

## **CRITICAL OUTLOOK AT SPECIAL ECONOMIC ZONE IN ASIA: A COMPARISON BETWEEN INDONESIA, MALAYSIA, THAILAND AND CHINA<sup>1</sup>**

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### **ABSTRACT**

*Special Economic Zones (SEZ) have been proven to help countries in fostering economic growth. The aim of this research is to try to help the government to improve SEZ policies in Indonesia by providing a benchmark with other SEZ countries in China, Malaysia, and Thailand. While China has the most established SEZ program, Malaysia and Thailand also have highly-regarded SEZs and investment incentives. These neighboring countries have developed SEZs in significant quantities but the greatest returns have come from a subsection of large-scale zones with favorable locations, good planning and access to resources. Thailand has a smaller number of zones, but a higher rate of successful zones, such as the automobile cluster which became the anchor of automotive production in Asia. How Indonesia's position compares to these three Asian countries is the main question of this study.*

**Keywords:** *special economic zone, foreign investment, benchmarking, competitiveness, China, Malaysia, Thailand*

### **INTRODUCTION**

The objectives of Indonesia's economic policy are to boost foreign direct investment, alleviate poverty, and decrease unemployment. These objectives will automatically lead to a better economic performance and improvement of the competitiveness index. One of the strategies to achieve a good economic performance is to increase exports. To support their export

strategy, many countries are vigorously promoting Export Processing Zones (EPZs), Special Economic Zones (SEZs), or Free Trade Zones (FTZs). These terms have been used interchangeably through most of the management literature. Those zones are seen as a key instrument not only for promoting exports and earning foreign exchange, but also for stimulating economic growth through additional investment, technology transfers, and employment generation. SEZ have been proven to help industrial investors to overcome these constraints and provide a stimulus to the economic growth of the country.

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In China, Thailand, Vietnam and Malaysia, SEZs have been the driving force in building up industrial capacity and have been the main destination for foreign investors. In each of these countries, most of the marquee multinational manufacturing firms are located in SEZs. For example in Penang, many well-known companies such as Dell, IBM, AMD, etc. have aggressively expanded their business in Malaysia. They are not operating one factory but they also have developed several sites of production in Penang. The strategic location of the SEZ in Penang (just 10 minutes from the airport and 15 minutes from the harbor) allows Dell to deliver their production from Penang to the U.S. within 28 hours. Our observations in the field showed that this strategic location, with well equipped infrastructure, transparency in customs procedures and the tax office, as well as the availability of an English speaking labor force became the sources of their competitiveness.

Indonesia so far, has lacked a comprehensive SEZ strategy and eventually lagged behind in industrial competitiveness (World Economic Forum, 2012). It is not a guarantee that SEZs can prove to be the same growth engine for Indonesia as they have for other countries. This paper is trying to provide an insight on how to improve the FTZ policies in Indonesia by providing a benchmark to China, Malaysia, and Thailand. While China has the most established SEZ program (Zhong, 2009), Malaysia and Thailand also have highly-regarded SEZs and investment incentives. China and Malaysia have developed SEZs in significant quantities but the greatest returns have come from a subsection of large-scale zones with favorable locations, good planning and access to resources. Thailand has a smaller number of Zones, but has a higher rate of successful zones.

## **THEORETICAL BACKGROUND**

A Special Economic Zone is an enclave of enterprises operating in a well-defined geographic area where certain economic activities are promoted by a set of policy measures that are not generally applicable to the rest of the country (Competitiveness Support Fund, 2007). Some of

the key characteristics of successful zones are that they offer immediate access to high quality infrastructure, clearly titled land, facilities, and support services. In addition, streamlined regulatory enforcement, simpler business establishment rules, expedited customs administration and other special administrative and approval procedures are also offered in such zones (CSF, 2007; Wahyuni, et al. 2009). Those characteristics are related to regional competitiveness. Most studies have used some of the following factors as main drivers of SEZ competitiveness: Input factors (natural resources, human resources, capital resources, physical infrastructure, administration infrastructure, information infrastructure, scientific and technological infrastructure), Role of the government (regulations, governance and institutional capacity), and related & supporting industries (quality and specification, the presence of capable locally-based suppliers, the presence of competitive related industries).

In this broader and more dynamic view of competition, Porter's five forces model (Porter, 2008) highlighted the importance of strategic location which eventually affects competitive advantage through its influence on productivity and especially on productivity growth. He insisted that competitiveness is highly dependent on factor inputs, demand condition, related supporting industries, and the firm's strategy and rivalry. The character of rivalry is also strongly influenced by many other aspects of the business environment (such as the available factors and local demand condition).

Since we are not measuring the firm's strategy, we will use the above variables which are related with country/region competitiveness.

## **RESEARCH MODEL**

Based on the above literatures, we developed a framework model to measure country competitiveness which is represented in Figure 1. From this model we can see that SEZ competitiveness could be measured from the input factors, the role of government and related supporting industries. These three variables will be

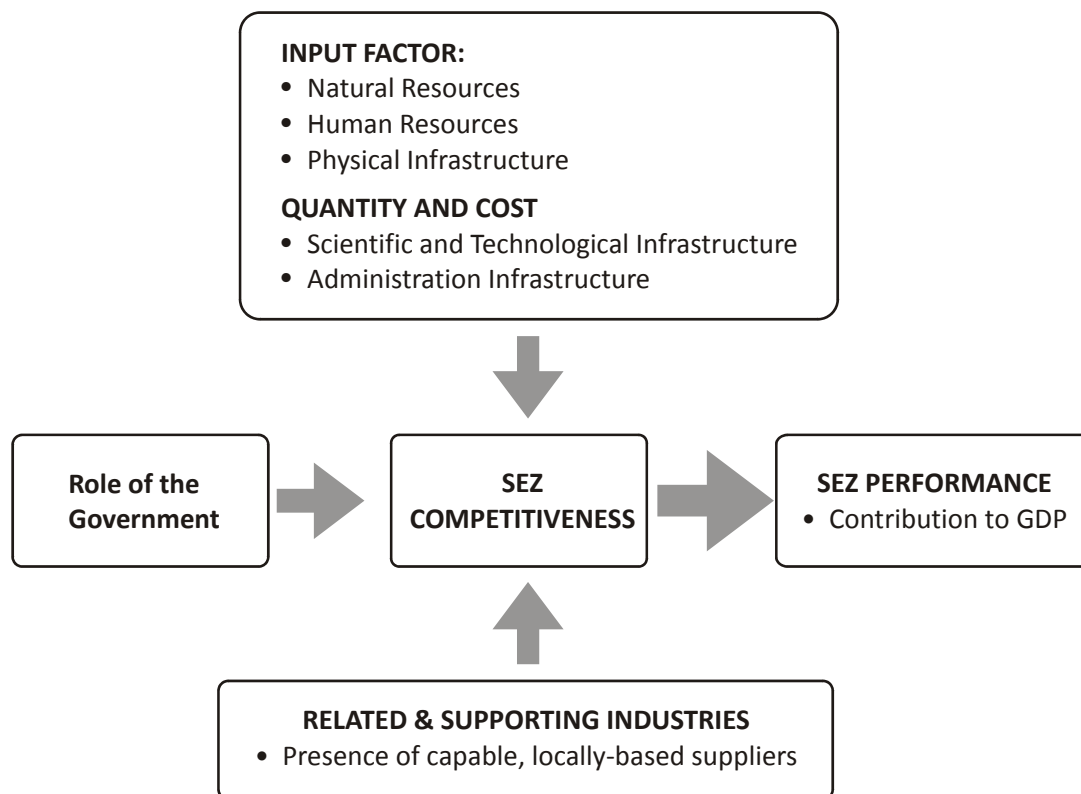


Figure 1. SEZ Competitiveness Model

measured qualitatively based on the results of direct observation and in-depth interview.

Especially for the administrative infrastructure, we will use secondary data about country competitiveness which is measured annually by many international organizations. In this respect, competitiveness can be defined as the set of institutions, policies, and factors that determine the level of productivity of a country (Bilbao-Osorio, et al. 2011). The level of productivity, in turn, sets the level of prosperity that can be earned by an economy. The productivity level also determines the rates of return obtained by investors in an economy, which in turn are the fundamental drivers of its growth rates.

### Methodology

The analysis of this study will be based on secondary data about country competitiveness, in-depth interviews and field visits/indirect observation in selected SEZ areas in Indonesia, Malaysia, China and Thailand which consist of:

1. Five SEZ areas in Batam, Indonesia which are categorized as the oldest and the biggest SEZ areas in Indonesia.
2. The SEZ area in Penang, Malaysia which has recorded the highest amount of investment in Malaysia
3. The SEZ area in Amatha Nakorn, Thailand which is acknowledged as the oldest and the most successful SEZ area in Thailand
4. The SEZ area in Tianjin, China which is a relatively well established SEZ (Zhong, 2010) and is close to Beijing, the capital city of China.

Besides observation, we also conducted in-depth interviews with the boards of investment in each of these countries, SEZ management, and investors in those SEZ's. In Indonesia, we conducted ninety eight in-depth interviews with investors at the same time as they filled in a questionnaire. The information we received from quantitative research has been crosschecked with the information from our in-depth interviews.

This type of triangulation therefore increases the reliability of the data.

## FINDINGS AND ANALYSIS

We divided the findings into three parts: the first part analyzed the input factor (except Administration infrastructure), the role of government, any related supporting industries and SEZ performance. In the second part we critically discuss the country competitiveness or administration infrastructure variable by using secondary data about the country competitiveness. At the end, we close this paper with our conclusion and policy recommendation.

### Input Factor, Role of Government, Related Supporting Industries and SEZ Performance

Our direct observations and in-depth interviews show that there are some differences among the countries being studied, which can be summed up in the following table 1.

The above justification is explained below.

### 1. Input factor

There are four variables we use to measure input factors: natural resources, human resources, physical infrastructure, scientific and technological structure. The condition and perception of investors about these variables is explained below.

#### Indonesia

**Natural Resources.** Our research in Batam, Bintan and Karimun (BBK) shows that there are two distinct factors that became the most significant factors in determining BBK competitiveness (see Table2). The two important factors of BBK are its geographic factors (proximity with Singapore) and its human resource factors. Interestingly, natural resources were not the magnet for investors (Wahyuni & Astuti, 2010).

**Human Resources and Infrastructure** in Indonesia is recognized to be very important but investor's satisfaction in this area is fairly low. The investor's degree of satisfaction is only 2.93 (see Table3). The human resources are measured by the availability of competent management,

**Table 1.** Summary of Finding

| Variable  | Indonesia                                     | Malaysia  | Thailand   | China   |
|---|---|---|--|---|
| <i>Input factor</i>                             |   |   |  |   |
| 1. Natural Resources                            | Rich resources                                | Somewhat limited                                  | Somewhat limited   | Somewhat limited  |
| 2. Human Resources                              | Skillful employees mostly outside of Batam    | Educated workforce, good communication in English | Difficult to find skillful engineer & management level employees | Abundant workers, diligent, mostly do not speak English |
| 3. Physical Infrastructure                      | Relatively good                               | Very good   | Good   | Good, developed by central gov                          |
| 4. Scientific and Technological Infrastructure  | In somehow neglected                          | Good  | Relatively good  | Good  |
| <i>Role of Government</i>                       |   |   |  |   |
| Central Gov                                     |   | Very strong                                       | Very strong  | Very strong   |
| Local Gov                                       |   | strong  | Very limited role  | Very active   |
| <i>Related &amp; Supporting industries</i>      |   |   |  |   |
| 1. Quality and specification                    | Low-middle                                    | High  | Middle-high  | Low-middle-high   |
| 2. Presence of capable, locally based suppliers | Yes, especially for low and middle technology | Yes, especially for high-tech electronics         | Yes, especially in automotive and its supporting electronics     | Yes, both for low and high-tech electronics             |

the human resource policies, and the availability of a competent workforce. The above low degree of satisfaction is further explained by the following quotes:

*“Difficult to find experienced technicians and engineers, so we have to employ them from Singapore, Malaysia and India”.*

*“It’s not easy to find good and skillful employees.”*

**Table 2.** BBK’s Competitiveness

|                         | Component1 |
|-------------------------|------------|
| COMPANY COMPETITIVENESS | ,491       |
| HUMAN RESOURCES FACTORS | ,753       |
| INSTITUTIONAL FACTORS   | ,597       |
| SUPPORTING INDUSTRIES   | ,589       |
| INFRASTRUCTURE          | ,503       |
| GEOGRAPHIC FACTORS      | ,775       |

### Malaysia

*Natural Resources* seem not to be the driving force for investors in choosing Malaysia as a place of investment. This is reflected from investors’ opinion in the following quote:

*“The main reasons why we choose Malaysia are due to: 1) the dynamic growing industrial cluster in Penang. Supply chain, people, skill, medical, high tech is good. Related industry will invest in Penang because of the cluster and people in there. Supplier is near. 2) Stable, progressive government. 3) Well educated, multilingual work force. Easy to communicate with each other, customer service has good communication skills in English. 4)*

*Developed infrastructure (close to the airport, port, and Singapore): very fast, very good delivery system, customs & immigration, the government has an online database, even the police check the criminals online. 5) A cost effective and vibrant business environment (we don’t have to set up training courses here, or sent them to our home country). Here, we have 48% foreigner (Indonesia, Nepal, etc) and 52% local. “(Venture in Malaysia)*

The above quote clearly shows that **human resources** in Malaysia are highly regarded by investors as Malaysia provides uneducated and productive workforce. The fact that they speak English makes communication and transfer of knowledge easier. In addition, the Malaysian education system is also supporting the growth of manufacturing industry:

For **physical infrastructure**, it is apparent that Malaysia has an outstanding infrastructure. This can be seen from the above quotes from Benchmark and Venture. The SEZ in Penang is very close to the airport and harbor which eventually leads to lower transportation costs and minimizes the delivery time of the product.

To assure the availability of **scientific and technological infrastructure**, the Human Resource Development Fund (HRDF) of Malaysia launched a program that encourages training, retraining and skills upgrading in the private sector. Employers, in the manufacturing and service sectors who contribute to this fund, are eligible to apply for grants to defray or subsidize the costs incurred in training and retraining their workforce (MIDA, 2011).

**Table 3.** Human Resources Based on Importance and Satisfaction

| (Scale 1 to 5)                  | Importance | Satisfaction with BBK SEZ |
|---------------------------------|------------|---------------------------|
| Labor Factors                   | 4.37       | 2.93                      |
| Institutional Factors           | 4.67       | 3.06                      |
| Governance Factors              | 4.69       | 2.91                      |
| Business Environment Factors    | 4.32       | 3.28                      |
| Infrastructure Factors          | 4.71       | 3.40                      |
| Overall Competitiveness Factors | 4.55       | 3.16                      |

## Thailand

**Natural resources** in Thailand are indeed important but prove not to be the main attraction. This is shown in the following quote:

*“The natural resources are imported. The most important thing for us here is the availability of water supply, etc”. (Triumph Management in Thailand)*

To understand why investors choose Thailand, Triumph expressed it as follows:

*“Our main reason of choosing Thailand were pushed by the following reasons:*

- a. Thailand already has had an automotive industry for quite a long time. The Japanese car and motorcycle companies have already been here for so many years. So there was already a good supply base in Thailand.*
- b. They have skilled labor, particularly Thai engineers which are very important for us. Most of them are very good; they have grown up with this company. We have recruited them when they were about 24-25 and they have developed quite well with Triumph.*
- c. The government attitude about foreign investment is very positive”.(Triumph Management in Thailand)*

From the above reasons for choosing to invest there, we can see that Thai **human resources**, especially engineers, are actually quite skilled in their fields although this was because of the training given by companies or available at industrial estates such as Amata.

Related to **physical infrastructure**, investors feel that infrastructure plays a crucial role in supporting investment growth, it makes companies daily operations easier to do. The physical infrastructure must always support industrial estates as shown in the following quote:

*“The Airport was moved to accommodate the industrial park 5 years ago (from Don Mueang to Suvarnabhumi). It is easier for the company to export and import. The deep sea port was also moved closer to Amata. So, these are the some of the reason why most in-*

*vestors choose Amatha. Another reason why we are very famous is that we have convenient transportation links. There are 2 main highways connecting to Amata Nakorn. So we don't have heavy traffic jams. Foreign people can also live in Bangkok because our location is not that far away.” (Amatha Management)*

Besides common physical infrastructure, Amata Nakorn tries to attract investors by providing social infrastructure facilities, good quality services and also green (environmental) industrial estates. Unlike other industrial parks, Amatha also provides an executive club and golf facilities in their industrial zone.

## China

**Natural resources** also are not the main attraction in China, as they are limited right now.

*“Natural resources that can attract investors are almost not found in China. But actually Tianjin only needs the government to provide electricity and gas”. (Tianjin Park Management)*

**Human resources** in China is really huge. The workers are also diligent; they are ready to work long hours for reasonable wages (Zeng, 2010) as shown in the following quote (Breakstone Group, 2012):

*“China can attract investment because of the labor force. Labor in China wants to work overtime and is very diligent”. (CIPA)*

Nevertheless, looking at our experience during our interviews and observation we have to admit that English speaking workers are scarce and thus may impede communication and the transfer of knowledge.

**Physical Infrastructure** is quite developed in China, even before the SEZ and parks were developed. Most of the infrastructure development was initiated by the government (Qian, 2008).

*“Tianjin Balitai Industrial Park (TBIP) lies between the land and sea, so the location is really strategic”. (Tianjin)*

*Scientific and technological infrastructure* was supported by the learning culture of the Chinese and the training given by companies.

## 2. Role of Government

### Indonesia

The institutional factors of BBK competitiveness are related to the satisfaction and adequacy of policies and regulations, the importance and satisfaction towards government support, and BBK governance.

**Table 4.** Institutional Factors

|                          | Correlation Coefficient |
|--------------------------|-------------------------|
| Policies and Regulations | ,872                    |
| Government Support       | ,381                    |
| Governance               | ,823                    |

As indicated in Table 4, policies, regulations and governance have a strong correlation with institutional factors. In contrast, government support has a weak correlation. This situation is shown in the following quotes: “No support from the Legislative”, “No program continuity from the Mayor’s Office”, “No consistency in rules, regulations and programs”.

Another important aspect of the institutional problem in BBK is related to coordination and responsiveness which is highly related to governance:

Although the Indonesian government has tried their best to eliminate this long bureaucratic procedure, confusion and uncertainty still exists. In this case, the institutional structures should be established with clear authority, responsibilities and roles identified for the organizations involved.

It is important to take note that Policies and Regulation have the highest correlation number. This number does not necessarily indicate that they are significantly better, but they do exist and affect the businesses and firms in general. As indicated by the following quote (Wahyuni and Astuti, 2010):

*“There is a need for Political stability. In Malaysia the political situation does not seem to cause a significant problem for the business environment, but the situation is*

*different in Indonesia”.* (CEO in Batam)

The swing of politics does not only influence the direction but also in some ways impede the process of implementation:

*“The regulation is easily changed as it goes with the changing of the person who holds the position. As a result, there is no consistency in rules, regulations and programs”*

*(Chairman of Association in BBK)*

The above comments reconfirm that regional competitiveness results from a mix of political struggles, economic spatial-fixes, social mobilizations and political practice. It is clear that there is much homework that needs to be done to improve policies, regulations, government support and of course the establishment of good governance.

### Malaysia

*Role of the government* in Malaysia is mostly done by the central government which in this case is represented by MIDA who are the first contact point for investors. They are very helpful, friendly, professional, and show clean governance (every year there is a monitoring program by the government to check the property of MIDA staff). As results from our interviews show, the Malaysian government is recognized by investors to be tough, but they are also a friendly, good, efficient, and clean government. Furthermore, they establish regulations that support the investment growth in Malaysia.

### Thailand

*Role of government* in Thailand (in the field of investment) is mostly controlled by the BOI (Board of Investors). Like in Malaysia and China, the central government plays a big role in regulating investment, whereas the provincial government doesn’t have any role at all. The result of centralization in Thailand is that there are no unclear/biased and overlapping regulations between the local and central governments. Based on our interviews, it can be concluded that the government of Thailand through the BOI is very supportive to investors; they are clean (of corruption), helpful, and transparent.

*“BOI is very business friendly. They offer help and are open to discuss your problem”. (Autoliv)*

*“Today BOI has no corruption, but 20 years ago there was corruption due to too many companies coming in to Thailand. Ten years ago they cleared out this corruption and established the one stop service called the investment club. So papers or forms should be given to this office, and you will pay according to your workload. It is transparent because it is operated by an outsourced company. You still have to pay but it is legal. So we improve a lot. Now, they have a one stop service in Bangkok as well, so it is a lot easier. I think that side of doing business is very good”. (Komatsu)*

### China

The Chinese government is a bit unique in making regulations for investment. It is often unclear and not integrated. Regulations in one region can be different to those in others. They also make it a bit complicated as some of the investors have said below.

*“China has tough regulations but they are not clear, (different regulations in every province and science park), Malaysia has tough regulations, but they are very clear and clean” (Benchmark)*

*“Overall, I think that the market is very excited about China, the potential that China has to offer, but is scared about the things they can’t see!”*

Although China has unclear regulations, on the other hand they are very supportive in the establishment of SEZs. Unlike Thailand, the Chinese (local) government takes care of their SEZs themselves, from developing the infrastructure, managing the SEZs, and promoting the SEZs (Zeng, 2010).

### 3. Related Supporting Industries

#### Indonesia

Related to the supporting industries it is apparent that many suppliers are available in BBK but when we asked the local government

representative (who is in charge of investment in BBK) he did not know how many electronic companies are in Batam and the type of products they produce (Wahyuni, et al., 2010). To get more in-depth understanding on the linkage between existing companies in BBK and the rest of the world, we measured the company’s connection with markets and suppliers in countries all over the world, with businesses and institutions in Singapore, and within Indonesia such as with the local industrial parks, business associations and chambers. The result of the factor analysis is shown in Table 5.

**Table 5.** Linkages with other markets

|  | Correlation Coefficient |
|--|-------------------------|
| International Linkages with Markets and Suppliers      | -,045                   |
| Linkages with Businesses and institutions in Singapore | ,920                    |
| Linkages within Indonesia                              | ,923                    |

An interesting part is that international linkages with markets and suppliers does not really have a correlation with the linkages factor as a whole because of the correlation coefficient of -0,045 is so close to 0, whilst linkages with businesses and institutions in Singapore and Indonesia are very strong, close to 1 (0,920 and 0,923). Apparently companies in BBK have a weak relationship with other countries in the world, because most of them have relationships with countries near to Indonesia. In other words, the relationship exists because of the location. But if we see the linkages with Singapore and Indonesia with the linkage factor as a whole, the correlation is very significant.

#### Malaysia

*Related and supporting industry* in Malaysia is considered to be very good. There are lots of suppliers that investors can co-operate with. This is due to the cluster strategy in Malaysia. Having a cluster strategy, will make a certain region more focused on a specific industry. Thus, investors in the same industry will choose to be located near their supporting industries, which eventually make their value chain more



effective and efficient, as shown in the following quote:

*“Investors like to stay in Penang because the supply of raw material comes from this region....Localized value chain will make the cost lower, lead time will be shorter. So it’s a good idea to make a strategic alliance with other companies to build a strong value chain”.* (Venture)

### Thailand

Investors see Thailand as a country with lots of experience and it is already in the automotive industries business. From this way of thinking, they said that it is obvious, when a country is already in the industry for quite a long time, there must be lots of *related and supporting industries* available and ready to support the demands of that industry. Investors, who at the beginning did not view suppliers in Thailand as being a high quality of suppliers, they are now in the way of believing that suppliers in Thailand have improved a lot during the past few years. This improvement leads them to start buying materials from local suppliers. We may conclude that the related and supporting industries have improved a lot in both quality and quantity.

*“Why Thailand? Thailand already has had an automotive industry for quite a long time”* (Komatsu).

*“When we started we used lots of our existing*

*suppliers outside of Thailand, but now we have localized them a lot more. Localization is very important because I see the prospect of the ASEAN market in the future”.* (Triumph)

### China

China is well-known for their cluster approach, which was developed by the regional governments and endorsed by the central government (Qian, 2008). Where there is a cluster strategy, common companies are grouped together and surrounded by *related and supporting industries*. Naturally, suppliers who see this as an opportunity will then locate in that same area (Zeng, 2010).

## CONCLUSIONS AND POLICY RECOMMENDATION

The above discussion provides a strong message that the Indonesian government still has a daunting amount of work to do to improve its capacity, performance, and competitiveness. The fact that its neighboring countries are in the race to attract investors, drives the urgency for state reform. We have to be aware that abundant natural resources are not the main attraction for investors. There are others things which are far more important in the eyes of investors. Our policy recommendation can be seen in the following figure 2.

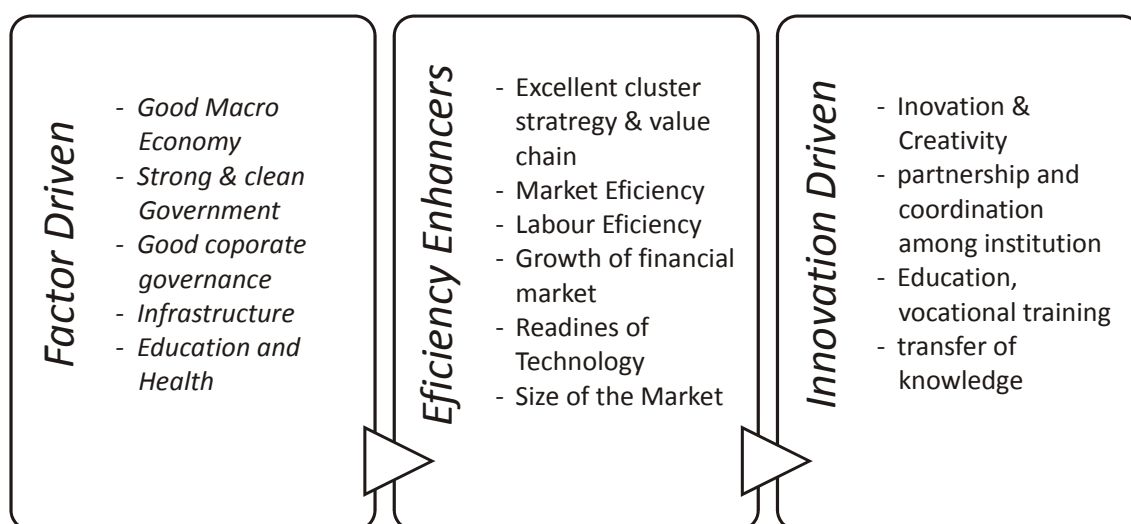


Figure 2. Policy recommendation

From the above figure we can see that there are three pillars of investment which are:

- Stage I. Factor driven economies are the basic requirements for investment
- Stage II: efficiency driven economies, where, in order to compete, countries must develop an excellent cluster strategy, more efficient production processes and increase the quality of their products.
- Stage III: innovation driven economies stage in which companies in a country compete by producing new and different goods through innovation and sophisticated production processes. This stage should also be accomplished with a transfer of knowledge strategy, which is coupled with enhancement of education and vocational training.

The Indonesian government should not only focus on the improvement of factor driven economies. We should also pay attention to strengthen the other two pillars which are even more essential in determining efficiency and innovation for products and services.

The urgent agenda for the government, business people, and Indonesian society overall can be divided in five broad spectra:

First, a successful SEZ requires a very capable government and a well-functioning market system. To have a successful SEZ, the government could employ the cluster approach which is a more bottom up than top down approach. In this sense, increasing competitiveness itself is not enough. We have to assess the market signals and have a perfect understanding of the domestic comparative advantages and market situations (both domestic and international). A proper supply chain and related supporting industries should be developed to strengthen the market positioning of the cluster.

Second, enough attention should also be given to the zone location, surrounding infrastructure, quality of governance toward and within the zone, and the blend of incentive packages offered by the central and regional governments. A cluster approach should be properly

developed by inviting credible investors that can develop a trickle-down economic effect to regions. In addition, the government should give a special power to the SEZs to create an efficient regulatory system and a conducive business environment, which make the SEZs attractive to investors.

Third, the above analysis also shows that it is the quality of the workforce that will make the real difference. The human factor plays a pivotal role. First-world infrastructure with third-world mentality will not produce the desired results. Therefore investments in education, training and skill development will determine the capacity of the nation to change with the changing times.

Fourth, the attractiveness of investment policy packages to create a beneficial investment environment. To improve its investment climate, Indonesia needs to have a coherent strategy which should be complimented by good governance. Therefore it is important to develop a key contact point for potential investors (such as the role of the MIDA) which is very helpful, professional, and not corrupted.

Finally, we have to be aware that to develop a successful SEZ, there is a need for a coherent overall strategy, and a close connection between economics and politics. In the present political setting, it is probably more difficult to come up with such a coherent strategy, but it is not impossible. Much will depend on the clarity of the government's vision, its technocratic capacity to translate this into operational policies, and its will to maintain the essential elements of the strategy and protecting its overall coherence, while accommodating elements thrust on it by political realities. Moreover, the strategy has to be implemented with a high degree of consistency over a long period. This will create a predictable environment and provide sufficient comfort for domestic and foreign investors. With a good understanding of the country and regional competitiveness, coupled with a comprehensive strategy, hopefully an outstanding SEZ can be developed.

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