**Peer Reviewed – International Journal** 

**Vol-5, Issue-4, 2021 (IJEBAR)** 

E-ISSN: 2614-1280 P-ISSN 2622-4771

https://jurnal.stie-aas.ac.id/index.php/IJEBAR

# THE IMPACT EVALUATION OF THE INSTITUTIONAL REFORMS OF THE ONE-STOP SERVICE (OSS) ON ECONOMIC PERFORMANCE IN INDONESIA

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#### **Abstract:**

This paper examines the impacts of institutional reform of the One-Stop Service (OSS) structures on increases in Indonesia's economic growth. This institutional reform aims to enhance the OSS effectiveness in developing a business regulatory simplification for a better business atmosphere, particularly for investments. According to Steer (2006), among three possible structures, which are units, offices, and departments, the most effective structure simplifying regulation is the department. Therefore, in 2016, there was a regulation in Indonesia, which set the obligation for local government at the district level to change the OSS structure into a department form. The impacts of reforms are then measured using staggered Difference-in-Difference (DID) methods. However, this paper finds that the reform may have significant negative effects on economic performance. There are some plausible underlying arguments to explain the findings. The impacts of institutional changes may have negative impacts in the short run due to the transition period of the reform. However, in the long run, such results may reverse. During this transition period, Indonesia may experience obstacles in implementing the reform. For example, human resources capacity is probably still low, and governance is poor. This, in turn, may hamper the effectiveness of the business regulation simplification. Also, the risk aversion behavior, which may impede entrepreneurship, may still dominate Indonesian people and thus hamper the effectiveness of institutional reforms. Therefore, this can impede the effectiveness of reform on the economic performance in Indonesia.

**Keywords:** *Economic Growth, Institutional Reform, the OSS* 

#### 1. Introduction

Business regulations with good quality may flourish the productive activities and thus may result in higher economic growth. A poor business regulation imposing the complex license procedures may result in high barriers for firms to entry and thus may hamper competition among business actors. On the other hand, according to Armstrong & Westland (2016), a high-quality business regulation may support a reduction in entry barriers and increases in competition among firms. It may then promote a better environment for firms and thus encourage business actors to innovate, which may contribute to a growing economic performance. A lower barrier may also give opportunities for informal small and medium firms to engage in formal structures (the OECD, 2014). Therefore, business regulatory

Peer Reviewed - International Journal

Vol-5, Issue-4, 2021 (IJEBAR)

E-ISSN: 2614-1280 P-ISSN 2622-4771

https://jurnal.stie-aas.ac.id/index.php/IJEBAR

reforms are required for developing economies that have low-quality business regulations. Some economies, such as China and Botswana, have implemented regulatory reforms and achieved higher economic growth.

Some empirical studies find a positive relationship between the reforms in business regulation and economic growth. Haidar (2012) indicates that the reforms may increase the economic growth indicated by the GDP. This study uses the World Bank data in 2006-2010 for 172 economies. This finding has similar results from other studies. Djankov et al. (2002) also suggest that a good business regulatory setting may contribute to better economic performance. The data used in this study is the World Bank data of business regulation for 135 economies applying OLS and SLS models.

However, some factors are influencing the quality of business rules such as the regulatory organization. According to Pollitt & Stern (2002), the regulatory body should have a large size with sufficient staff and thus can support the reform implementation. In developing economies, the organization's size handling regulation matters is relatively small, and they provide services with high transaction costs. Furthermore, according to Kirkpatrick (2014), the regulatory reforms in developing countries are less effective due to the poor quality of human resources and weak governance in the organization. Therefore, effective business reforms may require the organization with human capital with high quality and strong governance.

In terms of business reforms, the success of reforms may depend on the culture in society. According to North (1994), culture changes may require much more time than regulation changes. Therefore, according to Kirkpatrick (2014), certain cultures in society may hamper the regulatory reforms. This is indicated by many failures, which occur when the developing countries adopt the successful reform implemented in developed economies. Culture is one of the main factors affecting such unsuccessfulness. Thus, the success in applying the reforms may depend on cultures.

In general, the quality of business regulation in Indonesia is still relatively low and thus requires regulatory reforms in doing business. It is indicated by a poor position of Indonesia based on an indicator of starting a business in the World Bank Doing Business, which is 144th position (the OECD, 2018). The poor regulatory setting has led to a fall in economic growth significantly in the 1990s when Indonesia experienced the financial crisis. After the crisis period, there was a slow recovery in economic performance, which is relatively stagnant. Thus, Indonesia has implemented reforms in business settings to enhance business activities.

However, Indonesia still faces many challenges in implementing the regulatory reforms in doing business. Since 2001, during the decentralization period, the district government who had authority in deciding licenses rules for firms to start businesses perceived permits as the resource of fund (Steer, 2006). Therefore, there was increases in license rules number since 2002, imposing high transaction costs. Also, the business actors required much time to manage the licensing process before they started their business resulting in inefficiencies. Next, the license systems were complicated, and the information of the procedure was limited, and thus many firms could not get comprehensive information about the licensing systems. Therefore, the business activities were difficult to flourish and thus impede the economic performance.

Peer Reviewed - International Journal

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E-ISSN: 2614-1280 P-ISSN 2622-4771

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Since 2016, to support the regulatory reforms, Indonesia has implemented the one-stop-shop (OSS) Program. The objective of this program is to reduce the license procedures to enhance efficiency (Steer, 2006). There are two main factors, which may determine the effectiveness of the OSS, which are the organizational structures and the authority in the implementation. In terms of the organization forms, among three structures, including unit, office, and department, the most effective form is department. The OSS with department form will have the highest authority in receiving, processing, and approving the application. Thus, in 2016 Indonesia promogulated the regulation enforcing districts government to form the OSS in department structure. Recently there are 411 districts that have structured the OSS in department form.

This paper will study the impacts of the institutional reforms in the OSS on the increases in economic growth. The study shows that there is a significant negative impact of the organization form on economic performance. It may occur as the impacts of institutional changes may have negative effects in the short run due to the transition period of the reform. However, in the long run, such results may reverse. It is in line with a previous study, which shows that the impacts of institutional reforms on economic growth may have differences in the short-run and long-run effects (Siourounis cited in Zhao et al., 2021).

The paper will be split into the following parts. First, it will present the literature review regarding the importance of business regulatory reform, the business regulatory reform in Indonesia, and The Indonesia One-Stop-Shop Background, Second, it explains the data and methods applied in the study. Finally, it will present the analysis results of the study.

#### 2. Research Method

The sample in this paper consists of 369 districts. Table 1 presents the data of the district's number with the OSS in department structures in 2014-2018, which are two districts in 2014, six districts in 2015, 345 districts in 2016, 11 districts in 2017, and five districts in 2018. For other 145 local governments, eight districts have established the OSS in department form before 2014, 131 districts have no local regulation for the legal basis for the department establishment, and six districts have the OSS with other forms.

Table 1. The districts OSS, 2014-2018

Department Structure Reforms (regulation 100/2016)	
2014	2
2015	6
2016	345
2017	11
2018	5

Source: The Home Affairs Ministry, 2019

In terms of data collection, the study utilizes some data resources. These resources consist of the data of The Home Affairs Ministry, The Finance Ministry, the Indonesia Database for Policy and Economic Research (INDO-DAPOER) created by the World Bank, the Indonesia Statistics (BPS), and the Indonesian National Socio-Economic Survey (SUSENAS) published by Indonesia Statistics (BPS). The time period scoped in this study is

**Peer Reviewed – International Journal** 

**Vol-5, Issue-4, 2021 (IJEBAR)** 

E-ISSN: 2614-1280 P-ISSN 2622-4771

https://jurnal.stie-aas.ac.id/index.php/IJEBAR

the period of 2014–2018. Table 2 shows the data sources for each variable explored in this study.

Table 2. The data sources

Variables	Data Sources
Per-capita GDP of Districts	Indonesia Statistics
Reform	The Home Affairs Ministry
Per-capita government payment	The Finance Ministry
Expected years of schooling	SUSENAS
Access to Electricity	INDO-DAPOER

The independent variable in this study is the GDP per capita. In general, the economic performance in all districts shows relatively good progress in 2014-2018. Among 369 districts, only five districts have a decline in economic growth.

There are two types of variables used in this study, which are the treatment and control variables. The treatment variable used in this study is the institutional reforms in the OSS structures, which is the changes in the OSS organization into department form, which has the highest level of authority towards the approval of licenses. The control variable is the districts before they change the organization form into the OSS department.

In terms of control variables, there are three variables included in the study. Dorodjatoen (2018) suggests that the studies exploring economic growth in Indonesia generally use several variables, including national per-capita government transfer payment (in the log) and expected years of schooling. Thus, the control variables in the model are per-capita government transfer payment (in the log), expected years of school, and electricity access. Table 3 shows the summary statistics for the independent variable and three covariates included in this paper, and Table 4 presents the correlation coefficient between Per-capita GDP of Districts, Reform, Per-capita government payment, Expected years of school, and Access to Electricity.

**Table 3. Summary Statistics** 

Table 3. Summary Statistics									
Variables	Number of	Mean	Standard	Minimum	Maximum				
	Observation		Deviation						
Per-capita GDP of	1245	10.19	0.61	8.88	12.87				
Districts									
Per-capita government	1245	14.86	0.70	12.95196	19.54				
payment									
Expected years of	1245	8.14	1.51	4.39	12.60				
schooling									
Access to Electricity	1239	96.22	7.78	37.17	100.00				

**Table 4. Correlation between main variables** 

	District GDP per capita	Reform	Mean year of schooling	Household access to electricity	Log National government transfer per capita
Per-capita GDP of Districts	1.000				

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Reform	0.056	1.000			
Per-capita	0.398	0.070	1.0000		
government					
payment					
Expected years of	0.226	0.122	0.295	1.0000	
schooling					
Access to	0.185	0.042	-0.009	-0.320	1.0000
Electricity					

The hypothesis tested in this study is the OSS's institutional reforms may have positive impacts on economic performance indicated by the per-capita GDP. To test this hypothesis, the method used is a staggered fixed effect generalized difference-in-differences (FE DID) model with two specifications, which are FE DID model with and without covariates as follows.

$$Y_{it} = \alpha + \tau T_{it} + \eta_i + t_t + \varepsilon_{it} \tag{1}$$

$$Y_{it} = \alpha + \tau T_{it} + \eta_i + t_t + \varepsilon_{it}$$

$$Y_{it} = \alpha + \tau T_{it} + \beta X_{it} + \eta_i + t_t + \varepsilon_{it}$$
(1)

Where Y indicates per-capita GDP; T denotes a treatment variable (dummy), which is the OSS's organizational reform (1 for all years after the districts form the OSS in department structure, and 0 otherwise);  $\varepsilon$  is the random disturbance,  $\alpha$ ,  $\tau$ , and  $\beta$  are the parameters required to estimate. The first model is the FE DID Model without covariates, on the other hand in the second model, there are three covariates, including per-capita government transfer payment (in the log), expected years of schooling, and electricity access. Furthermore, considering the data structures, the method used will be the FE staggered DID Model. The definition of staggered timing is data structures in which the treatment group will remain treated after an individual gets treatment (Callaway & Sant'Anna, 2020).

The parallel trend is the key assumption required to fulfill and thus determine the DID model validity. Some biases are acceptable in the DID model when they are stable. Thus, the model cannot diminish the gap changes between the two groups (Gertler et al., 2010). A case in point, when the two development projects in a particular area are parallelly conducted, the DID model cannot determine the impacts of each project separately. It implies that there are no time-in-variant differences between the two groups. Therefore, there will the same trend in outcomes changes for the two groups when the treatment does not exist.

According to Wing et al. (2018), there are three methods to check the parallel trend assumption. The first method called the granger-type causality investigates whether there is a bias when the existing results anticipate the alternative treatment in the future. There are two additional variables included in the model, which are the first and second lead treatment variables. The parallel trend assumption holds when the two coefficients of the variables are jointly insignificant. The second method is group-specific linear trends used to identify the general trend of some period and the possibility of group-specific linear trends. The method is to test the null hypothesis, which is all the coefficients of the group-specific linear trends are jointly zero. The last method is that the covariate balance test. In this method, each covariate and the treatment variable are modeled. The parallel trend holds when there are balance covariates.

There is a procedure used in the study to choose the best model specification. The first step is to execute the FE DID Model without covariates and check whether the model can

**Peer Reviewed – International Journal** 

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E-ISSN: 2614-1280 P-ISSN 2622-4771

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fulfill the parallel trend assumption. When the parallel trend assumption holds, the next step is exercising the FE DID Model with covariates. After that, the model's standard error should be checked. When the model with covariates has a lower standard error, the parallel trend test should be then applied. When the assumption holds, the second model should be selected, but if it is not, the first model will be picked. For the second scenario, when the model without covariates cannot fulfill the parallel trend assumption, the model with covariates should be applied. When the model can fulfill the parallel trend assumption, this model is selected, but if it is not, other alternative methods should be identified.

The study will use the naïve method to estimate the effects of treatments as a comparison for both staggered FE DID models with and without covariates. The equation of the model will be as follows:

$$Y_{it} = \alpha + \tau T_{it} + \varepsilon_{it} \tag{3}$$

Where  $\alpha$  and  $\tau$  are the parameters to estimate using the Ordinal Least Square (OLS). But, this model may impose some bias problems. The first issue is that the parameter  $\tau$  may have selection and heterogeneity biases when T, which is the treatment variable, has a relationship in factors in disturbance terms. The model also does not have external validity.

#### 3. Results and Discussion

#### 3.1. Results

Table 5 shows the results of the three model specifications including the naïve models, the FE staggered DID Model without covariates, and the FE Staggered DID Model with covariates. The models apply the cluster standard errors considering the potential correlation within clusters. The naïve method only consists of treatment variable, while the FE Staggered DID Models add the effects of fixed time and districts.

The naïve model result shows that there are positive and significant impacts of the treatment variable on the outcomes, by about 0.761. It implies that the districts experience higher per-capita GDP after they have institutional reforms in the OSS's organization structure into department form by about 0.761 percent compared to before they have a reform. However, this model may have a lack of validity since both selection and heterogeneity bias issues may occur as the treatment variables may have a relationship with many other variables in error terms.

Table 5. Institutional Reforms and district GDP per capita

	Naive M	<b>Iodel</b>	FE Stagger without co		FE Stagge with cov	
Independent Variable	Coef.	SE	Coef.	SE	Coef.	SE
Reform	0.761**	(0.031)	-0.015**	(0.006)	-0.011*	(0.006)
Per-capita government payment (in the log)					0.031	(0.018)
Expected years of schooling					0.013	(0.017)

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Access to					-0.0004	(0.0004)
Electricity						
_cons	17.068***	(0.023)	17.035***	(0.003)	16.509**	(0.308)
					*	
$R^2$	0.00		0.71		0.72	
Number of	1,843		1,843		1,843	
observations						

\* p < 0.1; \*\* p < 0.05; \*\*\*  $p < \overline{0.01}$ 

On the other hand, for the FE Staggered DID Models, there is a negative impact of treatment variable on the outcomes significantly by about 0.015. Since the FE Staggered DID Model may have more valid results compared to the Naïve model considering the time and cluster inclusion, it may suggest that the naïve model result may have upward biased. According to this result, the tentative conclusion of the reform impacts is negative on the percapita GDP. However, the robustness check of both models will be further required.

Table 6 shows the results of parallel trend assumption testing for both FE Staggered DID Model with dan without covariates. The FE Staggered DID Model Without Covariates may fail to fulfill the parallel trend assumption. This is indicated by the results of the three methods used in checking the assumption. The first method, the granger type causality tests, shows that the parallel trend assumption can be satisfied since the lead reform variables do not show the jointly significant results implying existing outcomes do not affect the reforms in the future. However, based on the second method, which is group-specific linear trends, the assumption is failed to fulfill since the group-specific linear trends do not jointly zero. The last method, the covariates balance may also show that the parallel trend assumption is not satisfied since 1 out of 3 covariates is statistically significant (unbalance).

Table 6. Parallel trend assumption

FE DID – wi	thout covariates	FI	E DID – with covariate	es
Granger-Type Causality Tests	Group-Specific Linear Trends	Granger-Type Causality Tests	Group-Specific Linear Trends	Covariate Balance Tests
Jointly test of lead treatment is insignificant F(2, 368) = 1.62 Prob > F = 0.1998 The parallel trend assumption is <b>satisfied</b> .	<ul> <li>All the coefficients of the group-specific linear trends are jointly significant     F( 3 368) = 1.8         10<sup>5</sup>         Prob &gt; F = 0.0000</li> <li>The parallel trend</li> </ul>	Jointly test of lead treatment is insignificant F(2, 367) = 0.86 Prob > F = 0.4226 The parallel trend assumption is <b>satisfied</b> .	<ul> <li>All the coefficients of the group-specific linear trends are jointly significant     F( 6, 335) =     1.3 10<sup>5</sup>     Prob &gt; F =     0.0000</li> <li>The parallel</li> </ul>	1 out of 3 covariates is statistically significant (unbalance) The parallel trend assumption is not satisfied.
	assumption is not satisfied.		trend assumption is satisfied.	

Peer Reviewed - International Journal

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E-ISSN: 2614-1280 P-ISSN 2622-4771

https://jurnal.stie-aas.ac.id/index.php/IJEBAR

Next, FE Staggered DID Model with Covariates shows similar results for the parallel trend assumption testing. Among the three methods, only the granger type causality tests, which show that the parallel trend assumption holds, meanwhile other methods show that the model cannot satisfy the assumption. Therefore, both FE Staggered DID Model with and without covariates cannot satisfy the parallel trend assumption.

However, based on the comparison in estimates between the FE Staggered DID Model with and without covariates, there is some additional conclusion. First, since the magnitude and significance of effects are relatively the same between the two models, i.e. with and without covariates, it may indicate that the inclusion of the covariates in the model may have no effects on the treatment coefficient. Secondly, for the FE DID with covariates, the addition of group-specific linear time trends variable in the model may also have no effects on the magnitude and significance of the estimate. Thus, this may suggest that the FE DID Model with Covariates may still be eligible to be used in this study.

Table 7. Granger causality and group specific linear trend – FE Staggered DID without and with covariate

	Without Co	Covariates With Covariates			Covariates and pecific linear trend	
Independent variable	Coef.	SE	Coef.	SE	Coef.	SE
Reform	-0.015**	(0.006	-0.011*	(0.006)	0.010	(0.005)
Per-capita government payment			0.031	(0.018)	0.010	(0.008)
Expected year of schooling			0.013	(0.017)	0.005	(0.008)
Access to electricity			-0.0004	(0.0004	0.000	(0.0002)
Constant	17.035**	(0.003	16.509***	(0.308)	45.11 7	(7.173)
$R^2$	0.71		0.72			0.95
N	1,843		1,843			1,843

\* *p*<0.1; \*\* *p*<0.05; \*\*\* *p*<0.01

In terms of exogenous assumption, the treatment variable, which is the institutional reforms can be an endogenous variable since it may depend on the decision of the local mayor to implement the reforms. However, the FE DID model used can make treatment as good as randomly assigned and thus overcome the endogenous issues.

Table 8 shows the results of the heterogeneity analysis of per-capita GDP. The results suggest that there are no heterogeneity impacts of reforms on per-capita GDP between Kabupaten and Kota. The impacts of institutional reforms in the OSS's organizational structure into department form on the economic performance is negative and significant for both Kabupaten dan Kota. Therefore, since there are no differences in the impacts of the

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E-ISSN: 2614-1280 P-ISSN 2622-4771

https://jurnal.stie-aas.ac.id/index.php/IJEBAR

reforms between Kota dan Kabupaten, it may suggest that there are no heterogeneity effects between Kabupaten and Kota.

A similar result occurs for the heterogeneity test for two subgroups including eastern and western regions in Indonesia. The impacts of the institutional reforms in the OSS's organization structure into department form on the economic performance is significantly negative for both eastern and western subgroups. Therefore, it may imply that the heterogeneity effects between the two subgroups do not exist.

Table 8. Heterogeneity Test on district GDP per capita

	Kota		Kabupaten		Eastern		Western	
Independen t Variable	Coef.	SE	Coef.	SE	Coef.	SE	Coef.	SE
Reform	-0.003*	(0.002	-0.017**	(0.007	-0.020*	(0.010	-0.129*	(0.008
		)		)		)		)
_cons	17.317**	(0.005	16.962***	(0.003	16.778**	(0.004	17.079**	(0.003
	*	)		)	*	)	*	)
$R^2$	0.83		0.69		0.86		0.69	
Number of	380		1.463		270		1,573	
obervations								

<sup>\*</sup> *p*<0.1; \*\* *p*<0.05; \*\*\* *p*<0.01

#### 3.2. Discussion

Based on the robustness test results, the study selects the FE Staggered DID Model with Covariates. The results show that there are negative and significant impacts of the OSS's reforms on economic performance indicated by per-capita GDP. This negative result is in line with other studies, which show that in the short-run certain institutional reforms may have negative effects on the economic performance. Such negative impacts may occur since there is a transition period in implementing the reform, which is the changes in the OSS's organization form. In the transition period, the implementation of reforms may have some challenges particularly in terms of institutional quality (OECD, 2018). In addition, the structure of the OSS which has three different levels, which are the central government OSS, the province OSS, and the districts OSS may impose difficulties in having coordination among levels. Furthermore, there is a lack of human capital and weak law enforcement since the commitment of the local mayor is relatively still low (Bappenas, 2018).

The culture of the Indonesian people may also contribute to the less effective outcomes of the reforms to boost economic growth. According to the OECD (2018), most of the business actors (by about 47 percent) in Indonesia may have risk aversion behavior. Also, according to Hermanto & Suryanto (2017), entrepreneurship may give less opportunity than employees. It may also have contributed to the existence of informal sectors in Indonesia. According to the OECD (2018), the informal sectors in Indonesia are characterized by low productivity due to low skill, technology, and innovation. The sectors are about 70 percent of the total employment and 90 percent of the total number of business enterprises in Indonesia. Furthermore, since they do not have a formal structure, they cannot engage in the more productive sectors, particularly export sectors since the formality is one of the requirements to be satisfied. Therefore, the existence of informal sectors may indicate that the regulatory environment is still less sound.

Peer Reviewed - International Journal

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E-ISSN: 2614-1280 P-ISSN 2622-4771

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#### 4. Conclusion

The paper has investigated the impacts of institutional reforms of the OSS in the districts, which is the changes in the OSS organization form to the department form, on the economic growth indicated by per-capita GDP using the FE Staggered DID Model. The institutional reforms in the OSS's organization structure into department form may contribute to regulation simplification and thus may create favorable business environment which in turn may boost the economic performance.

However, the study finds that the institutional reforms in the OSS's structure have negative and significant impacts on per-capita GDP. It may imply that the economic performance is lower after districts implement the reforms compared to before they have the reforms. This may occur since, in the short run, there is possibly a transition period influencing the institution quality which may be still low. The human capital and governance in the organization may still require to improve. Also, the cultural aspects which influence the perspective of Indonesian people on entrepreneurship and also the existence of the informal business actors may also require to be considered to improve the effectiveness of the reforms in promoting economic growth. Therefore, further study is required to investigate the long-run effects of reforms on economic growth will be required.

In terms of robustness checking, the analysis shows that there are no heterogeneity impacts of institutional reforms of the OSS's organization structures on the economic growth between subgroups of samples. There are no differences in impacts of reform on the economic growth between the districts in Kabupaten and Kota and also in the eastern and western regions. The OSS organization reform has a significant negative impact on the district GDP per capita in districts in Kabupaten dan Kota and districts in eastern and western regions.

However, there are some caveats in the analysis. First, the parallel trend assumption is not satisfied under the Group-specific linear trend and covariate balance tests, however since the magnitude and significance of the treatment coefficient is relatively the same with and without covariates and also with unique code, the model is then relatively still reliable to use. Secondly, the study to investigate the impacts of institutional reforms in the OSS's organization body may be required to gain more arguments relating to the short-run impacts of the reforms on economic growth.

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Peer Reviewed - International Journal

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E-ISSN: 2614-1280 P-ISSN 2622-4771

https://jurnal.stie-aas.ac.id/index.php/IJEBAR

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