that have been transferred from central government, might also contribute significantly to the effectiveness of policy in promoting cluster industries.

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Wade 1990). In contrast, neo-liberal thinking takes the view that state intervention in the economy only causes government failure (Kim 1999; Bateman 2000)

## **Chapter Three**

### **Aim and the Use of Research**

#### **3.1. Research Aim**

This study aims to describe the ways local government support cluster industry after the implementation of decentralization policy

#### **3.2. The Use of Research**

In addition to enrich knowledge on the study of cluster industry policy, this study can be used by the Indonesian government in formulating and implementing programs for promoting cluster industry.



## Chapter Four

### Research Method

#### 4.1. Location and Case Study

This study takes the leather goods cluster industry in the District of Sidoarjo, which is located in East Java province. Two main reasons highlight the selection of this cluster industry.

The first reason deals with the implementation of the decentralisation policy. Sidoarjo was the only pilot project in East Java province for the implementation of the administrative decentralisation in 1995.<sup>4</sup> Theoretically, Sidoarjo experienced more of the implementation of the decentralisation policy compared to other districts/municipalities in East Java. Studying the leather goods cluster industry of Tanggulangin in Sidoarjo which experienced more on the implementation of the decentralisation policy, this study gets a better picture of the impacts of the decentralisation on the way the government nurturing cluster industries in Indonesia.

The second reason is about the nature of the leather good industry. It is dominated by cottage and small-scale enterprises (CSSEs), and has a high dependency in obtaining raw materials from other regions or imported raw materials. It experienced in marketing their products through showrooms located within the areas of cluster industries. More importantly, it experienced in obtaining guidance (*pembinaan*) from government such as through the establishment of UPT *Kulit* in the leather goods cluster industry of Tanggulangin in the mid-1980s. Some state-owned enterprises (BUMN) also experienced in the provision of financial support through the Foster-Father program in both cluster industries.

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<sup>4</sup> Administrative decentralisation in Indonesia was stated in Law No. 5/1974. However, in reality this policy was not fully implemented. Thus, in 1995 the government took 26 districts and municipalities throughout Indonesia as pilot projects for the implementation of decentralisation policy.

#### 4.2. Technique of gathering Data

The data used in this study consists of two types. The first type is secondary data. This secondary data was collected from institutions such as District Bureau of Statistics, local government, and other publications in books, journals, magazines and newspapers. This data helps in describing the development process of both of the cluster industries. The statistical data from Bureau of Statistics, for example, show the quantitative evidence about the process of industrialisation in Sidoarjo.

The second type is primary data from a survey. The main respondents are local government officers and those who are owners or managers (which is assumed represent firms). The local government officers are chosen purposively, based on their positions. They are heads of district, officers in local government development planning agency (*Bappeda*), officers in local office of trade and industry (*Disperindag*), and officers in local office for small and medium enterprises and cooperative, and other officers in the secretary of local government.

In this study 50 respondents, representing their firms. Initially the study planned to take about 10 per cent as the sample from population. However, considering the fact that there is no exact available data about the real number of firms in both clusters, then it was decided to interview 50 people.

In interviewing those respondents directly related to the firm (managers or owners and employees), this study used both structured questionnaires and non-structured questionnaires. For local government officers and local parliament this study used non-structured questionnaires.

#### 4.3. Analysing the Data

The collected data is analysed qualitatively in order to obtain a deep and clear understanding about industrialisation in the local area based on the case study. The statistical data such as the number of firms and their production is used to support the analysis. The analysis aimed at exploring, describing and explaining the extent to which the government nurtures cluster industries, both in the centralised form of government era and the decentralised form of government era.

## Chapter Five

### Discussion

#### 5.1. Cluster Industries in Sidoarjo

Sidoarjo is one of three the most industrialised regions in East Java.<sup>5</sup> It's proximity to Surabaya has enabled Sidoarjo to do so. Since the Dutch occupation, Surabaya was one of the main growth poles in Indonesia. The fact that it has had better infrastructures, many investments in Eastern Indonesia were allocated in Surabaya.

Table 5.1: Economic structure of the District of Sidoarjo based on the regional domestic bruto product, 2001 - 2005

Sectors	2001 %	2002 %	2003 %	2004 %	2005 %
Agriculture	5.3	5.1	4.5	4.2	3.9
Mining and Quarrying	0.1	0.1	0.1	0.1	0.1
Manufacturing Industry	61.7	60.2	58.8	57.3	55.2
Electricity, Gas, and Water Supply	1.6	1.8	1.9	2.1	2.1
Construction	1.4	1.4	1.5	1.5	1.5
Trade, Hotel and Restaurant	18.9	19.8	21.2	21.9	22.9
Transportation and Communication	6.6	7.0	7.5	8.2	9.3
Finance, Rental and Service of Enterprises	1.4	1.5	1.5	1.5	1.4
Services	10.0	3.1	3.2	3.2	3.4

Source: BPS Sidoarjo, *Sidoarjo Dalam Angka*, 2005.

The industrial growth of Surabaya has spilled over to the areas nearby, especially the District of Sidoarjo and Gresik. Previously, Sidoarjo was one of the

<sup>5</sup> Two other are Metropolitan City of Surabaya and the District of Gresik.

most important agricultural areas in East Java, as well as a large producer of frozen shrimps and prawns (Dick 1995:67). Most industries in the past related to the agricultural sector, particularly sugar industries. Over the last decade, this structure has changed. Table 5.1 shows the share of the manufacturing industry to the GDP is more than 50%, while the agricultural sector contributed to only around 5%.

Table 5.2 The number of large industry, small industry and handicraft in Sidoarjo, 1998-2005

Year	Large Industry		Small Industry		Handicraft	
	Unit	Employee	Unit	Employee	Unit	Employee
1998	325	43,093	1,557	36,990	11,323	45,092
1999	336	45,450	1,631	38,797	11,540	46,195
2000	341	45,600	1,737	42,161	11,525	46,342
2001	351	47,787	1,793	45,358	11,402	49,559
2002	383	49,125	1,865	48,249	11,913	49,683
2003	393	53,048	1,982	51,173	12,124	50,116
2004	396	51,753	1,995	51,472	12,132	50,148
2005	446	55,635	2,053	52,864	11,842	50,642

Source: BPS Sidoarjo, *Sidoarjo Dalam Angka*, 2001 and 2005.

Households and small-scale industries have been the dominant sectors. Table 5.2 shows that until 2005 there were almost 12,000 handicrafts, 2,053 small-scale industries, and only 446 large industries. The households and small industries produce agricultural products, such as prawn crackers and shrimp paste and non-agricultural products, such as clothes, footwear and metalwork. Many of them are clustered in certain areas. For example, the leather industries are clustered in Tanggulangin, footwear industries are clustered in Waru, the metalwork industries are clustered in Waru, while the food industries of prawn cracker and *Bandeng* fish are clustered in

Candi, Waru and Sedati. This pattern has made it easier for the Sidoarjo government to facilitate their growth, particularly in regard to providing public facilities.

The leather goods industry is the most developed clusters. A survey carried out in 2005 reveals that among 1,143 cottages, small and medium industries, 32.3% are the leather goods firms (BPS Sidoarjo 2005), and they are concentrated in the sub-district of Tanggulangin (72.5%). Thus, paper focuses discussion on the leather cluster of Tanggulangin, and section below explores more detail about the cluster and its characteristics

## **5.2. The Leather Goods Cluster Industry in Tanggulangin: Development and Its Characteristics**

The leather cluster of Tanggulangin is unique because it did not emerge in the region that has abundance raw materials as most clusters in Indonesia (Tambunan, 2000:113). It's emerging was mainly because the availability of skilled labour who experienced to work in the leather goods industries in Surabaya.

The story began in 1933 when the rice crop failed. This situation forced five young men of Kedensari village went to Surabaya and worked for a leather goods industry that produced suitcases and bags (Adib 1999:90). Working in all parts of the production process, they eventually became leather goods craftsmen. The new profession and expertise attracted more people from Kedensari who eventually started to produce suitcases and bags in their village. This was particularly possible when some leather good firms in Sidoarjo and Surabaya implemented a sub-contracting system. But some craftsmen who had experience, expertise, and most importantly capital, started to work independently at the end of 1950s.

Around the 1960s an oversupply of production problem came. Craftsmen attempted to solve it by establishing collaboration projects. But among the three experiences,<sup>6</sup> the establishment of co-operative INTAKO on 7 April 1976 was the

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<sup>6</sup> They are co-operative Budi Jaya, CV Tunggul Jaya, and co-operative INTAKO.

most successful one. Initially, as shown in table 5.3, only a small numbers of craftsmen joined the INTAKO. But when it was able to prove that it has better performance compared to the two previous collaboration projects, more craftsmen joined it. The benefits for joining INTAKO are obvious. These include selling raw materials to the craftsmen and marketing the leather products for its members which led to the creation of what Schmitz's called 'collective efficiency' (Schmitz 1995).

Table 5.3: The development of INTAKO membership, 1976/79–2002

1976-79	1980	1985	1990	1995	2000	2002
27	67	118	143	172	205	347

Source: Unofficial document of INTAKO Co-operative.

In addition, INTAKO gained a contract from the Garuda Indonesia Airways (GIA) for producing special bags and suitcases for the *Jema'ah Haji* (pilgrimages) between 1986 and 1990. This contract also made possible a wider recognition of the products. Unfortunately, the contract was terminated in 1991 without any clear reason.

The end of the contract forced the INTAKO to change the marketing rule. Previously, no members were allowed to establish a showroom, except for INTAKO and five others that already existed. The INTAKO then decided to let members to freely set up showrooms, which resulted in the significantly increasing number of showrooms (see Table 5.4). They are located in the street that connects village of Kludan and the village of Kedensari, along a distance of about 3 km.

Table 5.4. The Growth of Leather Goods Showrooms in Tanggulangin, 1981–2000

1981/ 84	1985	1986/ 88	1989 /90	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
1	2	4	5	15	32	65	97	105	117	121	129	136	147

Source: Unofficial Document of INTAKO Co-operative.

Even though the leather cluster of Tanggulangin has been able to survive its characteristics remain the same as other cluster in Indonesia, which is recognised as 'the dormant cluster' (Supratikno 2004:124), where most firms belonging businesses to the informal sector. But, in case of Tanggulangin, the industries might be different in some ways. On the basis of my fieldwork survey over 50 firms in 2002, here I highlight its characteristics that cover the size and the initial establishment of firms, capital and assets, linkages among firms and how firms get raw materials and market their products.

### **Size of enterprises**

Most enterprises located in the leather cluster of Tanggulangin are cottage and small-scale industries. Only a small number of firms can be classified as medium and large enterprises. Of the 50 surveyed firms in 2002, 47 enterprises started their business with fewer than five workers.

It should be noted that the size of enterprises influenced their legal status. Many firms are not registered as they do not have business permits for industry (*Ijin Usaha Industri*). Of the 50 firms surveyed only 16 considered themselves as registered firms. In other words, they can be classified as belonging to the informal sector (Lubell 1991; van Diermen 1997); that is, most firms are micro scale and not registered.

### **Establishment and regeneration of firm**

Most surveyed firms were being run by the third generation of leather craftsmen. The first generation was the five young villagers of Kedensari who became craftsmen in leather goods in the 1930s and started their own business in the 1950s. The second generation was those involved in this industry between the 1960s and late 1980s. This group attempted to get collaboration among craftsmen. The third generation was those who started their business after the 1990s.

Interestingly, only five respondents from the survey acknowledged that they were continuing their family business. This figure can be interpreted into two ways. First, the leather cluster of Tanggulangin has been well developed since the late 1980s, so there were many establishments founded during that time. Second, as for other cottage industries in general, the cottage industries in Tanggulangin have faced problems of continuity. The process of production can be stopped suddenly when the craftsman dies or goes bankrupt. In other words, these informal firms are easy to entry and exit (van Diermen 1999:9).

### **Capital and assets**

Because all initial establishments were cottage and small-scale industries, their capital was also relatively small. Of the 50 enterprises, 40 were founded with capital of less than Rp 10 million. Even though most of them were households, this amount is very small for an industry that needs raw materials and equipment for processing. As a consequence, the vast majority of small entrepreneurs in the leather goods cluster have faced the lack of capital for developing their business.

Nevertheless, because leather business is considered profitable, the majority of respondents acknowledged that they were able to accumulate their capital from profits made as the business developed. The increase of capital can be seen from the value assets of business. In 2002, 39 respondents confirmed that their assets amounted to between Rp 5 million and Rp 100 million. However, compared to the initial capital of the firms this shows improvement. Some respondents were able to grow their capital better than others. Of the 50 firms, seven industries had assets of more than Rp 100 million but less than Rp 1 billion; one firm had assets around Rp 1 billion; one firm had assets of Rp 2 billion; and two firms had assets around Rp 3 billion.

### **Linkages among firms**

One of the main characteristics of clusters is the relationship among firms within the cluster (Harrison 1992; Schmitz and Musyck 1994; Sengenberger *et al.*



1990; van Dijk, 1995). Through linkages, both vertically and horizontally, the firms are able to obtain benefits from the so-called external economies (Harrison 1992; Marshall 1920; McCormick 1999; Rabellotti 1995, 1997). Each firm within the cluster does not always prepare for competition with each other; they cooperate in order to reduce the cost of production and to create collaborative marketing. As McCormick (1999) points out, among the advantages of cluster industries are market access, the availability of skilled labour, the emergence of intermediate enterprises for providing materials and knowledge and technological spillover among the firms.

In the leather cluster of Tanggulangin linkages take two forms: first, linkages among firms within the cluster and second, linkages between firms within the cluster and firms outside the cluster. The first type of linkage means there is cooperation within the leather cluster industry. Of the 50 firms surveyed, 26% were major contractors, 60% were sub-contractors and 14% were independent enterprises. This means that the relationship among firms is relatively strong. These linkages are more visible because many of the firms are members of INTAKO.

Regarding the second type of linkage, most firms (76%) within the leather cluster of Tanggulangin are sub-contractors, eight per cent are main contractors and 16% are independent enterprises. The linkage between industries in Tanggulangin and outside industries Tanggulangin mainly are concerned with supplying raw materials and marketing the products.

### **Dependency on raw material**

Looking at the fact that initially Kedensari and other surrounding villages were agricultural villages that produced rice, the raw materials for the leather industry, such as the leather itself, and accessories, such as zips have come from other regions or are imported. In the 1950s, craftsmen received the materials from contractors as a consequence of the application of the sub-contracting system. When many of them became independent, they bought the materials from Surabaya. Since Tanggulangin has become an important centre for the leather goods production, some shops that specialise in selling raw materials, including the INTAKO shop, have been opened. In

addition, some people of the tannery leather industries from other regions have visited Tanggulangin to promote sales of their leather. However, because the price of genuine leathers is expensive many craftsmen have preferred to use synthetic leather.

As well as leather, other materials are needed for the manufacture of bags, wallets, suitcases and belts, especially for accessories. These have been imported from China with the price is determined by the international market. Since the depreciation of the rupiah in mid-1997, the price of these imported materials has risen. At the same time, the purchasing power of people in Indonesia has decreased. As a consequence, many leather goods producers in Tanggulangin have reduced their production.

#### **Dependency on domestic market**

The dependency on other regions and other countries for raw materials does not present a significant problem for the leather industries in Tanggulangin when firms are able to market their products widely to other regions or even export to other countries. In reality, however, many producers market their products locally. Of the 50 surveyed firms, 41 of them marketed most of their products in Sidoarjo itself. However, this does not mean that leather goods from Tanggulangin are only purchased by people in Sidoarjo. While some of the products are sold in Sidoarjo, buyers, traders and individual consumers do come from other regions.

The fact that there are many showrooms/shops specialising in selling leather goods in Tanggulangin seems to support the way many producers market their products in Sidoarjo itself. Individual buyers and traders usually come directly to Tanggulangin to buy the leather goods. The difference is that the individual buyers usually visit showrooms directly, while the traders visit both showrooms and producers. People from other regions come to Tanggulangin particularly during the yearly Tanggulangin Festival. Producers usually introduce new styles of the products and offer huge discounts at this time.

After reviewing the above characteristics, the question is 'did the government, either central or local, attempt to formulate and implement policy for supporting the leather goods cluster of Tanggulangin on the basis of its characteristics?' Two main sections below discuss the efforts of government, in particular at the local level, before and after implementation of the 1999 decentralisation policy.

### **5.3. Supporting Cluster During Centralization Era**

During the New Order, most policies in supporting cluster industries were mainly from the central government. However, government at the lower layers also issued some policies. This section is concerned with policies assistance of the central government as well as local government, and the extent to which these policies had a positive impact to cluster industry of Tanggulangin.

#### **Assistance policies from central government**

The policies to support clusters during the New Order covered technical and financial assistances. The technical assistance policy was illustrated by the provision of the UPT<sup>7</sup> *Kulit*, and the financial assistance policy was demonstrated by policies of subsidised and credit access, and Foster-Father program. The two policies had different arrangements and outcomes. The technical assistance policy that was applied on deconcentration principle, thereby involving sub-national government, to some extent was directly useful for the cluster. In contrast, the financial assistance policy, which only partially involved deconcentration principle, to a large extent did not directly useful for the cluster.

The UPT *Kulit* was established in Tanggulangin in the early 1980s. It was designed to assist the leather industries through the introduction of technology, new

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<sup>7</sup> UPT is an abbreviation of Unit *Pelaksana Teknis* (technical service unit), established by the Department of Trade and Industry for providing guidance to the certain sector.

design and ways to produce higher quality products. By this program, the industries were hoped to be able to compete in the market.

As part the BIPIK<sup>8</sup> program, the UPT *Kulit* was an institution for the provision of technical assistance from the Department of *Indag*. Operationally, the UPT *Kulit* was deconcentrated to *Kanwil Indag*<sup>9</sup> of East Java Province. But the financial resource came largely from the central government. In implementing this project, *Kanwil Indag* coordinated with *Kandep Indag*<sup>10</sup> of Sidoarjo. However, the UPT *Kulit* was directly responsible to the *Kanwil Indag* of East Java Province. The office of the UPT itself was located in the co-operative INTAKO.

Putting the office of UPT *Kulit* in one building with the office of INTAKO made it easier for UPT *Kulit* to provide assistance to the leather craftsmen. INTAKO, at the time, was the only collaborative institution for the leather craftsmen in Tanggulangin. Thus, both institutions had a common interest to foster the growth of the leather industry.

The establishment of UPT *Kulit* corresponded with the early stage of the rapid growth of the leather industries in Tanggulangin, between the middle 1980s and early 1990s. However, the UPT *Kulit* was not the main factor contributing to the rapid growth. Nevertheless, as a supporting institution, the UPT *Kulit* played an important role in the early growth of the leather cluster industry. The UPT, for instance, provided two generators for electricity. This enabled some craftsmen to work during the night, while at the time there was no electricity on in Kedensari. In addition, UPT *Kulit* provided several pieces of equipment for producing bags and suitcases. Many leather craftsmen at the time did not have sewing machines or cutters for the leather materials. The amount of equipment provided was limited but it was very useful for the craftsmen. The appearance of UPT *Kulit* was able to stimulate the leather industry.

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<sup>8</sup> BIPIK is an abbreviation of *Program Pembinaan dan Pengembangan Industri Kecil* (Small Scale Industries Development Program).

<sup>9</sup> *Kanwil* is technical department agency at provincial level.

<sup>10</sup> *Kandep* is technical department agency at district/municipal level.

Despite its importance role in the early growth, the role of UPT *Kulit* decreased in line with further growth of the leather cluster. Since the early 1990s, most craftsmen have had their own equipment. The quality and types of their equipment were even better and more up to date than that provided by UPT *Kulit*. Eventually, after the financial and economic crisis hit seriously the Indonesia economy in the middle of 1997, the UPT *Kulit* was closed.

Furthermore, some leather craftsmen had participated in the Foster-Father program. A number of BUMN such as PT PLN, PT Telkom, PT Pelabuhan and PT Sucofindo offered financial assistance. However, Kzn, an officer of INTAKO pointed out that many craftsmen rejected the offer because the amount of money was too small, about Rp 5 million per craftsmen. 'How can we use Rp 5 million rupiah for producing bags and suitcases?' he said. 'If they gave Rp 50 million, maybe we would accept it,' he added.<sup>11</sup>

Many business people preferred to use commercial banks to access credit. However they did not know whether the credit they received was classified as KIK, KMKP, KUK or commercial credit. Because many of them received credit from state banks such as BRI and BNI, and also from BPD Jatim, it is possible that they received concession credits such as KIK/KMKP.

From the above discussion we can see that the provision of technical assistance and financial assistance partly contributed to the development of the leather goods cluster industry of Tanggulangin. The UPT *Kulit*, to some extent, stimulated the leather craftsmen to apply better technology and management. SD, currently head of INTAKO explained the role of UPT *Kulit*, especially its manager.<sup>12</sup> The manager of UPT *Kulit* was active in giving assistance to some craftsmen in regard to management and ways to obtain bank credit. He was also involved in helping some craftsmen take part in training such as in the design of products and marketing. The fact that UPT *Kulit* was useful for the leather cluster industry of Tanggulangin came especially from

<sup>11</sup> Interview with Kzn in Sidoarjo on 31 July 2002.

<sup>12</sup> Interview with SD in Sidoarjo on 24 June 2002.

the members of the board of INTAKO and also from craftsmen who started their businesses before the 1990s.

However, due to UPT *Kulit* lacked of staff and equipment, its capability was limited. Only a small number of the leather craftsmen enjoyed the assistance of UPT *Kulit*. However, many entrepreneurs who were interviewed said that they never received technical or management assistance from the government (see Table 4.5). Note that these data cannot simply be interpreted that only four per cent of craftsmen experienced in receiving technical assistance from the government. This figure appears because most craftsmen interviewed in this study started their business after the 1990s when the role of the UPT was in decline. However, as mentioned above, UPT *Kulit* was able, in a modest fashion, to stimulate the growth of the leather industry in Tanggulangin.

Tabel 5.5: Experience of respondents in obtaining direct support from the government in Sidoarjo (n= 50)

Support types	Yes	No	Total
Financial	3	47	50
Technical	2	48	50
Management training	1	49	50

Source: Marijan (2006).

Table 5.5 shows that the majority of respondents never received financial assistance from the government. This response relates to their view of financial assistance. Most of them saw financial assistance as a grant with no obligation to repay, and did not consider receiving credit from state banks to be financial assistance because they had to pay it back. If financial assistance were viewed, for example, as concession credit, the figure for the recipients of financial assistance would be larger. This arises from the fact that many craftsmen received credit from commercial banks such as BRI and BNI 1946, which participated in the provision of concession credit.

### Local government initiates and the failure of the leather Accessories industry

During the centralisation era, still, there was a room for local government in supporting clusters. This sub-section deals with the efforts of local government in supporting cluster. Two issues are discussed. They are the budget allocated for government affairs related to supporting to SMEs and the direct effort to support cluster.

Even though the commitment of the local elite to promote the leather cluster was high, the institutional capacity was limited. This is illustrated by the small amount of local budget funds directed toward the industrial sector. In addition, special policy implemented to support the leather cluster through the leather accessories industry failed because it was not compatible with the needs of businesses in the cluster.

Table 5.6: The expenditure of the District of Sidoarjo to the sectors of industry, trade and co-operatives, 1990/1991– 2000 (in Rupiah)

Year	Industrial Affair	%*	Trade and Co-Operative Affair	%*
1991/1992	21,245,000	0.1	503,568,000	3.4
1992/1993	47,749,000	0.3	301,272,000	1.8
1993/1994	47,086,000	0.2	1,309,346,000	5.6
1994/1995	209,124,000	0.8	2,122,900,000	8.1
1995/1996	199,730,000	0.7	1,624,370,000	5.8
1996/1997	188,055,000	0.6	1,130,908,000	3.4
1997/1998	84,000,000	0.2	2,628,241,000	5.8
1998/1999	150,000,000	0.4	1,403,389,000	3.8
1999/2000	600,000,000	1.3	4,339,492,000	9.6
2000**	515,000,000	1.3	6,309,047,000	16.45

\* The percentage is based on the expenditure for development projects in every fiscal year.

\*\* Prior to 2000, the fiscal year was from April to March. In 2000, the fiscal year changed to January to December.

Source: The District of Sidoarjo government, *Local Budget (APBD)*, 1991-2000.

One craftsman said that local government elites were concerned during the early growth of the leather industry of Tanggulangin. Tgh, a leading figure in the leather industry explained that Suwandi, the *Bupati* (the head of the District) of Sidoarjo in the 1980s, paid serious attention to the industry.<sup>13</sup> Suwandi introduced and gave the leather products to his guests as souvenirs. As a result, the leather goods became better known by other people outside the District of Sidoarjo. In addition, Tgh confirmed that Soenandar Prijosoedarmo, East Java Governor in the 1980s, also did the same thing.

Institutionally, however, considering budget allocated for industrial affairs, the contribution of the Sidoarjo government to the growth of the leather cluster during the centralised form of government was relatively small. Table 5.6 shows that between the 1991 and 1998, the expenditure on industrial affairs was below 1% of the total budget for development expenditure.<sup>14</sup> Only between 1999 and 2000 was the expenditure more than 1%. However, for trade and co-operatives, the expenditure was higher. The average expenditure for trade and co-operatives between 1991 and 1998 was 4.5%. This number increased to 9.6% and 16.5% for 1999 and 2000 respectively. Overall, the budget for supporting industrial affairs, as well as for trade and co-operatives during the past ten years was small.

In addition, both East Java province and Sidoarjo governments supported the leather cluster through the establishment of an accessories industry. This began when Governor Basofi Sudirman met a manager of INTAKO in 1997.<sup>15</sup> They talked about particular problems faced by the leather industry in Tanggulangin: dependency on other regions and overseas countries for raw materials. Leathers had to be brought from other regions, while accessories for bags and suitcases such as zips, clasps and straps had to be imported from China. The manager asked Governor Basofi to support

<sup>13</sup> Interview with Tgh in Sidoarjo on 2 November 2002.

<sup>14</sup> In Indonesia, the budget for expenditure is divided into two categories: routine and development.

<sup>15</sup> Interview with IS in Sidoarjo on 5 November 2002.



the craftsmen by establishing an accessories industry. Governor Basofi fulfilled the request, by providing Rp 750 million. Sidoarjo government also contributed by providing Rp 250 million.

However, the accessories factory has proved to be a failure. Since its establishment in 1997, it has never produced the types of accessories for bags and suitcases. Some explanations were offered by a number of craftsmen. First, the machine for producing accessories was wrong. It was not for accessories of bags and suitcases, but for automobiles. Second, the capacity of the engine was limited therefore it was not able to produce good quality accessories for bags and suitcases. Third, the factory needed more capital if it were to produce accessories of a high enough standard. Currently the factory is managed by *Koperasi Logam* (a metal co-operative) that produces accessories for automotives.

#### **5.4. Supporting Cluster Under Decentralisation Era**

This section elaborates the ways local government attempt to promote cluster industries after the implementation of the 1999 decentralisation policy through two issues. First is budget allocated for supporting SMEs and the second is the existence of specific policies for supporting cluster.

As shown in the Strategic Plan (*Rencana Strategis – Renstra*) for the District of Sidoarjo for the year 2002 to 2005 that the Sidoarjo government was very concerned with cluster industries. The allocative budget for supporting the program, however, remains small. Table 5.7 illustrates that in terms of the percentage, the expenditures for industrial affairs and, trade and co-operative affairs are similar to the expenditure during the era of centralisation. This reality is politically contrasted to the change of political landscape in Sidoarjo. Since 1999, the local parliament of Sidoarjo has been dominated by PDIP and PKB, two political parties that are strongly supported by the grassroots. Given this fact, one would have assumed that economic policies would support empowering the cottage and small-scale enterprises.

Table 5.7: The expenditure of the District of Sidoarjo to the sectors of industry, trade and co-operatives, 2001-2005, (in rupiah)

Year	Industrial affair	%*	Trade and co-operative affair	%*
2001**	510,000,000	1.10	3,875,325,000	8.35
2002	525,000,000	0.51	4,700,000,000	4.52
2003	1,679,839,048	0.40	2,457,040,663	0.59
2004	2,195,245,353	0.49	2,072,326,616	1.67
2005	2,127,224,660	0.40	4,256,796,048	0.81

\* Between 2001 and 2006 the percentage is from the expenditure for development projects in each fiscal year. While, between 2003 and 2005 the percentage is from the expenditure for public services in each fiscal year.

\*\* Prior to 2000, the fiscal year ran from April to March. In 2000, the fiscal year changed to January to December.

Source: The District of Sidoarjo Government, Local Budget (*The APBD*), 2001-2005.

That might happen because, as in other parts in Indonesia (Hadiz 2003), instead of articulating and aggregating the interest of their constituents, the political representation (DPRD) favour to support their own interests. For example, the Sidoarjo parliament put a significant proportion of the APBD into its own activities. In the fiscal year 2001, local parliament in Sidoarjo gained Rp 12.3 billion out of Rp 58 billion for routine expenditure, and Rp 17.1 billion out of Rp 79.7 billion in fiscal year 2002. However, some of these funds were misappropriated by members of parliament.<sup>16</sup>

Another factor for the existence of the small number of budget for supporting the SMEs is that because most budgets go to the routine expenditures (see Table 5.8). The Sidoarjo is still concerned with the routine expenditures because decentralisation

<sup>16</sup> The speaker of the Sidoarjo parliament in the 1999-2004 period, Usm, was brought to the court with an allegation of corruption amounting to Rp 22 billion. The Sidoarjo court decided to sentence Usm eight years in jail.

is not only transfer of authority but also transfer of most staffs to the sub-national government.

Table 5.8: Comparison of routine and development expenditure in some years before and after implementation of decentralisation in Sidoarjo (in million rupiah)

Fiscal year*	Routine expenditure	Development expenditure
1998/1999	60,477.69	23,528.88
1999/2000	125,377.15	41,997.05
2000	119,155.94	38,719.96
2001	281,645.10	78,914.61
2002	334,703.50	104,209.13
2003	215,168.83	418,578.02
2004	199,933.11	452,264.18
2005	274,313.80	527,991.73

\*Since 2003 the Indonesian government introduced performance budget. In this type of budget, the budget is divided into three categories, namely budget for public services, budget for apparatus, and budget for capital.

Source: The District of Sidoarjo Government, *Local Budget (The APBD)*, 1998-2005.

The fact that more budgets are allocated for routine expenditures, however, seems to contradict with the significant increase of local revenue (PAD). As can be seen from table 5.9, since the implementation of decentralisation policy, the PAD of Sidoarjo has increased substantially. In fiscal year 1995/96, for instance, the PAD was Rp 33.7 billion. This jumped to Rp 330.7 billion in fiscal year 2005. The reality that most budgets are allocated for routine expenditures it can be concluded that the additional PAD is not mainly for development projects.

Despite the Sidoarjo budget for the industry, trade and co-operative sectors remain small the Sidoarjo government is actually still concerned with supporting clusters. In reality, the government's concern was not only demonstrated through

budget allocation for industry, trade and co-operative sectors, but also through other policies, as further illustrated in the bellow sections discussion. As happened during the centralisation era, policy assistances for supporting cluster industries are divided into two types, namely technical assistance and financial assistance.

Table 5.9: Target and Realisation of PAD of Sidoarjo, 1995/6 – 2005  
(in million rupiah)

Fiscal Year	Target	Realisation
1995/96	30,641.46	33,733.40
1996/97	41,293.42	46,858.06
1997/98	44,117.50	48,005.30
1998/99	47,583.89	54,609.20
1999/00	55,579.47	65,732.30
2000	52,422.37	68,503.15
2001	129,588.47	150,392.91
2002	151,901.75	178,268.62
2003	193,645.36	244,709.53
2004	229,645.36	280,244.26
2005	259,379.33	330,674.42

Source: CBS, *Sidoarjo Dalam Angka*, various issues

### Technical assistance: the establishment of the Indonesian Footwear Service Centre

The technical assistance for supporting the leather cluster is the Indonesian Footwear Service Centre (IFSC).<sup>17</sup> IFSC is a joint program between the Indonesian

<sup>17</sup> The IFSC project is a training institute aimed at improving the quality of human resources in the footwear industry. As stated in the MoU between the Indonesian government and the Italian government, in the long term, the project is intended to increase: (1) industrial production and export capacity, (2) the design and quality of the footwear production, (3) the selling price and the reduction of production costs, (4) the knowledge and the techniques of the production and management of footwear activities, and (5) the education for sector workers and the acquisition of the congruent social behaviour

government and the Italian government, involving three levels of government, as well as the private sector. Given that IFSC is primarily concerned with footwear, while the main products of the leather cluster of Tanggulangin are bags and suitcases, in the short term, the IFSC program is not directly related to the leather cluster. However, over time, the IFSC has the potential to have a greater impact on the leather cluster because of its technological and knowledge spill over. Some leather craftsmen in Tanggulangin currently have produced footwear products such as sandals and shoes. In addition, the IFSC is designed to train people to be able to produce shoes with internationally standards. By this, the leather craftsmen who are making footwear would have better knowledge in improving the quality of their products. Furthermore, because training programs carried out by the IFSC have invited people from all over Indonesia, the leather cluster of Tanggulangin is widely recognised throughout Indonesia.

The IFSC began around 2000 when the Italian government offered the Indonesian government technical assistance for the footwear industry. This assistance was offered to most regions that are potentially able to produce footwear products, including to the District of Sidoarjo. The central government favoured the District of Sidoarjo.<sup>18</sup>

The stakeholders of the IFSC project consist of six parties. First is the Italian government that provided a soft loan of 5,550,000 Euro. Second is the central government that is responsible for the loan repayment and the provision of funding for the three years of the operation of the project amounting to 1,150,000 Euro. Third is

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with the objective of improving living conditions. Thus, those who were trained in the IFSC would not only be leather goods craftsmen and footwear craftsmen from the District of Sidoarjo but also come from other parts of Indonesia.

<sup>18</sup> A senior officer from the Director of Apparel Industry, the Department of *Indag* said that Sidoarjo was selected because of two main reasons. First, in the District of Sidoarjo there are clusters related to the footwear industry, such as the leather cluster industry of Tanggulangin and the footwear cluster industry of Wedoro in the sub-district of Waru. Second, the response of the Sidoarjo government was the most enthusiastic compared to other local governments. The Sidoarjo government was prepared to commit to the development of physical infrastructure. The local government of Sidoarjo also promised to cooperate with the local business community in developing the project (Interview with ES in Jakarta on 17 September 2002).

the Sidoarjo government that provided finance for the development of infrastructure in the sum of Rp 3,600,544,000. Fourth is the East Java provincial government that provided finance for the development of infrastructure amounting to Rp 2,016,076,000. Fifth is the private sector, in this case PT Sentra Niaga Tanggulangin (SNT), which provided about 5000 square metres of land. SNT is mainly owned by two Tanggulangin businessmen, Haji Choirie and Haji Boali. The last stakeholder is the Indonesian Footwear Association (*Asosiasi Persepatuan Indonesia* – ASPERINDO), which is responsible for the provision of infrastructure within the building such as furniture and telephones.

The Sidoarjo government has strongly supported this project as indicated by three activities. First, it was actively involved in the negotiations between the Indonesian government and the Italian government. Second, it supported the project by providing funding for construction. Third, it facilitated supporting infrastructure, such as the central market for leather products within the complex of IFSC, which is owned by SNT. In addition, the Sidoarjo government provided compensation to SNT for its participation in providing 5,000 square metres of land, and it helped PT SNA to buy about 10,000 metres square more of land surrounding the IFSC for the market, as well as simplified the permit procedure.

The IFSC is a prestigious project for Sidoarjo as it involved many counterparts and is financially significant. Thus, the DPRD of Sidoarjo paid special attention to this project. A senior staff member of *Bappekap* explained that the DPRD asked the *Bupati* many times about the continuation of the project. In turn, the *Bupati* then asked the senior staff to directly contact the Italian embassy, asking for the continuation of the project. This occurred several months before the LPJ<sup>19</sup> of the *Bupati*.

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<sup>19</sup> LPJ is an abbreviation of *Laporan Pertanggungjawaban Jabatan* (Official Annual Progress Report). According to Law No 22 Of 1999, the governor and head of district/municipality must provide on LPJ to the provincial/local parliament. The LPJ demonstrates the accountability and responsibility of the governor or head of district/municipality. Therefore, it is a part of the main political processes in the sub-national governments. The provincial/local parliament may reject the LPJ and as a consequence they can sack the governor or head of district/municipality.

Because it concentrates on the training of making and improving the footwear products, the IFCS does not specifically address the core business in Tanggulangin, where craftsmen produce mainly bags and suitcases. However, given the fact that the footwear industry is part of the leather industry in general, and currently some craftsmen in Tanggulangin have started to diversify their products into the footwear products, its appearance will play a strong part in improving the dynamics of the leather cluster. Furthermore, its connection with the Italian government might encourage the leather industry in Tanggulangin to have an international network that can stimulate them to improve the quality and market their products.

In the context of central-local government relations, the IFSC project provides an interesting lesson. The project involved all three levels of government, and also involved public-private relationships, as well as with a foreign country. The main lesson is that the implementation of the decentralisation policy did not abolish functional relationships among the levels of government. In addition to providing additional financial assistance, the central government, for instance, functioned as mediator between local government and the foreign country.<sup>20</sup> In addition, besides providing a budget for the project, local government functioned as a mediator between local businesses and the central government. Furthermore, the provincial government supported the program through the provision of money for the construction of the IFSC building. Finally, this project demonstrated that a public-private partnership could work in supporting cluster industries.

Nevertheless, the implementation of the IFSC program is not as smooth as it was planned. The support funding from the Italian government for that project cannot be realised yet simply because the Italian government required a certain institution of the project. For example, it belongs to the central government or local government; it is a technical unit (UPT) or a firm. The Sidoarjo and the Indonesian government did

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<sup>20</sup> This happened because any relation between the sub-national governments with the foreign countries must get approval from the central government.

not decide it yet. An officer of the *Bappedab* of Sidoarjo confirmed that the DPRD and the Sidoarjo government would decide it in 2006.

The uncertainty for the full operation of the project resulted in the break of the public-private partnership in the project. The two businessmen asked to the Sidoarjo government to withdraw from the project and requested a compensation for their lands. The break of the public-private partnership also might happen because the project of the two businessmen that is special market for bags and suitcases did not success. They failed to sell their properties to the craftsmen. A number of craftsmen confirmed that this happened because the lack of facilities and there is another special market nearby that offer better infrastructures.

Even though the IFSC is not fully implemented, since the mid-2003 it has carried out training for craftsmen in making shoes. In addition to obtaining the support funding both central and local government, the training has been carried to fulfil the skilled labour for shoes industries. In a conversation, director of the IFSC explained that currently two shoes industries asked the IFSC to supply around 2000 skilled labour for them.

Indeed, it is too early to assess the effectiveness of the IFSC in stimulating more the growth of the leather goods industry in Tanggulangin while it is not fully operated yet. However, from the good intension of the government in supporting this institution, as well as its planning activities, its appearance might be able to stimulate the leather goods industry in Tanggulangin to be able to compete in the global market. As Schmitz (1999) argues the successful firms within clusters are those that are able to cooperate among firms within clusters and compete in the global market. This notion is parallel with the finding of Papanek (2006) on garment industry in Bali. According to Papanek, despite getting direct assistance from government, garment industries in Bali have been able to survive and grow because the ability of entrepreneurs to exercise opportunity global market through foreigners who often come to Bali.



### **Financial assistance: the establishment of BPR Delta Artha**

The implementation of the 1999 decentralisation policy encouraged the Sidoarjo government to explore and exploit the possibility of increasing revenue as much as possible from local resources. The Sidoarjo government looked to the banking sector as a potential source of revenue. In 2000 the Sidoarjo government established a small credit bank called BPR Delta Artha. For the Sidoarjo government, BPR Delta Artha also served as a local financial institution to support the local business sector, including the leather cluster of Tanggulangin. However, fieldwork revealed that this policy did not match the needs of the leather cluster. The BPR Delta Artha was quite prudent and avoided excessive risk taking.

A staff member of the Sidoarjo government who was involved in the preliminary discussions explained that the initiative for the establishment of BPR Delta Artha Sidoarjo came from Soejito, the *Bupati* of Sidoarjo during the period 1995–2000.<sup>21</sup> The idea was inspired by the fact that at the end of the 1990s many villages in Sidoarjo saved their *Kas Desa* (village assets in the form of money) in commercial banks. These villages received money from a compensation of their *Kas Tanah Desa* or the so-called *Tanah Ganjaran*<sup>22</sup> (village assets in the form of land) from business people. As a consequence of the growth of industrialisation and the function of Sidoarjo as a buffer zone for the metropolitan city of Surabaya, the need for land in Sidoarjo has increased dramatically, in particular for industry and real estate. Many villages sold the *Tanah Ganjaran* or were compensated with other land but in many cases this included some money. In 2000 there was about Rp 40 billion of the *Kas Desa* in Sidoarjo that was saved in commercial banks.

<sup>21</sup> Interview with AHY in Sidoarjo on 8 October 2002.

<sup>22</sup> In Indonesia, especially in Java, each village has its own assets particularly in the form of land. As a consequence of industrialisation and the growth of the construction business in Sidoarjo a lot of the lands were sold or compensated with other lands in a different location, and some money. In 2000, the assets of villages in the form of cash money were estimated more than Rp 40 billion. The money was saved in some commercial banks in Sidoarjo.

Furthermore, the staff of Sidoarjo government explained that the *Bupati* of Sidoarjo at the time questioned, why the money was managed by the government of Sidoarjo itself.<sup>23</sup> The establishment of the BPR Delta Artha emerged from this thinking. In addition, putting the *Kas Desa* in the BPR would not disadvantage the villagers because the interest rate was similar to the commercial banks. Hence, there would be mutual benefits for the Sidoarjo government and the villagers. However, not all of the *Kas Desa* was saved in the BPR Delta Artha. According to the director of Atha Graha, only about 30 per cent of the total *Kas Desa* was deposited in the BPR Delta Artha, while the rest remained in the commercial banks. This happened because at the time the villagers still did not fully trust the BPR Delta Artha.

The BPR Delta Artha was establishment to increase local government revenue. Its management has been directed to gain as many as possible benefits as possible and to avoid costs. In the short term, the bank has carefully selected its borrowers. Most of the borrowers have been employees of the local government of Sidoarjo itself. This policy has been undertaken to avoid default. Providing credit to local government employees ensures the loans would be repaid. Director of BPR Delta Artha explained that this policy has been adhered to because the BRP Delta Artha is still getting established.<sup>24</sup> However, the BPR Delta Artha is also trying to expand its customers. Even though the business sector represents a small percentage of loans given, the BPR is starting to extend credit to this sector, including cottage and small-scale enterprises. For this, the BPR has cooperated with large commercial banks, such as BII and Bank Niaga. The function of the BPR is to channel the large commercial banks in the provision of small credits to borrowers, including cottage and small-scale enterprises. However, BPR Delta Artha did not cooperate with BI, for example, in channelling small credits for cottage and small-scale enterprises.

Furthermore, the contribution of BPR Delta Artha to local revenue for the District of Sidoarjo has increased significantly since it was launched in 2000. In the

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<sup>23</sup> Interview with AHY in Sidoarjo on 8 October 2002.

<sup>24</sup> Interview with SM in Sidoarjo on 18 October 2002.

fiscal year 2001, BRR Delta Artha provided Rp 400 million dividends for the Sidoarjo government. The dividends increased to Rp 925 million in the fiscal year 2002.

Until the end of 2005 there is no clear contribution of the BPR Delta Artha to the leather cluster of Tanggulangin in particular, and cottage and small-scale enterprises in general. This is because most customers of the BPR Delta Artha are local government employees. None of the respondents interviewed had received credit from BPR Delta Artha. Some respondents received credit from banks, but mostly from commercial banks both in Sidoarjo and Surabaya. In other words, the aim of providing financial assistance to clusters through BPR was not achieved.

In 2006, the Sidoarjo government launched a special financial assistance program for SMEs amounting of Rp 5 billion. This program is coordinated by the Dinas of co-operative. This is a concessional credit as the interest rate is much lower compared to the interest rate in the market, which is only six per cent. However, the borrowers are requested to provide collateral before getting loans. This arrangement is carried out to reduce default. In addition, in implementing this program, the Sidoarjo government asked the BPR Delta Artha to join, especially in distributing loan and collecting the return. For this, the BPR Delta Artha will get two per cent fee of the six per cent interest rate.<sup>25</sup> In addition to supporting the Dinas of Co-operative administratively, the involvement of the BPR is designed to push this financial institution to provide more support to the SMEs, including for craftsmen in the leather goods cluster industry of Tanggulangin.

The function of BPR Delta Artha in supporting SMEs is just started. Therefore, it is difficult to look at the extent to which it contributes to SMEs. At least, its current opening door for SMEs can be interpreted that it is now an additional financial institution for channelling SMEs in getting financial support. However, without supporting the Sidoarjo government, it is impossible for the BPR Delta Artha to provide concessional credit to SMEs.

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<sup>25</sup> The arrangement for the fee is that, two per cent for operational fee, two percent for the BPR, and two per cent for the APBD.

Even though the arrangement requests the borrowers to provide collateral, the concessional credit itself might results in some problems as happened before (Bolnick 1982; Pangestu 1996; Papanek 2006). First, providing collateral is a big matter for SMEs as their capital is limited. Therefore, only those who have more capitals are eligible for getting cheap loans. Indeed, an alternative way to overcome this problem as suggested by Rhyne and Otero (1992) is through building group guarantees. But this is not part of the program. Second, as a matter of fact that the number of credit is small, while SMEs that need cheap credit are much higher might results in the practice of unfair decision among the authority. This might happens because clientelism is still practiced at the local politics. In other words, providing concessional credit program for supporting clusters might not an effective way.

## Chapter Six

### CONCLUSION

Cluster industries have been concerned of the Indonesian government for a long time. In addition to considering the fact that clusters are dominated by SMEs, therefore, they are able to absorb more labour forces, clustered firms tend to gain more benefits compared to the dispersed firms. Furthermore, given clusters are located at the same areas make it easier for government to provide assistances.

Nevertheless, from the viewpoint of central-local relations, the ways the Indonesian government to provide *pembinaan* to clusters are opposite to the nature of clusters, which is essentially are decentralised businesses. In this sense, local government supposed to be more active in supporting clusters. However, due to the Indonesian government were centralised before the reform era, efforts to promote clusters were mostly carried out by central government. Even though local government was still enabling to issue policy on cluster, its position was mainly just to implement policies of central government.

Turning point of central-local relations in post Suharto's government has given opportunity for local government to exercise clusters more as part of enhancing local economy. Experience of Sidoarjo suggests that local government has political commitment to pay attention more to clusters after it received more authorities from central government. Unfortunately, looking at budgets allocated for the industrial affairs there is no significant different between before and after implementation of the decentralisation policy. Institutionally, however, local government has shown it is more active in providing assistance to clusters.

The ways local government has attempted to promote cluster are essentially similar to what were done by central government during the centralisation era that is through providing technical assistance and financial assistance. Sidoarjo government has supported cluster in Tanggulangin through the establishment of IFSC for giving technical assistance and the BPR Delta Artha for providing financial support.

Between the two policies, the IFSC seems to be more promising compared to the BPR since it is designed to provide training for craftsmen in making internationally qualified footwear products. This is because, as indicated by its characteristics, the obvious problem of the leather goods cluster industry of Tanggulangin is how to produce qualified leather products in order to compete in the global market. Experience in the past suggested that the technical assistance program of *UPT Kulit* had more positive impact to cluster compared to the financial assistance of concessional credit. Therefore, providing concessional credit would not be a good answer in overcoming lacking financial problem.

Indeed, the main program of IFSC is not directly related to the core business of the leather goods cluster industry of Tanggulangin. But as the footwear products are part of the leather industry in general and currently some craftsmen in Tanggulangin have started to produce footwear, the IFSC might be function as being one of the stimulant factors in generating more dynamic of the leather goods cluster industry of Tanggulangin.

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### **Synopsis and Further Research**

Based on the research can be learned that decentralization policy has stimulated local government in providing a better services and programs for promoting cluster industry in the district level. However, this study is only based on the case of the leather cluster industry of Tanggulangin in the District of Sidoarjo, East Java. For a better conclusion and learning it is suggested to conduct further studies in other districts.

**Executive Report**  
**Competition for International Publication Batch I**  
**Year 2009**

**I. Research Question and Aim**

**I.1. Research Question**

Does local government play more roles in supporting cluster industries after it gain more authorities? If yes, in what ways, and how they induces a positive impact to cluster industries?

**I.2. Research Aim**

This study aims to describe the ways local government support cluster industry after the implementation of decentralization policy

**I.3. Contribution for Knowledge**

This study provide further knowledge on cluster industry from political perspective

**II. Contribution for Development**

In addition to enrich knowledge on the study of cluster industry policy, this study can be used by the Indonesian government in formulating and implementing programs for promoting cluster industry.

**III. The Use for Institution**

This study can be used by Airlangga University in conducting further cooperation with local government in promoting cluster industry.

**IV. Publication**

The article based on this study is currently under review by International Journal of Public Policy.