

GOVERNMENT POLICY, SMALL AGRIBUSINESS  
AND REGIONAL DEVELOPMENT  
IN THE PROVINCE OF SUMATERA UTARA,  
INDONESIA

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**GOVERNMENT POLICY, SMALL AGRIBUSINESS AND  
REGIONAL DEVELOPMENT IN THE PROVINCE OF  
SUMATERA UTARA, INDONESIA**

by

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## LIST OF ABBREVIATIONS

AAL	: Alami Agro Lestari
AFTA	: Asia Free Trade Area
APEC	: Asia Pacific Economic Cooperation
BADS	: Bureaucratic Authoritarian Developmental State
BAS	: Bureaucratic Authoritarian State
BIMAS	: Bimbingan Masyarakat
BIPUK	: Badan Industri Pengembangan Usaha Kecil
BPR	: Bank Perkreditan Rakyat
BRI	: Bank Rakyat Indonesia
BUMN	: Badan Usaha Milik Negara
CGI	: Consultative Group on Indonesia
DPR	: Dewan Perwakilan Rakyat
DPRD	: Dewan Perwakilan Rakyat Daerah
EEC	: European Economic Countries
EOI	: Export Oriented Industrialization
GATT	: General Agreement on Trade and Tariff
GDP	: Gross Domestic Product
GDRP	: Gross Domestic Regional Product
GNP	: Gross National Product
HIPMI	: Himpunan Pengusaha Muda Indonesia
HKTI	: Himpunan Kerukunan Tani Indonesia
IGGI	: International Government Group on Indonesia
INHUTANI	: Industri Hutan Indonesia
INKUD	: Induk Koperasi Unit Desa
ISI	: Import Substitution Industrialization
KIK	: Kredit Investasi Kecil
KKop	: Kredit Untuk Koperasi
KKPA-TR	: Kredit Koperasi Petani Tebu Rakyat
KLBI	: Kredit Likuiditas Bank Indonesia
KMKP	: Kredit Modal Kerja Permanen
KOPKINRA	: Koperasi Kerajinan Industri Rakyat
KOPTAN	: Koperasi Tani
KPN	: Koperasi Pegawai Negeri
KSU	: Koperasi Serba Usaha
KUD	: Koperasi Unit Desa
KUK	: Kredit Usaha Kecil
KUM	: Kredit Usaha Menengah
KUPEDES	: Kredit Usaha Pedesaan
KUT	: Kredit Usaha Tani
LKM	: Lembaga Kredit Mikro
MEE	: Masyarakat Ekonomi Eropa
MPR	: Majelis Permusyawaratan Rakyat
NAFTA	: North Atlantic Free Trade Area
NASAKOM	: Nasionalis Agama Komunis
NGO	: Non Government Organization
NICs	: Newly Industrialized Countries
PAKJAN	: Paket Januari
PAKTO	: Paket Oktober

PERTAMINA	: Perusahaan Tambang Minyak Nasional
PIR	: Perkebunan Inti Rakyat
PJP	: Pembangunan Jangka Panjang
PLN	: Perusahaan Listrik Negara
PMA	: Penanaman Modal Asing
PMDN	: Penanaman Modal Dalam Negeri
PNS	: Pegawai Negeri Sipil
PP	: Peraturan Pemerintah
PT	: Perseroan Terbatas
PTPN	: Perusahaan Terbatas Perkebunan Negara
PUSKUD	: Pusat Koperasi Unit Desa
REPELITA	: Rencana Pembangunan Lima Tahun
SIMPEDES	: Simpanan Pedesaan
SMEs	: Small Medium Enterprises
SPSS	: Statistical Package for Social Science
UD	: Usaha Dagang
UNCRD	: United Nations Centre for Regional Development
USA	: United States of America
WTO	: World Trade Organization



# **DASAR KERAJAAN, PERNIAGAAN PERTANIAN KECIL DAN PEMBANGUNAN KAWASAN DI WILAYAH SUMATERA UTARA, INDONESIA**

## **ABSTRAK**

Kajian ini bermatlamat menilai kesan campur tangan kerajaan dalam sektor perniagaan pertanian kecil di Indonesia. Pada amnya campur tangan kerajaan dilakukan dalam bentuk dasar, rancangan dan projek yang menyokong pembangunan produktif dalam sektor perniagaan pertanian kecil. Di Sumatera Utara, iaitu kawasan dimana kajian ini dijalankan, dasar kerajaan tempatan menggalakkan dan mungkin pula mengembangkan perniagaan pertanian kecil.

Tiga persoalan menjadi tumpuan kajian ini: kesan daripada dasar pengagihan kuasa Indonesia (yang bermula pada 2001) keatas pembangunan perniagaan pertanian kecil; kaitan antara sektor perniagaan pertanian kecil dengan pembangunan wilayah, dan pertolongan yang diberikan oleh dasar kerajaan tempatan dan program-program pembangunan perniagaan pertanian kecil.

Kajian ini menjalankan empat jenis tugas utama untuk membahas persoalan-persoalan tersebut. Yang pertama, kajian ini meninjau sektor perniagaan pertanian kecil di Sumatera Utara agar menunjukkan ciri-ciri dan masalah-masalahnya. Yang kedua, kajian ini menganalisis strategi yang digunakan oleh perniagaan pertanian kecil dalam menghadapi cabaran yang ditimbulkan oleh dasar kerajaan. Yang ketiga, dasar kerajaan yang membawa kesan khas keatas pembangunan perniagaan pertanian kecil dinilai. Akhir sekali, kajian ini mengenalpasti ciri-ciri perniagaan pertanian kecil yang dapat menyumbang kepada pembangunan wilayah di Sumatera Utara.

Berasaskan butir-butir data dan analisisnya, kajian ini mendapati bahawa di Sumatera Utara kesan dasar kerajaan keatas pembangunan perniagaan pertanian kecil terhad, iaitu ditujukan kepada pelawaan lessen dan program memperbaiki kualiti keluaran. Sekalipun, dasar kerajaan tempatan menghasilkan kesan yang lebih besar melalui menggalakkan penggunaan teknologi dan memupuk perhubungan antara perniagaan pertanian kecil dan institusi kewangan. Kajian ini juga mendapati bahawa takat sumbangan perniagaan pertanian kecil kepada pembangunan wilayah bergantung kepada jenis perniagaan, pusing ganti perniagaan tahunan, modal kendalian, teknologi pengeluaran, dan tahapan pendapatan. Khususnya, syarikat-syarikat perniagaan pertanian yang dikaji menyumbang kepada pembangunan kawasan kerana pusing ganti perniagaan mereka mencerminkan penggunaan tenaga buruh yang bererti dan penjanaan hasil cukai tempatan.

Justeru itu, walaupun campur tangan kerajaan penting, kesan benar dasar kerajaan adalah terhadap melainkan apabila bidang-bidang terpilih dalam sektor pembangunan perniagaan pertanian kecil dijadikan sasaran penjanaan faedah yang maksimum. Namun demikian, kerajaan tempatan mampu memainkan peranan yang bererti melalui cara-cara campur tangan yang khas, misalnya menyediakan perkhidmatan khas untuk menggalakkan pelesenan perniagaan dalam sektor perniagaan pertanian kecil dan memperbaiki kualiti keluaran mereka. Tambahan pula, kerajaan tempatan mesti memberikan tumpuan kepada mempertingkatkan modal kendalian hingga ke peringkat optimum demi memudahkan pengembangan perniagaan kecil yang seterusnya memberi manfaat kepada pengembangan kawasan yang lebih luas.

# **GOVERNMENT POLICY, SMALL AGRIBUSINESS AND REGIONAL DEVELOPMENT IN THE PROVINCE OF SUMATERA UTARA, INDONESIA**

## **ABSTRACT**

The objective of this study is to evaluate the impact of government intervention on small agribusiness in Indonesia. Generally government intervention here takes the forms of policies, programmes and projects that support the productive development of small agribusiness. In Sumatera Utara (North Sumatra), the region under study, local government policies encourage and may develop small agribusiness.

Three issues are central to this study: the effects of Indonesia's decentralization policies (starting in 2001) on small agribusiness development; the relationship between the small agribusiness sector and regional development; and the assistance given directly by local government policies and programmes to small agribusiness development.

This study carries out four principal tasks to explore these issues. First, the study surveys the small agribusiness sector in Sumatera Utara to show its characteristics and problems. Second, it analyzes the strategies adopted by small agribusiness to adapt in response to problems arising out of government policy. Third, it evaluates government policies that have had specific impact on small agribusiness development. Fourth, it identifies the characteristics of small agribusiness that will contribute to regional development in Sumatera Utara.

Based on its detailed data and analysis, the study finds that in Sumatera Utara, government policy has had a limited impact on the development of small agribusiness, mainly in terms of offering licensing and product quality improvement programmes. However, local government policies have had a

greater impact by promoting the use of technology and building relationships between small agribusiness and financial institutions. The study also finds that the extent of small agribusiness contribution to regional development is related to the type of business, annual turnover, operating capital, production technology, and level of income. In particular, the agribusiness establishments studied contribute to regional development because their annual turnover reflects significant labour force utilization and local tax revenue collection.

Hence, while government intervention is important, the actual impact of government policy is limited unless specific areas of small agribusiness development are targeted for maximum benefit. However, local government can play a significant role in offering specific forms of intervention, for example by providing specialized services to encourage the licensing of businesses in the small agribusiness sector and improve their product quality. Moreover, local government should focus on raising an optimum level of operating capital to assist small business expansion that in turn contributes to broader regional development.

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1. Background**

Small businesses can be a trigger to new regional development by creating new jobs and accelerating progression in technology. There is a significant concern towards the role of small businesses in regional development. Some studies consider small business as an important trigger of development, as it constitutes "the spirit of entrepreneurship, simple organizational structures, rapid decision making, and tailor-made production" (Giaoutzi, et. al. 1988: 6).

Although the role of small businesses is important, many developing countries do not put development of small businesses as a high priority. According to Giaoutzi, Nijkamp, and Storey (1988:2) "it is increasingly realized that the small and medium-sized industrial and service sector encompasses an enormous employment potential, it is unfortunately not fully recognized nor exploited in most countries".

In Indonesia, government attention on small businesses policy has led to the formation of the Department of Cooperative and Small Business. However, lack of comprehensive rules and regulations may obstruct the full development of small business for the benefit of national development.

In order to play a role in regional development it is important to have an institution or organization that is able to maintain the development process at the local level, a function that can only be taken by a local government.



In Indonesia, the government has issued a regulation, Law Number 9, Year 1995 that will principally regulate the development of small businesses. It states that small businesses are integral parts of business and as an economic activity in which they have significant position, potency and role in establishing an adequate national economic structure based on economic democracy.

## **1.2. Definitions and Importance of Small Business in National Development**

Small businesses as defined by the Indonesian Law Number 9/1995 are those that have the following features:

- The industry is owned by Indonesian citizens,
- Independent and not an affiliated firm or branch of industries owned, dominated by or affiliated directly or indirectly to any medium or big-sized industries.
- Having maximum asset of about two hundred million rupiahs, and not including land and building of businesses or its annual income.
- Private enterprise, in cooperative or non-cooperative enterprise.

Nevertheless, small businesses need to be empowered in order to take advantage of opportunities and to participate productively in economic development. A strategy that takes advantage on opportunities toward the empowerment of small businesses is a new issue in Indonesian economic policy (Kameo, 1996). In Indonesia, the empowerment of small business is mainly concentrated on providing financial resources for small business.

Therefore, the development of small business has not yet been adequately supported by various factors such as access to market or quality



improvement for their products. It can be seen in Table 1.1 that most of the policies since 1950 until 1999 have focussed predominantly on providing credit for small agribusiness. Sadoko et al. (1995: 14-15) have divided the history of policies and programmes of small and medium businesses in Indonesia as follows:

Table 1.1:  
Policies and National Programmes for Small Businesses in Indonesia  
1950 - 1999

Period	Macro Policies	Programmes
1950-1957	<ul style="list-style-type: none"> <li>• Economic Urgency Program, Prof. Sumitro Djojohadikusumo</li> <li>• <i>Kasimo</i> Program</li> <li>• Strategic Balance Development, between industry and trading sectors</li> <li>• Government institutions (Bank) acting as developing agents</li> <li>• Nationalization of Dutch businesses</li> </ul>	<ul style="list-style-type: none"> <li>• <i>Benteng</i> Program</li> <li>• Forming Main Business</li> <li>• Giving credit facility and small businesses training</li> <li>• Protection for small Batik businesses</li> </ul>
1957-1967	<ul style="list-style-type: none"> <li>• Controlled politics and economy</li> <li>• <i>Nasakom</i> (Nasionalis, Agama, Komunis = Nationalist, religion, communism)</li> </ul>	<ul style="list-style-type: none"> <li>• Forming paddy supplying and distribution centre</li> <li>• Government regulation No. 10/1959 on</li> </ul>
	<ul style="list-style-type: none"> <li>• Mutual help</li> <li>• Self-supporting concept</li> <li>• <i>Marhaenism</i> concept (Sukarno's populism)</li> <li>• Clothing, food and housing concept</li> <li>• Banking nationalization</li> <li>• The enactment of foreign capital investment (PMA)</li> </ul>	<ul style="list-style-type: none"> <li>• Chinese economic restriction</li> <li>• Forming all-purpose Cooperatives</li> <li>• Forming save and loan cooperatives</li> <li>• Forming all-purpose and mutual helping cooperative and regional development bank.</li> </ul>
1968-1983	<ul style="list-style-type: none"> <li>• Early <i>Orde Baru</i> (New Order)</li> <li>• Import substitution</li> <li>• Tripartite Development: growth, equal distribution and stability</li> <li>• Depoliticization of public</li> <li>• Five-year Development Program</li> <li>• Forming IGGI</li> <li>• Food Self-supporting program</li> <li>• Introduction concept for the weak economy group</li> <li>• An enactment of state capital investment (PMDN)</li> </ul>	<ul style="list-style-type: none"> <li>• Forming small businesses environment (LIK) and development centre for small businesses (BIPUK)</li> <li>• Credit program for small businesses (KIK) and permanent working capital credit (KMKP)</li> <li>• Public counselling program (BIMAS) and forming rural cooperative unit (KUD)</li> <li>• Forming sub-district credit body</li> <li>• Forming cooperative for public handicraft industry (KOPKINRA)</li> <li>• Forming welfare Farmer association of Indonesia (HKTI)</li> <li>• Young entrepreneur association of Indonesia (HIPMI)</li> <li>• Introduction program for foster father (business)</li> </ul>

Table 1.1: Continued

1983-1992	<ul style="list-style-type: none"> <li>• Deregulation and de-bureaucratization</li> <li>• Banking liberalization</li> <li>• Export oriented industry strategy</li> <li>• Funding mobilization through customs house (taxes) capital market and banking</li> <li>• Liquidity credit restriction</li> <li>• IGGI change into CGI (Consultative Group on Indonesia)</li> </ul>	<ul style="list-style-type: none"> <li>• Rural general credit program (KUPEDES)</li> <li>• Small businesses credit program (KUK) 20%</li> <li>• Foster parent program and 1-5% allocated to public enterprise's profit</li> <li>• Credit program for Farmer (KUT)</li> <li>• Credit program for Self-supporting businesses (KUM)</li> <li>• Tourism promotion</li> <li>• Various involvement of NGO</li> <li>• Introduction on various saving program (SIMPEDES, etc)</li> </ul>
1995	<ul style="list-style-type: none"> <li>• The Law no 9, 1995 on The Small Businesses</li> </ul>	<ul style="list-style-type: none"> <li>• Small businesses partnership program with the bigger ones</li> <li>• Small businesses supervision under the Cooperative &amp; Small Businesses Department</li> </ul>
1999	<ul style="list-style-type: none"> <li>• The Law no.22, 1999 on Local Government</li> </ul>	<ul style="list-style-type: none"> <li>• Policies &amp; Programmes by local government</li> </ul>

Source: Adopted and modified from Sadoko, et.al, (1995: 14-15)

One of the major efforts in the development of small businesses is to overcome the insufficiency of capital through policies, such as:

1. **The offer of Permanent Capital Loan** (Kredit Modal Kerja Permanen=KMKP), Loan for Rural Business (Kredit Usaha Pedesaan=KUPEDES), Small Businesses Loan (Kredit Usaha Kecil=KUK) and Agricultural Business Loan (Kredit Usaha Tani=KUT) to businesses with inadequate capital condition for development.
2. **The offer of a minimum 20 percent of banking credit to small businesses.**
3. **The provision of five percent of public corporation's profit in support of small businesses.**
4. **The exemption of collateral for small businesses acquiring loans of below 50 million rupiahs.**

Some government efforts have been extended to help small businesses overcome various problems, but they cannot encourage the overall

development of small businesses. It is because the program mainly concerns capital injection. Some programs even extend beyond capital injection; most of the programs seem not to have affected small business development. What small business needs are more of the external support factors such as market access, information availability, and good business climate.

The development of small businesses has not only focused on the prioritised sector but has also been centred on policy that is complex and at macro level, so it impedes the establishment of small businesses. Although the increase in the number of small and medium businesses was high, about 38 million in 1997, their contribution to the Gross Domestic Product was just 30 percent. The rest of it (70 percent) was by the big businesses. It means that small and medium businesses are less significant in contributing to the national product, but more so in the creation of employment.

The alternative approach to economic development in Indonesia can be done in two strategic ways, i.e., (1) revitalizing small and medium business and (2) complimenting social development with economic growth.

Micro business is a business with asset of less than 2 million rupiahs and turnover per day of less than 500 thousand rupiahs. Small and medium business is a business with a maximum asset reaching 200 million rupiahs and has a turnover 10 billion rupiahs per year (Law No.9/1995 on small and medium business). In 2000, the number of Micro Financial Institution (*Lembaga Keuangan Mikro*=LKM) assisting micro businesses were 53,644 LKM and in 2001 the number of small and medium business were 40,137,773 units. Out of this small businesses number 57,743 units, and medium sized and big businesses number about 2,005 and 2,095 respectively (Kompas, 2002, p.15).

The number of labour employed and growth rates are shown in Tables 1.2 and 1.3.

**Table 1.2:**  
The Growth of Small, Medium, and Big Businesses in terms of  
Employment Absorption in Indonesia 1997 – 2001

Type	Year					Growth (%)
	1997	1998	1999	2000	2001	
Small	57,482,688	57,341,962	59,939,760	63,501,890	65,246,294	3.2
Medium	7,726,268	6,971,611	7,230,084	7,630,398	7,993,499	0.8
Big	392,635	364,493	366,478	368,413	406,215	0.8
Total	65,601,591	64,678,006	67,536,322	71,518,701	73,646,008	2.9

Source: Kompas, 6 March 2002

**Table 1.3:**  
The Growth Rates of Small, Medium, and Big Businesses  
in Indonesia 1997 – 2001

Type	Year					Growth (%)
	1997	1998	1999	2000	2001	
Small	87.6	88.6	88.7	88.8	88.6	0.3
Medium	11.7	10.8	10.7	10.7	10.8	-2.0
Big	0.6	0.6	0.5	0.5	0.5	-2.0
Total	100.0	100.0	100.0	100.0	100.0	0.0

Source: Kompas, 6 March 2002

The data show that quantitatively Indonesia has the power or potential in developing micro, small and medium size businesses. The potential of micro, small and medium businesses is promising with a broad spectrum of distribution networks and high capacity for employment and growth.

Micro, small and medium businesses are known as people's (democratic) economy (*Ekonomi Kerakyatan*), consisting of small businesses, that can meet subsistence needs, by the people, with the use of limited capital and accumulation, using traditional technology and management and producing goods the people. *Ekonomi Kerakyatan* base on the values of collective ownership not base on individualistic. The practice of free fight or free market is



not allowed in this system. Many people involve in economic activities from producing until marketing. In other words, it is not monopolistic system.

*Ekonomi Kerakyatan* has the advantage of: (a) providing affordable products for ordinary households; (b) high efficiency and flexibility in business; (c) new production resources for existing business; (d) high motivation in doing business with high profitability and (f) high ability in loan repayment. While, the disadvantages are relatively fewer as in low management skills, persistence of traditional, low output technology and limited access to capital. It is clear that Indonesia needs to revitalize its economy and this should be being significantly based on small businesses which are appropriate areas to be developed for this purpose.

In Sumatera Utara, the role of small businesses is big in employment absorption. In 1993 from 4,178,026 employments that were absorbed, 2,856,890 employments (68.4 percent) were in small businesses. In 1997, around 3,234,404 employments were absorbed by small businesses (agricultural sector 66 percent, trade sector 15.1 percent, and service sector 2.1 percent (Central Bureau of Statistics or Biro Pusat Statistik = BPS, 1998).

Small businesses showed a small increase in their growth, about 18.35 percent, that is from 1,859,464 units in 1990 to 2,200,805 units in 1996 (shown in Table 1.4).

**Table 1.4:**  
**The Number of Small Businesses in Indonesia by Province in 1990–1996**

<b>No.</b>	<b>PROVINCE</b>	<b>1990</b>	<b>1991</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>
1	ACEH	24,247	25,237	26,533	27,165	27,710	28,416	29,591
2	SUMATERA UTARA	54,571	59,627	60,888	62,062	62,826	64,488	65,405
3	SUMATERA BARAT	40,032	41,412	41,776	43,082	43,938	44,731	46,146
4	RIAU	6,970	7,441	7,698	7,860	7,893	8,050	8,356
5	JAMBI	7,622	8,147	8,654	8,954	8,995	9,277	9,767
6	BENGKULU	5,498	5,698	9,213	6,362	6,446	6,543	6,818
7	SUMATERA SELATAN	29,806	31,776	32,464	33,157	33,839	34,631	35,337
8	LAMPUNG	15,157	16,571	16,654	17,211	17,494	17,811	18,219
9	DKI JAKARTA	24,420	26,513	27,385	27,917	28,585	29,078	29,725
10	JAWA BARAT	172,359	178,111	181,516	231,022	238,695	250,479	254,747
11	JAWA TENGAH	616,584	624,571	629,686	645,615	659,005	667,063	676,661
12	D.I YOGYAKARTA	72,642	75,002	76,392	78,358	77,514	78,658	80,033
13	JAWA TIMUR	453,597	462,094	468,311	476,316	483,145	489,107	495,373
14	KALIMANTAN SELATAN	59,362	65,548	70,474	72,045	73,312	75,297	77,314
15	KALIMANTAN BARAT	9,218	9,421	10,970	11,367	11,498	11,998	12,359
16	KALIMANTAN TENGAH	13,659	14,705	17,180	17,472	17,635	18,366	18,949
17	KALIMANTAN TIMUR	9,795	10,366	12,352	13,115	13,139	13,893	14,456
18	BALI	82,646	85,851	92,733	93,440	95,260	98,007	100,905
19	NUSA TENGGARA BARAT	35,368	35,397	38,018	38,626	38,890	39,599	40,320
20	NUSA TENGGARA TIMUR	11,764	13,031	13,701	14,901	23,617	27,084	28,154
21	SULAWESI SELATAN	57,221	61,563	64,733	66,370	67,034	69,133	71,233
22	SULAWESI UTARA	32,479	35,342	36,303	37,187	37,845	38,223	39,792
23	SULAWESI TENGGARA	7,013	7,434	7,803	8,093	8,102	8,375	8,649
24	SULAWESI TENGAH	7,221	7,855	8,632	8,854	9,030	9,419	9,692
25	TIMOR TIMUR	1,809	2,015	2,135	2,433	3,488	3,960	4,061
26	MALUKU	5,216	5,919	7,675	9,059	9,750	11,021	14,178
27	IRIAN JAYA	3,188	3,311	4,076	4,240	4,242	4,431	4,565
<b>TOTAL</b>		<b>1,859,464</b>	<b>1,919,958</b>	<b>1,970,995</b>	<b>2,062,283</b>	<b>2,105,927</b>	<b>2,157,138</b>	<b>2,200,805</b>

*Source: BPS, 1998*

To improve the contribution of small agribusiness to the Indonesian economy (in term of GDP) more appropriate policy formulation is needed especially affirmative action to develop small agribusiness. Those insignificant increases, show that the government political will (what they say will do or what they intend to do) in establishing small businesses is not adequate and has to be supported by strict and clear policy and regulations followed by a consistent implementation. It implies that besides internal impediments, such as low



education among its participants, unskilled labour force, insufficient capital and technology, other external factors, such as limited policy and regulation, lack of good business conditions, restricted market access and limited loan facility act as major impediments to the growth of small businesses.

However, through the implementation of Law Number 22 year 1999 on Local Government, governments at the local level have had a substantial change in the nature of their development participation. Government has been transformed from a centralist to a decentralist approach; a radical change has emerged in the role of local government to enhance its participation in local development including that of the small business sector.

It was realized that state has a greater role to play not only in the national context but also at the regional level of development during the post-Suharto era. Before this, there was the centralization approach in regional development. In those situations, the Suharto government had created institutions in regional level in order to maintain its power. It also centralized the planning activity for the purpose of national benefits (Rondinelli and Cheema, 1983:10). As quoted by Cheema (1981:4) there are four interrelated factors affecting regional development performance, these are:

- 1) Individual aspects, such as "technical skills, values, attitudes and beliefs of individuals within the society",
- 2) Environmental aspects such as socio-political structure,
- 3) The viability of resources which generates innovative ideas and programmes, and,
- 4). Institutional aspects as an engine of development.

The last factor is important in this study, since the state as an institution has a greater role to play in regional development. Moreover Cheema (1981:4) states that "institutional machinery provides the channel through which various regional development ends are accomplished; relevant societal issues and priorities are articulated; short-term and long-term plans are formulated; regional development projects are implemented; people are involved in specific activities undertaken by the government; and the planning and implementation processes are integrated".

However, by creating local government, it does not mean that the central government has lost its power to that of the region, since most of the development funds and planning are still in the hands of central government. The United Nation highlights the weaknesses of centralized type of development, and has concluded that there is a need to decentralize the development process.

### **1.3. Purpose of Study**

The purpose of this study then is to analyze the association of local government participation with the development of small businesses especially in the agribusiness sector. In general, it is hypothesized here that the development of small agribusinesses can be improved if local government adopts the appropriate policy, programs and other instruments in order to overcome problems and distortion such as unfair competition, difficulties in accessing resources and lack of infrastructure and capital supply.

This study was carried out in Sumatera Utara, Indonesia, well known as a major foreign exchange contributor to Indonesian economy from its tobacco

and rubber plantation sectors. These plantations are initially founded by foreign industries, especially Dutch companies then followed by some small-sized industries as a classic spread effect (see Thee Kian Wie and Barlow, 1988:1). Moreover, Thee Kian Wie and Barlow (1988) stated that what happened in the past had made the plantation sector a major contribution to the economic development of Sumatera Utara.

Table 1.5 shows the significant contribution of the agricultural sector of Sumatera Utara towards its Gross Domestic Regional Product (GDRP).

Table 1.5:  
Contribution of Each Sector to Gross Domestic Regional Product  
in Sumatera Utara 1993–1995

Sector	1993 (%)	1994 (%)	1995 (%)
1. Manufacture Industry	24.6	52.5	26.3
2. Others	48.5	49.1	48.7
3. Agriculture	26.9	25.3	25.0
3.1 Food crops	9.6	9.0	8.5
3.2 Estate crops	10.4	9.8	9.7
3.3 Livestock & Products	2.7	2.7	2.8
3.4 Forestry	1.5	1.3	1.4
3.5 Fishery	2.7	2.4	2.6
T o t a l	100.0	100.0	100.0
Gross Domestic Regional Product (Rupiah)	18,215,459	21,678,595	24,686,430

Source: BPS, 1996

In the agriculture sector, the estate crops sub sector gives a significant contribution followed by the food crops in second position (Table 1.5). It shows that besides the manufacturing industry, the estate crops sub-sector is an important economic contributor to Sumatera Utara's GDRP. In this context the agricultural sector, especially estate crops sub sector remains a reliable sector of economic development for Sumatera Utara in term of employment and output.

However, the contribution of the agricultural sector to GDRP had decreased over time; it was 26.9 percent in 1993 and dropped to 25 percent in 1995. On the other hand, there is an increase in the contribution of the manufacturing industry to GDRP from 24.6 percent in 1993 to 26.3 percent in 1995.

Based on such an economic structure where agriculture sector still contributes to Indonesian economy, it is suggested that the development priority can be focused on the agricultural sector, especially in the development of small agribusiness since there is a greater potential for agricultural produce to be commercialized upstream and downstream. Therefore, this study will observe small businesses in the agricultural sector, or better recognized as the agribusiness sector.

#### **1.4. The Importance of Small Agribusiness**

As agribusiness is an emerging sector its potential needs to be fully explored. Its development can help or correct the discrepancy in welfare benefits between groups and territories. This is especially so if the development targets are those of the low-income group or the poor who are mainly concentrated in agricultural fields or rural areas.

The resources available to eradicate poverty can be seen through the reflections of policies (for example Jazairy et.al, 1992). Poor communities (especially small farmers and agricultural labours) are not able to maintain the productivity of available natural resources. They try to maximize their earnings by opening up new fields by cutting forest trees and thereby causing damage to the environment. On the other hand, a well-developed agribusiness and agro-

business activity will improve the welfare of the community besides helping to preserve the functions of environment by limiting the opening of more agricultural lands or areas. In other words, well-managed agribusiness can help the poor to maintain and sustain the ecology of land under cultivation.

### **1.5. Conceptualizing Agribusiness**

Saragih (1997) pointed out that agribusiness can be defined as:

"... the sum total of all operations involved in the manufacture and distribution of farm supplies, production activities on the farm, and storage, processing and distribution of farm commodities and items made from them".

Transitions within the economic development stage will lead to an increase in the activities of agricultural-based business and services. The development of agribusiness will become one of the leading sectors of national economic development in various broad perspectives such as import substitutions strategy. More approaches are needed that are able to minimize the gaps between agriculture and industry and to expand employment opportunity. At the same time, they are also environmentally friendly, and are able to tone down the negative effects of the globalized economy. Therefore, the development of small agribusiness has become a strategic option in Indonesia's development planning (Saragih, 1997).

J.J. Drilon (cited in Saragih, 1997) was said to be the first to introduce the concept of agribusiness from the Philippine in the context of Southeast Asia. This concept adapted agribusiness as a system, which can be well accepted by all parties as a new way to look at agriculture sectors. So far, agriculture is seen narrowly as a product subsystem or merely involving farming activities. This



conventional view of agriculture has been less favourable for agricultural development, seeing agriculture and rural areas only as sources of primary products originating from plants and stocks without connecting it to its great business potential.

Agribusiness sector includes:

1. Up-stream agribusiness, economic activities (industry, trading) that produce production tools (input) for primary agriculture.
2. Sub-sector of primary agriculture (on farm agribusiness), namely, the activities of farm businesses using production tools to produce primary agriculture products (so that it is called primary agriculture).
3. It is its down stream agribusiness sub-sector in which, economic activities process primary agricultural product into manufactured product (agriculture products industry or agro industry) as well as trading activities (Saragih, 1997).

According to Saragih (1997), the data on agribusiness sector have not been fully gathered to expose the potential of agribusiness. This is due to two reasons: (i) the value-added created from providing services to facilitate agro industry activities (transportation, warehouses, finance, etc.) has not yet been fully accounted; and (ii) upstream industry which is important for an agribusiness system has also not been factored in such as the chemical industry, tractor, machinery, and agriculture equipment assembling industry.

The word agribusiness means a commercial business in agricultural sector (in a wide meaning) and fields that are directly connected to agriculture. These fields are: 1) producing and distributing agricultural tool/equipments,



agricultural production tools and other agricultural input (upper stream agrobusiness); 2) processing and manufacturing the agricultural goods and marketing them (down stream agro business); 3) supporting activities such as providing credit, agricultural insurance, training, consultation and transportation. This meaning is the same as proposed by Davis & Goldberg (1958). They define agribusiness as the additional result to all activities that are part of agricultural production, processing, maintenance and distribution of the agricultural commodity or things that are produced. Furthermore, the agribusiness system can be divided into sub-systems such as agricultural input, agricultural businesses, agricultural processing, agricultural marketing and agricultural support. A sub-system of agricultural/agribusiness is known as on-farm sub-system where else other sub-system is called off-farm.

In Indonesia's economy, agribusiness has a strategic value. These are due to the fact that: 1) a majority of families in their homes in Indonesia are doing agribusiness and the working standards of these people are in agribusiness; 2) agribusiness is the highest income contributor; 3) the level of import for the agribusiness sector is low; 4) agribusiness has become one of the greatest national income resources, outside of the oil and natural gas sector; 5) the agribusiness activity is environmentally-friendly; 6) the off farm agribusiness is an industry which has an easy access for the farmer to support the structural transformation; 7) food production and other household necessities are derived from agribusiness activity 8) agribusiness is labour intensive; 9) agribusiness has a high multiplier effect. Besides that, agribusiness has been the main lifeline during the time of Indonesia's economic recovery out of its financial crisis.

Human resources within the agribusiness sector includes the people who work in off-farm agribusiness, on-farm agribusiness, manufacturing and marketing agribusiness, agribusiness support sector such as of banks, insurance, training, including the government, NGOs (self-supporting community organizations), universities, etc. They are the ones who will facilitate, guide or assist and drive the agribusiness activities. For example, to support the development of a technological capacity a program on research and agribusiness development has to take place.

Agribusiness is a complex business activity that is interlinked in a system with vertical structure in a very wide sense. Agribusiness is an economic activity that is the most dominant in Indonesia. Agribusiness development strategies can strengthen the economic structure of Indonesia and in a short period, it can overcome some of the negative impacts of an economic crisis. Seen from the demands and the potential of the resources, agribusiness has a very good chance of thriving.

Agroindustry, an offshoot of agribusiness is an industry that converts the main agricultural products into processed products within the intermediate products and finishing products. They can be included in handling after harvesting, food and drink manufacturing industry, bio-pharmacy industry, bio-energy industry, manufacturing by-product industry and agro-tourism industry.

It is clearly observed that the export value of industrial products beyond agro industry during the period of 1981 to 1991 has distinctly surpassed the export value of the agro industry. The growth rate of industrial exports reached an average of 21.2 percent per year. Its contribution was more than 50 percent to non-oil export value and 30 percent to the total of export value. Hence, this

has led to the de-emphasis on agro exports although the industry has many other benefits (such as employment absorption) (Saragih, 1997).

The data from BPS (2000) show that the monetary crisis that happen in 1997 had a temporary influence on the quantity (unit) of agroindustry, whether it was medium, big small scale or home industry. Medium and big scale industries, from 1996 to 1998 have decreased in quantity from 5,608 units to 5,357 units. Small-scale industries have decreased from 91,922 units to 52,524 units. The home industry also faced a decreasing from 963,210 units to 719,668 units. In 2000, all these industries show a consistent increase in succession became 5,612 units, 82,430 units and 828,140 units.

The total output during the economy crisis hardly brought any negative impact towards agroindustry. This is shown from the data where the total output continually developed as big as Rp. 59.6 million in 1996, Rp. 68.6 million in 1997, Rp. 111.8 million in 1998, Rp. 126.5 million in 1999 and Rp. 145.3 million in 2000 (BPS, 2000).

Compared to fresh or perishable products, the processed products are able to give great additional value. Data from BPS show that the average income from export products 1997 to 2000 was US\$ 4.6 million where else from fresh production it was only US\$ 119,200. From the available data, the exports of processed products from the plantation are the biggest contributor to the national income.

The import data from 1997 to 2000 showed that the average import of processed products reached US\$ 1.9 million whereas for fresh production it reached US\$ 1.4 million. This big import value shows that

processing/manufacturing industry still has to be developed especially processing/manufacturing industry from the plantation area.

Agribusiness definition has shown the existence of vertical interrelations between the agribusiness systems and of horizontal interrelations between the agribusiness systems and the other systems or subsystems outside service systems (financial and banking, transportation, trading, education, etc.). These broad industrial linkages have been well understood by economists of the post-industrial revolution. It has been emphasized that placing agriculture (and rural areas) as core business during the development before taking-off stage is of strategic importance (see Rostow, 1960; the work of Nobel winner Arthur Lewis), particularly in relation to the process of industrialization. The neo classical economic growth theory from Solow (1953) assumes the existence of these linkages. These linkage ideas have underlined the unimodal approach (i.e. agriculture sector support of industrial activities) that was once proposed (James et al., 1987, Saragih & Tampubolon, 1989). However, there seems to be other factors that constrain the implementation of this unimodal approach for several countries, which fail to develop their industry (Saragih, 1997).

Clearly, agribusiness based economic development has the potential to become one of the leading sectors in the future. High growth rate within the agribusiness sector can be reached if there is strong support by the government, or specifically local governing authorities.

Currently, a specific strategy and policy need to be developed to thrust agribusiness into one of the leading sectors. This is particularly important whenever the development is targeted at low-income population, which is mainly concentrated in agricultural sector and rural areas. Employment growth



in agriculture sector and the rural areas are expected to absorb most of employment force. When there is welfare improvement this will also contribute to a potential growth source (Saragih, 1997).

In addition, Saragih (1997) mentioned that the source of poverty among others is policy bias in term of generalizing poverty programme (for example see Jazairy et al., 1992). However, when poor population (particularly small farmers and farm labourers) are no longer able to maintain the productivity of their acquired natural resources (particularly land) they cope with their problem by going to the forest and damaging the life support system or the environment. When the development of agribusiness improves the welfare of the low-income groups, they will be more likely to preserve the environment by minimizing their dependence on exploiting natural resources.

Hence, the development of small agribusiness is important and strategic. In 1997, there are more than 32 million small businesses with their working capital less than Rp. 2 billion per year. Ninety percent of them are small businesses with a working capital of less than Rp. 50 million per year. Furthermore, out of this 90 percent (more than 21.30 million business units) are household businesses which run business in agriculture sector. If the total includes the members of the household that support the business, the total number of small business with their household members can be predicted to reach 80 percent of the total Indonesian population (Saragih, 1995).

However, small agribusinesses face various problems and obstacles. The most basic one is their weak bargaining position. Consequently, they can only run their businesses marginally (subsystem) with little decision space.

Small agribusinesses have advantages due to several factors (Crawford, 1991: 53):

1. They have relatively little need for much capital investment, especially for those which run the services sector;
2. Small agribusinesses can move in more flexible ways to adapt to increasingly changing situations because they do not need to get embroiled or involved with bureaucratic matters as big businesses do;
3. Small agribusinesses have a sales force and naturally skilled entrepreneurs who have no vested-interests in the existing and established product system;
4. There maybe a shift of consumers' taste from the mass produced commodities to the more personalized goods, which is more suitably served by the small industries.

Nevertheless, some advantages of the small agribusiness industries cannot at all be realized due to, among others, the limited access they have to commercial bank credit. This is one but not the only problem which constrains small agribusinesses. The other problems that are no less significant are marketing, transfer of technology, and information access.

The above-mentioned problems and constraints can be traced to the weak bargaining position that small agribusiness have. The weak bargaining position exists due to: (i) small business is too small, which does not have enough power in its business, and (ii) lack of organized moves and activities as a group.



Saragih (1997) emphasized that the development of small agribusiness development can be enhanced:

1. If the bargaining position can be improved. The agribusiness development can become a way of democratizing the economy. In Indonesia, 21.3 million of household businesses in the agriculture sector constitute almost all of workforce which work in agriculture sector with primary output value reaching approximately 15 percent of Gross Domestic Product.
2. Within a democratic economic environment, the economic loss is at a minimum compared to monopolistic economic structure by big industries. Therefore, the development of small agribusiness is not "anti growth". In fact, the income improvement of 21.3 million households has been largely through the development of agriculture business. If the exchange rate is not worsened, the economic growth rate can be precipitated higher by improvement of the domestic market.
3. The development of small agribusiness is relatively easier to reorient to environment friendly policies.

It is however difficult to figure accurately the importance of the agricultural sector on a national and regional economic scale, except by measuring the contribution of primary agriculture products in GDP and export. Agribusiness in the agricultural sector constitutes one of the sectors that can be widely applied and is interdependent and inter-linked with other industrial sectors as well.

Therefore, agribusiness is considered a mega sector in national economy that covers entire regions of Indonesia. It absorbs 70 percent of the national labour force, involving 90 percent of both small and medium business

and cooperative, and sustaining almost 80 percent of the Indonesian population.

Nevertheless, various problems render the activity of small businesses, especially small agribusiness, their improper development. According to Aribowo (1995:4-5), the main problems are: (1) business condition and opportunity to establish the business are not used properly, such as special loan facilities, discharging of imports taxes, and access to information technology. (2) the unstable structure of small businesses, especially in production, marketing and capital system, and (3) incapability of human resources, either in business's capability, management or in applying the technology.

According to Baharsyah (1995: 16), the important elements that have to be taken into consideration in establishing agribusiness development patterns are:

- (1) **Quality Issue**, with regard to standardization and accreditation matters.
- (2) **Market Issue**, with regard to market information and efficiency of business administration sequence.
- (3) **Business Climate Issue**, with regard to bank interest, tax, and other environment problems and agro-ecosystem.
- (4) **Dualism Issue**, with regard to partnership in correlation with mutual advantage.

The strategic role of agribusiness can be analysed in international or export-import data or statistics. In Indonesia during 1981 to 1995, the contribution or export-value of agribusiness product on non-oil and natural gas export value is about 28 to 43 percent of GDP. During that period, relative

segment of agribusiness product export value is about 6.4 percent in 1981 (the lowest) and 24.5 percent (the highest). Moreover, the relative segment is about 11 to 24.5 percent, and development growth rate of agribusiness export value is 17.7 percent on an average per year during that period (Saragih, 1995:13).

## **1.6. The Importance of the Study**

There have been a limited number of studies on agribusiness due to developing countries' strategy including Indonesia which have largely focused on Import Substitution Industrialization (ISI) approach based on textile and manufacturing industry. Existing small business studies pay more interest in the development of informal sector in urban area. Therefore, to fill in this gap this study will focus on the agribusiness sector. It has become more urgent to consider the timely importance of agribusiness as during the Asian financial crisis of the 1997 to 1998 period the agribusiness sector had become one of the few sectors which were independent of foreign economic fluctuations. The agribusiness sector was one of the most reliable sectors in overcoming the economic problems created by the financial crisis.

According to Todaro (1997:296), three elements mutually support an agriculture based development strategy, that is:

1. Accelerating the output increase in technology, institutional, and price incentive to raise farmer's productivity,
2. Increase in domestic demand for agricultural output, and
3. Diversification either of non-agriculture, labour-oriented development activity that is supported, directly or indirectly by the agricultural community.

Furthermore, Todaro (1997:325) said there are several sources that can be nurtured to develop the small agribusiness agricultural sector: 1) Technology progress and innovation; 2) Appropriate government economic policy, 3) Supporting social institution.

In Indonesia, during the economic crisis in 1998, the contribution of agricultural sector on GDP increased from 16.1 percent in 1997 to 18 percent in 1998. The development rate of this sector was about 0.3 percent. This sector only registered 1.2 percent contraction as compared with bigger industry experiencing up to minus 14.3 percent contraction (BPS, 2000). It simply indicates that the agricultural sector and small businesses have cushioned the Indonesian economy from a bigger decline during the crisis.

The above explanation clearly shows that government policy must play an important role in agricultural development. Agricultural production needs to be increased by technology intervention, appropriate institutional system, and loan distribution as well as by incentives provided for the medium and small-scale farmer through price-policy by eventually lessening direct government intervention (Todaro, 1997:327). The participation of government in creating a supportive condition is thus very important for small businesses development in the agribusiness sector. Hence, this study will focus on looking at this aspect of small agribusiness development.

### **1.7. Problem Formulation**

The objectives of this study are to prove that an appropriate government policy as affirmed by researches before (Saragih, 1997; Baharsyah, 1998; Todaro, 1997) toward the development of small agribusiness is very essential.