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Transaction Cost Economics of Sugar Industry in East Java, Indonesia — A Comparative Study

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Abstract

In 1920's decade, Indonesia was recognized as one of the great sugar cane-producing countries in the world. Sugar cane is mostly grown in East Java Province. This area contributes about 70 percent to national sugar production. However, the performance of sugar industry in East Java during the last decade has declined, which is shown in decreasing volume of production and increasing sugar price. In effect, since the last ten years, Indonesia must import sugar due to the lack of domestic supply. Some analyses concluded that the decrease in production results from old milling machine. Another analysis inferred that the sugar cane farmers shift to other plants due to the long procedure in sugar production. The findings, of course, provided the description of the cause of the deterioration of sugar industry in East Java.

Nevertheless, a deeper investigation for the cause of decreasing production and increasing price of sugar should be made again. This study will utilize the analysis of transaction costs to identify the problems. It is expected that the institutional setting, both institutional environment and institutional arrangement at sugar industry cause high transaction costs, which shift farmers' decision to other plants and lead the sugar factory to be in high-cost economy situation. The transaction costs emerge due to some factors, such as rent-seekers, inefficient milling process, and weak enforcement law. In details, this research will empirically compare the transaction costs between state-owned and private-owned sugar factories; and credit-sugar cane farmers with self-sufficient (non-credit) sugar cane farmers. The comparison will provide the whole description of the factors causing the transaction costs at the sugar industry.

Keywords: East Java, Indonesia, institutional arrangement, institutional environment, sugar industry, transaction costs