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Local Leadership in Transition
Explaining Variation in Indonesian Subnational Government

by

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A thesis submitted for the degree of Doctor of Philosophy at the Crawford School of Economics and Government, the Australian National University, Canberra.

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Statement of Originality

This thesis is the original work of the author.
All sources used and assistance obtained have been acknowledged.

Christian von Luebke

Canberra, 28 September 2007
Abstract

Why do some local governments perform well, while others perform badly? This question, which frames the analysis of the present study, connects to a wider puzzle in recent development debates. Many post-authoritarian regimes that have embarked on pronounced decentralization and local democracy reforms display, if anything, declining government performance over the last ten years. The persistence of bureaucratic inefficiencies and corruption, irrespective of efforts to ‘move governments closer to people’, calls for a deeper inquiry into the dynamics of local decision-making after decentralization has come to pass.

Indonesia provides a unique study case in this respect. Indonesia’s rapid regime change, from centralized authoritarian to decentralized democratic rule, has brought about a large variation in subnational policy outcomes. This is particularly evident in strongly diverging tax, license and corruption practices across 440 newly-empowered district governments. These marked ‘business-climate’ variations make it possible to test two contending explanations for government performance: (1) ‘societal pressure’ which is advocated as an essential reform mechanism in the good-governance debate and (2) ‘government leadership’ which emerges as a key determinant in recent policy-reform literatures.

Based on eight district cases (comprising 1000 business surveys and 120 in-depth interviews) and multivariate regression analyses (using data from 200 districts), I demonstrate that societal pressure is less significant in explaining local policy outcomes than government leadership. In Indonesia's early transition to democracy, reform pressures by local firms and district councilors were found to be largely absent due to collective action problems and dysfunctional political incentives. Conversely, local government leaders were found to be the primary driving force for local business climates. In good cases, government leaders skillfully used their office powers – motivated by direct elections and career aspirations – to forge reform coalitions and supervise local bureaucracies. In response to the ‘good governance’ debate, these empirical findings signal that government leadership can be an effective, and often underestimated, reform mechanism, which compensates for weak societal pressures in early transition periods.
Acknowledgements

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<td>BC Business Climate</td>
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<tr>
<td>BPKP National Audit Agency (Badan Pengawasan Keuangan dan Pembangunan)</td>
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<tr>
<td>BPS Central Bureau of Statistics (Badan Pusat Statistik)</td>
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<tr>
<td>DAU General Allocation Funds (Dana Alokasi Umum)</td>
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<td>DPRD District parliament (Dewan Perwakilan Rakyat Daerah)</td>
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<td>GDP Gross Domestic Product</td>
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<td>GOLKAR Indonesia’s ‘State Party’ (Partai Golongan Karya)</td>
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<tr>
<td>GTZ German Technical Cooperation (Gesellschaft f. Technische Zusammenarbeit)</td>
</tr>
<tr>
<td>HO Community Disturbance Permit (Hinder Ordonantie or Ijin Ganguan)</td>
</tr>
<tr>
<td>IT Information Technology</td>
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<tr>
<td>KADIN Indonesian Chamber of Commerce (Kamar Dagang dan Industri)</td>
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<td>KADIN Local Business Chambers (Kamar Dagang dan Industri Daerah)</td>
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<tr>
<td>Kepres Presidential Decree (Keputusan Presiden)</td>
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<tr>
<td>KPPOD Regional Autonomy Watch (Komite Pemantauan Pelaksanaan Oton. Daerah)</td>
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<tr>
<td>MOF Ministry of Finance (Kementrian Keuangan)</td>
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<td>NGO Non-Governmental Organisation</td>
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<tr>
<td>NTB West Nusa Tenggara (Nusa Tenggara Barat)</td>
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<td>OLS Ordinary Least Square</td>
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<tr>
<td>PAD District Revenues (Pendapatan Asli Daerah)</td>
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<tr>
<td>PAN National Mandate Party (Partai Amanat Nasional)</td>
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<td>PC Per Capita</td>
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PDIP  Indonesian Democratic Party (*Partai Demokrasi Indonesia Perjuangan*)
Perda  District Regulation (*Peraturan Daerah*)
PKB  National Awakening Party (*Partai Kebangkitan Bangsa*)
PKS  Justice and Prosperity Party (*Partai Keadilan Sejahtera*)
PNS  Civil Servants (*Pegawai Negri Sipil*)
PPP  United Development Party (*Partai Persatuan Pembangunan*)
PR  Proportional Representation
SIUP  General Trade License (*Surat Ijin Usaha Pedagang*)
SMERU  Social Monitoring and Early Response Unit
TDI  General Industry Permit (*Tanda Daftar Industri*)
TDP  General Business Permit (*Tanda Daftar Perusahaan*)
UN  United Nations
UNDP  United Nations Development Programme
USAID  United States Agency for International Development
UU  National Law (*Undang Undang*)
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Chapter 1
Introduction

The last two decades have seen a marked shift in the development debate. The emphasis in the 1980s was on deregulation and 'getting prices right'. Since the mid-1990s, however, strategies to wind back the reach of government have been replaced with efforts to enhance public-sector quality. Today the World Bank, United Nations and other development agencies put strong weight on institutional reforms that improve the effectiveness and responsiveness of government functions. Guided by the maxim of 'moving governments closer to people' the good-governance agenda promotes decentralization and local democracy as promising means for societal oversight and, thus, better government performance.¹

What remains puzzling, however, is that the quality of government has hardly improved around the world, although more and more developing countries have indeed embraced decentralized and democratic government structures.² As Daniel Kaufmann, a leading governance analyst at the World Bank, summarizes it:

The picture that emerges ... is sobering. [Between 1995 and 2005 there] is very little evidence of statistically significant improvements in governance worldwide ... if anything the evidence is suggestive of a possible deterioration - at the very least in dimensions such as regulatory quality, rule of law, and control of corruption (Kaufmann et al. 2006:18).

¹ This new 'good-government' agenda is clearly observable in the World Development Reports after 1997; see, for instance, World Bank (1997:122). A similar emphasis emerges in recent UN publications emphasizing that policymakers should focus on 'decentralizing target-setting, decisionmaking, budgeting, and implementation responsibilities at the level of local governments ...They should encourage [government] service delivery with the participation and oversight of local communities and nongovernmental organizations' (United Nations 2005:58).
² Since the mid 1990s more than 80 percent of all developing countries (with populations of more than five million) have decentralized administrative/political powers to local levels (Dillinger 1994:1). Moreover, between 1974 and 1997, the number of countries with democratically elected governments tripled from 39 to 117: a rise from 20 to 60 percent (Jaggers and Gurr 1995; World Bank 1997:111).
This sobering picture is also reflected across several Asian, African and South American countries. Many former authoritarian regimes that embarked on pronounced decentralization and local democracy reforms in the 1980s (India, Kenya, and Brazil) and 1990s (the Philippines, Indonesia, Russia, Uganda and Argentina) do not validate the expectations stated in the good-governance agenda. Irrespective of institutional efforts to move governments closer to local constituencies, problems of administrative inefficiencies and corruption remain largely unchanged.³

This apparent mismatch between policy expectations and empirical realities marks the starting point for the present study. It suggests that decentralization per se is no guarantee for better government outcomes. While much of the existing research has debated the pros and cons of decentralized government structures⁴, this thesis seeks to go beyond structural explanations⁵: it starts with decentralization as a given reality, and seeks a better understanding of the dynamics of local government, by examining Indonesia’s experience since the advent of both democracy and decentralization.

Focus on Indonesia

Indonesia not only offers a superb ‘laboratory’ for testing some of the arguments in recent policy debates, but also represents an important case in its own right. After the Asian crisis and General Suharto’s resignation in 1998, the Indonesian government put an end to thirty years of authoritarian rule and implemented far-reaching political and administrative reforms. In 1999, Indonesian citizens were called upon (for the second

³ A more detailed description of stagnant (or declining) government performance across the countries mentioned is presented in Chapter 3.
⁵ As many scholars have demonstrated, structural (or institutional) conditions are key components of development, but they cannot be generalized into mechanical blueprints; rather, they are contingent on county-specific contexts such as historical backgrounds and established norms (North 1990; 1994:366; Stiglitz 1999; 2000; Acemoglu et al. 2001:1369; Rodrik et al. 2004:157; Rodrik 2006:986).
time in history) to elect their national and regional representatives in a truly democratic way. At the same time, the national government enacted decentralization laws\(^6\) that fully dispersed authority for local taxes and services to more than 440 district governments. This made Indonesia – at least in administrative terms - one of the most decentralized countries in the world. The rapid regime change and the sheer number of newly-empowered jurisdictions have brought about a wide variation in subnational policy outcomes and, thereby, provided an excellent opportunity to test explanations for local government performance.

Moreover, the Indonesian case is well worth exploring given its potential impacts on regional development. Indonesia is the world’s fourth most populous nation, and home to the largest Muslim community in the world. Given its size and geo-strategic position in Southeast Asia, Indonesia is a keystone for maintaining stability within the region.\(^7\) The control of socio-political problems and are widely seen as a prerequisite for limiting migration flows and safeguarding on of the world’s most important commercial sea routes (Reilly 2002:13,19).\(^8\) Although ethno-religious tensions have been contained (Aceh, Mollucas) and fair and non-violent elections were held, potential instabilities continue to lurk in the large economic and ethnic disparities that prevail across the country. Against this backdrop, then, variations in local government performance are not only methodologically interesting but also important in the context of regional development and security.

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\(^6\) The history of Indonesia’s steps towards decentralization is outlined in Chapter 2.

\(^7\) Arguably, the strong international concern about Indonesia is also reflected in the immense inflow of development aid. Indonesia has been the world’s largest recipient of Japanese development grants in cumulative terms over the last four decades (MOFA 1998: 135,188). Moreover, in 2006 alone, the World Bank pledged US$ 900 million for the support of ‘good governance’ measures (Witular 2006:6).

\(^8\) As Reilly notes, Indonesia spans across essential ‘sea lanes of communication (SLOCs) and trade, particularly the vitally important Straits of Malacca between Singapore and Indonesia off the east coast of Aceh, which is a major maritime conduit for international shipping between Europe, the Middle East, China, Japan and the United States. [Roughly] 40 per cent of the world’s seaborne trade passes through South-East Asian waters’ (2002:19-20). In the 1980s and 90s, nearly 90 percent of Japan’s oil imports and 45 percent of its trade flows passed through the Indonesian archipelago (Kaminski 1995:54).
Focus on Business Climates

The reason why this study focuses on district business climates (understood as government policies and practices that affect local business activity) is straightforward. Due to the sluggish domestic and foreign investment activity over the last few years, national and local business climates have moved to the forefront of Indonesia's policy debates. Since the Asian economic crisis, Indonesian investment and growth trajectories have fallen behind those of other Southeast Asian neighbor economies (Castle 2004). Interestingly, investment has remained comparatively low regardless of the country's improved macro-economic performance, including stable inflation and interest rates (Hill and Aswicahyono 2004). The reluctance of foreign and domestic firms to invest – despite sound macro-economic conditions, natural resource endowments and low labor costs – signals problems of corruption and other forms of administrative uncertainty.

Indeed, corruption and bureaucratic red-tape remain pronounced obstacles across the Indonesian archipelago. Although the collapse of the authoritarian regime (and its patronage systems) has reduced the extent of ‘grand’ corruption scandals, small-scale corruption has proliferated across subnational jurisdictions (Davidsen et al. 2006:7). Recent studies show that aggregate corruption levels have risen during Indonesia’s first transition years and remain well above those in other Asian countries.9 A similarly gloomy assessment has been made in the context of bureaucratic procedures. According to the 2006 ‘Doing Business’ report of the World Bank, Indonesia’s regulatory environment is considered one of the least attractive in Asia: extensive compliance costs for tax and licensing procedures have moved Indonesia down to rank 135 out of 175 countries.10

9 An analysis of Indonesia's corruption account over the last few years is found in the annual studies of Transparency International (2006).
10 See World Bank (2005; 2006a); a description of Indonesia's corruption and doing-business trends in comparison to other Southeast Asian countries is presented in Chapter 2.
Overall, the focus on local business climates yields two benefits. First, it provides a set of tangible indicators—such as tax regulations, license procedures and business services—that are clearly observable and comparable across Indonesian districts. Second, it is a very timely policy issue, which links this study to Indonesia’s current challenge to improve its investment attractiveness and economic growth in the years to come.

Research Questions and Approach

Inspired by the global policy debate on good governance, the main objective of the present study is to shed empirical light on the dynamics of local government performance in post-authoritarian regimes. Indonesia’s rapid regime change and strong variation in its local business climates offer an excellent opportunity for analyzing why some local governments perform better than others. Against this background, the overarching research question is as follows:

What sorts of forces, in Indonesia’s newly decentralized political framework, motivate local governments to reform prevailing business climates and reduce tax distortions, administrative inefficiencies, and corruption?

I approach this question by focusing on two particular ‘forces’ that are inspired by the recent development discourse: first, demand-side pressures from local, mostly cottage-sized, firms (henceforth ‘societal pressure’); and second, supply-side pressures from district government leaders (henceforth ‘government leadership’). The former arises as an essential reform mechanism in recent good-governance debates, whereas the latter emerges as a key determinant in recent policy-reform literatures and resonates well with my own work experience in rural Indonesia.
Undoubtedly, these two concepts of societal pressure and government leadership are a non-standard way of framing the discussion. The reasons for diverging from labels and frameworks that may be more familiar to readers are two-fold: for one thing, my interest in explaining a complex phenomenon like Indonesia's local government variation motivated me to cross disciplinary borders and explore political science, economics, business, and sociology literatures. While cross-disciplinary research provides more tools for coming to grips with real-world phenomena, it also makes it difficult to find a common language across different schools of thought. And for another, the starting point of this research was truly inductive: initial ideas for framing this study stem from field observations during an economic consultancy I undertook for the German government in Central and East Indonesia between 2000 and 2004.

The analytical methods chosen to examine the effects of these two concepts follow three consecutive steps: In the first step, societal pressures and government leadership are placed in the context of existing policy and theoretical literatures; in the second step, the impacts of these phenomena are measured across purposely designed case study comparisons (across eight district locations, and based on roughly 100 interviews and 1000 business questionnaires); and in the third step, the robustness of empirical case findings is tested by juxtaposing them with a cross-district dataset. The methodological details of the last two steps are laid out in greater detail in Chapter 3.

Research Findings

The society-centered view that prevails in much of today's applied policy literature, which preconceives societal pressure as the key explanation for better government performance, is not confirmed by this study. Seven years after Indonesia's
decentralization and local democracy reforms were instigated, there is little evidence that the quality of local government (measured in terms of district business climates) is determined by societal pressures (i.e. interest group activity and political representation). Case comparisons and regression analyses indicate that societal pressures are rather insignificant and incoherent explanations for the highly variable government performance. The transition to democracy in Indonesia's diverse districts has entailed pronounced initial obstacles: geographical and sectoral fragmentation, tenacity of authoritarian norms, and dysfunctional electoral rules undermine collective action and political representation. As a consequence, local firms, business associations, and local politicians rarely hold district bureaucracies to account, a finding which stands in clear contrast to the expectations of the good-governance literature.

The quality of local government leadership, on the other hand, is highly significant in explaining variations in local business climates. The case studies demonstrate that districts, which are endowed with good government leaders, exhibit good business climates, and vice versa. Similarly reaffirming messages arise from the qualitative analyses across 230 districts. As a bottom-line, district regents have become increasingly exposed to electoral and prestige-based incentives and compensate, for the time being, for weak societal pressures. Successful regents have initiated reform coalitions at communal and national levels and, at the same time, have introduced new oversight mechanisms and incentive structures for better bureaucratic performance. This remarkable phenomenon of ‘democratically-committed’ government leadership, which synergizes managerial and democratic qualities, emerges as an essential driving force for better government performance in Indonesia's early transition experience.
Contributions and Limitations

This thesis makes three contributions. First, the comparative analysis of local polities in Indonesia helps inform recent policy debates on good governance and decentralization. As Pranab Bardhan notes, despite the pronounced rise of decentralization over the past decades, 'the literature on decentralization in the context of development is still in its infancy' (2002:203). Based on systematic comparisons, the present study offers new empirical insights into the question what drives local government performance in transitional countries. Above all, it challenges the orthodox preconception of the main-stream policy agenda, which proposes societal pressures (and all related institutional measures) as the key explanation for government performance. The Indonesian experience suggests that early transitions towards decentralization can give rise to 'unorthodox' democratic mechanisms in which government leaders are more responsive to local citizens than are profession associations and political parties.

Second, this study contributes to Indonesia's current policy debate. The analysis of district governance accords well with national efforts to improve local business climates as a means to revitalize rural investment. Surprisingly, there has been little analytical work on decentralization and its impact on local business climates. Much of the academic research to date is concerned with fiscal transfers and macroeconomic stability (Smoke and Lewis 1996; Bahl and Wallace 2001; Azis et al. 2001) or with impacts on poverty alleviation and pro-poor growth (Rosser et al. 2004; Sumarto et al. 2004; Timmer 2004). Few studies have comprehensively examined the political economy of local government and deciphered the dynamics of bureaucratic policies and practices. Much of the existing empirical work (LPEM-FEUI 2002; REDI 2003; KPPOD 2005) helps to outline policy problems but offers few analytical insights

11 A similar argument is put forward by Litvack et al.: 'Many people hold strong beliefs about various aspects of [decentralization ]', including its merits of lower public sector corruption and inefficiency; but 'the actual empirical evidence on these propositions is either nonexistent or conflicting' (1998:7).
into the underlying causes. This study fills this gap: it offers an empirical snapshot of current tax/license/tender practices across eight districts in West, Central and East Indonesia and offers analytical explanations for observable results.

And third, the present study is a good example of what has become known as a mixed-method approach. The analyses are framed within a two-stage comparison: one across purposely selected case studies; and one across case observations and regression results. Although mixed-method analyses are gaining in popularity, the existing literature in the field is still rather compartmentalized into either quantitative or qualitative methods. On the one hand, we see systematic cross-country analyses that reveal trends on aggregate levels, but yield few answers on subnational policy drivers. On the other hand, we find individual case studies that yield rich contextualized information, but have little impact due to their unsystematic and non-replicable methodological frameworks (Remmer and Wibbels 2000:31). This research combines the analytical rigor of the former with the contextual depth of the latter.

Undoubtedly, this research also has limitations. Indonesia’s transition is still at an early stage; many institutional features, such as local elections, political party constellations and national laws, are changing over time and are altering the ways local governments and businesses behave. In light of this some readers might even feel that it is premature to evaluate local government performance in Indonesia, or that economic and institutional change will solve most government problems over time. While that may be true, it is debatable how long Indonesia’s rural districts can afford to wait for improvements. Against the background of stagnant investment, rampant corruption and sustained poverty, a deeper inquiry into the dynamics of local government appeared to

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12 Prominent examples of mixed-method studies on government performance are Putnam (1993), Stoner-Weiss (1997), and Grindle (2007).
be a timely task. As Iwan Azis notes, ‘unless necessary corrections are made early, the costs arising during this [early] period may be so high that they exceed [future] benefits … Meanwhile, the problem of local government vulnerability to capture by local elites is even more difficult to overcome if not addressed early’ (2003:4).

Structure of the Dissertation

The organization of this thesis is as follows. Following this introduction, Chapter 2 contextualizes this study by placing the Indonesian case (and its wide variation of local business climates) in the wider debate on decentralization and institutional change. Chapter 3 introduces two hypothetical explanations for variant government performance, namely societal pressures and government leadership, that frame the research design of this thesis.

Chapters 4 to 6 constitute the empirical centerpiece of this research. Chapter 4 analyzes the effects of government leadership on local business climates by using controlled district-comparisons in West Sumatra and Central Java. Similarly, Chapter 5 tests the effects of societal pressures on local business conditions across districts in Bali and West Nusa Tenggara. Chapter 6 uses a cross-distict dataset to triangulate case observations with statistical analyses.

Chapter 7 examines the political economy of local government performance. It brings together the theoretical and empirical threads running through this study. While the empirical chapters establish the ‘what’, Chapter 7 takes a closer look at the political economy of local government and enquires ‘why’ societal pressures and government leadership are (or are not) significant in explaining varied government performance. Chapter 8 connects the findings of this study to the wider policy debate, draws implications, and suggests directions for future research.
Chapter 2
Indonesian Decentralization in Perspective

2.1 Introduction

After the breakdown of the communist system in the early 1990s, authoritarian regimes increasingly moved towards democratic and decentralized forms of government. The fact that roughly four out of five developing countries embarked on decentralization reforms towards the new millennium\(^\text{14}\), has moved ‘local government’ to the center stage of development discourses. These waves of decentralization and local democracy were strongly supported by international donor organizations as a means to achieve better government performance.\(^\text{15}\) Many policy advisers share the belief that ‘bringing the state closer to people’ leads to efficient and effective public services and improved business conditions. In the words of former World Bank president Wolfowitz (2006:2): ‘... a free press, and a vibrant civil society are important components of good governance. They balance the power of governments, and they hold them accountable for delivering better services, creating jobs, and improving living standards.’

Empirical realities, however, are less clear-cut than this policy rationale suggests. The mere fact that many developing countries embarked on decentralization and democracy reforms does not, by itself, suffice to explain recent government performance. Since the mid 1990s more than 80 percent of all developing economies (with populations of more than five million) have started to decentralize administrative and political power to subnational jurisdictions (Dillinger 1994:1). Moreover, between 1974 and 1997, the number of countries with democratically elected governments

\(^{14}\) See Dillinger (1994:1)
\(^{15}\) The strong advocacy for decentralization is readily observable in World Bank country studies over the last 15 years (e.g. World Bank 1990; 2001; 2003; Lieberman 2002) and prevails, albeit in a slightly more cautious tone, in recent World Development Reports (World Bank 2004:53; 2007:31; forthcoming).
tripled from 39 to 117 (World Bank 1997:111). Yet, contrary to the expectation that developing countries embarking on democratic decentralization would exhibit better government performance, empirical evidence over the last ten years indicates that conditions remain largely unchanged. Taking stock of the performance of more than 200 countries between 1996 and 2005, Kaufmann et al. (2006:14,18) demonstrate that governance indicators such as ‘government effectiveness’ and ‘control of corruption’ have not improved on aggregate levels.16

Figure 2.1: Global Government Performance between 1996 and 2006

Indeed, recent governance data presented in Kaufmann et al. (2006) suggest that, government effectiveness in Asia, Africa and Latin America has, if anything, slightly deteriorated over the last ten years (Figure 2.1). The stagnant or slightly downward

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16 ‘Government effectiveness’ is an aggregate measures of the quality of public service provision, the competence of civil servants, and the credibility of the government’s commitment to policies; ‘control of corruption’ is an aggregate measure of bribery for administrative services, public rent-seeking, and ‘grand corruption’ incidences (Kaufmann et al. 2003:3-4).
trends have consolidated global disparities: government effectiveness and corruption indicators continue to display a notable rift between developed and developing nations (Figure 2.2). This critical picture is confirmed by a group of large transition and developing countries, which have embarked on pronounced decentralization reforms over the last decades. Salient examples in this regard include China, Kenya, and Brazil (who decentralized their government systems in the 1980s) as well as the Philippines, Indonesia, Russia, Uganda and Argentina (who followed suit in the 1990s). Despite efforts to devolve powers to local authorities, observable government indicators in this group have been at best static, and at worst deteriorating, over the last ten years.
Table 2.1: Government Performance of Selected Decentralized Countries

<table>
<thead>
<tr>
<th></th>
<th>Government Effectiveness</th>
<th>Control of Corruption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>0.1</td>
<td>-0.5</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>China</td>
<td>0.2</td>
<td>-0.1</td>
</tr>
<tr>
<td>Russia</td>
<td>-0.6</td>
<td>-0.4</td>
</tr>
<tr>
<td>Uganda</td>
<td>-0.6</td>
<td>-0.5</td>
</tr>
<tr>
<td>Kenya</td>
<td>-0.3</td>
<td>-0.8</td>
</tr>
<tr>
<td>Brazil</td>
<td>-0.3</td>
<td>-0.1</td>
</tr>
<tr>
<td>Argentina</td>
<td>0.4</td>
<td>-0.2</td>
</tr>
<tr>
<td>Average</td>
<td>-0.1</td>
<td>-0.3</td>
</tr>
</tbody>
</table>

Source: data from Kaufmann et al. (2006); available at http://info.worldbank.org/governance;
Note: Government effectiveness and corruption scales range from -2.5 (very poor) to +2.5 (very good);

As shown in Table 2.1, between 1996 and 2005 none of the countries listed could significantly improve their government effectiveness or control of corruption. While nations like Brazil, Russia and the Philippines, exhibit roughly the same performance, others nations like Argentina, China, Kenya, Uganda and Indonesia, display a clear decline. While this brief empirical snapshot is certainly not sufficient evidence from which to draw firm conclusions, it nonetheless begs the question of why decentralization has done so little to improve government performance.

By following up on this question, this chapter sets the contextual background for this study. While a detailed review on local governance literatures will follow in Chapter 3, the following sections place Indonesia’s decentralization experience in a wider context. After defining the key concepts of this research, the third section introduces the intellectual debate on decentralization and institutional change. Against this theoretical background, the fourth and fifth sections sketch Indonesia’s decentralization history and highlight the large variation in local business climates that has emerged with recent reforms. The sixth section concludes the chapter.
2.2 Defining Key Concepts

Considering the frequent usage of policy terminology in this and the chapters that follow, it is necessary to set some conceptual boundaries for this study. As Pierre (2000:3) points out, policy debates on government are often 'slightly confusing' as they lack definitional clarity. Thus, in order to avoid such confusion, I define a set of key concepts: namely governance, government performance, decentralization, local business, and local business climates.

Governance and Government Performance

Notwithstanding its salience in contemporary development debates it often remains unclear what 'governance' actually stands for. Governance 'has too many meanings to be useful, but the concept can be rescued by stipulating one meaning and showing how it contributes to the analysis of change' (Rhodes 1997:52). In the context of this thesis, governance is used in a specific sense, which makes it interchangeable with the term 'government performance': both terms are employed to describe regulatory policies and practices of government administrations, including typical functions of drafting regulations, collecting taxes, administering licenses, and providing public services. Unlike interpretations in good-governance literatures, dynamics outside public administrations (societal, economic, and political) are hence excluded from this specific governance definition.

17 This is close to the definition in Dethier (1999:1) that 'governance is the science of government behavior and performance'; and similar to the World Bank (1992) definition of governance as denoting the exercise of political authority and the use of regulatory resources to manage society's problems and affairs.
18 Kaufman et al. (1999:1), for example, define governance as the 'traditions and institutions by which authority in a country is exercised [including] the process by which governments are selected, monitored, and replaced, the capacity of the government to effectively formulate and implement sound policies, and the respect of citizens and the state for the institutions that govern economic and social interactions among them.' An equally broad definition is found in Shaw and Thompson (2002), Schacter and Shah (2004) and UNDP (1997).
Decentralization

The term decentralization describes the transfer of administrative powers from national to subnational tiers of government. Following the classification of Rondinelli, this transfer can be divided into three categories, depending on the degree to which planning, fiscal, and management functions have been handed down from central to local governments (Rondinelli 1999: 3-4):

(1) Deconcentration is the weakest form of decentralization. It describes a geographical relocation of national officials— from the center to provincial and/or district governments. Policy authorities remain strongly concentrated in the hands of the central government.

(2) Delegation is the next highest form of decentralization. Here, the center requests semi-autonomous organizations to act on its behalf. Possible examples include state enterprises, subnational departments for transport, health, education or housing, as well as regional development boards.

(3) Devolution is the highest form of decentralization. It entails the reassignment of far-reaching administrative powers from the center to subnational governments. Local governments receive the responsibility to provide local services and generate their own tax revenues.

The third category expresses Indonesia’s recent transition most accurately. As the next section will outline in greater detail, the 1999 reforms have widely dispersed authority for taxation and service provision to hundreds of district governments. Thus, in this thesis ‘decentralization’ embodies the devolution of administrative powers and fiscal authorities to subnational levels.19

In a related note, the term ‘local’ is used to refer to the district (second tier) level, whereas ‘regional’ refers to the first subnational tier of provinces. The main focus in this thesis is on ‘local governments’, hence on rural-based district administrations.20

19 For a detailed discussion of other types of decentralization including political, and market-based decentralization refer to Cheema and Rondinelli (1983) or Rondinelli (1981; 1999).
20 Rural districts constitute approx. 80 percent of second-tier jurisdictions (BPS 2004; BPKP 2006:1).
Local Business

Since this research is focusing on district-level governance, the term ‘business’ mainly refers to small businesses. Most of Indonesia’s districts - including the eight districts chosen for the empirical case analysis - are situated in rural areas. Unlike in larger industrialized urban centers (such as Jakarta, Surabaya, Denpasar, Medan or Makasar) business activities in rural districts are on a much smaller scale.

Table 2.2: Indonesian Ministry Business Classifications

<table>
<thead>
<tr>
<th></th>
<th>Micro/Cottage</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Numbers</td>
<td>1-5</td>
<td>6-19</td>
<td>20-99</td>
<td>&gt; 100</td>
</tr>
<tr>
<td>Annual Sales</td>
<td>&lt; 1 billion Rps</td>
<td>&lt; 1 billion Rps</td>
<td>1-49 billion Rps</td>
<td>&gt; 50 billion Rps</td>
</tr>
</tbody>
</table>

Source: BPS (1998) and Depkop (1999)

Following available business classifications from Indonesian ministries the large majority of enterprises in rural districts fall within the categories ‘cottage’ and ‘small’ (see Table 2.2). According to the estimations of Rice (2000:7), these two categories are an essential building block of Indonesia’s economy, accounting for roughly 90 percent of the labor force and more than 40 percent of national GDP. Cottage-sized and small firms (with fewer than 20 employees) also dominate the rural economies in this study: they cover roughly 99 percent of district business units and absorb nearly 90 percent of district employment.21 Consistent with the research focus on district-level economies, this thesis is chiefly concerned with small retailers, manufacturers, craftsmen, and traders with annual sales volumes below 1 billion Rupiah (US$ 100,000) and fewer than 20 employees.

21 These figures emerge from the statistical yearbooks of the eight case-districts (‘Kabupaten Dalam Angka’); in Klaten the local government stated that 85 percent of the district’s 2004 production value derived from cottage/small firms (and merely 15 percent from medium and large firms). The dominance of small firms in the four regions observed in this study (Central Java, West Sumatra, Bali and NTB) is also reflected in the comprehensive regional economic assessment conducted by Hal Hill and his colleagues in the 1980s; see for instance Hill and Weidemann (1989:27) and Booth and Damanik (1989:294).
Local Business Climates

In this study, local business climates are the operational means by which to measure government performance. They denote a jurisdiction’s attractiveness for firms to either extend existing activities or start up new ventures. While business people may take additional factors into account (for example, natural resources, skilled labor, geography, and security), the usage in this study is limited to conditions related to government services and practices. Hence, local business climates are understood to arise as a result of public costs (for instance, local taxes, license procedures and administrative corruption) and public benefits (for example, infrastructures and specific business services) for residential or prospective firms. In brief, local business-climates are a subset of district government action that directly bears upon investment and business activity.

Note that attributes of good/conducive/favorable business conditions are understood from a Welfare Economics perspective. Starting off from the Pareto (1896) principle, theoretically every action improving someone’s benefit without reducing anyone else’s is regarded as preferable. Policy decisions in the real world are naturally less clear-cut and entail significant tradeoffs between competing interests. Hence, seeking a middle ground between theoretical ideals and political realities, business climates are defined as ‘good’ if they raise the imaginary aggregate utility function of a given society. Under this definition, government action geared towards abolishing trade-distorting taxes, simplifying licensing procedures, and reducing corruption is thus preferable to action motivated by narrow self-interest (for example, seeking public rents by imposing trade barriers or bureaucratic red tape).

As a final note, if not specified otherwise, the usage of the terms ‘recent’ and ‘current’ in this study refers to the years 2005 and 2006, during which the Indonesian data collection and analyses took place.
2.3 Transition to Decentralization: Theoretical Perspectives

Virtues and Dangers of Decentralization

In order to put the Indonesian regime change into perspective, the following discussion provides a brief summary of the pros and cons of decentralization, including both the theoretical virtues and empirical setbacks. The theoretical economic and political propositions are considered first. Economic scholars in favor of decentralized arrangements, often referred to as ‘fiscal federalists’, stress two main advantages. First, decentralization moves policy making closer to local constituencies, which allows governments to provide services according to regional preferences and thereby utilize resources more efficiently. And second, subnational tax and service policies are more transparent and comparable for constituents, which leads to greater oversight and competition across local governments.

The second aspect is emphasized in Tiebout’s (1956) model of subnational competition. In his argument, which remains a ‘towering shadow’ in the decentralization debate (Treisman 2000:4), he suggests that the mere presence of mobile and well-informed assetholders is sufficient to induce local policy improvements. Assuming perfect information and rationality, Tiebout argues that citizens will compare the different expenditure and revenue patterns of surrounding jurisdictions and ‘vote with their feet’ for the best available combination of services and taxes within reach (1956:418-9). Hence, akin to Adam Smith’s invisible hand in private good markets, Tiebout envisions people’s invisible feet creating quasi-market pressures for public goods. In a decentralized environment where different policy-packages become

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22 The fiscal federalism literature has intensively debated the economic advantages of multi-level government; see Hayek (1939), Musgrave (1959; 1961), Riker (1964), Oates (1999) and Rodden (2006).
visible, people are likely to move themselves and their assets to locations that serve their preferences best. Over time, this ‘exit option’ induces local governments to compete for mobile asset holders by means of effective service provision and efficient revenue management.

Some scholars have recently built on Tiebout’s theory and empirically studied how decentralization plays out in transitional economies. Weingast (1995), Jin et al. (1999) and Zhuravskaya (2000), for instance, find that decentralization is favorable for economic development (‘market-preserving’) once a country strikes the right balance between subnational devolution and national control. Russia and China are instructive examples: while the former has experienced fiscal instabilities and rampant corruption across its regions (Shleifer and Vishny 1998; Zhuravskaya 2000), the latter displays a market-preserving federalism and less captive local governments (Montignola et al. 1995). What made China’s experience more successful, some argue, is the combination of decentralizing sufficient economic authority to local governments and, at the same time, maintaining strong national oversight to prevent fiscal imbalances and regional protectionism (Blanchard and Shleifer 2000).

In the political science literature, proponents of decentralization particularly stress the positive effects of administrative devolution towards political participation. A common argument is that decentralization is helpful to deepen local democracy and reduce conflict in multi-ethnic societies. Some scholars have observed that smaller administrative units encourage citizens to engage more actively in political debates and approach government more directly (Dahl 1967:969; Cooter 1999:8; Oliver 2000:361). Others argue that decentralization deepens democratic functions and reduces conflict.

\[23\] For a discussion of the importance of fiscal discipline and hard budget constraints, which underlies these comparative studies, see also McKinnon (1991; 1992) and McKinnon and Pill (1997).
simply by raising the number of political interfaces between governments and constituencies, including those with ethnic minorities (Dahl 1971:120-2; Beetham 1996:30-1). Others again, following in the footsteps of Mill and Tocqueville, stress that decentralization stimulates a process of democratic learning, most notably by means of voting, political association and free speech (Cole 1920:25-6; Pateman 1975:38; Azfar et al. 1999:7). The underlying theme of these propositions is that decentralized polities give citizens the chance to become politically involved in issues of direct concern.

This political involvement, some theorists argue, has positive effects on government policies. A prominent example of this line of thought is Besley and Case’s (1995) model of ‘yardstick competition’. Using US state-level data from 1960-88, the authors demonstrate that vote-seeking politicians do not excessively raise local tax levels above those of other jurisdictions. The reason for this is simple. Under decentralization rational citizens can compare local politicians with counterparts in other districts. This comparison sets regional yardsticks and allows citizens to vote out officeholders once they fall significantly below comparative benchmarks. As a result of this interjurisdictional competition, Besley and Case conclude, incumbents need to ‘look to other [local incumbents’] taxing behavior before changing taxes at home’ (1995:25). Thus, politicians find themselves in a situation where they carefully watch regional ‘yardsticks’ before determining policy directions.

While yardstick competition may appear similar to Tiebout’s model at first sight, it differs in one important respect. Poor performance is penalized by being ousted from office not by the loss of mobile assets: officeholders exit while assetholders stay. Besley and Case’s argument is supported by recent empirical studies in Europe (Bivand and Szymanski 1997; Bordignon et al. 2001) and Asia (Khemani 2001; Bhaskar et al. 21
2006). Khemani, for instance, shows that Indian voters over the last few decades have more vigilantly punished underperforming politicians in local elections compared to national elections where issues are hard to disentangle (2001:15-6). Hence, in light of this body of research, subnational elections arise as an important mechanism of decentralization: they induce competition among subnational incumbents and signal preferred policy outcomes.

Notwithstanding the rationale of these economic and political arguments, several scholars have also warned that decentralization is subject to notable caveats. Critics have pointed out that transitions from centralized to decentralized regimes can entail three kinds of problems – two economic and one political. First, rapid authority shifts to local levels often underestimate capacity constraints. They imprudently sacrifice economies of scale inherent to central governments - in particular in infrastructure, education or health services (Bennett 1990; Faguet 2000:11). Prud'homme concurs, arguing that local capacities are initially insufficient for strategic planning, public accounting and physical maintenance and, therefore, undermine the effective provision of public services (1995:209-10).

Second, decentralizing regulatory powers often impedes principles of free trade. Similar to problems of trade protectionism across countries (for example, perverse import and export tariffs), unconstrained regional autonomy can give rise to counterproductive trade barriers across subnational units. As Tanzi points out:

In many decentralized countries and especially in those that lack a strong tradition of respect for free markets – China, Russia, and to some extent, India – subnational jurisdictions often impose obstacles to [labor, capital and goods] movements. Such obstacles can lead to a de facto fragmentation of the national market (2001:6-7).
And third, decentralization often fails to establish broad political involvement. Recent empirical studies suggest that, instead of strengthening equal citizen participation, decentralization strengthens former elites and consolidates the local power imbalances (Hadiz and Robison 2005:231-2; Sidel 2005:75; Tornquist 2005:25-6). These imbalances are further aggravated, Prud’hommes asserts, if local elections are based on personal or ethnic loyalties, and judicial oversight is weak; under such circumstances decentralization is likely to result in elite capture (1995:211). As Dreze and Sen summarize it:

[whether decentralization provides outcomes in favor of all citizens] will undoubtedly depend on the nature and functioning of political institutions at the local level ... Where the poor are also powerless – as is frequently the case – the reliance on local institutions to allocate relief is problematic, and can end up being at best indiscriminate and at worst blatantly iniquitous (1989:107).

**Institutional Change: Gradualism and Shocks**

Much of the divide between decentralization advocates and critics becomes less pronounced once it is placed in a wider context of institutional change. From the literature that addresses how social/economic/political structures change over time, two perspectives in particular provide valuable insights for the decentralization puzzle: exogenous shocks and gradual evolution.

The exogenous-shock literature revolves around the idea that strong external impulses are a prerequisite for substantial structural changes. The historical experience of the 20th century, which displayed long periods of stasis as well as sudden ‘bursts of rapid institutional change’ (Krasner 1984:242), motivated scholars to explore the impact of different types of exogenous shocks: such as economic crises (Gourevitch 1986; Drazen and Grilli 1993), wars (Katzenstein 1985), or industrial revolutions
(Gershenkron 1966). As Krasner (1984) notes, the overarching argument in this literature is that new institutional structures emerge during periods of crisis:

They may be imposed through conquest or be implanted by a particular fragment of the existing social structure. But once institutions are in place they can assume a life of their own, extracting societal resources, socializing individuals, and even altering the basic nature of civil society itself (1984:240).

Economic crises in particular have attracted considerable academic interest. Gourevitch (1986), for instance, demonstrates that economic hardships in Western countries have provided a valuable momentum for change. Analyzing three distinct crisis periods - the long deflation in the 19th century, the 'Great Depression' in the 1930s, and the 'Oil Shocks' in the 1970s – Gourevitch identifies a common pattern: during extended periods of economic prosperity, countries exhibit strong (and sometimes rigid) political power constellations, whereas the outbreak of a crisis often serves to open up new policy spaces in which political coalitions are reshuffled and new policy directions are taken (1986:238-40). In light of this historical evidence, Gourevitch concludes that economic crises constitute crucial turning-points for institutional progress.

The second, and complementary, body of literature, which centers around the work of Douglas North (1990), emphasizes the evolutionary processes that take place irrespective of exogenous shocks. According to North's theory, institutional change is best understood as a gradual and continuous competition of formal (laws, regulations) and informal institutions24 (societal norms, traditions, customs). Although revolutionary changes or crises may instantly alter formal rules, they have little impact on societal

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24 North defines institutions as 'the rules of the game in a society ...that structure incentives in human exchange, whether political, social, or economic.' (1990:3). The interplay of formal and informal institutions sets the incentive structures (penalties and awards) and, thereby, determines human behavior (Eggertsson 1990; Lin and Nugent 1995; Clague 1997); for an excellent overview of the recent institutional debate see Furubotn and Richter (2005).
norms which change slowly in the course of history (1990:91). This tenacity of historically evolved norms leads to North’s well-known argument of path-dependency:

Institutions typically change incrementally rather than in discontinuous fashion … Although formal rules may change overnight as the result of political or judicial decisions, informal constraints embodied in customs, traditions, and codes of conduct are much more impervious to deliberate policies. These cultural constraints not only connect the past with the present and future, but provide us with a key to explaining the path of historical change (1990: 6).

Thus, in brief, history is paramount for understanding institutional progress; historical experiences shape the nature of informal societal norms and, thereby, explain much of the success (or failure) of formal institutional change.

Similar lines of thought can be found in the economic philosophy literature. Friedrich Hayek, for instance, advances the argument that social structures pass through an iterative selection process ‘in which those modes of conduct prevail [in a society] which lead to the formation of a more efficient order’ (1971:9). He further asserts that groups experiencing higher economic welfare tend to define the rules, norms and values for other less successful groups (1976:5; 1988:6). The notion of gradual selection is also a key aspect in Karl Popper’s work on ‘evolutionary knowledge’. People go through piecemeal, trial and error, adjustments, he argues, in which they – akin to the Darwinian principle of natural selection – adjust views and behaviors to external circumstances (Popper 1963:52; 1972:261). The overarching theme that runs through Hayek, Popper, and North’s arguments is the gradual evolution of societal norms which shape a country’s development outcomes.

The synthesis of these exogenous-shock and evolutionary-institutionalist theories provides valuable insights for the decentralization debate. Exogenous shocks can be helpful to set institutional change in motion. They serve to break down political
resistance in former (authoritarian) regimes and redefine the architecture of ‘formal institutions’, including laws on decentralization. Examples of shock-induced reforms are readily observable in the aftermath of the financial crises in Asia (MacIntyre 2001; Rodan et al. 2001; Jayasuriya 2004) and Latin America (Grindle and Thomas 1991:78; Tornell 1995). Yet while the literature on exogenous shocks helps in understanding how decentralization reforms come about, it makes little reference to why some post-crisis experiences – for example in Indonesia, the Philippines, Argentina, and Brazil (Table 2.1) – coincide with stagnant or declining government performance.

To understand the stasis of post-authoritarian government outcomes it is useful to apply the evolutionary-institutionalist view. As scholars like Hayek, Popper and North have emphasized, formal institutions are not implemented on a ‘blank slate’, but are conditioned by a country’s historical experience. Especially in post-authoritarian countries, non-democratic norms are likely to survive during early transition stages. This tenacity of prior, often counterproductive, norms helps to put the controversy over the benefits and dangers of decentralization in perspective. Much of the apparent contradiction can be reconciled by the factor of time. Optimistic scenarios of self-enforcing subnational competition (Tiebout 1956; Besley and Case 1995; Weingast 1995) and democratic deepening (Dahl 1971; Beetham 1996) can be classified as long-term objectives, not least because most developing countries do not satisfy assumptions of high information and mobility levels in the short run (Litvack et al. 1998: 2). Pessimistic scenarios of increased elite capture, political inequality and trade distortions (Prud’homme 1995; Tanzi 2001), on the other hand, are often based on observations made in early transition periods. If one accepts that theoretical optimism rests on assumptions that are yet to be met, whereas empirical pessimism rests on contemporary realities, the decentralization paradox becomes less pronounced.
But framing the decentralization debate from an evolutionary-institutionalist perspective also conveys a presumably unpopular message to the international development industry\textsuperscript{25}: due to inertia of prior norms, decentralization reforms in early post-authoritarian regimes often fail to improve government performance in aggregate terms. This cautious prediction may explain why large decentralization programs in the Philippines, China, Russia, Brazil, Argentina, Uganda and Kenya have left problems of corruption and bureaucratic ineffectiveness largely unchanged over the last ten years (see Table 2.1).\textsuperscript{26} It may also explain why Indonesia’s decentralization reforms, as will be seen, have sustained rather than improved bureaucratic red tape and misconduct.

\textsuperscript{25} A similar argument is put forward in Roland (2000:343).
\textsuperscript{26} For a review of the Philippines’ decentralization experience see Balisacan and Hill (2007); for Russia see Stoner-Weiss (1997; 2006); for Latin America see Remmer and Wibbels (2000) and Garman \textit{et al.} (2001); for Africa see Manor and Crook (1998), Agrawal and Ribot (1999), and Ribot (2002).
2.4 Decentralization in Indonesia

Indonesia is a country of enormous geographical spread and diversity. The archipelago consists of over 13,000 islands stretching over 1,800 kilometers from North to South (Kalimantan to Nusa Tenggara), and 5,000 kilometers from West to East (Sumatra to Papua). Indonesia's population is more than 210 million people and encompasses more than 300 linguistic and 20 major cultural groups (Turner and Podger 2003:1). When Indonesia was declared an independent unitary nation in 1945, the only thing that bound this diverse archipelago together was the fact that most of the 'islands were governed by one colonial power: the Dutch monarchy' (Niessen 1999:19). Indeed, the enormous variety of peoples, customs and languages has repeatedly prompted calls for regional self-governance. Although there were some attempts in the 20th century, it was not until the turn of the millennium that Indonesia implemented comprehensive decentralization reforms.

Brief Historical Overview

The foundations of the Indonesian decentralization were laid by the Dutch. For one thing, the colonial rule entailed a certain degree of decentralization, simply because not all parts of the 'Netherlands Indies' could be put under direct oversight of the Dutch crown. While Java was governed under a 'centralized' hierarchical bureaucracy of Dutch administrators (Binnenlands Bestuur) and Indonesian aristocrats (Inlands Bestuur), the 'outer islands', namely Sumatra, Kalimantan, Sulawesi, Nusa Tenggara, Maluku and Papua, were given self-governing rights (Zelfbesturende Landschappen) based on contractual agreements. For another, in the early 20th century the colonial

government issued a series of laws\textsuperscript{28} with the intention of further decentralizing the Netherlands Indies. Although these administrative reforms were never fully implemented before World War II broke out, they conceptually paved the ground for later decentralization initiatives. Above all, they outlined the rules for territorial structures (provinces and districts), the separation of local legislative and executive, and local elections (Niessen 1999:46-9,53).

After World War II, during the early years of Indonesia's independence, the challenges of building a coherent nation moved aspects of decentralization into the background.\textsuperscript{29} The overriding concern was to contain secessionist movements and attain national stability. Guided by the maxim of 'unity in diversity', the common feature during Sukarno's 'Guided Democracy' (1958-1965) and Suharto's 'New Order' (1965-1998) presidencies was a unitary and centralized government (Turner and Podger 2003:9). Although calls for regional autonomy surfaced at regular intervals, driven by subnational differences in culture, natural resources, and economic development, neither president ever fully responded. Sukarno initially conceded to decentralization demands in the late 1950s (Law No 1/1957 on 'Regional Government'). Yet, militant separatist movements in Sumatra and Sulawesi gave him a reason to declare martial law, defer decentralization, curtail pluralistic democracy, and reinforce a centralistic unitary government under his leadership (Legge 1961:53; Buente 2005:307).

\textsuperscript{28} The 1903 'Decentralization Act', the 1904 'Decentralization Crown Decision', the 1905 'Local Parliament Ordinance' and the 1922 'Government Reform Act Decentralization Act'; an excellent overview of these colonial laws is found in Niessen (1999:44-53).

\textsuperscript{29} During the struggle for independence Indonesian nationalists were apprehensive of decentralization, since the autonomy of provincial governments was associated with disintegration; not the least because the Dutch had undermined the national unification process by pressing for independent federal states (Maryanov 1959:30; Cribb and Brown 1995:24; Booth 2002:5). Between 1946 and 1949 the Dutch supported the establishment of six independent states: Eastern Indonesia, East Sumatra, South Sumatra, Madura, Pasundan, and East Java (Niessen 1999:66-9). It should be noted, though, that despite the founding father's anxiety of disintegration, the 1945 Constitution foresaw a certain degree of decentralization. In its original wording, Article 18 proclaims: 'The division of Indonesian territory into large and small regions, as well as the form and structure of their administrations, shall be laid down by law, with regard for and in observance of the principle of deliberation in the governmental system of the state, and the traditional rights of those regions, which have distinctive characteristics'.
When General Suharto took power in 1965, Indonesia’s political and economic instability provided the grounds to further centralize government power. Suharto installed the ‘New Order’ which rested on three basic pillars: a depoliticized and technocratic administration (Hill 2000:17,104), the uncontested dominance of a single state-party (MacIntyre 1999:264-5; Schwarz 1999:31-2), and a tight military-based surveillance extending from Jakarta down to village level (Webber 2006:400). In this controlled environment, ‘decentralization’ was pursued to improve coordination rather than to devolve power. In 1974, Suharto promulgated Law No. 5 on ‘Regional Government Principles’, which de jure suggested increased self-governance, but de facto kept the regions under tight national control. Central powers were maintained in three ways. First, the law served to contain regional separatist forces by weakening provincial governments. 31 Second, it fostered state control by employing deconcentration (instead of devolution) measures for all jurisdictions that were unprepared for autonomy. 32 And third, it was not accompanied by the necessary implementation regulations until 1992 (World Bank 2003:3) and, therefore, granted the central government a wide flexibility to interpret the legal wording in favor of their own objectives (Beier 1995:126; Turner and Podger 2003:10).

30 A decade of ever-increasing economic mismanagement [in Indonesia] had brought a degree of economic breakdown with few parallels in modern history. The country was literally bankrupt, unable to meet payments due to foreign debt [...] Export earnings had fallen to a level where they were barely sufficient to finance half of the country’s minimum requirements, excluding debt service’ (Arndt 1984:29 cited in Hill (2000:1)).

31 Contrary to his predecessor Sukarno, Suharto predominantly focused on the (second-tier) district level, while largely ignoring the autonomy issue at the (first-tier) provincial level. Given the separatist movements in some of Indonesia’s provinces during the late Sukarno presidency, the New Order administration rejected the idea of ‘extensive decentralization’ to all levels, as envisioned in the former Law 1/1957, and stipulated ‘responsible decentralization’ with a clear priority on district governments (UU 5/1974, Elucidation 1e and 4a; Matsui 2003:10).

32 The preamble of the 1974 Law signals a limited (‘responsible’) devolution of administration power to the regions that guarantees ‘progress and development’ and is accompanied by more centralistic administration structures (deconcentration). (See Law 5/1974, ‘Pembukaan e’). Section 3c of the elucidation underscores the prominent role of the central government and its line ministries. ‘Several public services’ cannot be autonomously managed by the regions; the planning, implementation and financing of such services remain entirely under the authority of the national government (See Law 5/1974, ‘Penjelasan 3c’).
In 1996, against the background of rising pressures from the donor community, the Suharto administration agreed to implement Law 5/1974 in a more comprehensive manner (World Bank 2003:3). A pilot program was launched, which was to devolve extensive administrative authorities to 26 districts – one district in each province. Yet again, this pilot initiative was ‘fraught with difficulties, not least because the center did not hand over the personnel and facilities the regions needed to perform their new tasks properly’ (World Bank 2003:3). At the turn of the 21st century, the situation in Indonesia was tense. While the central government increasingly held on to its powers, the frustration in the regions grew stronger (Malley 1999: 72-3; Matsui 2003:12). The combination of political suppression, high resource extraction and repeated national corruption created a hostile environment, which increasingly erupted in regional uprisings.33 Yet, despite separatist movements in Aceh, Papua and East Timor, the remarkable economic growth during the mid 1990s allowed Suharto to sustain political and military support.

Indonesia’s ‘Big Bang’ Decentralization in 1999

The introduction of far-reaching reforms became possible at the onset of the Asian crisis. Consistent with the arguments presented in the exogenous-shock literature, the breakdown of the Indonesian economy initiated the fall of the authoritarian regime and paved the way for extensive policy changes. In the words of MacIntyre (1998:367): ‘As local and foreign investors pulled their capital out and the economy went into a tailspin, it was only a matter of time before the resulting economic dislocation and pain produced a political backlash strong enough to force Suharto’s fall’. The economic shock strongly undermined the very basis of Suharto’s regime: a sophisticated far-

33 An excellent description of these combined regional grievances in the last years of the Suharto regime is presented in Booth (2002).
reaching patronage system sustained by a well-balanced mix of coercion and rewards (McLeod 2003:4-9; Webber 2006:410). Due to the capital flight during the crisis, absorbable rents became insufficient to sustain Suharto’s vast patron-client network of military officers, party members, government officials and business elites (Root 1996; MacIntyre 2001:26-7); after more than thirty years the authoritarian regime collapsed. In May 1998 Suharto resigned and opened up the necessary policy space, a ‘window of opportunity’, for radical reforms.

This policy space gave rise to the Indonesian ‘big bang’ decentralization (Fitrani et al. 2005:60), a reform initiative which surprised observers not only in terms of scope, but also in terms of its speedy and ‘secretive’ drafting process. In early 1999, a small reformist circle around Ryaas Rasyid, who was to become Indonesia’s first Minister of ‘Regional Autonomy’, and Rapiuddin, a senior official in the Ministry of Home Affairs, grasped the opportunity and revised the country’s administrative architecture (Law No 22 on ‘Regional Governance’). Simultaneously, a couple of streets away, a second working group in the Ministry of Finance prepared the fiscal guidelines for the decentralized government structure (Law No 25 on ‘Fiscal Balance’). Both of these working groups reported directly to President Habibie and their respective ministers, but refrained from circulating information to other line ministries or the press. As a result, when the decentralization laws were passed in the lower house in May 1999, many high-ranking officials were taken aback by the speed and the scope of the reform initiative.34

34 The author’s personal interviews with four key policy actors have enriched this description of Indonesia’s transition in 1999: (1) Ryaas Rasyid, Minister of Regional Autonomy (1999-2001); (2) Berhard May, Senior Advisor to the Ministry of Home Affairs (1995-2005), Sjarifuddin Baharsjah, Minister of Agriculture (1993-1998), (4) and Bungaran Saragih, Minister of Agriculture (2000-2004) on. For a well-presented chronological description of this early reform stage see also Turner and Podger (2003:12-7).
The new legislation, shifting Indonesia's governance system from one of the most centralized to one of the most decentralized in the world, has posed a considerable implementation challenge. The implementation of both decentralization laws was scheduled for January 2001, granting the country a brief preparation period of 18 months to restructure its administrative and fiscal arrangements. Pursuant to Law 22, district governments received the authority to manage all their tasks autonomously, except those touching on national affairs - such as justice, defense, foreign affairs, fiscal management, and religion. Hence, district administrations have become fully responsible for local services (infrastructure, health, education, agriculture, and business promotion), local administration (business and civil registration) and local taxation. 35

Against the background of rising responsibilities, local governments were in need of two things in particular: funding and staffing. The former was addressed by Law 25, which introduced a new intergovernmental funding mechanism replacing Suharto's earmarked grants (Impres) with general block grants (Dana Perimbangan). 36 In addition, districts received the authority to collect local tax/non-tax revenues (PAD) to complement national transfers. Yet, while national transfers to regional governments have more than doubled since 2001, the districts' own revenues have remained insignificant (World Bank 2003:1). Local revenues have contributed 5 to 8 percent, whereas over 90 percent of district budgets has been so far covered by central transfers (Fane 2003:161; Lewis 2006:214). The latter aspect, the transfer of national officials and assets, was equally challenging. Between 1999 and 2001, roughly 2,000,000 civil servants, 200 provincial agencies, 4,000 district offices, and 16,000 service providers, were handed over to the regions (World Bank 2003:1). In most cases this did not involve a physical relocation. Rather, it meant that the center gave up its control over

35 The specifications of district responsibilities are elaborated in Article 7 and 11 in Law 22/1999.
36 For a well-structured discussion on Indonesia's fiscal decentralization arrangements see Lewis (2001) and Fane (2003).
regional affairs by turning the ‘deconcentrated’ agencies of the Suharto period into truly ‘decentralized’ entities (Fane 2003:160).

Taking Stock

In summary, reengineering Indonesia’s governance in less than two years was an extraordinary achievement. Yet, the rapid devolution of authority, assets and staff to hundreds of local districts, spread across a vast, dispersed archipelago, also entailed considerable costs. Several problems have arisen since the implementation of reforms in 2001. First, administrative miscoordination delayed necessary follow-up regulations, leading to ambiguous and conflicting assignment of national, provincial and district tasks. Second, the mismatch of high expenditures and low self-generated revenues has left district governments dependent on national funding. Third, national transfers have overproportionally benefited districts with higher natural resource revenues, thus aggravating rather than alleviating regional inequalities. And fourth, against the background of revenue shortages and weak national guidelines, some districts have burdened local businesses with distortionary tax regulations, high compliance costs and administrative corruption.

In light of these initial problems, some observers conclude that Indonesia’s regional autonomy has simply happened too fast. Instead of the rapid reforms taken in 1999, which were akin to ‘building a ship while sailing’ (Buente 2005:318), some

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37 This paragraph builds on personal interviews with Ryaas Rasyid and Berhard May (see footnote 34), two prominent actors who were directly involved in the 1999 decentralization reforms.
scholars advocate a more gradual approach, such as a step-wise transfer of district authority (from simple to complex tasks) or reducing the scope of autonomy (provinces rather than districts). Although these suggestions are well taken, they neglect to some extent the political realities of the time.

The interviews with policy actors involved in the 1999 decentralization reforms highlight two political constraints which rendered a gradual sequencing difficult. For one thing, the architects of the decentralization laws were eager to use the temporary policy space that opened up after Suharto’s resignation. Anticipating that political deadlocks in the lower house would complicate the envisioned changes, the team around Rasyid and Rapiuddin was under pressure to finalize reforms before elections were held in June 1999. For another, decentralizing powers to provincial governments was an unviable option, as it contained the risk of strengthening secessionist movements in the outer regions. Thus, although initiated by an economic crisis, Indonesia's reform process was driven primarily by political rather than economic concerns. The swift devolution of administrative powers to district level was a feasible compromise, appeasing outer regions without jeopardizing national unity.

Since the reforms were motivated almost entirely by political (not economic) concerns, they naturally entailed challenges for the Indonesian economy. One of these economic challenges is the diverging performance of district governments, a feature that is clearly reflected in the wide variation in local business climates.

2.5 Indonesia's Local Business Climate

The main purpose of this section is to outline a phenomenon of Indonesia's rapid and far-reaching decentralization reforms that is at the center of this study: the pronounced differences of local business climates that emerge across the 440 newly-empowered district governments. But before elaborating on this, this section provides a brief look at Indonesia's business environment in general.

Empirical evidence to date suggests that Indonesia's decentralization has not led to any improvements in the country's overall business climate. The World Bank, for instance, reports that 'business undoubtedly felt the pinch of decentralization', as many districts have used their new authority arbitrarily to enact a 'plethora of taxes, levies and fees' and thereby undermined conditions for business activity (2003:21,30). Critical observers note that problems of corruption and bureaucratic red tape have not ceased, but have merely spread across 440 districts and continue to obstruct foreign and domestic investment.40

Table 2.3: 'Ease of Doing Business' in Indonesia and Southeast Asia in 2006

<table>
<thead>
<tr>
<th>Country</th>
<th>Rank</th>
<th>Business Registration (Days)</th>
<th>Licensing Time (Days)</th>
<th>Licensing Cost (% PCI)</th>
<th>Tax Administration (Hours)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>135</td>
<td>97</td>
<td>224</td>
<td>311</td>
<td>576</td>
</tr>
<tr>
<td>Singapore</td>
<td>1</td>
<td>6</td>
<td>129</td>
<td>22</td>
<td>30</td>
</tr>
<tr>
<td>Thailand</td>
<td>18</td>
<td>33</td>
<td>127</td>
<td>11</td>
<td>104</td>
</tr>
<tr>
<td>Malaysia</td>
<td>25</td>
<td>30</td>
<td>281</td>
<td>78</td>
<td>190</td>
</tr>
<tr>
<td>Vietnam</td>
<td>104</td>
<td>50</td>
<td>133</td>
<td>56</td>
<td>1050</td>
</tr>
<tr>
<td>Philippines</td>
<td>126</td>
<td>48</td>
<td>197</td>
<td>113</td>
<td>94</td>
</tr>
</tbody>
</table>

Source: World Bank (2006a);  
Note: Licensing time and costs refer to building a standard warehouse; Tax administration extends to all necessary business taxes in each country; 'PCI' stands for a country's average per-capita income.

40 See Castle (2004:72-5) and Davidsen et al. (2006).
The impression that decentralization has initially worsened rather than improved Indonesia’s business environment is confirmed by national indicators. Corruption levels in 2005 remain higher than during the late Suharto regime in 1996 (see Table 2.1) and higher than in most parts of the world. Similarly critical findings emerge from the 2006 ‘Doing Business’ assessment of the World Bank. Compared to other ASEAN states, Indonesia displays one of the least conducive business environments in the region (see Table 2.3): on average, registering a new business took 97 days; filing tax declarations amounted to 576 hours; and obtaining licenses for a common warehouse required 224 days (and involved costs equal to 311 percent of national per-capita income). In light of these high compliance costs Indonesia currently ranks 135th among 175 countries.

Yet apart from this overall negative picture, the more interesting finding is that districts have responded very differently to the nation-wide (and uniform) introduction of decentralization. According to the annual surveys of the Regional Autonomy Watch (henceforth KPPOD) – which evaluate the performance of more than 200 districts – local governments vary distinctly in the way they enact taxes, administer licenses and provide business services. The main purpose of this section is to outline this variation. Based on the KPPOD data and other relevant sources, the following discussion will focus on three salient business climate factors: (1) local taxes, (2) business licensing, (3) and administrative corruption.

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42 The Regional Autonomy Watch is a private think-tank created in 2001 as a conjoint effort of the National Chamber of Commerce (KADIN), academic institutions (University of Indonesia, LPEM, CSIS, and Prasetiya Mulya Business School), and national media (Jakarta Post, Bisnis Indonesia and Suara Pembaruan). Since 2001, KPPOD has increasingly stimulated policy debates on local business climates by its publication of nationwide district rankings (see KPPOD 2003; 2004a; 2005).

43 This selection of policy factors is consistent with the main themes running through existing business climate studies; see for example REDI (2003), Ray (2003), KPPOD (2003. 2004a, 2005), LPEM-FEUI (2002) and Kuncoro et al. (2005).
Local Taxes

One trade-off of the rapid decentralization process is that it has provided district governments with a limited and imprecisely-defined tax base. While principal taxes (income, value-added and property) have remained with the center, districts have been given control over small existing levies (restaurant, hotel, small-scale mining, advertisement, parking, and road lighting) and the discretion to create new local taxes. Unfortunately, the attempts to raise local revenues by enacting new local levies - without clearly defined national guidelines - have motivated some districts to enact distortionary tax regulations.

Empirical studies illustrating these regulatory problems are readily available. Reviewing almost 900 regulations in 190 districts, KPPOD find twice as many local governments obstructing their economies as those installing business friendly tax environments (2004a: 71). The National Chamber of Commerce (KADIN) reaches a similar conclusion estimating that over 70 percent of local regulations were hampering economic development; either because they overlapped with existing national taxes, or because they constrained intra-regional trade flows (Tagukawi 2003:4). Due to these inherent economic or legal problems, the Ministry of Finance cancelled nearly a third of

44 Local tax assignments are clarified in article 22 in Law 25/1999 (on ‘Regional Government’) and elaborated in Law 34/2000 (on ‘Regional Taxation’).
45 Law 34/2000 (Article 2.4) merely states that new taxes are not to ‘obstruct economic development’ or the ‘common good’, without providing clear descriptions of what constitute such obstructions. While efforts to revise Law 34 and return to a clear positive list of acceptable local taxes have been delayed by parliamentary debates, the vague legal framework prevails (interview with Agung Prambudi, Director of KPPOD, 13 February 2006). Moreover, as Ray (2003: 23) points out, the burden of proof lies with the central government. National ministries have to identify district shortcomings ex post (‘innocent until proven guilty’), as opposed to the common practice of local governments defending regulations ex ante (‘guilty until proven innocent’). As a result, the Ministry of Finance is unable to keep up with an ever-increasing number of local tax regulations (World Bank 2003:29; Lewis 2003b).
46 A tax is defined as ‘distortionary’ if it imposes avoidable welfare costs on a local economy. Economic theory suggests that taxes on trade flows (Ricardo 1817; Ohlin 1933; Samuelson 1962; Caves et al. 1993) and mobile price-elastic goods (Ramsey 1927) result in especially high welfare losses.
all reviewed district tax regulations in 2001 (Lewis 2003b:187) and a total of 450 district tax bills between 2001 and 2005 (Simanjuntak 2005:2).

Figure 2.3: Variation in District Tax Regulations across Districts

![Graph showing variation in district tax regulations](image)

Source: Own estimates based on KPPOD (2005).
Note: Indicators of local tax regulations are based on economic impacts and legal clarity; they range from 1 (very distortionary) to 5 (very conducive); districts are displayed in order of ascending tax evaluations.

Yet the degree to which imprudent tax policies have become a burden for local business communities is far from uniform across local governments. As illustrated in Figure 2.3, KPPOD’s regulatory analysis indicates a considerable variance in the degree to which new taxes have affected local economies. Of the 190 districts evaluated, roughly one half has been afflicted with economic and legal distortions (scores below 3); one quarter has installed moderate conditions (scores of 3); and one quarter has created conducive tax environments (scores above 3). Thus, the main message arising from this cross-district survey is that regulatory conditions remain critical, but nonetheless vary significantly across districts.
License Administration

A similar picture arises in the context of license administration. Experience to date indicates that decentralization has not eased the administrative burden for local business. On the contrary, the rapid devolution of loosely-defined administrative functions has evoked at least as many setbacks as improvements. In this early stage of transition, local bureaucracies (Dinas) have attained monopoly-like positions; they are no longer under strict central supervision but are not yet under full-fledged democratic control (Azis 2003:3). Against this backdrop, compliance costs – the time and money firms spend to obtain their business permits – have increased across the regions.

As outlined in Table 2.3, the World Bank 2006 ‘Doing Business’ assessment ranks Indonesia’s administrative procedures as one of the most time- and cost-intensive in the world. Registering a limited liability company in Indonesia takes more than three months – twice as long as in most other ASEAN countries. In order to obtaining necessary permits, firms continue to face a myriad of desks and paperwork involving multiple technical agencies. As Ray aptly summarizes it:

Licenses and fees are especially burdensome and distorting for small business activities. Formalization requires many licenses, but very few are necessary on public interest grounds. The licensing process is overly complicated requiring many unnecessary documents and approvals. Fee setting is non-transparent, lacks rationality and typically very burdensome. Often, licenses from one agency duplicate that of another, but are imposed upon the same business (Ray 2003:9).

However, it is important to note that these license procedures vary markedly across local bureaucracies. A good example of this variation is provided by Rustiani (2003:80) who compares cross-district compliance costs for obtaining common industry

47 The most common business permits include trade licenses (SIUP), general business licenses (TDP), industry licenses (TDI), building certificates (IMB), compensation for community disturbance (HO), licenses for change of land usage (IPPL), certificates of principal agreement (Ijin Prinsip), certificates for warehouses (Ijin Gudang), and certificates for business locations (Ijin Lokasi).
permits (*Tanda Daftar Industri*). The differences emerging from her study are significant, with license costs ranging from Rps 5,000 (Yogyakarta) to Rps 477,000 (Bandung) and license processing times ranging from 2 days (Yogyakarta) to 20 days (Medan). The 2005 business survey of *KPPOD* affirms these variant outcomes. The data of 8700 private sector respondents in 224 districts indicates that the quality of local license administration is far from homogeneous. The composite license indicator in Figure 2.4 comprising aspects of information availability, bureaucratic ease, time and cost certainty, and service quality – indicates a distinct spread of high and low ranking districts.
Administrative Corruption

Administrative corruption is not a new phenomenon in Indonesia. Many local business people report that unofficial fees – often referred to as ‘cigarette’, ‘speed’ or ‘grease’ money – were a common feature during Suharto’s authoritarian regime. But even since decentralization, illegal exactions continue to be the highest-ranking constraint for local businesses (Ray 2003: 13; REDI 2003:3). Two country-wide surveys by LPEM and KPPOD conclude that up to 80 percent of local businesses pay informal fees when dealing with district bureaucracies. On average bribe payments raise license costs by 60 percent and overall business expenses by 10 percent (LPEM-FEUI 2002:5-7; KPPOD 2004a:70). Other studies infer that due to these high corruption costs and uncertainties, every third firm refrains from investing (Sumarto et al. 2004: 9).

Figure 2.5: Variation in Bribe Payments across Districts

Source: Own estimates based on KPPOD (2005).
Note: The ‘license corruption index’ is calculated as the mean value of reported bribe payments (in Rps) for five common business licenses (see footnote 47): SIUP, Lokasi, Gudang, IMB, and HO.
But below the aggregate level, we find large variation in local administrative corruption. Figure 2.5 displays reported bribe payments during licensing procedures in 224 districts, calculated on the basis of the 2005 KPPOD Business Survey. The results indicate that roughly one third of the districts are imposing no unofficial fees; one third demand payments up to 50,000 Rps; and one third inflict illegal charges ranging from 50,000 to 450,000 Rps.

Figure 2.6: Relationship between Bribe Payments and Administration Times

Source: Own estimates based on the KPPOD (2005) Business Perception Survey. Note: The graph depicts roughly 80 districts with information on both dimensions; green shading indicates good, red shading poor conditions; shading-borders refer to average processing times (13 days) and average bribe payments (Rps 51,000); outlier districts were omitted due to limited plotting space.

In light of these varied outcomes it is worth asking whether higher bribe costs coincide with lower administration times. While some economists claim that corruption helps to speed up the wheels of bureaucracy (Leff 1964; Lui 1985), others have argued the opposite (Shleifer and Vishny 1998; Kaufmann and Wei 1999). In the context of Indonesian districts, however, plotting bribe-payment against license-time data yields

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48 For a detailed discussion of the 'grease hypothesis' see Kaufmann and Wei (1999) and Kuncoro (2003).
no clear evidence for either hypothesis (Figure 2.6). But it does provide evidence for the pronounced variation in district performance. While some local governments are both faster and less corrupt than the sample average (green shaded area), others impose a mix of overproportional time and bribe requirements on local firms (red shaded area).

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49 Simple bivariate regression estimates – based on the KPPOD (2005) business survey data – suggest that, if anything, bribe payments increase processing times for general business permits (TDP). The coefficients for the regressor ‘bribe payments for TDP permits’ are slightly positive (4.35 e-06) and significant (t-value of 2.45).

50 The average administration time across 224 districts is 13 days; average bribe payments in rural districts account to 50.700 Rps (exclusive of outliers above 500.000 Rps).
2.6 Conclusion

This chapter has laid the contextual background for this study. Positioning the Indonesian experience in the context of the wider decentralization debate has conveyed two main messages. First, Indonesia’s rapid decentralization reforms have brought as many drawbacks as they have brought improvements. Similar to other nations with similar reform agendas (see Table 2.1), the first seven years of decentralization have resulted in, if anything, declining government services and rising corruption. Second, and most importantly, beyond declining national trends there is tremendous variation in local government performance. Notwithstanding that business climates remain critical on aggregate levels, recent empirical data indicate a marked difference in tax distortions, red tape, and bureaucratic misconduct across subnational units.

The first message, that Indonesia's rapid decentralization displays sustained bureaucratic inefficiency and corruption, resonates well with the literature debate reviewed in the beginning of this chapter. As suggested in exogenous-shock theories, the Asian crisis provided enough economic turmoil to unseat Suharto’s authoritarian regime and initiate pronounced formal institutional changes, including the introduction of far-reaching decentralization reforms. However, although this economic shock completely revised the formal institutions setting, it hardly touched the informal norms and power structures across rural Indonesia.

As North argues, these informal constraints are important determinants for today’s outcomes and future development paths. Indonesia’s authoritarian history — stretching from Dutch colonialism to Suharto’s New Order regime — has arguably entrenched tenacious elite-centered norms in rural societies. Following the North’s institutionalist logic, these informal ‘authoritarian’ remnants set the ground for the new
decentralization laws. The somewhat disappointing outcomes of Indonesia's early transition to decentralization should thus be seen in the context of the country's historical and institutional inheritance. As North summarizes it:

[Economies adopting] formal rules of another economy will have very different performance characteristics than the first economy because of different informal norms and enforcement. The implication is that transferring the formal political and economic rules of successful Western economies to third-world...economies [does not guarantee] good economic performance (1994:366).

But while the evolutionary-institutionalist view is helpful in predicting the stasis (or decline) in aggregate governance indicators, it does not help to explain the pronounced variation across Indonesia's newly decentralized polities. Notwithstanding that decentralization will take time to meet its theoretical expectations, today's policymakers in Indonesia are confronted with a pressing policy challenge: stagnant investment and sustained business climate problems highlight the urgency to understand what constitutes the difference between 'poor' and 'better' conditions. This concern relates well to the second message of this chapter. Recent business climate indicators clearly demonstrate that some local bureaucracies have done better than others: under the same institutional conditions (identical decentralization reforms, and common historical/cultural background) some districts have used their new administrative powers in a prudent manner, whereas others have not. It is this phenomenon of variant local government performance that motivates and frames the present study: the following chapter will now discuss possible explanations for this variation and outline the research design of this thesis.
Chapter 3
Local Government Performance: Hypotheses and Research Design

3.1 Introduction

‘If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary’

(James Madison, Federalist No. 51, 1788)

The concern for ‘good government’, which Madison expressed in the Federalist Papers more than two centuries ago, continues to be at the forefront of today’s policy debates. Today, after several waves of decentralization swept across the developing world without improving national outcomes, policy advisors are increasingly concerned with deciphering the dynamics of local government. Not only the Indonesian but also other country experiences demonstrate that post-decentralization periods are accompanied by vast differences in local government performance.

This phenomenon motivates the research question of this study. By taking Indonesia as a showcase, and local business climates as an operational measure, this thesis sets out to answer the following problem: What sorts of forces, in Indonesia's newly decentralized political framework, motivate local governments to reform prevailing business climates and reduce tax distortions, administrative inefficiencies, and corruption?

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51 See Section 2.1.
As these questions indicate, the central concern of this research is to test different kinds of ‘forces’ in regard to their explanatory strength of local government variation. The assumption that countervailing pressures are necessary to achieve good government conduct warrants justification. Intellectually, this skeptical assumption—which underpins this study and much of the recent government debate—finds support in three different currents of thought: literatures on public-choice\textsuperscript{53}, state-failure\textsuperscript{54}, and corruption\textsuperscript{55}. Although each of these literatures takes a slightly different angle, they convey a common message that resonates well with the statement of James Madison at the beginning of this chapter: the incentives for bureaucracies to perform well (in a welfare-maximizing sense) depend on the employment of ‘external’ and ‘internal controls’.

Based on this bureaucracy assumption, this study sets out to analyze the importance of external and internal controls in explaining local government variation. It does this by gauging to what extent ‘societal pressure’ and ‘government leadership’ explain differences in Indonesia’s local business climates. The decision to frame the discussion around these two explanatory factors is motivated by a controversial issue emerging in the development debate: while good-governance literature strongly advocates demand-side pressures such as societal participation and control, recent experience from transition countries stresses supply-side pressures and highlights that

\textsuperscript{53} The public-choice literature asserts that bureaucrats pursue private rather than public interest; for instructive discussions on the behavior of bureaucracies see, for instance Tullock (1965), Downs (1967), Niskanen (1971) and Breton and Wintrobe (1975).

\textsuperscript{54} The notion of ‘state-failure’ has been advanced by scholars like Krueger (1974; 1990) and Srinivasan (1985), who demonstrated how state regulations (trade quotas, permits and taxes) were misused for rent-seeking purposes. Empirical support for state-failure is readily available in country studies on Africa (Bates 1981; 1983; Frimpong-Ansah 1991; Easterly and Levine 1997), East Europe and Russia (Shleifer and Vishny 1998; Treisman 1999; Hellman \textit{et al.} 2000) and Asia (Myrdal 1968; Wade 1982; Campos 2001; Wedeman 2003).

\textsuperscript{55} The corruption literature centering around Klitgaard argues that bureaucracies with unconstrained powers are especially prone to corruption. In the absence of societal accountability, Klitgaard notes, ‘the combination of monopoly power and discretion – so often involved in the public sector – invites various forms of rent-seeking or directly unproductive profit-seeking activities’ (Klitgaard 1998:47).
government leadership is the key factor for better public outcomes. Based on these two contending explanations, the remaining discussion in this chapter proceeds as follows: The second section introduces society-centered explanations by outlining the 'good governance' agenda and exploring interest-group and electoral pressures. The third section outlines the concept of government leadership by discussing mechanisms of public entrepreneurship and bureaucratic supervision. The fourth section places both of these explanatory factors within the overall research design of this study.
3.2 Societal Pressure

*Good-Governance Policy Agenda*

In the last two decades the government debates emerging from international development agencies have notably moved from state-level pessimism to local-level enthusiasm. While former reform guidelines revolved primarily around eradicating inefficient nation-state domains, recent agendas focus on improving and strengthening local governments. In the course of this paradigm shift, the international donor community has put more weight on 'societal pressures' for good-government.

Especially since the 1990s, after mixed experiences with structural adjustment policies, the rhetoric changed. In light of strong criticism from NGO activists and World Bank vice-president, Joseph Stiglitz, the policy community drew up a new agenda that placed more emphasis on citizen-led than on market-led development. Former guidelines for 'winding back government' and 'getting the prices right' gradually gave way to the advocacy of 'good governance' and 'societal pressure'. This paradigm shift is well documented in the 1997 World Development Report:

[Strategies for good government include] designing effective rules and restraints, to check arbitrary state actions and combat entrenched corruption. [This] means making the state more responsive to people's needs, bringing government closer to

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56 In the 1980s, policy agendas were dominated by the idea that governments should be replaced by markets wherever possible. Responding to protectionist trade regimes, rent-seeking, and state inefficiencies (Srinivasan 1985; Krueger 1990), developing countries were ‘encouraged’ to reshape state bureaucracies by introducing a set of market-led reforms. This reform package, which is commonly referred to as ‘structural adjustment’ or ‘Washington consensus’, revolved primarily around privatizing, liberalizing, and deregulating redundant state domains. For a reflection on the success and failure of structural adjustment policies see Stiglitz (2000; 2002) and Williamson (1993; 2000).

57 Stiglitz, renowned for his criticism of neoliberal market fundamentalism, received the 2001 Nobel Prize in Economics for his theories on market failure due to information asymmetries; For a detailed discussion of his skepticism on narrow market-led policies see Stiglitz (1989; 1998; 1999; 2000; 2002).

58 'But reducing or diluting the state's role cannot be the end of the reform story. Even with more selectivity and greater reliance on the citizenry and on private firms, meeting a broad range of collective needs more effectively will still mean making the state's central institutions work better. For human welfare to be advanced, the state's capability - defined as the ability to undertake and promote collective actions efficiently - must be increased' (World Bank 1997:3).
the people through broader participation and decentralization. (World Bank 1997:3)
Governments are more effective [and less corrupt] when they listen to businesses and citizens ... Evidence is mounting that government programs work better when they seek the participation ... of local people. This is in contrast with top-down approaches, which often fail (World Bank 1997:10).
The salient feature in this agenda is the strong emphasis on societal pressure. Instead of internal top-down leadership, people's participation and oversight are advocated as important counter-measures against entrenched bureaucratic inefficiency and corruption.

This new policy agenda, with pronounced weight on society-led government improvements, has been enthusiastically embraced by international donors and NGOs alike (Batterbury and Fernando 2006:1854). The sustained enthusiasm rests on the fact that the new agenda successfully unites different currents in the development community. The emphasis on societal pressure appeals to neoliberal policymakers, who remain skeptical of internal government structures and, at the same time, to grassroots activists, who have long been concerned with citizen empowerment.59

Daniel Kaufmann, a leading figure in the World Bank-led governance debate, further elaborates the new paradigm by spelling out the channels by which societal pressure is expected to improve government performance:

Where capture is prevalent, we need to rethink the strategies to address misgovernance. Instead of focusing on changes in the internal bureaucratic structures ... [we] need to focus on broader external accountability measures prominently featuring voice and transparency mechanisms – including disclosure of parliamentary votes ...more focus is required in working with the competitive segments of the private sector [e.g. through] business associations... the challenge is to encourage ... voice and feedback mechanisms to stakeholders outside the executive... In this context, focusing more on parliamentary, NGO, and citizen oversight is crucial (Kaufmann 2003:21).

To add weight to the argument that societal pressure is essential, Daniel Kaufmann, Gil Mehrez and Tugrul Gurgur (2002) present evidence from Bolivia. Based on quantitative analyses of more than 100 public offices, they find that ‘external’ citizen voice, the capacity of electorates to express views and press for demands, is highly significant, whereas ‘internal’ public management (i.e. wages and leadership) is insignificant for explaining government performance. Other donor-financed governance studies come to similar conclusions, highlighting citizens’ ability to induce public improvements by means of concerted action or electoral participation.

In brief, the overarching assertion in this applied governance literature is that societal pressure can improve government performance by means of two demand-side channels: (1) interest group pressure (2) and electoral pressure. Although the former aspect has attracted more direct donor involvement than the latter, both are recurring themes in the good-governance agenda. The following sections proceed by exploring the theoretical debates that underlie both of these channels.

Interest Group Pressure

The notion of interest group pressure connects to a large body of literature revolving around the question of how, and to what end, societal groups partake in public policy making. A useful starting point for discussion of societal involvement is Albert Hirschman’s (1970) well-known study on ‘Exit, Voice and Loyalty’.

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61 The notion that electoral pressures and democracy are important drivers of better government performance features prominently in Crook (1997), Crook and Manor (1998) and Keefer (2004:24).

62 Typically, interest group pressure includes means of public hearings, auditions, ombudsmen, community groups, user networks, and business associations; these ‘participatory’ mechanisms have received strong donor support over the last few years; ‘politically sensitive’ issues like electoral reforms, on the other hand, are often left to political foundations; for a detailed discussion on participatory development see Paul (1992:1054), Crook and Manor (1998:16-18) and Gray-Molina et al. (1999:10).

63 Interest groups are understood in this study as organized bodies of individuals who act together to influence public policy, guided by common interests; a similar definition is found in Pross (1992:3).
Responding to the economic orthodoxy in the 1960s, Hirschman introduces the idea that discontented citizens can not only ‘exit’ from poorly performing governments, as suggested in Tiebout’s model, but also ‘voice’ for public improvements. Citizens can ‘change, rather than escape from, an objectionable state of affairs’, Hirschman notes, through ‘collective petition, … through appeal to a higher authority, … or through various types of actions and protests… that are meant to mobilize public opinion’ (1970:30). Especially in the developing world, he asserts, these collective voice mechanisms are more viable than permanent out-migration, because people are less informed and mobile than those in advanced economies (1970:34). Thus, although originally directed at economic theorists, his message had notable impacts on the development community (Paul 1992), in particular the proposition that collective voice is an effective mechanism to improve government performance in developing countries.

Two decades later, Robert Putnam (1993) refined this proposition and advanced the argument that public outcomes and economic development are better in areas with higher ‘civic engagement’. In his comparative analysis of local government performance in Italy, Putnam observes a distinct decline in public service quality from Northern to Southern provinces. By combining historical and empirical analyses, he convincingly explains this interregional variation by differences in civic engagement. In the North, where local governments perform well, communities are highly engaged in associations that cut across social boundaries: such as neighborhood societies, choral groups, sport clubs, and farm cooperatives (1993:91-2). These cross-cutting engagements – bringing together people of all ages, professions and positions – are

64 Tiebout’s propositions were outlined in Section 2.3. Hirschman does not explicitly mention Tiebout in his work. In fact, he frames the ‘exit’ option in a more general economic sense that goes beyond subnational government competition, including the ability of economic actors to stop buying a firm’s product or leaving the organization they work in (1970:4). In this discussion Hirschman’s exit argument is, however, reduced to the context of governments – hence making it comparable to Tiebout’s argument.

65 Networks of civic engagements are an essential building block for Putnam’s widely-disputed concept of social capital. Social capital also includes informal norms of reciprocity and trust (Putnam 1993: 171); for initial propositions see also Granovetter (1973; 1985) and Loury (1987).
pivotal in strengthening communal solidarity. Putnam concludes that these dense ‘horizontal civic bonds’ within communities (strong in the North, sorely absent in the South) pave the way for collective action and, therefore, better government performance (1993:181).

Unlike these optimistic scenarios in Hirschman (1970) and Putnam (1993), Mancur Olson (1965) advances a more skeptical perspective on collective action. Olson predicts a situation in which small particularistic interest groups dominate policy arenas, while large groups with more encompassing membership fail to effectively organize their interests. The dysfunctionality of the latter is based on the mismatch of individual and collective interests: in large, highly dispersed groups with a low level of oversight, Olson argues, any one member can expect to profit from group benefits, even if he/she opts to defect from his/her group responsibilities. Led by individual interests, members will decide to free-ride on other’s efforts and, therefore, render collective action unfeasible (1965:43-4). According to Olson’s logic, the only way to mobilize these ‘latent’ large groups is by introducing ‘selective incentives’ for individual members: namely, rewards for those who comply, and punishments for those who defect (1965:51).

Small groups, on the other hand, have fewer problems with collective action. Since members’ action can be easily observed and coordinated, these ‘privileged groups’ are more successful in collectively pursuing their interests. Based on this group logic, Olson predicts a fragmentation into special-interest coalitions, in which the beneficiaries have little incentive to oppose government inefficiencies, and every incentive to seek special deals and public subsidies (Olson 1982:41,47). Thus, in a nutshell, Olson remains highly skeptical of broad-based societal pressure to improve
government performance. Since selective incentives to mobilize large societal groups are often unavailable or costly, it is unlikely that large groups of citizens would unite in concerted reform efforts.

Putnam disagrees with this pessimistic perspective. In his view, civic networks create self-perpetuating forces that solve Olson’s collective action problems. Given the strong interconnectedness of associative life, even members of large groups decide not to defect because they risk social sanctions by the community (Putnam 1993:173). Yet similar to North’s aforementioned argument of ‘path dependency’, Putnam stresses the importance of historical embeddedness. Strong networks of civic engagement do not arise instantly, but evolve slowly over time. ‘Regions characterized by civic involvement in the late twentieth century’, Putnam asserts, ‘are almost precisely the same regions where cooperatives and cultural associations and mutual aid societies were most abundant in the nineteenth century, and where neighborhood associations and religious confraternities and guilds had contributed to the flourishing communal republics of the twelfth century’ (Putnam 1993:162). In brief, Putnam rejects Olson’s dysfunctionality-thesis by propounding that large societal groups, once embedded in long-standing civic traditions, can be important initiators for better government performance.

Beyond this general debate on collective action, we can trace a similar dispute about the specific role of business groups and associations. On the one hand, there is skepticism. Olson, extending his argument to the private sector, argues that large business associations, such as chambers of commerce, display the characteristics of a ‘latent group’ – with all the corresponding collective action problems; whereas small, special-interest associations (of specific industries) wield disproportionate power over
policy outcomes. ‘Often a relatively small group of industry will win a tariff, or a tax loophole’ Olson argues, ‘at the expense of millions of consumers or taxpayer in spite of the ostensible rule of the majority’ (1965:144). This argument that business groups tend to form ‘distributional coalitions’ with policymakers finds further support in the rent-seeking (Tullock 1967; Krueger 1974) and iron-triangle literature (Huntington 1952; McConnell 1966; Lowi 1979). Another cautious view arises from the evidence in developing countries. As scholars like Bates (1981), Ramsay (1987) and Ostrom (1990) have discussed in great detail, private-sector organizations in rural areas face great challenges to overcome structural problems. In light of the geographic and sectoral dispersion of members, coordination costs can become prohibitive and, thereby, render associative action unfeasible.

On the other hand, there is optimism. As Becker (1983) demonstrates, rent-seeking behavior decreases with rising interest-group competition. Although business associations can exert strong influence in the policy arena, they nonetheless have to compete with other powerful interest groups (e.g. labor unions, environmental groups, consumer associations). As Dahl cogently argues, this process of competitive bargaining among diverse interest groups ensures that democracy remains a ‘relatively efficient system for reinforcing agreement, encouraging moderation, and maintaining social peace’(1956:151). Pluralistic democracies in Europe and Canada, in particular, present a showcase for this argument. European business associations, some scholars note, have become integral parts of pluralistic democracies and fulfill important mediator functions (Streeck and Schmitter 1985:128; Katzenstein 1985:35). Such associations reduce frictions between governments and business communities, by informing both parties of each other’s opinions and demands, by jointly drafting regulations with authorities, and by assisting with implementation of business policies.
(Atkinson and Coleman 1989:55-57). And as Coleman observes in the case of Canada, business-group powers were strong enough to reduce government inefficiencies but never predatory, due to other pluralistic forces that kept excessive rent-seeking in check (1988:4-6).

In sum, the theoretical debate over collective action is much less clear-cut than the good-governance agenda suggests. The widespread assertion among policy advisors that civil society groups in general, and business groups in particular, press for better government performance needs to be qualified in two ways. First, large citizen groups in societies devoid of historical traditions of civic interconnectedness are likely to face substantive collective action problems. And second, business groups that are unconstrained by competitive pluralistic forces are more likely to pursue narrow distributional coalitions rather than encompassing reforms. Above all, this discussion highlights that the effectiveness of societal group pressure is not universal, as often suggested in the good-governance literature, but highly context-specific.

Electoral Pressure

In the context of Western democracies, electoral competition has become 'the inescapable sine qua non' (Huntington 1991:9) for holding governments to account. The ability of voters to reward or punish officeholders sets effective incentives for better government performance (Peltzman 1987:293). This nexus between electoral incentives and policy outcomes features prominently in Besley and Case's (1995) model of 'yardstick competition' (see Section 2.3), where local electorates dismiss incumbents...

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66 Empirical analyses in Western democracies suggest that the ballot box is primarily used to punish (rather than reward) incumbent governments. For a discussion on punitive voting in the US, see Fiorina and Shepsle (1989) and Kernell (1977); for empirical accounts in the context of European countries refer to Bordignon et al. (2001) and Bivand and Szymanski (1997).
once their performance lags behind comparative benchmarks. Electoral pressure, strengthened by an independent media, is widely regarded as the keystone of democracy and good government. Yet as Seymour Martin Lipset opined, the ‘move toward democracy is not a simple one. Countries that previously have had authoritarian regimes may find it difficult to set up a legitimate democratic system, since their traditions and beliefs may be incompatible with the workings of democracy’ (1994:1).

Following up on Lipset’s note, the following discussion will focus on two difficulties encountered in introducing democratic elections in post-authoritarian regimes: first by outlining the challenges of early democratic transitions per se; and second, by juxtaposing a country’s choice of electoral rules.

What are the enabling conditions for successful democratic transition? While the responses to this question have created a large body of literature, for the scope of this thesis it suffices to briefly summarize some of the key propositions that emerge in the transition-to-democracy literature. The first proposed condition for successful transition to democracy is the presence of a well-developed capitalist economy. Some scholars have demonstrated that there exists a positive link between the capitalist development of a country and its level of democracy (Lipset 1959; Diamond et al. 1990). Building on this proposition, others have demonstrated that democracies are more likely to consolidate, ceteris paribus, if they exhibit economic equality (Acemoglu and Robinson 2001). Hence, the first message is that economic development and equality are necessary, but not sufficient, conditions for democratic transitions.

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67 The notion, that punitive voting aligns local governments with citizens’ interests, is affirmed in recent Asian case studies (Khemani 2001; Bhaskar et al. 2006). Khemani, for instance, demonstrates that local voters in India are vigilant in punishing politicians for bad economic performance in local elections (2001:15-6).

68 Media can play an important role in making governments more responsive to the needs of citizens. Besley and Burgess (2001; 2002), for instance, show that Indian governments are more responsive to local food shortages and poverty in states with higher levels of newspaper circulation. Media pressures expose politicians and civil servants to more transparency and thereby curb temptations to abuse discretion for private gain. Unfortunately, in many countries investigative journalism is still constrained by national laws (Vogl 1999; Suphachalasai 2005) and government interventions (Besley and Prat 2006).
Apart from these economic prerequisites, political scientists have also stressed the importance of enabling socio-cultural factors. As scholars like Almond and Verba (1963) and Dahl (1971) have pointed out, effective democracies require a supporting culture of political rights. Democracies are more likely to be sustained once political elites and citizens accept freedoms of speech, assembly and press, as well as opposition, legal, and human rights (Lipset 1994:3). These individual rights are often weak in societies where orthodox religious beliefs or ethnic affiliations define political life. Some political scientists have therefore argued that the interference of religion in politics (Tocqueville 1946; Huntington 1993) and the presence of ethnic fragmentation (Horowitz 1985) are counterproductive for democratic development. Hence, the second message is that ethnically homogenous societies, a secular state system, and a supportive culture of political rights and freedoms are further enabling conditions for democratic transitions.

Certainly, as Lipset’s note in the beginning suggests, few of these economic and socio-cultural conditions are fully satisfied in early post-authoritarian regimes. In most cases democracy develops slowly over time, entailing continuous struggles of competing groups (economic, professional, ethnic, religious) over political powers (Lipset 1994:4). Overall, the literature reviewed here advances a nuanced and cautious perspective on democratic transition in developing countries, in which democratic functions emerge gradually and are contingent on underlying economic and socio-cultural conditions.69

In addition to these general time- and context-bound qualifications, another aspect that deserves attention is specific design of electoral rules. While there is wide

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69 It is worth noting here that this notion of gradual transformation resonates well with the evolutionary view on institutional change discussed earlier in Section 2.3.
agreement that elections are an important means of holding governments to account, there is little agreement on which electoral rules are preferable for this purpose. Traditionally, the political debate on electoral systems revolves around two alternatives: plurality rule or proportional representation (PR). While some scholars have argued that plurality systems are less preferable, as they induce politicians to direct disproportionate and unaccounted favors to specific voter groups ('pork-barrel'), others have claimed that multi-party PR systems are more susceptible to corruption and rent-seeking due to the lack of direct accountability between incumbents and electorates. Overall, the theoretical tradeoffs of both alternatives make it difficult to decide which electoral rule is preferable. Plurality allows voters to directly punish candidates’ misbehavior at the ballot box, yet entails more group-specific favoritism in the run-up to elections. Proportionality entails fewer pork-barrel problems, yet can have the concomitant effect of obfuscating individual accountability functions.

A related controversy extends to the question which electoral rules are preferable in developing countries with fragmented societies. Scholars like Arend Lijphart (1969; 1980) have argued that multi-ethnic societies fare better under proportional representation that allows for ‘consociational’ power-sharing among different ethnic groups. Consociation allows for an equitable distribution of public goods across ethnic groups and, thereby, reduces the risk of political conflict (Alesina et al. 1999; Betancourt and Gleason 2000). In contrast, other scholars hold that

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70 Under plurality rule ('first past the post') seats are exclusively allocated to contenders with the highest number of votes. Under proportional representation, on the other hand, seats are allocated among multi-party contenders in proportion to received votes; this commonly leads to multi-party legislatures. For an excellent overview on majoritarian and proportional electoral rules, see Reynolds et al. (2005); for a global snapshot of electoral systems currently in practice see Soudriette and Ellis (2006).

71 Lijphart (1999), for example, puts forward the hypothesis that PR-systems are less corrupt than plurality systems. Many other scholars have identified pork-barrel politics as a main problem of plurality rule; see Rogowski (1987), Myerson (1993), Lizzeri and Persico (2001), Milesi-Feretti et al. (2002), and Stratmann and Baur (2002).

72 A recent study by Kunicova and Rose-Ackerman (2005), for instance, demonstrates that PR systems are more prone to political rent-seeking and corruption than plurality systems; especially in connection to presidentialism. Similar arguments are found in Persson and Tabellini (2000:Ch 9) and Perrson (2004:22).
consociation can lead to a consolidation of ethnic disparities, and therefore aggravate social tensions (Horowitz 1985; 2003). In order to cut across ethnic divides and rival groups, political leaders should be encouraged to seek support outside core constituencies; this is more likely to happen under plurality rules, in particular by using the 'alternative vote' system (Reilly 2002:157-9).

In sum, the concept of electoral pressure is more complicated as the good-governance literature suggests. The important message offered by the transition-to-democracy literature is that democratic functions are not instant 'assets' that citizens have access to once election laws are installed. Especially in post-authoritarian regimes, democratic development entails gradual processes and a certain amount of uncertainty. Thus, in a nutshell, the strength of societal pressure – both electoral and interest group-based – strongly depends on the specific historical and socio-economic underpinnings in each country.
3.3 Government Leadership

Approaching Government Leadership

The second explanation for government variation that features in this study is government leadership. Despite a long lineage of classic scholarship (Sun Tse, Plato, Macchiavelli)\(^{73}\) and a strong presence in business literatures\(^{74}\), the notion of leadership has received little attention in recent economic and political debates (Jones and Olken 2005:1). A widely-held view is that elite-centered perspectives are inapt for building generalizable theory. Judith Tendler, for instance, prominently displays this skeptical stance in her study of Brazil’s regional government. She asserts: an ‘explanation of good performance that stresses outstanding leadership emphasizes, by its very focus on individuals, the singularity of certain experiences, namely, their unlikelihood of being repeated’ (1997:18).

This skepticism, however, is challenged by recent evidence from transition countries around the world that highlights government leadership as a key determinant for public outcomes. A study by the Institute for International Economics, for instance, which systematically analyzed policy drivers in thirteen countries in Latin America, Europe and Asia, concludes that ‘visionary leadership’ is one of the more significant explanations for policy improvements (Haggard and Williamson 1994:589). In the same vein, Arnold Harberger, reflecting on his extensive experience on Latin America’s government reforms, propounds: ‘in every case about which I have close knowledge, the policy would in all likelihood have failed (or never got started) but for the efforts of a key group of individuals, and within that group, one or two outstanding leaders’ (1993:343). Harberger’s viewpoint finds support in an earlier study by

\(^{73}\) For a discussion of classical leadership arguments see McGregor et al. (1966) and Bass (1990).
\(^{74}\) See Tannenbaum and Schmidt (1973), Donelly et al. (1985), Bennis (1989) and Kotter (1996).
Diamond and Linz (1989:14) who hold that the strategies, skills, values of public leaders explain a large part of the differences observed in Latin America’s democratic transitions.

Similar findings emerge from Asia. After reviewing democratic transitions in ten Asian developing countries 75, Larry Diamond concludes on the note that ‘if there is any common thread running through the democratic prospects of all ten of these countries ... it is the critical importance of effective and democratically committed leadership’ (1989:49). Others scholars follow suit, arguing that government leaders in Asian tiger economies 76, who had the freedom to operate relatively unconstrained by interest-group struggles, were the driving force behind the East Asian miracle (Rodrik 1996:21; Ahrens 2002). Haggard et al., for instance, observe that South Korea’s economic development in particular benefited from the decisive actions of Presidents Park and Chun: they ‘permitted the government to cut through previous patterns of rent-seeking’; they ‘eliminated from the economic policy agenda contending policy platforms’; and they ‘infused government deliberations in general, and the determination of economic actions in particular, with an urgency and an authority that they might not otherwise have had, in part by concentrating decision-making authority within the government itself’ (1993:328). 77

75 The ten countries that were reviewed included Indonesia, India, Pakistan, Sri Lanka, Turkey, the Philippines, South Korea, Thailand, Malaysia, and Papua New Guinea.

76 According to Ahrens, most of Asia’s high-performing economies ‘had strong political leaders at the beginning of their economic catch-up processes: Park Chung Hee and Chun Doo Hwan in South Korea, Lee Kuan Yew in Singapore, Suharto in Indonesia, and Mahathir Mohamad in Malaysia. All had strong mandates and the capacity to give new direction to their countries’ development policies’. But it was not ‘always the head of state ... who assumed the strongest leadership position regarding economic reforms. In many cases, it has been a minister...or a senior government official, who was the leader of an economic change team’ (2002:338).

77 In an earlier study Stephan Haggard argued that the strong, at times authoritarian, leadership in East Asia was an essential ingredient for the success of economic reforms: ‘authoritarian political arrangements give political elites autonomy from distributionist pressures, they increase the government's ability to extract resources, provide public goods, and impose the short-term costs associated with efficient economic adjustment’ (1990:262).
But apart from success stories where public leaders have become ‘heroes of the economic profession’ (Rodrik 1996:9), some scholars also warn of the detrimental effects of leadership. As Gray and McPherson remind us, Africa’s legacy of ‘corrupt and non-visionary leaders’ has proven to be ‘a serious impediment to policy reform’ that has left African populations ‘tyrannized, and impoverished …over the past four decades’ (2001:712,728). The common theme running through all these accounts from Asia, Latin America and Africa, is that government leadership – be it for good or bad – makes ‘a critical difference in the introduction, scope and pursuit of policy reform’ (Grindle and Thomas 1991:xiv).  

In light of this mounting evidence from recent transition experiences, it does not seem sensible to categorically rule out leadership explanations. The assertion that leadership is personalistic and non-replicable may be warranted for ‘great man in history’ theories, which focus exclusively on heroic individuals and their traits. It is less justified, however, once leadership is understood as elite-based activities that rest on a combination of personal skills and structural conditions. The question is not so much ‘what leaders are’, but more ‘what leaders do’ in a given institutional environment. Thus, for the purpose of this study I propose the following working definition:

Government leadership is the skillful synthesis of strategic management and operational supervision that local government heads employ in order to improve public outcomes.

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78 In a different publication Marilee Grindle (together with Francisco Thoumi) holds that, ‘much of the content and timing of policy changes can be understood by viewing them from the perspective of leadership by policy elites’(1993:159).
79 As Van Wart (2003:216) notes, ‘great man’ theories were the common paradigm in the 19th century (while great women were neglected in much of the research up to that time); prominent studies in which historical changes are strongly attributed to the action of a single person include Carlyle’s (1841) ‘On Heroes, Hero-Worship, and the Heroic in History’ and Galton’s (1892) ‘Hereditary Genius’.
80 This definition builds on Heifetz’s suggestion that leadership goes well beyond trait-specific characteristics: it extends to managerial activities, which executives exert in an adaptive manner to improve social outcomes (1994:20-2).
Guided by this definition, the following discussion of leadership is divided into two parts: a ‘strategic’ and an ‘operational’ dimension. The first part will explore empirical and theoretical literatures concerning ‘public entrepreneurship’, while the second part will do likewise for ‘bureaucratic supervision’.

Public Entrepreneurship

As the transition experience in Asia, Africa and Latin America suggests, policy outcomes in the developing world are strongly affected by the presence of reformist and visionary leadership. Notwithstanding that social and political forces are important for legitimizing reform efforts in the long run, in early transitions the initiation, design, and implementation of policy changes requires visionary leaders that hold the capacity to break initial reform resistance. Building on her experience in Latin America, Marilee Grindle nicely summarizes this entrepreneurial leadership process:

[Government] leaders faced significant political and institutional obstacles in their efforts to champion change ... To overcome these barriers, they drew on institutional sources of power to undermine the institutional resources of reform opponents. They sought to control the timing of reform initiatives, to use their powers of appointment to bolster the capacity to lead policy change, and to set the terms under which reform would be discussed in the political arena. They sought to weaken the position of the opposition and at times to garner broad public support for what they wanted to accomplish. In the early phases of reform initiation, then, leadership strategies were critically important to the survival of proposals for change (Grindle 2004:20).

Adaptive strategies of this kind are the essence of ‘public entrepreneurship’. Borrowing Schumpeter’s logic,81 Roberts characterized public entrepreneurship as the ability of public leaders to find innovative solutions to a reform problem by strategically combining all resources at their command (1992:56). According to Cunningham, public-sector entrepreneurs face similar challenges to those of their

81 For Schumpeter’s original thoughts on political entrepreneurship see Schumpeter (1950:81-5).
private-sector counterparts: they maximize public benefits from limited fiscal resources by applying creative techniques, creating mutual benefits and taking calculated risks (1970:11-5). The empirical policy literature contains several examples of this entrepreneurial spirit, on both national\textsuperscript{82} and local\textsuperscript{83} levels.

The local public entrepreneur debate features strongly in Dahl's (1961) well-known account of local government in the US. Based on a detailed analysis of New Haven in the 1950s, Dahl finds that local economic success rested, first and foremost, on the skillful and innovative management of its mayor who forged policy partnerships between bureaucrats, politicians, and business associations and, in doing so, redeveloped urban structures and accelerated economic growth:

The mayor was the only individual who was highly influential in all the coalitions, in education, urban redevelopment, political nominations, welfare, police, and others. If it were possible to single out any one person as the leader of the 'grand coalition of coalitions', the mayor was unmistakably that man ... He negotiated, cajoled, exhorted, beguiled, charmed, pressed, appealed, reasoned, promised, insisted, demanded, even threatened (1961:204). Initially the mayor had access to no greater resources than his predecessor, but with superb skill he exploited them to the limit. In this way he managed to accumulate new resources; he rose to new heights of popularity ... found it easy to tap the business community for campaign contributions ... appoint to office the kinds of people he wanted, obtain the cooperation of the Boards of Finance... and gain widespread support for his policies... An executive-centered order gradually emerged... [The mayor] was, in short, a highly successful political entrepreneur (1961:309).

Dahl's answers to the question 'who governs' have since become seminal guidelines in the debate on local government. \textsuperscript{84} In particular his notion of elite-

\textsuperscript{82} For reviews of public entrepreneurship on national levels in the US, Latin America and Africa see for instance Walker (1974), Doig and Hargrove (1987), and Grindle (1996; 2000; 2004).
\textsuperscript{83} For a detailed account of public entrepreneurship in Mexico's local governments see Grindle (2007); a discussion on local public entrepreneurs in the context of the US can be found in Nader (1968), Murphy (1971), and Schneider and Teske (1992).
\textsuperscript{84} Recent studies indicate that mayors continue to be influential agents of change. Based on a survey across US cities in 2001, Svara reports that mayors are perceived as the most important policy actors in roughly half of the observed cases; they are instrumental in advocating goals, setting objectives, mobilizing support and forging coalitions (2005:143-6).
centered consensus as a key driver for economic development finds support in the recent literature on economic and political transition. John Higley and Richard Gunther, after reviewing thirteen Latin American and South European post-authoritarian transition experiences, come to the conclusion that 'in independent states with long records of political instability and authoritarian rule, distinctive elite transformations, carried out by the elites themselves, constitute the main and possibly the only route to democratic consolidation' (1992:xi). The assertion that 'elite pacts' are necessary means for successful transitions from authoritarian to democratic regimes (O'Donnell and Schmitter 1986:37-8), is confirmed in Russia's regime change in the 1990s. Kathryn Stoner-Weiss provides detailed evidence that elite consensus amongst Russian governors (oblast leaders) and large entrepreneurs played an essential role in bringing 'relative stability in a highly transitional political and economic environment' (1997:165). She contends that this consensus of 'local heroes' has positive effects not only for 'institutional performance but also for the growth of democracy' (1997:198).

The main message emerging from this discussion is that visionary public entrepreneurs, mostly high-ranking government officials, initiate and sustain reform processes that would otherwise have not come to pass. They do this by skillfully forging a 'consensus' or 'pact' with other societal elites, including business, political and community leaders. Thus, although societal groups are part of the reform process, they are mostly reactive to reform initiatives of proactive government leaders.

85 The reviewed countries included Argentina, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Italy, Mexico, Peru, Portugal, Spain, Uruguay, and Venezuela.
Bureaucratic Supervision

After mobilizing sufficient support for government reforms, the second, and equally challenging, step is to secure bureaucratic compliance to implement reform commitments. This leads to the second leadership dimension: bureaucratic supervision. Reasons why policy reforms have succeeded in some and failed in many other developing countries, Anne Krueger notes, are often linked to supervision efforts. Reform policies will have more satisfactory outcomes 'under a politically strong leadership of a government with a well functioning bureaucracy capable of carrying out the wishes of the leadership, than [under] a weak leadership ... where bureaucrats believe that they can generate support for opposition to those policies' (1993:9).

In his comparative analysis of economic reform, Rodrik (1996) picks up on this point, highlighting bureaucratic supervision as a key aspect for successful policy implementation in East Asia. Government leaders in Singapore, Korea, Taiwan and Hong-Kong 'could supervise the bureaucracy closely and make sure that the bureaucrats assisted rather than hindered private entrepreneurship' (1996:21). This elite-centered oversight reduced two problems that are 'fatal to economic performance'; it prevented bureaucrats from being 'captured by the interests they are supposed to regulate' and discouraged them from inflicting 'excessive red tape' on business activity (1996:21).

Another showcase for bureaucratic supervision is provided in Olken's (2007) recent study on rural government. Analyzing the quality of public road projects across rural Indonesia, Olken shows corruption leakages of rural administrators are markedly lower once high-ranking government executives announce supervisory audits to the

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86 Cited in Rodrik (1996:19).
construction site. The study concludes that administrators' anticipation of 'top-down' oversight reduces material and labor fraud to a significant degree; whereas communal 'bottom-up' oversight has no substantial effect. All these empirical assessments show that bureaucratic oversight matters. An important question that remains to be answered, however, is what determines the effectiveness of these oversight functions.

A useful starting point for this question is Gary Becker’s (1968) well-known argument that individuals pursue illegal activities once they expect higher benefits from illegal actions (after discounting penalty costs) than from legal ones. Inspired by Becker’s study, several scholars have further explored solutions for public inefficiency and corruption by using principal agent, public choice or game-theoretical frameworks. The principal-agent literature in particular provides two useful insights into the issue of effective supervision. First, government leaders, understood as ‘principals’ of public administrations, need to have credible incentive instruments (rewards and penalties) for securing bureaucratic compliance. And second, government leaders, understood as ‘agents’ of society at large, need to be exposed to credible incentives themselves, in order to supervise reforms and refrain from misconduct. While the former aspect is relatively straightforward, the latter merits further explanation.

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87 Olken’s study is highly innovative as it draws its findings from on-site quality checks of 600 roads (i.e. physical 'drilling samples') across Indonesia.
88 Principal-agent theories predict administrative misconduct as a result of asymmetric information structures between service providers ('agents') and service requestors ('principals'). The classical problem proceeds as follows: societal or government principals authorize bureaucratic agents to provide public goods on their behalf; but because the former have insufficient technical expertise ('hidden information') and insufficient overview of the latter ('hidden action'), outcomes tend to be suboptimal unless adequate incentive structures are introduced (Arrow 1985: 37). For seminal contributions in the principal-agent debate see Rose-Ackerman (1975), Tirole (1986; 1992), Pratt and Zeckhauser (1985) Mookherjee and Png (1992) Holstrom and Milgrom (1991; 1994), and Sappington (1991). For an excellent overview on this debate see Furubotn and Richter (2005); Harriss (1995) and Tommasi and Weinschelbaum (2003) extend the discussion on agency problems to developing countries.
89 See footnote 53.
90 See, for example, Bianco and Bates (1990:144) Hermalin (1998), and Scharpf (1997).
91 Note that the strength of rewards/punishments at the command of government leaders is likely to depend on national laws ('power of appointment') and existing support networks (see public entrepreneurship discussion above).
Isolating incentives for government leaders is not an easy task. As Dahl puts it, the ‘motives that animate leaders are evidently as varied as the dreams of men’ (1961:95). Yet among these varied motives, two incentives seem particularly noteworthy in the context of transitional regimes. The first incentive is the exposure to popular vote. Given the global waves of decentralization and democratization, many subnational leaders – governors, mayors, and regents – are no longer appointed by the central government, but directly elected by local citizens (Treisman 2002:19; Larsen 2005:203-4). Especially if they run for reelection, local government leaders have high incentives to improve bureaucratic performance (Grindle 2007:185). As discussed in Section 3.2, the strength of these ‘electoral pressures’ depends on a country’s democratic consolidation process and its choice of electoral rules. It is important to stress here, however, that although they face similar electoral incentives, local government leaders are not politicians. As scholars like Haggard, Rodrik, and Grindle have argued, as outlined above, successful leaders in transition countries often operate relatively unconstrained by party politics and interest-group struggles and, therefore, are able to pursue reform efforts in a timely manner.

The second incentive is the desire for social prestige. As William Goode demonstrates, the quest to gain prestige (or limit disesteem) motivates elites to strive for performances that society considers ‘above average’ (1979:7); while money may be more commanding, prestige is the most widespread incentive in day-to-day interactions and is a very effective control for elite behavior (1979:30-2). In a recent study on rural China, Lily Tsai extends Goode’s argument to government officials:

92 Dahl proposes a long list of possible motivations, including ‘greater income, wealth, economic security, power, social standing, fame, respect, affection, love, knowledge, curiosity, fun, the pleasure of exercising skill, delight in winning, esthetic satisfaction, morality, salvation, heroism, self-sacrifice, envy, jealousy, [and] revenge’ (1961:95).
Even when formal governmental accountability is weak, [government officials] may still have a strong incentive to provide public goods when citizens award them moral standing for doing so. ... [moral standing] not only makes [officials] feel good about themselves, but also it can translate into economic and social advancement (Tsai 2007:356).

Both of these incentives tend to align government leaders with public interests. In order to remain in office or gain social prestige, leaders need to anticipate the demands of society at large. Or put differently, the stronger these 'aligning incentives', the stronger the likelihood that government leaders become, what Larry Diamond calls, 'democratically committed’ (1989:49).

In summary, empirical evidence suggests that government leadership has been an essential ingredient for successful policy reform in many transition countries. Yet regardless of these empirical accounts, many academics and policy advisors remain silent or skeptical about leadership, often assuming that leadership functions are personalistic, unreplicable and undemocratic. The discussion in this section, however, helps to partly dispel these assumptions. Personal skills (for example anticipation, communication, mediation, determination) are means not ends; they are tools that underpin – both good and bad – leadership action. In successful transition cases (with relatively high, equitable economic development), leaders have skillfully used powers of appointment to initiate government reforms and supervise bureaucratic implementation. In unsuccessful cases, leaders have abused official discretion for personal gain and rent-seeking purposes. Theory suggests that much of these differences – productive or predatory outcomes – rest on underlying incentive structures. Government leaders whose careers depend on social prestige and popular vote are, ceteris paribus, more likely to act in the public interest than those who lack such incentives. Similar to societal pressures, the effects of leadership functions cannot be
easily detached from their historical and socio-economic backgrounds. Thus, whether or not government leadership is 'undemocratic' or 'democratically-committed' is best explored in the context of each country.
3.4 From Theory to Research Design

All in all, the theoretical and empirical discussion in this chapter yields two key findings: first, effects of societal pressure and government leadership on policy outcomes are highly contingent on country-specific contexts and, therefore, cannot be easily converted into universal theories of causation. And second, in early transition contexts, where pre- and post-democratic norms coexist side by side, government leadership is at least as plausible in explaining varied government performance as societal pressure. While these two findings are largely in line with transition-to-democracy and evolutionary-intuitionalist perspectives, they stand in notable contrast to the views expressed in recent good-government policy literatures. To shed further light onto this matter, the present study sets out to test these contending views by means of both qualitative and quantitative analyses. The following sections explain the overall research design by outlining the hypotheses and methods that underpin this study.

Research Hypotheses

As seen above, a salient proposition in the applied policy debate of the last fifteen years is that government performance improves with external pressure from local societies. Particularly, in post-decentralization periods, ‘societal pressure’ – either through interest-groups or electoral participation – is widely advanced as an important means for good governance. Proponents for this society-centered view draw theoretical inspiration from recent governance literatures as well as from Hirschman’s ‘Voice’ and Putnam’s ‘Civicness’ theories. Daniel Kaufmann embodies this view well by stating: ‘We find that undue emphasis may have been given ...to a number of conventional public sector management variables (such as civil servant wages, internal enforcement of rules, autonomy of agency by fiat) while undermining the priority due to more
‘external’ ... variables, such as external voice, transparency, and politicization.’ Applied to the context of Indonesia, and in particular to the large variation in local business climates, the first research-hypothesis thus reads:

Societal-Pressure Hypothesis: Variations in local policy outcomes can be explained by societal pressure. Differences in local business climates are the result of interest-group pressures of local firms and electoral pressures of district constituencies.

At the same time, a growing body of political economy literature disagrees with society-centered explanations of good government, especially in transition countries. Several country studies in Africa, Asia and South-America highlight aspects of ‘visionary leadership’, ‘public entrepreneurship’, and ‘bureaucratic supervision’ as significant drivers for reform outcomes. This line of thought stands in contrast to much of today’s mainstream policy advice insisting that societal pressure is the primary source of change. Marilee Grindle aptly summarizes this perspective by noting that in many developing countries ‘high level administrators and political leaders dominate the policy making process’ (1989:24). In situations where rules and mechanisms of political competition are yet to be fully established ‘the use of society-centric political economy models [can be] misleading’ (1989:26). Thus, the second research-hypothesis is as follows:

Leadership Hypothesis: Variations in local policy outcomes can be explained by government leadership. Differences in local business climates are the result of the efforts of local government leaders to build strategic reform coalitions and supervise local bureaucracies.
Methodology Overview

Indonesia’s decentralization experience, in particular its highly variant local business climates, provides an excellent opportunity to test explanations of local government outcomes. As foreshadowed in the hypotheses presented above, this study treats ‘societal pressure’ and ‘government leadership’ as independent (explanatory) variables, whereas local business climates – namely local taxes, licensing procedures and administrative corruption – are treated as dependent (outcome) variables in the following analyses.

Figure 3.1: Explanatory and Outcome Variables

Explanatory Variables:
- Societal Pressure
- Government Leadership

Outcome Variables:
- Licensing Procedures
- Local Taxes
- Administrative Corruption

Local Business Climates

In order to gauge the causal effects of societal pressure and government leadership (see Figure 3.1), this study employs a mixed-method approach⁹³ that entails two complementary stages. The first stage is qualitative: it rests on comparative case studies in eight purposely selected districts in West, Central and East Indonesia; incorporating roughly 1000 business surveys and 100 in-depth interviews. The second stage is quantitative: it juxtaposed field results with regression estimates from a 200-

⁹³ The mixed-method approach sets this research apart from much of the existing work on decentralisation, which is either quantitative (e.g. Salmon (1987), Fisman and Gatti (2000), Bardhan and Mookherjee (2000) De Mello and Barenstein (2001) and Huther and Shah (1998)) or qualitative in nature (e.g. Crook and Manor (1998), Manor (1999), Agrawal and Ribot (1999), and Sidel (2005)).
district dataset. While the regression analyses are explained in greater detail in Chapter 6, the following sections elaborate the case-study design and methods that are employed in Chapters 4 and 5.

Comparative Case Studies

Robert Yin notes that comparative case studies are the preferable research method for answering empirical questions of 'how' and 'why' a contemporary set of events takes place (2003:9,12). Hence, translated into the research question at hand, the case-study approach is used as a means to inquire how business climates vary across Indonesian districts; how this variation can be linked to the explanatory variables government leadership and societal pressure; and why leadership- and society-centered explanations are more or less powerful explanations. Above all, comparative case studies provide a useful tool to contextualize the analysis with empirical depth without sacrificing the ability of structured comparisons.

However, as case studies are by their nature limited in their number of observations, special care is required in the way cases are selected. As Ragin and Becker point out, in case study research observation sites are not chosen on a random basis – as samples in large cross-sectional studies - but on the grounds of theoretical interest (1992: 222). While this provides the opportunity to explore empirical phenomena in greater detail, it also entails representativeness and generalizability problems. In order to reduce such problems and enhance analytical traction, King et al. (1994) urge researchers to design case studies in a scientific manner. According to their argument, the guiding principle is to select cases on the basis of independent (not dependent) variables. Cases that vary distinctively in an explanatory variable (while remaining similar across other determinants) allow for more plausible and robust
analytical inferences (King et al. 1994:132-8). Geddes affirms this principle, emphasizing that case selection on the basis of key explanatory ‘drivers’ rather than explained ‘outcomes’ is an important precondition for generating instructive and generalizable findings that inform theory (1990:149).

In a similar manner, Yin (2003) advises that researchers should aim to enhance the representativeness of case-study research in two ways: prior theorizing and case replication. The process of prior theorizing is essential to formulate a ‘theoretic roadmap’ before approaching the actual field study. Thus, similar to King et al.’s suggestion, Yin highlights the importance of selecting cases on the grounds of intellectual interests that arise in the early stage of the research (2003: 38). In addition, replicating case studies under controlled conditions, similar to natural-science experiments, allows researchers to refine and strengthen empirical arguments. By controlling for external effects as much as possible, repeated ‘field experiments’ of this kind provide a robust basis for drawing causal inferences. Based on this iterative algorithm of theorizing and replication, Yin posits, scholars are in a better position to link case-study findings to wider theoretical debates (2003: 38).

Informed by King et al., Geddes and Yin’s propositions, the case analysis of Indonesian local governments follows two sets of guidelines. First, case studies are selected on the basis of independent variables. That is, district-cases are chosen for their distinctiveness in government leadership and societal pressure, not for their distinctiveness in local business climate. And second, in order to draw more robust inferences, effects of government leadership and societal pressure are measured independently in controlled pair-wise case comparisons. As available financial and time resources allowed for an assessment of eight district-cases, each variable will be tested in four districts, or more precisely, in two pair-wise comparisons.
Since these systematic district comparisons are of central importance for the empirical analyses that will follow, let us consider an example. As suggested by King et al., comparative district-pairs should be constructed in such a way that they differ distinctly in the explanatory variable at hand, while showing identical (or at least similar) values in all other respects. Applying this guideline to the Indonesian context, a district pair should notably vary in, say, the quality of government leadership and, at the same time, display equal levels of societal pressure and other socio-economic factors.

Table 3.1: Selection Criteria for District-Pairs

<table>
<thead>
<tr>
<th>Leadership</th>
<th>Societal Pressure</th>
<th>Other Factors</th>
<th>Business-Climate</th>
</tr>
</thead>
<tbody>
<tr>
<td>District A</td>
<td>High (Controlled)</td>
<td>(Controlled)</td>
<td>Field Evaluation</td>
</tr>
<tr>
<td>District B</td>
<td>Low (Controlled)</td>
<td></td>
<td>Field Evaluation</td>
</tr>
</tbody>
</table>

Table 3.1 helps to illustrate this methodological principle. Here, ‘District A’ is chosen for its high and ‘District B’ for its low level in government leadership. While leadership levels vary markedly, societal pressure and other control variables (for example district GDP, resource endowments, national transfers, political affiliations) are held constant as much as possible. After ‘isolating’ leadership effects in this way, the study then proceeds to evaluate prevailing business climates in each district case.

If field evaluations show that local government practices (i.e. tax, license, and tender procedures)\(^\text{94}\) are more efficient and less corrupt in District A (compared to those in District B, then we can draw the causal assumption\(^\text{95}\) that leadership has a positive

\(^{94}\) Business climates are measured in terms of tax, license and corruption practices in each district by using three methods: business surveys, in-depth interviews, and direct observations; a detailed description of these three methods is presented below.

\(^{95}\) Certainly, causal assumptions need to be strengthened by triangulating multiple information sources: both within (business surveys, interviews, secondary data) and across districts (regression analyses).
effect on government performance. Causal assumptions of this sort become more plausible, as Yin has pointed out, if the repetition of the same setting exhibits similar results. Thus, in order to strengthen proposed causal links, the same ‘field experiment’ is repeated once again with two different districts. Naturally, although the description here has focused on ‘government leadership’, the same logic and procedure apply, *mutatis mutandis*, for the testing of ‘societal pressure’.

Case Selection

The actual selection of district cases in this study is based on methodological and Indonesian-specific considerations. First, in order to control for effects of informal socio-cultural institutions, I decided to primarily compare district pairs situated in the same ‘cultural regions’ (same provinces). Thus, the initial step was to choose four provinces that reflected Indonesia’s diversity in Western, Central and Eastern regions and, at the same time, were sufficiently accessible and secure. As a result of this deliberative process, I selected the provinces of (1) West Sumatra, (2) Central Java, (3) Bali and (4) West Nusa Tenggara.

Second, in each of these four provinces I then systematically identified two districts that were distinct in the explanatory variable to be tested, yet similar in other exogenous variables (per capita income, population, ethnicity, national transfers, poverty, dominant political party). In the first two provinces (West Sumatra, Central Java) district pairs where chosen for their differences in government leadership; in the second two provinces (Bali, West Nusa Tenggara) they were chosen for their differences in societal pressure. Based on available statistics, media data and expert
interviews, the selection process (which is described in detail elsewhere\(^{96}\)) resulted in the following four comparative district-pairs: Solok/Pesisir-Selatan (West Sumatra), Kebumen/Klaten (Central Java), Gianyar/Karang-Asem (Bali) and Bima/Lombok-Timur (West Nusa Tenggara). Figure 3.2 illustrates the locations of the eight district-cases that emerged from this identification process.

**Figure 3.2: Location of the Eight District Cases**

![Map of Indonesia showing the locations of the eight district-cases](image)

Source: Author's map, adapted from (Eckardt 2006).

In each of these eight research sites – which span over a distance of 2500 km from West to East Indonesia – I collected empirical data through using four different techniques: (1) local business surveys, (2) in-depth interviews, (3) direct observations, (4) and desk review of secondary data.

**Local Business Surveys**

During 12 months of fieldwork, from April 2005 to March 2006, and with the assistance of local students\(^{97}\), I conducted business surveys with 1000 respondents.

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\(^{96}\) Detailed descriptions of case selections in West Sumatra and Central Java (based on the distinctiveness of government leadership) and Bali and West Nusa Tenggara (based on the distinctiveness of societal pressure) are presented in Chapters 4 and 5, respectively.

\(^{97}\) In each district I identified local students, who (after receiving intensive conceptual and practical training) administered the business questionnaires in respective districts. This approach had three advantages. First, it reduced the ‘foreigner’ bias during questionnaire situations; second, it was more
(roughly 125 in each district). Before the survey was administered in the eight districts I undertook a 4-week pilot test in Jakarta, which helped to refine the questions (see Appendices 3.1 and 3.2) and set realistic goals for the implementation. The applied sampling frame was straightforward. Questionnaire respondents were randomly chosen from listing in the local ‘yellow pages’, and were evenly stratified across retail, manufacturing and service sectors. Consistent with employment structures in rural Indonesia (for details see Section 2.2), roughly 90 percent of the surveyed respondents were owners or senior employees in small and cottage firms.

**In-depth Interviews**

To gain further contextual information, I conducted roughly 120 in-depth interviews with local stakeholders and national policy elites (see Appendices 3.3 and 3.4). Interviews were semi-structured and covered salient issues of local business conditions, government, corruption, and democracy. The selection of informants was guided by an occupation-based sampling frame. In each district I interviewed four public officials (finance, planning, small-industry, economic development), four business people (retail, manufacturing, public construction, service), the head of the local business chamber, two NGO members, two media representatives, and one academic. 98 At a later stage, local opinions were complemented by national perspectives. With the objective to crosscheck and elaborate the interview data from the regions, I consulted a group of high-ranking informants in Jakarta, including former Indonesian ministers (Regional Autonomy, Agriculture), senior officials (Finance, Home Affairs), policy experts (World Bank, UN, GTZ, Asia Foundation, KADIN, KPOPOD), and academics (University of Indonesia, CSIS).

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98 In-depth interviews took place at private residences or offices and lasted between 30 to 90 minutes.
Direct Observations

The third method was the direct observation of local government performance. The four weeks I spent in each district provided ample opportunities to investigate different facets of district bureaucracies. First and foremost, unannounced visits to public business-service providers (‘one-stop-shops’) proved a useful and illustrative technique to assess the quality of local business services. Second, the time before and after interviews with public officials provided a good opportunity to study the quality of office facilities, converse informally with public servants and observe the informal dynamics in each district government. And thirdly, visits to local markets and interactions with local vendors helped to contextualize each district economy and provided additional pointers for in-depth interviews.

Secondary Data

As a fourth and final step, I collected a range of secondary data sources. Official reports from local governments, business associations and NGOs were useful to triangulate interview information and further enlarge my technical understanding of district tax regulations, license requirements and business services. Moreover, local news clippings proved a rich source of information on business complaints, corruption scandals, and local politics. In Jakarta, the libraries of the Center for Strategic and International Studies (CSIS) and the World Bank were useful for keeping up to date with decentralization studies and national media. The Regional Autonomy Watch (KPPOD) generously supplied numerous reports and data on local business climates.
After elaborating the underlying design and methods, the discussion can now proceed to the actual case-study analyses. Guided by the hypotheses and methodological guidelines laid out above, Chapter 4 examines leadership effects in West Sumatra and Central Java; Chapter 5 investigates the effects of societal pressure in Bali and West Nusa Tenggara.
Chapter 4
Leadership Cases – Business Climates in Java and Sumatra

4.1 Introduction

This chapter tests the leadership hypothesis, that is, it empirically measures whether differences in local government leadership have an effect on district policy outcomes. Can variations in local regulation, administration and corruption practices be explained by diverging qualities of district heads? Based on the case evidence from West Sumatra and Central Java, the answer is in the affirmative.

Based on comparisons across purposely selected district-pairs, which enable me to ‘isolate’ differences in government leadership, I find that districts with higher leadership qualities exhibit significantly better business climates. That is, locations that have been endowed with a good government leader since the introduction of decentralization show fewer regulatory tax distortions, more efficient license administration and less public corruption. These empirical results, which rest on roughly 500 surveys conducted with small firms and 60 in-depth stakeholder interviews across four district cases, serve as a first indication that government leadership is a key explanation for Indonesia's varied business conditions.

The discussion in this chapter proceeds along the following lines. The second section introduces the two regions in which these comparative district studies are placed and, more importantly, outlines the distinct differences in leadership qualities across regional district-pairs. In order to test the leadership hypothesis, the following sections then analyze business climate outcomes and make pair-wise comparisons across high- and low-leadership districts: the third section presents an empirical snapshot of
local taxation practice; the fourth section evaluates local licensing practices – in terms of both compliance costs and one-stop services; and the fifth section examines the extent of corruption during public recruitment, administration, and tender management. The final section pulls together the different business-climate outcomes, and draws preliminary conclusions about the effects of leadership qualities on local government performance.
4.2 Selecting Leadership Cases

As outlined in the research design in Chapter 3, the leadership hypothesis will be tested by using controlled district comparisons. In each province I choose two districts that meet two conditions (see Table 3.1): first, they should vary distinctly in government leadership; and second, they should be nearly homogenous in terms of societal pressure and other social, economic and political controls. The underlying idea for this systematic selection is straightforward: if it is known that district-pairs hardly differed in anything else but leadership during the first decentralization period (between 1999 and 2005), observable variations in recent business climate outcomes can be linked to the underlying qualities of local government leaders.

Figure 4.1: Case Study Locations in West Sumatra and Central Java

As illustrated in Figure 4.1, the two pairs that fulfill these selection criteria best – that is, they isolate leadership factors as much as possible – are the districts Kebumen and Klaten in Central Java and the districts Solok and Pesisir in West Sumatra. The next sections will introduce these district-pairs (1) by briefly describing the provincial context and, most importantly, (2) by outlining the pairwise differences in government leadership.
The Region of Central Java

The first district-pair is situated in Central Java, the geographical heartland of the Javanese people. Framed by the Java Sea to the North and the Indian Ocean to the South, Central Java stretches over a landmass of 32,000 sq km. As its name suggests, it lies in the middle of the island of Java, between the provinces of West and East Java. Its coastal plains rise up to volcanic mountain ranges that reach heights of 3,000 meters above sea level. With a population of 32 million (1,000 inhabitants per sq km) Central Java is one of Indonesia's largest and most densely populated provinces. This density also translates into a high number of government units, with 35 districts and more than 8,500 villages.

Central Java's economy has experienced pronounced structural change. In the 1970s the agricultural sector still accounted for more than 50 percent of regional GDP. But the conjunction of limited arable land and a rapidly rising population drove many smallholders into non-agricultural sectors such as small-scale manufacturing of textiles, wood, metal and leather (Booth and Damanik 1989:289-94). Today most of the income of the region accrues from the secondary and tertiary sectors. In 2004, for instance, 22 percent of regional GDP derived from agriculture and mining; 39 percent from manufacturing, construction and utilities; and 39 percent from trade and services.

In isolation, these economic figures may evoke an image of an industrialized and prosperous region. Recent income statistics, however, point to the opposite. Notwithstanding the rising share in manufacturing, Central Java's welfare indicators remain well below national averages. Annual per-capita incomes are around US$ 480

99 If not mentioned otherwise, the data appearing in the next two sections are taken from national (BPS 2005; 2006) and local government statistics (BPS Kebumen 2004; BPS Klaten 2004).
(US$ 220 below Indonesian average) and the poverty rate is at 22 percent (5 percent above the Indonesian average). These critical welfare figures stem from the fact that Central Java’s has experienced large population growth and little growth in productivity over the last five decades (Booth and Damanik 1989). Available statistics show that the bulk of the regional labor force continues to be occupied in small family businesses rather than in large-scale industry. Capital-intensive industries are absent in most of Central Java’s districts due to the lack of purchasing power and skilled labor. As a result, the high share of small-scale manufacturing neither translates into pronounced regional investments nor into notable welfare improvements; on the contrary, Central Java remains one of the poorer provinces in Indonesia, and the second poorest (after NTB) in this study.

Culturally, Central Java has been a melting pot of various influences. Up to the 12th century, Hinduism and Buddhism penetrated deeply into Java’s society and amalgamated with indigenous traditions and culture; this period is embodied in ancient heritage sites such as the Borobudur and Prambanan temples. In the following centuries, Muslim seafarers established strong trade relationships with Java and introduced Islamic beliefs and practices (van der Kroef 1961:18). Although elements of animistic and Hindu-Buddhist beliefs prevail in many Javanese communities (Geertz 1960:5), Islam eventually became the dominant religion of the region and is officially practiced by 97 percent of today’s population. In the center of this cultural amalgam stand Central Java’s royal courts (kraton) in Yogyakarta and Surakarta, which still exert a strong influence on social and political affairs up to the present day.

101 For one thing, the sultan of Yogyakarta continues to be a leading figure in regional politics (Legowo 2004:142), for another, even today the kraton-based aristocracy constitutes the ‘top layer’ of the region’s social system. This social stratification finds its roots in pre-colonial times and was reinforced by the Dutch, who placed Javanese elites in leading civil servant positions and, thereby, extended social hierarchies to the government sphere (Geertz 1960:6). In broad terms, Javanese society can be divided
Kebumen and Klaten: Differences in Government Leadership

Two districts in Central Java in particular are at the center of this analysis: Kebumen and Klaten (see Figure 4.1). While Kebumen is situated in the costal plains in the southwest of the province; Klaten is in the eastern lowlands, at the foot of Mount Merapi midway between the two royal court cities Yogyakarta and Surakarta. As mentioned, these two districts are chosen for their distinctive differences in government leadership. While societal-pressure and other control factors are sufficiently homogenous (see Appendix 4.1 for details), Kebumen and Klaten vary significantly in the quality of their government leader.

Expert interviews and media reports point to distinct differences in government leadership across the two cases. Numerous policy experts identify Kebumen’s regent Rustriningsi, the first female incumbent in the decentralization era, as an exceptional leader. In fact, ever since her inauguration in 2000, Rustriningsi has attracted considerable attention from national and international observers: in 2001 she received the ‘Outstanding Woman in Local Government Award’ from the UN Economic and Social Commission Asia Pacific (UNESCAP); in 2002 she was honored with the nationwide ‘Female Leadership Award’ by the Martha Tilaar Foundation; and in 2004 she accepted the ‘Good Government Award’ by the economic newspaper Warta Ekonomi.

into four social strata: first, aristocrats of royal decent (ndara); second, upper-class bureaucrats (priyayi); third, Islamic scholars, urban dwellers and merchants (santri); and fourth, common workers and rural peasants (wong cilik). Notwithstanding that borders of these social groups have become more fluid in the course of modern education and regime change, Javanese continue to set invisible hierarchical benchmarks against which individuals are ranked and against which social interaction takes place (Sairin 1992:12-3).

102 Experts that were consulted on the case-selection prior to the fieldwork in April 2005 include Neil McCulloch and Erman Rahman (World Bank), Hadi Susastro and Raemond Atje (Center for Strategic and International Studies), Agung Prambudhi (Regional Autonomy Watch), I Gede Suratha (Ministry of Home Affairs), Birgit Kerstan and Sebastian Eckhard (GTZ), Thee Kian Wie and Syarif Hidayat (LIPI), Andi Ikhwan (CESS), Hastuti (SMERU), Frida Rustiani (Asian Foundation), Bambang Brojonegoro and Raksaka Mahi (University of Indonesia);
Even more remarkable is the attention her leadership has received in the international media, including the *New York Times*, *CNN*, and *Newsweek Asia*. The *New York Times* for example reports:

Rustriningsih has carved out a reputation for being rigorously honest, a rare attribute in a government official in a country that regularly scores in international surveys as among the world's most corrupt... Because Ms. Rustriningsih has done such audacious things as appoint school principals on the basis of merit rather than bribery, she has been invited by the United States Agency for International Development to seminars to explain her methods... The World Bank has held her up as the paradigm of a new, clean Indonesia (Perlez:6).

In a similar vein, *CNN* (2003) broadcast a five-minute feature entitled ‘One Woman’s Fight against Corruption in Indonesia’, underscoring Rustriningsi’s exceptional determination to reform her bureaucracy and improve rural service delivery against the odds of prevailing corruption and patronage. *Newsweek* describes her as a promising reformer who, once ‘she was appointed regent... four years ago, did a very unusual thing for an Indonesian official: she refused to take bribes. Instead, the 36-year-old... began building one of the country’s cleanest and most transparent [district] governments’ (Cochrane 2004:2). Considering that Kebumen is but one out of 440 Indonesian districts, this international media attention is all the more remarkable and, thus, highlights the leadership qualities of Kebumen’s top executive.

The news coverage of Klaten’s regent Wibowo, on the other hand, points in the opposite direction. National media sources reveal multiple corruption allegations. As an illustration, the national newspaper *Kompas* reported that Wibowo had been accused of embezzling public assets in multiple instances: first, the illegitimate sale of a government-owned estate for the price of Rps 670 million; second, the non-transparent (and partly missing) procurement of 13,000 government uniforms worth Rps 400 million; and third, the misappropriation of public funds for vocational training centers amounting to Rps 50 million (Kompas 2003a:3). Other newspaper articles in *Kompas*,...
Tempo and SoloPos have featured similar reports. And, although a final verdict has not been announced to date, the scope of these corruption scandals indicates that the leadership qualities of Klaten's government leader are compromised.

Table 4.1: Leadership Qualities in Kebumen and Klaten

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Kebumen</th>
<th>Klaten</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Anti-Corruption Efforts</td>
<td>3.2</td>
<td>1.9</td>
</tr>
<tr>
<td>(2) Power to Change</td>
<td>3.6</td>
<td>2.0</td>
</tr>
<tr>
<td>(3) Reform Vision</td>
<td>3.7</td>
<td>2.1</td>
</tr>
<tr>
<td>(4) Communication Skills</td>
<td>4.0</td>
<td>1.9</td>
</tr>
<tr>
<td>(5) Local Popularity</td>
<td>4.3</td>
<td>2.4</td>
</tr>
<tr>
<td><strong>Leadership Score (Mean Value)</strong></td>
<td>3.8</td>
<td>2.1</td>
</tr>
<tr>
<td><strong>Overall Evaluation</strong></td>
<td>Good</td>
<td>Poor</td>
</tr>
</tbody>
</table>

Source: Author's estimates based on roughly 125 business respondents in each district. Note: Scores are mean values of reported leadership qualities (survey questions G3a-e); 1 = 'very poor,' 2 = 'poor,' 3 = 'fair,' 4 = 'good,' 5 = 'very good.'

The media-based leadership indications are affirmed (ex-post) in the local business-survey conducted in Kebumen and Klaten. In each district, 120 business respondents were asked to evaluate the leadership qualities of their respective regent in five aspects: (1) anti-corruption efforts, (2) power to change, (3) reform vision, (4) communication skills, (5) and local popularity (see Table 4.1). While the first factor arises from the specific Indonesian context, the latter four factors are inspired by business and public administration literatures. Consistent with the theoretical

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103 See for instance 'Bupati Klaten Siap Diperiksa Kejaksaan Tinggi' (Klaten's Regent Prepared to be Investigated by the High Court), Kompas, 18 March 2005; 'Tiga Kepala Daerah Segera Diperiksa' (Three Regents under Investigation), Kompas, 5 March 2005; 'Dana PKB/BBKNB Jadi Bancakan, Bupati Klaten: Akan Kami Kembalikan' (Klaten's Bupati will Return Misappropriated PKB/BBKNB Vehicle Taxes), SoloPos, 18 Feb 2005; and 'Kejaksaan Tunggu Izin Presiden untuk Periksa Bupati Klaten' (Judges Awaiting President's Approval for Investigating Bupati in Klaten), Tempo, 5 Juni 2003;

104 According to Bennis (1989: 139) 'Leadership revolves around vision, ideas, direction, and has more to do with inspiring people [...] A leader must be able to leverage more than his/her own capabilities.' Donnelly et al. (1985: 362) stress that leaders attempt to influence 'the activities of followers through the communication process'. The Australian Public Service Commission declares that leaders in senior government positions (1) show personal drive and integrity, (2) shape strategic thinking, (3) communicate with influence, (4) cultivate productive working relationships, (5) and achieve results (Australian Government 1998).
discussion on leadership in Chapter 3, the first two factors give an indication of executive efforts to supervise local bureaucracy, whereas the latter three provide the basis to forge reform coalitions.

The survey results in Table 4.1 indicate that the leadership qualities in Kebumen are distinctly higher than those in Klaten. While Russriningsi is overall perceived as a well-performing leader (average score of 3.8), her colleague Wibowo receives a much lower rating (average score of 2.1). The most notable differences arise in terms of communication and popularity. In these aspects, Klaten's government leader remains two marks below his counterpart in Kebumen. According to interviewees in both districts, Kebumen's regent Russriningsi is both a visionary reformer and strong supporter of the common people, whereas Klaten's government leader lacks such qualities and tends to communicate in a patriarchal top-down manner, hardly tolerating any criticism or suggestions from below. Thus, in light of the interviews with policy experts, the media reports and ex-post data checks, it becomes evident that the selected district-pair provides an adequate basis for testing the impacts of different leadership qualities. In the following analyses Kebumen will thus serve as a 'high-leadership' and Klaten as a 'low-leadership' case. After establishing the suitability of the two district cases in Central Java, the section now turns to the second district-pair.

*The Region of West Sumatra*

The second district-pair is situated in the province of West Sumatra. Set between North Sumatra to the north and Bengkulu to the south, West Sumatra occupies an area of 43,000 sq km.\(^\text{105}\) While the eastern half of the province is dominated by a mountainous volcanic terrain with altitudes to 2,900 m, the western half can be

\(^{105}\) If not mentioned otherwise, the data appearing in the next two sections are taken from national (BPS 2005; 2006) and local government statistics (BPS Pesisir Selatan 2004; BPS Solok 2004).
described as a strip of coastal lowlands spanning 375 km along the Indian Ocean. In terms of its population size (4.5 million) and density (100 inhabitants per sq km) West Sumatra lies within the national average. The provincial territory comprises 19 districts and more than 2,000 villages.

Although average in size, West Sumatra’s economy has displayed comparatively high economic growth over the past decades. In 2002, the provincial GDP reached Rps 29 trillion (US$ 2.9 billion), a value five times smaller than that of Central Java, but twice as large as that of West Nusa Tenggara (the fourth province in this study). The West Sumatran province has seen considerable structural change from the primary to secondary and tertiary sectors. Over the last 30 years (1975-2004) the income shares accruing from agriculture declined from 41 to 29 percent. Today, more than 70 percent of regional GDP derives from manufacturing and service industries. Unlike in Central Java, this structural transition coincided with less population growth and more large-scale investment in agro-processing (palm oil, rubber) and manufacturing (cement, wood) enterprises (Lains 1989:444-8). In the course of this transition the province experienced high economic growth, in some years reaching up to 8 percent.

Remarkably, the province displays one of the lowest poverty rates in Indonesia. In 2004, the central bureau of statistics (BPS 2005) estimated that a mere 11 percent of West Sumatra’s population live below the poverty line, a ratio significantly below national poverty levels (17 percent). Annual per-capita incomes amount to an average of US$ 650 and the distribution of wealth remains one of the most egalitarian in the country (Lains 1989:437; UNDP 2001:30). Similar to the province of Bali (the third

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106 According to national income statistics (BPS 2005), the sectoral distribution in 2004 was as follows: manufacturing (13 percent), construction (5 percent), trade (13 percent), private services (22 percent) and government services (18 percent).
province in this study), West Sumatra displays a medium sized economy with sound
growth and low poverty rates. Due to this simultaneous attainment of growth and
equity, West Sumatra received a national award (‘Parasamya Purnakarya Nugraha’) for

Culturally, West Sumatra is most strongly influenced by the Minangkabau people, a unique ethnic group that constitutes the world's largest matrilineal society. These matrilineal structures are evident in inheritance traditions and social roles. For one thing, property and land ownership is passed down the female bloodline, i.e. from grandmother to mother to daughter to granddaughter. For another, the oldest females in each household (bundo kandang) continue to be the leading figures in family debates in communal affairs. Most young men, in contrast, are predestined to live many years outside their family home. As elementary-school boys, they leave their families and move into communal boarding schools where they study Islam teachings and Minang culture. Once they become adults, Minang males traditionally embark on long journeys across Indonesia (merantau). Once they have accumulated sufficient experience and wealth, most Minang travelers return and fill representative positions in their communities.

108 Legend holds that the term Minangkabau - the combination of the words minang (victorious) and kabau (buffalo) – describes how the regional tribes defeated a large Javanese army during the Megapahit era. Instead of engaging in battle and sacrificing thousands of unnecessary souls, the chiefs on both sides agreed to settle the issue by a fight between two buffalos. The Javanese side selected the most powerful and aggressive bull at his disposal, whereas the Minangkabau chose a hungry baby buffalo and armed its horns with sharp knives. In search of milk the starved calf instinctively ran full burst towards the belly of its adversary and killed the Javanese bull with its sharpened horns, thus saving the Minangkabau from the Javanese invasion (Loeb 1972:97).

109 For an excellent description of the matrilineal culture of West Sumatra’s Minangkabau people see Oki (1977 ), Kahn (1993) and Sanday (2002).
The religious beliefs and practices of the Minang are an amalgam of local traditions (*adat*) and strict Islamic thought. While the former dates back to early animistic and Hindu influences, the latter arrived with Muslim merchants and scholars in the 15th century. Some scholars argue that Minang communities have been a showcase for grassroots democracy for many centuries (Loeb 1972:106); for one thing, community representatives (*datuk, mamak*) are directly elected by tribal families and can be replaced (or even expelled) at any time; for another, communal issues are discussed in family units under the direction of female household-heads before they are presented to government representatives.

*Solok and Pesisir: Differences in Government Leadership*

As illustrated in Figure 4.1, the two district-cases selected in West Sumatra are Solok and Pesisir. While Solok is situated on a volcanic plateau in the West Sumatran highlands (60 km east of the provincial capital Padang), Pesisir stretches along the coastline of the Indian Ocean (80 km south of Padang). As the two districts in Central Java, Solok and Pesisir display nearly identical societal-pressure and common social/economic/political indicators (see Appendix 4.1). But, most important, they vary significantly in the quality of government leadership.

Solok's regent Gamawan stands out among his colleagues in West Sumatra. Policy experts, donor agencies and national media concur that Gamawan has shown exceptional leadership since the introduction of decentralization. He was the country's first regent to officially sign an 'Integrity Pact', a bilateral agreement with

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110 Today, approximately 98 percent of West Sumatra's inhabitants refer to Islam as their religion; Christians (1.6%), Buddhists (0.3%) and Hindus (0.01%) represent small minority groups (BPS 2005).
111 To be precise, 'Pesisir' refers to the district Pesisir Selatan and 'Solok' refers to the district of Solok (not Solok City).
112 See Footnote 102.
Transparency International aimed at reducing public corruption by means of local NGO audits. In 2004, Gamawan received the ‘Bung Hatta Anticorruption Award’ for his strong efforts to reduce irregularities within his administration. These anti-corruption efforts have been well-received by the press. The national newspaper Tempo, for instance, praises Solok’s local government leader for taking action against public misconduct – by demoting and dismissing over 60 corrupt bureaucrats in his administration (Fasabeni 2004).

Another unprecedented reform measure, the Jakarta Post reports, has been Gamawan’s initiative to abolish ‘project allowances’ (tunjangan daerah), a common government convention across Indonesia granting top-level officials (regents, department heads, project managers) disproportionately high benefits from public projects (Bachyul 2004:4). According to several interview respondents, Gamawan redistributed project allowances evenly amongst public servants and, in doing so, succeeded in raising the motivation of lower-ranking officials.

The leadership of Pesisir’s regent Basir appears to be at the opposite end of the spectrum. In April 2005, President Yudhoyono authorized a national investigation into a suspected misappropriation of public development funds. According to the magazine Tempo, Basir is currently accused of embezzling grants earmarked for local micro-credits and agricultural extension services. This allegation is confirmed by Indonesian Corruption Watch, which put Basir on their list of ongoing corruption assessments (ICW 2005:7). Apart from this corruption scandal, repeated incidences of illegal logging in national parks (Kompas 2003b) – which are under the official supervision of

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114 These allegations were reported in the national magazine Tempo under the title ‘Presiden Keluarkan Izin Pemeriksaan Dua Bupati’ (President Authorizes Investigation of Two Regents), on 29 April 2005; a description of this investigation was also published by Indonesian Corruption Watch (ICW 2005:7).
Basir and the local tourism department – further underline the doubtful quality of Pesisir’s local government leader.

Table 4.2: Leadership Qualities in Solok and Pesisir

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Solok</th>
<th>Pesisir</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Anti-Corruption Efforts</td>
<td>4.2</td>
<td>2.1</td>
</tr>
<tr>
<td>(2) Power to Change</td>
<td>4.2</td>
<td>2.9</td>
</tr>
<tr>
<td>(3) Reform Vision</td>
<td>4.3</td>
<td>2.9</td>
</tr>
<tr>
<td>(4) Communication Skills</td>
<td>4.1</td>
<td>3.1</td>
</tr>
<tr>
<td>(5) Local Popularity</td>
<td>4.3</td>
<td>2.7</td>
</tr>
</tbody>
</table>

**Leadership Score (Mean Value)**

<table>
<thead>
<tr>
<th>Solok</th>
<th>Pesisir</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.2</td>
<td>2.7</td>
</tr>
</tbody>
</table>

**Overall Evaluation**

<table>
<thead>
<tr>
<th>Good</th>
<th>Fair</th>
</tr>
</thead>
</table>

Source: Author’s estimates based on roughly 125 business respondents in each district.

Note: Scores are mean values of reported leadership qualities (survey questions G3a-e); 1 = ‘very poor’, 2 = ‘poor’, 3 = ‘fair’, 4 = ‘good’, 5 = ‘very good’.

These strong differences between Solok and Pesisir’s government leadership are confirmed (ex-post) in the business surveys done for this study. Applying the same indicators as in Central Java, the survey results in Table 4.2 indicate a distinct variation in perceptions of leadership. While business people in Solok give exceptionally high scores to their regent (mean score of 4.2 out of 5.0), respondents in Pesisir perceive comparatively low leadership qualities (mean score of 2.7). It should be noted that the strongest differences arise in the category ‘anti-corruption efforts’: according to over 120 respondents in each district, Gamawan has made credible attempts to reduce government misconduct (score of 4.2), whereas Basir has apparently failed to do so (score of 2.1).
Pulling together the information from the discussion above, the Javanese and Sumatran district-pairs vary markedly in government leadership. Expert interviews, media reports and local business perceptions show that leadership qualities in Kebumen and Solok are distinctly higher than in Klaten and Pesisir. The significance of these leadership differences is further enhanced by the homogeneity of other factors: since the enactment of decentralization each provincial pair has been embedded in the same national laws and cultural norms and exposed to nearly identical social, political, economic influences.\textsuperscript{115} These controlled baselines, which approximate an imaginary 'ceteris paribus' condition, provide a good foundation for exploring the leadership-hypothesis. Consistent with the discussion in Section 2.5, the following sections test the impact of government leadership by examining three salient business climate issues: (1) local taxation practices, (2) license administration and services, and (3) public-sector corruption.

\textsuperscript{115} As mentioned, the similarity of social/economic/political conditions is outlined in greater detail in Appendix 4.1.
4.3 Local Taxation

In light of Indonesia's rapid decentralization process, business communities throughout the country are concerned about the enactment of imprudent new tax regulations. A recent World Bank report on Indonesia's rural economy, for instance, cautions that many districts have reverted to protectionist policies by using newly gained powers to reintroduce inter-regional trade barriers (2006b:119). Since 2001, district governments have not only been entitled to manage existing local taxes (for example levies for restaurants, hotels, and small-scale mining) but also to create new revenue instruments. The following section will take a closer look at the extent to which the four governments in Java and Sumatra have used these enhanced authorities to introduce trade-distorting tax regulations.

Table 4.3: Distortionary Trade Taxes in Central Java and West Sumatra

<table>
<thead>
<tr>
<th>District</th>
<th>Tax Type</th>
<th>Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kebumen*</td>
<td>None</td>
<td>No distortions</td>
</tr>
<tr>
<td>Klaten</td>
<td>Unofficial Timber Levies</td>
<td>No distortions</td>
</tr>
<tr>
<td>Solok*</td>
<td>None</td>
<td>No distortions</td>
</tr>
<tr>
<td>Pesisir</td>
<td>Road Tax &amp; Unofficial Timber Levies</td>
<td>Implausible Trade Distortions</td>
</tr>
</tbody>
</table>

Source: KPPOD desk evaluation (2004b).
Notes: The asterisk (*) denotes district cases with high leadership qualities.

A good starting point for a discussion on local taxation is provided by the Regional Autonomy Watch (KPPOD). Since the introduction of decentralization, KPPOD has reviewed roughly 900 local government bills (perda) across 200 districts, including the four districts covered in this chapter. The assessment of KPPOD, which

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117 Local tax-assignments are outlined in the Fiscal Decentralization Law (No. 25/1999, Article 22) and the Regional Taxation Law (No. 34/2000, Article 2.4 ). These laws have been criticized, however, for failing to set clear guidelines. Law 34/2000 merely cautions district governments not to obstruct 'economic development' or the 'common good'; see also footnote 45.
118 For information on KPPOD see footnote 42.
scrutinizes recent business-related *perda* in terms of economic impacts and juridical coherence, comes to the conclusion that the tax bills in Kebumen, Klaten and Solok inflict no significant distortions on the local economy (see Table 4.3). The taxes evaluated—covering a large array of recently-enacted levies—neither obstruct regional trade flows nor overlap with existing national charges.

Pesisir, on the other hand, exhibits more tax-induced distortions. Since 2001 Pesisir’s government has had a local road-usage tax (district bill 13/2001: ‘*Retribusi Pemiliharaan Jalan*’) inflicting additional fees on commercial vehicles crossing its borders. As one businessman in Pesisir recalls, these road tariffs have been controversial for several years. According to his account, public servants have unofficially collected road fees (at least) since 1999. Contrary to official statements that these fees are used for maintaining road quality, he estimates that toll officers capture half of the payments by giving only every second truck a receipt. As a result of this perceived exploitation, two collection posts—one in Sagu and one in Siguntur—were burnt to the ground by local fishermen in 1999. Yet, regardless of these incidents, the government nonetheless made the road-usage tax official once they received the authority to do so (field interview in Pesisir, 22 Sep. 2005).

The local dismay at this road bill is echoed by the observations of the Regional Autonomy Watch. According to internal evaluations, KPPOD rejects Pesisir’s road tax for three reasons\textsuperscript{119}: first, it obstructs regional trade dynamics; second, it fails to compensate taxpayers with relevant services; and third, it conflicts with existing provincial vehicle and petrol taxes. Akin to Pesisir’s business voices, KPPOD concludes

\textsuperscript{119} This evaluation is found in an unpublished evaluation report titled ‘*Ringkasan Analisis terhadap Peraturan Daerah di Berbagai Daerah: Perda Pesisir Selatan*’ (Analytical Evaluation of Local Regulations in Various Regions: District Bills in Pesisir Selatan) in KPPOD (2004b).
That this bill is an example of the government’s imprudent efforts to raise district revenue without considering economic impacts.

That border tariffs represent a serious problem, not only in Pesisir but also in other parts of Sumatra, is well-illustrated in a regional trade study by SMERU (2001). Taking the busy trade route from North Sumatra to Jakarta as an example, the study demonstrates the negative impact of road and border levies on local businesses. According to SMERU, a truck transporting oranges from Kabanjahe to Jakarta is required to pay levies (official and non-official) ranging from Rps 270,000 to Rps 1,000,000. ‘Paying the lowest amount would only be possible if the truck complies with its permitted capacity. Nevertheless, even when trucks comply with [capacity regulations] drivers still have to pay levies’ (SMERU 2001: 26). As a result, the cumulative levies of 16 weighing stations have reduced business profits up to 7 percent.

SMERU’s regional trade study indicates that formal tax bills are not the only way by which local economies can be distorted. Other salient, albeit less visible, tax-like trade distortions have emerged in Indonesia's newly decentralized polities. In Klaten, for instance, trucks carrying timber and other valuable natural resources have become prone to unofficial ‘transport taxes’ (Table 4.3). As a senior official in Klaten disclosed, the forestry department collects roughly US$ 20,000 worth of transport levies each year by making use of a legal ‘grey zone’: while the district has yet to enact an official regulation, officials collect unofficial charges on timber imports based on an outdated (and controversial) ministerial decree.120 Even more disturbing, however, is that collected revenues are not transferred to district accounts but are mostly divided among powerful officials.121 According to local firms, these unaccounted charges raise

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120 Ministry of Forestry Decree No. 310/Kpts-II/1999 (‘Guidelines for Granting Forestry Rights’).
121 Author’s interview with a senior official in Klaten, 7 June 2005.
timber costs and inflict unnecessary burdens on Klaten’s furniture and ceramic industries.

Similar unofficial charges on timber transport occur in Pesisir. But, due to the district’s vast national forests, the phenomenon seems less clear-cut than in Klaten. In Pesisir, illegal logging has become a pronounced problem that involves officials and traders alike. As a local timber trader explains, paying informal fees to ‘forestry officers’ (polisi hutan) is a necessary evil for keeping the business going. He admits that most wood-traders are occasionally dealing with cheap illegal timber from Pesisir’s rural forests. Hence, complying with forestry officers – who are often connected to military circles – saves a business from unnecessary trouble, including the next raid against illegal loggers (field interview in Pesisir, 24 Sep 2005).

To recap, the discussion so far shows that taxation practices across the four cases obstruct business communities to different degrees. In Kebumen and Solok there is no evidence of distortionary trade taxation – neither from the field observations in this study nor from the desk reviews of KPPOD. Klaten and Pesisir, on the other hand, exhibit pronounced trade barriers: both districts inflict imprudent unofficial charges which are, in the case of Pesisir, further aggravated by a controversial road tax bill. Based on these findings, tax environments in Kebumen and Solok are ranked as ‘good’, in Klaten as ‘poor’, and in Pesisir as ‘very poor’.\textsuperscript{122}

\textsuperscript{122} Please note that the ranking of district tax distortions (and of all other business climate indicators) are based on a systematic scoring table; details are outlined in Appendix 4.2.
4.4 License Administration

The comparative assessment of license administration focuses on two central aspects. The first section analyzes administrative compliance costs – the time and fees entailed for receiving standard business permits; the second section evaluates administrative services – particularly the quality of ‘one-stop licensing shops’.

Licensing Time and Fees

The data from local business surveys provide valuable information for comparing license procedures across districts – both in terms of time and cost requirements. In each district more than 120 small businesses gave an account of how many days per year they typically spend obtaining standard government licenses before and after the introduction of decentralization.

Table 4.4: Licensing Times before and after Decentralization (in days)

<table>
<thead>
<tr>
<th></th>
<th>Pre-Decentralization Years</th>
<th>Current Years</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Kebumen</strong></td>
<td>16.4</td>
<td>15.9</td>
</tr>
<tr>
<td><strong>Klaten</strong></td>
<td>18.7</td>
<td>15.5</td>
</tr>
<tr>
<td><strong>Solok</strong></td>
<td>10.0</td>
<td>7.1</td>
</tr>
<tr>
<td><strong>Pesisir</strong></td>
<td>12.9</td>
<td>9.7</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>14.5</td>
<td>12.1</td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 500 randomly selected local firms in four districts.
Note: Survey question L2: ‘Please estimate the average time you spend to obtain necessary business permits – (a) before decentralization and (c) during the last two years (2004/2005)’; estimates are based on median-values of time intervals in the survey; the asterisk (*) denotes cases with high leadership qualities.

License requirements naturally vary from case to case, depending on particular business activities (i.e. trade, manufacturing, service); in principal every business is required to obtain a general business permit (TDP) and in addition, once it imposes negative externalities, a so-called community-disturbance permit (HO); common sector-specific requirements include general trade licenses (SIUP) and general industry permits (TDI). Although other license requirements exist, this study focuses on these four ‘standard’ permit types.
The results of this survey, which are depicted in Table 4.4, have yielded two main findings. First, the length of administrative procedures has become shorter since decentralization. The cumulative figures of this four-district sample indicate that recently, local businesses have received necessary permits within 12 days, two days faster than in the pre-decentralization years. This trend of shortened license procedures holds true across all individual district-cases.

The second finding is that current licensing procedures vary widely in the two Sumatran cases, while remaining similar across the two Javanese cases. In West Sumatra, Solok administers business permits within 7 days, whereas in Pesisir local firms require 10 days on average to finalize all administrative paperwork. In fact, Solok's government exhibits less administrative 'red tape' than any other case in the group. The comparison in Central Java is less clear-cut. Local administrations in Kebumen and Klaten inflict similarly high processing times on local businesses: in both cases firms need to wait roughly 16 days for standard business permits.

Table 4.5: Official Time Estimates for Business Licenses (in days)

<table>
<thead>
<tr>
<th>District</th>
<th>Business License (TDP)</th>
<th>Trade License (SIUP)</th>
<th>Industry License (TDI)</th>
<th>Disturbance Permit (HO)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kebumen*</td>
<td>5</td>
<td>5</td>
<td>14</td>
<td>15</td>
<td>39</td>
</tr>
<tr>
<td>Klaten</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>30</td>
<td>45</td>
</tr>
<tr>
<td>Solok*</td>
<td>7</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>22</td>
</tr>
<tr>
<td>Pesisir</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>5</td>
<td>35</td>
</tr>
</tbody>
</table>

Source: Local government documents and interviews with officials in technical departments.
Note: the asterisk (*) denotes district cases with high leadership qualities.

These license time estimates can be cross-checked with official documents from local government departments. As Table 4.5 illustrates, official time estimates display an overall similar pattern to the survey data. Time requirements for four common business licenses – namely TDP, SIUP, TDI, and HO permits – are significantly lower
in Solok (22 days) than in Pesisir (35 days) and somewhat lower in Kebumen (39 days) than in Klaten (45 days). The fact that official figures are overall higher than the reported survey estimates is due to two things: first, because processing times are often shortened by bribe payments (discussed in Section 4.5); and second because local firms rarely comply with all official licensing requirements, but rather choose to obtain permits that are most relevant for their business.

Table 4.6: Official Prices for Business Licenses (in thousand Rps)

<table>
<thead>
<tr>
<th>District</th>
<th>Business License (TDP)</th>
<th>Trade License (SIUP)</th>
<th>Industry License (TDI)</th>
<th>Disturbance Permit (HO)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kebumen*</td>
<td>100</td>
<td>25</td>
<td>100</td>
<td>200</td>
<td>425</td>
</tr>
<tr>
<td>Klaten</td>
<td>200</td>
<td>40</td>
<td>100</td>
<td>250</td>
<td>590</td>
</tr>
<tr>
<td>Solok*</td>
<td>150</td>
<td>50</td>
<td>160</td>
<td>250</td>
<td>610</td>
</tr>
<tr>
<td>Pesisir</td>
<td>75</td>
<td>32</td>
<td>75</td>
<td>600</td>
<td>782</td>
</tr>
</tbody>
</table>

Source: Government documents and interviews with local officials in technical departments.
Note: prices refer to mid-sized trade businesses (investment of US$ 20,000, business type ‘CV’) in mid-sized buildings (50sqm); the asterisk (*) denotes district cases with high leadership qualities.

According to government guidelines, the prices for these four standard business licenses also differ notably across district-pairs in Central Java and West Sumatra. As depicted in Table 4.6, firms in Kebumen pay a total of Rps 425 thousand, roughly 30 percent less than their regional counterparts in Klaten (Rps 590 thousand). The Sumatran comparison reveals that Solok’s business-holders officially spend Rps 610 thousand for obtaining standard permits, approximately 20 percent less than their colleagues in Pesisir (Rps 782 thousand).

Overall, these pairwise comparisons show that districts with ‘good leadership’ display more business-friendly licensing procedures than districts with comparatively

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124 The administration times presented are based on official government publications that were obtained from local industry and trade departments (Dinas Perindustrian dan Perdagangan), local economic bureaus (Bagian Ekonomi) and official ‘one-stop licensing services’ (Pelayanan Satu Pintu).
'poor leadership'. The comparison in West Sumatra shows that Solok's government is more time and cost efficient than its provincial counterpart in Pesisir. In Central Java the district comparison shows similar, albeit less pronounced, features: Kebumen's administration inflicts considerably lower licensing fees on local firms than its regional equivalent in Klaten, whereas processing times are reported to be roughly the same in both Javanese districts. Table 4.7 summarizes the discussion in a simple scoring board.

Table 4.7: Evaluation of License Time and Costs (in days and thousand Rps)

<table>
<thead>
<tr>
<th></th>
<th>Time Evaluation</th>
<th>Cost Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Central Java</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kebumen*</td>
<td>16 Fair</td>
<td>425 Good</td>
</tr>
<tr>
<td>Klaten</td>
<td>16 Fair</td>
<td>590 Fair</td>
</tr>
<tr>
<td><strong>West Sumatra</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Solok*</td>
<td>7 Very Good</td>
<td>610 Fair</td>
</tr>
<tr>
<td>Pesisir</td>
<td>10 Good</td>
<td>782 Poor</td>
</tr>
</tbody>
</table>

Note: Evaluation marks are explained in detail in Appendix 4.2.; the asterisk (*) denotes district cases with high leadership qualities.

Licensing Services

Another good illustration for the variation in administrative performance across districts is given by one-stop licensing services (OSS). These service facilities are a relatively new feature in Indonesia's public sector, introduced as a means to process business licenses in a time-efficient and responsive manner (Kaut 2003). The main objective of OSS is to streamline administrative procedures, which are often dispersed across various technical departments, into one single unit. Theoretically, businesses no longer need to grapple with a long line of desks but simply complete all bureaucratic formalities with 'one stop'.

106
However, for these benefits to materialize, these integrated service stations need to meet a set of conditions. Interviews with local firms and policy experts highlight that the functionality of OSS units depends on whether they are equipped with sufficient technical and human resources; whether they provide transparent information on involved procedures and costs; and whether they hold sufficient authority to independently process license requests. Unless all these criteria are met, OSS services are likely to become just another ‘layer of bureaucracy’ that adds to (rather than simplifies) administrative requirements of local firms. Indeed, empirical evidence shows that the quality of these service stations differs strongly across the four district cases. The following field observations in Central Java and West Sumatra, which were made during unannounced visits to each district’s OSS, provide an illustrative account of these prevailing differences:

Kebumen’s OSS unit (*pelayanan perijianan*) displayed a moderate service environment. General facilities appeared functional, including three standard service-counters and a small waiting area (see Figure 4.2). A group of young public servants responded eagerly to our inquiries and provided us with some photocopied documents that answered most of our licensing questions. However, officials also reported that Kebumen’s OSS service had just recently (6 months prior to our visit) been established by a decree of the regent. Due to this early stage of operation, license services were still compromised by two things: first, the lack of IT equipment to process business licenses; and second, the lack of clearly defined work descriptions and authority of the newly installed service unit.

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125 Author’s interview with a businessman in Klaten, 26 June 2005.
126 Together with local research assistants, these unannounced assessments were conducted in Klaten on 23 June 2005, in Kebumen on 14 July 2005, in Solok on 25 August 2005, and in Pesisir on 23 September 2005; evaluations followed a standardized checklist consistent with the indicators displayed in Table 4.8.
Figure 4.2: Impressions of One-Stop Licensing Services across Case Districts

<table>
<thead>
<tr>
<th>Entrance Area</th>
<th>Counter Area</th>
<th>Working Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Solok</td>
<td></td>
<td></td>
</tr>
<tr>
<td>'Good' Score 4.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kebumen</td>
<td></td>
<td></td>
</tr>
<tr>
<td>'Fair' Score 2.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pesisir</td>
<td></td>
<td></td>
</tr>
<tr>
<td>'Poor' Score 1.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Klaten</td>
<td></td>
<td></td>
</tr>
<tr>
<td>'Very Poor' Score 1.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s pictures taken during unannounced visits to local OSS units (see footnote 126)

Klaten’s one-stop office (*unit pelayanan satu atap*), in contrast, revealed poor service standards. Hidden in an isolated part of the regent’s office, the first appearance of this service unit was rather unwelcoming. The faded paper notice on the front window, the dark and dusty service area, and the ancient typewriters in the corners did not give an impression of a professional needs-oriented environment. Similarly surprising was the lack of technical knowledge and authority of the duty officers, who required more than 15 minutes to produce an outdated information brochure and were
unable to give precise answers to technical license questions. All in all, Klaten’s OSS service unit lacks technical, human and administrative means and therefore merely adds to the bureaucratic burden of local business people. Unsurprisingly, most of Klaten’s business interviewees declared that they were either unaware of the OSS service or preferred going to the technical departments instead.

In West Sumatra, Solok’s service unit (satu pintu plus) set a high benchmark for professional business services. Owing to multiple signposts, the OSS office was easy to spot in the government compound. The clean and bright entrance area - equipped with benches for waiting customers, colorful information boards, and a suggestion-box – created a welcoming and professional atmosphere. During our visit, three out of four service counters were attended by friendly and well-trained officers. A striking feature, on approaching the service area, was that each counter displayed an anti-corruption sticker (‘anti suap’) indicating that bribe-money would not be accepted to accelerate administrative matters. When questioned on licensing details, duty officers instantly provided a well-structured information brochure, precisely outlining the documents required, the costs and administration times for each license.127 Behind the service area, in an adjacent office, we could observe a group of public officials using modern IT facilities to administer license requests. As a senior officer explained, licensing services have been continuously improved to serve the needs of Solok’s business community. Remotely situated business people do not even have to come to the OSS any longer, they can make use of the so-called ‘plus’ option, which allows handing in applications (and receiving licenses) at local post offices. In comparison, the OSS in Solok clearly sets a high standard of professionalism and transparency which is recognized by business people and civil society observers alike.

127 The brochure can be downloaded from Solok’s website at http://www.solok.go.id/html/yantu.html.
The conditions in Pesisir were distinctly less professional than those in Solok. Located in a temporary building near the main government street, Pesisir's service unit (pos yantu) turned out to be a one-room facility. The small office, which was attended by two public officials, was equipped with run-down tables and chairs, a whiteboard with outdated license information from 1998, and a set of dusty typewriters. Although eager to help, the two duty officers were unable to respond to our licensing queries. After several unanswered questions, they disclosed that only one officer (who was absent at the time of the visit) had been trained for these sorts of inquiries. Interviews with local firms revealed that Pesisir's OSS is rarely utilized by the local business community. It is regarded as a rather dysfunctional service unit that fails to provide transparent information and merely prolongs administrative procedures.

Table 4.8: Scoring Board on One-Stop Licensing Services

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Central Java</th>
<th>West Sumatra</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Kebumen*</td>
<td>Klaten</td>
</tr>
<tr>
<td>Information Availability</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Staff Capacity &amp; Attitude</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Physical Facilities</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Data Management</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Decisions Making Authority</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Anti-Corruption Measures</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td><strong>OSS Score (Mean Value)</strong></td>
<td><strong>2.5</strong></td>
<td><strong>1.0</strong></td>
</tr>
<tr>
<td><strong>Overall Evaluation</strong></td>
<td>Fair</td>
<td>Very Poor</td>
</tr>
</tbody>
</table>

Source: Author's evaluation based on direct observations and interviews with local firms.
Note: Scores range from 1-5: 1 = 'very poor,' 2 = 'poor,' 3 = 'fair,' 4 = 'good,' 5 = 'very good'; the asterisk (*) denotes district cases with high leadership qualities.

Table 4.8 presents the impressions of these unannounced OSS visits and quantifies them along six indicators: (1) availability of transparent licensing
information, (2) authority to process license applications, (3) capacity and service attitude of staff, (4) physical facilities and equipment, (5) data management, (6) and additional measures against corruption. Based on the direct observations above (crosschecked with local interview data) the quality of individual licensing services is evaluated on a scoring board, in which each OSS indicator can take values from 1 (very poor) to 5 (very good). The results of this scoring process serve to highlight the differences between regional district-pairs. On the basis of these scores, Solok provides the better licensing service in West Sumatra (score of 4.2); due to high standards in all service indicators it clearly outperforms its equivalent in Pesisir (score 1.7). And Kebumen clearly leads the comparison in Central Java (score of 2.5); the moderate performance of Kebumen’s newly established OSS unit remains well above the poor conditions found in Klaten’s service unit (score of 1.0). Thus, as a bottom-line, districts with higher leadership qualities also display distinctly better business licensing services.
4.5 Public-Sector Corruption

As outlined in the general business climate discussion in Section 2.5, public corruption is often seen as the greatest obstacle for local business development in Indonesia's newly decentralized political framework. Given its illegal character, it is by default also the most elusive one. In this section I present survey and interview evidence that help to assess the different degrees of bureaucratic misconduct in the Javanese and Sumatran district-cases. The following discussion investigates corruption incidents in the context of public recruitment, taxation, licensing, and tender projects.

Corruption during Public-Sector Recruitment

In-depth interviews with local respondents reveal a remarkable phenomenon in Indonesia's local bureaucracies. In three out of four case districts, there is considerable evidence that a number of public servants (PNS) received government positions owing to upfront bribe payments rather than personal qualifications. Arguably, bribe payments of this kind are bound to affect business climates negatively. The reason is simple. Public applicants who pay high entrance fees are likely to seek a ‘return on

128 See Business Climate discussion in Section 1.4.
129 The Indonesian media has reported on PNS bribe incidences in many districts. The Indonesian newspaper Kompas for instance, features a story of a PNS candidate complaining to President S. B. Yudhoyono for being asked to pay Rps 40 million to enter the public service in Bekasi, West Java. (Kompas 2004b); other examples include: (1) ‘Penerimaan CPNS dinilai KKN’ (Acceptance of Public Servants Evaluated as Corrupt), Waspada, 24 March 2006, page 12; (2) ‘Penerimaan Karyawan Perusahaan Syarat KKN’ (Approval of Regional State-Owned Enterprise Staff depends on Corruption Fees), Bernas, 10 February 2004, page 3; (3) ‘Pengakuannya Seorang Mantan CPNS: Bayar 50 Juta, Saya Diterima jadi Pegawai’ (Confession of a former local PNS Candidate: Once I Pay 50 Million, I am accepted as a Public Servant), Pedoman Rakyat, 9 December 2003, page 1; (4) ‘Perlu Pelicin Rp. 40-75 Juta Untuk Jadi PNS Di Sum-Ut’ (In North Sumatra, You Need to Pay 40-75 Million to Become a PNS), Republika, 3 December 2001, page 11; (5) ‘PNS Keluhkan pungli ambil SK naik pangkat’ (Public Servant complains promotion requires bribes), Surya, 23 April 1998, page 8; (6) ‘PNS: Antara Idealisme dan Realitas’ (Public Servants: Between Idealism and Reality), Kompas, 6 July 2003, page 30; (7) ‘Penerimaan PNS - Joko Terindikasi Langgar Disiplin Pegawai’ (PNS Recruitment – Joko under Disciplinary Procedure), Kompas 04 August 2006, page 24; (8) ‘Memberantas KKN, Memangkas Pegawai’ (Alleviate Corruption, Cut Public Servants’), Kompas, 6 July 2003, page 26; (9) ‘Isu Suap Warnai Penerimaan CPNS Lamongan’ (Grease Money Issue in Lamongan’s Public Servant Selection), Surya, 16 January 2002, page 17. (10) ‘Rekrutmen CPNS Sering Pakai “Uang Pelicin” (Public Servant Recruitment often connected to ‘Grease Money’ ), Banjarmasin Post, 14 March 1997, page 2.
'investment'. Once becoming part of the local government system, they are likely to pursue financial compensations in their new positions, including illegal exaction during local tax collection, business licensing and project tendering.

Table 4.9: Bribe Incidences during Public-Sector Recruitment (in million Rps)

<table>
<thead>
<tr>
<th>District Respondent</th>
<th>Central Java</th>
<th>West Sumatra</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Kebumen*</td>
<td>Klaten</td>
</tr>
<tr>
<td>No 1</td>
<td>15</td>
<td>90</td>
</tr>
<tr>
<td>No 2</td>
<td>8</td>
<td>75</td>
</tr>
<tr>
<td>No 3</td>
<td>8</td>
<td>75</td>
</tr>
<tr>
<td>No 4</td>
<td>0</td>
<td>75</td>
</tr>
<tr>
<td>No 5</td>
<td>0</td>
<td>70</td>
</tr>
<tr>
<td>No 6</td>
<td>exist</td>
<td>60</td>
</tr>
<tr>
<td>No 7</td>
<td>exist</td>
<td>55</td>
</tr>
<tr>
<td>No 8</td>
<td>-</td>
<td>50</td>
</tr>
<tr>
<td>No 9</td>
<td>-</td>
<td>50</td>
</tr>
<tr>
<td>No 10</td>
<td>-</td>
<td>45</td>
</tr>
<tr>
<td>Average</td>
<td>6</td>
<td>65</td>
</tr>
</tbody>
</table>

Evaluation | Fair | Very Poor | Very Good | Poor |
--- | --- | --- | --- | --- |

Source: Interview data with 10 non-government respondents in each district. Note: respondents in each district are displayed in descending order of reported bribes; the statement 'exist' indicates that respondents affirm bribe payments without providing clear estimates; evaluation marks are explained in detail in Appendix 4.2; the asterisk (*) denotes cases with high leadership qualities.

During interview sessions in each district the question 'do you know whether some PNS applicants pay bribes in order to receive government positions' received a surprisingly large response. Many of the (non-governmental) interviewees were not only willing to affirm the bribing phenomenon but also prepared to give an estimate on illegal payments. As illustrated in Table 4.9, the strongest evidence of illegal payments includes the following: (1) 'Some PNS candidates pay between Rps 25 to 30 million depending on their degree. [...] Some Teachers are asked for Rps 15 million [...] police officers around Rps 35 million. [...] I was asked myself to pay Rps 10 million in 1996 to get accepted into the public service. But I declined. (interview with a businessman in Pesisir, 22 Sep. 2005); (2) 'Under Suharto some people paid between Rps 2.5 and 10 million to become public officials. Now, there are no payments any longer. [...] I believe officials in other West Sumatran districts pay between Rps 20 and 40 million to be accepted' (interview with two academics in Solok, 28 Aug 2005); (3) 'Before [decentralization] there were rumors that a high-school head had to pay Rps 19 million. [...] Also, it doesn't seem unlikely that some people had to pay certain amounts to become PNS to that time. 130

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130 Some exemplary statements include the following: (1) 'Some PNS candidates pay between Rps 25 to 30 million depending on their degree. [...] Some Teachers are asked for Rps 15 million [...] police officers around Rps 35 million. [...] I was asked myself to pay Rps 10 million in 1996 to get accepted into the public service. But I declined. (interview with a businessman in Pesisir, 22 Sep. 2005); (2) 'Under Suharto some people paid between Rps 2.5 and 10 million to become public officials. Now, there are no payments any longer. [...] I believe officials in other West Sumatran districts pay between Rps 20 and 40 million to be accepted' (interview with two academics in Solok, 28 Aug 2005); (3) 'Before [decentralization] there were rumors that a high-school head had to pay Rps 19 million. [...] Also, it doesn't seem unlikely that some people had to pay certain amounts to become PNS to that time.
recruitment practices arises in Klaten. Here, all respondents (who were questioned on this issue) affirmed the existence of upfront bribe payments and estimated that some public servants have invested between Rps 45 and 90 million to secure their government position (average of 65 million). In Kebumen, on the other hand, only a few interviewees report recruitment irregularities. Overall, bribe estimates in Kebumen do not exceed Rps 15 million (average of Rps 6 million). This clear difference between the two Javanese cases is accompanied by diverging trends across time: while interviewees in Klaten repeatedly state that recruitment practices have become more corrupt since decentralization, interviewees in Kebumen report marked improvements.

A similar distinction arises in the comparison of the two Sumatran cases. In Pesisir, interview respondents estimate that ‘entry fees’ can range between Rps 15 and 30 million (average of 23 million) and declare that recruitment irregularities have somewhat increased since 2001. Solok’s recruitment process, in contrast, receives an exceptionally good evaluation. All interviewees in Solok – without exception - assert that bribe payments are entirely absent. While some acknowledge incidents in the 1980s and early 1990s, there is mutual agreement that incoming public servants have been selected in a truly transparent manner since the introduction of decentralization.

Undoubtedly, due to its sample-size and perception-based nature, this data is not an entirely reliable measure of illegal recruitment payments. Nonetheless, it clearly serves to highlight diverging trends: in one district there is none, in one district there is some, and in two districts there is substantial indication that some public servants have taken office by paying bribes instead of passing entry-exams. Based on these bribery trends – and consistent with the scoring table in Appendix 4.2 – the level of integrity in

[...]

it also seems that brokers ‘selling’ PNS positions do not have to be in Kebumen – they can be situated in Yogyakarta (interview with senior official in Kebumen, 12 July 2005).
public recruitment is ‘very good’ in Solok, ‘fair’ in Kebumen, ‘poor’ in Pesisir, and ‘very poor’ in Klaten.

One question that needs to be addressed in this context, however, is why some PNS candidates pay high premiums to enter the public service. In order to pay a bribe of Rps 50 million, for instance, an applicant may be forced to take out a bank loan or sell personal assets. Given that initial monthly salaries of incoming public servants are roughly Rps 1 million (Rachmadi 2005) an investment of this kind would be equivalent to more than four years of income. Hence, given the apparent imbalance of costs and benefits, decisions to make such bribe payments appear – at least at first sight – to be counterintuitive.

Then again, a closer look into the socio-economic features of the districts explains this phenomenon. The field interviews point to two main aspects. First, government officials enjoy a high social status in rural Indonesia. Rural society at large still considers public-service positions as the most prestigious employment. Arguably, ever since the Dutch established the first rural administrations by placing regional aristocrats in leading positions, holding a government rank has been widely recognized as a privilege. As a local trader in Pesisir describes it: ‘The high social value of PNS positions is deeply rooted in our society. Fathers want to entrust their daughters to securely employed officials rather than successful businessmen’ (field interview in Pesisir, 22 Sep. 2005). And second, formal and informal discussions with local respondents indicate that the majority of people prefer public- to private-sector employment because the former apparently guarantees more economic security than the latter. In light of crisis-induced fluctuations and sluggish economic growth, private-sector jobs often fail to guarantee stable living standards. Hence, the hope of many
locals is geared towards attaining a life-long government position, with secured health and pension benefits.

This pursuit of social recognition and economic security has led to an enormous demand for government positions. In the year 2004, for instance, 4.5 million applicants competed Indonesia-wide for 200,000 government openings (Kompas 2004a). In light of this pronounced over-demand, some applicants seem prepared to pay illegal bribes worth several times their annual salaries in order to secure a government position. Unfortunately, by making such payments, bribe-payers are likely to be drawn into a vicious corruption circle. As an official in Klaten disclosed: ‘in order to become a PNS some pay between Rps 40 and 60 million ... Automatically, against this backdrop of investing so much money, one has to coordinate means to make a profit. That’s a basic economic principle, I guess ... Officials needs to get [the money] back from local businesses; this eventually leads to our unfavorable business climate’ (field interview in Klaten, 7 June 2005). In light of this dilemma, in which a number of public servants seek a ‘return on investment’, it is not surprising that corruption remains an endemic feature of Indonesia's local bureaucracies (see Chapter 2). The following sections will examine three facets of public corruption in particular: extortion during tax collection, license administration and tender management.

Corruption during Tax Collection

Looking at local taxation, many tax irregularities seem to arise from mutual agreements between officials and local business people to cut down tax charges. According to the business survey in this study, special tax deals are a widespread feature in all case study districts except Solok. Roughly one in two business-
respondents in Klaten, Kebumen and Pesisir admits that it is possible to ‘bargain with tax officials to find a beneficial solution for both sides’ (see Table 4.10).

Table 4.10: Perceptions of Tax Bargaining Practice (Respondent Shares)

<table>
<thead>
<tr>
<th>District</th>
<th>'It is possible to bargain with tax officials'</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
</tr>
<tr>
<td>Kebumen*</td>
<td>31.4</td>
</tr>
<tr>
<td>Klaten</td>
<td>33.9</td>
</tr>
<tr>
<td>Solok*</td>
<td>47.7</td>
</tr>
<tr>
<td>Pesisir</td>
<td>40.4</td>
</tr>
<tr>
<td>Average</td>
<td>38.4</td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 500 randomly selected local firms in four districts.
Note: based on survey question T3a: ‘please give your opinion on the following statements: It is possible to bargain with tax officials to find a beneficial solution for both sides; the asterisk (*) denotes cases with high leadership qualities.

As a businessman in Klaten explains, it is common practice for district officials to strike special deals with local businesses. He provides the following example: ‘let us suppose a local entrepreneur has a tax debit of, say, Rps 100,000. Since bookkeeping and independent audits are largely absent, tax officials are often willing to strike a deal, provided that the entrepreneur accepts a false tax receipt. Eventually, the business owner may end up paying Rps 50,000 to the official, while receiving a tax receipt on merely Rps 25,000. Since both sides clearly benefit from this practice, the matter remains largely undetected (field interview in Klaten, 14 June 2005).

To give another illustration, the owner of a seaside restaurant in Pesisir reports that he negotiated a fixed monthly charge of Rps 25,000 with local officials. Interestingly, this amount is but a small fraction of what he officially needs to pay. Given monthly sales of roughly Rps 10,000,000 (conservative estimation of the owner) and a restaurant-tax of 10 percent, his monthly payments cover merely 2.5 percent of
the legal tax obligation. In any case, he declares, this is still much more compared to what other restaurants pay in the area (field interview in Pesisir, 13 Sep. 2005).

Table 4.11: Corruption during Tax Collection (Percent of Tax Charges)

<table>
<thead>
<tr>
<th>District</th>
<th>Pre-Decentralization Years</th>
<th>Current Years</th>
<th>Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kebumen*</td>
<td>3.6</td>
<td>4.0</td>
<td>Fair</td>
</tr>
<tr>
<td>Klaten</td>
<td>5.5</td>
<td>6.8</td>
<td>Poor</td>
</tr>
<tr>
<td>Solok*</td>
<td>2.8</td>
<td>2.2</td>
<td>Good</td>
</tr>
<tr>
<td>Pesisir</td>
<td>3.5</td>
<td>5.1</td>
<td>Fair</td>
</tr>
<tr>
<td>Average</td>
<td>3.9</td>
<td>4.5</td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 500 randomly selected local firms in four districts.
Note: survey question T2 (b/d): ‘Please estimate average informal payments to district tax collectors as percentage of total tax charges’; estimates are based on median-values of time intervals in the survey; for a systematic overview of evaluation marks see Appendix 4.2; the asterisk (*) denotes cases with high leadership qualities; ‘current years’ refers to 2004 and 2005.

In light of these mutual tax deals, where revenues are embezzled not only by public servants but also (indirectly) by taxpayers, an assessment of tax corruption becomes more complicated. It is likely that businesses which commit tax offenses are somewhat biased in their perception and, for that matter, are unlikely to report the full extent of tax corruption. As a result, the business survey may well ‘underestimate’ the actual level of tax corruption. Keeping this caveat in mind, the survey data nonetheless clearly indicates two things (see Table 4.11). First, corruption fees – measured in percent of total tax charges – have slightly increased since decentralization: the average across the four observed districts increased from 3.9 to 4.5 percent. And second and more importantly, the data highlights diverging trends across the two district-pairs in West Sumatra and Central Java. In recent years, corruption fees have been more than twice as high in Pesisir (5.1 percent) as in Solok (2.2 percent), and considerably higher in Klaten (6.8 percent) than in Kebumen (4.0 percent). It should also be noted that Solok is the only district that has had declining corruption figures since decentralization. In
light of these figures (and the scoring table in Appendix 4.2), the tax administration in Solok receives a ‘good’, in Pesisir and Kebumen a ‘fair’, and in Klaten a ‘poor’ score.

*Corruption during License Administration*

Turning to corruption incidences during the administration of business licenses, the business survey data indicates a similar pattern to the one during local tax collection. A notable difference, however, is that extortion levels – measured in percent of total license charges – are overall higher.

Table 4.12: Corruption during License Administration (Percent of Total Charges)

<table>
<thead>
<tr>
<th></th>
<th>Pre-Decentralization Years</th>
<th>Current Years</th>
<th>Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kebumen*</td>
<td>8.9</td>
<td>9.8</td>
<td>Poor</td>
</tr>
<tr>
<td>Klaten</td>
<td>6.2</td>
<td>8.4</td>
<td>Poor</td>
</tr>
<tr>
<td>Solok*</td>
<td>5.2</td>
<td>2.9</td>
<td>Good</td>
</tr>
<tr>
<td>Pesisir</td>
<td>6.3</td>
<td>7.4</td>
<td>Poor</td>
</tr>
<tr>
<td>Average</td>
<td>6.6</td>
<td>7.1</td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 500 randomly selected local firms in four districts. Note: based on survey question ‘L3’: ‘Please estimate average unofficial costs (as percentage of official prices) for business licenses’; estimates are based on median-values of percentage intervals in the survey; for a systematic overview of evaluation marks see Appendix 4.2; the asterisk (*) denotes cases with high leadership qualities; ‘current years’ refers to 2004 and 2005;

Among the two West Sumatran districts, Solok – once again – sets a clear performance benchmark. Local firms in Solok report that illegal add-on fees for business permits have significantly decreased from 5.2 percent during the pre-decentralization years to 2.9 percent in recent years (see Table 4.12) In contrast, business people in Pesisir have experienced rising extortions since decentralization and currently pay average corruption premiums of 7.4 percent. Bureaucratic extortion in the two Central Javanese cases is higher and less distinct. According to my survey results, local firms in Kebumen are burdened on average with 9.4 percent corruption fees,
whereas their colleagues in Klaten pay 8.4 percent. Although the reported corruption

tendencies in Klaten are slightly lower, they have increased more strongly since the
introduction of decentralization. In light of these corruption tendencies in West Sumatra
and Central Java (and consistent with the scoring frame outlined in Appendix 4.2), the
license administration in Solok is ranked as 'good', and in Pesisir/Kebumen/Klaten as
'poor'.

Table 4.13: Uncertainties during License Administration (Respondent Shares)

<table>
<thead>
<tr>
<th>District</th>
<th>'Since decentralization, license administration has become more uncertain'</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
</tr>
<tr>
<td>Kebumen*</td>
<td>48.8</td>
</tr>
<tr>
<td>Klaten</td>
<td>36.7</td>
</tr>
<tr>
<td>Solok*</td>
<td>61.5</td>
</tr>
<tr>
<td>Pesisir</td>
<td>45.4</td>
</tr>
<tr>
<td>Average</td>
<td>48.1</td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 500 randomly selected local firms in four districts.
Note: Based on survey question L4b: 'Please give your opinion on the following statement: 'Uncertainties
of license administration have increased since decentralisation!'; the asterisk (*) denotes cases with high
leadership qualities;

Solok’s good performance is also echoed in the responses to survey questions on
whether license administration has become more uncertain under the new decentralized
framework. As indicated in Table 4.13, the share of firms reporting rising uncertainties
is three times lower in Solok (10.0 percent) than in Pesisir (31.9 percent). This is similar
in Central Java, where roughly half as many businesses in Kebumen (14.9 percent) are
worried about uncertain license procedures as in Klaten (29.2 percent).

The prevailing problems of license corruption are widely confirmed in the field
interviews. To give an example, the owner of a medium-sized shop in Pesisir reports
that he paid a total of Rps 250,000 for obtaining business and trade licenses. According
to his statements, he was neither informed of the actual license prices, nor did he receive
any official receipts for his payments; he suspected that the illegal fee was 20 percent of official license charges (interview in Pesisir, 22 Sep. 2005). A closer look at Pesisir’s licensing regulations (district bill 34/2003), which is not openly distributed to local businesses but kept on the shelves of the government’s law office (bagian hukum), reveals that the two business permits officially cost Rps 107,000 (see also Table 4.7 above). In other words, the payment of Rps 250,000 entailed a hidden corruption fee of 140 percent, a level of administrative capture that strongly exceeds the expectation of the merchant. This example is not exceptional. In fact, several other interviewees – in Pesisir, Klaten, and to a lesser extent Kebumen – reported similar scenarios. Overall, many business people tend to comply with the ‘calculations’ of public officials in order to get their paperwork done quickly – often without knowing actual prices or implicit corruption premiums.

*Corruption during Public Tender Administration*

The third indicator of public-sector corruption is the fairness of government tender. As stipulated in the presidential decree (Kepres) 80/2003, government projects and procurements that exceed budget-lines of Rps 50 million need to be publicly announced and allocated on a competitive and transparent basis. Empirical evidence, however, shows that local administrations often fail to adhere to this national

131 As a general note, corruption estimates arising from in-depth interviews appear to be distinctly higher than those from survey questionnaires. This can partly be attributed to different levels of privacy during interview sessions. Survey questionnaires were randomly administered during unannounced visits in respective working places (e.g. bustling shops, local markets, hotels, restaurants, and small-scale industries). In these busy work environments, survey respondents often remained suspicious (despite research identification) as to whether questionnaires were linked to local tax offices and as to whether their answers would negatively affect future relationship with local governments. In-depth interviews, on the other hand, were conducted with purposely selected business representatives during announced visits in private offices or residencies. In most cases interviewees trusted that statements would remain confidential and were less cautious to speak out. Against this backdrop, business surveys are especially useful to compare relative corruption trends across districts, but not necessarily accurate in absolute terms.
guideline. According to local informants, public tender – for instance for the construction of public roads, schools, hospitals and government buildings or the purchase of public vehicles, education materials, furniture or stationery – remain the main target for rent-seeking activities. Large amounts of money change hands in short periods of time, opening up ample opportunities for illegitimate capture.

The interviews with non-government respondents across four districts indicate a common pattern. According to local informants, rent-seeking activities involve a network of selected (1) senior public servants (including security forces), (2) local parliamentarians, (3) and large construction/procurement companies. A few powerful administrators, legislators and private providers tend to form an informal triangular arrangement to jointly extract rents. Such ‘collusion triangles’ have arguably two negative effects on local business climates. For one, they establish uncontested markets and thereby create disincentives for existing/incoming entrepreneurship and investment. For another, reduced output qualities undermine the quality of public streets, hospitals and schools and, thereby, the locational attractiveness for prospective investors. Examples of such collusion arrangements were frequently reported during field interviews. The following accounts serve to illustrate this trend:

As a businessman from District A argues, ‘merely 50 percent of local infrastructure budgets are used for earmarked purposes; the rest is divided among a powerful few who happen to be involved in government projects. From the

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132 Davidsen et al. point out that this new national procurement regulation 80/2003 is a step in the right direction, as it fosters transparency, open-market competition, and efficiency. It’s implementation, however, deserves greater vigor (2006:28). The Joint Donor Committee (CGD) comes to a similar conclusion. It emphasizes that the ‘current procurement scheme, as defined by Keppres 80/2003, is in line with good international practice, although its consistent enforcement is a problem’ (CGD 2006:6).

133 These ‘collusion triangles’ are similar to the ‘iron triangle’ phenomenon observed in developed countries (Michels 1962; McConnell 1966; Lowi 1969), in which private-sector actors capture bureaucrats and legislators for their private interests. The clear difference in the Indonesian case is that bureaucrats and legislators are likely to be active players rather than passive targets in rent-seeking activities.

134 In order to secure the anonymity of respondents district-cases are not specified.
budget for a district road project, for instance, senior officials overseeing the
tender process tend to capture 15 percent; construction companies ‘winning’ the
bid keep 15 percent; political parties and parliamentarians legalizing the deal
receive 10 percent; construction associations ask for 5 percent; and police officers
securing the site demand another 5 percent’ (pre-fieldwork interview, 12 Feb
2004).

As a businessman in District B recalls: ‘I was offered the chance to implement a
public infrastructure project, in which 30 percent of the total value was ex-ante
captured by local decision makers: 15 percent by the department of public works;
and another 15 percent by the local parliament. Initially I wanted to decline this
project, but - given my economic circumstances – I finally decided to comply with
the offered conditions’ (field interview, 22 Sep 2005).

A member of an NGO in District C reports that ‘the government has made some
efforts in making public tenders more transparent. Although there have been
notable improvements, many problems remain unsolved. A credible penalty
system is needed, as well as a blacklist of corrupt construction companies.
Moreover, as long as the rural economy is weak and people are struggling to
secure enough money for their children’s’ education, transparency is often
secondary. Although, tender practices are improving, there is still room for
corruption. Either people fake a ‘free market’ tender by adding fictive
competitors; or selected applicants collude to cover up lower implementation
qualities. Leakages still amount to 30 percent of budgeted values (field interview,
24 Aug 2005).

In District D a businessman revealed that in 2005, 40 percent of the budget for
procurement of school tables was captured by local elites. Twenty companies
officially tendered. Yet, all tender applications but one were false; nineteen
applicants were paid off for quietly withdrawing their applications later on. In this
project, the official budget for school tables was set at Rps 1.5 billion. Since
actual costs amounted to only Rps 900 million, the remaining Rps 600 million
could be divided among the colluding parties. The entrepreneur delivering the
tables received around Rps 100 million; Rps 200 million went to government
departments; and the rest was distributed to local politicians and other powerful
elites (field interview, 13 July 2005).
Table 4.14: Transparency and Fairness of Government Tender (Respondent Shares)

<table>
<thead>
<tr>
<th>District</th>
<th>Intransparent Information</th>
<th>Unfair Procedures</th>
<th>Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kebumen*</td>
<td>42.5</td>
<td>45.0</td>
<td>Poor</td>
</tr>
<tr>
<td>Klaten</td>
<td>95.0</td>
<td>97.5</td>
<td>Very Poor</td>
</tr>
<tr>
<td>Solok*</td>
<td>5.4</td>
<td>8.1</td>
<td>Good</td>
</tr>
<tr>
<td>Pesisir</td>
<td>12.5</td>
<td>10.0</td>
<td>Fair</td>
</tr>
<tr>
<td>Average</td>
<td>38.9</td>
<td>40.2</td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s own estimates based on 2005 KPPOD Business Survey data.

Note: 40 business respondents in each district were asked to evaluate (1) the transparency of information and (2) the fairness of procedures during publicly tendered government projects – on a scale of 1 (very poor) to 9 (very good); presented figures embody the share of all negative responses (1 to 4); evaluation scores are based on average transparency and fairness shares in each district; for details see Appendix 4.2; the asterisk (*) denotes cases with high leadership qualities.

Although these statements signal that corrupt public tender arrangements remain a problem for local business climates overall, there is nonetheless significant variation across district cases. Based on the data of the 2005 KPPOD business survey (see Table 4.14), a vast majority of informants in Klaten perceive public tenders not to be transparent (95 percent) and unfair (98 percent). In Kebumen, on the other hand, skepticism prevails on a lower level (43 and 45 percent). In West Sumatra, complaints are even lower. Only a small fraction of Pesisir’s business community - and an even smaller one in Solok - indicates procedural shortcomings during public tender. Consistent with these diverging survey perceptions, Klaten receives a ‘very poor’, Kebumen a ‘poor’, Pesisir a ‘good’ and Solok a ‘very good’ score.
4.6 Conclusion

Informed by the series of in-depth business climate analyses presented above, the stated leadership hypothesis can be examined. Do higher qualities of government leadership coincide with better business climates? The answer, based on the roughly 60 in-depth interviews and 500 business questionnaires, is in the affirmative.

Figure 4.3: Leadership and Business Climates in Kebumen and Klaten

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Kebumen</th>
<th>Klaten</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leadership</td>
<td>Good</td>
<td>Poor</td>
</tr>
<tr>
<td>(1) Non-Distortionary Taxation</td>
<td>Good</td>
<td>Poor</td>
</tr>
<tr>
<td>(2) License Time</td>
<td>Fair</td>
<td>Fair</td>
</tr>
<tr>
<td>(3) License Cost</td>
<td>Good</td>
<td>Fair</td>
</tr>
<tr>
<td>(4) License Services</td>
<td>Fair</td>
<td>Very Poor</td>
</tr>
<tr>
<td>(5) Non-Corrupt Public Recruitment</td>
<td>Fair</td>
<td>Very Poor</td>
</tr>
<tr>
<td>(6) Non-Corrupt Tax Collection</td>
<td>Fair</td>
<td>Poor</td>
</tr>
<tr>
<td>(7) Non-Corrupt Licensing</td>
<td>Poor</td>
<td>Poor</td>
</tr>
<tr>
<td>(8) Non-Corrupt Public Tender</td>
<td>Poor</td>
<td>Very Poor</td>
</tr>
<tr>
<td>Overall Business Climate (Mean)</td>
<td>Fair (3.0)</td>
<td>Poor (1.9)</td>
</tr>
</tbody>
</table>

Note: Summary evaluations range from very poor (1 block) to very good (5 blocks);

By juxtaposing leadership qualities with local business indicators, it becomes obvious that districts endowed with better government leaders exhibit better business climates. As Figure 4.3 illustrates, the comparison of the two Javanese cases suggests that Kebumen leads in six, and is equal to Klaten in two out of eight business climate indicators. While the good leadership qualities of Kebumen’s regent coincide with fair business scores (average of 3.0), the poor quality of Klaten’s government leader corresponds with poor business conditions (average of 1.9).
In West Sumatra, the alignment of good business climates with good leadership is even more marked. As summarized in Figure 4.4, Solok’s tax, license and public-tender practices are clearly more favorable for local business communities (average score of 4.1) than those prevailing in Pesisir (average score of 2.4). Recalling that Solok displays distinctly better leadership qualities than Pesisir, and recalling that both districts are nearly identical in other (economic, social, and political) respects, these results clearly support the notion that the nature of prevailing business climates correspond with leadership qualities.

What remains to be answered, however, is the direction of causality. Is government conduct a result of leadership, or is leadership a result of prevailing government conduct? The evidence from the district-cases suggests that the former causal flow is much more likely than the latter one. On the one hand, interviewees repeatedly emphasized that the quality of government leaders is a crucial determinant of tax regulations, license administration and public-sector corruption; none of the
respondents argued for the reverse logic. On the other hand, the comparison of business-climate results before and after decentralization strengthens the impression that leadership is a driving force for local business conditions. The fact that tax, licensing, and public recruitment practices changed (in most cases, they improved under good government leadership) while leadership qualities remained virtually unchanged\textsuperscript{135}, supports the predicted causal flow. Thus, in light of the interview and survey data, it is much more plausible that government leadership is a cause of, and not a result of, local business climates.

Overall, the two case comparisons provide considerable evidence that government performance (in terms of tax, licensing and tender practices) is linked to government leadership. The results in this chapter hence resonate well with the elite-centered view suggesting that local government leaders, who scrutinize bureaucracies and build reform coalitions, are instrumental in explaining government outcomes. In other words, the leadership-hypothesis deduced from this body of literature is affirmed by the case findings. So far, this affirmation rests on comparative case-analyses across four districts. Chapter 6 further elaborates this proposition from a statistical point of view. By using a large cross-district dataset, a series of regression analyses is undertaken; these help to crosscheck case findings and, at the same time, provide an additional opportunity to examine the significance of economic and socio-political factors that were held constant in this chapter.

\textsuperscript{135} Regents in Klaten, Kebumen, Solok and Pesisir were all in office during the first (post-Suharto) legislation period from 2000 to 2005; for Solok's regent this was, in fact, the second appointment.
Chapter 5
Societal Pressure Cases – Business Climates in Bali and NTB

5.1 Introduction

As outlined in Chapter 3, a common assertion in the good governance literature is that societal pressure – through interest group activity and political representation – is a key factor in good government performance. This chapter sets out to empirically analyze this societal-pressure hypothesis in the context of Indonesia's newly decentralized political framework. It does so by looking at pressures emerging from a particular subset of rural societies: local business people.

Do districts with better educated, informed business people and more dynamic business associations exhibit better government performance? By and large, the empirical findings in this chapter provide little support for this causal link. The controlled case-comparisons in the two provinces Bali and West Nusa Tenggara (NTB)\textsuperscript{136} show no consistent evidence that potential business pressure relieves tax distortions, administrative inefficiencies or corruption problems. On the contrary, the empirical results (encompassing 500 business surveys and 60 in-depth interviews) suggest indistinct, at times even adverse, business climate effects.

The structure of this chapter is similar to the previous one. The second section familiarizes readers with the two provinces in which the district comparisons take place and describes the differences in business pressure across regional district-pairs. The following sections then explore the societal-pressure hypothesis by comparing tax (third

\textsuperscript{136} Note that ‘NTB’ (short for \textit{Nusa Tenggara Barat}) is the common Indonesian term for the region of West Nusa Tenggara, a region that English geographers sometimes refer to as the ‘Lesser Sunda Islands’.
section), licensing (fourth section), and corruption practices (fifth section) across districts with high and low business pressure. The sixth section summarizes the empirical outcomes and draws preliminary conclusions on business-pressure effects.
5.2 Selecting Societal-Pressure Cases

Similar to the analysis of government leadership in Chapter 4, the societal-pressure hypothesis will be tested by comparing local business climates across controlled district-cases. For this purpose I chose district-pairs in Bali and NTB that differ markedly in societal pressure indicators and, at the same time, remain relatively homogenous in government leadership and other social/economic/political factors. As explained in Chapter 3 (Table 3.1), a controlled setting of this type allows more robust inferences to be made on the effects of business pressure on local government performance.

Figure 5.1: Case Study Locations in Bali and West Nusa Tenggara

As depicted in Figure 5.1, the two district-pairs that best meet these selection criteria are Gianyar and Karangasem in the province of Bali and Bima and Lotim\(^{137}\) in the province of West Nusa Tenggara. The next sections describe these district pairs, first by sketching the respective provincial context, and second, by explaining the pairwise differences in the societal-pressure indicators.

\(^{137}\) In this study, the district of ‘Lombok Timur’ is referred to as ‘Lotim’ – an abbreviation that has become common in the region of West Nusa Tenggara.
The first district-pair is located in the province of Bali. The island of Bali is situated between Java and West Nusa Tenggara. Stretching over a landmass of 5,600 sq km, Bali is one of the smallest provinces in Indonesia. With a total population of 3.4 million (600 people per sq km) it is also the most densely populated province outside Java. This population density explains Bali’s relatively high number of administrative government units in relation to its small geographical size, namely 9 districts and roughly 700 villages.

Compared to other parts of Indonesia, the Balinese economy is relatively well-developed with an annual per-capita income of US$ 680 and a poverty rate of 7 percent (national averages lie at US$ 720 and 18 percent). According to provincial statistics, in 2004, 23 percent of Bali’s regional income derived from agriculture and mining; 15 percent from manufacturing, construction and utilities; and 62 percent from trade and services. A large share of regional GDP derives from the tourism industry. The Balinese tourist industry in a wider sense (including incomes from hotels, restaurants, trade, transport and tourist services), accounts for the largest part of tertiary incomes – adding up to roughly half of the island’s GDP. Such a high income from tourism, however, should not lead to the presumption that agriculture plays a secondary role in Bali. As in most parts of Indonesia, rural communities continue to concentrate strongly on agricultural production. The most obvious example is rice farming. Balinese rice

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138 If not mentioned otherwise, the data appearing in the next two sections are taken from national (BPS 2005; 2006) and local government statistics (BPS Gianyar 2004; BPS Karangasem 2004). For reasons of simplification, some of the figures presented are rounded.
139 Approximately US$ 1 = Rps 10,000; this currency rate (as at November 2005) is underlying all following conversions from Indonesian Rupiah (Rps) to US Dollars ($US). The figures presented above are based on 2002/2003 per-capita incomes at current prices (without oil/gas production).
140 Timmer (2002; 2004) and Warr (2003) argue, for instance, that growth in agriculture has been instrumental for Indonesia’s declining poverty rates; industry and non-agricultural services, on the other hand have contributed less to pro-poor growth.
farmers are renowned for their long-standing, efficient irrigation systems (Subak) which yield high surpluses and - since the 1970s - make them one of the largest rice exporters in Indonesia (Jayasuriya and Nehen 1989:338).

Culturally, Bali is well-known in the Western world for its handicraft, music, fine arts, and dance. Similarly well-known is the fact that the Balinese society is based on a caste system which was introduced from the Indian subcontinent centuries ago. As Geertz (1963) points out, however, the Balinese caste system can hardly be compared to its modern Indian counterpart. Although social stratifications formally exist, they are offset by a multitude of communal activities and groups (seka) cutting across traditional divides, including residential units, temple congregations, irrigation societies, and economic production units (Geertz 1963:85). Visitors traveling across Bali today can readily observe these egalitarian communal structures. For one thing, many communities have established handicraft cooperatives along the main roads, open-air workshops in which local family businesses jointly produce and display their craft. And for another, Balinese of all walks of life (and caste affiliation) jointly prepare and finance the numerous temple ceremonials that take place each year.

Gianyar and Karangasem: Differences in Societal Pressure

Gianyar and Karangasem are the two Balinese cases selected for analyzing the impact of local business pressures on district government outcomes. Gianyar is a relatively small district, whose territorial boundaries stretch from Bali’s fertile central uplands down to the island’s southern coast. Karangasem, on the other hand, occupies

141 As Geertz notes, ‘in each seka all members have absolutely equal rights and duties; no externally based discriminations between their various roles are acknowledged and no internally derived ones are permitted to arise, although there are usually one or more hereditary or popularly chosen leaders, with diffuse and wholly non-authoritarian directive and representative functions. Every Balinese belongs to from three or four up to nearly a dozen of these groups, and the value of seka loyalty, putting the needs of one’s group above one’s own, is, along with caste pride, a central value in Balinese social life’ (1963: 84).
Bali’s eastern hemisphere, a large arid territory encompassing the towering Mount Agung and an arch of rough coastal plains. As discussed above, both of these districts are sufficiently homogenous in leadership and socio-economic controls (see Appendix 5.1) and, most importantly, are heterogeneous in terms of local business pressure.

However, identifying business communities that differ in their potential to press for government reforms is a more challenging task than identifying variation in leadership qualities. The reasons are twofold. For one thing, local business pressures seem to have attracted less public attention than district leadership issues over the last few years.¹⁴² Hence, media reports on rural businesses voicing their interests are rare. For another, reliable quantitative data on district-level associations – such as membership in local Chambers of Commerce (KADINDA) or other listed business organizations – is either non-existent or patchy.¹⁴³ In the absence of first-best indicators, the selection of the two cases in Bali (and later in NTB) is therefore based on a set of alternative quantitative and qualitative proxies. Since choosing these alternative indicators entails a certain degree of measurement error¹⁴⁴, this study will crosscheck the effects of societal pressures with additional quantitative (Chapter 6) and political-economy analyses (Chapter 7).

¹⁴² One explanation for the strong media attention on local leadership is that regents (bupati) have been directly elected by district constituencies (pilkada) since 2005. ¹⁴³ A senior manager of the Indonesian Chamber of Commerce in Jakarta acknowledged that membership data is so far only available on a provincial level. He also admitted that data quality and communication with regional offices are general problems that need to be addressed in the near future (interview in Jakarta, 13 February 2006). Previous attempts to attain KADINDA membership data during individual visits to local offices failed as well; membership information was either unavailable or too patchy to be used as an indicator for the analysis of local business pressure. ¹⁴⁴ As King, Keohane and Verba point out, the attempt to operationalize qualitative explanatory variables (such as societal pressure) is often subject to measurement error. This can lead to ‘an estimation of a weaker causal relationship than is the case’ (1994:158). This point will be picked up in Chapter 7, in which the significance of societal pressure is analyzed from a political-economy perspective.
Table 5.1: Business Pressure Indicators in Gianyar and Karangasem

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Gianyar</th>
<th>Karangasem</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) District Schooling in 1999 (years)</td>
<td>7.6</td>
<td>4.7</td>
</tr>
<tr>
<td>(2) District Literacy in 1999 (percent)</td>
<td>82%</td>
<td>68%</td>
</tr>
<tr>
<td>(3) Business Associations (observation)</td>
<td>significant</td>
<td>insignificant</td>
</tr>
<tr>
<td>(4) Informed on 1999 Bupati Election (percent)</td>
<td>72%</td>
<td>62%</td>
</tr>
</tbody>
</table>

Potential Business Pressure

<table>
<thead>
<tr>
<th></th>
<th>Moderate/High</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sources: (1) and (2) Indonesia Human Development Index (UNDP 2001); (3) Author's pre-fieldwork observations and interviews; (4) Indonesia Governance and Development Survey (World Bank 2002).</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The first two proxies for local business pressure are district education levels. The data of the 2001 UN ‘Human Development Index’ reveal considerable differences across the two districts. In Gianyar, people attend primary and secondary schools for almost eight years on average, three years longer than their counterparts in Karangasem (see Table 5.1). In addition, literacy varies considerably: almost one in three residents in Karangasem is unable to read or write, roughly twice as many as in Gianyar. Hence, in comparison, business people in Gianyar appear better educated and, arguably, better positioned to monitor and scrutinize government action.

The third indicator is the strength of business associations. There are strong indications that business people in Gianyar are more engaged in business associations than their colleagues in Karangasem. Business associations in Gianyar look back on a long-standing tradition of craftsmanship and fine arts. In fact Ubud, a subdistrict of Gianyar, is renowned as Bali’s cultural center and is a major tourist attraction. This combination of artistic heritage and tourism reinforces local business activity and, thereby, the presence of business associations. For one thing, handicraft associations have formed around village-centered economic clusters and produce silverware, stone

145 The information in this paragraph builds on interviews with policy experts in Bali including Agung Lidartawan (Udayana University), Birgit Kerstan (GTZ), Marc Hayton (World Bank), and Nita Noor (PPLH); as well as on earlier observations in Bali during my assignment for the German government in Eastern Indonesia (2001-2004).
sculptures, textiles, ceramics, wood carvings, and paintings. For another, the growing demand of Balinese art products has accelerated the establishment of sector-specific associations (e.g. furniture, textile, or silversmith cooperatives). Karangasem, in contrast, takes a more peripheral position. Tourist inflows are lower; handicraft clusters are less widespread; and business organizations are less prevalent. Thus, as outlined in Table 5.1 above, the degree of association is evaluated as ‘significant’ in the case of Gianyar, and ‘insignificant’ in the case of Karangasem.

The fourth indicator derives from the 2002 Indonesia Governance and Development Survey (World Bank 2002). The household questionnaire, which was administered to roughly 10,000 households in 177 districts, included a question as to whether local citizens had actively followed the local elections in 1999. According to the survey results, people in Gianyar (72 percent) were better informed on electoral outcomes than their counterparts in Karangasem (62 percent). Although these differences are not very large, they nonetheless signal that political awareness is somewhat higher in Gianyar.

Gianyar’s government statistics (BPS Gianyar 2004) report that 1350 small business people were associated in rural cooperatives in 2003. The stronger presence and dynamism of Gianyar’s business affiliations were, later on, affirmed during interviews with local business people and officials. The head of Gianyar’s industry and trade bureau (Disperindag), for example, confirms that the Woodwork and Furniture Association (Asosiasi Pengusaha Kerajinan Kayu Gianyar), the Silversmith Cooperative (Koperasi Pengrajin Perak), the Forum for Handicraft Export (Forum Komunikasi Pengusaha Ekspor), the Hotel and Restaurant Association (Pengusaha Hotel dan Restoran Indonesia), and the Indonesian Businesswomen’s Association (Ikatan Wanita Pengusaha Indonesia) are very active. Moreover, he stresses that Gianyar is the only Indonesian district with a functional Cooperative of Fine Art (Koperasi Seniman Gianyar). According to his experience, these business associations interact with the district government on a frequent basis (field interview, 24 October 2005).

Official government statistics show, for instance, that Gianyar’s hotels, restaurants and trade-shops generated US$ 78 million in 2003, whereas Karangasem’s tourist-related sector created an income of roughly US$ 28 million. Another indication of lower tourist inflows is given by the total number of tourist accommodations units: 410 in the former and 140 in the latter case. Regarding economic clusters, government statistics report half as many handicraft businesses (9,011 units) in Karangasem as in Gianyar (18,734 units). Note that these differences occur against a population size that is roughly the same across both districts (BPS Gianyar 2004; BPS Karangasem 2004).

In light of these four indicators, it is evident that business people in Gianyar are in a better position to articulate their interests and press for government improvements than their colleagues in Karangasem. Especially Gianyar’s pronounced lead in terms of education and associative dynamism underscores this point. Thus, in the following comparative analyses Gianyar will thus serve as a ‘high business pressure’ and Karangasem as a ‘low business pressure’ case. After introducing the district-pair in Bali, the following sections now turn to the two selected districts in NTB.

The Region of NTB

The second district-set is situated in the province of NTB. Surrounded by the Indian Ocean and the Java Sea, NTB spans an area of 20,000 sq km. As the full name ‘West Nusa Tenggara’ suggests, the region comprises the western part of an island group (Nusa) in Southeast (Tenggara) Indonesia. Both of NTB’s main islands, Lombok and Sumbawa, are of volcanic origin. Lombok’s round-shaped landmass bears witness to the tectonic emergence of Mount Rinjani, which overlooks the island at 3,700 meters above sea level. The neighboring island Sumbawa lies 300 km to the east over a jagged volcanic land mass that reaches altitudes of up to 2,800 meter. With a total number of 4 million people and a density of 200 inhabitants per sq km, the population in NTB is average among Indonesian provinces. Although the province is four times larger than Bali in terms of physical size, the number of administrative units in NTB – 9 districts and 790 villages – is roughly the same.

150 If not mentioned otherwise, the data appearing in the next two sections are taken from national (BPS 2005; 2006) and local government statistics (BPS Bima 2004; BPS Lombok Timur 2004). For reasons of simplification, some of the figures presented are rounded.
The economy of this eastern island group is one of the weakest in the country. Arid climates, rough terrains, and lacking water storages restrain agricultural production and make the province one of the poorest regions of the archipelago (Corner 1989:179). Regional per-capita income amounts to US$ 380 (roughly half of the nationwide average),\(^{151}\) and poverty rates lie at 27 percent (10 percent above the Indonesian standard). Despite the challenging natural conditions, the largest share of regional GDP still accrues from primary sectors, whereas secondary and tertiary sectors remain comparatively weak. In 2004, for instance, 55 percent of the provincial income derived from agriculture and mining; 11 percent from manufacturing, construction and utilities; and 34 percent from trade and services (BPS 2006). Overall, NTB’s structural change towards industrial development has been slow and largely limited to small-scale cottage industries in areas of textile weaving, food processing and woodcraft (Corner 1989:189).

Culturally, NTB is an amalgam of two ethnic groups. The island of Lombok is mainly populated by Sasak people, who were ruled by the kingdom of Bali during the 19\(^{th}\) century; the island of Sumbawa is largely inhabited by Mbojo people, who have been historically linked to the kingdom of Makassar since the 17\(^{th}\) century (Hitchcock 1996:8,17; Chambert-Loir 2004:311). Notwithstanding specific differences in language and culture, from a regional perspective Lombok and Sumbawa share strong similarities: both have been Muslim outposts in Eastern Indonesia (set between Hindu societies in Bali and Christian societies in East Nusa Tenggara); both display a stronger resemblance to Javanese heritage and society than to other neighboring regions; and both had extensive ties with Arab and Malay traders (Hitchcock 1996:2-3; Hamzah

\(^{151}\) Based on 2003 per-capita incomes at current prices without oil/gas production (BPS 2005).
Due to these similarities the province of NTB is treated as a single cultural unit in this study.

**Differences in Local Business Pressure**

The two selected district-cases in NTB are spread across the two main islands of the province (Figure 5.1). The first case, the district of Bima, occupies the eastern third of the island of Sumbawa. Stretched around a historical port town, Bima’s arid territory is characterized by numerous jagged mountains, swidden and dry-rice fields, and rocky beaches. The second case, the district of Lotim, is situated roughly 400 km to the west of Bima. It occupies the eastern third of the island of Lombok, and is an area of great topographic diversity stretching down from the lush volcanic highlands of Mount Rinjani down to the dry coastal plains of the district capital, Selong. Similar to the two Balinese cases, the districts of Lotim and Bima are chosen for their distinct differences in business pressure.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Bima (years)</th>
<th>Lotim (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>District Schooling in 1999</td>
<td>7.0</td>
<td>5.5</td>
</tr>
<tr>
<td>District Literacy in 1999</td>
<td>82%</td>
<td>75%</td>
</tr>
<tr>
<td>Business Associations</td>
<td>significant</td>
<td>insignificant</td>
</tr>
<tr>
<td>Informed on 1999 Bupati Election</td>
<td>72%</td>
<td>40%</td>
</tr>
</tbody>
</table>

Sources: (1) and (2) Indonesia Human Development Index (UNDP 2001); (3) Author’s pre-fieldwork observations and interviews; (4) Indonesia Governance and Development Survey (World Bank 2002).

As summarized in Table 5.2, Bima exhibits higher levels of education, associative dynamics, and political awareness. Bima displays the highest education levels across all districts of West Nusa Tenggara: its citizens have 7.0 years of schooling on average, whereas residents in Lotim are educated for 5.5 years. This also
translates into a higher literacy rate in the former (82 percent) compared to the latter
district-case (75 percent).

A further distinction is observable in the level of activity of local business
chambers (KADINDA). In the national newspaper Kompas, for instance, the head of the
Bimanese chamber of commerce, Qurais Abidin, has openly criticized local government
officials for not providing effective agricultural services and attending to private rather
than public needs (Anwar 2001). Other local newspaper articles followed suit,
describing Bima’s KADINDA head as a rigorous government observer and supporter of
small local businesses (Bali Pos 2004; Suara NTB 2006). In comparison, the business
chamber in Lotim has received little media attention and appears to have been rather
inactive over the last years.152

A notable difference within the selected district-pair arises also in the degree to
which local citizens were informed on the 1999 elections. According to the 2002
‘Indonesia Governance and Development Survey’ (World Bank 2002), over 70 percent
of Bima’s respondents closely followed local political affairs at the time. In Lotim only
40 percent of the respondents reported a similar interest in local politics. Thus, in light
of these four indicators, Bima’s business sector seems better positioned to press for
business climate improvements. The Bimanese firms are better educated, more aware of
local politics, and better represented by the local business chamber. Thus, for the
upcoming analyses of public tax, licensing and corruption practices Bima is classified as
‘high business pressure’ and Lotim as a ‘low business pressure’ district.

152 Reasons for the inactivity for the KADINDA office in Lotim and other districts in this study are
outlined in greater detail in the political-economy discussion in Chapter 7.
5.3 Local Taxation

Differences in distortionary tax regulations are readily observable in the two cases in NTB. Although imprudent tariffs exist in both districts, regional trade obstructions are particularly evident in Bima. In Bali, on the other hand, there is no notable distinction – simply because both district-cases have refrained from enacting distortionary tax regulations.

Table 5.3: Distortionary Trade Taxes in Bali and NTB

<table>
<thead>
<tr>
<th>District</th>
<th>Tax Type</th>
<th>Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gianyar*</td>
<td>None</td>
<td>No distortions (K)</td>
</tr>
<tr>
<td>Karang</td>
<td>None</td>
<td>No distortions (K)</td>
</tr>
<tr>
<td>Bima*</td>
<td>Regional Export Tax</td>
<td>Imprudent distortion of regional trade (M)</td>
</tr>
<tr>
<td></td>
<td>Local Fishery Tax</td>
<td>Unjustified burden for small firms (M)</td>
</tr>
<tr>
<td></td>
<td>Cooperative Tax</td>
<td>Illegitimate enforcement of donations (M)</td>
</tr>
<tr>
<td>Lotim</td>
<td>Regional Export Tax</td>
<td>Imprudent distortion of regional trade (M)</td>
</tr>
</tbody>
</table>

Source: KPPOD (2004b) and Ministry of Finance desk evaluation (Government of Indonesia 2002).
Note: (K) refers to KPPOD evaluations, (M) denotes evaluations of the Ministry of Finance; asterisk (*) denotes district cases with high business pressure.

The desk reviews of the Indonesian Ministry of Finance show both districts in NTB have enacted local government bills that obstruct regional trade markets. According to these ministerial reports, the larger distortions are found in Bima (see Table 5.3). Since the year 2000 the Bimanese government has enacted three local government bills (perda) that clearly constrain regional trade flows and business activity. The first of these impediments is the tax bill No.16/2000 on regional exports (pajak pengeluaran hasil bumi). Pursuant to this regulation, local firms that export

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153 The evaluations presented were obtained from the Ministry of Finance; they are found in the reports ‘S 26/MK.07/2002’, ‘S486/MK.07/2002’ and ‘S 523 /MK.07/2002’, see Government of Indonesia (2002).
agricultural and manufactured commodities are taxed between 5 and 10 percent. According to interviews with business people in Bima, these export taxes are based on fixed ‘basic prices’ (harga dasar). As these fixed prices are determined by the government in a non-transparent way, they fail to reflect actual market fluctuations and evoke lobbyism and patronage. As many interviewees concur, this tax bill in conjunction with current administrative practice induces an unequal tax environment: it leads to a situation where large business people with close government connections pay relatively less than small firms in less fortunate positions.

Another negative aspect of this regional trade tax is that it ultimately burdens the rural poor. Tax-induced costs are often transferred downwards and borne by the least powerful in the chain: rural farmers and workers. As one large trader puts it: Bimanese entrepreneurs are fully aware of the higher costs evoked by export taxes, but they rarely object to these regulations because they compensate tax burdens by reducing wages for village workers and raising local commodity prices. Hence, in the end, the rural poor are most strongly affected by these taxes (field interview, 16 January 2006).

As shown in Table 5.3, two more tax regulations in Bima led to criticism in the Ministry of Finance. One is a regulation for Bima’s fishery sector (government bill 7/2001) that compels local fishermen to pay annual taxes ranging from Rps 50 to 200 thousand per head, irrespective of their incomes. The other one is a tax for business cooperatives (government bill 15/2000) compelling rural business groups (mainly small-scale handicraft and agro-processing groups) to transfer 4 percent of their annual surplus values to the Bima government. According to statements in interviews, and ministerial guidelines, both of these taxes are unlikely to raise government incomes and have the concomitant effect of discouraging productive activity.
Eventually, all three of these Bimanese tax bills (export, fishery and cooperative) were rejected by the Ministry of Finance due to their negative effects on the local economy. Following this disapproval, the Ministry of Home Affairs issued a decree in 2002 (Kepmen 42/2002) which officially annulled the export tax regulation in Bima. Yet regardless of the national annulment, all of these taxes are still in place. The annulment of the export tax has been deliberately ignored as it contributes a major share of Bima’s annual revenue.

The tax environment in Lotim is slightly less distorted. Although the parliament of Lotim has refrained from imposing levies on small-scale business activities, it has also imposed an export tax of 5 percent on all regional commodity transports (government bill 16/2001 – ‘pajak atas pengiriman barang antar pulau’). Akin to the situation in Bima, this export tax is collected regardless of the fact that it has been disapproved by the Ministry of Finance. ‘Yes, it is true that this [regional export tax] has already been annulled by the central government’, a senior tax official admits, ‘but for the time being we adhere to our regulation; we believe there may still be leeway to further investigate and discuss’ (field interview, 2 December 2005).

Overall, this analysis of taxation in NTB carries two messages. First, and more generally, Bima and Lotim’s tax policies are examples of initial setbacks to decentralization. Both districts deliberately ignored national disapproval of legislation: they misused newly-gained authority to pursue instant revenue growth and, at the same time, sacrificed potential trade and productivity gains. And second, although tax

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154 According to the interministerial oversight procedure, the Ministry of Finance can make suggestions for annulments; the final decision, however, lies with the Ministry of Home Affairs (Lewis 2003a).
155 In a discussion at Bima’s Economic Bureau, two senior officials shed some light on the issue: ‘We had many discussions on Perda 16 – whether we should abolish it after the ministry had officially cancelled it in 2002. But the head of our law department decided that Bima was now in the position to make its own decisions. ‘After all, it’s the era of autonomy, he said’. Since then the national decree has been ignored; today, the export tax constitutes one of our highest revenue incomes.’ (field interview, 24 January, 2006);
distortions prevail in both district-cases, they are more pronounced in the case of Bima. Consistent with the scoring table in Appendix 4.2, the tax environment in Lotim can be categorized as ‘poor’ (one distortionary tax bill) and in Bima as ‘very poor’ (three distortionary tax bills).

The comparative analysis in Bali, on the other hand, showed little indication of regulatory trade-distortions. As outlined in Table 5.3, neither the desk review of the Regional Autonomy Watch (KPPOD 2004b) nor ministerial reports (Government of Indonesia 2002) point to any regulatory problems. These positive conditions were confirmed in most interviews in both Balinese districts. Thus, since Gianyar and Karangasem have refrained from enacting distortionary tax bills, there is no distinction possible in this first business climate indicator: the tax environment in both cases is ranked as ‘good’.
5.4 License Administration

Licensing Time and Fees

The second part of this business climate assessment is concerned with local license administration. A look into official government publications serves as the first orientation point for a comparative assessment of business permits across the two district-pairs in Bali and NTB.

Table 5.4: Official Time Estimates for Business Licenses (in days)

<table>
<thead>
<tr>
<th>District</th>
<th>Business License (TDP)</th>
<th>Trade License (SIUP)</th>
<th>Industry License (TDI)</th>
<th>Disturbance Permit (HO)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gianyar *</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>4</td>
<td>13</td>
</tr>
<tr>
<td>Karangasem</td>
<td>5</td>
<td>7</td>
<td>5</td>
<td>14</td>
<td>31</td>
</tr>
<tr>
<td>Bima*</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>15</td>
<td>30</td>
</tr>
<tr>
<td>Lotim</td>
<td>7</td>
<td>6</td>
<td>14</td>
<td>7</td>
<td>34</td>
</tr>
</tbody>
</table>

Source: Government documents and interviews with local officials in technical departments.
Note: The asterisk (*) denotes district cases with high business pressures.

A comparison of the published licensing information of technical district departments – industry and trade (dinas perindustrian dan perdagangan) and one stop shops (pelayanan satu atap) – suggests that Gianyar takes a lead among the four case districts. As summarized in Table 5.4, official figures suggest that business people spend less than half as much time in Gianyar to receive standard government permits (TDP, SIUP, TDI, HO) than in Karangasem, Lotim or Bima. While the administration in the former case requires 13 days, procedures in the latter cases entail between 30 and 34 days. Gianyar time-efficiency is also echoed in international donor

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156 Necessary licenses vary from business to business: standard requirements include – but are not limited to – general business permits (TDP), trade licenses (SIUP), industry permits (TDI) and community disturbance compensations (HO).
reports. Studies of OECD-ADB (2000:147) and Asia Foundation (2002:2)\textsuperscript{157} present Gianyar as a benchmark for fast and transparent license administration.

Table 5.5: Licensing Times before and after Decentralization (in days)

<table>
<thead>
<tr>
<th></th>
<th>Pre-Decentralization Years</th>
<th>Current Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gianyar*</td>
<td>21.3</td>
<td>26.6</td>
</tr>
<tr>
<td>Karangasem</td>
<td>12.9</td>
<td>13.9</td>
</tr>
<tr>
<td>Bima*</td>
<td>9.6</td>
<td>7.6</td>
</tr>
<tr>
<td>Lotim</td>
<td>10.4</td>
<td>9.4</td>
</tr>
<tr>
<td>Average</td>
<td>13.6</td>
<td>14.4</td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 500 randomly selected local firms in four districts.
Note: Survey question L2: ‘Please estimate the average time you spend to obtain necessary business permits – (a) before decentralization and (c) during the last two years (2004/2005)’; estimates are based on median-values of time intervals in the survey; the asterisk (*) denotes cases with high business pressure.

Interestingly, these government and donor statements are not supported by the empirical evidence collected during this study. On the contrary, the results of the business survey suggest that waiting times are significantly longer in Gianyar than in other observed cases (see Table 5.5). Since the enactment of decentralization, businesses in Gianyar report that they spend almost four weeks in clearing license requirements (an increase of 25 percent since decentralization), whereas their colleagues in Karangasem require two weeks (an increase of 8 percent). In comparison, time differences in NTB are less significant: on average local firms in Bima currently wait 8 days (a decrease of 21 percent), while their peers in Lotim wait 9 days (a decrease of 10 percent) for standard business permits. The most striking feature in these pairwise comparisons, is the pronounced mismatch of Gianyar’s officially proclaimed and empirically observed license conditions.

\textsuperscript{157} It should be noted here that both the Asia Foundation and the Asia Development Bank are jointly involved in the support of local licensing services across Indonesian districts (Asia Foundation 2002:1).
Possible explanations for this mismatch can be derived from the interview data. According to Gianyar’s license officers, a number of standard business licenses (for example TDP or TDI) can only be granted after applicants have acquired a preliminary ‘business activity permission’ (SITU). Naturally, this additional permission (which is not required in the other district cases) imposes additional red tape: that firms need to obtain the approval of communal (kepala banjar), village (kepala desa), subdistrict (camat) and district authorities (bupati) complicates and prolongs the licensing process (field interview, 24 October 2005). Contrary to official declarations, a senior businessman complained, Gianyar’s license procedures have become even more convoluted since the enactment of decentralization. During the late 1990s administrative formalities were a manageable burden: the pre-decentralization government provided ‘mobile license units’ and ‘recommendation letters’ for local firms. With the introduction of decentralization and the inauguration of the new regent, however, these services have ceased and business people nowadays face long chains of administrative desks (field interview, 25 October 2005).

Table 5.6: Official Prices for Business Licenses (in thousand Rps)

<table>
<thead>
<tr>
<th>District</th>
<th>Business License (TDP)</th>
<th>Trade License (SIUP)</th>
<th>Industry License (TDI)</th>
<th>Disturbance Permit (HO)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gianyar *</td>
<td>0</td>
<td>250</td>
<td>0</td>
<td>100</td>
<td>350</td>
</tr>
<tr>
<td>Karangasem</td>
<td>150</td>
<td>75</td>
<td>75</td>
<td>125</td>
<td>425</td>
</tr>
<tr>
<td>Bima *</td>
<td>100</td>
<td>50</td>
<td>500</td>
<td>125</td>
<td>775</td>
</tr>
<tr>
<td>Lotim</td>
<td>100</td>
<td>75</td>
<td>250</td>
<td>50</td>
<td>475</td>
</tr>
</tbody>
</table>

Source: Government documents and interviews with local officials in technical departments.
Note: prices refer to mid-sized trade businesses (investment of US$ 20,000, business type ‘CV’) in mid-sized buildings (50sqm); the asterisk (*) denotes district cases with high business pressure.

The second license indicator – official permit fees – also differs notably across district-pairs. As illustrated in Table 5.6, costs for four standard business licenses amount to Rps 775 thousand in Bima, while fees in Lotim only add up to Rps 475.
thousand. Considering the two Balinese cases, firms in Karangasem pay slightly more (Rps 350 thousand) than their colleagues in Gianyar (Rps 350 thousand), which is due to the fact that Gianyar's authorities issue trade (SIUP) and industry licenses (TDI) free of charge.

Table 5.7: Evaluation of License Time and Costs (in days and thousand Rps)

<table>
<thead>
<tr>
<th></th>
<th>Time Evaluation</th>
<th>Cost Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bali</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gianyar*</td>
<td>27 Poor</td>
<td>350 Very Good</td>
</tr>
<tr>
<td>Karangasem</td>
<td>14 Good</td>
<td>425 Good</td>
</tr>
<tr>
<td><strong>NTB</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bima*</td>
<td>8 Good</td>
<td>775 Poor</td>
</tr>
<tr>
<td>Lotim</td>
<td>9 Good</td>
<td>475 Good</td>
</tr>
</tbody>
</table>

Note: Evaluation marks are explained in detail in Appendix 4.2; the asterisk (*) denotes district cases with high business pressure.

Overall, the pair-wise comparisons of licensing procedures result in limited support for the notion that higher business pressure coincides with better business climates. As summarized in Table 5.7, overall licensing conditions in the 'high business-pressure cases', Gianyar and Bima, are, if anything, worse than those in the 'low business-pressure cases' Karangasem and Lotim. After allocating evaluations (see Appendix 4.2 for details), it becomes evident that licensing time/cost practices in Gianyar (poor/very good) are not better than in Karangasem (good/good). The same is true in the NTB comparison, where licensing conditions in Bima (poor/good) are not preferable to those in Lotim (good/good).

**Licensing Services**

The quality of one-stop licensing services (OSS) is another useful indicator for evaluating the administrative obstacles faced by local business communities. As discussed in Chapter 4, ideally, OSS put an end to the former administrative
merry-go-rounds by integrating all licensing procedures into one single office. The value of such service units, however, relies on their authority, staff, and facilities. The following field observations summarize the strongly diverging OSS conditions in the Balinese and NTB district-cases.¹⁵⁸

Figure 5.2: Impressions of One-Stop Licensing Services across Case Districts

<table>
<thead>
<tr>
<th>Entrance Area</th>
<th>Counter Area</th>
<th>Working Area</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(1) Gianyar</strong></td>
<td>'Good'</td>
<td>Score 3.7</td>
</tr>
<tr>
<td>Entrance Area</td>
<td>Counter Area</td>
<td>Working Area</td>
</tr>
<tr>
<td><strong>(2) Lotim</strong></td>
<td>'Fair'</td>
<td>Score 2.8</td>
</tr>
<tr>
<td>Entrance Area</td>
<td>Counter Area</td>
<td>Working Area</td>
</tr>
<tr>
<td><strong>(3) Karang</strong></td>
<td>'Poor'</td>
<td>Score 1.8</td>
</tr>
<tr>
<td>Entrance Area</td>
<td>Counter Area</td>
<td>Working Area</td>
</tr>
<tr>
<td><strong>(4) Bima</strong></td>
<td>'Not Existent'</td>
<td>'Very Poor' Service</td>
</tr>
</tbody>
</table>

Source: Author’s pictures, taken between October 2005 and January 2006.

The one-stop office in Gianyar (unit pelayanan terpadu) exhibits the best service standards within the group. Positioned prominently in the front of the government

¹⁵⁸ The unannounced OSS assessments took place in Gianyar on 24 October 2005, in Karangasem on 16 November 2005, in Lotim on 2 December 2005; Bima has not yet installed a one-stop service unit; assessments were based on the standardized checklist displayed in Table 5.8.
compound, the service unit is well-accessible to Gianyar’s business community. The large service area, a light-flooded hall with high ceilings and Balinese ornaments, welcomes the visitor with well-designed notice boards and a wide variety of information brochures (see Figure 5.2). At the time of our visit, eight service counters – each representing a different license category – were available for incoming license queries. OSS officials responded instantly to our questions concerning license times, prices and requirements. Requests of incoming customers were handled in a friendly and professional manner. A look behind the counters and into adjacent offices revealed that working areas are well equipped with modern computer facilities. What Gianyar’s OSS lacks, however, is decision-making authority. The operational staff admits that sectoral departments are reluctant to devolve responsibilities to the OSS, which creates bottlenecks in the administration of business licenses. Moreover, there are no signs of specific anti-corruption efforts (as for example in Solok). All in all, Gianyar’s OSS provides a good service environment that is, unfortunately, slowed down by internal bureaucratic constraints.

Licensing services in Karangasem are poor in comparison. The ‘integrated service office’ (kantor unit pelayanan terpadu) does not deliver what its name suggests. For one thing, due to the isolated position in the backstreets of the district capital, it is very difficult to find this service unit. The small sign at the side of the street directs license applicants towards an older government building. The first thing that incoming visitors encounter is an austere waiting room with old wooden chairs, an uninformative blackboard (indicating ranks of public servants), and a small service-counter. During our unannounced visit the service area was virtually deserted, except for one duty official. After we asked for further details, the official clarified that the OSS is not yet entitled to accept applications for business licenses. So far sectoral departments
(industry and trade, economic, and cooperative bureaus) have refused to devolve licensing authority to the service unit. Ironically, due to the absence of an administrative mandate, a set of brand new IT facilities – provided by the World Bank – has remained idle for over six months. Overall, Karangasem’s OSS remains, despite its technical assets, a dysfunctional licensing service.

In NTB, the licensing service in Lotim (sintap) provides a moderate service environment. Situated in the center of the capital Selong, the service unit displays functional facilities, including four standard service-counters, detailed information boards, and a spacious waiting area. During our visit, officials attended to our technical inquiries in a friendly manner and provided helpful handouts. Signboards in the service area provided information about license procedures and clearly warned of administrative corruption. Two posters at the entrance – reading ‘do not trust intermediary agents – come to the service unit in person’ and ‘double-check published rates, please report diverging prices’ – indicate efforts to reduce bribery practices. The general working conditions in Lotim’s OSS, however, were less professional. By and large, officials relied on pocket calculators, typewriters and manual folder-based filing systems; IT facilities were largely missing.

An even more dismal picture emerges in the case of Bima. According to interviews with local businessmen, Bima’s administration announced the establishment of an OSS unit (around the year 2001), including the assignment of physical and financial resources. However, due to sectoral power struggles and a lack of political will, this OSS project was never realized and earmarked facilities were redistributed for other purposes. As a result, local business people are still required to visit many technical departments in order to fulfill their license requirements.
Table 5.8: Scoring Board for One-Stop Licensing Services

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Bali</th>
<th>Karangasem</th>
<th>Bima*</th>
<th>NTB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information Availability</td>
<td>5</td>
<td>1</td>
<td>n/a</td>
<td>4</td>
</tr>
<tr>
<td>Staff Capacity &amp; Attitude</td>
<td>5</td>
<td>3</td>
<td>n/a</td>
<td>4</td>
</tr>
<tr>
<td>Physical Facilities</td>
<td>5</td>
<td>4</td>
<td>n/a</td>
<td>2</td>
</tr>
<tr>
<td>Data Management</td>
<td>4</td>
<td>1</td>
<td>n/a</td>
<td>2</td>
</tr>
<tr>
<td>Decisions Making Authority</td>
<td>2</td>
<td>1</td>
<td>n/a</td>
<td>2</td>
</tr>
<tr>
<td>Anti-Corruption Measures</td>
<td>1</td>
<td>1</td>
<td>n/a</td>
<td>3</td>
</tr>
<tr>
<td><strong>OSS Score (Mean Value)</strong></td>
<td>3.7</td>
<td>1.8</td>
<td>No Score</td>
<td>2.8</td>
</tr>
</tbody>
</table>

Overall Evaluation

<table>
<thead>
<tr>
<th>Good</th>
<th>Poor</th>
<th>Very Poor</th>
<th>Fair</th>
</tr>
</thead>
</table>

Source: Own evaluations based on interviews with business people and personal observations. Note: Scores range from 1-5: 1 = ‘very poor,’ 2 = ‘poor,’ 3 = ‘fair,’ 4 = ‘good,’ 5 = ‘very good’; the asterisk (*) denotes district cases with high business pressure.

The impressions of these unannounced OSS visits are summarized in Table 5.8. As in the previous chapter, a simple scoring board quantifies the conditions of licensing services within six categories: (1) availability of licensing information, (2) decision making authority, (3) staff capacity and service attitude, (4) physical facilities, (5) data management, (6) and additional anti-corruption measures. In light of these indicators, differences in licensing service become even more discernible. In Bali, Gianyar’s service unit displays a moderately ‘good’ performance (score of 3.7) – a result of high technical facilities which are offset by low administrative authority. In comparison, Karangasem’s OSS exhibits an overall ‘poor’ service environment (score of 1.8) – a reflection of a well-equipped service unit that remains idle due to bureaucratic resistance. In NTB, the one-stop shop in Lotim receives a moderate score: although facilities are generally poor, the district’s effort to inform customers on license procedures and discourage corruption results in a ‘fair’ performance (score of 2.8). Bima receives the lowest evaluation in this comparison (‘very poor’), since it is the only district-case that has not shown any apparent effort to streamline license procedures.
5.5 Public-Sector Corruption

_Corruption during Public-Sector Recruitment_

A basic indication of public-sector corruption is the degree of bribery that takes place during the recruitment of civil servants (PNS).  In-depth interviews with non-government respondents indicate that ‘upfront investments’ from PNS applicants are not an exception, but rather a recurrent phenomenon. In fact, eight out of ten non-government informants confirm that bribery conventions exist and that some public servant candidates invest significant sums to secure life-long government employment. The most illustrative accounts include the following:

One of my close friends was eager to join the government. Someone offered to secure a PNS position for him in exchange for Rps 35 million. In order to raise less public attention, he was asked to transfer the money in four separate installments – they call it ‘onion payment’, one layer at a time. In the end he did not get the job, because someone else paid more than Rps 50 million ... There is an enormous motivation among Bimanese people to enter the public service ... Farmers sell their land and livestock in order to pay for their children’s future government position; unfortunately they are often betrayed by fake mediators that pretend to have influence on recruitment decisions. Many have lost a fortune in this gamble. (NGO representative in Bima, 17 January 2006)

[Bribe payments] can be seen as a sort of investment – which will return to bribe-payers once they receive a PNS position. Instead of opening a business, a small shop for example, where you may go bankrupt in no time, people prefer to become a government official. In the business sector you may lose all your money; but once you are a public servant, once you wear an official uniform, you are on the safe side. Many are also attracted by the social status ... Just the other day around 3000 people applied for only 200 government positions. (Journalist in Lotim, 3 December 2005)

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159 A detailed discussion of this phenomenon was presented in Section 4.5.
People are willing to pay [upfront bribe payments] because they are looking for a secure and easy-going job... Many people living in the rural areas urge their children to join the government – public servants are still held in high esteem. In fact, business people ought to be appreciated more – after all it is them who accelerate the economy and create new job opportunities. [During the Suharto era] most irregularities happened on the central government level, now with decentralization most problems arise in the districts... Some people pay money, others offer a ‘service’. In one case, a PDI-P politician received a PNS position in exchange for promising to mobilize voters for the upcoming bupati election. (Businessman in Gianyar, 25 October 2005)

Table 5.9: Bribe Incidences during Public-Sector Recruitment (in million Rps)

<table>
<thead>
<tr>
<th>District Respondent</th>
<th>Bali</th>
<th>NTB</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gianyar*</td>
<td>Karangasem</td>
</tr>
<tr>
<td>No 1</td>
<td>30</td>
<td>40</td>
</tr>
<tr>
<td>No 2</td>
<td>25</td>
<td>30</td>
</tr>
<tr>
<td>No 3</td>
<td>exist</td>
<td>20</td>
</tr>
<tr>
<td>No 4</td>
<td>exist</td>
<td>15</td>
</tr>
<tr>
<td>No 5</td>
<td>exist</td>
<td>15</td>
</tr>
<tr>
<td>No 6</td>
<td>exist</td>
<td>12</td>
</tr>
<tr>
<td>No 7</td>
<td>exist</td>
<td>8</td>
</tr>
<tr>
<td>No 8</td>
<td>0</td>
<td>exist</td>
</tr>
<tr>
<td>No 9</td>
<td>-</td>
<td>exist</td>
</tr>
<tr>
<td>No 10</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Average</td>
<td>18</td>
<td>20</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Evaluation</th>
<th>Poor</th>
<th>Poor</th>
<th>Very Poor</th>
<th>Very Poor</th>
</tr>
</thead>
</table>

Source: Interview data with 10 non-government respondents in each district.
Note: respondents in each district are displayed in descending order of reported bribes; the statement ‘exist’ indicates that respondents affirm bribe payments without providing clear estimates; evaluation marks are explained in detail in Appendix 4.2; the asterisk (*) denotes cases with high business pressure.

The interview data condensed in Table 5.9 suggest that recruitment irregularities prevail across both regional district-pairs. The highest level of reported bribery arises in two districts in NTB. In Lotim and Bima the average bribe payment amounts to Rps 36 million. Given that monthly salaries of incoming officials remain below Rps 1 million (see discussion in Section 3.2.3), this implies that average bribe payments are roughly
equal to what junior staff members earn during their first three years in office. Another striking feature, which adds to the credibility of these findings, is the small variation across reported values. Six respondents in Bima and five respondents in Lotim report bribery trends between Rps 30 and 40 million.

Looking at the Balinese cases, bribery tendencies are also rather uniform across the two district-cases. On average, respondents estimate that bribe payments are around Rps 20 million in Karangasem, and Rps 18 million in Gianyar. As mentioned before, given the small sample-size of interviewees, these figures should be interpreted with caution. They do not serve as a proof, but rather as an indication of bribery practices. Based on this indication (and the scoring table in Appendix 4.2), public recruitment practices in Bima and Lotim are ranked as ‘very poor’ and in Gianyar and Karangasem as ‘poor’. The following sections will take a look at three additional, and somewhat more tangible, indicators of public misconduct: corruption during tax collection, license administration and tender management.

Corruption during Tax Collection

Similar to the discussion of the Javanese and Sumatran cases above, the analysis of tax corruption in often obfuscated by mutual deals between public and private actors. The survey data indicate that tax-collectors and taxpayers frequently engage in negotiations that are advantageous for both sides; this often entails tax payments being scaled down and the resulting benefits shared.

Note that bribery trends in Gianyar are less robust than those in other cases. Although eight respondents affirm that conventions of illegal inducements exist, only three of them are positioned to quantify prevailing bribery trends.
Table 5.10: Perceptions of Tax Bargaining Practice (Respondent Shares)

<table>
<thead>
<tr>
<th>District</th>
<th>'It is possible to bargain with tax officials'</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
</tr>
<tr>
<td>Gianyar*</td>
<td>16.7</td>
</tr>
<tr>
<td>Karangasem</td>
<td>19.1</td>
</tr>
<tr>
<td>Bima*</td>
<td>43.8</td>
</tr>
<tr>
<td>Lotim</td>
<td>26.2</td>
</tr>
<tr>
<td>Average</td>
<td>26.4</td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 500 randomly selected local firms in four districts. Note: Based on survey question T3a: ‘please give your opinion on the following statements: It is possible to bargain with tax officials to find a beneficial solution for both sides; the asterisk (*) denotes cases with high business pressure.

As illustrated in Table 5.10, roughly half of the 500 respondents surveyed in Bali and NTB affirm that tax bargains are possible. A businessman in Karangasem, for instance, describes the bargaining process as follows:

In order to clear our tax obligations we sometimes need to pay something to the official in charge. Once this is done, no further questions are asked... Much depends on the negotiations between tax subjects and collectors... A nominal tax payment of Rps 500 thousand may be reduced to Rps 100 thousand, provided that we add an extra Rps 100 thousand into the official’s pocket... It's not easy to change these things. After all, tax subjects are accustomed to special treatments. In fact, we should be more consistent: if tax obligations amount to, say, 10 [percent] then we should pay exactly 10 [percent] (field interview with a businessman in Karangasem, 11 November 2005).

Against the background of mutual tax negotiations, it is very likely that business responses underestimate actual tax corruption. But although these estimates may paint an overoptimistic picture in absolute terms, they are nonetheless helpful in identifying pair-wise corruption differences in relative terms.
Table 5.11: Corruption during Tax Collection (Percent of Tax Charges)

<table>
<thead>
<tr>
<th>District</th>
<th>Pre-Decentralization Years</th>
<th>Current Years</th>
<th>Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gianyar*</td>
<td>6.5</td>
<td>9.4</td>
<td>Poor</td>
</tr>
<tr>
<td>Karangasem</td>
<td>2.9</td>
<td>1.9</td>
<td>Good</td>
</tr>
<tr>
<td>Bima*</td>
<td>1.6</td>
<td>1.7</td>
<td>Good</td>
</tr>
<tr>
<td>Lotim</td>
<td>1.6</td>
<td>2.2</td>
<td>Good</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>3.2</td>
<td>3.8</td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 500 randomly selected local firms in four districts.
Note: Survey question T2 (b/d): ‘Please estimate average informal payments to district tax collectors as percentage of total tax charges’; estimates are based on median-values of time intervals in the survey; for a systematic overview of evaluation marks see Appendix 4.2; the asterisk (*) denotes cases with high business pressure; ‘current years’ refers to 2004 and 2005.

Seen from this comparative angle, Gianyar exhibits distinctly higher corruption during tax collection than Karangasem: add-on fees amount to 9.4 percent in the former and to 1.9 percent in the latter case (see Table 5.11). In NTB, the distinction is less pronounced: firms report that irregularities comprise to 1.7 percent of official tax duties in Bima and to 2.2 percent in Lotim. Moreover, while perceptions of tax corruption in the two NTB cases have remained more or less the same since decentralization, the comparison in Bali signals marked changes: Gianyar’s irregularities have soared by 45 percent, whereas Karangasem’s extortions have declined by 34 percent over the last years. Based on these currently prevailing corruption tendencies, Gianyar receives a score of ‘poor’, while Karangasem, Lotim and Bima receive a ‘good’ evaluation.

*Corruption during License Administration*

A similar pattern to that discussed above arises in the administration of business licenses. According to the business survey conducted for this study, differences in public corruption are – once again – more significant between the two Balinese cases. Respondents in Gianyar state that average corruption fees, that is illegal top-ups on
Table 5.12: Corruption during License Administration (Percent of Total Charges)

<table>
<thead>
<tr>
<th>District</th>
<th>Pre-Decentralization Years</th>
<th>Current Years</th>
<th>Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gianyar*</td>
<td>5.5</td>
<td>12.3</td>
<td>Very Poor</td>
</tr>
<tr>
<td>Karangasem</td>
<td>2.9</td>
<td>2.8</td>
<td>Good</td>
</tr>
<tr>
<td>Bima*</td>
<td>2.3</td>
<td>2.6</td>
<td>Good</td>
</tr>
<tr>
<td>Lotim</td>
<td>4.4</td>
<td>4.1</td>
<td>Fair</td>
</tr>
</tbody>
</table>

Average 3.8 5.5

Source: Author’s business survey with 500 randomly selected local firms in four districts.
Note: based on survey question L3: ‘Please estimate average unofficial costs (as percentage of official prices) for business licenses’; estimates are based on median-values of percentage intervals in the survey; for a systematic overview of evaluation marks see Appendix 4.2; the asterisk (*) denotes cases with high business pressure; ‘current years’ refers to 2004 and 2005;

official license prices, have doubled from about 5.5 to 12.3 percent since the beginning of decentralization (see Table 5.12). In the other three district-cases, business people face less government extortion. In Karangasem, Bima and Lotim survey participants report recent add-on fees of between 2.6 and 4.1 percent, a trend that has hardly changed compared to pre-decentralization levels. Based on these corruption indicators Gianyar receives a ‘very poor’, Karangasem a ‘good’, Bima a ‘good’ and Lotim a ‘fair’ score for their licensing environment (see Appendix 4.2 for scoring details).

Table 5.13: Uncertainties during License Administration (Respondent Shares)

<table>
<thead>
<tr>
<th>District</th>
<th>‘Since decentralization, license administration has become more uncertain’</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
</tr>
<tr>
<td>-----------</td>
<td>----</td>
</tr>
<tr>
<td>Gianyar*</td>
<td>11.8</td>
</tr>
<tr>
<td>Karangasem</td>
<td>36.5</td>
</tr>
<tr>
<td>Bima*</td>
<td>61.7</td>
</tr>
<tr>
<td>Lotim</td>
<td>50.8</td>
</tr>
<tr>
<td>Average</td>
<td>40.2</td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 500 randomly selected local firms in four districts.
Note: Based on survey question ‘L4b’: ‘Please state your opinion to the following statement: ‘Uncertainties of license administration have increased since decentralization!’’ the asterisk (*) denotes cases with high business pressure.
Diverging license corruption fees are also reflected in the varying responses regarding administrative uncertainties since the introduction of decentralization. As indicated in Table 5.13, Survey participants in Gianyar are slightly more pessimistic than their counterparts in Karangasem. While 36.8 percent of the business people in Gianyar affirm that license procedures have become less predictable over the last years, 29.4 percent of Karangasem’s respondents share the same concern. In NTB, bureaucratic uncertainties were more perceived as a bigger obstacle in Lotim than in Bima: 25.4 percent of the firms surveyed in Lotim report rising uncertainties since decentralization, whereas merely 14.8 percent of the business respondents in Bima make similar statements.

Recalling the high standards of Gianyar’s one-stop licensing service, it seems somewhat ironic that corruption fees are comparatively higher there than in other districts. Two interviewees in Gianyar shed some light on this issue:

The problem of unofficial add-on payments may not meet the eye at first sight. Such payments arise whenever someone requires faster services – that’s when officials start to bargain for extra rents. [In these situations] an official tariff of Rps 100 thousand may well increase to 200 thousand... Business people often have limited time to spare. Unfortunately, licensing services have become very slow in recent years. Eventually, due to high administrative delays, businesses are keen to accelerate licensing procedures and agree to make ‘invisible payments’ (field interview with a businessman, 25 October 2005).

The information brochures at Gianyar’s one-stop licensing service [which clearly outline license prices and times] are nothing more than rhetoric. Once we arrive at the desks of license officials, we are offered ‘special assistance’ during license procedures – provided that we pay for officials’ efforts. In fact, they do exactly the same thing – just in less time. In other words, actual license procedures could be much faster... It is already an open secret that disturbance permits and business licenses require special negotiations. In general, the establishment of Gianyar’s
OSS is a step in the right direction. But because the bureaucratic system has remained unchanged, there are no improvements (field interview with a NGO representative, 25 October 2005).

These statements indicate that business people revert to ‘speed money’ conventions once procedures are delayed by sectoral administrations. Hence, a look behind the façade of Gianyar’s well-equipped and friendly service station reveals a slow-working bureaucratic apparatus that induces higher bribe payments and, thus, renders official statements of ‘complementary’ services implausible.

Corruption during Public Tender Administration

The final corruption indicator dealt with in this section consists of irregularities that occur during the administration of public tenders. As mentioned earlier, local governments are required to announce public projects exceeding budget values of Rps 50 million. Ideally, funds for these projects are allocated on competitive grounds. The interviews with non-government informants, however, indicate that tender procedures are often skewed towards the interests of a powerful few. In rural economies, which lack natural resources and commercial industries, government projects seem to be the main target for rent-seeking. As in the Javanese and Sumatran cases discussed in Chapter 4, the interview data suggest that such rent-seeking activities exist on a broader scale and involve selected individuals that administer, oversee and implement public projects. How such collusion agreements unfold is best described in the words of local informants:

Project leakages are a common problem. According to my experience, there are too many procurement teams, too many personal interests – yet too little transparency and enforcement. If a public building is budgeted at Rps 100 million, for example, less than Rps 60 million is usually spent for its actual construction.
The current budget system still allows for transgressions and private gain. Ultimately, this induces high costs for our economy (field interview with a district parliament head in District A, 21 November 2005).  

Public tender procedures continue to provide vast opportunities for rent seeking. Leakages are immense. Since I am in the construction business myself, I can observe tender procedures. Parliamentarians, executives and larger businesses are involved. On average, absorbed rents lie between 30 and 40 percent. Last year, I witnessed an illegal mark-up of about 100 percent for the construction of an elementary school in our neighborhood. The issue was even picked up by the local media. I intended to file a legal complaint, but the legal staff at the local court was reluctant to investigate the case and discouraged me to get involved (field interview with a businessman in District B, 17 January 2006).

Many public tender, seemingly competitive at first sight, are predetermined. Insiders know from the beginning who is going to win the bid; some make-believe contenders get paid off and those in powerful positions get the deal. By and large, leakages in public projects revolve around 40 percent. These rents are divided within between project executives, politicians and constructors. We can see a clear indication of these rent-seeking activities every day: the quality of district streets has become worse and worse in recent years (field interview, with an NGO representative in District C, 1 December 2005).

Some weeks ago, my colleague was asked to build a security fence for a road running along a dangerous cliff. Although Rps 50 million was set aside for this project, he was asked to construct the fence for Rps 35 million. Due to the lower budget he decided to use sand instead of cement for the foundation. The result was disastrous. After the first heavy rain the security fence was about to fall down the cliff. Hence during one night, we had to drive up there and fix it. Cases like these are quite common. Public tender are usually marked-up about 30 to 40 percent (field interview, with a businessman in District D, 18 January 2006).

161 In order to ensure the anonymity of respondents, district-cases ('A', 'B', 'C', 'D') are not specified.
Table 5.14: Transparency and Fairness of Government Tender (Respondent Shares)

<table>
<thead>
<tr>
<th>District</th>
<th>Intransparent Information</th>
<th>Unfair Procedures</th>
<th>Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gianyar*</td>
<td>7.5</td>
<td>7.5</td>
<td>Good</td>
</tr>
<tr>
<td>Karangasem</td>
<td>10.0</td>
<td>5.0</td>
<td>Good</td>
</tr>
<tr>
<td>Bima*</td>
<td>40.5</td>
<td>40.5</td>
<td>Poor</td>
</tr>
<tr>
<td>Lotim</td>
<td>62.5</td>
<td>62.5</td>
<td>Very Poor</td>
</tr>
<tr>
<td>Average</td>
<td>30.1</td>
<td>28.9</td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s own estimates based on 2005 KPPOD Business Survey data.
Note: 40 business respondents in each district were asked to evaluate (1) the transparency of information and (2) the fairness of procedures during publicly tendered government projects – on a scale of 1 (very poor) to 9 (very good); presented figures embody the share of all negative responses (1 to 4); evaluation scores are based on average transparency and fairness shares in each district; for details see Appendix 4.2; the asterisk (*) denotes cases with high business pressure.

Although interviewees often stress the ubiquity of such tender irregularities, there is reason to believe that corruption practices vary considerably across the four district-cases. The data from KPPOD’s 2005 business survey, displayed in Table 5.14 show that a large number of business respondents in Lotim (63 percent) and Bima (41 percent) perceive tender procedures to be both intransparent and unfair. In Bali, in contrast, these critical perceptions are roughly shared by merely one in every ten respondents. Based on these perceived tender conditions (and the scoring table in Appendix 4.2), Gianyar and Karangasem receive a ‘good’, Bima a ‘poor’, and Lotim a ‘very poor’ score in this last business climate indicator.
5.6 Conclusion

The assessment of individual business climate indicators – including local taxation, license administration and public-sector corruption – sheds empirical light on the societal-pressure hypothesis. The comparisons of controlled district-pairs provide overall little support for the assertion that the locations with higher potential business pressure (i.e. associative activity and education levels) display better tax, license and corruption practices.

Figure 5.3: Societal Pressure and Business Climates in Gianyar and Karangasem

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Gianyar</th>
<th>Karangasem</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Potential Business Pressure</strong></td>
<td>Strong</td>
<td>Weak</td>
</tr>
<tr>
<td>(1) Non-Distortionary Taxation</td>
<td>Good</td>
<td>Good</td>
</tr>
<tr>
<td>(2) License Time</td>
<td>Poor</td>
<td>Good</td>
</tr>
<tr>
<td>(3) License Cost</td>
<td>Very Good</td>
<td>Good</td>
</tr>
<tr>
<td>(4) License Services</td>
<td>Good</td>
<td>Poor</td>
</tr>
<tr>
<td>(5) Non-Corrupt Public Recruitment</td>
<td>Poor</td>
<td>Poor</td>
</tr>
<tr>
<td>(6) Non-Corrupt Tax Collection</td>
<td>Poor</td>
<td>Good</td>
</tr>
<tr>
<td>(7) Non-Corrupt Licensing</td>
<td>Very Poor</td>
<td>Good</td>
</tr>
<tr>
<td>(8) Non-Corrupt Public Tender</td>
<td>Good</td>
<td>Good</td>
</tr>
<tr>
<td><strong>Overall Business Climate (Mean)</strong></td>
<td>Fair (3.0)</td>
<td>Fair/Good (3.5)</td>
</tr>
</tbody>
</table>

Note: Summary evaluations range from very poor (1 block) to very good (5 blocks);

In fact, as the two Balinese district-cases show, higher business-pressure indicators are, if anything, negatively aligned with local business climates. Although Gianyar is endowed with higher education levels and more dynamic business associations, business-related government conditions are less favorable than in Karangasem. Looking at individual business climate indicators (summarized in Figure
5.3), Gianyar displays better licensing services and lower official costs but, at the same time, slower and more corrupt administrative procedures.

### Figure 5.4: Societal Pressure and Business Climates in Bima and Lotim

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Bima</th>
<th>Lotim</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Potential Business Pressure</strong></td>
<td>Strong</td>
<td>Weak</td>
</tr>
<tr>
<td>(1) Non-Distortionary Taxation</td>
<td>Very Poor</td>
<td>Poor</td>
</tr>
<tr>
<td>(2) License Time</td>
<td>Good</td>
<td>Good</td>
</tr>
<tr>
<td>(3) License Cost</td>
<td>Poor</td>
<td>Good</td>
</tr>
<tr>
<td>(4) License Services</td>
<td>Very Poor</td>
<td>Fair</td>
</tr>
<tr>
<td>(5) Non-Corrupt Public Recruitment</td>
<td>Very Poor</td>
<td>Very Poor</td>
</tr>
<tr>
<td>(6) Non-Corrupt Tax Collection</td>
<td>Good</td>
<td>Good</td>
</tr>
<tr>
<td>(7) Non-Corrupt Licensing</td>
<td>Good</td>
<td>Fair</td>
</tr>
<tr>
<td>(8) Non-Corrupt Public Tender</td>
<td>Poor</td>
<td>Very Poor</td>
</tr>
</tbody>
</table>

**Overall Business Climate (Mean)**
- **Bima**: Poor (2.4)
- **Lotim**: Fair (2.8)

Note: Summary evaluations range from very poor (1 block) to very good (5 blocks);

The results from the two districts in East Indonesia are equally inconsistent with the societal-pressure hypothesis. Once again, the district with higher business pressure does not exhibit more conducive business conditions. Even though Bima’s business communities seem better educated, better represented by local chambers, and more critical towards government misconduct, they nonetheless face overall higher government-induced constraints than their counterparts in Lotim. Comparing individual scores (see Figure 5.4), Bima’s government leads (by a small margin) in two corruption indicators but, at the same time, falls behind (by a larger margin) in three licensing and taxation aspects.

All in all, these mixed empirical results fail to provide a convincing indication that local government performance is aligned with local business pressures. Seemingly,
the presence of vibrant handicraft associations, more active chambers of commerce, or higher education standards does not easily translate into less tax, license and corruption problem. Why is this so? Why are potential business pressures seemingly insignificant in explaining local government variation? One explanation for this insignificance, which will be developed in greater detail in Chapter 7, is that local business groups are constrained by factors that are not reflected in the selection indicators\textsuperscript{162} used in this chapter. In other words, despite their apparent potential to express their interests, many local firms seem to remain idle. As I will outline in greater detail in Chapter 7, reasons for this phenomenon extend to collective action problems and initial democratic deficits in Indonesia's early transition to decentralization.

\textsuperscript{162} As mentioned in footnote 144, this indicates that the selection entails a certain degree of 'measurement errors'. This methodological qualification prompts two comments. For one thing, it should be noted that cases were selected on grounds of available district data; although it would have been desirable to use statistical measures that clearly indicate actual business pressure, such indicators are unfortunately not provided at this point of time. And for another, as I will argue in Chapter 7, actual business pressure is likely to be low across most districts in rural Indonesia. This would make it difficult to identify business-pressure variation even if appropriate indicators were available.
6.1 Introduction

Moving on from the field comparisons in Java, Sumatra, Bali and NTB, this chapter extends the analysis to a larger sample of local governments. Based on the data of 231 Indonesian districts – 66 percent of the total number in 2001 – I employ a series of bivariate and multivariate regression analyses to test the government-leadership and societal-pressure hypotheses. The overall aim is to triangulate field results and, in doing so, substantiate them from a statistical perspective.

As I will demonstrate in this chapter, the statistical results are in line with the empirical arguments emerging in preceding chapters. Controlling for a set of economic and socio-political factors, the regression analyses show a strong positive link between local business climates and the quality of government leadership. The relationship between tax/license/tender practices and societal (business) pressure, on the other hand, is less pronounced and – in some respects – negative. While the main focus of this chapter is on testing these two research hypotheses, some interesting findings can also be drawn for economic and socio-political controls: the results indicate that local business climates are negatively related to district per-capita incomes and positively related to levels of ethnic homogeneity. Conversely, local partisan structures (that is, council majorities of the two major political parties) show no coherent relationship with the quality of current policy outcomes.

The statistical discussion in the following sections is divided into three parts. The first section explains the variables and data-sources used in the analyses.
second section explores the effects of government leadership and business pressure on selected business climate indicators, using both district- and individual-level data for a set of bi/multivariate regression analyses. The third section draws conclusions.
6.2 Data, Variables and Methods

In order to explore statistical explanations for business climate variations, I use a cross-district dataset compiled from various Indonesian data sources. A main source of district-level business information is the 2005 KPPOD business survey.¹⁶³ This survey, which covers 8900 private-sector respondents across 231 district governments, represents the largest available data compilation of local business indicators to date. For the purpose of multivariate regression analyses the KPPOD data is complemented by economic, political, social and geographic indicators from Indonesian and international organizations.¹⁶⁴

Dependent and Independent Variables

As outlined in the research design in Chapter 3, the phenomenon to be explained, the dependent variable, is the quality of district business climates. Similar to the case-discussions in Chapters 4 and 5, business climates will be assessed in terms of local government (tax) bills, license procedures, and public-sector corruption. Based on KPPOD data sources, I construct four indicators to measure local business conditions: (1) quality of local regulations;¹⁶⁵ (2) efficiency of license administration;¹⁶⁶ (3) corruption during license administration;¹⁶⁷ (4) and corruption during tender

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¹⁶³ For information on KPPOD, the Regional Autonomy Watch, see footnote 42.
¹⁶⁴ These additional indicators are compiled from the World Bank and UNDP as well as from Indonesian authorities, including the Ministry of Finance, the Central Bureau of Statistics (BPS), and the National Election Committee (KPU).
¹⁶⁵ For quantifying the quality of local (tax) regulations I use KPPOD’s district-bill database (kajian perda). Since 2001 KPPOD has reviewed government bills from over 200 districts and graded them in terms of their ‘business friendliness’. The scores from these desk-reviews range from 1 (very business unfriendly) to 5 (very business friendly). Further details can be found at www.kppod.org.
¹⁶⁶ The efficiency of license administration is measured by combining four indicators of the 2005 KPPOD business survey: perceptions of (1) ‘bureaucratic ease of license procedures’, (2) ‘license time requirements’, (3) ‘certainty of license costs’, (4) and ‘license service standards’. This composite variable, which is constructed by taking the unweighted mean of these four perception indicators, ranges from 1 (very poor) to 9 (very good) and is henceforth referred to as ‘license administration’.
¹⁶⁷ License corruption is quantified by using responses in the 2005 KPPOD business survey as to how much ‘additional unofficial fees’ (in Rps) firms pay for general business permits (TDP). This indicator is henceforth referred to as ‘business permit bribes’. 
management. Each of these four business climate indicators acts as a dependent variable and will be tested against possible explanatory factors.

The independent variables used for this analysis are the two hypothesized explanations for business climate variation: government leadership and business pressure. The quality of government leadership is quantified by constructing an unweighted composite variable based on four aspects covered in the 2005 KPPOD business-survey: namely, firm perceptions of (1) regents’ action against bureaucratic transgressions, (2) regents’ efforts against public corruption, (3) regents’ example of honesty/discipline, (4) and regents’ dialog with the private sector. These leadership perceptions were obtained in mid 2005, shortly before or during the elections of new district heads (Pilkada). It is important to note here that leadership indicators refer to regents who were in office from 2001 to 2005. Hence, the responses of the KPPOD survey provide a good estimate of leadership qualities during the first five years of decentralization.

The second independent variable is also covered in the KPPOD survey. In the following analyses, the presence of business pressure is approximated by the involvement of private-sector actors in local decision-making. It is assumed here that the degree to which local firms participate in business regulations, zoning decisions, and development plans serves as a good proxy for their ability to articulate their interests and press for business climate improvements. Similar to the leadership variable, it is important to stress that the business-pressure indicator is not limited to the year 2005;

168 Tender irregularities are measured by combining two indicators of the 2005 KPPOD business survey: (1) 'fairness of government tender decision-making' and (2) 'absence of illegal fees in tender processes'. This composite variable, which is constructed by taking the unweighted mean of these two perception indicators, ranges from 1 (very poor) to 9 (very good) and is henceforth referred to as 'fairness of public tender'.

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rather, given the way the survey-question is constructed, it describes private-sector participation over the first five decentralization years (2001 to 2005).

Table 6.1: Descriptive Statistics of District- and Individual-Level Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Obs.</th>
<th>Mean</th>
<th>SD</th>
<th>Median</th>
<th>Min</th>
<th>Max</th>
<th>Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Individual-Level Data</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>[Individual]</td>
</tr>
<tr>
<td>License Administration*</td>
<td>8565</td>
<td>5.56</td>
<td>1.53</td>
<td>5.75</td>
<td>1</td>
<td>9</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td>Business Permit Bribes (ln)*</td>
<td>846</td>
<td>11.46</td>
<td>1.49</td>
<td>11.51</td>
<td>3.91</td>
<td>16.12</td>
<td>000' Rps</td>
</tr>
<tr>
<td>Public Tender Fairness*</td>
<td>8273</td>
<td>4.54</td>
<td>1.77</td>
<td>5</td>
<td>1</td>
<td>9</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td>Government Leadership*</td>
<td>8637</td>
<td>5.38</td>
<td>1.59</td>
<td>5.5</td>
<td>1</td>
<td>9</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td>Business Pressure*</td>
<td>8038</td>
<td>4.59</td>
<td>1.9</td>
<td>5</td>
<td>1</td>
<td>9</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td><strong>District-Level Data</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>[District Average]</td>
</tr>
<tr>
<td>Local Regulations†</td>
<td>178</td>
<td>2.83</td>
<td>0.51</td>
<td>2.8</td>
<td>1.75</td>
<td>4</td>
<td>Perception [1-5]</td>
</tr>
<tr>
<td>License Administration†</td>
<td>231</td>
<td>5.53</td>
<td>0.91</td>
<td>5.52</td>
<td>1.79</td>
<td>7.85</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td>Business Permit Bribes (ln)†</td>
<td>155</td>
<td>11.75</td>
<td>1.24</td>
<td>11.65</td>
<td>8.75</td>
<td>16.12</td>
<td>000' Rps</td>
</tr>
<tr>
<td>Public Tender Fairness†</td>
<td>231</td>
<td>4.52</td>
<td>0.97</td>
<td>4.57</td>
<td>1</td>
<td>7.18</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td>Government Leadership†</td>
<td>231</td>
<td>5.34</td>
<td>1.06</td>
<td>5.39</td>
<td>1.93</td>
<td>8.07</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td>Business Pressure†</td>
<td>231</td>
<td>4.53</td>
<td>1.1</td>
<td>4.62</td>
<td>1</td>
<td>7.3</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td>Per-Capita Income (ln)</td>
<td>328</td>
<td>15.3</td>
<td>0.73</td>
<td>15.18</td>
<td>13.57</td>
<td>19.14</td>
<td>000' Rps</td>
</tr>
<tr>
<td>National PC Transfers (ln)</td>
<td>306</td>
<td>13.32</td>
<td>0.69</td>
<td>13.23</td>
<td>12.12</td>
<td>16.11</td>
<td>000' Rps</td>
</tr>
<tr>
<td>State Party Majority</td>
<td>440</td>
<td>0.09</td>
<td>0.29</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>Dummy [0,1]</td>
</tr>
<tr>
<td>Reform Party Majority</td>
<td>440</td>
<td>0.06</td>
<td>0.23</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>Dummy [0,1]</td>
</tr>
<tr>
<td>School Education</td>
<td>369</td>
<td>7.24</td>
<td>1.59</td>
<td>7.00</td>
<td>2.00</td>
<td>11.10</td>
<td>Years</td>
</tr>
<tr>
<td>Ethnic Homogeneity</td>
<td>372</td>
<td>77.03</td>
<td>22.66</td>
<td>85.87</td>
<td>24.61</td>
<td>100</td>
<td>Percent</td>
</tr>
<tr>
<td>District on Java</td>
<td>440</td>
<td>0.26</td>
<td>0.44</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>Dummy [0,1]</td>
</tr>
<tr>
<td>District is Urban</td>
<td>440</td>
<td>0.21</td>
<td>0.41</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>Dummy [0,1]</td>
</tr>
</tbody>
</table>

Source: A description of data sources is presented in Appendix 6.1.
Note: Dependent variables are marked with a cross (†) and independent variables with an asterisk (*); the last eight indicators in the district-level data are economic, political, social and geographical control variables which are used in both district-level and individual-level analyses; ‘PC’ refers to Per-Capita.

All dependent and independent variables, except ‘local regulations’, are observed as individual-level responses in the KPPOD data. This allows me to construct two different datasets to test the leadership and business-pressure hypotheses: (1) an individual-level dataset – comprising 8000+ unaggregated individual responses – and (2) a district-level dataset with aggregated individual responses (collapsed around arithmetical means for each district) that are complemented with other district-level
variables. The statistical properties of these variables, in both aggregated and unaggregated form, are summarized in Table 6.1.

Control Variables

Since local business climates are unlikely to be the result of local leadership and business-pressure factors alone, regression analyses need to control for other district-specific conditions. Salient control factors can be divided into four categories: economic, political, social and geographic. From each of these categories, I choose two control variables. These eight control variables rest on district-level data sources (the last eight indicators in Table 6.1) and will be used in both district-level and individual-level analyses.

To account for economic differences, the regression models will include per-capita incomes and national per-capita transfers for each district.\textsuperscript{169} Per-capita incomes indicate different levels of economic development across districts; another alternative development indicator, the UNDP Human Development Index, was not chosen as it overlaps strongly with other variables in this analysis (particularly education). The second economic control, the extent of per-capita transfers, is included as a measure for budget (and hence tax) pressures of local governments. Due to the skewed distribution, both these economic variables are transformed by taking natural logarithms.

\textsuperscript{169} Per-capita incomes are calculated on the basis of 2003 GDP (real prices); National per-capita transfers are based on the 2003 APBD Budget (\textit{Dana Alokasi Umum}); both data sources were obtained from the World Bank office in Jakarta.
Political differences are controlled for by means of two partisan variables.\textsuperscript{170} Districts are categorized as to whether their parliaments are dominated by either of the two dominant parties of Indonesia's 1999 elections. In other words, two dummy variables are included in the regression analyses: (1) the first one accounting for political majorities of Suharto's former state party GOLKAR; and the second one indicating majorities of the reformist party PDIP, which was headed by Sukarno's daughter Megawati during this first legislative period. Interestingly, strongholds of each party follow geographically patterns; while PDIP finds its main support in Central Indonesia (large parts of Java and Bali), GOLKAR is the dominant party in many outer regions (most notably in Nusa Tenggara and Sulawesi).

Societal differences are represented by indicators of district-level education and ethnic homogeneity.\textsuperscript{171} Education is measured in average years of primary and secondary schooling. As a standard measure for social development, district schooling levels are regularly assessed in Indonesia's UNDP 'Human Development' studies and, therefore readily available in the public domain. Ethnic homogeneity, a less common indicator, is measured in population share of the dominant ethnic groups\textsuperscript{172}. It is important to note that the homogeneity index does not differentiate among different ethnicity 'types'; it simply displays the share of any one dominant ethnic group, regardless of its denomination. The motivation for including ethnic concentrations derives from the literature, in particular from propositions that homogenous (ethnic or social) groups are more likely to see more horizontal civic cooperation and, thereby,

\begin{itemize}
\item \textsuperscript{170}The data on political election results were obtained directly from the National Indonesian Election Committee (KPU). More information on 1999 elections and geographical party distribution can be found at www.kpu.go.id.
\item \textsuperscript{171}Data for average district schooling is drawn from the 2001 Indonesian Human Development Report, published by UNDP (2001); the ethnic homogeneity variable is constructed on the basis of Indonesia's 2004 SUSENAS household survey.
\item \textsuperscript{172}To give an example, in the district-pairs discussed in Chapters 4 and 5 dominant ethnic groups were 'Javanese' (Kebumen/Klaten), 'Minang' (Solok/Pesisir), 'Balinese' (Gianyar/Karang), 'Sasak' and 'Mbojo' (Lotim/Bima).
\end{itemize}
more concerted action for better government (Axelrod 1984; Putnam 1993:175; Gillinson 2004:28).

Geographical differences are, to some degree, accounted for by the underlying focus on district units.\footnote{District boundaries are clearly present in the district-level data, but also in the individual-level data they are accounted for by employing district fixed-effects regressions. The geographical dummy variables ‘urban’ and ‘java’ are constructed based on the 2005 district classification provided by the Indonesian Central Bureau of Statistics (BPS).} In addition, the analysis includes two geographical dummy variables: ‘urban’ and ‘java’. As the name suggests, the urban-dummy describes whether districts are urban- (kota) or rural-based (kabupaten). The java-dummy simply distinguishes whether local governments are situated on or off the central island of Java. Both of these indicators exhibit a positive (but non-critical) correlation with economic incomes,\footnote{Pairwise correlations show a positive alignment of both geographic variables with district per-capita income; in the case of the java dummy correlation estimates amount to 0.07, in the case of the urban dummy to 0.47; both of these estimates remain well below the critical mark of 0.7.} an expected result given that urban areas (in general) and Java (in particular) tend to exhibit high economic growth. Descriptive statistics for all of these eight control variables are presented in Table 6.1.

Figure 6.1: Overview of Regression Analyses

<table>
<thead>
<tr>
<th>District-Level Data</th>
<th>Individual-Level Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bivariate Plots</td>
<td>Bivariate Plots</td>
</tr>
<tr>
<td>Multivariate</td>
<td>Multivariate</td>
</tr>
<tr>
<td>Uncontrolled OLS</td>
<td>Controlled OLS</td>
</tr>
<tr>
<td>Controlled OLS</td>
<td>Standard OLS</td>
</tr>
<tr>
<td></td>
<td>Refined Models</td>
</tr>
<tr>
<td></td>
<td>Fixed-Effects</td>
</tr>
<tr>
<td></td>
<td>Heckman</td>
</tr>
</tbody>
</table>

Figure 6.1 illustrates the analytical methods that are employed in the next section. The quantitative analysis is divided into two parts. The first part uses district-level data: it estimates bivariate regression plots (between dependent business climate...
and independent variables) before proceeding to multivariate Ordinary-Least-Squares (OLS) regressions, which include all independent and control variables. The second part follows a similar structure. It uses individual-level data to first test bivariate relationships before proceeding to multivariate regression models. Here, multivariate analyses extend to both standard OLS models and refined models, latter of which include fixed-effects regressions and Heckman estimations. Fixed-effects models, which control for all unobservable district-specific factors, constitute a useful crosscheck for the estimates emerging from the standard OLS regressions. And the Heckman model complements standard OLS estimates for the low-response regressant 'business-permit bribes' by estimating missing responses based on individual-specific characteristics.
6.3 Results of Regression Analyses

District-Level Data

A first useful step for identifying possible correlations is to look at simple scatterplots. Figure 6.2 illustrates the results of regressing the four dependent business climate (BC) indicators against government leadership (left column) and business pressure (right column), respectively. The scatter plots in the left column exhibit a clear

Figure 6.2: Bivariate Linear Regressions Plots (District-Level Data)

Source: Cross-district dataset compiled from KPPOD data sources (see Appendix 6.1).
Note: Red lines depict bivariate regression estimates.
alignment between good leadership and favorable business-climate indicators. As indicated by predicted regression-lines, districts with high levels of leadership quality also tend to report efficient license administration, fair public tender management, prudent local regulations, and low incidences of bribes for business permits. This correlation with government leadership is particularly strong in the case of license administration and public-tender fairness which is illustrated by the close fit of data points with predicted regression lines.

At first sight, the scatterplots and bivariate regression lines for business pressure, which are displayed in the right-hand column of Figure 6.2, seem to indicate similar results. Nonetheless, a closer look reveals three differences. First, as foreshadowed in the descriptive statistics in Table 6.1, business pressure revolves around a lower mean (4.5) than government leadership (5.3). Viewed from the baseline score of 5.0 which marks ‘indifferent’ perceptions, these average figures suggest that local firms (across 230 Indonesian districts) are not satisfied with private-sector involvement in local policy-making and, on the other hand, are at least somewhat satisfied with the efforts of local government leaders to improve public-sector conduct. Second, while business-permit bribes tend to be lower with rising leadership, they seem unaffected by business pressure (the regression line is almost flat). And third, the positive effect on local regulations seems smaller in the case of business pressure than for government leadership (the slope of the former is less steep). Although differences remain subtle, these last two points provide a first indication that leadership has more positive effects on local business climates than pressures arising from local firms.

175 In the following discussion the term ‘favorable’ indicates business climates improvements; thus, looking at the scales of business-climate indicators, higher values for local regulations, license administration and tender fairness; but lower values for permit bribes.
So far we only at uncontrolled bivariate estimates have been considered. Once multivariate regression models are employed that include both of the key independent variables (and other control factors), results become more reliable. Table 6.2 summarizes OLS estimates for local regulations (models 1 and 2) and license administration (models 3 and 4); Table 6.3 displays estimates for public-tender fairness (models 5 and 6) and business-permit bribes (models 7 and 8).

Table 6.2: Multivariate Regression Results for District-Level Data

<table>
<thead>
<tr>
<th></th>
<th>Local Regulations</th>
<th>License Administration</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Leadership</td>
<td>0.14***</td>
<td>0.14**</td>
</tr>
<tr>
<td></td>
<td>(2.97)</td>
<td>(2.43)</td>
</tr>
<tr>
<td>Business Pressure</td>
<td>-0.04</td>
<td>-0.00</td>
</tr>
<tr>
<td></td>
<td>(0.78)</td>
<td>(0.08)</td>
</tr>
<tr>
<td>Per-Capita Income</td>
<td>-0.11</td>
<td>-0.15*</td>
</tr>
<tr>
<td></td>
<td>(1.51)</td>
<td>(1.70)</td>
</tr>
<tr>
<td>National Transfers</td>
<td>0.11</td>
<td>0.20**</td>
</tr>
<tr>
<td></td>
<td>(1.10)</td>
<td>(1.98)</td>
</tr>
<tr>
<td>GOLKAR Party Majority</td>
<td>-0.07</td>
<td>0.24</td>
</tr>
<tr>
<td></td>
<td>(0.55)</td>
<td>(1.55)</td>
</tr>
<tr>
<td>PDIP Party Majority</td>
<td>-0.01</td>
<td>0.32*</td>
</tr>
<tr>
<td></td>
<td>(0.04)</td>
<td>(1.88)</td>
</tr>
<tr>
<td>Ethnic Homogeneity</td>
<td>0.00</td>
<td>-0.00</td>
</tr>
<tr>
<td></td>
<td>(1.24)</td>
<td>(0.64)</td>
</tr>
<tr>
<td>Education</td>
<td>0.10**</td>
<td>-0.05</td>
</tr>
<tr>
<td></td>
<td>(2.28)</td>
<td>(0.99)</td>
</tr>
<tr>
<td>Jawa</td>
<td>0.05</td>
<td>0.15</td>
</tr>
<tr>
<td></td>
<td>(0.41)</td>
<td>(1.04)</td>
</tr>
<tr>
<td>Urban Area</td>
<td>-0.11</td>
<td>0.06</td>
</tr>
<tr>
<td></td>
<td>(0.73)</td>
<td>(0.31)</td>
</tr>
<tr>
<td>Constant</td>
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<td>1.48</td>
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<tr>
<td></td>
<td>(11.40)</td>
<td>(1.09)</td>
</tr>
<tr>
<td></td>
<td>2.30***</td>
<td>2.41</td>
</tr>
<tr>
<td></td>
<td>(10.14)</td>
<td>(1.53)</td>
</tr>
</tbody>
</table>

|                                | (3)               | (4)                    |
|                                | 0.39***           | 0.37***                |
|                                | (7.05)            | (5.44)                 |
|                                | 0.25***           | 0.26***                |
|                                | (4.74)            | (4.17)                 |
|                                | 0.20**            | (1.98)                 |
|                                |                  |                        |
| Observations                   | 174               | 158                    |
| Adjusted R2                    | 0.05              | 0.07                   |
|                                | 0.48              | 0.47                   |
| VIF (Mean)                     | 1.86              | 2.13                   |
|                                | 1.84              | 2.11                   |

Source: Cross-district dataset compiled from KPPOD and other Indonesian data sources (see Appendix 6.1).
Notes: t statistics in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%.

Regarding the results displayed in Tables 6.2 and 6.3, the most striking finding is that government leadership has strong favorable effects across all four business-
climate indicators. This is true for models testing the two independent variables only (odd column numbers) and for models that include district-specific controls (even column numbers). Leadership coefficients are positive and highly significant in the OLS regressions for local regulations (0.14 and 0.14), license administration (0.39 and 0.37), and public-tender fairness (0.36 and 0.35) and negative for business-permit bribes (-0.29 and -0.23). High t-statistics (for three out of four business-climate indicators) and high similarities between controlled and uncontrolled estimates underline the robustness of leadership effects.

Table 6.3: Multivariate Regression Results for District-Level Data (Continued)

<table>
<thead>
<tr>
<th></th>
<th>Fairness of Public Tender</th>
<th>Business Permit Bribes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(5)</td>
<td>(6)</td>
</tr>
<tr>
<td>Leadership</td>
<td>0.36***</td>
<td>0.35***</td>
</tr>
<tr>
<td></td>
<td>(7.12)</td>
<td>(5.98)</td>
</tr>
<tr>
<td>Business Pressure</td>
<td>0.41***</td>
<td>0.40***</td>
</tr>
<tr>
<td></td>
<td>(8.32)</td>
<td>(7.44)</td>
</tr>
<tr>
<td>Per-Capita Income</td>
<td>-0.12</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(1.50)</td>
<td></td>
</tr>
<tr>
<td>National Transfers</td>
<td>0.09</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.96)</td>
<td></td>
</tr>
<tr>
<td>GOLKAR Party Majority</td>
<td>-0.28**</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(2.13)</td>
<td></td>
</tr>
<tr>
<td>PDIP Party Majority</td>
<td>0.03</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.17)</td>
<td></td>
</tr>
<tr>
<td>Ethnic Homogeneity</td>
<td>-0.00*</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(1.69)</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>-0.04</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.77)</td>
<td></td>
</tr>
<tr>
<td>Jawa</td>
<td>0.03</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.26)</td>
<td></td>
</tr>
<tr>
<td>Urban Area</td>
<td>-0.09</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.57)</td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>0.75***</td>
<td>2.10</td>
</tr>
<tr>
<td></td>
<td>(3.63)</td>
<td>(1.54)</td>
</tr>
<tr>
<td>Observations</td>
<td>231</td>
<td>205</td>
</tr>
<tr>
<td>Adjusted R2</td>
<td>0.61</td>
<td>0.63</td>
</tr>
<tr>
<td>VIF (Mean)</td>
<td>1.84</td>
<td>2.11</td>
</tr>
</tbody>
</table>

Source: Cross-district dataset compiled from KPPOD and other Indonesian data sources (see Appendix 6.1).
Note: t-statistics in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%.
The estimates for business pressure indicate less favorable impacts. While effects on public-tender fairness (0.41 and 0.40) are similar, effects on license administration (0.25 and 0.26) are distinctly smaller in comparison to leadership. Estimated impacts on the quality of local regulations are insignificant (t values below 0.8) and, therefore, do not allow any inference to be drawn. Most striking, however, are the results for business-permit bribes: positive and significant estimates (0.21 and 0.28) suggest that business pressures actually raise the likelihood of illegal inducements. This finding may appear counterintuitively at first sight. One possible interpretation is that districts with higher levels of corruption (that is, business-permit bribes) may also exhibit more collusive ties between government officials and large construction/procurement firms; if these firms overstate the ‘involvement of local firms in district policy-making’, then the positive relationship between observed bribe incidences and reported business pressure becomes less startling. This interpretation resonates well with anecdotal accounts of corruption discussed in the previous two chapters and, as will be seen, with the political-economy discussion in Chapter 7.

Turning to control variables, the regression analysis shows that economic, political, social and geographical factors are, in most cases, less significant than the two key independent variables. Nonetheless, the OLS estimates reveal a set of interesting findings. First, considering economic controls, higher per-capita incomes tend to coincide with more business climate problems. Although of limited significance (at the 10%-level or slightly below), the results suggest that higher economic incomes evoke more distortionary regulations, less effective license administration and less fair tender management. One way of interpreting this is to suppose that business climate problems are higher, ceteris paribus, in districts where more economic rents can be extracted by means of trade taxation and administrative extortion. Another notable result is the significant positive link between national transfers and the quality of local
license administration; this suggests that higher district budgets partly translate into better human and physical resources and, eventually, into better service environments.

Partisan structures exhibit, by and large, mixed effects on local business climates. Local council majorities of the two major political parties emerge as an inconsistent predictor. While strongholds of Suharto's former state party GOLKAR exhibit more problems with public tenders, districts with reformist PDIP majorities display more business-permit bribes. The quality of local license administration, on the other hand, seems to benefit under both party majorities. Moreover, it is noteworthy that partisan leadership has no significant impact on the quality of local district regulations, an interesting finding, given that government bills are reviewed by district councils.

While geographical factors remain largely insignificant, social variables exhibit two notable effects on local business climates. For one thing, education levels, all things being equal, tend to significantly raise the quality of local (tax) regulations. This effect may be explained by the public servants being better trained and/or by better-educated business communities: both of these can serve to limit trade-distorting taxes and other imprudent business regulations. For another, higher degrees of ethnic homogeneity tend to reduce the magnitude of illegal payments for business permits, a result that indicates that districts with dispersed, multi-ethnic business communities (whose interests are often less well coordinated) are more vulnerable to administrative extortion.

In terms of methodology, two statistical issues deserve further attention: multicolinearity and goodness-of-fit. Regarding the former, problems of multicolinearity seem overall low. Low variance inflation factors (VIF), ranging between 1.84 and 2.13 (well below the critical level of 10),

\[ VIF = \frac{1}{1-R^2} \]

give little reason for concern about collinear variables. Considering the goodness-of-fit of the regression models, two points can be made. First, the full models seem to explain much of the

\[ R^2 = \frac{\text{sum of squares explained}}{\text{total sum of squares}} \]

For a discussion on VIF tolerance levels see for instance Bowerman and O'Connell (1990).
variation in ‘license administration’ (adjusted $R^2$ of nearly 50 percent) and ‘public-tender fairness’ (adjusted $R^2$ of over 60 percent). It is worth mentioning here that $R^2$ values hardly differ across full and reduced models, hence indicating that government leadership and business pressure are two major predictors of local business climates.

Second, lower $R^2$ values in ‘local regulations’ and ‘business-permit bribe’ models are likely to be caused by differences in the underlying data. As explained earlier, the data on local regulations differs to the extent that it derives from external reviews, and the data on permit-bribes differs to the extent that it is based on precise monetary estimates (not perception values). In fact, given the more sensitive nature of the issue in question, only 10 percent of the individual respondents made clear estimates of bribe payments. This non-response problem will be further explored in the next section by applying a Heckman two-step regression model.

Overall, OLS regressions based on district-level data affirm that government leadership is the best predictor for the quality of local business climates. Leadership estimates are highly significant (across most regression models) and display expected effects for all business climate variables. Business pressure shows lower positive impacts on license administration and public-tender management and, at the same time, adverse effects on bribery indicators. The next section will crosscheck these findings by extending bivariate and multivariate analyses to individual-level data.

**Individual Level Data**

Turning to the individual-level dataset, first insights can again be obtained by exploring simple bivariate scatterplots. Figure 6.3 illustrates the relationship of government leadership (left column) and business pressure (right column) with three dependent variables: license administration, public-tender fairness and business-permit bribes. The fourth dependent variable, local regulations, is dropped in this section as it
is only observed on aggregate (not individual) levels. Since the data comprise roughly 9000 survey responses, which are no longer condensed for each district, bivariate plots appear naturally more 'noisy' than those in Figure 6.2. Yet despite this increased dispersion, it is possible to identify correlational patterns.

Figure 6.3: Bivariate Linear Regressions Plots (Individual-Level Data)

Source: Cross-district dataset compiled from KPPOD data sources (see Appendix 6.1).
Note: Red lines depict bivariate regression estimates.
The scatterplots suggest, once again, that government leadership has more positive effects on local business conditions compared to business pressure. Similar to the results from the district-level data, two differences emerge. For one thing, bivariate regression-lines for ‘license administration’ and ‘public-tender fairness’ show larger positive impacts (steeper regression lines) in the case of leadership. And for another, while local business tends to aggravate ‘business-permit bribes’ (positive slope), leadership seems to counteract such illegal exactions (negative slope).

Table 6.4: Multivariate Regression Results for Individual-Level Data

<table>
<thead>
<tr>
<th></th>
<th>License Administration</th>
<th>Fairness of Public Tender</th>
<th>Business Permit Bribes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td></td>
<td>Fixed-Effects</td>
<td>OLS</td>
<td>Fixed-Effects</td>
</tr>
<tr>
<td>Leadership</td>
<td>0.38***</td>
<td>0.36***</td>
<td>0.42***</td>
</tr>
<tr>
<td></td>
<td>(33.66)</td>
<td>(31.95)</td>
<td>(32.11)</td>
</tr>
<tr>
<td>Business Pressure</td>
<td>0.21***</td>
<td>0.18***</td>
<td>0.29***</td>
</tr>
<tr>
<td></td>
<td>(22.01)</td>
<td>(20.84)</td>
<td>(27.27)</td>
</tr>
<tr>
<td>Per-Capita Income</td>
<td>-0.10***</td>
<td>-0.08**</td>
<td>0.26**</td>
</tr>
<tr>
<td></td>
<td>(3.27)</td>
<td>(2.26)</td>
<td>(2.56)</td>
</tr>
<tr>
<td>National Transfers</td>
<td>0.18***</td>
<td>0.05</td>
<td>-0.38***</td>
</tr>
<tr>
<td></td>
<td>(5.40)</td>
<td>(1.27)</td>
<td>(3.36)</td>
</tr>
<tr>
<td>GOLKAR Party Majority</td>
<td>0.29***</td>
<td>-0.39***</td>
<td>-0.35**</td>
</tr>
<tr>
<td></td>
<td>(5.86)</td>
<td>(7.04)</td>
<td>(2.12)</td>
</tr>
<tr>
<td>PDIP Party Majority</td>
<td>0.32***</td>
<td>0.07</td>
<td>0.19</td>
</tr>
<tr>
<td></td>
<td>(5.88)</td>
<td>(1.23)</td>
<td>(1.03)</td>
</tr>
<tr>
<td>Ethnic Homogeneity</td>
<td>-0.00**</td>
<td>-0.00***</td>
<td>-0.02***</td>
</tr>
<tr>
<td></td>
<td>(2.20)</td>
<td>(3.38)</td>
<td>(4.64)</td>
</tr>
<tr>
<td>Education</td>
<td>-0.06***</td>
<td>-0.02</td>
<td>-0.05</td>
</tr>
<tr>
<td></td>
<td>(3.33)</td>
<td>(0.84)</td>
<td>(0.74)</td>
</tr>
<tr>
<td>Jawa</td>
<td>0.16***</td>
<td>0.01</td>
<td>0.18</td>
</tr>
<tr>
<td></td>
<td>(3.44)</td>
<td>(0.13)</td>
<td>(1.10)</td>
</tr>
<tr>
<td>Urban Area</td>
<td>0.04</td>
<td>-0.19***</td>
<td>0.35</td>
</tr>
<tr>
<td></td>
<td>(0.62)</td>
<td>(2.74)</td>
<td>(1.55)</td>
</tr>
<tr>
<td>Constant</td>
<td>2.16***</td>
<td>2.80***</td>
<td>2.00***</td>
</tr>
<tr>
<td></td>
<td>(4.21)</td>
<td>(48.01)</td>
<td>(3.43)</td>
</tr>
<tr>
<td>Observations</td>
<td>7160</td>
<td>7929</td>
<td>6973</td>
</tr>
<tr>
<td>Adjusted R2</td>
<td>0.34</td>
<td>0.22</td>
<td>0.36</td>
</tr>
<tr>
<td>VIF (Mean)</td>
<td>1.96</td>
<td>n/a</td>
<td>1.96</td>
</tr>
</tbody>
</table>

Source: Cross-district dataset compiled from KPPOD and other Indonesian data sources (see Appendix 6.1).
Note: t statistics in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%; in fixed-effects models (columns 2 and 4) standard economic/political/social/geographic controls are dropped.
The tendencies arising from the bivariate plots are next tested by means of multivariate regression analyses. As outlined in Table 6.4, I use individual-level data to test each of the three dependent variables in standard (odd column numbers) and refined regression models (even column numbers). Standard models employ common OLS methods and include the eight economic, political, social and geographic controls described in Section 6.2. Refined models vary in type according to the dependent variables. For the dependent variables ‘license administration’ and ‘public-tender fairness’, I choose the fixed-effects regression method to control for all district-specific differences across individual observations. For the dependent variable ‘business-permit bribes’, which exhibits a critically low response rate, I use the Heckman-method to estimate unobserved values. The two-stage maximum likelihood algorithm, initially proposed in Heckman (1979), allows to correct for sample selection bias by re-estimating responses on the grounds of individual-specific characteristics. In this analysis, the Heckman model (sixth column in Table 6.4) is applied to extrapolate permit-bribes responses by using three observable attributes of each individual respondent: respondents’ education level, business sector, and duration of residency.

The results in Table 6.4 are largely consistent with the results in the previous section. Two main findings stand out. First, leadership and business-pressure estimates are not only highly significant (mostly at the 1%-level) but also adhere to similar values in refined and unrefined regression models (for each dependent variable). This underscores the robustness of the results and strengthens the validity of the causal inferences they imply. And second, leadership clearly exceeds business-pressure in terms of strength and consistency of associated business climate effects. OLS and fixed-effects models for the dependent variable ‘license administration’ (columns 1 and 2) demonstrate that the effects associated with government leadership are up to twice as
large (coefficients of 0.38 and 0.36) as those associated with business pressure (0.21 and 0.18). A similar result arises from the estimates for 'public-tender fairness' (column 3 and 4). Again, OLS and fixed-effects estimates suggest that business pressure has smaller impacts (0.29 and 0.25) in comparison to leadership (0.42 and 0.42). Turning to the third dependent variable, 'permit-bribes' (column 5 and 6), the same diverging tendencies are found as in the bivariate tests. Results from OLS and Heckman models indicate that higher leadership qualities reduce illegal payments for the provision of licenses (-0.10 and -0.09), whereas higher business involvement tends to increase such payments (0.08 and 0.06). The positive link between business pressure and permit bribes may be explained, as outlined in the district-level discussion above, by biased responses of firms with strong government ties. Overall, in light of all six regression models, the key message is that leadership emerges as the more coherent explanatory factor for business climate variation.

The predicted effects of economic, political, social and geographic controls point to similar tendencies to those seen in the district-level regressions. Per-capita incomes show adverse effects on all three business climate indicators. Regression estimates suggest that respondent in high-income districts are exposed to more administrative inefficiency (-0.10), non-transparency (-0.08), and extortion (0.26/0.37). Estimates for national transfers point in the opposite direction. High per-capita transfers from the national government tend to stimulate better license administration (0.18) and reduce bribe incidences for business permits (-0.38/-0.47). As mentioned above, these findings might suggest that business climate problems increase with the availability of absorbable rents (higher per-capita incomes) and decrease with the availability of district funding for human and physical resources (higher per-capita transfers).
of-fit remains mostly below district-level regressions: for the ‘license administration’ models $R^2$ values amount to 0.34, for the ‘public-tender fairness model 0.36, and for ‘business-permit bribes’ model 0.13.

In sum, the results from the individual-level dataset reaffirm the findings from its aggregated equivalent. Standard OLS regressions and refined fixed-effects/Heckman models clearly suggest that leadership has significant and favorable impacts on all three business climates indicators. The results for business pressure, in comparison, indicate either weaker or negative effects: the involvement of local firms has weaker impacts on license administration and public-tender management (especially once fixed effects are controlled for) and accelerating effects on bribe incidences for business permits. Regarding the control variables specified in the OLS and Heckman models, per-capita incomes and urban concentration tend to have a negative, partisan structures an ambiguous, and ethnic homogeneity a positive relationship with local business climates.
6.4 Conclusion

The quantitative analyses in this chapter cast further light on the two research hypotheses regarding government leadership and societal pressure. Summing up the results from both district- and individual-level data, it becomes obvious that the quality of government leadership is a more powerful and consistent predictor for business climate variation than the degree of local business involvement. While differences in bivariate regression plots – assessing business-pressure and government-leadership correlations in isolation – remain subtle, they become more marked once independent and control variables are analyzed together.

The strongest differences emerge in the models on regulatory quality and permit irregularities. Based on the OLS estimates, stronger private-sector involvement in local decision-making seems to have either insignificant or detrimental impacts on the way local bills and business-permits are issued. The opposite holds true for government leadership: higher qualities of government leaders tend to induce improvements, both in terms of fewer distortionary regulations and fewer illegal add-ons. Arguably, this finding suggests that distortionary taxes and corrupt provision of business-permits are, at this stage, counteracted by executive rather than private-sector scrutiny.

Differences in the results for license administration and public-tender fairness are less marked, but nevertheless apparent. Although societal-pressure and government-leadership effects point in the same (positive) direction, the former exceeds the latter in terms of magnitude. Considering that leadership estimates display higher impacts across most district- and individual-level models, the quality of business licensing and public tender management seems, once again, more a matter of executive than of private-sector
involvement. All in all, the series of regressions analyses provides substantive support for the leadership-hypothesis, whereas they display a mixed picture – both affirmative and contradictory messages – for the societal-pressure hypothesis.

In general, these findings rest on regression estimates that are significant and coherent across different models. While the general robustness and low multicolinearity of regression results are reassuring signs for model specifications, there are nonetheless two qualifications that must be made. One qualification is the limited scope of the data. The observations underlying this analysis span across space, but not across time. Put differently, the regression models rest on cross-sectional (not inter-temporal) data; most variables are single-year observations.\(^{178}\) Another issue that warrants attention is the assumed direction of causal inference. Do leadership and societal pressure lead to better business climates, or do causalities actually run the other way round? A common response to solve this ‘endogeneity problem’ is to employ time-lagged or instrumental variables. Unfortunately, such techniques cannot be applied in a cross-sectional dataset. Thus, strictly speaking, the existing data do not permit robust tests of causality.

There is nonetheless considerable indication that causal directions are correctly specified in the presented models. Considering the mixed-method approach taken in this study, it is possible to refer back to the findings from the case-study analyses. Recalling the interview-data in Chapters 4 and 5, key informants never report that leadership and societal pressure are the results of prevailing business climates; instead, they repeatedly stress the reverse causality. Leadership, in particular, is often highlighted as a driving force for, not a function of, good tax/license/tender practice. These interview statements are further affirmed by the business surveys from the eight district-cases, which suggest

\(^{178}\) KPPOD did not conduct a business survey in 2006, but it is scheduled to publish a new survey at the end of 2007; extending the cross-sectional data to a two-year panel hence needs to be postponed and placed on my future research agenda.
that tax/license corruption has considerably changed since decentralization (see for example Table 4.12), whereas government leadership and business pressure have remained relatively constant over this period. Thus, although it is important not to overstate causality (in the absence of robust statistical tests), evidence from preceding case studies also suggests that there is little reason to reject specified causal directions.

A key finding in this chapter is that results from statistical and case-study analyses match remarkably well. Both data-based and field-based results suggest that leadership is the more substantial and consistent explanation for business climate variation. Moreover, both quantitative and qualitative assessments cast some doubt on the explanatory strength of business pressure at this early stage of decentralization. The favorable effect of leadership qualities, illustrated in the Java and Sumatra cases, as well as the ambiguous and sometimes adverse effect of business-pressure, emerging from the Bali and NTB cases, are reaffirmed by the statistical analysis. The fact that the regression analyses, based on a dataset of 230 districts, yield almost identical messages to those of the case studies, clearly helps to substantiate the field-based argument.

Apart from triangulating case-findings, the regression results also shed light on the impacts of some economic and socio-political factors. Individual effects of these control factors, which were kept to a minimum in the case studies, become discernible in the regression models. An important message from the OLS estimates is that higher per-capita incomes tend to prompt more business climate problems. The quality of license administration seems less efficient, tender management less transparent, and bribe incidences higher in districts where businesses are better off.

As mentioned, the cross-sectional dataset does not allow for robust causality tests. Hence, the proposed business-climate effects of per-capita incomes, party majorities and ethnic homogeneity are indications based on the specified regression models. It should also be noted that all control factors fulfill the ‘time-order condition of causation’, that is, control factors are observed prior to business climate conditions. For a discussion on the time-order condition see Yee (1996:75).
Arguably, these negative influences of higher income point to the weakness of collective business pressures. Instead of enhancing their power to press for policy improvements, higher incomes and urban concentration seem to make local businesses a more attractive and susceptible target for bureaucratic capture. The Balinese case-study exemplifies this tendency. Despite higher per-capita incomes and concentrated handicraft associations (assumed as indicators of stronger business-pressure), Gianyar exhibits more license and tax irregularities than its counterpart Karangasem. The phenomenon that large businesses (generally more numerous in high-income districts) have seemingly little improved local business climates will be covered in more detail in the synthesis presented in the next chapter.

Two additional issues that will also be revisited in the discussion that follows are partisan structures and ethnic homogeneity. Regarding the first issue, the regression analyses show that political majorities of the two major Indonesian parties, GOLKAR and PDIP, did not have a coherent impact on the quality of local business climates. Both cases display similar problems and improvements, hence making it difficult to infer any clear message. And regarding the second issue, OLS estimates indicate that districts with higher concentrations of any one ethnic group are less prone to bribery problems, a result suggesting that local firms’ efforts to press for better government performance are less likely to occur in heterogeneous district societies.

All in all, the statistical analyses have substantiated the case-study evidence. The district-level and individual-level regression analyses in this chapter have shown that government leadership is a more consistent explanation for business-climate variation than local business pressure. The following chapter now proceeds to place these empirical findings in the political-economy perspective of local government.
Chapter 7
Political Economy of Local Government

7.1 Introduction

The previous three chapters established my principal empirical findings about the dynamics of local government in Indonesia’s newly decentralized political framework. In essence, I showed that leadership exerted by a district regent was more important for explaining local business climates than the pressure exerted by business groups. This finding is not what the ‘good governance’ policy literature would lead us to expect. It stands in marked contrast to the argument that societal pressure is the driving force for better government performance in early decentralization stages. In this chapter I seek to explain this finding.

The guiding principle of the political economy analysis presented in this chapter is straightforward: individuals or groups will press for improvements in government if they have sufficient incentives to do so. As Edward Banfield once aptly put it, people’s reform efforts ‘will be in proportion to the advantage to be gained from a favorable outcome multiplied by the probability of influencing the decision’ (1961:333; cited in Hirschman 1970:39). Translating this into the context of contemporary rural Indonesia, I argue that district regents have larger incentives to improve government outcomes than local firms and district councilors. In order to attain national recognition, electoral success, and social prestige, some regents skillfully build reform coalitions and supervise local bureaucracies. Local firms, on the other hand, often remain constrained by typical collective action problems and local politicians by non-programmatic cleavages and ill-defined electoral rules. In this early transition stage, the strategic and
operational skills of local government leaders are a stronger driving force for business climate outcomes than pressures arising from local firms and their council representatives.

The argument in this chapter is divided into three parts. The second section presents the underlying causes of the weak empirical evidence for societal pressure. Consistent with the conceptual frameworks introduced in Chapter 3, a closer look at interest-group and electoral pressures in Indonesia’s newly decentralized districts is taken. The third section assesses the reasons underlying the strong significance of government leadership. Guided by a review of other transition experiences, the chapter then investigates aspects of strategic entrepreneurship and operational supervision. The fourth section draws conclusions.
7.2 Societal Pressure

7.2.1 Interest Group Pressure

Following the structure outlined in Chapter 3, the discussion of interest group pressure is divided into two sub-sections. The first one will focus on general issues of collective action, paying special attention to large groups (of small firms) and small groups (of large firms). The second sub-section will then focus on a more specific issue and examine interest articulation in local business chambers.

Large and Small Firms

Group-specific collective action problems, as predicted by Olson (1965), are readily observable in rural Indonesia\(^{180}\), due to the constellation of business groups, both in terms of size and geographical dispersion. Statistical figures affirm that cottage-sized and small firms (with less than 20 employees) dominate the rural economies in this study – and in most other Indonesian districts: they cover roughly 99 percent of district business units and absorb roughly 90 percent of district employment.\(^{181}\) This naturally divides rural economies into two distinct groups: first, a very large and geographically dispersed group of small firms – common traders, shopkeeper and craftsmen – who constitute a large part of a district’s civil society; and second, a very small and more concentrated group of business elites – most notably large entrepreneurs working in the construction and procurement industries. As Olson’s group theory leads us to expect,\(^{180}\)

\(^{180}\) To state the obvious, conditions in the rural districts (kabupaten) are very different to those in urban areas (kota). Some urban business groups seem to have successfully transmitted their interests into policy making (even during the Suharto era). A prominent example is Macintyre’s study (1991) on ‘Business and Politics in Indonesia’. By looking at selected urban business groups, most notably in the spinning and pharmaceutical industry, MacIntyre demonstrates that urban businesses were able to lobby for better sectoral policies in the 1980s and 90s. He concludes that these examples of collective business action indicate a greater role of extra-state forces than reflected in the Indonesian literature at the time.

\(^{181}\) These figures emerge from the statistics of the eight observed districts (‘Kabupaten Dalam Angka’); for details see Section 2.2; for a discussion on economic structures in rural Indonesia see also Hill and Weidemann (1989) and Booth and Damanik (1989).
the majority of small firms face pronounced obstacles to acting collectively in their own interest, whereas the handful of business elites is often relatively well organized.

For small firms in rural Indonesia, participation in collective reform initiatives remains unattractive as it induces relatively high individual burdens compared to low and uncertain benefits. As a consequence, each member of this large ‘latent group’ is inclined to refrain from speaking out and free-ride on others’ efforts, not the least because individual defects remain largely undiscovered in the large and widely dispersed community. The case interviews conducted for this study affirm that small businesses prefer to stay ‘below the radar’ of district bureaucrats. Most of the interviewees concur that their personal disadvantages from complaining about government shortcomings are almost certain to outweigh expected common benefits from doing so. Individual costs are high, since many small firms do not have the economic backing to risk tensions with local government departments. Exposing oneself – by means of public complaints, demonstrations or petitions – is likely to raise officials’ resentment and, thereby, raise more administrative problems in the future. A local trader in Lotim aptly summarizes this widely-held belief by stating:

Originally, I quite liked the idea of associating [for better government outcomes]. But, I do not see enough benefits in doing so. I rather concentrate on my own business. Engaging for a joint cause often raises problems [with local bureaucrats]; many conflicts arise here and there. And, in the end, there are no results; nothing changes (field interview, 8 December 2005).

Because most small firms tend to behave in this way, collective action rarely takes place among small firms.

Indeed, many small businesses seem doubtful that their efforts would lead to tangible improvements. Based on experience, respondents repeatedly state that ordinary
business people, individuals with little social and economic status, remain largely unheard in public arenas. Many informants agreed that unless someone has a strong standing in the community – based on monetary power, political influence, high education, or professional achievements – his/her voice is likely to be ignored or repudiated. This widespread belief is further enhanced by the fact that local law enforcement is virtually non-existent across the eight case studies. Based on the empirical evidence of this and other studies, it is plausible to presume that court verdicts and local police forces often aggravate rather than contain corruption problems. Thus, in light of personal risks, uncertain benefits, and weak law enforcement, small firms have virtually no incentives for joining, let alone initiating, concerted actions for better business climates.

It is revealing that the few reported cases of collective action were not the result of small firms’ common cause but of individual inducements or coercion for external sources. This mechanism, which Olson refers to as the installment of ‘selective’ personal incentives, is exemplified in the case observations. Kebumen’s shopkeepers, for instance, who jointly demonstrated against the construction of a new shopping mall in 2005, were not driven by a collective motive but simply by monetary initiatives. As several informants concur, the owner of the existing shopping mall – who had substantial interest to keep competition at a minimum – staged the demonstration by paying each shopkeeper a substantial amount of money. Similar accounts emerge in the two NTB cases. NGO and media respondents in Bima and Lotim affirm that local elites can easily ‘engineer’ public demonstrations, as long as they hold sufficient

\[\text{\textsuperscript{182}}\] There is broad agreement among business people interviewed that local courts fail to uphold the rule of law: verdicts are generally skewed towards those who hold money and power. This notion is confirmed by an Indonesia-wide regional corruption study by Transparency International (2005). Based on 1300 surveyed business people, Transparency International finds that 56 percent of all police, and 48 percent of all court interactions, involve corrupt payments.

\[\text{\textsuperscript{183}}\] Author’s field interviews with a senior politician and a journalist in Kebumen, 25/27 July 2005.
financial and social means to do so.\textsuperscript{184} Hence, as a preliminary summary, the power small firms can exercise is limited to the rare occasions on which their individual cost-benefit calculus is artificially altered by external monetary or social incentives; in the absence of such external factors collective action amongst small firms remains unlikely.

The situation for large firms is different. The empirical evidence affirms that local business elites, the small 'privileged group' in Olson's (1965) terminology, face fewer coordination and free-rider problems (due to smaller group size and dispersion) and, therefore, sustain collective action more easily. But these collective efforts are rarely geared towards reformist and often towards exclusive, if not collusive, ends. Unlike their urban colleagues, rural entrepreneurs are strongly dependent on public contracts. And due to the small consumer markets, engagement in government projects (for example the construction of schools, hospitals, and roads) remains a primary income source. Against this backdrop, benefits from maintaining close government ties generally remain well above benefits from criticizing administrative shortcomings. For many large firms, incomes from government contracts outweigh business-climate costs arising from trade-distorting taxes, administrative inefficiency or bribes for business licenses. These adverse incentive structures are further aggravated by weakly enforced laws and often result in rent-seeking activities in public-tender projects (see Chapters 4 and 5). Thus, as long as cooperating (or colluding) with government officials is the more lucrative option, business elites have arguably little reason to abandon the status quo and press for broad business-climate improvements.

\textsuperscript{184} As one large businessman in Bima contended: 'If I have problems with the government I can initiate a protest rally. The price for doing so varies. Some locals, who are closely connected to me, will not ask for money; others will demand payments – at least a daily allowance for food and transportation.'(field interview, 17 January 2006)
The 'Lawata Scandal' in Bima illustrates the large gains that business elites can accrue by joining private-public collusion networks.\(^{185}\) In 2002/3, the local parliament in Bima decided to turn the beach hotel Lawata, which declared bankruptcy after the Asian crisis in 2000, into a public 'night bazaar' (*pasar malam*). To remodel the property into an attractive market with food and entertainment facilities, Bima’s parliamentarians dispensed a budget of 800,000,000 Rps (roughly US$ 80,000) and appointed a group of 20 business elites to implement the project.\(^{186}\) But the night bazaar was never realized. In 2006, roughly four years after the project was announced, the site presents a depressing picture: run-down hotel bungalows and inhospitable beaches with countless debris (see Figure 7.1). There are no signs of renovation efforts, nor of attempts to prepare the property for its announced purpose; in its place, one encounters empty bottles, the remains of bonfires and graffiti. This suggests that the budget for the night bazaar was not utilized for its earmarked purpose, but instead was divided among project members.

Figure 7.1: Beach Hotel Lawata

Source: Author’s pictures (January 2006).

One aspect of local firms that to some extent transcends the Olsonian logic is the, what we might call, ‘vulnerable group’ of Chinese Indonesians. As in other parts of Southeast Asia, ethnic Chinese in rural Indonesia are in an exposed position. Tensions

\(^{185}\) The description of the Lawata case rests on internal GTZ reports, personal observations, as well as on interviews with local business people, journalists and NGO activists.

\(^{186}\) These figures are reaffirmed in Bima’s 2002 Annual Budget Report (*APBD 2002 Kabupaten Bima*).
between ethnic Chinese (tionghoa) and indigenous residents (pribumi) are not a new phenomenon in Indonesia. In fact, Geertz’ (1963) acclaimed study of a rural Javanese town, written shortly before the 1965 anti-communist (and anti-Chinese) homicide, continues to reflect current circumstances:

... Chinese have some tremendous advantages: they have more capital, more business acumen and experience, more organizational resources by far than the Javanese shopkeepers; but they have one tremendous disadvantage: they are Chinese. Resentment against them, always great, actually increases in direct proportion as they and their Javanese competitors gain in strength... [The] vicious circle of suspicion, hatred, resentment, separateness and reinforced suspicion on the part of the two communities promises to continue unabated for some years (Geertz 1963: 76-7).

Despite their strong economic power in rural Java, Bali and NTB\textsuperscript{187}, Chinese firms are generally reluctant to involve themselves in public debates. Many of the Chinese interviewed had experienced ethnic discrimination and overproportionate bureaucratic complexities. Some of them witnessed the killings during the anticommmunist riots in the 1960s\textsuperscript{188}, others have seen demolition, looting, or other forms of injustice over the last four decades.\textsuperscript{189} Against this background of social vulnerability, Chinese minorities are preoccupied with maintaining a stable social balance with local powerholders and communities and, therefore, are not inclined to openly criticize local government performance. As one Chinese entrepreneur in Bima\textsuperscript{190} summarized: ‘The Chinese business community in this district is generally afraid to

\textsuperscript{187}In Bima, for instance, most supermarkets, restaurants, hotels and retail shops are in the hands of ethnic Chinese. Also in Lotim, Klaten, Kebumen, Gianyar, and Karangasem, respondents report that Chinese entrepreneurs are dominating local trade markets (approximately 75 percent of all Chinese respondents operate in the trade sector).

\textsuperscript{188} One businesswoman in East Lombok, for example, recalls that many young Chinese escaped to West Lombok in 1965 after their parents were killed in front of their eyes (field interview, 3 December 2005). Although there are no confirmed numbers, scholars agree that the death toll during the anti-communist riots extended to hundreds of thousands of (mainly Chinese) people (Schwarz 1999; Hofman \textit{et al.} 2004:37; Webber 2006).

\textsuperscript{189} As Webber notes: ‘evidently well-organized anti-Chinese ‘riots’ wrought havoc in Jakarta and several other large cities, resulting in an estimated total of 1188 deaths, the rape of several hundred – mainly Indonesian Chinese – women and extensive property damage.’ For further details on anti-Chinese sentiments and riots refer to Chang (1973:590-1) and Ham (2005).

\textsuperscript{190} field interview in Bima, 12 January 2006.
speak out. They believe that criticizing [indigenous] officials harms their business … Caution has further increased after some of their shops were burnt down in the 1998 [post-Suharto] riots.’

To stay clear of local conflicts many ethnic Chinese try to maintain a ‘low key’ appearance – not only politically but also in terms of economic wealth. 191 Yet, irrespective of such containment strategies, several Chinese respondents are still exposed to social and economic discrimination. 192 Due to their special status as an economically powerful but, at the same time, socially vulnerable group, Chinese firms are chiefly concerned with securing a ‘safe’ relationship with local powerholders; voicing against corrupt and inefficient tax/license/tender practices is thus of lesser importance than safeguarding their own position in a rather volatile environment. Thus, irrespective of their small and coherent group structure, 193 which theoretically allows for collective action, most Chinese entrepreneurs remain risk-averse and refrain from reform-oriented collective action.

191 In order not to raise the jealousy of surrounding residents, some Chinese Indonesians maintain a ‘low-key’ appearance in their communities: instead of obvious investments in expensive shop-fronts, houses, or cars, they prefer more discrete alternatives such as investments in education or projects outside their district (Informal discussion with a Chinese trader in Bima, 16 January 2006).

192 An illustrative example emerges in Lotim. The strong segregation between pribumi-Indonesians and Chinese-Indonesians is illustrated by the official ban on Lotim’s public servants purchasing their daily goods at Chinese grocery supermarkets. ‘Three years ago [2003] the government told people not to buy goods in our supermarket. I do not understand why. We are also people. We never caused any problems or confronted anyone. Now they say locals should go to Muslim shops’ (field interview, 3 December 2005; summarized version of the original wording).

193 Field observations in Bima, for instance, showed that the Chinese business community is cohesively organized. Chinese firms interact on a regular basis in church meetings, sport clubs and social events.
Table 7.1: Collective/Individual Articulation of Business Climate Concerns (in Percent)

<table>
<thead>
<tr>
<th>District</th>
<th>Individual Efforts</th>
<th>Collective Efforts</th>
<th>Obs.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Weak</td>
<td>Strong</td>
<td>Weak</td>
</tr>
<tr>
<td>Gianyar</td>
<td>55.6</td>
<td>5.6</td>
<td>24.3</td>
</tr>
<tr>
<td>Karang</td>
<td>44.0</td>
<td>11.2</td>
<td>37.3</td>
</tr>
<tr>
<td>Bima</td>
<td>52.0</td>
<td>14.2</td>
<td>44.1</td>
</tr>
<tr>
<td>Lotim</td>
<td>49.2</td>
<td>18.5</td>
<td>49.2</td>
</tr>
<tr>
<td>Kebumen</td>
<td>52.1</td>
<td>14.1</td>
<td>47.9</td>
</tr>
<tr>
<td>Klaten</td>
<td>72.3</td>
<td>7.6</td>
<td>66.1</td>
</tr>
<tr>
<td>Solok</td>
<td>56.9</td>
<td>7.7</td>
<td>46.9</td>
</tr>
<tr>
<td>Pesisir</td>
<td>66.0</td>
<td>13.5</td>
<td>48.9</td>
</tr>
<tr>
<td>Average</td>
<td>56.0</td>
<td>11.5</td>
<td>45.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Business Size</th>
<th>Individual Efforts</th>
<th>Collective Efforts</th>
<th>Obs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small (≤20 empl.)</td>
<td>56.0</td>
<td>11.4</td>
<td>45.1</td>
</tr>
<tr>
<td>Large (&gt;20 empl.)</td>
<td>56.9</td>
<td>12.3</td>
<td>48.5</td>
</tr>
</tbody>
</table>

Source: Author's business survey with 1000 randomly selected local firms in eight districts.

Note: Based on the survey question G4f/g: 'Please evaluate your private/collective efforts to articulate concerns to the local government'; the category of 'small businesses' refers here to firms with 20 employees or less; 'large businesses' to firms with more than 20 employees; roughly 85 percent of the survey respondents fall into the former category. For reasons of emphasis, 'moderate' perceptions are omitted; they equal the residuals of presented values; 'empl.' refers to employees.

The overriding message of the discussion so far, that collective action for business-climate improvement is rare both among small and large firms, is also reflected in the survey data. In each district more than 130 businesses were asked to evaluate their efforts to express policy concerns to local governments. As summarized in Table 7.1, responses suggest that firms rarely complained about policy shortcomings (on tax, license and corruption issues). This applies to both collective and individual complaints. On average, 46 percent of the respondents perceive collective efforts to be poor, whereas only 15 percent report the opposite. Individual attempts are equally insignificant: while 56 percent of all respondents rate their engagement as weak, a mere 12 percent report strong efforts. These findings hold true irrespective of the size of a business. Perceptions of marked individual and collective efforts remain scarce among small (11 and 15 percent) and large (12 and 17 percent) business respondents.
It is also important to note here that even though Gianyar and Bima were selected on grounds of higher societal-pressure indicators (Section 5.2) the business survey indicates equally weak (or even lower) individual and collective efforts than in their comparative district-cases (Karangasem and Lotim).\(^{194}\) This provides an important ex post indication that a strong potential for societal pressure does not necessarily translate into strong action. Given the adverse incentive structures described in this section, there seems to be no robust link between well-educated/informed/associated businesses and their actual efforts to press for business climate improvements.

The empirically-confirmed deficits in collective efforts to improve business climate problems can also be explained from another angle. Recalling the essence of Putnam’s (1993) theory of civic engagement, vertically-structured societies are likely to face more collective action problems than horizontally-structured ones. Unfortunately, in rural Indonesia social networks that cut across economic status, professional rank, religious denomination, and ethnic affiliation are still rarely found.\(^{195}\) Despite decentralization and democratization, much of the observed interaction patterns, especially along private-public interfaces, continue to be hierarchical. Field interviews and observations show that top-down management structures prevail across all walks of life: in government and police offices, but also across political, educational, religious,

\(^{194}\) Put in a different way, in hindsight the measures (education, association, political awareness) applied in Chapter 5 to purposely select case-wise variation in societal pressure are prone to statistical ‘measurement error’; The expected differences cannot be affirmed in the field. In fact, as I outline in this section these differences are likely to remain indistinct across most districts at this point of time, due to collective action problems and nascent democratic functions.

\(^{195}\) According to the interviews, occasional ‘communal cooperation’ efforts (gotong royong) occur, but mostly involve people of similar ethnicity or status. For a critical review of the gotong-royong concept and its ‘ideological construction’ see Bowen (1986). This critical view is confirmed in a recent countrywide household study by Alatas et al.. The authors provide evidence that only a few communities have departed from the former hierarchical organization pattern. The few cases that departed from top-down structures, however, engaged more frequently in concerted action and increased the responsiveness of local government (Alatas et al. 2003:34,38). For a more detailed discussion on community structures during the Suharto regime see Evers (2000).
media, and communal organizations. Under these hierarchical preconditions district elites revert to what Putnam (1993:177) calls, 'amoral familism': close nepotistic government ties driven by exclusive interests. Meanwhile small business people and Chinese minorities find themselves isolated, and lacking of meaningful linkages to policy makers.196

Local Business Chambers

The discussion now turns to a specific example of organized business interests: local business chambers. As outlined in Chapter 3, the role of business organizations in policy-making has been mainly addressed in neo-pluralist literatures of the 1980s in the context of Western urbanized democracies (Schmitter 1981; Streeck and Schmitter 1985; Katzenstein 1985; Coleman 1988). The overarching assertion is that business organizations were key policy agents that could aggregate business interests into clear demands towards governments, reduce private-public friction, and implement business-related public services. The situation of business organizations in rural Indonesia is very different. Given the authoritarian heritage and the dispersed nature of private sector activity in rural economies, business chambers across the eight observed districts predictably fall short of the functions envisioned in advanced economies.

The reasons for this apparent shortcoming are two-fold. First, unlike the neo-pluralist assertion that policy-makers in capitalist systems depend on business elites to retain their power (Lindblom 1977:123), rural business elites often depend on district

196 As discussed earlier, the results of the cross-district regression analyses in Chapter 6 suggest that districts with homogenous ethnic compositions have somewhat fewer problems with corrupt licensing practices. This may indicate that civic ties are stronger in communities in which business people share the same ethnic background and weaker in multi-ethnic societies. However, cooperation that is confined to narrow ethnic boundaries, Putnam (1993:175) cautions, is often insufficient to nourish broad collective action that translates into government reforms. Whether strong ethnocentric ties lead to meaningful collective action and whether they can extend to more inclusive civic networks over time, is an interesting question for future research (but cannot be answered in the context of this study).
governments to gain lucrative public contracts; officials and politicians, on the other hand, rely less on local firms as their funding mostly originates from national sources. This inverted dependency structure shifts the power balance from private to public actors. And second, similar to the previously described propositions of Bates (1981) and Ramsay (1987)\textsuperscript{197}, the high fragmentation of rural businesses – both in terms of geographic location and sectoral affiliation – makes it extremely difficult and costly to coordinate business interests. As Olson (1965:146) notes in the context of US business chambers, encompassing business organizations with a sectorally and geographically fragmented membership are bound to face the same collective action problems that prevail in large societal groups in general.

Both these aspects are well-reflected in the district-cases of this study, particularly if the most prevalent business organization across rural Indonesia is considered: the chamber of commerce and industry (Kamar Dagang dan Industri Daerah, short KADINDA). Apart from some exceptional cases,\textsuperscript{198} local chambers are weak representatives of common business needs. During the Suharto era KADINDA retained a monopolized position as designated coordinator for public infrastructure projects. It was designed as an umbrella organization for large government contractors rather than as an advocate for generic private-sector interests. As MacIntyre (1991) notes in the early 1990s:

Many of the regional and district KADINDA exist almost in name only, having little membership and organizational depth. [The] KADIN network is primarily an instrument of control for political [GOLKAR] authorities, herding business people into a single corporatist pen. With some exceptions, the KADINDA are generally seen as passive and pliant organizations, whose membership tends to be

\textsuperscript{197}Ramsay (1987:266) concurs with Bates’ (1981) findings in Africa, and outlines three reasons why Thailand’s rural sugar producers were able to overcome typical collective action problems: ‘there is a disproportionate number of large farmers in sugarcane cropping, they are geographically concentrated, and the industrial structure of the sugar industry facilitates organization through its quota system’.

\textsuperscript{198}One of these exceptional cases is described in Jim Schiller’s (1986) account of the Central Javanese district Jepara, where a vibrant wood-manufacture sector managed to revitalize the local business chamber and utilize its representative powers to press for government improvements.
dominated by building contractors. The dominance of building contractors is due to the fact that public sector work, which represents a huge slice of the industry, is unobtainable unless they are member of KADIN. (MacIntyre 1991:48)

Figure 7.2: Impressions of Local Chamber Offices in Rural Indonesia

Note: Pictures were taken during unannounced visits to KADINDA offices in Karangasem (top left), Lotim (top right), Solok (bottom left) and Gianyar (bottom right);

The interviews and observations in Java, Sumatra, Bali and NTB show that the absence of KADINDA's representative functions has been even more striking since the implementation of decentralization. With the fundamental revisions of public tender laws (e.g. Kepres 18/2003 and 80/2003) under the new government, KADINDA has lost its former key position: firms involved in public tender projects no longer require KADINDA membership or authorization. Given the authoritarian nature of former private-public interaction in rural areas, the short-term result of these new laws is not an emergence of new encompassing organizations, but rather a fragmentation of former business elites: large contractors increasingly terminate their chamber affiliation, create
small splinter groups, and manage their public-tender projects and government relations on their own behalf.\textsuperscript{199} 

With the decline of their organizational umbrella functions, local chambers are on the verge of insignificance. Rapidly declining membership numbers\textsuperscript{200} have led to severe cuts in operational budgets. In the absence of clear strategic bearings \textit{KADINDA} branches have become ‘stuck in the middle’: between their New Order past and an indistinct vision of their future role in decentralized district polities. The evidence of this demise is readily observable (with the exception of Bima\textsuperscript{201}) in all district-cases. Run-down offices, devoid of permanent staff and tangible service portfolios, confirm the dysfunctional state (see Figure 7.2). According to the interviews with local business people, \textit{KADINDA} branches fail to provide meaningful advocacy, information, or technical advice. As one entrepreneur in Karangasem summarizes it: ‘Over the last years, I have never witnessed any meaningful activity of [\textit{KADINDA}]. Local chambers and other sectoral business associations are preoccupied with internal power conflicts and, hence, are unable to serve wider business interests.’\textsuperscript{202} 

Even in Bima and Gianyar, two districts where a relatively strong presence of professional bodies was discernible (Section 5.2), organizational efforts remain limited

\textsuperscript{199} The fact that \textit{KADINDA} or other business associations have so far failed to build a broad-based membership amongst common business people is clearly reflected in the business survey: Only 4 percent of all small businesses (≤ 20 employees) and 6 percent of all large businesses ( >20 employees) are registered members of \textit{KADINDA}; similarly low figures apply to the ‘Public Constructors Association’ \textit{GAPENSI} (3 and 5 percent, respectively); membership in other business organizations, that have become salient in urban areas, such as the ‘Young Entrepreneurs Organization’ \textit{HIPMI} or ‘Association of Indonesian Entrepreneurs’ \textit{APINDO} remain well below 1 percent.

\textsuperscript{200} The KADINDA office in Solok, for instance, reports a loss of more than half of its official members between 2003 and 2005. Indeed, membership has been plummeting in all observed KADINDA offices; in most cases numbers hardly exceed 100 registered businesses. Budget problems are further accelerated by the fact that local branches can only retain 50 percent of local membership fees, whereas the remainder is absorbed by the Jakarta head office to cover its overhead costs. Unfortunately, as several interviewed KADINDA managers complain, the head office provides few services in return: training and guidance for strategic repositioning are in short supply (field interview, 25 August 2005).

\textsuperscript{201} Bima’s KADINDA branch exhibits a comparatively well-functioning office. This is partly due to the strong leadership of its head Haji Qurais, a reform-minded successful businessman, who managed to attract additional financial/organizational support from foreign donors to maintain his faculties and staff.

\textsuperscript{202} Author’s field interview with a local businessman in Karangasem, 12 November, 2005.
to business promotion and rarely touch on government reforms. Bima’s *KADINDA* head Haji Qurais, for instance, was able to successfully conduct economic assessments and motivated government officials to explore regional trade links, but failed to rid local firms of distortionary trade taxes (Section 5.3). The main reason for this limit, as Qurais emphasizes, is that *KADINDA* lacks political power due to the weak engagement of its members: ‘Bimanese businesses are still accustomed to Suharto’s rules ... they refrain from engaging in local politics; instead they focus on their personal business ... especially Chinese firms are very cautious.’ In Gianyar, the interview with Wayang Arsania – head of a large handicraft association (*APKKG*) and deputy of *KADINDA* – revealed a similar picture. In this early stage of democratization, Arsania contends, the main function of sectoral business associations is to ‘host regional and national business fairs in cooperation with the local government’. Issues of government inefficiencies or corruption are not addressed: partly because *KADINDA*’s organizational structure is weak and partly because local businesses are not demanding that professional associations do so.

Table 7.2: Representation through Local Business Chambers (in Percent)

<table>
<thead>
<tr>
<th>District</th>
<th>Poor</th>
<th>Moderate</th>
<th>Good</th>
<th>Obs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gianyar</td>
<td>29.6</td>
<td>65.5</td>
<td>4.9</td>
<td>144</td>
</tr>
<tr>
<td>Karang</td>
<td>47.5</td>
<td>41.8</td>
<td>10.7</td>
<td>126</td>
</tr>
<tr>
<td>Bima</td>
<td>47.3</td>
<td>38.6</td>
<td>14.2</td>
<td>128</td>
</tr>
<tr>
<td>Lotim</td>
<td>52.0</td>
<td>35.4</td>
<td>12.6</td>
<td>130</td>
</tr>
<tr>
<td>Kebumen</td>
<td>53.8</td>
<td>41.2</td>
<td>5.0</td>
<td>121</td>
</tr>
<tr>
<td>Klaten</td>
<td>47.4</td>
<td>39.7</td>
<td>12.9</td>
<td>121</td>
</tr>
<tr>
<td>Solok</td>
<td>53.9</td>
<td>41.5</td>
<td>4.6</td>
<td>130</td>
</tr>
<tr>
<td>Pesisir</td>
<td>64.5</td>
<td>27.7</td>
<td>7.8</td>
<td>141</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>49.5</strong></td>
<td><strong>41.4</strong></td>
<td><strong>9.1</strong></td>
<td><strong>130</strong></td>
</tr>
</tbody>
</table>

Note: Survey question G4e: ‘Please evaluate how well your interests are represented by local chambers’
Source: Author’s business survey with 1000 randomly selected local firms in eight districts.

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203 For a review of Bima’s ‘participatory assessment of competitive advantages’, a joint imitative of KADINDA, the Bimanese government and the German Technical Cooperation Agency (GTZ), see Reger and Von Luebke (2004).

204 Author’s interview with Haji Qurais, 17 January 2006.

205 Author’s interview with Wayang Arsania, 28 October 2005.
These current deficiencies of local chambers are readily observable in the business survey of this study. The perceptions of over 1000 (mainly small) firms provide a clear indication that local business communities are, on average, strongly dissatisfied with KADINDA’s representative functions. As depicted in Table 7.2, a majority of the business respondents (50 percent) reports that their interests are poorly represented by local chambers, whereas only a few respondents (9 percent) approve of KADINDA’s role.\textsuperscript{206} While responses are somewhat less negative in Bima (14 percent affirm good performance) and less decisive in Gianyar (66 percent remain undecided), the overall message from this survey data is that KADINDA has so far failed to reposition itself as a meaningful intermediary for wider business interests.

As a bottom-line, the Indonesian regime change has not improved but merely revealed former deficiencies of local business chambers (KADINDA). A useful way to summarize the discussion is to refer, once again, to the language of collective action. Applying the logic of collective action, KADINDA currently holds no ‘selective incentives’, to use Olson’s (1965) terminology, to sustain its membership: it has neither the powers to ‘coerce’ nor the services to ‘convince’ firms to join its organization. At this stage, large contractors have no mandatory requirement and small firms no tangible benefit in being a KADINDA member. As a result of declining membership and operational means, most local chambers have become empty façades without real functions.

\textsuperscript{206} These few supportive respondents do not all (as some may suspect) belong to the large-business group; they are divided in the same 85:15 ratio (small: large businesses) as the underlying sample frame.
7.2.2 Electoral Pressure

Indonesia's local democracy is at a nascent stage. The literature on democratic transitions makes it clear that Indonesia, roughly ten years after the cessation of Suharto's authoritarian regime, has inherited a set of unfavorable start-up conditions. Recalling the discussion in Chapter 3, political scientists highlight a set of enabling factors for democratic transitions: new democracies are likely to consolidate, *ceteris paribus*, if they exhibit economic equality (Lipset 1959; Acemoglu and Robinson 2001), a separation of religion and politics (Tocqueville 1946; Huntington 1993), a supporting culture of political rights and principles (Almond and Verba 1963; Dahl 1971), a low degree of ethnic fragmentation (Horowitz 1985), and distinct party platforms that aggregate popular interests (Lipset and Rokkan 1967; Lipset 1994).

Observable conditions in Indonesia's rural polities, however, point in opposite directions. Local districts exhibit marked economic inequalities and ethnic fragmentation, a lack of grown political culture, an intertwined nature of religion and politics, and an absence of clearly distinguishable party policies. In the absence of these democracy-enabling conditions, it is not surprising to find that political representation functions are initially impaired. Notwithstanding that decentralization laws have officially empowered citizens to hold local governments to account by means of elected district councils (*DPRD*), in the short term electoral pressures are compromised by disadvantageous 'startup conditions' and the nascent stage of Indonesia's democracy.

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207 In order to align executive government powers with common interests, the designers of the decentralization laws (see Chapter 2) initially granted local councils strong veto functions. Pursuant to decentralization law 22/1999 councils were empowered to elect regents (among candidates proposed by political parties); control regents' performance on the basis of annual 'accountability reports' (*Laporan Pertanggung Jawaban*); and impeach regents if their performance strongly failed to meet the public good (USAID 2006:116). Unfortunately, many DPRD misused their legislative powers to extort financial favors from incumbent regents, which eventually led to a reduction of local legislative powers. Eventually in 2004, with the enactment of revised decentralization laws (32/2004), the national government introduced direct elections for regents (majors and governors) and, in doing so, shifted accountability checks from local councils to local electorates.
Table 7.3: Representation through Local Councilors (in Percent)

<table>
<thead>
<tr>
<th>District</th>
<th>Poor</th>
<th>Moderate</th>
<th>Good</th>
<th>Obs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gianyar</td>
<td>45.8</td>
<td>50.7</td>
<td>3.5</td>
<td>144</td>
</tr>
<tr>
<td>Karang</td>
<td>65.6</td>
<td>27.2</td>
<td>7.2</td>
<td>126</td>
</tr>
<tr>
<td>Bima</td>
<td>54.3</td>
<td>34.7</td>
<td>11.0</td>
<td>128</td>
</tr>
<tr>
<td>Lotim</td>
<td>56.2</td>
<td>34.6</td>
<td>9.2</td>
<td>130</td>
</tr>
<tr>
<td>Kebumen</td>
<td>57.0</td>
<td>36.4</td>
<td>6.6</td>
<td>121</td>
</tr>
<tr>
<td>Klaten</td>
<td>66.7</td>
<td>27.5</td>
<td>5.8</td>
<td>121</td>
</tr>
<tr>
<td>Solok</td>
<td>62.3</td>
<td>31.5</td>
<td>6.2</td>
<td>130</td>
</tr>
<tr>
<td>Pesisir</td>
<td>70.2</td>
<td>21.3</td>
<td>8.5</td>
<td>141</td>
</tr>
<tr>
<td>Average</td>
<td>59.8</td>
<td>33.0</td>
<td>7.3</td>
<td>130</td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 1000 randomly selected local firms in eight districts.
Note: Survey question G4d: ‘Please evaluate how well your interests are represented in local councils’.

The compromised nature of electoral pressures is readily observable in the empirical findings of this study. Across the eight observed district polities, local firms were asked to evaluate how well their interests are represented by district councilors. The results are strikingly negative. As outlined in Table 7.3, roughly 60 percent of the 1041 respondents feel that they are poorly represented by elected politicians, compared to only 7 percent who are satisfied with councilors’ representational efforts. These results that show disapproval across all eight districts\(^\text{208}\) call for a deeper examination of Indonesian local politics. Two features in particular have a constraining effect on local electoral pressure: first, the shallowness of political cleavages and programmatic profiles; and second, the lack of direct accountability links between local politicians and electorates.

Let us first turn to the issue of political cleavages. Historically, political cleavages\(^\text{209}\) in Indonesia run along religious socio-ethnic lines\(^\text{210}\) the main political

\(^{208}\) Even the districts Bima and Gianyar (selected on grounds of higher education/association/political awareness indicators) exhibit equally low perceptions of political representation than their counterparts.

\(^{209}\) Cleavages are here understood as fundamental social/cultural/ economic divides that manifest in divergent interests and, eventually, translate into the formation of political parties; for a comprehensive discussion of social cleavages and political alignments see Lipset and Rokkan (1967).

\(^{210}\) Clifford Geertz, for instance, describes in detail the socio-ethnic/religious distinctions (aliran) in Java and how they effected party formations in the 1950s and 60s (1960; 1963:14-5); a concise summary of the aliran debate and its applicability for contemporary Indonesian politics can be found in Ufen (2006).
streams are either secular nationalist (GOLKAR, PDIP), Islamic traditionalist (PPP, PKB), or Islamic modernist (PAN, PKS, PBB). Apart from these secular-religious distinctions political parties are virtually identical in terms of their programmatic profiles. Clear economic positions, a decisive factor in winning elections in advanced industrial nations, are either absent or indistinct. As a result of this ‘programmatic shallowness’, as a number of recent studies show, rural electorates base their votes almost entirely on politicians’ charisma, ethnic/religious affiliation, piousness and personal integrity, and less so on economic policy content.

The current lack of policy contents in political debates is unsurprising if we consider the historical and socio-ethical context. Looking at Indonesia’s recent history, it cannot be overemphasized that the thirty years of authoritarian rule (1965 to 1998) have thoroughly depoliticized rural societies. Under the strong presence of military forces, General Suharto rigorously banned regime-critical political activity – not only by replacing post-Independence pluralism with an all-powerful state party (GOLKAR), but also by severely curtailing student associations and labor movements. In light of these authoritarian interventions, political rights and values – in the sense of Almond and

211 Recent studies of local politics (Vel 2005; Mietzner 2006; Buehler and Tan forthcoming) and national politics (Sherlock 2004; Ufen 2006; Webber 2006) confirm that party platforms lack programmatic differences.


213 Under the slogan ‘politik tidak, pembangunan ya’ – say no to politics, yes to development – Suharto merged all post-Independence parties into two artificially created political amalgams (Hofman et al. 2004:38): the United Development Party (PPP) and the Indonesian Development Party (PDI). While PPP was the amalgamation of four rival Islamic parties, PDI resembled the fragmented mix of five nationalist and Christian parties (MacIntyre 1999:264-5). Unsurprisingly, this intervention unleashed internal conflicts in the heterogeneous PDI and PPP camps – rendering their role as opposition parties virtually insignificant (Schwarz 1999:32). This political insignificance was further aggravated by Suharto’s prohibition of organized political activity and campaigns in rural areas since 1971. While Golkar’s political influence was secured by its country-wide network of associated military officials and public servants, the two remaining ‘democratic’ parties were strongly disadvantaged by this restriction (Syafrudin 1993:218; MacIntyre 1999:266). As a result, Suharto depoliticized Indonesia’s rural areas and installed an all-powerful state-party which was able to single-handedly determine policy outcomes over the following three decades.
Verba (1963) and Dahl (1971) – are naturally underdeveloped in rural Indonesia. Another apparent constraint is given by the country’s socio-ethnic fragmentation. In search of common denominators between highly diverse cultures, ethnicities and traditions, political debates often remain vague on issues like government or anti-corruption reforms (USAID 2006:122; Ufen 2006).

Apart from historical and socio-ethnic factors, electoral pressure is further compromised by weak accountability links between citizens and local politicians. These accountability problems are well reflected in the current specification of electoral rules. Notwithstanding that proportional representation (PR) can be a preferable choice in many circumstances (see discussion in Section 3.2), the introduction of a closed-list PR system in rural Indonesia has arguably created more problems than it has solved. As interviews with local NGO and Media observers confirm, the prevailing intransparency of the current list system makes it extremely difficult for electorates to punish or reward political behavior. List positions are granted at the discretion of the party leadership, often to local candidates who have made high ‘contributions’ to party headquarters.

The main problem of the current setting is that candidates who are put at the top of the list (‘posisi topi’) virtually always win parliamentarian seats. This institutional defect

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214 It should be noted that ‘political learning’ in rural area is further disadvantaged (compared to urban areas) due to limited access to secondary education and political information (Beetham 1996).

215 Since 2004 closed lists have been replaced by semi-open lists which continue to exhibit serious accountability deficits; under the new election laws (UU 31/2002 and 23/2003) lower listed candidates can only take office if their votes exceed the threshold level for a direct seat; if they remain below this threshold (if only by one vote) their entire votes are transferred to the top of the party list. As critical media observers summarize it: the ‘current law on general elections authorizes political parties to determine the sequence on a list of running candidates […] Under this scheme, potential candidates tighten their relationships with party leaders, while they ignore [the] voice of [local people]’ (Jakarta Post, February 11 2007).


217 A good illustration how the current system is skewed against candidates without top list positions is presented in Sherlock (2004:40): consider a situation where ‘Party B receives 50,000 votes in an electoral district. The quota for that district is 50,000 votes – therefore Party B is allocated 1 seat. Candidate 1 on the party list receives no individual votes. Candidate 4 on the party list[, however,] receives 49,000 votes
makes it nearly impossible for voters to dismiss misbehaving politicians once they are at the top of the ballot. As a result, local politicians have become preoccupied with managing their relations with national superiors and pay less attention to local electorates.

This missing accountability link has the concomitant effect of exposing local politicians to corruption. Since the enactment of decentralization, the Indonesian Corruption Watch has identified over 80 cases in which local councilors have misused public means for private gains – amounting to a total loss of roughly US$ 50 million.\textsuperscript{218} According to case informants, candidates that have heavily invested in top list positions are preoccupied with obtaining a ‘return on investment’; they are naturally more concerned with extracting rents from public projects than with improving government services.\textsuperscript{219} As the former minister of regional autonomy, Ryas Rasyid, puts it, political corruption has mushroomed across the regions, irrespective of party affiliations, making it difficult for local voters to build an informed opinion of any one political party (Rasyid 2003:66). This finding also resonates well with the regression results reported in Chapter 6, which indicated that neither of the two major parties – \textit{GOLKAR} nor \textit{PDIP} – has significantly reduced local corruption: the former tends to exhibit more irregularities in public tender projects, the latter more extractions in license administration.

In summary, electoral pressures remain weak across rural districts. The combination of the authoritarian inheritance, religious cleavages, and ethnic

\textsuperscript{218} Detailed descriptions and background materials are accessible at the Indonesian Corruption Watch website (www.icw.or.id).
\textsuperscript{219} This notion that the current electoral setting provides local politicians with incentives for corruption was widely affirmed in nearly all interviews with NGO and media respondents across the eight districts.
fragmentation poses major challenges for Indonesia's local democracy. After thirty years of depoliticization, the demand for and supply of programmatic platforms remains low across the observed cases. This dearth of meaningful policy debates is further exacerbated by a dysfunctional electoral setting: closed-list PR systems that are highly skewed towards top-listed party candidates fail to effectively align local politicians with societal interests. In view of this weak alignment, political 'yardstick' competition, as envisioned by Besley and Case (1995), is virtually non-existent. Right now, local politicians do not compete for critical well-informed voters by proposing policy reforms, but rather for national support and list positions by making substantial 'donations' to national party coffers.
7.3 Government Leadership

In this study government leadership emerges as a salient factor in explaining variation in local business climates. Both empirical and statistical discussions provide strong indication that district tax/license/tender practices depend on the qualities of local government leaders. Why is government leadership such a strong determinant in this early stage of transition? The answer is straightforward: compared to the business groups and district councilors described earlier, district government leaders (i.e. regents) have stronger powers and incentives for pursuing local policy reforms. Throughout the New Order period, regents have been at the top of the local power pyramid, in both government and social spheres. Moreover, with the introduction of direct elections, regents have become, as will be seen, more responsive to local society than district councilors. There is substantive evidence that effective leaders act as 'public entrepreneurs' in anticipation of public demands, but are independent of political platforms.

By linking the empirical case evidence to the leadership literature outlined in Chapter 3, the discussion here proceeds in three steps. The first section examines general power and incentive structures. Guided by other Asian, African and Latin American transition experiences, the second and third sections discuss strategic and operational measures by which regents can improve local government outcomes: public entrepreneurship and bureaucratic supervision.

7.3.1 Regent Powers and Incentives

Regents have historically been at the center of power in rural Indonesia. Starting from the colonial rule in the 19th and early 20th century, the Dutch government hand-picked local elites to govern district bureaucracies on its behalf and to maintain a
sufficiently high performance of local plantation and processing industries.\textsuperscript{220} This pattern of elite-centric rural bureaucracies continued throughout Indonesia’s post-independence years.\textsuperscript{221} Especially during the New Order period, most regents were high-ranking military or \textsc{golkar} officials appointed by the center to oversee district affairs (Kartodirdjo 1994:27; Liddle 1996:257). Thus, given the authoritarian and bureaucracy-centric legacy in rural Indonesia, it is not surprising that many district citizens\textsuperscript{222} still consider regents to be at the top of both administrative and social pyramids.

The change to decentralization has further emphasized this pre-eminent role of rural government leaders. With the devolution of policy responsibilities – in terms of both local revenues and services – the official powers of regents have clearly been elevated. In the decentralized district polities regents have the power to initiate local taxation, licensing, education, health and infrastructure policies (\textit{perda});\textsuperscript{223} delegate policy implementation to bureaucratic units; and steer bureaucratic performance by applying both disciplinary (demotion, dismissal) and meritocratic (promotion, rewards) incentives. Yet, as often pointed out, the fact that local elites hold sufficient powers does not necessarily translate into good policy outcomes.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{220} As Maddison (1989:652) notes, in Java alone, the Dutch crown governed more than 70 regencies and 34,000 villages under direct colonial rule. In order to secure steady trade incomes, economic policies were made in the Netherlands and subsequently implemented by Indonesian aristocrats (\textit{Inlands Bestuur}) under the supervision of Dutch administrators (\textit{Binnenlands Bestuur}). As local regents (‘volkshoofden’) became indispensable for Dutch commercial operations they were given more autonomy to exercise power. This evoked a rise in feudal patron-client structures, which – to some degree – still prevail across district bureaucracies today (Kartodirdjo 1994:22-6). On the colonial roots of rural bureaucracies see also Geertz (1965:78-87), van Doorn (1983), Niessen (1999) and Wertheim (1963).
\item \textsuperscript{221} Dutch bureaucratic structures were adopted in Indonesia’s early Independence years and became increasingly centralized and patrimonial under the leadership of Suharto during the last three decades of the 20\textsuperscript{th} century (Anderson 1972; Jackson 1978; Emmerson 1983:1220-22; Anderson 1983:478-88).
\item \textsuperscript{222} The notion that regents (\textit{bupati}) are the most powerful individuals within any one district – in both administrative and social spheres – was widely shared in most of the 100 in-depth interviews in Sumatra, Java, Bali and NTB.
\item \textsuperscript{223} With the revisions (Law 32/2004) of the initial decentralization laws (22/1999) regents have gained an even more prominent position in local policy-making; former legislative veto functions have been replaced with direct elections of local government heads (see also footnote 207). Besides, as a recent stock-taking exercise of Indonesia’s decentralization shows, local regulations are mostly the brain-child of district executives. Local councilors rarely make use of their ‘right of proposal’ due to a lack of technical expertise and experience (USAID 2006:117).
\end{itemize}
\end{footnotesize}
The scholarly debates outlined in Chapter 3, recognize two common pitfalls in the emphasis on local leadership. The first problem is that powerful leaders may be prone to misuse their designated positions and enrich themselves at the cost of society at large. As Robert Bates observed in the context of rural Africa, elites are likely to ‘persist in seeking their individual, short-run, best interests... that are harmful [for the collective good]’ (1981:132). Indonesia is clearly not free from such problems. Several accounts of bribe payments to local councilors, who were responsible for the selection of district heads in 1999, demonstrate that some regents have strongly ‘invested’ to attain their position and are indeed prone to prioritizing personal interests. The second problem is generalizability. Some scholars hold that a focus on individual leaders can only account for singular events and, *ipso facto*, fails to describe wider societal forces for reform (Tendler 1997:18). In light of these two skeptical views, it seems all the more necessary to ask critically what motivates Indonesian regents to pursue policy reforms that benefit a wider constituency.

Why should regents refrain from collusion and corruption and, instead, opt for broad (business climate) reforms? Arguably, regents are more likely to favor universalistic over personalistic ends if they see higher benefits in doing so. As outlined in the general debate above, leaders have ample monetary temptations for power misuse (e.g. see Krueger 1974; 1990; Bates 1981; Srinivasan 1985). Nonetheless, there are also several reasons for refraining from illegitimate practices. The Indonesian case evidence highlights four incentives that stimulate productive rather than predatory behavior: (1) absence of initial bribery, (2) national acknowledgments, (3) social sanctions, (4) and

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224 As a senior public servant in Bima disclosed, for his inauguration Bima’s former regent was required to ‘buy’ 23 out of 45 council votes; since the average bribe to each councillor amounted to roughly Rps 50 million he invested more than Rps 1 billion (approximately US$ 100 thousand) to gain the regent position (author’s field interview, 16 January 2006). Similar accounts of bribe conventions during the selection of local government heads are presented in Choi (2004) and Hadiz and Robison (2004).
electoral success. While the first two incentives emerge from particular Indonesian circumstances, the last two were outlined in detail in the literature discussion in Chapter 3.

The absence of initial bribe-payments is an important determinant as it reduces a regent’s pressure to seek monetary returns. Similar to public-recruitment corruption (discussed in Chapters 4 and 5), regents who need to pay high bribes to local councilors in order to secure office are likely to be ‘predetermined’ for captive rather than reform-committed practices. So, considering the entrenched nature of bribing customs in many parts of Indonesia's bureaucracy, what makes it possible to sidestep such inducements? Looking at the ‘leadership benchmarks’ in Solok and Kebumen, the regents Gamawan and Rustriningsih seem to have escaped the necessity to make upfront payments due to their strong support base prior to council selections. Both regents benefited from a combination of strong local and national support structures. Endorsed by grassroots and elite levels, Rustriningsih and Gamawan were less susceptible to common ‘corruption traps’ at the initial stage of their careers.

The second factor that can motivate regents to pursue the public good is national acknowledgement. With the devolution of administrative powers, Indonesia has seen a notable rise in donor-funded governance projects and anti-corruption awards. In

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225 For accounts of the entrenched nature of corruption in Indonesia's bureaucracy see, for instance, Davidsen et al. (2006), Kuncoro and Henderson (2004), and McLeod (2000).
226 Although Gamawan Fauzi was elected governor of West Sumatra in 2005, I refer to him here as ‘Regent Gamawan’ as this study is mainly concerned with his former role as regent of Solok.
227 Local informants report that Gamawan was widely respected in society for his Islamic virtues (his father was a renowned religious figure in the community); whereas Rustriningsih received wide support for her reformist political stance (her father was also a PDI politician) and from the fact that she was the first female regent-candidate in Post-Suharto Indonesia. Furthermore, both regents had close links to high-ranking mentors: Rustriningsih was the protégé of PDIP head Megawati, and Gamawan received strong support from the governor in West Sumatra.
228 Both regents in Kebumen and Solok received several national government awards. Regent Rustriningsih received awards from the UN (‘Outstanding Woman in Local Government 2001’), the Martha Tilaar Foundation (‘Female Leadership Award 2002’) and the national newspaper Warta Ekonomi (‘Good Governance Award 2004’); Regent Gamawan was bestowed with awards from the Bung Hatta
addition, decentralization has moved regents' reform efforts increasingly into the spotlight of (inter)national media observers. Rustriningsih's reform efforts, for instance, have been covered by *Newsweek Asia*, *CNN* and the *New York Times* (see Section 4.2): a coverage that is matched by few local government officials in Southeast Asia.\(^{229}\) Furthermore, in light of Indonesia's sluggish investment figures, there is increasing pressure to rank districts according to their 'investment attractiveness'.\(^{230}\) Thus, decentralization has created a set of new incentives for regents to build a 'reformist image': as the two examples in Solok and Kebumen illustrate, attracting the attention of donors, journalists, and analysts can be a promising strategy for attaining project funding, popularity, positive public opinion, foreign study tours, conference invitations, national awards, and wider recognition.\(^{231}\)

The third factor is a regent's desire to gain social prestige, or, in reverse terms, to contain social sanctions. As Goode (1979) and Tsai (2007) have pointed out, social affirmation and punishment can be powerful controls for elite behavior. The cases in West Sumatra and Central Java provide indirect support for this argument. Both regents emphasize their strong commitment to the development of social morals and, at the same time, seem well aware of the powerful impact of social sanctions. Citing his idol Mohamed Hatta, one of Indonesia's founding fathers, Regent Gamawan repeatedly stresses that strong social and religious incentives are a promising pathway out of

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\(^{229}\) For a description of the international media interest in Rustriningsih's public sector reforms please refer to Section 4.2.

\(^{230}\) As outlined in Chapter 2, district-level 'investment attractiveness' rankings are conducted by KPPOD (Regional Autonomy Watch), LPEM (Institute for Socio-Economic Studies) and BKPM (National Investment Board).

\(^{231}\) Regent Gamawan, for instance, was invited to join the '11th International Anti-Corruption Conference' in Seoul/South Korea in 2004 (financed by Transparency International/GTZ) and the 'International City Management Conference' in San Diego/California in 2005 (financed by BIGG/USAID).
corruption. At this stage, where formal law enforcement is weak, Gamawan propounds, ‘social sanctions are more powerful than jail sentences’ (Gamawan 2005:50). ‘We know that our system is lax and the function of religion is, in my view, one of the main driving forces in the fight against corruption’ (Bachyul 2004:5). Regent Rustriningsih, on the other hand, places emphasis on more generic values of egalitarianism and social justice. She describes a good leader as ‘someone who is truly needed by the majority of the people – someone who can bring about necessary improvements for common people and is rewarded for doing so... Good leadership is honest leadership – it is measured in actions, not words.

The last and most important factor is electoral success. Since 2003, with the emerging discussions on direct elections, incumbent regents have recognized the importance of popular support for their career advancement. The official introduction of popular elections of local government heads (Pilkada) in 2004 provides regents with strong incentives to attend to the voices of their constituencies. Responding to people’s demands for better employment and welfare conditions, regents like Rustriningsih and Gamawan have prioritized bureaucratic reforms and, in doing so, have improved (especially in the latter’s case) local business climates. An important

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232 'My determination derives from my religious beliefs. My religion requires leaders to be just. They have to be just in the way they decide and implement decisions; if they fail to do so, many common people are forced to suffer. Until this very day, many national policies are unjust – yes, please write this down and feel free to publish it – the current policy design is often unjust' (interview with Regent Gamawan, 15 September 2005) The Jakarta Post quotes him saying 'My father strictly instilled in me the importance of religion and worship so that religious values have become my daily guide. [...] a leader should be the first to account for his deeds.' (Bachyul 2004:5). In his book ‘Governments Without Borders’ Gamawan further outlines how religious ideals pave the way for ‘clean government’ (Gamawan 2005:69-75).

233 Her moral motivation to pursue common rather than personal goals, Rustriningsih notes, derives from the strong influence of her father, who was a reformist politician and owner of a movie cinema with a great concern for the needs of common people; ideals of social justice and equity were fostered by watching western movies and reading biographies of former US presidents (Perlez 2003:6).

234 Interview with Regent Rustriningsih, 12 July 2005.

235 In order to counterbalance strong executive powers with people’s interests, local councils initially held strong veto functions. But with the rise of numerous blackmailing and corruption cases these legislative controls were replaced with direct regent elections in 2004. See footnote 23.
question that warrants attention, however, is why regents respond more to popular needs than do elected councilors.

The answer is quite simple: candidates running for top government positions are more exposed to electoral scrutiny than those running for council seats. This may seem counterintuitive at first sight, but it becomes plausible once we take a closer look at current district circumstance. For one thing, it is important to stress that most regents operate independent of political parties. They are well-known public figures from non-partisan backgrounds (business, government, NGOs) who base their decisions on local circumstances rather than on national party platforms. In view of the dysfunctionalities outlined above, this temporary detachment from local party politics is arguably an asset rather than a problem.

For another thing, prospective regents are elected under plurality rule (first past the post), while prospective councilors are elected under closed-list PR systems. Under the current specification, the former system allows voters to effectively vote out bad and retain good incumbents, whereas the latter (as discussed in the previous section) fails to do so. The likely result is that regents depend on local electorates, while local

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236 The fact that prospective regents officially need a 'party ticket' for their candidature is not much more than a pro-forma requirement at this time, which does not carry any weight once a regent is elected. As Michael Buehler observes in South Sulawesi, the link between prospective regents and political parties is indeed insignificant. Candidates seem to shift easily from one party platform to another if it serves their needs. The weak regent-party links are an indicator, Buehler concludes, for the weak institutionalization of political parties at regional levels (Buehler and Tan forthcoming). Similar accounts of the weak regent-party ties are found in Mietzner (2005) and Vel (2005).

237 In the long-term, as democracy progresses and local party politics become more responsive to citizens' needs, it is possible that government leaders become more integrated in party systems. For a discussion on the democratic virtues of party-based representation see for example Linz and Stepan (1996:274); Lipset and Rokkan (1967).

238 Recalling the debate on electoral systems, some scholars argue that plurality rule is less favorable as it induces more pork-barrel projects during campaign periods (Rogowski 1987; Lizzieri and Persico 2001; Milesi-Ferretti et al. 2002; Stratmann and Baur 2002); others propose the opposite: namely that plurality is less prone to corruption due to its stronger accountability links to electorates (Myerson 1993; Persson and Tabellini 2000). The case evidence supports the latter view. Although there are reports on pork-barrel spending during regent elections (e.g. promises to village heads or community leaders who can deliver the votes), such inducements appear preferable to the high unaccounted 'contributions' that councilors pay to...
councilors depend on national party elites for electoral victories. Put differently, the current electoral setting exposes regents to electoral competition and regional ‘yardstick’ pressures, as suggested by Besley and Case (1995), but fails to do so in the case of district councilors. This is not to say that plurality rule works better than PR systems in general. What it does show, however, is that under the current setting, plurality-based elections of regents create stronger electoral incentives than PR-based elections of local councilors.

The electoral victories of Rustriningsih and Gamawan, against the background of successful public-sector reforms, provide a good example of this alignment of regent and citizen interests. Good government performance and anti-corruption efforts, illustrated in the business-climate analyses in Chapter 4, were rewarded in the 2005 elections: Rustriningsih was reaffirmed with 77 percent of Kebumen’s votes – the highest victory of that electoral year; Solok’s regent Gamawan was elected governor of the province of West Sumatra with 44 percent of the votes in a four-way race. National newspapers hail Rustriningsih and Gamawan’s success as a triumph for democracy, stressing that both regents won their respective elections on ‘clean governance’ platforms and refrained, unlike their opponents, from ‘money politics’ and ‘vote buying’.  

secure their list positions: while former inducements often induce communal welfare (building of roads, mosques etc.), the latter simply divert local funds into the coffers of national parties.

The Indonesian institutional settings in rural Indonesia are very specific and therefore cannot be easily connected to the controversial debate on electoral rules (outlined in Section 3.2).

See for instance ‘Gamawan Fauzi – Marlis Rachman Menangi Pilkada Sumbar’ (Gamanwan/Marlis Win Provincial Elections in West Sumatra), Kompas, 10 July 2005; ‘Gamawan Fauzi Jadi Calon Gubernur Sumbar’ (Gamawan Nominated as Governor Candidate in West Sumatra), Kompas, 19 March 2005; ‘Gamawan Dipastikan Pimpin Sumatera Barat’ (Gamawan To Lead West Sumatra), Tempo, 28 Juni 2005; ‘Rustriningsih Dipastikan Pimpin Kebumen Lagi’ (Rustriningsih Reaffirmed as Kebumen’s Regent), Tempo, 6 Juni 2005; ‘Konsekuensi Jadi Bupati Pilihan Rakyat’ (Implications of Direct Regent Elections), Kompas, August 11, 2005.
Table 7.4: Local Power and Business Climate Improvements (in Percent)

<table>
<thead>
<tr>
<th></th>
<th>Strong Power</th>
<th>Strong Improvements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regent</td>
<td>56.6 (61.6)*</td>
<td>28.3 (50.1)*</td>
</tr>
<tr>
<td>Local Council</td>
<td>41.3</td>
<td>15.0</td>
</tr>
<tr>
<td>Political Parties</td>
<td>12.2</td>
<td>4.3</td>
</tr>
<tr>
<td>Business Chamber</td>
<td>11.5</td>
<td>9.6</td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 1000 randomly selected local firms in eight districts.  
Note: Survey question G1: 'Please evaluate the power/influence of 'X' in the local policy making' and G2: 'Please evaluate the business-climate improvements that 'X' has brought about in your district';  
Presented figures are aggregates of the survey responses 'strong' and 'very strong'. stars (*) indicate values for the high-leadership district Solok.

The discussion so far has highlighted that local regents – in comparison with other representative bodies – have relatively high powers and strong incentives to improve local government performance in general and business climates in particular. This notion receives support from the field survey. As illustrated in Table 7.4, 57 percent (of 1041 surveyed business-respondents) affirm that regents are highly powerful in local policy-making, and 28 percent emphasize that regents have strongly improved local business conditions. If the benchmark-case Solok under the leadership of Regent Gama wan (figures in parentheses) is considered, responses rise to 62 and 50 percent, respectively. In contrast, the power/improvement figures for local councils (41 and 15 percent), political parties (12 and 4 percent) and local business chambers (12 and 10 percent) remain distinctly below those of local government leaders.

These figures should, however, not lead to the conclusion that regents are uniform in their efforts to improve policy outcomes. Apart from positive incentives (national acknowledgement, social prestige and direct elections), there are two factors that can lead district heads in opposite directions. First, the absence of credible law enforcement gives regents at least as much reason to pursue illegitimate gain as to attend to common interests. And second, as mentioned above, regents who paid high
bribes\textsuperscript{241} to be appointed (by district councils in 2000) are predisposed to favor private over public goals. In light of these negative incentives, it is not surprising that some regents – for example the district heads in Klaten and Pesisir (see Section 4.2) – have made few efforts to eradicate corruption in their bureaucracies.

The important point to make here is that while negative and positive incentive structures coexist, the former decreases while the latter increases with Indonesia's ongoing democratization process. With the introduction of direct elections, regents' bribe payments to local councilors are a thing of the past. Moreover, the evidence from the cases suggests that a number of regents are increasingly responding to democratic incentives. In particular, younger regents with long-term career aspirations\textsuperscript{242}, like Gamawan and Rustriningsih, have used their skills and the powers of their office to induce broad policy reforms. Over time, electoral and prestige-based incentives will presumably become more pronounced: as election rounds progress, and voters increasingly reward good and punish bad leadership performance, competitive forces are bound to increase. It is therefore likely that Indonesia's districts will see more regents with good personal skills and reformist agendas in the upcoming years.

7.3.2 Public Entrepreneurship

Having argued that regents have stronger incentives and powers to promote policy reforms, the remaining sections now examine how such reforms actually come to pass. How do government leaders motivate local bureaucracies to embrace more

\textsuperscript{241} See footnote 224.

\textsuperscript{242} I assume here that regents' career aspirations are linked to their remaining office years before retirement. This assumption finds support from the case evidence. The ages of the two 'good' leaders is distinctly lower (Rustriningsih and Gamawan are in their 40s) than those of their counterparts (Wibowo and Basir are in their 50s and 60s, respectively).
efficient and less corrupt practices? Consistent with empirical accounts from other post-authoritarian transition cases (Section 3.3), the evidence from Kebumen and Solok suggests that regents induce change in two different ways: first, on a strategic level, they initiate public reforms by linking the interests of rural citizens with those of national powerholders and international donors. And second, on an operational level, they translate reform visions into clear incentive structures (rewards and punishments) for local bureaucrats. This section focuses on the strategic, while the following section discusses the operational, dimension of government leadership.

Solok’s regent Gamawan and Kebumen’s regent Rustriningsih are good examples of ‘public entrepreneurs’. Similar to the descriptions of effective leadership in the political science literature (Dahl 1961; Stoner-Weiss 1997; Grindle 2007), both Indonesian reformers have skillfully made use of all available reform resources to initiate reforms. In order to break down the resistance of entrenched interests, they have united reform powers at various levels and forged coalitions for policy improvements. The interviews with both regents showed that, building broad reform coalitions is a key ingredient for reducing bureaucratic inefficiencies and corruption. As indicated in the case studies, many public servants in rural Indonesia continue to be vulnerable to high entry prices in order to secure government positions. These corruption payments are not only common during recruitment but also, as Gamawan points out, emerge during internal promotions and project appointments. Due to this entrenched corruption structure, most bureaucrats are unlikely to push or initiate public-sector reforms. This is

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243 A large number of local media reports (see footnote 129 in Chapter 4) confirm that the corrupt recruitment practices reported in the case studies extend to many other Indonesian districts.

244 In his book ‘Governments without Borders’ Regent Gamawan (2005:49-50) notes: ‘Pada saat penerimaan PNS ada korupsi. Praktik yang sama terjadi pada kenaikan pangkat, mendapatkan jabatan, pengadaan barang dan jasa. Hampir pada setiap kesempatan, ada yang berusaha memberikan uang lelah, uang administrasi dan uang lainnya kepada orang yang mempunyai kekuasaan atau jabatan.’ (During the recruitment of public officials there is corruption. Similar [corrupt] practices arise whenever public servants rise in bureaucratic ranks, take new administrative positions, or manage public procurements. With every emerging opportunity, there is someone willing to pay special compensations - fees for effort, administration and [general goodwill] – to senior powerholders).
further aggravated, both regents contend, by the void of functional law enforcement: local judiciaries and security forces, that report to national superiors in Jakarta (not to local government leaders), fail to uphold legal standards. According to Rustriningsih, it is a ‘public secret’ that local court verdicts and police protection are often a matter of money rather than evidence. 245 Thus, in light of corruption-ridden bureaucracies and dysfunctional law enforcement, change requires regents to seek coalitions outside common government structures, with both local society and high-ranking (inter)national supporters.

In a way, forging a broad alliance with community leaders and gaining trust from society at large serves two functions at the same time: for one thing, large popular support strengthens the reform cause and, thereby, helps to break bureaucratic resistance; and for another, popular support is a prerequisite for electoral success, which allows leaders to continue reform programs with enhanced political legitimacy. Both regents have realized the importance of such alliances and have fostered their ties with the grassroots levels. Regent Rustriningsih, for instance, strongly prioritized rural development. During her first incumbency (2000-2005) she gained wide support from village communities by improving villagers’ education, health and infrastructure conditions; 246 by directing development funds directly to village heads, she empowered rural areas and prevented ‘project leakages’ to senior bureaucrats and urban-based constructors. In a similar vein, Regent Gamawan became popular among Solok’s rural communities by reintroducing the indigenous self-government structures (Nagari) abolished under Suharto’s rule. Similar to his colleague in Kebumen, he provided

245 Interview with Regent Rustriningsih, 12 July 2005. For a published critique of the vertical structures and inefficiencies of local courts and security forces see also Rustriningsih (2004:401) and Gamawan (2005:50).
246 Rural development achievements during Rustriningsih’s incumbency (2000-2005) include the rehabilitation of over 2600 classrooms in village schools, which drew on joint district-donor-society funds (Interview with Regent Rustriningsih, 12 July 2005).
community leaders with autonomous administrative and fiscal powers to autonomously administer village health and infrastructure projects.²⁴⁷

The second important pillar was to forge, what some political scientists have refer to as, ‘elite pacts’ (O’Donnell and Schmitter 1986; Diamond 1989), strategic coalitions with high-ranking politicians, officials, media people, entrepreneurs and donors. As the first female regent in the decentralization era, Rustrimingsih became the protégé of three powerful Jakarta-based individuals: Megawati Sukarnoputri (current head of the PDIP party and Indonesia’s fifth president), Ken Sudarta (media and public relation baron), and Martha Tilaar (Indonesia’s leading female entrepreneur). Owing to her well-connected mentors, Rustrimingsih was elevated to an international media platform (New York Times, CNN and Newsweek Asia; see Section 4.2) and gained instant popularity among national and international observers. Moreover, the international coverage of her reforms resonated well with the interests of international donors and, eventually, led to an increased inflow of financial assistance for Rustrimingsih’s rural development projects. International donor organizations were also an important ingredient in Regent Gamawan’s reform alliance. As the former private secretary of the governor of West Sumatra, Gamawan was familiar with donor agencies and programs when he took office as Solok’s regent. With the growing ‘good governance’ focus, Gamawan became renowned for his anti-corruption stance and could forge important coalitions with organizations such as Transparency International, World Bank, GTZ and USAID. This provided him with additional technical expertise and funding for his holistic bureaucracy reforms.

²⁴⁷ These reforms towards Nagari self-governance are embodied in two local regulations (Perda 4/2001and 8/2004) and one regent bill (Surat Keputusan Bupati 16/2001); for a discussion on the empowerment of indigenous Nagari communities refer to Gamawan (2005:127-33).
Another important feature is that regents can forge coalitions that cut across ethnic and religious divides. This bridging function is well exemplified in the case of Kebumen. In the 1998 riots, Regent Rustriningsih (herself a devout Muslim) became the guardian of the Chinese minority group. By providing shelter at local *PDIP* party branches, she protected ethnic Chinese against an upsurge of violence. In doing so, Rustriningsih gained a strong support base in the Chinese community, which extended beyond Kebumen’s borders and strengthened her standing in Jakarta’s business circles (for example with the aforementioned Chinese media baron, Sudarta). At the same time, Rustriningsih forged a coalition with modernist Islamic groups, most notably with the Justice and Prosperity Party (*PKB*), by choosing a young Islamic scholar as her deputy. This strategic tie helped to moderate hostilities amongst orthodox Muslims, who initially rejected the idea of a female regent. It also served as a first step to narrow the gap between historically divided Christian/Chinese and Muslim/Javanese communities.

Table 7.5: Regents’ Political Will, Communication and Popular Support (in Percent)

<table>
<thead>
<tr>
<th></th>
<th>Strong Political Vision/Will</th>
<th>Strong Communication</th>
<th>Strong Popular Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>Solok</td>
<td>94.6</td>
<td>91.5</td>
<td>96.2</td>
</tr>
<tr>
<td>Kebumen</td>
<td>75.8</td>
<td>88.4</td>
<td>95.0</td>
</tr>
<tr>
<td>Klaten</td>
<td>6.7</td>
<td>5.8</td>
<td>5.8</td>
</tr>
<tr>
<td>Pesisir</td>
<td>37.6</td>
<td>46.1</td>
<td>20.0</td>
</tr>
<tr>
<td>Gianyar</td>
<td>7.0</td>
<td>14.1</td>
<td>16.8</td>
</tr>
<tr>
<td>Karangasem</td>
<td>15.9</td>
<td>13.5</td>
<td>11.9</td>
</tr>
<tr>
<td>Bima</td>
<td>46.5</td>
<td>59.5</td>
<td>38.6</td>
</tr>
<tr>
<td>Lotim</td>
<td>54.6</td>
<td>38.5</td>
<td>36.2</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>42.3</strong></td>
<td><strong>44.7</strong></td>
<td><strong>40.0</strong></td>
</tr>
</tbody>
</table>

Note: Respondents were asked to evaluate their regent’s ‘political vision and will’ (G3b); ‘communication skills’ (G3c); and ‘degree of popular support’ (G3d); Presented figures are aggregates of the survey responses ‘strong’ and ‘very strong’. Source: Author’s business survey with 1000 randomly selected local firms in eight districts.
In forging these strategic reform coalitions, both regents benefited from personal qualities such as political determination and good communication as well as the underlying public support for their efforts. These skills become especially evident once they are compared to those of other regents in the study (see Table 7.5). Survey results clearly affirm Gamawan and Rustriningsih's strong 'political vision and will' (95 and 75 percent), 'communication skills' (92 and 88 percent), and 'popular support' (96 and 95 percent). These figures, which are roughly twice as high as the eight-district average, not only emphasize the positive public image that both regents enjoy, but also strongly support the argument in this section: namely that Gamawan and Rustriningsih forged multi-level reform coalitions by successfully communicating political visions and building strong ties with communal and national allies.

7.3.3 Bureaucratic Supervision

Turning from the strategic to the more operational side of leadership, a clear pattern can be identified in the way Kebumen and Solok's leaders have supervised their respective bureaucracies. Both employed a two-step approach for inducing business climate improvements: as a first step, they established effective mechanisms to oversee bureaucratic behavior; and as a second step, they revised the incentive structures for local staff by introducing rewards and penalties for good and bad performance.

Regarding the first step, the installation of supervisory mechanisms to monitor public servants' daily routines and procedures, Regent Rustriningsih has set a benchmark. Supported by powerful allies in Jakarta, most notably President Megawati and media-expert Sudarta, Rustriningsih introduced three media-based mechanisms to enhance public transparency: one, the broadcasting of a daily TV talk-show (Selamat
"Pagi Bupati – Good Morning Regent),\textsuperscript{248} an innovative approach during which Rustriningsih listens and responds to locals’ complaints on government shortcomings; two, the establishment of a government-funded radio (IN FM) enabling local citizens to follow current district affairs; and three, the introduction of a press center, which makes media sources accessible to the wider public and convenes regular roundtables with the local press. As local firms, NGOs and journalists widely confirmed, this media-based interaction with local citizens has become an effective tool to expose bureaucratic misbehavior and, thereby, reduce corrupt and inefficient practices.

Regent Gamawan has taken a similar, albeit less technological, approach. Inspired by his participation in an international anticorruption conference in South Korea, Gamawan became the first regent in Indonesia to follow Transparency International’s call and implement a local ‘integrity pact’\textsuperscript{249}, which is a formal contract between senior officials, NGOs and public contractors intended to reduce corruption in public tender projects and services. Under this anticorruption agreement local NGOs are officially encouraged (and funded) to scrutinize public service and infrastructure provision by monitoring project sites and official documents.\textsuperscript{250} The performance of Solok’s public servants to public was further enhanced by Gamawan’s routine, rigorous monitoring of administrative units. As one public servant recalls: ‘we were never sure whether Regent Gamawan would suddenly drop into our office; he made it a habit to

\textsuperscript{248} Rustriningsih’s innovative call-in shows were also covered in Newsweek; see Cochrane (2004:2).
\textsuperscript{249} Transparency International has worldwide advocated ‘integrity pacts’ as an effective tool to curb corruption; for more information see Kostyo (2006b). Solok’s integrity pact was further endorsed by a local regulation on ‘government transparency and public participation’ (Perda 5/2004).
\textsuperscript{250} According to local journalists and NGO activists, the integrity pact is a useful step towards a ‘clean’ government, but it will also take time to revise entrenched rent-seeking structures. ‘The government has made strong efforts to make public tendering more transparent. In theory these steps are good, but their implementation in our current reality will take time. We need a penalty system – a blacklist of corrupt construction companies. Moreover, as long as the rural economy is weak and people are struggling to provide basic needs and schooling for their children, the fight for greater transparency still faces notable constraints. […] Nonetheless, tender practices are better than before’ (field interview with a local NGO activist, 24 August, 2005)
pick one department each morning and see if everyone was doing his job properly. Moreover, the two regents in Solok and Kebumen disclosed their personal mobile number and encouraged local citizens to report any administrative irregularities by sending a short text message.

These transparency-based incentives for better bureaucratic conduct are further enhanced – in a second step – by additional rewards and penalties. Rustriningsih, for instance, broke with deep-rooted conventions, in which career advancements were based on preferentialism and bribe payments, and established a meritocratic promotion system. She replaced back-room deals with open award ceremonies: each year she publicly honors and promotes outstanding civil servants in Kebumen’s assembly hall. ‘Ultimately, the only viable approach comes down to rewards and punishments’, Rustriningsih contends, ‘[public servants] need to understand their responsibilities and respond to people’s demands’. Although senior officials initially opposed the new promotion schemes, the broad support of lower-ranked officials allowed the regent to push through her reforms. Moreover, to signal credible penalties and compensate for dysfunctional law enforcement, Rustriningsih initiated a legal advocacy organization (Lembaga Bantuan Hukum) to penalize bureaucratic misconduct and corruption.

Solok’s regent Gamawan applied a similar mix of motivational and coercive incentives. He gained much respect among low and mid-ranked public servants by

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252 For a review of the detrimental norms of seniority and nepotism, inherent in many bureaucracies in rural Indonesia see Hidayat and Firdausy (2002), USAID (2006), and Webber (2006).
253 Interview with Regent Rustriningsih, 12 July 2005.
254 The introduction of merit-based promotion, based on a coalition with low-ranking officials, was also the main topic of the CNN (2003) report ‘One Woman’s Fight against Corruption in Indonesia’, which was broadcast on 26 September 2003.
255 Interview with Regent Rustriningsih, 12 July 2005; further information on the work of Indonesia’s Legal Aid Foundation, which inspired Rustriningsih in the design of her local imitative, can be obtained at: www.ylbhi.or.id.
putting an end to seniority-based preferentialism. He abolished so-called ‘project allowances’ (tunjangan daerah), which allowed high-level officials (including himself) to secure overproportionally high benefits from public projects, irrespective of their performance. As an encouragement measure, he redistributed project allowances evenly amongst all public servants and introduced, similar to his colleague in Java, merit-based promotion schemes.\(^{256}\) At the same time, Regent Gamawan employed strict disciplinary measures. Under his leadership public servants were strictly prohibited from receiving any kind of bribe payments – a principle that became apparent, for example, in the anticorruption stickers placed across Solok’s public service units (see Figure 4.2). In order to ensure that his anticorruption stance was not just rhetoric but an actual priority, Gamawan set a clear example among his staff: during his incumbency he dismissed 8 and demoted 23 of his staff for their involvement in corrupt activities.\(^{257}\)

<table>
<thead>
<tr>
<th></th>
<th>Strong Anti-Corruption Efforts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Solok</strong></td>
<td>86.2</td>
</tr>
<tr>
<td><strong>Kebumen</strong></td>
<td>42.5</td>
</tr>
<tr>
<td><strong>Klaten</strong></td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Pesisir</strong></td>
<td>14.9</td>
</tr>
<tr>
<td><strong>Gianyar</strong></td>
<td>0.8</td>
</tr>
<tr>
<td><strong>Karangasem</strong></td>
<td>5.7</td>
</tr>
<tr>
<td><strong>Bima</strong></td>
<td>26.8</td>
</tr>
<tr>
<td><strong>Lotim</strong></td>
<td>26.0</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>25.9</td>
</tr>
</tbody>
</table>

Source: Author’s business survey with 1000 randomly selected local firms in eight districts.

Note: Survey question G3a: ‘Please evaluate the anti-corruption efforts of your regent’; Presented figures are aggregates of the survey responses ‘strong’ and ‘very strong’.

\(^{256}\) Interview with Regent Gamawan 15, September 2005; the abolishment of project allowances is laid down in government bill (Peraturan Bupati) No. 02/2005.

\(^{257}\) These figures originate from a national news report in the *Jakarta Post* (Bachyul 2004:5); similar figures emerged from the interviews with local government officials in August 2005.
Regent Gamawan’s efforts to fight corruption and reform bureaucratic conduct are widely acknowledged by Solok’s business community. As displayed in Table 7.6, roughly 9 out of 10 respondents believe that Solok’s regent is truly determined to eradicate graft and promote government reforms. Regent Rustriningsih’s survey responses are moderate in comparison. Nearly 43 percent of the businesses surveyed in Kebumen recognize her strong anti-corruption stance and 64 percent confirm her strong reform powers. This somewhat less ‘enthusiastic’ support may stem from the fact that Rustriningsih has attended more closely to villagers’ than business people’s interests during her first incumbency. Nonetheless, the most important thing to note here is that both regents are perceived as being far less corrupt and more reformist than all other regents in the eight case-districts.

In sum, backed by their reform coalitions, the regents in Solok and Kebumen have used their strong management and communication skills to induce change. They have improved bureaucratic behavior by employing an effective mix of transparency, penalties and rewards: Regent Rustriningsi made public conduct transparent by interactive media-based mechanisms and motivated her staff by replacing seniority-based with merit-based promotion; Regent Gamawan elevated civil watchdog functions, rigorously monitored the performance of his staff, redistributed the ‘spoils’ of senior bureaucrats among all employees and dismissed corrupt officials. Recalling the pairwise case comparisons in Chapter 4, regents’ efforts to replace ‘patrimonial’ with ‘meritocratic’ norms is clearly accompanied by lower levels of corruption in public recruitment, licensing and tender management.

258 The notion that Kebumen’s regent has prioritized rural development – and postponed local business development – is frequently criticized in the interviews with local business-holders; in an informal conversation, Regent Rustriningsih confirmed that business climate issues will become a higher priority in her second period in office.
7.4 Conclusion

Taking stock of Indonesia's newly decentralized district polities, this chapter identified reasons why societal pressure is less significant – and government leadership more significant – in explaining variation in local government performance. The first key message is that societal pressure – as envisioned in the 'good governance' policy literature – remains low because neither business groups nor district councilors have the incentives to press for government reforms. By framing district observations in terms of collective action theory (Olson 1965; Bates 1981; Putnam 1993), it became evident that small as well as Chinese firms in rural Indonesia are unlikely to organize their interests, either because they are constrained by typical group-size problems or because they expect prohibitive retaliation-costs. Large rural firms, on the other hand, benefit strongly from close government relationships and therefore have little motivation to change status quo conditions. Equally doubtful are reform impulses from local business chambers. Now lacking former New Order privileges and general business services, local chambers of commerce have become hollow shells that provide neither government contractors nor other local firms with sufficient incentives to join a collective cause.

Dysfunctional incentive structures also undermine local political representation. Compared to the 'enabling conditions' outlined in the transition-to-democracy literature, Indonesia's current circumstances are anything but favorable. The mix of authoritarian inheritance, socio-ethnic diversity, and religious politics poses considerable challenges for the consolidation of local democracy. But the largest impediment for an effective alignment with popular demands is the misspecification of the current PR election system in rural Indonesia. Due to intransparent party lists and biases towards top-listed
candidates, local politicians have become dependent on party rather than voter preferences. In view of these defective electoral rules, substantive policy reforms are rarely discussed in local political arenas. It is thus not surprising that district councilors have made little effort to solve collective action problems and transmit unarticulated business interests into local policy making.

The second key message is that government leadership emerges as a highly significant explanation, because district regents have comparatively high incentives and powers to improve local government performance. Motivated by plurality elections (‘first past the post’), national acknowledgement and social prestige, some regents have attended strongly to the interests of society in general, and small businessholders in particular. The case evidence suggests that district heads with both long-term career aspirations and high managerial skills have been a strong driving force for policy reforms. Similar to the leadership accounts from other Asian and Latin American transition countries (Diamond 1989; Stoner-Weiss 1997; Grindle 2004; 2007), the two benchmark leaders in Solok and Kebumen have skillfully used their official powers to improve government performance. They have done so by forging strategic reform pacts, reducing collective action problems of ‘latent’ groups, and installing meritocratic incentives in local bureaucracies. In short, some government leaders in contemporary rural Indonesia have become ‘democratically committed’ and, for the time being, compensate for weakly organized societal pressures.
8.1 Revisiting the Problem

Why do some local governments perform well, while others perform badly? This question, which stimulated and underpinned the analyses in this study, has experienced a surge of interest among policy makers and thinkers over the last few years. With the marked rise of decentralization and democratization throughout the developing world, policy debates have increasingly focused on local government dimensions and society-led development. The persistence of public-sector inefficiency and corruption, irrespective of pronounced structural efforts to move governments 'closer to the people', has become a puzzling phenomenon and an urgent policy problem. While theories of institutional change help to predict long-term developments, the current deficiencies necessitate a careful analysis that goes beyond structural explanations and examines the varied nature of local governments after formal decentralization reforms have come to pass.

Indonesia provides an excellent opportunity for studying the dynamics of local government. During its rapid regime change in 1998, Indonesia catapulted from one extreme to another: the collapse of the authoritarian regime gave way to a nascent democracy with 440 autonomous district governments. This radical transformation naturally coincided with a wide variation in local policy outcomes, which provided this study with a valuable framework to investigate causal explanations. Based on mixed method analyses – comprising comparative case studies and multivariate regressions –
I was able to shed empirical light onto two contesting explanations for local government performance: societal pressure and government leadership.

The first explanation, societal pressure, has gained much prominence in the good-governance literature over the last fifteen years. Development banks, NGO activists, and grassroots practitioners alike, have stressed that societal checks, in terms of collective reform action and electoral participation, are a prerequisite for improving government performance. This assertion, however, receives little support in the policy-reform literature. Recent experiences in Asia, Africa and Latin America suggest that it is not so much the pressure from society at large but rather the presence of committed government leaders that drives policy outcomes in early transition stages. The advantage of focusing on these two ‘stylized’ explanations – societal pressure and government leadership – was twofold: for one thing, it encapsulates the divide between today’s policy agendas and recent academic debates on post-authoritarian transition; for another it provided two distinct research hypotheses to operationalize comparative case studies and regression analyses.
8.2 Empirical Findings

The society-centered view that currently dominates the discourse and practice of development banks and donor agencies is not confirmed by the empirical evidence in this study. Taking stock of Indonesia's decentralization experience to date, there is little reason to believe that societal pressure is the main driving force behind diverging local government outcomes. The comparative case studies in Bali and West Nusa Tenggara challenge the idea that high societal (business) pressure is aligned with, let alone the cause of, better business climates. The district-cases that were purposely chosen on the basis of higher societal-pressure indicators (i.e. education, associative dynamics, and political awareness) did not display any coherent pattern of better tax/license/corruption practices. Despite their better access to education and business associations, firms in Gianyar and Bima are on average confronted with more business-climate problems than their provincial counterparts in Karangasem and Lotim. The overall picture emerging from these regional comparisons (based on roughly 500 business questionnaires and 50 in-depth interviews) is bleak: business-pressure and business-climate indicators exhibit a weak (or even a negative) alignment at this stage.

This outcome, as I have argued in the previous chapter, stems from dysfunctional incentive structures for local firms and district councilors. For most local firms, the benefits of engaging in collective reform action rarely justify the costs of doing so: this holds true for small firms that face high coordination and retaliation costs, for Chinese minorities who anticipate disproportional social and bureaucratic risks, and for large firms that expect higher benefits from sustaining collusive government ties than from scrutinizing public shortcomings. Thus far, neither local business chambers nor local councils have provided the means to solve these incentive problems and
mobilize latent reform interests. The former find themselves idle without clear professional mandates, and the latter tend to be more occupied with securing party list positions (in a defective PR election system) rather than solving local collective action dilemmas.

The leadership-centered view, on the other hand, receives substantial support from the case analyses. The two controlled regional comparisons in West Sumatra and Central Java show that districts with high leadership qualities also display fewer regulatory tax distortions, more efficient license administration and less public-sector corruption. The triangulation of interview and survey data suggests a positive causal link between government leadership and local business-climate outcomes. The comparison in West Sumatra provided a particularly striking indication of this causality. Respondents affirm, almost unanimously, that the visionary and committed leadership of Regent Gamawan has been the driving force behind Solok’s remarkable government reforms, observable in the introduction of highly functional business services and cross-cutting anticorruption initiatives. Conversely, Pesisir’s regent, himself accused of embezzling public development funds, has failed to improve the overall poor business conditions in his district.

As outlined in the political-economy discussion in Chapter 7, the salience of government leadership rests on both person-specific and systemic explanations. Considering individual district leaders, the case evidence showed that the personal managerial skills of the two benchmark regents in Solok and Kebumen, Gamawan and Rustriningsih, were important assets in seeking to induce local government improvements. Both regents skillfully built a strategic support base from which they pushed for more public transparency and better bureaucratic performance. These
leadership qualities, which emerge as the main explanation for business climate variation in this study, can also be linked to a larger, systemic perspective.

Indonesia’s regime change, namely the introduction of decentralization and local democracy, provides district regents not only with more administrative powers but also with more reform incentives than other representative bodies. Two of these new incentive mechanisms are particularly worth noting. First, national acknowledgement for good performance – either through media reports or governance awards – is a notable reform stimulus, not the least because ‘reformist districts’ tend to attract additional donor-financed projects and benefits. And second, the introduction of plurality elections (‘first past the post’) serves to align regents’ interests more closely to those of local citizens. Against the background of these electoral and prestige-based incentives, a number of regents have started to tackle bureaucratic inefficiency and public corruption. All in all, the findings from the case comparisons and the political economy discussion point to a remarkable phenomenon: a mechanism of ‘democratically-committed’ government leadership, which holds the potential to compensate for the temporary lack of societal pressure in early transition stages.

The strong significance of government leadership in comparison to societal pressure is also confirmed by statistical cross-checks. As the regression analyses in Chapter 6 demonstrated, the quantitative and qualitative findings match well in most respects. Similar to field-based observations, the data from 200 districts overtly suggests that leadership is the most coherent explanation for business climate variation. Regression estimates indicate that the presence of reformist regents is more significant for policy improvements (in 12 out of the 14 specified statistical models) than the involvement of local firms in district decision-making. Overall, the quantitative results
vindicate the leadership hypothesis and, therefore, validate the overall argument emerging from the qualitative case studies.

The finding that government leadership is highly significant in explaining local policy outcomes should not lead to the conclusion that societal factors are irrelevant. The case findings from Solok and Kebumen clearly indicate that regents require the support of society for their reform efforts and prospective re-election. Thus, although common societal-pressure mechanisms (such as collective business action or councilor representation) are found to be rather insignificant, societal groups can play an important role in monitoring bureaucratic shortcomings and signaling reform preferences to local government leaders. Over time – as local democracy progresses and rural (business) communities become more aware of, and engaged in, local politics – this society-leadership nexus is likely to become more pronounced.

A concomitant finding arising from the empirical analyses is that local business environments in rural Indonesia remain critical. Average business climate indicators – identified in the case studies and statistical datasets – suggest that a majority of local firms continue to be obstructed with high informal payments and excessive bureaucratic red tape. The field observations in particular demonstrate that corruption in relation to license and tax procedures has, in general, increased rather than declined since the introduction of decentralization (see Sections 4.5 and 5.5). Moreover, one-stop licensing services are either poorly configured or entirely absent in four out of eight observed district-cases (Figures 4.2 and 5.2). And newly enacted export or transportation taxes have distorted intraregional trade flows in three of the eight case-districts (namely Pesisir, Bima and Lotim). Taken as a whole, this empirical snapshot in 2005 suggests that local government performance has not improved during the first years of
decentralization – a finding consistent with the declining trend of Indonesia’s governance indicators over the last ten years (Table 2.1). In light of the sustained problems, national and international policymakers are challenged to increase joint efforts in improving local business climates and, equally important, to adjust their future support measures to the political economy of local government.
8.3 Implications for Policy and Scholarship

These empirical findings hold important messages for two different audiences. Firstly, they inform the current ‘good governance’ debate that sets the policy agendas in many developing countries. And secondly, they have concrete implications for Indonesian policymakers and scholars who are concerned with stimulating local investment and development.

Good Governance Debate

The contemporary debate that focuses on good governance in general and decentralization in particular faces two constraints. For one thing it is often isolated from the intellectual progress made in transition-to-democracy and government -reform literatures (Keefer 2004:14); and for another, it tends to base its advocacy on general beliefs rather than systematic research (Litvack et al. 1998:7). In response to this analytical gap, the present thesis has attempted to systematically assess the dynamics of local government by taking a close look at recent transition case with one of the most far-reaching decentralization reforms of the last two decades: the Republic of Indonesia. The implications from this analysis inform the current good-governance discourse in two respects: first, they highlight the evolutionary character of decentralization reforms; and second, they urge policymakers to complement narrow, society-centered paradigms with the notion of democratically-committed government leadership.

Considering the first implication, Indonesia's recent decentralization experience clearly shows that the installment of formal decentralization rules, per se, is hardly a guarantee of better government outcomes in the short run. Sustained problems of administrative inefficiencies and corruption, evidence for which is presented in this
study (Chapters 4 and 5) and other Indonesian assessments (Chapter 2), are best explained from an evolutionary-institutionalist perspective. Consistent with North’s (1990) ‘path dependency’ argument, Indonesia’s newly decentralized political framework is a good example of the interplay of inherited and newly installed rules, of evolutionary and externally induced changes. While formal rules and authorities changed drastically in the aftermath of the 1998 Asian crisis – as predicted in exogenous-shock literatures (Krasner 1984; Gourevitch 1986) – informal rules and power structures exhibited considerable inertia.

The field evidence in this study confirms that newly installed democratic norms (such as fair local elections and the freedom of speech) coexist with a set of tenacious pre-democratic norms (such as traditions of patronage and preferentialism). The latter are readily observable, for example, in surprisingly-high bribe payments for public sector recruitment, which were found in 6 out of 8 district-cases (see Table 4.9 and 5.9). Moreover, at the outset of decentralization, many official positions in rural areas were filled by members of local elites from the late Suharto era, who had weathered the storms and reinvented themselves under new democratic labels (Hadiz 2003:598). The perpetuation of local rent-seeking networks – senior officials, politicians and public contractors who jointly extract rents from infrastructure projects (Sections 4.5 and 5.5) – provides an indirect indication of the slow-moving nature of existing power structures.

Against this backdrop, the assumption that rapid decentralization reforms will see immediate government improvements, which implicitly underlies much of the good-governance literature, is misleading. Especially in early post-authoritarian transitions, it is more sensible to assume a gradual and often complex process, as predicted in the evolutionary-institutionalist (e.g. Hayek 1971; North 1990) and transition-to-democracy...
literatures (e.g. Lipset 1994; Acemoglu and Robinson 2001). But over the past decades, Gerard Roland (2000) notes, international donors have often been preoccupied with promoting structural ‘shock therapies’ (including rapid decentralization reforms) without paying sufficient attention to the institutional underpinnings. These attempts to dislodge past institutions and directly replace them with best-practice institutions from Western countries have mostly led to disappointing results (2000:343-4).

The second implication stems from the core analysis of this study. Based on systematic comparisons across Indonesian districts, this research offers empirical insights into the question of what drives local government performance in transitional contexts. Above all, the results from the case studies and the regression analyses contradict the widespread proposition that societal pressure is the key determinant of improved policy outcomes. In Indonesia’s early transition years (1999 to 2006), reform pressures from local firms, business associations and councilors have been relatively insignificant. The underlying causes of this insignificance, namely dysfunctional collective action and political representation, are likely to prevail into the near future. For one thing, high coordination and free-rider problems are bound to continue due to the unchanging geographical and sectoral fragmentation of rural business communities. And for another, the representation of broad business interests in district councils is likely to stay weak as there are no signs that the ‘defective’ electoral rules (Section 7.2.2) will be replaced for the upcoming elections in 2009.

Weak demand-side pressures can be compensated, as this study demonstrates, by supply-side mechanisms of government leadership. Especially in early transition stages, where authoritarian traditions gradually give way to more democratic norms, leadership is a decisive element for good government performance. The empirical results presented
in this thesis showed that the presence of committed and skillful regents is a highly
significant explanation for varied business climate outcomes. The two benchmark
district-cases, Solok and Kebumen, provide interesting insights into the strategic and
operational dimensions of effective government leadership. On a strategic level, the
regents of these districts (Gamawan and Rustriningsih) skillfully linked the interests of
local grassroots and national powerholders and, in doing so, created sufficient
momentum for broad-based policy reforms. On an operational level, the two district
heads were able to introduce a set of innovative measures that kept bureaucrats on their
toes and, at the same time, encouraged local firms to voice their concerns. The
introduction of media-based monitoring instruments – such as call-in talk shows and
virtual complaint boxes with mobile text messages – allowed small firms to
anonymously criticize government shortcomings. And the replacement of seniority-
based conventions with meritocratic promotion schemes helped to stimulate the
performance of local officials.

In brief, the analysis of Indonesia’s recent regime change holds two important
messages for the good-governance debate. First, in early transition stages, the strong
emphasis of society-based reform pressures (and linked donor-financed support
projects) should be critically reexamined in terms of the political economy that
underpins respective project sites. Some governance programs – including the ones I
was personally involved in – tend to be overly optimistic and confident in their
judgment of societal forces at the outset of decentralization and democratization
reforms. Hence, it would be advisable to systematically investigate prevailing norm,
power and incentive structures, before designing an external intervention. And second,
based on the evidence presented in this study, it appears warranted to extend the (often
exclusive) focus on societal driving forces to the effects of subnational government
leaders, their skills, and their incentives for reform. In early democratic transitions, government leadership may be the best available mechanism to reduce reform resistance, bureaucratic inefficiencies and public corruption.

*Local Business Climates in Indonesia*

After addressing general 'good governance' implications, let me now turn to a more specific issue in the Indonesian context. Due to the strong focus on local business climates, this study connects to a timely debate in contemporary Indonesia, namely the challenge to stimulate investment activity and economic growth in rural areas. In view of the empirical evidence from West Sumatra, Central Java, Bali and West Nusa Tenggara – particularly the numerous in-depth interviews with local firms and business chambers – I offer the following propositions for Indonesia's future policy directions.

The first set of propositions revolves around measures to enhance the quality of local government leadership. The reform-enhancing effects of district regents should be investigated on a wider scope (across more district cases), stimulated by additional incentive schemes, and strengthened through joint national/international support initiatives. Possible measures include the following:

*Understanding Leadership:* Further cases of democratically committed, reformist government leaders (such as Regent Rustriningsih in Kebumen and Regent Gamawan in Solok) need to be identified and systematically investigated; based on a wider scope of good leadership cases it will be possible to identify recurrent patterns and draw general lessons for future policy measures.

*Stimulating Leadership:* In addition to existing democratic incentives (for example direct regent elections), it would be useful to set up nation-wide performance measures to further stimulate leadership qualities. Options that come
to mind include (a) the introduction of clearly defined minimum standards for service and taxation practices; (b) the employment of fiscal rewards (e.g. in annual national transfers) for districts exceeding minimum standards; (c) and the launching of regular national ‘good governance awards’ for regents exhibiting outstanding anti-corruption or public reform efforts.

**Strengthening Leadership:** Apart from institutional incentives, policymakers may wish to consider introducing capacity-building instruments for local government leadership. The development of national curricula for training programs in managerial skills (communication, mediation and anti-corruption strategies), regular national conferences (to exchange innovative ideas), and study tours to best-practice locations may be effective mechanisms to strengthen future leadership qualities.

The second, and related, set of propositions revolves around measures to assist regents in their efforts to reduce public corruption and integrate latent societal (business) groups into the policy making process. Measures worth exploring include the following:

**Reducing Recruitment Bribes:** Entry fees for incoming public servants were found to be extensive in 6 out of 8 district cases. As these illicit entry fees are bound to aggravate public corruption, it is advisable that the responsible ministries (e.g. the State Ministry of Administrative Reform, Menpan) cooperate closely with district regents and societal groups in an attempt to limit informal recruitment bribes.

**Extending Integrity Pacts:** The perseverance of rent-seeking activities in public infrastructure projects, which were widely reported in this study, should be addressed by joint transparency efforts. Regent Gamawan in Solok has set a notable benchmark in this respect by initiating a formal contract between senior officials, local NGOs and public contractors to reduce corruption in public tender projects. The enactment of this ‘integrity pact’, which was supported by Transparency International, serves as an instructive example that should be considered for other districts.
Integrating Chinese Minorities: Although undoubtedly a sensitive issue, the re-integration of Chinese firms into local decision-making constitutes an important policy objective. Due to their pronounced business knowledge, experience, and assets, the involvement of Chinese Indonesians – for example in joint business forums and business-to-business initiatives – would provide a valuable economic impetus and, at the same time, secure a stronger cohesion of local business communities.
8.4 Future Research

The analysis of local government leadership and societal pressure has touched on some issues that could not be more fully addressed in this present study. Three issues in particular stand out. First, more work needs to be done on the interactions between subnational government leaders and local (business) communities. The case studies indicate that local leaders can stimulate latent pressures within society (for example by installing ‘call-in talk shows’ and ‘integrity pacts’) and, at the same time, depend on societal support for upcoming elections. In order to elaborate on this society-leadership nexus, it would be useful to explore further the effects of local mass media. As briefly outlined in the incentive effects of ‘national recognition’, media reports (and associated public opinion) are likely to play an increasing role as local democracy progresses and communication technology develops in rural Indonesia.

Second, one aspect that is bound to play an increasing role in the context of political representation (but beyond the scope of the present study) is the impact of reformist Islamic parties. A noteworthy phenomenon that emerged in the last national elections in 2004 is that local citizens have shifted their votes from secular incumbents to reformist Islamic parties. While the Indonesian Democratic Party (PDIP) lost nearly half the votes it received in 1999 (34 to 18 percent), the Party of Justice and Prosperity (PKS) – a bloc of reformist Islamic intellectuals – could increase its votes fivefold (from 1.7 to 7.3 percent). This increasing trend of voting for reformist Islamic forces, which finds support in a recent study by Henderson and Kuncoro (2006), may provide new impetus for constructive debates on public corruption.

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259 Recent political economy studies confirm that independent media organizations can be instrumental in aligning policy makers more closely with public interests. See for example Besley and Prat (2006), Besley and Burgess (2001; 2002), Sen (2001:183) and Djankov et al. (2003).


261 Henderson and Kuncoro (2006:26) show that local electorates have begun to respond to the corruption incidents of former secular incumbents and increasingly voted for Islamist parties in the 2004 lower-house elections.
And finally, building on the evidence of this study, it would be revealing to investigate to what extent the phenomenon of ‘democratically-committed’ government leadership, which emerged as a driving force for local business climates in Indonesia, can be observed in other parts of the world. Do large countries with pronounced decentralization reforms (such as Russia, Pakistan, China, India, the Philippines, or Brazil) exhibit similar mechanisms of reformist subnational leadership? And how do these leadership mechanisms relate to institutional, cultural and historical underpinnings? While the results of this study have provided interesting insights and suggestions for prospective research, the debates on ‘local leadership in transition’ have only just begun.
Appendix 3.1 – Local Business Survey (in English)

Section 1: General Business Climate

BC1) Since enactment of decentralization in 2001, how do new district policies influence your business activities?
   (a) they obstruct my business  (b) no changes  (c) they support my business (Please Skip to Question BC3)

BC2) Please evaluate to what extent the following aspects have obstructed your business since the introduction of decentralization:

<table>
<thead>
<tr>
<th>Aspect</th>
<th>No Obstacle</th>
<th>Small Obstacle</th>
<th>Moderate Obstacle</th>
<th>Large Obstacle</th>
<th>Very Large Obstacle</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Official costs of new district taxes</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) Unofficial costs during tax collection</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) Official costs of business licenses</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(d) Time spent for obtaining business licenses</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>(e) Unofficial costs during license administration</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>(f) Uncertainty of district policies</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

BC3) Please evaluate to what extent the policy environment in your district has been business-friendly:

<table>
<thead>
<tr>
<th>Period</th>
<th>Very Friendly</th>
<th>Friendly</th>
<th>Moderate</th>
<th>Unfriendly</th>
<th>Very Unfriendly</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) – before decentralization</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) – early decentralization years (2001 – 2003)</td>
<td></td>
<td></td>
<td>3</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>(c) – recent decentralization years (2004 – 2006)</td>
<td></td>
<td></td>
<td>3</td>
<td>4</td>
<td>3</td>
</tr>
</tbody>
</table>

BC4) Please estimate overall real investments (buildings, machinery, and equipment etc.) that have been made since decentralization:

<table>
<thead>
<tr>
<th>Investments inside your business</th>
<th>No Investment</th>
<th>Small Investment</th>
<th>Moderate Investment</th>
<th>Large Investment</th>
<th>Very Large Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

BC5) Please provide an estimate of your investments into your business between 2001 and 2004:

My investments amounted to approximately Rp. _______ million (sum total of real investment over the last four years)

Section 2: Local Taxes

T1) Please estimate the influence of newly enacted tax regulations on the economic development in your district:

<table>
<thead>
<tr>
<th>Taxes / Fees on:</th>
<th>No Obstacle</th>
<th>Small Obstacle</th>
<th>Moderate Obstacle</th>
<th>Large Obstacle</th>
<th>Very Large Obstacle</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Trade Goods</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) Agro, Livestock, Fishing, Forestry Products</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) Mining Goods</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(d) Manufactured Goods (Wood, Metal, Chemistry)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(e) Services (Hotel, Restaurant, Transportation)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(f) Other: (please specify)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

T2) Please estimate average informal payments to tax collectors (as percentage of tax payment):

<table>
<thead>
<tr>
<th>Before Decentralization (up to 2000)</th>
<th>Nil</th>
<th>10%</th>
<th>11-20%</th>
<th>21-30%</th>
<th>31-50%</th>
<th>51-70%</th>
<th>71-100%</th>
<th>&gt; 100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) National Taxes (e.g. VAT, Property, Petrol)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>(b) District Taxes and Fees (based on local regulations)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>

T3) Please state your opinion on the following statements:

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Maybe</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) It is possible to bargain with tax officials to find a beneficial solution for both sides</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) Bargaining efforts with tax officials are more frequent since decentralization</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) It is easier to bargain with national than of local tax collectors</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>
Section 3: Business Licenses

1.1) Please evaluate to what extent the following licensing aspects obstruct your business activity:

- (a) Amount of licenses required for my business
  - No Obstacle
  - Small Obstacle
  - Moderate Obstacle
  - Large Obstacle
  - Very Large Obstacle

- (b) Time for bureaucratic license procedures
  - 1-7 days
  - 8-14 days
  - 15-21 days
  - 22-30 days
  - >1 month

- (c) Official costs for business licenses
  - <10%
  - 11-20%
  - 21-30%
  - 31-50%
  - 51-70%
  - 71-100%
  - >100%

- (d) Informal payments to obtain business licenses
  - 1-2
  - 3
  - 4
  - 5

- (e) Uncertainty of administrative procedures
  - (please specify)

1.2) Please estimate the average time you spend to obtain necessary business permits in your district:

- (a) ... before Decentralization (up to 2000)
  - 1
  - 2
  - 3
  - 4

- (b) ... early decentralization years (2001 - 2003)
  - 1
  - 2
  - 3
  - 4

- (c) ... recent decentralization years (2004 - 2006)
  - 1
  - 2
  - 3
  - 4

1.3) Please estimate average informal costs you paid for standard business licenses (as percentage of official license cost)

- (a) ... before Decentralization (up to 2000)
  - <10%
  - 11-20%
  - 21-30%
  - 31-50%
  - 51-70%
  - 71-100%
  - >100%

- (b) ... early decentralization years (2001 - 2003)
  - <10%
  - 11-20%
  - 21-30%
  - 31-50%
  - 51-70%
  - 71-100%
  - >100%

- (c) ... recent decentralization years (2004 - 2006)
  - <10%
  - 11-20%
  - 21-30%
  - 31-50%
  - 51-70%
  - 71-100%
  - >100%

1.4) Which business permit(s) proved to be especially problematic:

- (1) __________
- (2) __________
- (3) __________

1.5) Please state your opinion on the following statements:

- (a) Bureaucratic license procedures are more complex since decentralization
  - Strongly Disagree
  - Disagree
  - Uncertain
  - Agree
  - Strongly Agree

- (b) Uncertainties of license administration have increased since decentralization
  - Strongly Disagree
  - Disagree
  - Uncertain
  - Agree
  - Strongly Agree

- (c) Personal connections with district officials help to speed up the licensing process
  - Strongly Disagree
  - Disagree
  - Uncertain
  - Agree
  - Strongly Agree

Section 4: Governance

2.1) Please evaluate the power/influence of ___ in the policy-making process of business-related regulations:

- (a) Regent
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (b) District Council
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (c) Technical Departments
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (d) District Planning Agency (BAPPEDA)
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (e) Political Parties
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (f) Local Business Chamber (KADIN)
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (g) Public Construction Association (GAPENSI)
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (h) Local NGOs
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (i) Local Business People
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (j) Local Academics
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (k) Civil Society
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

2.2) Please evaluate the business climate improvements that ___ has brought about in your district since decentralization:

- (a) Regent
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (b) District Council
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (c) Technical Departments
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (d) District Planning Agency (BAPPEDA)
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (e) Political Parties
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (f) Local Business Chamber (KADIN)
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (g) Public Construction Association (GAPENSI)
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (h) Local NGOs
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (i) Local Business People
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (j) Local Academics
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong

- (k) Civil Society
  - Very Weak
  - Weak
  - Moderate
  - Strong
  - Very Strong
G3) Please evaluate the leadership qualities of your regent since 2000

Leadership Qualities: 
(a) Integrity (Anti-Corruption Efforts) 
(b) Political Vision and Will 
(c) Communication Skills 
(d) Degree of Popular Support 
(e) Power to bring about Change 
(f) Other: (please specify)

G4) Please express your level of satisfaction of the following societal pressure aspects since 2000

Societal pressure aspects: 
(a) Information on new district regulations by the government 
(b) Information on new district policies by local media 
(c) Involvement of local firms in the drafting process of new regulations 
(d) Representation of business concerns in the district council 
(e) Representation of business concerns in the local business chamber 
(f) Local firms' efforts to collectively articulate concerns to local government 
(g) My personal efforts to articulate concerns to local government 
(h) Level of trust among business people in this district

G5) Please state your opinion on the following statements:

(a) The direct elections of the district parliament in 2004 have a positive impact on business-related policies and practices in this district! 
(b) The direct elections of the regent in 2005 have a positive impact on business-related policies and practices in this district! 
(c) The key for business climate improvements is the leadership of the regent! 
(d) The key for business climate improvements is the scrutiny of district parliament! 
(e) The key for business climate improvements is the pressure from the business-sector!

Section 5: Personal Information

Please provide the following information about yourself (please circle appropriate answers):

1) Age: 
   (1) 20 or less 
   (2) 21 - 29 
   (3) 30-39 
   (4) 40-49 
   (5) 50 or more

2) Sex: 
   (1) Male 
   (2) Female

3) Firm Type: 
   (1) Trade/Retail 
   (2) Construction 
   (3) Agro Processing 
   (4) Service 
   (5) Manufacture 
   (6) Other

4) Employment Position: 
   (1) Owner 
   (2) General Manager 
   (3) Manager 
   (4) Supervisor 
   (5) Employee 
   (6) Other

5) Establishment of Business: 
   Year

6) Ethnic Background: 
   (1) Indigenous Indonesian 
   (2) Chinese Indonesian 
   (3) Arab Indonesian 
   (4) Foreigner

7) No of Employees: 
   (1) 1-5 employees 
   (2) 6-10 employees 
   (3) 11-20 employees 
   (4) more than 20 employees

8) Duration of Residence: 
   (1) Born in this district 
   (2) More than 10 years 
   (3) Between 6-10 years 
   (4) 5 years or less

9) Highest Education Degree: 
   (1) Senior High School (SMA/U) 
   (2) Diploma (D1-D4) 
   (3) Bachelor (S1) 
   (4) Master or PhD (S2/S3)

10) Years of schooling: 
    (please specify)

11) Memberships: 
   (1) KADIN 
   (2) GAPENSI 
   (3) HIPMI 
   (4) PERPUK 
   (5) Muhammadiyah 
   (6) Nahdlatul Ulama (NU)

Thank you very much for your kind cooperation - your contribution will strongly benefit this research!
### Bagian 1: Iklim Usaha Daerah Secara Umum

<table>
<thead>
<tr>
<th>BC1</th>
<th>Setelah otonomi daerah (di tahun 2001), bagaimana memandang Anda, kebijakan-kebijakan Pemda mempengaruhi aktivitas bisnis yang Anda lakukan?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sama Saja</td>
</tr>
</tbody>
</table>

### Bagian 2: Pajak Daerah

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Pajak Pusat (misalnya, PPN, PBB)</td>
<td>Sama Saja</td>
<td>Sering</td>
<td>Dapat</td>
<td>Sangat Menurut Anda</td>
<td>Sangat Menurut Anda</td>
</tr>
</tbody>
</table>

### Appendix 3.2 – Local Business Survey (in Indonesian)
Bagian 3: Perijinan Daerah

1.1 Mohon diinformasikan bahwa beberapa aspek perijinan berikut ini merupakan hambatan untuk bisnis Anda:

| (a) Jumlah ijin yang diperlukan untuk menjalankan bisnis | 1 | 2 | 3 | 4 | 5 |
| (b) Waktu yang dibutuhkan untuk pengurusan ijin | 1 | 2 | 3 | 4 | 5 |
| (c) Biaya resmi perijinan | 1 | 2 | 3 | 4 | 5 |
| (d) Biaya tambahan untuk mendapatkan ijin | 1 | 2 | 3 | 4 | 5 |
| (e) Ketidakpastian dalam prosedur administratif | 1 | 2 | 3 | 4 | 5 |

1.2 Tolong kirikan secara umum berapa rata-rata waktu yang dibutuhkan untuk mendapatkan ijin:

<table>
<thead>
<tr>
<th>1-7 hari</th>
<th>8-14 hari</th>
<th>15-21 hari</th>
<th>22-30 hari</th>
<th>&gt;1 bulan</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) selama otonomi daerah (hingga 2000)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(b) awal otonomi daerah (2001-2003)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(c) selama otonomi daerah (2004-2005)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>

1.3 Tolong perkirakan berapa rata-rata biaya yang harus dibayar untuk mendapat ijin (sebagai persentase dari biaya ijin resmi):

<table>
<thead>
<tr>
<th>Tidak ada</th>
<th>&lt;10%</th>
<th>10-20%</th>
<th>21-30%</th>
<th>31-50%</th>
<th>51-70%</th>
<th>&gt;70%</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) selama otonomi daerah (hingga 2000)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>(b) awal otonomi daerah (2001-2003)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>(c) selama otonomi daerah (2004-2005)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
</tr>
</tbody>
</table>

1.4 Seni ijin apa merupakan masalah utama untuk bisnis anda: (1) __________ (2) __________ (3) __________

1.5 Bagaimana sikap Anda terhadap penyataan-penyataan berikut ini:

<table>
<thead>
<tr>
<th>Sangat Tidak Setuju</th>
<th>Tidak Setuju</th>
<th>Biasa</th>
<th>Setuju</th>
<th>Sangat Setuju</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Selalu otonomi daerah, berkenaan perijinan semakin marak!</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(b) Selalu otonomi daerah, prosedur perijinan semakin tidak pasti!</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(c) Hubungan dengan 'orang dalam' pemerintah dapat mempercepat proses perijinan!</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>

Bagian 4: Pemerintahan

G1 Tolong Anda menilai Kekuasaan/Pengaruh dari instansi berikut ini dalam proses pembuatan peraturan daerah (Perda) di daerah Anda:

<table>
<thead>
<tr>
<th>Kekuasaan</th>
<th>Sangat Lebih</th>
<th>Lebih</th>
<th>Sama</th>
<th>Kurang</th>
<th>Sangat Kurang</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Bupati</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) DPRD</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) Dinas Teknis (Dispora, Pertani, Koporni dll.)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(d) Bappeda</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(e) Kerjasama</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(f) GAIN</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(g) GAPENSI</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(h) LSM</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(i) Pengusaha</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(j) Pengurus Tinggi</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(k) Masyarakat umum</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

G2 Tolong Anda menilai sejauh mana institusi berikut sudah melakukan perbaikan dalam iklim usaha di daerah Anda:

<table>
<thead>
<tr>
<th>Institusi ini sudah melakukan perbaikan dalam iklim usaha di daerah Anda</th>
<th>Sangat Ssstifl</th>
<th>Sedikit</th>
<th>Sama</th>
<th>Kurang</th>
<th>Sangat Kurang</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Bupati</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) DPRD</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) Dinas Teknis (Dispora, Pertani, Koporni dll.)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(d) Bappeda</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(e) Kerjasama</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(f) GAIN</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(g) GAPENSI</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(h) LSM</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(i) Pengusaha</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(j) Pengurus Tinggi</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(k) Masyarakat umum</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>
G3) Tolong jelaskan kualitas kepemimpinan Bupati di daerah Anda antara 2000-2005:

<table>
<thead>
<tr>
<th>Kualitas kepemimpinan</th>
<th>Sangat</th>
<th>Kurang</th>
<th>Biasa</th>
<th>Baik</th>
<th>Sangat Baik</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Integritas (tidak terkait dengan KKN)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) Visi dan nilai yang berkelanjutan</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) Keterampilan berkomunikasi</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(d) Populitas / Dukungan Masyarakat</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(e) Kekuasaan untuk mengatasi pembahar / hasil lebih baik</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(f) Lainnya:</td>
<td>(tolong sebutkan)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

G4) Tolong jelaskan transparansi dan dorongan masyarakat di daerah Anda sejak 2000:

Aspek-aspek transparansi dan partisipasi:

<table>
<thead>
<tr>
<th>Aspek</th>
<th>Sangat</th>
<th>Tidak / Kurang</th>
<th>Sederhana</th>
<th>Puas</th>
<th>Sangat Puas</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Informasi dari pemerintah daerah tentang peraturan daerah (Perda)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) Informasi dari media massa tentang kebijakan daerah</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) Partisipasi dunia usaha dalam pembuatan Perda yang baru</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(d) Keterwakilan dunia usaha di DPRD</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(e) Keterwakilan dunia usaha di KADIN</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(f) Upaya kerja sama pengusaha secara terpadu menyampaikan aspirasi kepada pemerintah</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(g) Upaya pribadi untuk menyampaikan aspirasi kepada pemerintah</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(h) Tingkat keterwakilan antarpengusaha di daerah ini</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

G5) Bagaimana sikap Anda terhadap pemilihan-pemilihan berikut ini:

<table>
<thead>
<tr>
<th>Aspek</th>
<th>Sangat</th>
<th>Tidak / Kurang</th>
<th>Sederhana</th>
<th>Puas</th>
<th>Sangat Puas</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Pemilihan langsung anggota DPRD tahun 2004 memiliki dampak yang positif dalam hal kebijakan dan praktik perijinan/pentingan di daerah ini</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) Pilgub langsung (Bupati) tahun 2005 memiliki dampak yang positif dalam hubungan dan praktik perijinan/pentingan di daerah ini</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) Keterpimpinan Bupati adalah kunci perbaikan iklim usaha</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(d) Pengawasan oleh DPRD adalah kunci perbaikan iklim usaha</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(e) Tekanan dan suara dari sektor dunia usaha adalah kunci perbaikan iklim usaha</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

Informasi Pribadi

Silakan mengisi informasi tentang diri Anda (mohon lengkapi jawaban yang tepat):

1) Usia: (1) 20 atau kurang (2) 21 - 29 (3) 30-39 (4) 40-49 (5) 50 atau lebih

2) Jenis Kelamin: (1) Laki-laki (2) Perempuan

3) Jenis Usaha: (1) Perdagangan (2) Bangunan (3) Agrobisnis (4) Jasa (5) Manufaktur (6) Lainnya

4) Pendidikan Terakhir: (1) Pemilik (2) pengurus/manajer (3) pengawas (4) karyawan (5) Lainnya

5) Jenis operasi bisnis: Tahun

6) Latar belakang etnis: (1) Propinsi (2) Peranakan China (3) Peranakan Arif (4) Orang Arif (5) Lainnya

7) Jenis usaha: (1) 1-5 orang (2) 6-10 orang (3) 11-20 orang (4) Lebih dari 20 orang

8) Lainnya: Tahun

9) Penduduk Terakhir: (1) SMU (2) D1-D4 (3) SL (4) S2/S3 (5) Lainnya

10) Lainnya: (1) KADIN (2) GAPENSI (3) HIPMI (4) PARPOL (5) Muhammadiyah (6) Nahdlatul Ulama (NU)

Terima kasih banyak atas bantuan dan partisipasi Anda dalam penelitian ini!
Appendix 3.3

List of Interview Respondents

### Interviewees in Klaten

<table>
<thead>
<tr>
<th>Respondent</th>
<th>Profession/Sector</th>
<th>Date</th>
<th>Duration (min)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. 1</td>
<td>Government Official</td>
<td>7 June 2005</td>
<td>87</td>
</tr>
<tr>
<td>No. 2</td>
<td>Business Person</td>
<td>8 June 2005</td>
<td>67</td>
</tr>
<tr>
<td>No. 3</td>
<td>District Councilor</td>
<td>9 June 2005</td>
<td>81</td>
</tr>
<tr>
<td>No. 4</td>
<td>District Councilor</td>
<td>9 June 2005</td>
<td>23</td>
</tr>
<tr>
<td>No. 5</td>
<td>NGO Activist</td>
<td>10 June 2005</td>
<td>72</td>
</tr>
<tr>
<td>No. 6</td>
<td>NGO Activist</td>
<td>10 June 2005</td>
<td>65</td>
</tr>
<tr>
<td>No. 7</td>
<td>Government Official</td>
<td>11 June 2005</td>
<td>48</td>
</tr>
<tr>
<td>No. 8</td>
<td>Journalist</td>
<td>13 June 2005</td>
<td>77</td>
</tr>
<tr>
<td>No. 9</td>
<td>Journalist</td>
<td>14 June 2005</td>
<td>70</td>
</tr>
<tr>
<td>No. 10</td>
<td>Business Person</td>
<td>14 June 2005</td>
<td>74</td>
</tr>
<tr>
<td>No. 11</td>
<td>Government Official</td>
<td>15 June 2005</td>
<td>84</td>
</tr>
<tr>
<td>No. 12</td>
<td>Business Person</td>
<td>17 June 2005</td>
<td>72</td>
</tr>
<tr>
<td>No. 13</td>
<td>Business Association Head</td>
<td>18 June 2005</td>
<td>52</td>
</tr>
<tr>
<td>No. 14</td>
<td>Business Person</td>
<td>20 June 2005</td>
<td>146</td>
</tr>
<tr>
<td>No. 15</td>
<td>Academic</td>
<td>21 June 2005</td>
<td>78</td>
</tr>
</tbody>
</table>

### Interviewees in Kebumen

<table>
<thead>
<tr>
<th>Respondent</th>
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Appendix 3.4
Interview Guidelines

The following questions served as a guideline for the in-depth interviews with local firms and business associations. Similar guidelines (adjusted to each context) were employed for the interviews with local government officials, district councilors, NGO activists, academics and journalists.

Section 1) Business Climate and Development

Business Description
- What is the nature/sector of your business?
- How long have you been doing business in this district?
- (for start-up firms) What motivated you to start up your firm in this district?

General Business Climate
- How would you evaluate the general business conditions in this district?
- What are the major obstacles (general/government-induced) for local firms?
- Has decentralization improved or deteriorated local business conditions?

Investments
- Have you made any real investments (buildings, machines etc.) since 2001?
- Can you give reasons for these investment decisions?
- Did other firms in your business sector make pronounced investments?

Section 2) Local Taxes

New Local Taxes and Tax Collection
- How do new local tax regulations affect your business?
- Are there any new tax regulations that are particularly obstructive?
- In what way do these taxes constrain your business activity?
Do you follow the decision making process of new tax regulations?  
Who are the main actors involved in the regulatory process?  
Is the local decision-making process transparent?  
Are local firms/business associations involved in local decision-making?

What is your experience with local tax administration/collection?  
How/Where/To whom do you pay tax duties in this district?  
Is it possible to bargain with local tax officials?  
Are there any changes since decentralization?

Section 3) Business Licenses

What are the common business license procedures in this district?  
Which licenses are required for your business activities?  
How many days (other firms) are required to obtain standard business permits?  
Which technical departments are in charge of common business permits?  
Are there any changes since decentralization?

How would you characterize the performance of the license administration?  
How time-efficient are the license procedures in this district?  
Do standard business-permits entail informal (bribe) payments?  
(And if so) do such informal (bribe) payments speed up license procedures?  
Are there any changes since decentralization?

Section 4) Public Tender

What are your observations regarding infrastructure/procurement projects?  
Is the decision-making process of public tenders transparent and fair?  
Have you observed tendencies of public-private rent-seeking activities?  
(If so) which actors are involved in such rent-seeking networks?  
Have you personally witnessed corrupt tender processes?
Section 5) Government Leadership and Societal Pressure

How would you describe the leadership qualities of your regent?

Has the regent improved the local business climate since decentralization?

(If so) in what way, and by what means?

Did the introduction of direct regent elections have any notable effects?

How do you evaluate your regent’s...

... anti-corruption efforts?
... communication skills?
... popularity/public support?
... political will to bring about policy reforms?
... power to initiate and implement policy reforms?
... relationship with local firms/councilors/NGOs/society at large?

How would you describe the impacts of the following policy actors/bodies?

Has/have ...

... district council/political parties
... local business chamber
... other business associations
... NGOs
... Local Media

... improved local business conditions since decentralization?

(If so) in what way and by what means?

How do you evaluate the reform efforts of local firms and council representatives?

Are you actively involved in the local business chambers?

How well does the local business chamber represent your interests?

Do local firms in this district act collectively to improve business conditions?

Are you aware of recent business-related (tax/license) regulations?

Have you ever officially complained about government shortcomings?

(If so) when, how and to whom?

How would you describe the level of trust among local firms in this district?

Do you regularly follow local political affairs (elections/political debates)?

How well do district councilors/political parties represent your interests?

Are district councilors responsive to societal interests/business interests?

Looking into the future, what are the main drivers for business climates improvements?

Thank you very much for your kind cooperation!
Appendix 4.1
Leadership Cases: Similarities in Socio-Economic Controls

1. Kebumen and Klaten in Central Java

Apart from the distinct differences in leadership (see Section 4.2), Kebumen and Klaten are comparable in many respects. As illustrated in Table A4.1 below, indicators

Table A4.1: Socio-Economic Characteristics of Kebumen and Klaten

<table>
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<td><strong>Government Leadership</strong></td>
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<tr>
<td>Media Evaluation</td>
<td>Very Good</td>
<td>Poor</td>
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<td>Expert Evaluation</td>
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<td>Poor</td>
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<td>Overall Evaluation</td>
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<td><strong>Business Pressure</strong></td>
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<tr>
<td>Chambers/Associations</td>
<td>Insufficient</td>
<td>Insufficient</td>
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<td>Literacy/Schooling 1999</td>
<td>Moderate (85% / 6.2 yrs)</td>
<td>Moderate (83% / 7.3 yrs)</td>
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<td>Overall Evaluation</td>
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<tr>
<td><strong>Control Variables</strong></td>
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<tr>
<td>Formal Institutions</td>
<td>Identical National Intuitions (formal laws &amp; political architecture)</td>
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<tr>
<td>Population 2001</td>
<td>1,162,280</td>
<td>1,108,140</td>
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<tr>
<td>National Transfers 2001</td>
<td>US$ 29 million</td>
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</tr>
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<td>Annual Per-Capita 2002</td>
<td>US$ 230</td>
<td>US$ 350</td>
</tr>
<tr>
<td>Poverty Rate 2001</td>
<td>28%</td>
<td>24%</td>
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<tr>
<td>Major Ethnic Group</td>
<td>Javanese (99%)</td>
<td>Javanese (99%)</td>
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<td>Major Religions</td>
<td>Islam (99%), Christian (1%)</td>
<td>Islam (93%), Christian (6%)</td>
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<td>Major Political Parties 1999</td>
<td>PDIP (39%), PKB (21%)</td>
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<tr>
<td>Overall Evaluation</td>
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Source: For government leadership indicators see Section 4.2; for business-pressure indicators see Section 5.2; and for control variables see Appendix 6.1.
Note: Expert interviews were held with regional policy observers at CSIS, World Bank, GTZ and the Ministry of Home Affair (see footnote 102)
of local business pressure, such as literacy (85 and 83 percent), schooling (6.2 and 7.3 years), and business associations (both insignificant) do not indicate any significant divergence. Other social and political control factors are also similar. Both districts show an almost identical population size of 1.1 million; both display an equal distribution of ethnic (99 percent Javanese) and religious groups (90+ percent Islam); both received national transfers (DAU) of approximately 30 million in 2001; both show high poverty rates (20+ percent); and both are traditional strongholds of the PDIP, a secular party led by former president Megawati Sukarnoputri. The only factor that varies somewhat is per-capita income. In 2003, the average person in Kebumen had an annual income of US$ 230 at his/her disposal (see Table A4.1), whereas the average person in Klaten was endowed with US$ 350.

Taking a closer look at both district economies, we find that more than 90 percent of the workforce in both districts is absorbed in cottage and small industries. Both districts have undergone a structural change from agriculture to manufacturing and service sectors. Klaten, in particular, once known by the Dutch for its rich rice yields and sugarcane plantations (Schweizer 1987:39), has moved increasingly into the non-farm sector, due to rising population pressures and land scarcity (Booth 1974:140). Today, almost half of Klaten’s regional income accrues from the manufacturing and vending of metalwork, woodwork, textiles, food products and handicrafts. In Kebumen structural change has been less extensive. Kebumen’s agricultural sector (mostly grain and fishery products) accounts for twice as much local GDP as its production and trade sectors (mostly ceramics and handicrafts).

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262 Business-pressure indicators are explained in further detail in Chapter 5.
263 The figures appearing in this section are based on statistical government publications from Kebumen and Klaten (BPS Kebumen 2004; BPS Klaten 2004); as well as additional district statistics for the years 2004 and 2005 obtained from the United Nations Development Program (UNDP 2001).
264 A comparative overview of sectoral incomes in Kebumen and Klaten is presented in Appendix 4.3.
Pulling together the information from the discussion above, the two Javanese cases vary – above all other things - in government leadership. As outlined in detail in Chapter 4, expert interviews, media reports and local business perceptions show that leadership qualities in Kebumen are distinctly higher than in Klaten. At the same time, other social, economic, and political indicators remain closely aligned in both district cases. This relatively controlled baseline approximates a ‘certeris paribus’ condition and, by doing so, provides a good foundation for analyzing the effects of leadership on local business climates.
2. Solok and Pesisir in West Sumatra

Apart from their distinctiveness in leadership, Solok and Pesisir are nearly identical in terms of business-pressure and common socio-economic indicators (see Table A4.2). The comparison of business-pressure proxies – literacy, schooling, and associative activity – suggests that business people are equally well educated and represented in both districts.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Solok</th>
<th>Pesisir</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Leadership</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Media Evaluation</td>
<td>Very Good</td>
<td>Poor</td>
</tr>
<tr>
<td>Expert Evaluation</td>
<td>Very Good</td>
<td>No Comments</td>
</tr>
<tr>
<td>Survey Evaluation</td>
<td>Good</td>
<td>Fair</td>
</tr>
<tr>
<td>Overall Tendency</td>
<td>Very Good</td>
<td>Fair/Poor</td>
</tr>
<tr>
<td>Business Pressure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chambers/Associations</td>
<td>Insignificant</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Literacy/ Schooling</td>
<td>High (95% / 6.8 yrs)</td>
<td>High (94% / 7.4 yrs)</td>
</tr>
<tr>
<td>Overall Tendency</td>
<td>Moderate in both cases</td>
<td></td>
</tr>
<tr>
<td>Control Variables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formal Institutions</td>
<td>Identical National Intuitions (formal laws &amp; political architecture)</td>
<td></td>
</tr>
<tr>
<td>Population 2001</td>
<td>434,680</td>
<td>388,720</td>
</tr>
<tr>
<td>National Transfers 2001</td>
<td>US$ 16 million</td>
<td>US$ 14 million</td>
</tr>
<tr>
<td>Annual Per-Capita 2002</td>
<td>US$ 450</td>
<td>US$ 400</td>
</tr>
<tr>
<td>Poverty Rate 2001</td>
<td>12%</td>
<td>13%</td>
</tr>
<tr>
<td>Major Ethnic Group</td>
<td>Minang (96%)</td>
<td>Minang (95%)</td>
</tr>
<tr>
<td>Major Religions</td>
<td>Islam (99,9%), Christ. (0,1%)</td>
<td>Islam (99,9%), Christian (0,1%)</td>
</tr>
<tr>
<td>Major Political Parties 1999</td>
<td>Golkar (33%), PPP (20%)</td>
<td>Golkar (25%), PPP (21%)</td>
</tr>
<tr>
<td>Overall Tendency</td>
<td>Similar in both cases</td>
<td></td>
</tr>
</tbody>
</table>

Source: For government leadership indicators see Section 4.2; for business-pressure indicators see Section 5.2; and for control variables see Appendix 6.1.
Note: Expert interviews were held with regional policy observers at CSIS, World Bank, GTZ and the Ministry of Home Affair (see footnote 102)
Furthermore, neither case indicates significant differences across socioeconomic indicators.²⁶⁵ Both districts have a population of around 400 thousand; both are strongly homogenous in their ethnic (95 percent Minang) and religious (99 percent Islam) composition; both received national budget transfers close to 15 million in 2001; both show comparatively low poverty rates (13 percent or less); and in both cases GOLKAR and PPP were the leading political forces in the first post-Suharto legislation (1999-2004).

Turning to economic indicators, annual per-capita incomes in Solok and Pesisir are estimated at US$ 450 and US$ 400, respectively. In both economies the primary and tertiary sectors constitute more than 80 percent of regional GDP.²⁶⁶ However, Solok shows a higher share in agriculture, while the sectoral composition in Pesisir reveals larger shares in manufacturing and trade. Due to its volcanic soils and temperate climate Solok is renowned for its rice (bareh solok), and fruit and vegetable production, whereas the coastal plains of Pesisir display high yields in grain, oil palm, forestry and fishery commodities. Considering manufacturing and trade, incomes in both districts predominantly accrue from processing and vending of agricultural products and machinery. The labor force in both economies is almost entirely (95+ percent) absorbed in cottage and small industries.

In summary, the comparison shows that Solok and Pesisir are sufficiently homogenous in terms of social, economic, and political features. Moreover, the districts are situated in the same province and, thereby share not only the same formal institutions (i.e. national constitution, political architecture, decentralization laws, and

²⁶⁵ The figures appearing in this section are based on statistical government publications from Kebumen and Klaten (BPS Pesisir Selatan 2004; BPS Solok 2004); as well as additional district statistics for the years 2004 and 2005 obtained from the United Nations Development Program (UNDP 2001).
²⁶⁶ A detailed sectoral overview of Solok’s and Pesisir’s economies is presented in Appendix 4.3.
electoral rules) but also the same cultural heritage. The two cases differ markedly, however, in the quality of their government leader. While Solok's Bupati has been credited with pursuing administrative reforms and anti-corruption measures, his colleague in Pesisir has been accused of misusing his authority for private gain. Overall, by choosing these two district-cases the leadership factor can be 'isolated' from other influences; this creates a more robust baseline for the analysis. Together with the district-pair in Central Java, described earlier, these two controlled 'regional experiments' have allowed a repeated assessment of leadership effects on local government outcomes.
Figure A4.1: Local Economy and Society in Kebumen and Klaten

Notes: (top-left) street vender and becaks (pedicabs) in Kebumen; (top-right) metalwork in Klaten; (bottom-right) Muslim girl in Klaten; (bottom-left) pottery manufacturing in Kebumen.

Figure A4.2: Local Economy and Society in Solok and Pesisir

Notes: clockwise description: (1) two paddy farmers in Solok; (2) fishing boats and traditional architecture in Pesisir; (3) local vegetable market in Pesisir; (4) soft-drink production in Solok.
Source (of all eight images): Author’s pictures taken during field observations in 2005
Appendix 4.2
Evaluation Scales for Case Study Comparisons

The following evaluation scales are constructed to compare business climate indicators across the selected district-cases:

### Evaluation Intervals for Business Climate Assessments

<table>
<thead>
<tr>
<th></th>
<th>Very Good</th>
<th>Good</th>
<th>Fair</th>
<th>Poor</th>
<th>Very Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Local Taxation</strong></td>
<td>no</td>
<td>little</td>
<td>some</td>
<td>strong</td>
<td>very strong</td>
</tr>
<tr>
<td><em>(observation-based)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>indication of formal and informal trade distortions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>License Time</strong></td>
<td>X ≤ 7</td>
<td>7 &lt; X ≤ 14</td>
<td>14 &lt; X ≤ 21</td>
<td>21 &lt; X ≤ 28</td>
<td>X &gt; 28</td>
</tr>
<tr>
<td><em>(in days)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>License Costs</strong></td>
<td>X ≤ 400</td>
<td>400 &lt; X ≤ 500</td>
<td>500 &lt; X ≤ 700</td>
<td>700 &lt; X ≤ 1000</td>
<td>X &gt; 1000</td>
</tr>
<tr>
<td><em>(in thousand Rps)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Recruitment Corruption</strong></td>
<td>X = 0</td>
<td>0 &lt; X ≤ 5</td>
<td>5 &lt; X ≤ 15</td>
<td>15 &lt; X ≤ 30</td>
<td>X &gt; 30</td>
</tr>
<tr>
<td><em>(in million Rps)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Tax Corruption</strong></td>
<td>X = 0</td>
<td>0 &lt; X ≤ 3 1/3</td>
<td>3 1/3 &lt; X ≤ 6 2/3</td>
<td>6 2/3 &lt; X ≤ 10</td>
<td>X &gt; 10</td>
</tr>
<tr>
<td><em>(in percent of tax payment)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>License Corruption</strong></td>
<td>X = 0</td>
<td>0 &lt; X ≤ 3 1/3</td>
<td>3 1/3 &lt; X ≤ 6 2/3</td>
<td>6 2/3 &lt; X ≤ 10</td>
<td>X &gt; 10</td>
</tr>
<tr>
<td><em>(in percent of license fees)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Intransparency/ Unfairness</strong></td>
<td>X = 0</td>
<td>0 &lt; X ≤ 10</td>
<td>10 &lt; X ≤ 30</td>
<td>30 &lt; X ≤ 60</td>
<td>X &gt; 60</td>
</tr>
<tr>
<td><strong>of Public Tender</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>(in respondent shares)</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Appendix 4.3
Economic Structures of Selected Case Districts

Economic Structure in Kebumen and Klaten in 2004 (in million Rps and percent)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Kebumen</th>
<th>Klaten</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Share</td>
</tr>
<tr>
<td>Primary Sector</td>
<td>1,002,900</td>
<td>46.8%</td>
</tr>
<tr>
<td>- Agriculture</td>
<td>870,700</td>
<td>40.7%</td>
</tr>
<tr>
<td>- Mining</td>
<td>132,200</td>
<td>6.2%</td>
</tr>
<tr>
<td>Secondary Sector</td>
<td>331,430</td>
<td>15.5%</td>
</tr>
<tr>
<td>- Manufacturing</td>
<td>224,700</td>
<td>10.5%</td>
</tr>
<tr>
<td>- Construction</td>
<td>90,950</td>
<td>4.2%</td>
</tr>
<tr>
<td>- Utilities</td>
<td>15,780</td>
<td>0.7%</td>
</tr>
<tr>
<td>Tertiary Sector</td>
<td>806,660</td>
<td>37.7%</td>
</tr>
<tr>
<td>- Trade</td>
<td>247,300</td>
<td>11.6%</td>
</tr>
<tr>
<td>- Private</td>
<td>307,360</td>
<td>14.4%</td>
</tr>
<tr>
<td>- Government</td>
<td>252,000</td>
<td>11.8%</td>
</tr>
<tr>
<td>Total</td>
<td>2,141,000</td>
<td>100%</td>
</tr>
</tbody>
</table>

Sources (both tables): data from the Indonesian Central Bureau of Statistics (BPS) and the World Bank; presented values refer to the gross national product in 2004 (current prices) in million Rps.
Appendix 5.1
Business Pressure Cases: Similarities in Socio-Economic Controls

1. Gianyar and Karangasem in Bali

As foreshadowed in the discussion on business associations in Chapter 5, demand-side pressures in the two Balinese cases are connected to economic development.

Table A5.1: Socio-Economic Characteristics of Gianyar and Karangasem

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Gianyar</th>
<th>Karangasem</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business Pressure</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Associative Strength</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Literacy/Schooling</td>
<td>High (82% / 7.6 yrs)</td>
<td>Low (68% / 4.7 yrs)</td>
</tr>
<tr>
<td>Political Awareness</td>
<td>Moderate (72%)</td>
<td>Moderate (62%)</td>
</tr>
<tr>
<td>Overall Evaluation</td>
<td>Moderate/High</td>
<td>Low</td>
</tr>
<tr>
<td><strong>Government Leadership</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business Survey Score</td>
<td>Moderate (2.6)</td>
<td>Moderate (2.7)</td>
</tr>
<tr>
<td>News Coverage</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Expert Interviews</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Overall Evaluation</td>
<td>Moderate in both cases</td>
<td></td>
</tr>
<tr>
<td><strong>Control Variables</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Institutional Factors</td>
<td>Identical National Intuitions (formal laws &amp; political architecture)</td>
<td></td>
</tr>
<tr>
<td>Population 2001</td>
<td>391,540</td>
<td>359,510</td>
</tr>
<tr>
<td>National Transfer 2003</td>
<td>US$ 28 million</td>
<td>US$ 24 million</td>
</tr>
<tr>
<td>Annual Per-Capita 2002</td>
<td>US$ 670</td>
<td>US$ 400</td>
</tr>
<tr>
<td>Poverty Rate 2001</td>
<td>6%</td>
<td>19%</td>
</tr>
<tr>
<td>Major Ethnic Group</td>
<td>Balinese (97%)</td>
<td>Balinese (96%)</td>
</tr>
<tr>
<td>Major Religions</td>
<td>Hindu (99%), Islam (1%)</td>
<td>Hindu (96%), Islam (4%)</td>
</tr>
<tr>
<td>Major Political Parties 1999</td>
<td>PDIP (87%), Golkar (7%)</td>
<td>PDIP (78%), Golkar (12%)</td>
</tr>
<tr>
<td>Overall Evaluation</td>
<td>Largely Similar – except for Economic Welfare</td>
<td></td>
</tr>
</tbody>
</table>

Source: For business-pressure indicators see Section 5.2; for government leadership indicators see Section 4.2; and for control variables see Appendix 6.1.
Note: Expert interviews were held with regional policy observers at CSIS, World Bank, GTZ and the Ministry of Home Affair (see footnote 102)
Gianyar’s high associative dynamism and education seem to not only facilitate a stronger business pressure but also a stronger local economy. In other words, Gianyar surpasses Karangasem not only in terms of private-sector pressure but also in terms of economic welfare.\textsuperscript{267} While the former displays annual per-capita income of US$ 670 and a poverty rate of 6 percent, the latter falls behind exhibiting income of US$ 400 and a prevailing poverty of 19 percent (see Table A5.1).\textsuperscript{268} All other control factors, however, closely match across the two cases. Both districts display a similar population size (360 and 390 thousand); both exhibit an equal distribution of ethnicity (96+ percent Balinese) and religious affiliation (96+ percent Hindu); both received similar amounts of national transfers (US$ 24 and 28 million); both are ruled by majorities of the PDIP party; and both display, ex post, equal leadership conditions (average of 2.6 and 2.7).

In sum, the data suggest that Gianyar and Karangasem are sufficiently homogenous across most control factors. Gianyar’s higher per-capita incomes (and lower poverty rates) are accepted as a necessary tradeoff for choosing two (among nine) Balinese districts with the highest possible variation in business pressure. According to the business-pressure indicators presented above, firms in Gianyar appear better educated, better informed on district politics, and more strongly engaged in sector-specific associations than their equals in Karangasem. Thus, in light of similar demographic, political and social indicators on one side, and diverging business-pressure indicators on the other, the Balinese district-set provides an apt baseline for examining the impacts of local business pressure.

\textsuperscript{267} The figures appearing in this section are based on statistical government publications from Kebumen and Klaten (BPS Gianyar 2004; BPS Karangasem 2004); as well as additional district statistics for the years 2004 and 2005 obtained from the United Nations Development Program (UNDP 2001).

\textsuperscript{268} The sectoral GDP distribution in 2004 reveals that half of Gianyar’s income accrued from manufacturing and trade (18 and 32 percent) and a quarter from agriculture and government services (19 and 8 percent). In Karangasem the picture is reverse: industry and trade sectors accounted for less than a quarter (7 and 16 percent) and agriculture and government sectors (34 and 16 percent) constituted more than half of regional GDP. A detailed summary of sectoral incomes is presented in Appendix 5.2.
2. Bima and Lotim in NTB

Apart from the business pressure indicators outlined in Chapter 5, Bima and Lotim are virtually homogenous in terms of social, economic and political controls. As shown in Table A5.2 below, both districts display low economic welfare indicators. Per-capita income remains under US$ 250 and roughly a third of each district’s population

Table A5.2: Socio-Economic Characteristics of Bima and Lotim

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Bima</th>
<th>Lotim</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Pressure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Associative Strength</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Literacy/ Schooling</td>
<td>High (82% / 7 yrs )</td>
<td>Moderate (75% / 5.5 yrs)</td>
</tr>
<tr>
<td>Political Awareness</td>
<td>Moderate (72%)</td>
<td>Low (40%)</td>
</tr>
<tr>
<td>Overall Evaluation</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Government Leadership</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business Survey Score</td>
<td>Moderate (3.2)</td>
<td>Moderate (3.1)</td>
</tr>
<tr>
<td>News Coverage</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Expert Interviews</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Overall Evaluation</td>
<td>Moderate in both cases</td>
<td></td>
</tr>
<tr>
<td>Control Variables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Institutional Factors</td>
<td>Identical National Intuitions (formal laws &amp; political architecture )</td>
<td></td>
</tr>
<tr>
<td>Population 2001</td>
<td>505,030</td>
<td>971,22</td>
</tr>
<tr>
<td>National Transfers 2003</td>
<td>US$ 21 million</td>
<td>US$ 25 million</td>
</tr>
<tr>
<td>Annual Per-Capita 2002</td>
<td>US$ 245</td>
<td>US$ 240</td>
</tr>
<tr>
<td>Poverty Rate 2001</td>
<td>34%</td>
<td>37%</td>
</tr>
<tr>
<td>Major Ethnic Group</td>
<td>Mbojo (99%)</td>
<td>Sasak (97%)</td>
</tr>
<tr>
<td>Major Religions</td>
<td>Islam (99%), Christ. (1%)</td>
<td>Islam (99%), Hindu (1%)</td>
</tr>
<tr>
<td>Major Political Parties 1999</td>
<td>Golkar (52%), PPP (9%)</td>
<td>Golkar (44%), PPP (9%)</td>
</tr>
<tr>
<td>Overall Evaluation</td>
<td>Similar – except for population size (and ethnic specification)</td>
<td></td>
</tr>
</tbody>
</table>

Source: For business-pressure indicators see Section 5.2; for government leadership indicators see Section 4.2; and for control variables see Appendix 6.1. Note: Expert interviews were held with regional policy observers at CSIS, World Bank, GTZ and the Ministry of Home Affair (see footnote 102)
lives below the national poverty line. The local economies of both districts are strongly reliant on agriculture. In recent years roughly half of local GDP accrues from agriculture, while manufacturing and trade each contribute more or less a quarter of district incomes.

Except for population size, the remaining social-economic indicators match equally well. First, Bima and Lotim are identical in terms of religious affiliation. In both cases 99 percent of the population declares itself to belong to the Islamic faith. Second, the two districts are comparable on ethnic grounds. Residents are either Sasak (97 percent in Lotim) or Mbojo (99 percent in Bima), which are – from a cross-regional perspective – very similar. Third, national transfers are similar. In 2003, Bima and Lotim received US$ 21 and US$ 25 million, respectively. Fourth, political structures are comparable. After the first Post-Suharto elections in 1999, GOLKAR remained the dominant force occupying approximately half of local parliament seats, followed – by a wide margin – by the Islamic party PPP. And fifth, government leadership proxies are homogenous. The business surveys data verify (ex-post) that perceptions of local leaders are almost identical (scores of 3.1 and 3.2).

Thus, taken as a whole, the indicators presented suggest that Bima and Lotim are closely aligned across standard control factors. At the same time, there is a strong indication that local business pressure is higher in the former compared to the latter case (see Section 5.2). Based on the five business-pressure indicators discussed above, Bima’s private sector seems to be more educated, more alert towards district politics,

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269 The figures appearing in this section are based on statistical government publications from Kebumen and Klaten (BPS Bima 2004; BPS Lombok Timur 2004); as well as additional district statistics for the years 2004 and 2005 obtained from the United Nations Development Program (UNDP 2001).

270 A detailed snapshot of sectoral income distributions in Bima and Lotim is presented in Appendix 5.2.

271 The United Development Party – ‘Partai Persatuan Pembangunan’ (PPP) – was one of the three ‘admitted’ political forces during the Suharto regime. In fact, PPP is the result of an enforced government decree in 1973. Accordingly, four competing Islamic parties were artificially amalgamated into one political unit, which was subsequently labeled the United Development Party (MacIntyre 1999:264-5).
and better represented by local chambers. This concurrence of matching socio-economic and diverging business-pressure indicators, in both the Balinese and NTB cases, constitutes a systematic baseline for analyzing effects of local business pressure.
Figure A5.1: Local Economy and Society in Gianyar and Karangasem

Notes: ceremony for village ancestors in Karangasem (top-left); woodcarving in Gianyar (top-right); cremation ceremony in Karangasem (bottom-right); rice farmers in Gianyar (bottom-left);

Figure A5.2: Local Economy and Society in Bima and Lotim

Notes: Selong Mosque in Lotim (top right; textile home industry in Lotim (top right); Bimanese trader (bottom left); local market in Bima (bottom right).

Source (of all eight images): Author’s pictures taken during field observations in 2005 and 2006
Appendix 5.2
Economic Structures of Selected Case Districts

### Economic Structure in Gianyar and Karangasem

<table>
<thead>
<tr>
<th>Sector</th>
<th>Gianyar Total</th>
<th>Gianyar Share</th>
<th>Karangasem Total</th>
<th>Karangasem Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Sector</td>
<td>471,982</td>
<td>19.5%</td>
<td>480,830</td>
<td>35.2%</td>
</tr>
<tr>
<td>- Agriculture</td>
<td>462,300</td>
<td>19.1%</td>
<td>460,200</td>
<td>33.7%</td>
</tr>
<tr>
<td>- Mining</td>
<td>9,682</td>
<td>0.4%</td>
<td>20,630</td>
<td>1.5%</td>
</tr>
<tr>
<td>Secondary Sector</td>
<td>581,850</td>
<td>24.1%</td>
<td>146,621</td>
<td>10.7%</td>
</tr>
<tr>
<td>- Manufacturing</td>
<td>453,700</td>
<td>18.8%</td>
<td>98,210</td>
<td>7.2%</td>
</tr>
<tr>
<td>- Construction</td>
<td>107,600</td>
<td>4.4%</td>
<td>42,130</td>
<td>3.1%</td>
</tr>
<tr>
<td>- Utilities</td>
<td>20,550</td>
<td>0.8%</td>
<td>6,281</td>
<td>0.5%</td>
</tr>
<tr>
<td>Tertiary Sector</td>
<td>1,364,800</td>
<td>56.4%</td>
<td>738,660</td>
<td>54.1%</td>
</tr>
<tr>
<td>- Trade</td>
<td>759,300</td>
<td>31.4%</td>
<td>213,100</td>
<td>15.6%</td>
</tr>
<tr>
<td>- Private</td>
<td>396,200</td>
<td>16.4%</td>
<td>306,660</td>
<td>22.4%</td>
</tr>
<tr>
<td>- Government</td>
<td>209,300</td>
<td>8.7%</td>
<td>218,900</td>
<td>16.0%</td>
</tr>
<tr>
<td>Total</td>
<td>2,419,000</td>
<td>100.0%</td>
<td>1,366,000</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

### Economic Structure in Bima and Lotim

<table>
<thead>
<tr>
<th>Sector</th>
<th>Bima Total</th>
<th>Bima Share</th>
<th>Lotim Total</th>
<th>Lotim Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Sector</td>
<td>666,770</td>
<td>55.9%</td>
<td>987,850</td>
<td>45.4%</td>
</tr>
<tr>
<td>- Agriculture</td>
<td>630,800</td>
<td>52.9%</td>
<td>893,200</td>
<td>41.1%</td>
</tr>
<tr>
<td>- Mining</td>
<td>35,970</td>
<td>3.0%</td>
<td>94,650</td>
<td>4.4%</td>
</tr>
<tr>
<td>Secondary Sector</td>
<td>110,714</td>
<td>9.3%</td>
<td>347,634</td>
<td>16.0%</td>
</tr>
<tr>
<td>- Manufacturing</td>
<td>34,090</td>
<td>2.9%</td>
<td>161,500</td>
<td>7.4%</td>
</tr>
<tr>
<td>- Construction</td>
<td>74,350</td>
<td>6.2%</td>
<td>180,100</td>
<td>8.3%</td>
</tr>
<tr>
<td>- Utilities</td>
<td>2,274</td>
<td>0.2%</td>
<td>6,034</td>
<td>0.3%</td>
</tr>
<tr>
<td>Tertiary Sector</td>
<td>415,270</td>
<td>34.8%</td>
<td>840,000</td>
<td>38.6%</td>
</tr>
<tr>
<td>- Trade</td>
<td>174,800</td>
<td>14.7%</td>
<td>337,200</td>
<td>15.5%</td>
</tr>
<tr>
<td>- Private</td>
<td>121,970</td>
<td>10.2%</td>
<td>269,600</td>
<td>12.4%</td>
</tr>
<tr>
<td>- Government</td>
<td>118,500</td>
<td>9.9%</td>
<td>233,200</td>
<td>10.7%</td>
</tr>
<tr>
<td>Total</td>
<td>1,193,000</td>
<td>100.0%</td>
<td>2,175,000</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Sources (both tables): data from the Indonesian Central Bureau of Statistics (BPS) and the World Bank; presented values refer to the gross national product in 2004 (current prices) in million Rps.
Appendix 6.1
Data Sources for Regression Analyses

<table>
<thead>
<tr>
<th>Variable</th>
<th>Data Sources</th>
<th>Obs.</th>
<th>Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Individual-Level Data</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>License Administration t</td>
<td>KPPOD 2005 Business Survey</td>
<td>8565</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td>Business Permit Bribes t</td>
<td>KPPOD 2005 Business Survey</td>
<td>846</td>
<td>000' Rps</td>
</tr>
<tr>
<td>Public Tender Fairness t</td>
<td>KPPOD 2005 Business Survey</td>
<td>8273</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td>Business Pressure *</td>
<td>KPPOD 2005 Business Survey</td>
<td>8038</td>
<td>Perception [1-9]</td>
</tr>
<tr>
<td><strong>District-Level Data</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Local Regulations *</td>
<td>KPPOD Desk Review</td>
<td>178</td>
<td>Perception [1-5]</td>
</tr>
<tr>
<td>Per-Capita Income</td>
<td>Indonesian Ministry of Finance</td>
<td>328</td>
<td>000' Rps</td>
</tr>
<tr>
<td>National Per-Capita Transfers</td>
<td>Indonesian Ministry of Finance</td>
<td>306</td>
<td>000' Rps</td>
</tr>
<tr>
<td>State Party Majority (GOLKAR)</td>
<td>Indonesian National Election Commission</td>
<td>440</td>
<td>Dummy [0,1]</td>
</tr>
<tr>
<td>Reform Party Majority (PDIP)</td>
<td>Indonesian National Election Commission</td>
<td>440</td>
<td>Dummy [0,1]</td>
</tr>
<tr>
<td>School Education</td>
<td>UNDP Human Development Index</td>
<td>369</td>
<td>Years</td>
</tr>
<tr>
<td>Ethnic Homogeneity</td>
<td>Indonesian Central Bureau of Statistics</td>
<td>372</td>
<td>Percent</td>
</tr>
<tr>
<td>District on Java</td>
<td>Indonesian Central Bureau of Statistics</td>
<td>440</td>
<td>Dummy [0,1]</td>
</tr>
<tr>
<td>District is Urban</td>
<td>Indonesian Central Bureau of Statistics</td>
<td>440</td>
<td>Dummy [0,1]</td>
</tr>
</tbody>
</table>

Note: KPPOD refers to the ‘Indonesian Regional Autonomy Watch’; UNDP to the United Nations Development Program; dependent variables are marked with a cross (†) and independent variables with an asterix (*); the last eight indicators in the district-level data are economic, political, social and geographical control variables which are used in both district-level and individual-level analyses;
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