

# Bureaucratic Reform in East Java Province Trade: Review of MSMEs

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## ABSTRACT

*Abstract*— The Indonesia's trade balance experienced two times deficit, in January (US \$ 1.06 billion) and April 2019 (US \$ 2.29 billion). Then, the government examined the needs and potential of Indonesia's bilateral and multilateral trade agreements, and increased utilization of foreign trade representatives. This study aims to improve the quality of SMEs in East Java Province through bureaucratic reform using qualitative analysis. The results show the diversity of bureaucracy associated with SMEs is overlapping. Therefore, a new breakthrough is needed to facilitate export potential SMEs to be able to compete with imported commodities and reach international markets. Bureaucratic reform begun from the readiness of SMEs including internal production and compliance with standards for export destination countries, and then clarity of destination markets through government assistance in the form of business adjustments, free trade agreements, etc.

**Keywords**— *bureaucratic reform, trade, MSME*

## 1. INTRODUCTION

The trade development is very important as an effort to accelerate economic growth and equity, and to make a significant contribution in creating business opportunities, expanding employment opportunities, and increasing income. Trade sector activities are interrelated and support each other sectors activities, such as the production sector, namely agriculture, industry and mining; financial sector; the transportation and telecommunications sector. Trade development also plays an important role in creating and maintaining economic stability in controlling inflation and securing the balance of payments. The results of advancement of trade development, i.e., it is reflected in the value and structure of exports and imports development. Furthermore, trade policies and activities are also directed to encourage and assist small entrepreneurs, economically weak groups, including domestic and informal and traditional businesses. This effort is carried out as a form of absorption and provision of media for people's economic potential which is carried out in an integrated manner.

However, in practice, the national trade balance experienced 2 (two) times deficit, namely in January and April 2019 each of US \$ 1.06 billion and US \$ 2.29 billion. One of the causing factors is the increase in oil and gas prices. The government is making efforts to reduce the trade balance deficit. The Indonesian trade balance can cumulatively become a surplus. Even the President opines the acceleration of trade agreements. He said:

*"I request that the FTA / PTA Indonesia negotiations with the trade partners can be immediately concluded".*

Although the Government of Indonesia currently has a trade network with several export destination countries such as the Indonesia - Chile (CEPA) trade union, Indonesia - Australia

(CEPA), Indonesia - Japan (EPA), Indonesia - Pakistan (PTA), Indonesia - Palestine, Indonesia - Mozambique (PTA), and Indonesia in the PTA FTA. Furthermore, to strengthen and expand overseas markets, the government is increasing efforts to expand export destinations through the *Indonesian Trade Promotion Center (ITPC)*. Thus, the promotion of exports can be carried out to a number of major markets and new markets, utilizing domestic and international marketing networks, increasing market research activities abroad and various trade regulations in export destination countries.

Furthermore, the following are the elements that inhibit exports in foreign market networks:

1. For 50 years, the Indonesian exports have been supported by *natural intensive products*
2. Trade surplus is due to an increase in commodity prices not the sale value
3. Weak of focus on developing potential product exports, introduction and deepening, and market analysis
4. Lack coordination between government agencies related to exports

To handle these obstacles, the government seeks to provide policies to increase exports of MSME products including by significantly increasing production capacity so as to require increased investment and development of downstream industries; improvement of infrastructure related to trade (transportation, capacity of household equipment, port facilities, banking, internet, etc.; synergy between central and local governments; and incentives for export-oriented MSMEs). Furthermore, the government also said that strategies and policies had been prepared to increase trade MSME products by developing markets through trade missions, based promotions *e-commerce*, implementing campaigns of 100% love Indonesian products, increasing MSME product competitiveness in the global market, mapping entrepreneurs based on products and locations, facilitating and strengthening

networks of Indonesian entrepreneurs and buyers; opening new exports goals for Indonesian MSME products

However, development of efforts and discourse cannot be completed due to the old bureaucratic implementations, which actually inadvertently hinder the acceleration of MSME trade transactions in the wider market. Therefore, in this case, the researcher wanted to give a new perspective regarding the importance of trade bureaucracy reform in East Java Province by reviewing the MSMEs.

## **2. LITERATURE REVIEW**

### **2.1. Bureaucratic Reform**

Reform is a movement to change the shape and behavior of an order to be in accordance with the current development of era, due to its inefficient, unclean, and undemocratic characters. While bureaucracy is a large organization, carrying a large-scale mission, and is carried out by many people / personnel / employees. Bureaucracy is a government carried out in the office, not on the streets, not in the fields or on the battlefield. So bureaucracy is a government written, planned and neatly documented community management carried out by educated people. Deeper, bureaucracy is one of the factors that effects the realization of a clean government and good governance. Having such an important position and role in the management of policies and public services, the bureaucracy determines the efficiency and quality of services to the community, as well as the efficiency and effectiveness of governance and development. Furthermore, Islamy revealed bureaucratic reforms in the context of developing the country's administrative system, both at the center and in the regions, needing to pay attention to the actualization of values and principles which include democracy and empowerment, service, transparency, partnerships, decentralization, and policy consistency and certainty law.

In this case study, bureaucratic reform focuses on the trade bureaucracy of East Java Province which includes the institutions and systems that are built in strengthening domestic and international trade transactions. Trade bureaucracy reform is a hope for SMEs to get guidance, assistance, and product quality improvement. Thus the enthusiasm of MSMEs can strengthen international trade in East Java Province with high competitiveness.

### **2.2. Institutional Economics (Rent Seeking and Asymmetric Information**

#### **2.2.1. Rent Seeking**

Rent-seeking theory is firstly introduced by Krueger, which then developed by Bhagwati and Srinivasan. At that time, Krueger discussed about the practice to get import quota. Import quota is defined as the differences between border price (cum price) and domestic price. In this case, rent-seeker is defined as the resource release to change economics policy, or to limit the policy so that the rent-seeker can be benefitted. In the classic economics theory, the rent-seeking concept is not negatively appreciated as an economics activity which can be

harm for another party. Moreover, rent-seeker can be positively appreciated because they can simultaneously push ahead the economics activity, as well as tobacco sellers who want to gain benefit or wages. Yet, on the other hand, in the politic economics literature, rent-seeking concept is assumed as negative behavior.

According to Michael Ross, rent seeking can be divided to two types:

1. Rent Creation, in which firms seek rents created by the state, by bribing politicians and bureaucrats;
2. Rent Extraction, in which politicians and bureaucrats seek rents held by firms, by threatening firms with costly regulations;

Rent Seizing, as efforts by state actors to gain the right to allocate rents.

#### **2.2.2. Asymmetric Information**

Asymmetric information is the difference of information obtained by one of the parties to another one in economics activity. This information can happen between exporters which will do international trading transaction. The exporters have to know the market condition well before they do a transaction either sell or buy. It makes exporters will seek for the market condition completely and correctly to the firms in obtaining capital gain in future. Yet, it is not easy in seeking information process. Some exporters often get minimum information than expected about domestic and international markets. It is because the firms are impossible to give the information about their firms' condition completely to public. The information is firms' secret which is given to the trusted parties and in the right time. In coping with this problem, the smart exporters will seek for information and analyze it to get a correct description. The obtained information will be different between the exporters' and firms agents', this difference is called as asymmetric information. Asymmetric information does not only happen in the modal markets, but also in other industries. Moreover, in law aspect, this information might happen. There are two basic types of asymmetric information which can be differentiated. First, hidden knowledge refers to a situation when a party has more information than the others about the quality or type of traded tobacco or variable contract. Second, hidden action is when a party can affect the quality of the traded tobacco or variable contract by using some actions and the actions cannot be observed by other parties.

### **2.3. MSME Concept**

In Article 1 of Paragraph 1 of Act No. 20/2008 concerning Micro, Small and Medium Enterprises (MSMEs), Micro, Small and Medium Enterprises is defined as follows:

1. Micro Business is productive business owned by individuals and / or business entities individuals who meet the Micro Business criteria as regulated in this Act;
2. Small Business is a productive economic business that stands alone, which is carried out by individuals or business entities that are not subsidiaries or branch companies that are owned, controlled, or become a part either directly or indirectly of Medium Enterprises or

Large Enterprises that fulfill Small Business criteria as referred to in this Act;

3. Medium Business is a productive economic business that stands alone, which is carried out by an individual or business entity that is not a subsidiary or branch of a company that is owned, controlled, or becomes a part either directly or indirectly with a Small Business or Large Business with the amount of wealth net or annual sales results as provided for in this Act.

The World Bank defines MSMEs as follows:

1. *Micro enterprise* (micro business) with this criteria: the number of employees is less than 10 people, the annual income does not exceed USD 100 thousand, and the total assets do not exceed USD 100 thousand.
2. *Small enterprise* (small business) with this criteria: the number of employees is less than 30 people, a year income does not exceed USD 3 million, and the number of assets does not exceed USD 3 million.
3. *Medium enterprise* (medium business) with this criteria: a maximum number of employees is 300 people, a yearly income of up to USD 15 million, and total assets of up to USD 15 million.

The Central Statistics Agency (BPS) provides a definition of MSMEs based on the number of workers, entities classified as small businesses are businesses that have a workforce of 5-19 people and medium businesses have a workforce of 20 - 99 people.

Characteristics of MSMEs in general are that it has simple management, low access to credit institutions, some business units do not have legal entity status, and are concentrated in certain business groups. The low level of micro and small business actors in accessing banking is related to difficulties in providing collateral as determined by the bank. Micro and small businesses also still have difficulty in meeting administrative requirements and credit lending procedures as determined by the bank. Sometimes business and small businesses still object to the burden of interest rates which are too high. Production process capability of MSMEs in general also have limitations, especially in terms of production technology. Another weakness is the aspect of access to marketing. However, MSMEs have high flexibility in adjusting to rapidly changing market conditions. Compared to large-scale companies which are generally bureaucratic in nature, the MSME sector has flexibility towards a number of policies that sometimes do not favor MSME development.

The explanation above indicates that Micro, Small and Medium Enterprises are a form of productive economic business carried out by individuals or individual business entities that meet the criteria of Micro, Small and Medium Enterprises.

### 3. METHOD

Lofland in Moleong (2000) described that the main data in qualitative research are the words and actions, and the additional data are documentation, etc. The data collected in this research are verbal data from informant's information. Data collection technique used in this research is

documentation, interview and focus group discussion (FGD). The procedure implementation is agreed with data source and location where the informant place their business and related instance that is pointed. This content analysis is an equipment analysis on qualitative research with copying and making specific conclusion from the data in form of text data. This conclusion compiled using a long method by comparing the situation in a field with the empiric theory (Cavanagh, 1997), Titscher et al (2000) in Kohlbacher (2006) in Krippendorf (1969) in Myring (2000)). Content analysis method is arranging the core meaning from one manuscript data by doing empiric approach and analysis of methodology that is controlled. The written data (obtained from the interview, speech, observation, recording speech and field note) will be interpreted and categorized in special code, then it will be compared to theory empirically (Myring (2000) and Kohlbacher (2006)

## 4. RESULTS AND DISCUSSION

### 4.1. Results

The results of in-depth interviews with some experts and reviewing documents - trade-related documents to SMEs in East Java, the followings are important points in the discussion of the research:

1. Readiness of SMEs entering international trade
  - In-depth interviews to trade expert provide optimistic views on SMEs Province East Java. Exporters' representatives expressed the high enthusiasm of the UMKM Province of East Java in both domestic and international trade. They do the development of production as a form of competency elevation through updating tools and machinery. The MSMEs also carry out variations
2. Strengthening MSME trade
  - One expert representative from the East Java Provincial Government explained that the government had launched a framework for strengthening inter-regional trade through the East Java Trade Representative Office (KPD). The intended framework consists of:
    - a. Market intelligence; a strategy carried out to obtain information by collecting data and analyzing markets in accordance with current market conditions that will be processed in the information system marketing. In its business marketing intelligence is work that does not violate the law, work that does not steal data from other companies or steal illegal data to obtain confidential information. The failure of trade in MSME in East Java is often caused by the lack of marketing information needed about markets, consumers, competitors and stakeholders. Market research really helps MSMEs to see the external situation they face. Uncertain business conditions often become a serious obstacle for MSMEs to strengthen their position and existence in the market.
    - b. Business Aggregator; in the digital financial ecosystem, aggregators function as adhesives that help entities such as businesses, governments, and capital owners to easily connect with various payment platforms such as m-banking or bank services to customers who pay through

these services. This facility makes it easy for SMEs in East Java to transact with buyers in real time.

- c. Place for business meetings and trade transactions; The Provincial Government of East Java through the Department of Trade and Industry provides business matching and free trade agreement facilities by utilizing trade attaches (Atdag) and the Indonesian Trade Promotion Center (ITPC) in several export destination countries. On this occasion SMEs met with various domestic and foreign business people for trade discussions and strengthening business networks. In addition, the government also gave MSMEs the opportunity to involve in trade agreements with buyers from East Java domestic businesses or transactions with exporters from abroad facilitated by the Trade Attaché or ITPC.
  - d. Promotion of superior products in East Java; The government strives for MSME to be ready in improving the quality of human resources and standardization of export-oriented products. Furthermore, the government provides an opportunity for excellent MSME products to participate in international exhibitions. In this case, MSME products must meet the terms and conditions set by the East Java Provincial Government as proof of MSME readiness to enter into international trade. This activity is expected to be able to encourage an increase in the quantity of business gatherings between SMEs with entrepreneurs in partner countries. Thus, East Java's MSMEs are not limited to domestic trade with manual transactions but are also able to utilize international trade networks guaranteed by financial institutions.
  - e. Support Value Chain of domestic commodities; the support chain system is built in such a way that includes government, MSME, financing and marketing. The government acts as a media to facilitate the improvement of the quality of human resources and product standardization; MSME as a provider of goods and services; financing is a managerial financial facility by financial institutions guaranteed by the government and non-government institutions in the form of control and policy decisions; and marketing as an effort to strengthen trade between regions, increase exports, and stabilize prices and protect consumers.
3. Continuity of Trade Information

Expert representatives from trade observers point out that trade information systems are the most important thing in maintaining the sustainability of trade communications.

One form of East Java trade information system was built by providing applications that are more easily accessible by MSMEs through the Information system availability and price development of basic commodities (Siskaperbapo). In addition, the government also places television monitors (TV) in traditional markets which are distributed starting from the Rogojampi Market in Banyuwangi Regency to the Sleko Market in Madiun Regency. Then this information is provided by the Provincial Government of East Java on the dashboard trade in real time.

**4.2. Discussion**

Viewing the case study of MSME, the trade bureaucracy of East Java Province indeed needs reform. The role and function of the Government of East Java Province related to trade should be able to work optimally. This bureaucratic reform development program was supported by various related parties. Furthermore, in order the development plan for the utilization of the functions of foreign representatives both Atdag and ITPC can be implemented, it requires cooperation which is divided as follows:

1. Intergovernmental Cooperation  
The corporation is a form of intergovernmental coordination that is authorized in trade intervention and control such as Ministries, Financing Institutions, Local Government and a Presidential Decree are needed as another legal basis. Coordination was established between the Ministry of Trade and the Provincial Government of East Java through the Department of Industry and Trade with the Ministry of Industry, the Ministry of Cooperatives and SMEs, Financial Institutions, Regional Representatives and Foreign Representatives abroad, etc.. This form of cooperation tends to be in formal cooperation with bureaucratic communication making it easier to oversee the development of trade promotions.
2. Cooperation with entrepreneurs  
Unlike the form of intergovernmental cooperation, this cooperation serves to encourage entrepreneurs to actively participate in the development program of trade promotion as a form of export governance reforms to escalate trade competitiveness. More clearly, collaboration with entrepreneurs can be in the form of direct government meetings with or through communities or trade associations. The explanation will be clarified through the following table:

**STAKEHOLDER ANALYSIS**

No.	Relations	Organization	Information
<b>A. NATIONAL</b>			
1		Ministry of Trade and Provincial Government of East Java	Initiator and implementer of trade bureaucratic reform, especially in the case of MSMEs

		(Department of Industry and Trade)	
2		Ministry of Industry	Escalation of coordination with entrepreneurs in the framework of standardized production assistance to increase the selling power of products such as completing company documents legally
3		The Ministry of Cooperatives and SME	Reform is <i>updating dashboard on</i> ongoing SME inventory basis for easy access to company profiles for trade market promotion
4		Financial Institutions	Simple payment system socialization to accelerate export transactions safely to protect domestic companies
5		Foreign Representatives	Building trade communities and / or trade associations that function as media and facilitators to support trade attaches and ITPCs in the context of escalating trade promotions and market expansion.
<b>B. REGIONAL</b>			
		Department of Industry and Trade of East Java Province	Developing a work program focused on increasing the quantity of ITPC in potential export destination countries that have not been reached such as the trade market in the African region. At the same time it facilitates companies to communicate with foreign trade attaches to build an intensive export network
2		Department of Industry and Trade in Regency / City	Synergy work programs with regional government work programs in order to succeed the goal of developing export governance to increase the company's export passion and high selling power
<b>C. USER-CLIENT</b>			
1		Domestic Entrepreneurs	Joint business actors both small and medium scale to prepare themselves at the bargaining position of the company to achieve high selling power
2		ITPC	Implementing, promoting and facilitating importing entrepreneurs in each export destination country
3		Importer Entrepreneurs	Combined importer entrepreneurs in each destination country to set up broader trade market gates

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