

UPDATE ON INDONESIA’S EAST JAVA PROVINCE: STILL A CASE OF ‘BALANCED DEVELOPMENT’?

Heath McMichael

Member of Katalis Technical Services Panel, Indonesia-Australia Closer Economic Partnership Agreement

Email: hcmichael@tpg.com.au

Article Info

Article history:

Published: Dec 30,2022

Page: 54-59

Keyword:

*East Java Province.
Balanced Development.*

Abstract

Since the 1980s, surveys have portrayed East Java Province as an economic success story, with high levels of growth spread across all major sectors in rural as well as urban settings. East Java appears a victim of its own success with large-scale investors in the processed food sector considering relocating to Central Java where minimum wages are lower. In terms of domestic investment, housing, industrial estates and offices (27 per cent), transportation and warehousing (14 per cent) and food (8 per cent) were the main destinations in Q1 22. In Q2 2022, the principal sources of foreign investment were the United States (43 per cent, comprising mainly PT Freeport Indonesia’s Rp 5 trillion realised investments in its Gresik copper smelter), Hong Kong (19 per cent), Singapore (15 per cent) and Japan (9 per cent). Another aspect of the balanced development thesis was that trade was not the driving force in growth. That still seems to be so. Input-output analysis appears to show that the province’s surplus is actually not very large – suggesting a high degree of complementarity between East Java’s agricultural, manufacturing and export sectors. While the balanced development thesis was never meant to imply that East Java’s regions had experienced a uniform stage of development, it is possible to identify ‘winners’ and ‘losers’ within the province. So, what is East Java’s future trajectory and does it continue to deserve a reputation for balanced development? In terms of investment, balance may still be the hallmark of provincial development. In order to navigate through the ‘middle-income trap’, the province will need to invest more in human capital to foster entrepreneurship, productivity and wellbeing. Management of the provincial economy will be increasingly difficult as the intricate and complex nexus of politics and business in the province evolves.

Copyright © 2022 *OECONOMICUS Journal of Economics*

Editorial Office:

Prodi Ilmu Ekonomi Fakultas Ekonomi dan Bisnis Islam, UIN Sunan Ampel Surabaya

Jl. Ahmad Yani 117 Surabaya, Jawa Timur 60237, Indonesia.

Email: oje@uinsby.ac.id

Introduction

Following the tragic soccer riot in the normally quiet provincial town of Malang in early October, Indonesia's province of East Java received some bad press around the world. This is unfair because my recent field work in East Java has revealed a provincial economy responding strongly to pent up demand for its goods and services after the worst of the Covid-19 pandemic. With 5.7 per cent provincial GDP growth in Q2 2022 (y-on-y), East Java is again showing other provinces it is Indonesia's economic powerhouse.



Since the 1980s, surveys have portrayed East Java Province as an economic success story, with high levels of growth spread across all major sectors in rural as well as urban settings. Dick, Howard, James J. Fox (2003) argue that East Java was able to capitalize on a large population; a broad manufacturing base; rising wages and purchasing power; well-established transport and irrigation networks, and; a generally competent bureaucracy, to create a 'balanced' pattern of growth and

development. Does this thesis hold water today?

Various factors account for East Java's strong economic performance. High on the list is the province's proximity to Bali which is a source of significant demand for processed food and furniture. East Java's economy also benefits from a high degree of economic integration with the agriculture and manufacturing sectors both supporting exports. According to Bank Indonesia in Surabaya, 60 per cent of provincial demand is driven by household consumption, with domestic and foreign investment accounting for 25 per cent of GDP. Bank Indonesia in Surabaya estimates consumer confidence in East Java is rising with an index increasing from 126 to 131 in the first half of 2022. At 7 per cent, inflation is above the national average.

In terms of investment realisation in the province, real estate, food and beverages, paper and chemicals and pharmaceuticals constitute the leading sectors. The tobacco industry is a significant contributor to the provincial economy although provincial officials are reticent about providing firm figures (maybe 8 per cent of provincial GDP?).

In Q2 2022, the principal sources of foreign investment were the United States (43 per cent, comprising mainly PT Freeport Indonesia's Rp 5 trillion¹ realised investments in its Gresik copper smelter), Hong Kong (19 per cent), Singapore (15 per cent) and Japan (9 per cent). FDI is dominated by mining which accounts for 27

Editorial Office:

Prodi Ilmu Ekonomi Fakultas Ekonomi dan Bisnis Islam, UIN Sunan Ampel Surabaya

Jl. Ahmad Yani 117 Surabaya, Jawa Timur 60237, Indonesia.

Email: oje@uinsby.ac.id

per cent of overseas investment (mainly at the Freeport smelter). East Java appears a victim of its own success with large-scale investors in the processed food sector considering relocating to Central Java where minimum wages are lower. In terms of domestic investment, housing, industrial estates and offices (27 per cent), transportation and warehousing (14 per cent) and food (8 per cent) were the main destinations in Q1 22.

East Java's transport infrastructure is amongst Indonesia's most efficient. With its reliable bulk-handling facilities, Surabaya is an efficient container port and less congested than Jakarta. Upgrades to toll roads from Surabaya to Malang and from Surabaya to Ngawi (on the Trans Java Highway) have eased congestion. The planned extension of the Trans Java Highway from Probolinggo to Banyuwangi could facilitate supply chains and access for those wishing to add to their Bali holiday a visit to East Java's tourism destinations. In addition to new roads, the freight task in East Java will be facilitated by an improved rail corridor linking Surabaya with Jakarta as part of the Japan-financed Java North Line Upgrade, to connect Surabaya with Semarang in Central Java and Cirebon in West Java. The national government announced plans in 2020 to extend the China-backed Jakarta-Bandung high-speed railway project to Surabaya via Yogyakarta and Solo in Central Java.

Another aspect of the balanced development thesis was that trade was not the driving force in growth. That still seems to be so. Input-output analysis appears to show that the province's surplus is actually not very large – suggesting a high degree of

complementarity between East Java's agricultural, manufacturing and export sectors. (Batubara, 2018)

While the balanced development thesis was never meant to imply that East Java's regions had experienced a uniform stage of development, it is possible to identify 'winners' and 'losers' within the province. At present there are four main growth axes ('poros pertumbuhan'). The first is centred on Surabaya and the north coast Regencies of Gresik, Tuban, Lamongan and Bojonegoro. Oil and gas is the leading sector with Bojonegoro contributing 25-30 percent of national production. In its singular dependency on oil and gas, however, Bojonegoro faces a variety of challenges, not least from volatile global prices. Oil and gas and mining have driven a flourishing mining equipment and technology services sector. The most significant investment is the PT Freeport copper and gold smelter located near the port of Gresik. Property developer, Ciputra, is dominant in the real estate and retail sectors, especially in Surabaya and Mojokerto.

Sidoarjo Regency, south of Surabaya, was originally part of this growth axis (under a formulation known as Gerbangkertosusila) but suffered a drastic economic setback following the 2006 Lapindo mudflow disaster. A long-term local observer estimates that the disaster stripped around six per cent from the Regency's annual GDP growth rate. (McMichael, 2009)



Surabaya skyline

The ‘horseshoe’ growth area centred on Probolinggo, Pasuruan, and Jember and Madura is the heartland of East Java’s historical plantation sector. Sugar and tobacco have been the traditional mainstays of the economy although the quality consistency of sugar produced within the region has come under question in recent years. Based on its UN Human Development Index, this area is doing well with higher education attainment and income levels than other parts of East Java. Paradoxically, however, the region also exhibits lower life expectancy scores than other regions in the province.

East Java’s easternmost region centred on Banyuwangi on the Bali Strait has achieved some success in attracting investment in IT-related enterprises. Under the dynamic leadership of husband-and-wife Bupati team, Bpk Abdullah Aziz and, subsequently, Ibu Ipuk Fiestiandani, Banyuwangi Regency is developing a hub for digitally-delivered service industries. Although it was not the first to introduce a one-stop shop (Pusat Pelayanan Publik) for e-government services, Banyuwangi has been quick to extend the concept to encompass a whole ‘shopping mall’ of community-facing services. The regency

sees itself as a serious promoter of eco-tourism. Apart from the ‘G land’ resort well-known to international surfers, Banyuwangi is hopeful of attracting nature lovers to the Meru Bitiri National Park and Gunung Tumpangpitu near Pasanggaran on the south coast (although in the latter case, proximity to a gold mine development owned by PT Merdeka Copper Gold Tbk may complicate development of a world-class eco-tourism site).

Eco-tourism is the economic focus in the fourth growth area: the ‘Bromo-Tengger-Smeru (named after two of the principal volcanoes in the region) or BTS as it is called. Malang, home to the now infamous Kanjuruhan football stadium, and the horticulture-centred hill station of Batu, form the main urban hubs in this region. Tourism and the dairy industry – a large investment by multinational, Nestle, is located near Malang - are the flagship sectors.



Leafy Tugu Park in Malang

Beside these growth axes, on the other hand, several persistently laggard regions complete East Java’s development profile. The Selingkar Wilis/Southern Crossroad region in the province’s south west was recognised as a priority area in Presidential Decree 80/2019 on Acceleration of East Java

Growth. At the head of the list of infrastructure development projects planned for this region are a new airport in Kediri which has been given 'National Strategic Project' status by the national government. In East Java's version of public-private partnership project financing, it is understood Kediri-based kretek cigarette maker PT Gudang Garam will invest Rp10 trillion in the airport.

Even in this laggard region there are success stories. Near the border with Central Java, Magetan, located on the fertile slopes of Mt Lawu, has long been a centre for horticulture. In recent years, the Regency has developed niche home industries in leather shoe manufacturing and conical hats for, amazingly, farm workers in China. In the southern city of Blitar, egg production is a growing industry spurred by an agglomeration of family companies that have been able to control egg prices throughout Java and in Jakarta. On the province's south-west coast, Pacitan, the birthplace of former Indonesian President Yudhoyono, is endeavouring to promote eco-tourism based on its abundance of natural limestone caves and beaches. However, like other towns along the south coast of East Java, the need for long supply chains as a result of a deeply indented and rugged coastline and a lack of direct east-west road and rail connections is retarding further growth in the region.



Headquarters of PT Gudang Garam in Kediri

Economic development on the island of Madura near Surabaya continues to lag. Completion of the Suramadu bridge in 2009 was expected to stimulate growth and investment from the mainland. However, despite the abolition of toll charges in 2018, there has been little development in the Bangkalan Regency near the bridge and an industrial estate proposed by the now defunct Surabaya-Madura Region Development Agency has yet to materialise. A proposed Rp 17.2 trillion port development at Tanjung Bulupandan in Bangkalan is yet to commence. Provincial government plans to develop Madura as a halal 'culinary industry' centre appear so far to be 'pie in the sky'.

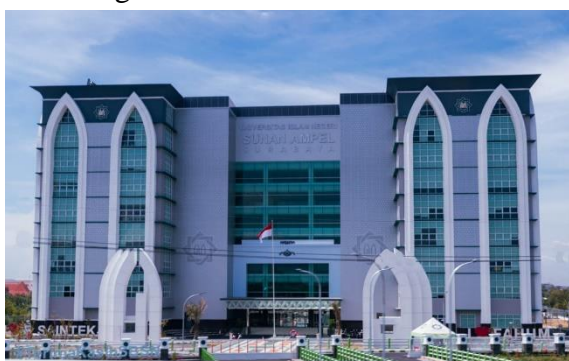
A failure to fully realise national and provincial government spending has undoubtedly stymied development on the island. That said, it is evident that Madura's unique socio-cultural environment, which is steeped in Islamic conservatism, constitutes a systemic brake on growth. Community resistance to outside influence, often fanned by local Muslim clerics, has hindered efforts to integrate Madura economically with the mainland. In recent years, local vigilantes, known as 'blater', are widely considered to

have impeded the entry of FDI, especially in the Sampang Regency in central Madura.



Suramadu Bridge

So, what is East Java's future trajectory and does it continue to deserve a reputation for balanced development? Mackie and Zain observed in 1991 that growth in East Java had been a cumulative process in most parts of the province, not the result of investment in one or two leading sectors. In terms of investment, balance may still be the hallmark of provincial development. In order to navigate through the 'middle-income trap', the province will need to invest more in human capital to foster entrepreneurship, productivity and wellbeing.



State Islamic University of Sunan Ampel, Surabaya

The reputation of East Java's higher education institutions is improving. A flourishing Faculty of Economics and Islamic Business now exists at the State Islamic University of Sunan Ampel in

Surabaya. The state universities of Airlangga in Surabaya and Brawijaya in Malang maintain well-regarded faculties of economics, although their output is still dwarfed by that of universities in other provinces in Java (e.g., Indonesia and Gajah Mada Universities).

As new industries emerge in East Java, for example, in advanced manufacturing and IT-based healthcare services, it will become increasingly important for provincial policy-makers to provide incentives to retain investors lured to transfer their investments to other provinces. Management of the provincial economy will be increasingly difficult as the intricate and complex nexus of politics and business in the province evolves.

Reference

- Batubara, Rumayya. 2018. "Village Government Corruption In Decentralized Indonesia : Democracy , Ethnic Diversity And Budget." *Journal of Developing Economies* 1(1): 49–62.
- Dick, Howard, James J. Fox, Jamie Mackie. 1999. *Balanced Development: East Java in the New Order*. Oxford University Press.
- Mackie and Zain, 'Balanced Growth and Diversification', in Hill, Unity and Diversity, Oxford University Press, Singapore, 1991.
- McMichael, Heath. 2009. "The Lapindo Mudflow Disaster: Environmental, Infrastructure and Economic Impact." *Bulletin of Indonesian Economic Studies* 45(1).