

Intergovernmental Relations and the Dynamics of Local Revenue Mobilisation in a Decentralised Indonesia

by

Bella Rifaldi

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Abstract

This thesis investigates how local revenue mobilisation is affected by the institutional arrangements governing decentralisation through a case study of Indonesian local government. It establishes the expectations and scope of local autonomy in the country through analysis of the rules and regulations affecting decentralisation and intergovernmental relations. It then examines specifically the impact of the devolution of revenue-raising powers on local own-source revenue in the 2011-2013 period as an example of increased local autonomy. Lastly, through interviews of central officials and local officials in two individual municipal case studies, the study reveals the factors and considerations which shape the use of new revenue-raising powers alongside other existing sources of local revenue such as intergovernmental transfers.

The findings show evidence of the impact of devolution of property tax on local revenue mobilisation in Indonesia and how contextual and institutional factors affect the local revenue mobilisation process. Changes in the institutional arrangements governing decentralisation in Indonesia from the year 1999 to 2015 provided local governments with an increased autonomy over policy making and financial resources, yet those changes still left a room for central control in the name of maintaining the unitary state and promoting the centrally-led development planning agenda. Within these institutional arrangements, the devolution of property tax in the 2011-2013 period increased the proportion of own-source revenues and average local own-source revenues per capita in the municipalities implementing the reform, despite an increase of central transfers in the same period. Evidence from the interviews showed that despite the positive effect of devolution on revenue mobilisation the rules regarding the allocation and use of central transfers have lessened the impact of that below its maximum potential. Local revenue mobilisation is conditioned by the extent

of mismatch between activities driven by local preferences and activities promoted by central policy makers.

The findings of this thesis contribute to the literature by showing that in this case study of Indonesia, the devolution of revenue-raising powers increased local revenue mobilisation although this increase was limited by the rules governing intergovernmental transfers and central-local relations in decision making processes. In particular, central control over human resources reduced the impact of devolution of property tax, which show that local revenue mobilisation is also lessened by the lack of autonomy municipalities work under in decision making concerning human resources. The thesis also shows a nuanced picture about local autonomy in Indonesia, where there is room for local decision makers to influence central government's decisions regarding the use of central transfers. The results from this study provide support for a more detailed analysis in institutional arrangements governing decentralisation in future studies to better understand the scope of local autonomy which can affect decentralisation outcomes.

To the memory of my dear mother, Syahridal, and my dear aunt, Noviati,
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List of Abbreviations

ABRI	<i>Angkatan Bersenjata Republik Indonesia</i> (the Indonesian armed forces)
APBD	<i>Anggaran Pendapatan dan Belanja Daerah</i> (annual budget of subnational government)
APBN	<i>Anggaran Pendapatan dan Belanja Negara</i> (annual budget of the central government)
BKN	<i>Badan Kepegawaian Negara</i> (the National Civil Service Agency)
BPKP	<i>Badan Pengawasan Keuangan dan Pembangunan</i> (the Financial and Development Supervisory Agency)
BPK-RI	<i>Badan Pemeriksa Keuangan Republik Indonesia</i> (the Supreme Audit Agency in Indonesia)
BUMN	<i>Badan Usaha Milik Negara</i> (state-owned enterprise)
COVID-19	Coronavirus disease 2019
DBH	<i>Dana Bagi Hasil</i> (Revenue Sharing Fund)
DAK	<i>Dana Alokasi Khusus</i> (Special Allocation Fund)
Dati I	<i>Daerah Tingkat I</i>
Dati II	<i>Daerah Tingkat II</i>
DAU	<i>Dana Alokasi Umum</i> (General Allocation Fund)
DKI	<i>Daerah Khusus Ibukota</i> (a designation for Jakarta, the capital city)
DKY	<i>Dana Keistimewaan Yogyakarta</i> (Yogyakarta Special Fund)
DOK	<i>Dana Otonomi Khusus</i> (Special Autonomy Fund)
DPD	<i>Dewan Perwakilan Daerah</i> (the Regional Representative Council)
DPR	<i>Dewan Perwakilan Rakyat</i> (the People's Representative Council)

DPRD	<i>Dewan Perwakilan Rakyat Daerah</i> (legislative body at provincial and municipal level)
FGFF	First generation theory of fiscal federalism
GDP	Gross Domestic Product
Golkar	<i>Golongan Karya</i>
GRDP	Gross Regional Domestic Product
INDO-DAPOER	Indonesia Database for Policy and Economic Research
Inpres	<i>Instruksi Presiden</i>
JDIH	<i>Jaringan dan Dokumentasi Informasi Hukum</i> (online database of laws and government regulations)
Kemensetneg	<i>Kementerian Sekretariat Negara</i> (Ministry of State Secretariat)
MDG/MDGs	Millennium Development Goal/Goals
MPR	<i>Majelis Permusyawaratan Rakyat</i> (the People's Consultative Assembly)
Musrenbangnas	<i>Musyawarah Perencanaan Pembangunan Nasional</i> (national development planning meeting)
NGO/NGOs	Non governmental organisation/organisations
PBB-P2	<i>Pajak Bumi dan Bangunan - Pedesaan dan Perkotaan</i> (a type of property tax)
PBB-P3	<i>Pajak Bumi dan Bangunan - Perkebunan, Perhutanan, dan Pertambangan</i> (a type of property tax)
PDI	<i>Partai Demokrasi Indonesia</i>
Perpres	<i>Peraturan Presiden</i> (presidential regulation)
Perpu	<i>Peraturan Pemerintah Pengganti Undang-Undang</i> (special government regulation)
PP	<i>Peraturan Pemerintah</i> (government regulation)
PPh	<i>Pajak Penghasilan</i> (income tax)

PPP	<i>Partai Persatuan Pembangunan</i>
RKP	<i>Rencana Kerja Pemerintah</i> (annual development plan)
RPJMN	<i>Rencana Pembangunan Jangka Menengah Nasional</i> (medium-term development plan)
RPJPN	<i>Rencana Pembangunan Jangka Panjang Nasional</i> (long-term development plan)
SDG/SDGs	Sustainable Development Goal/Goals
SDO	<i>Subsidi Daerah Otonom</i>
SGFF	Second generation theory of fiscal federalism
SOE/SOEs	State-owned enterprise/enterprises
TP	<i>Tugas Perbantuan</i>
UN	United Nations
UN-HABITAT	United Nations Human Settlement Programme
UU	<i>Undang-Undang</i> (laws derived from the constitution)
UUD	<i>Undang-Undang Dasar</i> (the constitution)

1 Institutions, Intergovernmental Relations and Revenue Mobilisation at Subnational Level: An Introduction

Domestic revenue mobilisation has been an important agenda in development as it relates to sources of financing to fund development efforts across the world. There have been capacity building initiatives promoted in various parts of the world to improve domestic revenue mobilisation. The support comes in different areas of reform related to taxation, such as taxation and revenue policy, campaigns to increase compliance, usage of information and communication technologies, and judicial disputes (Junquera-Varela *et al.*, 2017). There are also various development projects supported by international financial institutions, such as the World Bank and the Asian Development Bank, which aim to strengthen domestic resource mobilisation, both at national and subnational level.

Some countries encounter challenges in domestic revenue mobilisation and these challenges has been linked to various factors. Domestic revenue mobilisation can be affected by economic structure or political institutions, both of which are factors specific to each country (Besley and Persson, 2014). These country-specific factors are usually developed as responses to the contextual situation in the country and sustained as long as they can fulfil their objectives. Challenges are not only encountered in revenue mobilisation at national level, there are also impediments for revenue mobilisation at subnational level (Gadenne and Singhal, 2014; Smoke, 2014). Subnational governments have a relatively limited discretion compared to government at national level, which encourage a suggestion to provide subnational governments with greater revenue-raising powers. More revenue-raising powers is

expected to enable subnational governments to collect more revenue from inside their jurisdiction.

While there has been an interest in giving greater revenue-raising powers to subnational governments, practices vary between countries. Each country has its own system in organising levels of government and the relationship between government at different levels. In some countries, central governments retain a significant degree of control over political and fiscal matters under a decentralised government system (Bhatti and McDonald, 2020). This has implications for the scope of activities which can be carried out by subnational governments, and particularly on their fiscal decisions. Therefore, at subnational level, revenue mobilisation can potentially be affected by constraints from the institutional arrangements governing intergovernmental relations in each country.

This study examines institutional and contextual factors which influence subnational revenue mobilisation and how those factors interact with revenue-raising efforts at subnational level. The section that follows explains the significance of local government in relation to the efforts of countries to achieve global goals in development. The section after that introduces the context of Indonesia, the country where this study is situated. It is followed by the research questions which guide this study in investigating subnational revenue mobilisation. Then, the next section discusses the scope of this study, including the period with which this study is concerned. The last section in this chapter outlines the structure of the thesis.

1.1 Financing Sustainable Cities and Communities

The role of government in facilitating development has been acknowledged in the global discourse on development. Countries in the United Nations (UN) have promoted global goals as a reference for governments and development actors around the world since 2000. From 2000 to 2015, these global goals are presented as

Millennium Development Goals (MDGs). Currently, there is a new set of global goals being promoted as Sustainable Development Goals (SDGs), which also serves as a continuation from the MDGs. Both MDGs and SDGs look to engage governments around the world to play their roles to facilitate better economic and human development through various indicators (Sachs, 2012; Assefa *et al.*, 2017). In line with this, the role of local governments has been discussed as well to support the fulfilment of SDGs (Guha and Chakrabarti, 2019; Jones and Comfort, 2020). This is because many activities related to SDGs are situated at local level, where local governments can play an important role.

Local governments have played an increasing role in different sectors of development, such as education and health. Many decisions regarding education intervention for example necessitate involvement of local actors, either as champions of reform or as an important part in service delivery. For example, Levy *et al.* (2018) argues that many important processes and influential actors in public service delivery of education in South Africa are located in schools, or at local level. Interventions intended to improve learning, therefore, should not neglect school-level dynamics. Chukwu and Nnogo (2022) finds that issues at local level, such as inadequate human and financial resources, are attributed by stakeholders to the lack of improvement in the health sector in Nigeria. It has been argued for some time that government at local level is positioned in the frontline of service delivery, with the potential to be responsive and accountable to the citizens and service users (World Bank, 2003). Achieving the global goals in SDGs will need the support of local governments and local leaders.

The realisation of the role of local governments in achieving objectives of SDGs translates into efforts to mainstream the global goals into the local level. Government at national level still plays an important role in adopting and adapting issues relating SDGs into each country, but there is a further need to continue the

process of adoption and adaptation to local level so that it can find alignment with existing local priorities. That can be challenging because there is a contextual variation at local level which can influence implementation, such as in capacity and finance. Croese *et al.* (2021) argue that the interdependence between central and local governments and multi-level governance framework are important factors which can influence the success of the localisation of SDGs. In their country case studies, they find variation across countries in terms of the role of central and local governments to national development policy. Jönsson and Bexell (2021) point out that clarity of responsibility between central and local governments can help SDGs to be more easily adopted. Clarity of responsibility between different levels of government helps define which level of government is responsible to which activity and facilitates implementation of activities relating the SDGs.

While the SDGs comprise various goals across different sectors, urban development as one of its goals is particularly related to local governments' activities. The urban area has received an increasing global attention for decades, where the formation of United Nation Human Settlements Programme (UN-HABITAT hereafter) in 1978 can be considered as an international landmark. With regards to the SDGs, the UN General Assembly mandated the UN-HABITAT to promote the development of sustainable cities and communities. This attention to urban development is also formally articulated in SDG 11: make cities and human settlements 'inclusive, safe, resilient and sustainable'. The targets for SDG 11 include housing and public services, transport systems and waste management. All of these targets are important for local governments, and are key to local governments' achieving SDG 11.

Even so, there is a different interplay of contextual factors at local level, across different countries and within each country, which can be influential to the achievement of SDGs. In each country, a particular structure of government can be found, responding to various political and economic needs within the country. Hooghe

et al. (2016) note that physical characteristics of a jurisdiction in a country can be associated to variation in population and area and whether minimising or maximising variation in population and/or area is deemed to be beneficial by decision makers. It can have implications for policy making at local level as local decision makers engage with heterogeneity of preferences at local level, which in turn can be affected by the degree of variation in the population or area. Moreover, jurisdictions at local level can have variation in natural resource endowments which then can result in variation in economic development between those jurisdictions. Control of resources can be withheld by the government at national level to facilitate redistribution or to address political motives (Diaz-Cayeros, 2006; Diaz-Rioseco, 2016). Those types of contextual factors can affect the roles played by central and local governments in the country, and are expected to influence how SDGs are addressed in the country. Localisation of SDGs can be harder if the local governments do not have sufficient authority to address issues at local level.

As local governments have a key role in achieving SDGs, particularly SDG 11, they need to be supported by adequate resources. Local government financing has been discussed as an important factor by both academics and practitioners alike (Kamiya and Zhang, 2016; Platz *et al.*, 2017). In many cases, local governments lack financial resources which affects their ability to address various issues relating SDG 11 and public service provision which also corresponds to other targets of SDGs (UN-HABITAT, 2015). Therefore, many exercises to explore opportunities to improve local governments revenue mobilisation have been carried out. Such explorations have led to a range of policy recommendations (Bird, 2010; Bird and Slack, 2014; Burbidge and Cheeseman, 2016). However, different contexts may require different solutions, and different policy environments may be more receptive to some policies than others (Andrews, 2012). The point on which many agree is the importance of local government financing, but there is less agreement on how this may be improved.

This idea of the importance of local government financing resonates with recent studies in the literature which relate government revenue-raising activities with its accountability. Some have argued that actors in government respond differently to various sources of revenue (Moore, 2018). Governments which depend more on their citizens, through taxation, for their financing mix will be more likely to engage in a sort of ‘bargaining’ process with their citizens (Moore, 2008; Prichard, 2015). This view also resonates with a previous study which links leaders’ provision of accountability and limiting their discretionary power with their need to collect revenue from citizens (North and Weingast, 1989). Conversely, governments which have significant access to alternative sources of revenue other than by taxing their citizens, like from natural resources (van der Ploeg, 2011), may feel less obliged to pay attention to the views of their citizens. While these studies observe government revenue-raising activities and accountability at national level, more studies have been increasingly carried out to examine this issue at subnational level.

Compared to what is available at the national level, potential revenue sources at the subnational level are relatively more limited and can be affected more easily by issues of spillover and mobility, which add another layer of complexity to revenue mobilisation. In the literature, there is a concept of ‘partial decentralisation’, where subnational governments are not given enough autonomy in terms of managing revenue sources, which then can influence their accountability to their citizens (Devarajan *et al.*, 2009; Brueckner, 2009). In that respect, giving subnational governments more power to mobilise revenue is viewed as one possible way to enhance their accountability, possibly by prompting citizens to be more critical of their governments’ policies. Even so, types of revenue and the extent of power to be devolved are still subject to debate, with different countries adopting different arrangements, and can be highly influenced by contextual factors. There have been suggestions in the existing literature regarding principles to follow regarding

subnational revenue management, but fully following those principles can be challenging in some countries (Bird, 2010; Smoke, 2014).

Ideas to improve local governments' revenue mobilisation at times clash with other goals of policy makers, which may force countries to deviate from following the principles for subnational revenue mobilisation discussed in the literature. The literature on decentralisation and on development has provided reasons to let central government retain a significant control of the overall government operation. Prud'homme (1995) discusses many things which can go wrong with greater decentralisation to local governments, such as regional inequality, reduced fiscal stability, and decreased efficiency. Cox *et al.* (2019) show that a particular organisation of government may not be desirable from a financial point-of-view, but this may be outweighed by advantages in reducing violence. Similarly, Whitfield and Buur (2014) show that countries engaging in active economic intervention may need to have central policy makers making the final decision. The results of the political decisions in weighing these various goals are reflected in the structure of government and overall policy making processes. Therefore, efforts to expand local revenues will take place within this structure and processes, which then will influence their likelihood of success and result in variation of outcomes between countries.

Therefore, local governments across the world will face challenges related to availability of financing. Some of these challenges are expected to come from governments both at national and subnational level. It is possible that central government is reluctant to provide subnational governments with adequate revenue instruments, as that could work against central government interest in national policy outcomes and could also induce competition over tax bases between different levels of government. Another possibility is that subnational governments do not make sufficient use of the revenue instruments under their authority, in relation to the investments they need to use those revenue instruments and the unpopularity of such

investments. This matter affects the political economy dynamics involving politicians, government officials, and citizens, which will influence decisions at national and subnational levels.

At subnational level, there is a need to understand both the incentives are for revenue mobilisation and feasible sources of revenue. There is a theoretical contention that decentralisation incentivises subnational governments to develop prosperity and mobilise revenue within their jurisdiction (Weingast, 2009). This contention is based on the second generation theory of fiscal federalism. Fiscal policy decisions in a subnational government are viewed as being sensitive to the incentives faced by subnational leaders (Weingast, 2009; Weingast, 2014). While subnational own-source revenue is seen as holding significance in the potential of greater responsiveness and accountability, how decentralisation is designed and implemented is also crucial considering that this will affect incentives for each level of government (Faguet, 2012; Pöschl and Weingast, 2015). A recent review on subnational revenue systems gives further emphasis on the importance of understanding political economy factors affecting the system (Smoke, 2014). The literature implies that the design of a decentralised system will need to consider the ability to foster subnational revenue generation and to be cautious of arrangements where expenditure is more decentralised than revenue, which then can influence accountability at subnational level (Rodden, 2019).

Decentralisation design entails defining and specifying scope of authority between different levels of government and interactions between those governments. This can vary in different countries, and each country will likely have a specific arrangement. Examining institutions that govern intergovernmental relations is one way to shed light on the detail of subnational autonomy and the choices available for subnational political leaders (Oates, 2008; Weingast, 2008). Institutional arrangements governing relationship between central and local governments structure

the possible decisions for policy makers and how their counterparts at different levels of government may respond to those decisions.

1.2 Introducing the Case of Indonesia

Indonesia's shift toward decentralisation can be considered to be driven by political factors following the fall of Soeharto's regime in 1998 (Hadiz, 2010). Under Soeharto, the government was highly centralised, with subnational leaders supervised and held accountable by their central counterparts. That centralised form of government resulted in a high degree of patronage in Indonesia's political system, extractive policy for natural resources, and unequal development among Indonesia's regions, with most of the development initiatives concentrated on Java island (Hadiz, 2010). After the regime had changed, there was a strong call for decentralisation throughout the country, which was also in line with the "good governance" agenda promoted by international development organisations, such as the World Bank (Hadiz and Robison, 2005). Decentralisation became an agenda of reform in Indonesia, and was regarded as a high priority in a period of unrest characterised with high risk of separatism in regions such as Aceh and East Timor (Bardhan and Mookherjee, 2006, pp. 81-124).

Between the period of 1998-2011, Indonesia experienced a large number of territorial splits and proliferation of new municipalities. Fitriani *et al.* (2005, p. 58) noted an increase in the number of municipalities outside Jakarta from just below 300 to more than 430 municipalities between the year 1998 and 2004. Meanwhile, Firman (2013) also notes the increase from 27 to 33 provinces and from 298 to 493 municipalities in the period between the year 1999 and 2011. The expansion in the number of subnational units can be considered to be motivated by various kind of reasons, but some argues that increased access to financial resources for subnational political leaders to be a primary motivation (Fitriani *et al.*, 2005, pp. 62-75). Financial factors are an issue because the policy to extract natural resources which was practiced

by the Soeharto regime left some regions feeling unfairly treated. Furthermore, the study by Firman (2013, p. 190) argues that the creation of new subnational governments does not translate into better development, because it is captured by the interest of subnational political elites with self-interested motives. Hadiz (2010) also suggests that Indonesian politics during the early period of decentralisation still showed characteristics of patronage and rent-seeking behaviour. Therefore, decentralisation in Indonesia may not result in better governance, as the implementation of decentralisation can vary across the regions.

Currently, there are two levels of subnational government in Indonesia which have substantial autonomy to manage policy making and financial resources. First, the provincial government is the immediate level below the central government. Second, the municipal government is the lowest level, which is usually referred as the local level. This multiple levels of government in Indonesia do not reflect a fully hierarchical relationship between different levels of government. Subnational leaders in both levels are elected by the citizens inside the jurisdiction.

1.2.1 Expenditure and revenue assignments in a decentralised Indonesia

Fiscal decentralisation in Indonesia has been noted to be more advanced in the expenditure side than in the revenue side. When the Indonesian government started to adopt nation-wide decentralisation in 1999, subnational governments were assigned responsibilities and authorities in many sectors, such as education and health, also with more responsibilities in various other sectors. The central government retained its authority only in a limited number of sectors, such as foreign affairs, defence and security, judiciary, fiscal and monetary policy, religion, planning, intergovernmental transfers, public administration, human resources in the public sector, natural resource utilisation, and advanced technology. Consequently, there was an increase in the expenditure assignment for each level of government. This

substantial expenditure assignment resulted in more than 75% increase in subnational expenditure between the years 2000 and 2001 (Fitriani *et al.*, 2005).

Other than its financial impact, there was a question about the capacity of subnational governments to provide public goods and services, because the central government had played a major role in decision making process (Alm *et al.*, 2001). The law regulating decentralisation in Indonesia underwent changes in the 1999-2015 period, with further consequences to the authority of central and subnational governments and intergovernmental relations. While subnational governments experienced an expansion in their roles and sectoral responsibilities, the central government still has room to influence policy making at subnational level, for the purpose of promoting the national development agenda and policy coordination (Guess, 2005). Moreover, the central government still retains authority on human resources management in the government.

In contrast with the expenditure side, revenue assignment in Indonesia's decentralisation has taken a different emphasis. In the early phase of decentralisation in Indonesia, major sources of revenue with large tax base such as income tax, property tax, and value added tax were retained under the control of the central government (Alm *et al.*, 2004). The subnational governments, on the other hand, were given some freedom to propose and formulate new revenue instruments under their jurisdiction, as long as they do not target the same tax base as the central government. This flexibility had another implication, however, as subnational governments created many new taxes and charges in response to their increased responsibility after decentralisation (Lewis, 2003b). Because of the adverse effects of such taxes and charges to business and investment climate, many of the new taxes and charges were cancelled by the central government.

Administrative inefficiency was also a concern which hindered subnational taxation. Lewis (2006, pp. 227-230) estimates that the administrative cost of levying

taxes is more than 50% of the amount of tax levied. Related to the issue of inefficiency, another analysis by Simanjuntak and Mahi (2004, pp. 122-124) considers to abolish some local taxes which cause nuisance to local citizens and businesses and to improve local capacity for revenue administration as two possible actions for reform. But they also suggested possible reassignment of some taxation powers from central to subnational governments and better administration of user charges. These measures were expected to improve revenue situation at subnational level (Simanjuntak and Mahi, 2004, pp. 124-125). In 2009, the central government devolved the authority to manage property tax from the central government to municipalities. This reform was expected to provide municipalities with new revenue-raising powers.

1.2.2 Intergovernmental transfers in a decentralised Indonesia

There are three main types of intergovernmental transfers according to the regulation: 1) General Allocation Fund (*Dana Alokasi Umum/DAU*); 2) Special Allocation Fund (*Dana Alokasi Khusus/DAK*); and 3) Revenue Sharing Fund (*Dana Bagi Hasil/DBH*). While each type of intergovernmental transfers has its own unique set of objectives, the impact it causes may not be fully accounted for in those objectives. For instance, Firman (2003) analyses the impact of intergovernmental transfers in the period 2000-2003, pointing out that the DAU and DBH might actually broaden fiscal disparities between subnational governments. He suggests further that some subnational governments 'receive large or at least sufficient transfer from revenue sharing', and as such, 'might merit no DAU payments at all' (Firman, 2003, p. 268). An analysis from Lewis (2014) shows that DAU still fills a significant portion of subnational governments' revenue. On the other hand, own-source revenue showed no significant improvement in the period 2001-2009, which is similar with the result of a previous analysis in Lewis (2005).

The characteristics of each type of transfer merit further attention. First, DAU has no specific conditions on its use, so subnational governments have discretion in

terms of using the fund. The amount of DAU transferred to a subnational government (a province or municipality) is determined using a formula. Because the main objective of DAU is to close the fiscal gaps, every subnational government receives the DAU (Brodjonegoro and Martinez-Vazquez, 2004). Second, DAK is a type of conditional grant, where subnational governments need to follow the regulation on the condition to use the fund. The main objective of DAK is to promote subnational expenditure on priority sectors, and also ‘addressing externalities across regional governments’ (Brodjonegoro and Martinez-Vazquez, 2004, p. 167). Because of its objectives, DAK is often tied to particular sectoral spending, depending on the development priorities being promoted at the time. Third, DBH is a transfer based on revenue sharing mechanism. There are three kinds of taxes associated with DBH, which are ‘natural resource taxes, personal income taxes, and property taxes’ (Brodjonegoro and Martinez-Vazquez, 2004, p. 161). In the 2004 decentralisation law, types of natural resource which are used in the calculation of DBH are forestry, general mining, fishery, oil, gas, and geothermal.

Public finance and service delivery at subnational level in Indonesia have been discussed by a wealth of literature (Hill, 2014), yet there are still many dimensions that need to be analysed, especially because of the incremental changes witnessed on the effect of government’s policies (Lewis, 2010). One of these dimensions is in regards of subnational revenue mobilisation. The significance of this dimension has also been reflected in media coverage. That is one of the factors which motivates this research. Existence of concern regarding the issue both in the academic and policy domains is another factor which motivates this study.

Indonesia is suitable as a case study for investigating this topic based on several reasons. First, Indonesia has devolved land and building tax to subnational governments through a 2009 change in law. Prior to the enactment of that law, land and building tax had been administered by the central government. This devolution

of land and building tax will provide data for analysing the research questions proposed in the previous section. Second, it has been two decades since decentralisation reform was enacted in Indonesia. Decentralisation has become an issue which receives high and constant attention, not only from academics, but also from policymakers and civil society in Indonesia (Jaweng, 2014). This prominence can help possible data availability across research networks and user groups, and also help access to the data in the government.

Third, there has been a vast and diverse literature on Indonesia's decentralisation and subnational fiscal behaviour, albeit with limited attention on some areas. For example, despite an increasing number of empirical studies considering 'political economy factors underlying local government fiscal behaviour and performance', those factors 'received limited formal attention in Indonesia (Eckardt, 2008; Lewis, 2010; Skoufias *et al.*, 2011)' – cited in (Lewis and Smoke, 2017, p. 135). There are ambiguous results from recent studies, Skoufias *et al.* (2011) and Skoufias *et al.* (2014), on the effect of electoral reforms on subnational revenue generation, which indicate a puzzle either in the context of reform or revenue generation. Fourth, given the substantial body of existing research on Indonesia's decentralisation, there is a wealth of studies that provide counterfactuals or further evidence related to this research. Previous studies can support the unpacking of causal processes involved in the revenue reform by providing a list of observations as a point of identification for possible causal processes.

Finally, local governments in Indonesia have been provided with autonomy in managing both expenditure and revenue since 1999, and it is important to know how that autonomy has been used across subnational units. Subnational autonomy is structured by various rules governing decentralisation, which can affect how this autonomy is used. It is possible that this autonomy is not used to its potential. It is also possible that there is uneven implementation between subnational units.

Investigating this issue further can extend our understanding on factors which can influence decentralisation outcomes, especially the ones which are affected by the institutions governing decentralisation.

1.3 Research Questions

This research investigates how changes in the institutional arrangement of subnational taxation can affect subnational revenue mobilisation. It argues that devolution of power to raise revenue will affect local governments' choices between alternative revenue sources, subject to contextual factors, and this analytical framework can be used to explain revenue outcomes. Therefore, in order to pursue this question the processes which influence revenue mobilisation can be set out. The main research questions proposed are as follows:

1. What is the impact of devolution of revenue-raising power on local revenue mobilisation in Indonesia?
2. How do the institutional arrangements regarding decentralisation and contextual factors in Indonesia influence the impact of devolution of revenue-raising powers on local revenue mobilisation?

The first research question aims to understand the extent of impact from the devolution of property tax in Indonesia on local own-source revenues. This devolution of property tax provides governments at local level with new revenue-raising power in addition to their existing revenue sources. With this new revenue-raising power, local governments have another financing option at their disposal and it is important to understand how they decide to use it. Decision regarding the use of this power is likely to vary between local governments in Indonesia, as not all local governments immediately demonstrate readiness to undertake the reform. The average effect of the reform, therefore, can be different from the prediction of policy makers and observers. Local governments have various financing alternatives which can affect the

significance of property tax and other own-source revenues in the local government budget.

It is important to empirically assess the impact of this kind of devolution because the existing evidence in different country contexts so far has been mixed. Each country is likely to have particular institutional arrangements which govern the relationship between central and subnational governments and they are argued to shape decision making processes in both levels of government. Some countries can give relatively more power to the central government to intervene in subnational policy, which may decrease the importance of subnational fiscal autonomy. Local governments are situated close enough to the citizens and service users to receive feedback, but local governments can only provide responses in accordance with their scope of authority as defined by the institutional arrangements. Therefore, the influence of institutional arrangements governing decentralisation need to be investigated to understand more about local revenue mobilisation, which leads to the second research question.

The second research question aims to understand how factors in the policy making environment shape decisions regarding local revenue mobilisation in Indonesia. The new reform exerts a change in the institutional arrangements of decentralisation in Indonesia which affect intergovernmental relations between central and local governments. The change is expected to affect and be affected by other existing institutions which structure intergovernmental relations, such as fiscal and political institutions. As this change relates to multiple dimensions of decision making, politicians and decision makers will face different available alternatives as a result of the reform, and it is important to know how these actors consider and act upon the new available option amidst all other decision points and constraints they face.

1.4 Scope of the Study

This study examines decentralisation in Indonesia in the 1999-2015 period when a series of key decentralising policies were introduced. As explained in Section 1.2, the Indonesian decentralisation system comprises three main levels of government: central government, provincial government, and local government. The level of government in which this study is interested is the local level where *kabupaten* and *kota* is located, which is also the target of the devolution of revenue-raising powers. The devolution was initiated by the enactment of a new law on subnational taxes and charges in 2009, and was implemented by the local governments in the 2011-2014 period. This devolution is intended to provide more control to local governments on property tax management. This thesis uses the term municipalities or municipal government to refer to *kabupaten* and *kota*, and use the term province or provincial government to refer to *provinsi*.

Secondary data relating institutional arrangements of decentralisation, public finance, social and economic indicators during the period is collected and analysed. Primary data on actors' observation relating the implementation of decentralised system and revenue mobilisation is collected and analysed. As such, the availability of data and observations may differ between years in the period of observation, and there are possible gaps. Efforts have been done to mitigate the effect of these gaps, including by comparing between different types of data and comparing with observations and analyses done by others.

1.5 Structure of the Thesis

This thesis comprises seven chapters which discuss various elements of the research. Chapter 1 discusses the background of the research and introduces the country where the study is located. It discusses the importance of government at local level and its financing in achieving the objectives of the Sustainable Development Goals. Aside

from the role local governments play in various sectors such as provision of health and education, the local governments are also objects of SDGs, especially relating to developing sustainable cities and communities. There was an overview of Indonesia as the context of the research in this study. Next, it presents the research questions and scope of the study, before presenting the structure of the thesis.

Chapter 2 reviews the literature and discusses the relevant theoretical considerations for the study. It draws upon literature on fiscal federalism, decentralisation and institutions to develop the theory which underpins this research. The theory of fiscal federalism has developed from its early discussion some decades ago to the current state of discussion. There has been a discussion on incentives faced by subnational leaders which may not always act for the social welfare in the jurisdiction but can also pursue their self interests. Institutions are argued as important aspects which structure the relationship between individuals in the central government and local governments.

Chapter 3 elaborates on the methodology and design of the research. The chapter presents the research philosophy and justifications for the methodological decisions in this research. The philosophical position of the researcher affects the assumptions and theories used in this research. Then, it further explains about the quantitative and qualitative analyses which are used in the study. The decision to use mixed methods in this study is driven by the varying information which each method can provide which can complement the evidence obtained from using the other method. Moreover, the chapter also addresses issues regarding research ethics and offers some reflections on data collection. All of the elements discussed in the chapter guide the implementation of the research.

Chapter 4 analyses the institutional arrangements governing decentralisation in Indonesia and discusses the scope of local decision making in the fiscal and political spheres. There can be cases where the written rules have gaps from the

implementation of the rules. It is therefore useful to define and analyse the boundary of decision making which was organised by the rules. The chapter takes a periodic approach to make it easier to distinguish different scope of local decision making throughout the years. From there, this chapter discusses how the institutions change over time and how that change modifies central-local relations.

Chapter 5 presents the quantitative analysis on the secondary data used in this study. The chapter discusses the variables used and discusses various results from the econometric analysis and robustness checks. The analysis carried out in the chapter is a quantitative analysis to reveal patterns and regularities regarding subnational revenue mobilisation. The main analysis examines the impact of the devolution of property tax in Indonesia to the municipalities implementing the reform. The results of the analysis are complemented with various checks which objectives are to support the validity of the results. The analysis shows the impact of devolution while under a certain institutional arrangements governing decentralisation in Indonesia.

Chapter 6 analyses the views of central and local actors based on interviews and secondary data. The presentation of the chapter emphasises the themes which appear in the theoretical discussion and which emerge from the interviews. It discusses observations from central and local level to explain how institutional and contextual factors facilitate or restrain the effects of reform. The experience of people in the field (or people who directly interact with the process) is apparent to be valuable in answering the research questions. The secondary data in this chapter complements the evidence from interviews and also enable triangulation between two different methods.

Chapter 7 summarises the findings from the previous chapters and presents a discussion on the research questions. The findings of this study provide answers to the research questions posed in chapter 1. The author then identifies and discusses contributions from the research, policy implications, and outlines some areas where

future research can be done. Contributions from the research consider the empirical, theoretical and methodological dimensions. The policy implications outlined in chapter 7 show some ideas which can be considered by policy makers engaging with decentralisation. The chapter then concludes with a presentation of areas where there can be further conversations and engagements with the topic discussed in this study.

2 Theorising Institutional Influence in Subnational Revenue Mobilisation

This chapter provides a theoretical framework to analyse the influence of intergovernmental institutions on subnational revenue mobilisation. The analysis draws on theoretical discussions and empirical evidence on decentralisation, institutions, and subnational autonomy. Politicians and policy makers are at the centre of fiscal policy making process, hence factors which affect their autonomy and perceived accountability shape their decisions on subnational revenue mobilisation. Intergovernmental institutions organise and structure the interaction between those actors in a multi-level government system (e.g. between central and local policy makers), with consequences for subnational autonomy. It is argued here that focusing on intergovernmental institutions and their consequences for local autonomy facilitates our understanding of choices and patterns of fiscal behaviour at local level, especially regarding subnational revenue mobilisation.

In the first section, the theoretical dimension regarding decentralisation is reviewed, highlighting the development and debates in theories of fiscal federalism. It discusses economic approaches and models which view decentralisation as a potential strategy in public finance, especially for the provision of public goods and services. In practice, decentralisation exist as an arrangement of rights given to different levels of government to enable each level of government to exercise functions allocated to them and to organise the relationship between them. Based on the nature and degree of rights allocated to each level of government and on contractual (or non-contractual) relationships between the parties involved, there can be multiple possible arrangements.

The second section discusses this issue of allocation of rights to different units inside and outside of government and identifies aspects of institutional arrangements which are particularly relevant to subnational autonomy. The literature has differentiated various possible arrangements where distinction can be drawn regarding actors' responsibility, authority of decision making and access to resources and political offices. These three aspects underpin subnational autonomy as they influence the range of activities to be carried out by decision makers at subnational level.

The third section discusses how institutions regulate responsibility, authority of decision making and access to resources and political offices and how they further influence local autonomy. Attention is given to fiscal and political institutions as those are the dimensions which relate closest with subnational autonomy. These institutions may also respond to various motivations other than addressing the problem of public goods and services provision. The fourth section that follows explores how institutional arrangements governing decentralisation influence the authority over information and decisions and encourage competition at subnational level. Adjusting the elements of the institutional arrangements, therefore, will affect policy making at different levels of government and the state of intergovernmental competition.

The fifth section examines further how policy identification and selection are important in decentralisation. Different institutional arrangements will result in different roles for central and local actors in the process. The need for fiscal autonomy corresponds to the process of identification and selection at local level, as financial resources are needed for successful implementation of policy. The sixth section concludes and discusses the implications for the study in this thesis.

2.1 Theoretical Discussion on Decentralisation and Public Finance

The theoretical origin for decentralisation can be traced to the literature in public finance. Particular attention in the literature of public finance regarding resource allocation brought about ideas relating provision of public goods and services by government operating below the national level (Tiebout, 1956; Musgrave, 1959). In the last five decades, discussions regarding decentralisation have developed into a distinctive group of theories, which has been identified as theories of fiscal federalism (Oates, 2005). Based on the underlying assumption regarding political leaders, the theory of fiscal federalism can be differentiated into the first generation and the second generation theory of fiscal federalism. In the first generation theory, motivations of political leaders are assumed to be to maximise social welfare; while the second generation theory considers alternative motivations, which then place significance on various kinds of incentive facing the leaders (Oates, 2005; Weingast, 2009). Even though there may be an overlap of issues discussed under these different generations of theory, the distinction is important to signal how the theory increasingly develops its consideration of incentives.

2.1.1 First generation theory of fiscal federalism (FGFF)

Originating from the economics perspectives, FGFF assumes that governments at different level operate to maximise social welfare, responding to the existence of market failure. In the theory of public finance, governments intervene mainly in the area of economic stabilisation, income distribution, and resource allocation (Musgrave, 1959). Musgrave (1959) hints that efficiency costs can be minimised when service provision in a certain jurisdiction is financed by taxation that approximate the price for local public goods. Efforts towards redistribution and macroeconomic stabilisation and their related financing, therefore, are more properly done at higher level of government where such efforts are viewed as desirable. This indicates that

decentralisation can contribute to allocative efficiency by better matching resource allocation (including public goods) and tax burden to citizens' needs and preferences at local level, compared to uniform resource allocation and tax burden conducted by government at national level. This point has also been touched upon by Buchanan (1970), providing a theoretical discussion of different organisational forms of public goods and service provision and how they may affect efficiency.

That indication alludes to the 'principle of fiscal equivalence', where it is acknowledged that jurisdictional boundaries qualifies efficiency in resource allocation and its financing through taxation (Olson, 1969). When benefits from public goods and service provision are contained within a jurisdiction, citizens inside the jurisdiction can be expected to contribute towards their financing as those citizens potentially enjoy the full benefits. Considering that there is a possibility of heterogeneity of needs and preferences for public goods and service provision across jurisdictions, the role of local governments in deciding resource allocation becomes important.

Another argument which provides a rationale to the development of FGFF is regarding the possibility for citizens to select the jurisdiction which provide public goods based on their preferences. Tiebout (1956) argues that there is a category of public goods provided within a boundary at subnational level that is subject to congestion when the number of users increases, which he further identifies as 'local' public goods. Assuming that citizens have no restrictions on mobility, each can sort herself into the community which best matches their preference pattern for local public goods. Further, this has the underlying message that subnational governments which can provide preferable patterns of local expenditure and public goods provision may attract more citizens.

Those arguments put forward the significance of local governments and jurisdictional boundaries at subnational level. Efficiency of public goods and service

provision at local level is qualified by jurisdictional boundaries, which provide a case for decentralisation. Consequentially, the decentralisation theorem (Oates, 1972, p. 35) states:

For a public good – the consumption of which is defined over geographical subsets of total population, and for which the costs of providing each level of output of the good in each jurisdiction are the same for the central or the respective local government – it will always be more efficient (or at least as efficient) for local governments to provide the Pareto-efficient levels of output for their respective jurisdictions than for the central government to provide any specified and uniform level of output across all jurisdictions.

The argument underpinning the theorem is an expectation of local governments to be responsive to citizens' demands because local governments can have better information regarding local preferences, and citizens can provide feedback directly to governments at local level, as also discussed by Tiebout (1956). This local level interaction between citizens and local governments is expected to happen in relation to service provision and its financing through taxation.

2.1.2 Second generation theory of fiscal federalism (SGFF)

Theoretical discussions in FGFF have outlined the operating framework of governments at local level, but other contributions in the economics literature have also exposed possible alternative propositions. Brennan and Buchanan (1980) discuss the possibility of governments, and individuals who take political decisions within them, having a tendency to maximise revenue and enlarge the size of governments. Salmon (1987) argues that political leaders may treat re-election prospects as a consideration when deciding a policy affecting citizens. Both of those examples introduce diverging possible motivations for political leaders other than focusing on maximising social welfare of the community. This opens a new possibility in relation

to the way decentralisation can be theorised, with different assumptions regarding motivation of political leaders than the one assumed in FGFF.

Consideration of different assumptions opens up the discussion regarding political and economic institutions in decentralisation and how it can encourage political leaders to behave closer to what assumed as benevolent. Weingast (1995) outlines political assumptions in decentralisation in a more explicit way than described in the FGFF literature, and argues that decentralisation can be ‘market-preserving’ by encouraging subnational governments to foster local economic development rather than engage in market intervention and corruption. This incentive comes in part from competition between subnational jurisdictions, which require subnational governments having a sufficient autonomy to choose and adjust their policies. Furthermore, it is also necessary for subnational governments to have hard budget constraints, so they will not be encouraged to overspend beyond their means. With the necessary conditions in place, decentralisation can make governments commit to support private market activities and not to unnecessarily expand themselves.

Another consideration that needs to be taken into account is the role of information in shaping selection and behaviour of political leaders. Seabright (1996) models relations between citizens and political leaders as ‘incomplete contracts’, assuming that outcomes from decisions taken by those leaders may not be directly observed by citizens, or may not be verifiable when they can be directly observed. The issue of political accountability between centralised and decentralised governments is discussed as a trade-off between enabling coordination of policies between jurisdictions and incentivising government to act in a direction aligned with preferences contained within a jurisdiction.

The assumption of uniform public good provision under centralisation is also elaborated further in the SGFF literature. Lockwood (2002) and Besley and Coate

(2003) explore how centralised public good provision can account for heterogeneity, using models where allocation is decided by legislators representing specific districts. However, even though it can be efficient, this centralised allocation does not internalise interjurisdictional spillovers. The models complement the FGFF literature by showing that deciding between centralised and decentralised resource allocation and public good provision will need to consider relative heterogeneity of preferences and interjurisdictional spillovers.

2.1.3 Further discussion in the literature

From a public finance perspective, the reason underlying decentralisation is about achieving efficiency while considering jurisdictional boundaries, heterogeneity of preferences and interjurisdictional spillovers. Political leaders can either be maximising social welfare or following other types of motivation. This introduces different possibilities which translate into varying theoretical implications as discussed in the previous section. From a normative point of view, to choose between prioritising allocative efficiency or other objectives (e.g. ensuring successful implementation of a nation-wide policy) is a political choice which can have implications to how the government is organised in multiple levels. More recent studies have explored some more possibilities by considering various conditions where efficiency is not the utmost priority, so that some degree of efficiency can be conceded to allow support for other priorities.

For example, Inman and Rubinfeld (1997) discuss a different possible focus on organising a multilevel government system based on consideration of political participation and individual rights. In their discussion, a decentralised government structure can have different mechanisms to incorporate subnational governments' participation in central government's policy decisions. They demonstrate that, depending on how political participation and individual rights are prioritised, the structure of government needs to adapt to facilitate achieving those priorities.

Therefore, prioritisation of different objectives will have consequences in the institutional arrangements of a multilevel government system, such as the extent subnational governments are represented in the central government or how policy responsibilities are assigned between different levels of government. They also acknowledge that differing objectives may at times conflict each other, so that deciding on the institutional arrangements of a multilevel government system will need to consider the trade-offs between different alternatives available.

This possibility of conflict between different objectives arguably drive countries to adopt varying multilevel government systems. Bardhan (2002) points out that a subset of countries, e.g. many low- and middle-income countries and countries in democratic transition, face limitations and conflicting objectives which make them opposed to the ideas given in the theory of federalism, especially FGFF. That subset of countries can have limited population mobility and monitoring of public officials, have weak mechanisms for political accountability, prioritise particularistic spatial distribution of resources as much as (if not more than) efficiency, have different degree of technical capacity and revenue potential between levels of government. In the context of those countries, the institutional arrangements which regulate multilevel governments can vary, enabling achievement of some objectives and constraining others (Bardhan and Mookherjee, 2006). As decentralisation is often carried out as a form of public sector reform in many developing countries, the complexity facing the implementation of a multilevel government system has been acknowledged more widely (Smoke, 2015a; Faguet and Pöschl, 2015).

In the area of public finance, decentralisation interacts with reform in the wider public financial management system which are also carried out in developing countries. Reform at national level often requires actors at national level to have an adequate control on budgetary institutions, which also needs to consider public financial management at subnational level (Allen, 2013). Depending on the situation

of public financial management in the country, it can be prudent to develop a sound public financial management first before engaging with a multilevel government system (Boex and Kelly, 2013; Fedelino and Smoke, 2013). This means that the country can develop capacity for budgeting and revenue management at national level and only decentralise when that capacity has been developed and successfully implemented. However, there are cases where the country needs to decentralise immediately to respond to the political dynamics in the country, such as in Kosovo (Fedelino and Smoke, 2013, pp. 376-378). In the end, both decentralisation and public financial management reforms are complex interventions and the direction each country should take is affected by the contextual factors in the country (Smoke, 2015b).

Realising that decentralisation can be designed in consideration of multiple objectives, local revenue continues to be an important issue which underpins local autonomy and accountability. Ways to improve local revenue mobilisation have been a subject of discussion in the context of countries adopting multilevel government system, from OECD countries (Forman *et al.*, 2020, pp. 14-23) to developing countries (Bird, 2010, pp. 8-14; Bahl and Bird, 2018, pp. 386-387). The design of intergovernmental transfer systems has been argued as an important factor which has implications for local accountability because it also affects the ability to raise local revenue (Weingast, 2009; Yilmaz *et al.*, 2010; Pöschl and Weingast, 2015; Rodden, 2019). However, even when seemingly there is an increase of local fiscal autonomy, what local governments can do with local fiscal resources may be more limited than it appears on the surface (Gomes, 2012). Local officials can also be content with the financial resources to which they have access and be less active in their revenue effort (Piracha and Moore, 2016; Jia *et al.*, 2020).

Following the discussion in the literature, institutional arrangements of a multilevel government system are a reflection of a within-country tension between

different objectives and limitations. Therefore, different types of institutional arrangements are expected to have varying implications on economic efficiency, flexibility on targeting redistributive policy, government responsiveness and accountability, and other objectives. As countries are likely to differ in their institutional arrangements, understanding how the aspects of local autonomy are affected by each rule requires a greater scrutiny on the institutional details in each country (Blume and Voigt, 2011; Smoke, 2015b). Thus, it is deemed useful to investigate which kind of local autonomy results from particular institutional arrangements.

2.2 Examining Local Autonomy within Decentralisation

At subnational level, government works within a set of institutional arrangements which have been defined in relation to their responsibility in public service provision, authority in decision making, and access to resources and political offices. While this set of institutional arrangements may often be discussed in academia and the policy making arena as “decentralisation”, it is important to distinguish the different sets of arrangement which may be categorised as decentralisation by different people, and to explain which arrangements will be appropriate to examine in this study under the term “decentralisation”. Rondinelli and Nellis (1986) argue that decentralisation entails ‘transfer of responsibility for planning, management, and the raising and allocation of resources from the central government and its agencies’ to different other units inside or outside the government. These transfer arrangements to different units can be broadly differentiated into at least four distinctive categories (Rondinelli and Nellis, 1986, pp. 5-10):

- *Privatisation*, this arrangement entails transfer of ‘responsibility for functions’ to units outside the government. These units may be ‘private enterprises’ or ‘organisations that represent various interest in society’.

- *Delegation*, this arrangement entails transfer of ‘managerial responsibility for specifically defined functions’ to units outside the ‘regular bureaucratic structure’, with central government still retaining ultimate responsibility.
- *Deconcentration*, this arrangement entails transfer of ‘some administrative authority or responsibility’ to subordinate units within central government. This subordinate units will be located ‘outside the national capital’.
- *Devolution*, this arrangement entails ‘the creation or strengthening, financially or legally, of sub-national units of government, whose activities are substantially outside the direct control of central government’.

These different kinds of arrangement are not mutually exclusive and can coexist within a certain country. In this study, the term decentralisation will refer to a devolution arrangement, while other types of arrangement, whenever encountered, will be referred as their respective terms above. This also follows a more recent discussion by Faguet (2014), where decentralisation is defined as ‘the devolution by central (i.e., national) government of specific functions, with all the administrative, political, and economic attributes that these entail, to regional and local (i.e., state/provincial and municipal) governments that are independent of the centre within given geographic and functional domains’ (p. 3). One specific feature in the devolution arrangement which contributes to the independence of subnational governments is the use of local election to select political leaders. This provides a condition where the leaders may feel the need to be accountable to citizens at local level instead of the central government.

In the development arena, decentralisation has been linked with efforts to strengthen citizen voice and improve service provision, especially in low- and middle-

income countries. Decentralisation is argued to help citizens in monitoring the performance of government and service providers, and to facilitate citizens in providing feedback regarding service provisions through local politicians (World Bank, 2003). However, some studies give cautionary messages and evidence of diverse outcomes from decentralisation, suggesting the need for careful considerations in designing a decentralisation system (Prud'homme, 1995; Bardhan and Mookherjee, 2006). More recently, there is an increasing emphasis towards examining the incentives which arise from institutional arrangements under decentralisation, especially the incentives facing political leaders (Faguet and Pöschl, 2015; World Bank, 2017). This calls for further research towards decentralisation, intergovernmental relations and how they may influence different policies at subnational level.

Following strictly to the four categories discussed above, different arrangements affects intergovernmental relations and local autonomy differently. *Privatisation* and *delegation* do not lead to any changes in the relationship between central and subnational governments, while *deconcentration* and *devolution* require adjustments to the existing intergovernmental relations. Privatisation and delegation carried out by the central government might not affect subnational governments because the functions are transferred to other units than the existing subnational governments. In contrast, deconcentration and devolution may directly affect central-subnational relations because there are changes to the existing arrangements on subnational governments' authority relative to the central government. In deconcentration, subnational governments are assigned a role as a subordinate of the central government, in which their authority will have some restrictions. In devolution, subnational governments are expected to face less control from the central government, and therefore have more discretionary power over their decisions. Thus, the degree of local autonomy is relatively higher in the devolution arrangement compared to the deconcentration arrangement.

The differences in the degree of local autonomy are reflected in the institutional arrangements. There are formal rules which structure the relationship between central and subnational governments in the context of deconcentration and decentralisation. Informal constraints such as existing norms and values also affects the implementation of those formal rules, which then also define the extent to which formal rules are credible. There are three important areas regulated by the institutional arrangements which can affect the degree of subnational autonomy. Firstly, a clear delineation of responsibility for each level of government is important because it defines the expectation of activities to be carried out by subnational governments. An ambiguous delineation of responsibility can result in redundant government activities or can be a justification for one level of government to encroach on other government at a different level.

Secondly, authority of decision making is important because it provides the boundary within which subnational governments can decide a set course of action in carrying out their responsibility. Subnational governments which lack authority of decision making are only implementers of policy or subordinates of the central government. Thirdly, access to financial resources and political offices is important because it shows the extent of resources available to subnational governments and the credibility of decision making of subnational governments. Without access to financial resources, subnational governments cannot exercise their authority. Moreover, an involvement of the central government in appointment to subnational political positions can result in subnational governments which are less independent to the central government. This can further decrease the degree of local autonomy. Arguably, the higher the degree of local autonomy, the higher the need for subnational revenue mobilisation. This is because subnational governments have a wider area for decision making which then needs to be funded. Therefore, it is important to examine how the institutions in a decentralised government structure regulate these three aspects.

2.3 Fiscal and Political Institutions in Decentralisation

As mentioned in section 2.2, institutional arrangements governing decentralisation consist of at least three major aspects: responsibility, authority of decision making and access to resources and political offices between different levels of government. Those aspects are regulated by various institutions in different dimensions of the government, such as fiscal and political dimension. These institutions have a role in shaping fiscal behaviour of subnational governments.

Some previous studies examine the influence of fiscal and political institutions in different areas in a decentralised government structure. Rodden (2005) in his study argues that a combination of intergovernmental fiscal relations and political alignment between different levels of governments can make subnational governments face soft budget constraints which result in a bailout game between central and subnational governments. When the central government finances most of subnational expenditures through intergovernmental transfers and subnational governments have the autonomy to borrow, subnational governments can expect the central government to support them when they cannot pay back the money they borrow. Wibbels (2005) argues that the characteristic of intergovernmental fiscal system and intergovernmental political relations can hinder implementation of economic reforms. Subnational governments which depend on intergovernmental transfers can use policy reform as a bargaining chip to get more fiscal support from the central government, or they can also be pressured by the central government to proceed with the reform. Diaz-Cayeros (2006) shows that a bargain between national and subnational politicians can result in fiscal centralisation. All of those studies show that fiscal and political institutions are important elements in understanding performance of a decentralisation government structure.

Looking closer towards how the interactions between central and subnational governments are organised through fiscal and political institutions, one important

aspect is which level has the final say on specific policy decisions. For example, in Argentina, subnational representatives have a relatively more dominant position in decisions regarding intergovernmental transfers (Ardanaz *et al.*, 2014). A survey on six African states shows further how this can vary across countries, with central decision makers dominating the process in some countries (Fessha and Kirkby, 2008). The level of government with the power to determine the final policy position has relatively more control towards the outcome of the decision making process.

2.3.1 Institutions in the context of decentralisation

Before discussing fiscal and political institutions in decentralisation, it is useful to examine the concept of institutions which is used in this study. Following North (1991, p. 97), institutions are understood as ‘the humanly devised constraints that structure political, economic, and social interaction’, or ‘rules of the game in a society’ (North, 1990, p. 3). In the context of a decentralised government system, these institutions structure the interaction between central and subnational governments, or between central and subnational decision makers in terms of individuals. Institutions modify incentives and constraints of actors by providing the scope of action available to actors at a certain situation. In principle, actions carried out by each actor happen under a set of rules which define what can be done by each actor or set of actors. Crawford and Ostrom (1995) introduces the classification of actions using three modal verbs: ‘*may* (permitted), *must* (obliged), and *must not* (forbidden)’ (p. 584, emphasis in the original). Using that classification, a set of rules in institutions regulate actions which may be carried out, actions which must be carried out, and actions which are forbidden to be carried out by each actor or set of actors.

Looking back at the theory of fiscal federalism, a decentralised government structure needs to be supported with institutions which enable each level of government to behave as the theory suggests. Weingast (1995; 2009) provides a useful elaboration when he argues that there are necessary conditions which need to be in

place: hierarchy, subnational autonomy, common market, hard budget constraints, and institutionalised authority. A hierarchy clarifies the structure of government and scope of authority for each level of government. Subnational autonomy signifies the substantial ability of subnational governments to regulate local economy and provide public goods and services. Common market allows mobility of various factors such as individuals, goods and financial capital, between jurisdictions. Hard budget constraints set a limit to financial resources accessible to subnational governments; they do not have the ability to print money, for example. Institutionalised authority allows for political authority for each level of government to be credible and enforceable (Weingast, 1995, pp. 4-6; Weingast, 2009, pp. 280-282).

Possibilities of variation in institutions governing decentralisation enable countries to have contextually different relationships between central and subnational governments. The decision to decentralise is a political one because it has redistributive consequences for the allocation of political power and financial resources. Various economic and political motives which are salient in each country, therefore, are expected to influence the design of decentralisation to be adopted by decision makers. Faguet *et al.* (2015b), for example, discuss some of these motives and how countries can have different views on how to internalise the prevailing interests into the design of decentralisation. The end-result can be a decentralisation which either provides more autonomy or less autonomy to subnational governments, more restrictions or less restrictions to subnational policy making, the ability of the central government to veto subnational decisions or vice versa. The discussion of various political and economic motives also appears in decision making regarding how countries sequence their decentralisation across different dimensions (Falleti, 2010).

The discussion above shows the importance of a detailed examination of relevant rules which affect decision making actors within decentralisation. Previous studies have examined the average effects of decentralisation on various set of

economic and social outcomes using cross-country observations. However, those studies cannot provide much clarity on how contextual characteristics in each country influence the effects at the margin. Martinez-Vazquez *et al.* (2017, pp. 1100-1120) analyse previous studies on the impact of decentralisation, finding that the impact on some issues cannot be firmly established and findings from country case studies show different outcomes across countries. Based on their findings and discussion, it can be argued that understanding the detail of institutional arrangements governing decentralisation can provide an additional useful explanation regarding the impact of decentralisation on various outcomes.

Therefore, it is important to clarify the extent to which institutional arrangements governing decentralisation support the conditions for decentralisation-as-theorised and the extent to which those institutions facilitate salient political motives. Regulations which define how hierarchy in decentralisation operates are also a reflection of relative influence of government at one level over others at a different level. Those regulations can also be legislated to accommodate the purpose of making politicians at one level of government weaker than at another level. Regulations which clarify the details of subnational autonomy frame the significance of subnational government in respect to the economy at subnational level. This area can also be confounded by the need to enable central politicians to enforce national economic policy, to push central planning decisions, or to enact policies leaning towards clientelism. Bednar (2005) outlines how each level of government may behave opportunistically in a multilevel government system, either in the relationship between central and subnational governments or between subnational governments themselves. In the end, institutional arrangements governing decentralisation might serve many different purposes, and this situation would have effects on the implementation of decentralisation as discussed in the theory of fiscal federalism.

Focusing on the three major aspects which can affect the degree of subnational autonomy, attention is given to fiscal and political institutions. Fiscal institutions regulate the aspects of responsibility and access to financial resources of governments. In this area, the central government can assign a set of responsibilities to subnational governments which is reflected in the law and also in the expenditure assignments. Access to financial resources includes provision of intergovernmental transfers and the power to tax. There can be instances where subnational governments receive much responsibility but with limited options regarding financial resources. Political institutions regulate authority of decision making and access to political offices. Area of decision making requires a deeper examination to observe the *de facto* authority, which may be different than what is written on paper. Regulations regarding access to political offices also reflects how much political influence central government has over subnational governments. The following sections discuss intergovernmental relations across those fiscal and political dimensions in a multilevel government structure.

2.3.2 Fiscal institutions in decentralisation

Intergovernmental fiscal relations in a decentralisation will be regulated through a set of fiscal institutions. Those institutions will define the scope of fiscal decisions that can be taken by national and subnational governments. They involve expenditure assignments, revenue assignments, arrangements for intergovernmental transfers and a set of fiscal rules. Expenditure assignments allocate responsibility for public goods and service provision between national and subnational governments. Revenue assignments allocate powers to raise revenue from the citizens between national and subnational governments. Normatively, expenditure and revenue assignments can be based on principles derived from economic reasoning, such as a consideration of benefit areas of public goods, benefit spillovers and economies of scale (Boadway and Shah, 2009). In practice, however, there are factors which render such normative

reasoning infeasible, which then often creates a Vertical Fiscal Imbalance, a gap between subnational expenditure responsibilities and revenue-raising powers (Boadway and Shah, 2007, p. 17). This in turn necessitates central government to provide additional financial resources to some subnational governments through intergovernmental fiscal transfers so that subnational governments can fulfil their expenditure responsibilities.

An intergovernmental fiscal transfer is a mechanism where the central government provides additional funds to subnational governments to ensure subnational governments do not have unfunded responsibilities. In the early discussions of intergovernmental transfers which were informed by FGFF and its assumption of benevolent political leaders, there is an argument to design transfers to also target Horizontal Fiscal Imbalance, which considers moves towards equalisation of 'revenues (including transfers) and the actual expenditures of each local government' (Bird and Smart, 2002, p. 901). In contrast, SGFF does not advise equalisation transfers, as that type of transfer may introduce perverse fiscal incentives and also result in soft budget constraints (Pöschl and Weingast, 2015). Furthermore, political decisions concerning equalisation can be based on individual residents rather than subnational units. However, studies show that politicians tend to base their identification and selection on subnational units for reasons such as political representation and distribution of economic activities (Beramendi, 2012; Rickard, 2018).

There are studies examining the effect of intergovernmental transfers to subnational governments' revenues, with various results and using various estimation strategies, using various independent and dependent variables. Some studies provide evidence that intergovernmental transfers negatively affect revenue generation in subnational governments (Dash and Raja, 2013; Garg et al., 2017; Liu and Zhao, 2011; Mogues and Benin, 2012; Rajaraman and Vasishtha, 2000). Other studies argue that

intergovernmental transfers can encourage subnational revenue generation (Caldeira and Rota-Graziosi, 2014; Masaki, 2018). There are also studies that find no association between intergovernmental transfers and subnational revenue generation (Guo, 2008; Sagbas, 2001). It should be noted that due to the diversity of variables, these studies use different definitions of intergovernmental transfers. These analyses are also conducted in specific country settings, which may not be generalisable. The various results therefore can be explained by the different nature of institutional arrangements, different characteristics of intergovernmental transfers, or different estimation strategies used in the research.

Fiscal institutions relating intergovernmental transfers will define criteria in selection, allocation, and usage of intergovernmental transfers. These criteria can be rule-based parameters which relate to a set of observable characteristics, such as social indicators (e.g. portion of poor population) or economic indicators (e.g. gross regional domestic product). Alternatively, these criteria can also be highly discretionary according to the decision of central (or subnational) politicians. Selection criteria determine which subnational governments are considered for the list of recipients. Allocation criteria determine how much funding each selected subnational government will receive. Usage criteria determine how subnational governments can use the allocated amount of fund.

Considering the possibility of self-interested decision makers, fiscal institutions relating intergovernmental transfers between countries can vary based on the prevailing motivation of those decision makers at the given context. Central politicians may support funding allocation to reward some jurisdictions which support them, or to get more voters in jurisdictions with a significant portion of swing voters (Rickard, 2018; Banful, 2011). In those situations, selection of where to allocate is based on revealed voters' characteristics, and the same situations can also influence the amount of fund to be allocated. Some studies also discuss how political identity of

subnational leaders might affect selection and allocation of intergovernmental transfers. In these situations, subnational governments where executive leaders are politically aligned (e.g. coming from the same political party) with central politicians receive more funding allocation from intergovernmental transfers (Brollo and Nannicini, 2012). Qualitative study may also reveal this kind of phenomenon, e.g. in Sierra Leone, where political identity motivates subnational leaders to be more active in mobilising their own-source revenues because of a perceived unfairness in fund allocation for intergovernmental transfers (Jibao and Prichard, 2015).

There is also another type of allocation rule which can constrain central government in relation to the transfers it should provide to subnational governments. Formula-based transfers match the amount of transfers to be allocated to a set of parameters associated with each subnational government. The parameters can be derived from variables in each jurisdiction, such as population size, area size, proportion of citizens categorised as living in poverty, and so on. Formula-based transfers can also use parameters which relate to the portion of revenues coming from each jurisdiction, such as value added tax, income tax, or natural resources. In practice, these allocation rules determine the amount which central government needs to allocate for intergovernmental transfers. For tax revenue sharing, for example, India required 30.5 per cent of central revenues to be shared with subnational governments in the period between 2005 and 2010 (Rao, 2007). For natural resources revenue sharing, Venezuela required the central government to provide transfers through a guarantee in the constitution (Diaz-Cayeros, 2006).

Another part of fiscal institutions are fiscal rules, which include various rules that frame the space in fiscal decision making with the purpose of achieving fiscal discipline, promoting allocative and operational efficiency. In the context of decentralisation, central government may be able to promulgate and enforce fiscal rules to structure fiscal decisions of subnational governments. In his analysis, Rodden

(2005) argues that fiscal restraint imposed by central government can prevent fiscal indiscipline of subnational governments. Subnational borrowing can provide additional financial resources for capital expenditure of subnational governments. When central government can credibly restrict subnational borrowing, subnational governments tend to be more prudent in their fiscal behaviour. This happens because *ex ante* restriction in the fiscal rules can prevent subnational governments to behave in a way that undermine fiscal discipline (Ter-Minassian, 2007). While this idea has its merits, these rules can also result in limited subnational autonomy and prevent subnational leaders from addressing citizens' preferences.

2.3.3 *Political institutions in decentralisation*

Intergovernmental political relations relating access to political offices and political decision making will be regulated through a set of political institutions. These institutions will define whether local governments have agency in national decision making, and whether central government can override decision made by local governments. In relation to the five political conditions outlined in SGFF, political institutions determine the possibilities for encroachment by each level of governments in another's delineated scope of authority and the effectiveness of central government in analysing and policing a common market that allows for product and factor mobility. Ponce-Rodríguez *et al.* (2018) argue that benefits of decentralisation can potentially be provided by locally-elected leaders in combination with political parties that have national-level coverage. With that combination, they argue that there are benefits of information at local level, while regulation of spillovers is controlled at national level as such to not reduce level of service provision below what is necessary.

However, intergovernmental political relations which are mainly organised and structured through political parties do not exist in every country with multilevel government system. In some federations, subnational autonomy is safeguarded through the constitution so that central politicians cannot intervene on many issues

under subnational governments' scope of authority. This may not be the case for unitary countries, where there can be provisions for central government to influence or directly intervene on subnational decisions (Bhatti and McDonald, 2020). Therefore, it is useful to reflect on the discussion by Elazar (1987) about what each level of government can do in regards to other levels' scope of authority. His categorisation of 'self-rule' and 'shared-rule' supports the idea that interactions between actors in different governmental level can happen through multiple channels (e.g. executive, legislative) and institutionalised.

Therefore, there can be different institutional arrangements for intergovernmental political relations which lead to different types of interaction between different levels of government. On one hand, these arrangements can provide subnational governments with sufficient means to influence policy outcomes at national level. Rodden (2005) posits that legislative malapportionment can result in fiscal indiscipline, as national decision making can be driven by agenda of local politicians with little regard for national macroeconomic objectives. The structure of decision making process that position local representatives to have the final decision made budget allocation relatively greater to subnational units that have more representatives. Another study from Ardanaz *et al.* (2014) also provides empirical evidence from Argentina which show how local concerns dominate national decision making. On the other hand, there is also a possibility of severe limitation to policy making at local level, which may not explicitly appear at first glance. Gomes (2012) shows Brazil has lower fiscal autonomy in practice compared to what can be interpreted from its classification of revenue. This discrepancy is caused by restraint in the national regulations on spending powers of Brazilian local governments, which made the scope of decision making to be narrower at subnational level.

Even with its uneven effects on subnational autonomy, variations on the structure and organisation of intergovernmental political relations exist and are

sustained. This suggests that the effects from such arrangements might in some way correspond to some preferences in the country in which those arrangements are adopted. Voigt and Blume (2012, pp. 248-249) argues for a deeper examination of the institutional details of multilevel government in the country adopting such systems. Their study takes into account that some federal countries can have a high degree of centralisation, therefore they use multiple variables to reflect the multidimensional nature of federalism and decentralisation in their sample countries. Their study argues that institutions which facilitate local election, the ability of subnational units to veto national decisions, and fractionalisation of parliament show some effects on economic variables such as budget deficits and sectoral spending on social and welfare services (Voigt and Blume, 2012, pp. 245-248). While there can be differences on what constitutes a desirable level of budget deficits and social spending in a country, that study provides some ideas on which type of institutions that can be fruitful for deeper investigation.

Various political motives can influence decisions of political actors when they design intergovernmental political relations between different level of governments. Faguet *et al.* (2015a, p. 62) argue that decentralisation can be a threat to national unity because it may reinforce the existing divides between political cleavages in the country. In contrast, it can also be designed to maintain unity, depending on how far the design of decentralisation takes into account the spatial concentration of factors such as ethnic or other identity-based groups (Faguet *et al.*, 2015a, pp. 63-64). Agranoff (2004, pp. 50-58) also notes ethnic tensions and historical claims of nationalism as contributing factors which result in different structure of central-subnational political relations in some countries such as Ethiopia, Spain, Scotland, and South Africa. Both of those studies show that there are modifications to intergovernmental political relations such as the ability of subnational governments to participate in national decisions or block them from being enacted.

Another dimension of intergovernmental political relations between central and subnational government is regarding access to political offices. In a decentralised government structure, appointment to political offices at subnational level can be decided by decision makers at the higher level of government (e.g. central government). Another alternative is to select subnational political leaders through an election with voters from inside the jurisdiction. Faguet (2012) argues that involvement of decision makers from the central government in selection of subnational political leaders can make those leaders to be less accountable to the citizens and can be more inclined to support central government's decisions. Grossman (2019) discusses leadership selection rules and argues that both selection of subnational political leaders through a subnational election and through appointment by central decision makers can be justified from different standpoints. Selection of subnational leaders through an election allows those leaders to be more motivated in responding to local preferences. On the other hand, appointment of subnational leaders by central decision makers can result in an easier coordination between different levels of government (Grossman, 2019, pp. 48-54). In another study, Hessami (2018) finds that elected mayors in Germany exert more effort to get investment grants compared to mayors appointed by the local council. These studies argue that access to political offices can affect behaviour of political leaders.

Those studies discussed in this section show possibilities of encroachment on political decision making by local and central governments. To understand policy relating revenue mobilisation, therefore, intergovernmental political institutions in a decentralisation system need to be carefully observed. Whether political leaders at subnational level are appointed by central governments or determined through an election, or whether national leaders need approval from subnational politicians, are examples of different institutional arrangements relating access to political offices.

2.4 Institutions, Information and Competition under Decentralisation

Following the preceding discussions, there is an expectation that institutions governing decentralisation will shape the extent of subnational revenue mobilisation. Fiscal and political institutions will determine the political scope of local decision making and the expectation of additional fiscal support from central to local governments. An issue that has not been discussed in the previous section is the role of information and competition. SGFF argues that, for local governments to be motivated in preserving market, there needs to be a limit on authority of and information that can be obtained by central government (Qian and Weingast, 1997). Limited information and authority of central government will allow it to commit not to encroach on local governments' policy space. A practical illustration of this is a local government that have more information regarding citizens' demand and revenue sources compared to its counterpart at national level. An empirical example of this includes local governments in China and the information which they have about extra-budgetary revenue (Qian and Weingast, 1997; Knight and Shi, 1999; Jin *et al.*, 2005). Historical experience also shows the possibility of how *de facto* power over information and decisions determine intergovernmental relations and may inform the design of intergovernmental arrangements (Young, 2021).

To some extent, decentralisation will also promote interjurisdictional competition. Subnational governments may compete with each other in many different sectors, for example to attract investment and promote economic growth (Weingast, 2009). This competition happens mainly in the realm of policy, where subnational governments may choose to foster economic growth or to use their authority for narrower set of gains through an alternative policy set. In China, there is even a formal competition mechanism which is used as an instrument to promote improvements in public service provision (Li and Zhang, 2015). This competition can

also occur in subnational taxation policy, especially when subnational governments have sufficient degree of discretion over policy. Evidence from the Philippines shows that competition between subnational governments is focused on the funding of social and economic services (Capuno et al., 2015). In China, competition between governments also influences subnational tax efforts, aside from other factors that act as incentive or disincentive (Xing and Zhang, 2018).

Thinking about intergovernmental relations and encroachment possibilities encourages consideration of how politicians value each subnational unit and the characteristics that view is based on. FGFF puts forward economic rationale based on economies of scale and interjurisdictional spillovers. However, SGFF assumes politicians are self-interested, so deriving a rationale from this assumption will need to justify whether that rationale will further the achievement of politicians' goals. Taken this way, the relative value for each subnational unit will be based on its political potential.

Another further elaboration from this assumption is that it is possible for a subnational unit to expect differentiated treatment based on its political potential. This unique treatment can result in asymmetric institutional arrangements, such as particularistic political autonomy which is not enjoyed by most other subnational units (e.g. asymmetric decentralization (Fiorillo *et al.*, 2021)), or targeted institutional specifications for intergovernmental resource transfers. This last treatment can vary from selection of subnational units for the location of megaprojects, or usage rules of intergovernmental transfers that cater more to some subnational units than others. Some studies record a more explicit implementation of particularistic treatment, with discretionary transfers directed to politically-aligned subnational units (Banful, 2011; Caldeira, 2011; Brollo and Nannicini, 2012; Fiorillo and Merkaj, 2021).

If this assumption regarding preferential treatment is realised, it can distort interjurisdictional competition and provide a means for subnational politicians to

lower tax efforts in their jurisdiction. Interjurisdictional competition may not disappear, but it may happen within a cluster of subnational units, of which cluster is based on the parameter for political potential. Subnational governments can also be more relaxed in their tax effort, because they can expect financial support from transfers. Evidence from several empirical studies does show subnational units do not fully use their revenue-raising powers in different country contexts, e.g. in Poland (Bukowska and Siwińska-Gorzelak, 2018) or China (Jia *et al.*, 2020).

Central to this discussion is to understand the scope of decision making of politicians at subnational level as a result of the institutional arrangements. Subnational governments may seem to have sufficient autonomy, but in reality they probably can only decide in a much more limited scope in practice (Gomes, 2012). In contrast, intergovernmental transfers mechanism may provide subnational governments with enough discretion to identify and select the use of the fund, practically enabling subnational governments to have a wider scope of decision making. Further investigation of these features of fiscal and political institutions in a decentralised system can provide more evidence regarding incentives faced by subnational politicians and decision makers.

2.5 Policy Identification and Selection and Fiscal Autonomy in Decentralisation

From the discussion in the previous sections, the scope of decision making of politicians can be specified as decision making in policy identification and selection. The process of policy identification and selection is especially important in the context of multilevel government system because it can determine target beneficiaries of the policy (e.g. which set of individuals would benefit from the policy) (Ostrom, 2011, p. 11). Drawing from the literature of poverty targeting as an illustration, it can be seen that a change in rules for policy identification and selection can result in different

target beneficiaries, which can then also create a situation for strategic choice making. Laderchi *et al.* (2003) provide a comparison to four different approaches in measuring poverty, each with its own rule in identifying incidence of poverty. Two of those approaches, monetary approach and participatory approach, are used to illustrate their differences on identification and selection mechanisms and the implications.

A monetary approach identifies incidence of poverty when an individual satisfy a set of criteria with reference to a monetary value (e.g. daily expenditure of less than \$1). In contrast, the participatory approach identifies incidence of poverty based on loosely-defined criteria determined by the local community. The implication of those different approaches is they may end up with a different list of incidence of poverty. In addition, because the monetary approach provides a more rigid identification method, it is highly likely that the approach will be more consistent in identifying the same incidences of poverty, whoever is doing the identification, as long as the identification rule is followed. In contrast, because the participatory approach provides more room for discretion, the incidences of poverty identified are more likely to be affected by the perception and values of the people who do the identification. Next, after the identification process, the person who is given the authority can decide whether to accept the result of the process or select other beneficiaries irrespective of the result. From the illustration, it can be seen that different identification rules can result in varying specific lists of beneficiaries or resource allocation decisions, but the final list of beneficiaries and resource allocation is contingent on the selection rule.

Putting it in the context of intergovernmental relations under decentralisation, policy identification and selection for government activities at local level can be done by either central or local actors. For example, local governments may be given the authority to identify local schools to be supported with intergovernmental transfers for the education sector, but the final decision is decided by the central government.

This process involving policy identification and selection for government activities can be regulated in the institutional arrangements governing decentralisation or in other regulations specifying the authority of central and subnational governments. These institutional arrangements and regulations also affect policy implementation and credibility of policy decisions. Inclusion of more actors, e.g. involvement of subnational decision makers may allow identification of a broader set of policy alternatives, but it can also make selection of policy more complicated, especially when there are heterogeneous preferences at local level.

Local governments can have better information and closer proximity to citizens which enable local governments to address local preferences, yet some issues remain. Policy decided at local level still has the possibility of failing to address local preferences because the policy process is skewed to the preferences of a subset of local actors, e.g. local elites (Bardhan and Mookherjee, 2006). Local policy making can also deviate from national priorities because of ideological differences or differing prioritisation of public goods and service provision between national and subnational governments (Eaton, 2017). In a given country context, the institutional arrangements governing decentralisation may reflect an attempt to engage with those issues by providing government at national level with the ability to influence local policy. Studies in the area of health systems (Bossert, 1998; Bossert, 2015) demonstrate how this is done by providing more choices to local decision makers in one dimension of policy, but providing limited options in another dimension. In Bossert and Beauvais (2002, pp. 17-21), a comparison of four countries (Ghana, Philippines, Uganda and Zambia) in health sector finance shows that each country has a distinctive decision space for allocating revenue and expenditure in the health sector. Different practices between those four countries are made possible by adjusting the elements of intergovernmental fiscal institutions in response to the desired outcome in each country. It also shows that adjusting the scope of decision making can be done through

a partial adjustment in the institutional arrangements, specifically in the fiscal and political institutions.

The institutional arrangements comprise a bundle of rules which specify the boundaries of action which can be taken by all the actors involved. There are rules which regulate a certain aspect of policy to be carried out by either level of government and specifying this boundary is the first step in identifying the degree of local autonomy. There have been theoretical discussions regarding this division of authority and responsibility, with reference to various factors. As discussed in the previous sections, heterogeneity of preferences, benefit spillovers, and economies of scale are important factors from an economic perspective. However, when designing a decentralised government system, deciding the boundary of action of central and subnational actors purely based on those factors might need redrawing or rescaling of jurisdictions, which can be less desirable than maintaining the existing jurisdictional boundaries to politicians at each level of government.

Considering the fiscal and political institutions which underpin decentralisation, there are several possible implications to local fiscal autonomy. As discussed above, delineation of responsibility, intergovernmental transfers and fiscal decision making are important elements in intergovernmental fiscal institutions. For intergovernmental political institutions, access to political offices and the ability to influence political decision making are crucial. Firstly, clarity of responsibility between different levels of government is important to determine the range of activities of local governments. Clear expenditure assignments avoid redundancy or duplication of activities between central and subnational governments and prevent each level of government from avoiding certain responsibilities or claiming credit from activities done by other levels of government.

Secondly, intergovernmental transfers can restrict local decision making if the allocation details of intergovernmental transfers at local level is not part of the

authority of local governments. An illustration to this is an intergovernmental transfer mechanism which has strict and specific criteria for programmes, activities, and beneficiaries to be funded. The other side of this spectrum is an intergovernmental transfer mechanism where the central government allocates the fund to subnational units, but local governments can decide the use of the transfer fund (e.g. where to allocate the fund and what it is used for) at local level. A strict rule in deciding the use of intergovernmental transfer limits the range of possible alternatives identified by local governments. Following that, intergovernmental transfers can increase or decrease the need for more local fiscal autonomy depending on how much range of choices local governments have in deciding the use of transfer fund.

Thirdly, rules which influence fiscal decision making at each level of government can influence how financial resources are allocated to local governments. For example, the central government might restrict subnational borrowing to ensure a hard budget constraint for subnational governments. In this situation, subnational governments need to discipline themselves fiscally because the central government will not bail them out when there are borrowing crises at subnational level (Rodden, 2005). In contrast, there may be some provisions in the constitution or the law which regulate aspects of intergovernmental transfers, like the amount to be allocated or revenue sharing formula (e.g. minimum spending for education sector in Brazilian municipalities (Cruz and Silva, 2020)). This kind of rule can improve the reliability of intergovernmental transfers for subnational actors because the amount to be received by subnational governments can be better predicted. Fiscal rules can limit the range of possible alternatives for subnational borrowing, which then force local governments to access other financial resource alternatives. Fiscal rules can also limit the range of possible choices for central government relating intergovernmental transfers which possibly reduces (or increases) the need for additional financial resources at local level. Therefore, rules pertaining to fiscal decision making can increase or decrease

the need for more local fiscal autonomy depending on how the rules affect the availability of other financial resources for local decision makers.

Finally, access to political offices determines the extent to which central government can exert its authority to subnational governments and influence political decision making at local level. Subnational political leaders who are appointed by the central government are likely to be under the influence of central government. Grossman (2019, p. 45) argues that subnational political leaders who access their offices through appointment by the central government can be more reliable to implement policies requiring coordination between multiple levels of government. On the other hand, when local citizens have the ability to elect leaders at subnational level, subnational political leaders are likely to experience less control from the central government. Some studies documented the effect of leadership selection rules at local level, e.g. Hessami (2018) argues in the context of Germany where elected mayors are more motivated to choose policies which are perceived to benefit the municipalities and Grossman (2014) in the context of community organisations in Uganda. When the central government can influence decision making at local level or veto local decisions, the credibility of decisions made by local decision makers is compromised. Additional fiscal autonomy can be less meaningful to local governments if they face a possible intervention regarding decisions that they have identified. Therefore, rules on access to local political offices can increase or decrease the need for more local fiscal autonomy depending on how those rules support the credibility of local decisions.

2.5.1 Implications for subnational revenue mobilisation

From the discussion above, intergovernmental fiscal and political institutions influence the need for more subnational fiscal autonomy. Intergovernmental fiscal and political institutions affect the range of choices for local politicians in terms of policy identification and selection. Clarity of responsibility between central and subnational

governments affect the activities which each level of government needs to engage with. Rules on intergovernmental transfers affect the range of decisions for subnational decision makers regarding how to use the fund. Rules on fiscal decision making affect the access of subnational decision makers to certain financial resources. Rules on access to political offices affect the credibility of subnational decisions funded by financial resources available at local level. Interaction of those rules can encourage politicians and bureaucrats at subnational level to strive for more financial resources, with effect on subnational revenue mobilisation. Therefore, the impact of the devolution of new revenue-raising powers is contingent on intergovernmental fiscal and political institutions.

Subnational governments may respond positively when they are provided with new revenue-raising powers, but this needs to be put in context with considerations of other available sources of revenue and intergovernmental institutions. Public revenue is a key resource for politicians which enable them to achieve their goals, either for benevolent reasons or self-interested motives (Brennan and Buchanan, 1985; Levi, 1988). Previous studies have argued and documented evidence of subnational governments not reducing the level of taxation in their jurisdiction even though they receive additional amount of intergovernmental transfers (Hines and Thaler, 1995; Bailey and Connolly, 1998; Bae and Feiock, 2004; Kjaergaard, 2015). Intergovernmental fiscal and political institutions are expected to have influence on how subnational governments respond to new revenue-raising powers, either to amplify, moderate or negate the effects, but the natural response of subnational governments are to use the new revenue-raising powers. Therefore, this study considers this initial hypothesis:

H: Devolution of a new revenue-raising power in Indonesia increases subnational revenue.

Institutional arrangements governing decentralisation in Indonesia are expected to shape how the devolution operates. Subnational politicians and officials can face the need for more fiscal autonomy because of how intergovernmental fiscal and political institutions affect their range of decisions relating policy. Regarding fiscal institutions, rules on expenditure assignments clarify the responsibility of local governments and how it is positioned relative to the responsibility of the central government. Rules on revenue assignments, subnational borrowing and intergovernmental transfers affect the availability of financial resources to local governments and how much autonomy they have in terms of deciding the use of those financial resources. These two areas regulated by intergovernmental fiscal institutions shape the scope of fiscal decision making of local governments, including in the context of Indonesia in which this study is interested. If local governments in Indonesia hold many responsibilities without as much financial support from the central government, they are expected seek for more financial resources from their own jurisdiction, or own-source revenues. In contrast, the provision of more financial resources from the central government is expected to lessen the need for own-source revenues for local governments in Indonesia.

Regarding intergovernmental political institutions, rules on selection of political leaders and the ability of each level of government to influence decision making at the other levels are important for subnational revenue mobilisation. There are cases where the central government holds the authority to select political leaders at subnational level, which are also accompanied by rules to enable the central government to control local governments' activity. This kind of situation put central decision makers as important veto players in policy making at subnational level because subnational political leaders face possible threats from the central government relating their offices. Even when the central government is not involved in the selection of political leaders at subnational level, there can be provision of rules which provide the central government with the authority to intervene or veto local

policy decisions. The main issue in this respect is whether intergovernmental political institutions reduce the scope of decisions for local leaders, which affect the credibility of decisions made by local decision makers as seen by voters. When local decisions are not credible from the voters' perspective, additional financial resources can be not as much desirable to local governments. This study examines these issues further in the context of Indonesia.

Institutional arrangements governing decentralisation may have been developed to respond to other objectives which are at a higher level of priority in the country. The contextual factors within the country are expected to bear some relations with the design of decentralisation adopted by the country. Countries may favour a design which provide the central government with more space to address spatial inequality from natural resource endowments. Another design may allow for extended fiscal control by the central government to mitigate the risk of fiscal malfeasance at subnational level. Some other countries may adopt a design which provide different extent of autonomy to different subnational units or asymmetric decentralisation. A deeper investigation on the design of decentralisation in Indonesia and the objectives it attempts to address is expected to give insights about elements within the devolution which affect the observed impact on subnational revenue.

2.6 Conclusion

The literature on decentralisation and public finance has provided theoretical discussion to frame and develop this study. The first generation theory of fiscal federalism argues that the benefit of decentralisation is because subnational governments are closer to the citizens and are able to respond to subnational preferences better than the central government. The second generation theory of fiscal federalism analyses various other assumptions about politicians which makes it possible for decentralisation to have different designs and implementation results.

Decentralisation policy is often conceived with many objectives and these objectives are not always aligned with efficiency objective as discussed in the literature of public finance. Studies in the context of developing and transitional countries and regarding public financial management reform show that decentralisation is a complex intervention because elements in a decentralisation policy are likely to interact with other political or economic objectives which can result in varying designs of decentralisation across countries. These different designs exhibit particular features regarding the relationship between central government and subnational governments, which then affect the extent of subnational autonomy enjoyed by subnational governments.

Institutional arrangements on decentralisation can show relevant aspects and the organisation of intergovernmental relations under decentralisation. These institutional arrangements have rules regulating responsibility of governments at different level, authority of decision making at local level and access to financial and other resources. Characteristics of intergovernmental relations in those three aspects affect the extent of local autonomy and the need for fiscal autonomy. They can also have effects on intergovernmental competition and the information benefit obtained by subnational governments. In a decentralised system, central and local decision makers can have power over the other in a given context of policy based on the institutional arrangements adopted by the country.

Therefore, intergovernmental fiscal and political institutions affect local autonomy in terms of the credibility and scope of decision making at subnational level. Fiscal institutions affect credibility and reliability of access to financial resources for subnational governments through rules concerning intergovernmental transfers and fiscal rules for national and subnational governments. Political institutions influence credibility of decisions made by subnational governments through rules on selection of subnational political leaders and the extent of central government is able to

influence or override decisions taken by subnational politicians. Each of those institutions affects the scope of decision making of subnational decision makers, which then affects the need for more fiscal resources. Subnational governments would need more fiscal resources when they have a larger scope of decision making.

Based on the discussion in this chapter, there is an expectation on how a devolution of revenue-raising powers would result and how it is influenced by the institutional arrangements and contextual factors. A government requires financial resources to function and it needs to be accompanied by a degree of discretion in deciding the use of those resources. Subnational governments can have a relatively more limited discretion than the central government, which then result in a narrower scope of decision making. Devolution of new revenue-raising powers is expected to motivate subnational governments in mobilising own-source revenues because the devolution provides subnational governments with additional financial resources. However, intergovernmental fiscal and political institutions are expected to influence the extent of impact through how those institutions constrain scope of decision making of local decision makers. Therefore, there is a need to examine intergovernmental fiscal and political institutions more deeply to understand how they modify the scope of decision making of subnational decision makers which then feeds into decisions concerning subnational revenue mobilisation.

Next, this study will investigate how the institutional arrangements governing decentralisation shape subnational revenue mobilisation. The analysis will comprise several elements. First, the institutional arrangements governing decentralisation in Indonesia are examined, including clarification of the political conditions outlined in SGFF and how they change over different periods which have effects on the scope of decision making for central and subnational decision makers. Second, the average treatment effect of devolution of revenue-raising powers to subnational units undertaking the reform is estimated. Possibilities of factors which can cause variation

between subnational units are then analysed. Third, case studies of different subnational units are examined, with an emphasis on assessing the experience at subnational level regarding political conditions, scope of information obtained and interjurisdictional competition which then affect revenue mobilisation at subnational level. Finally, the evidence from those analyses is integrated together to synthesise findings and generate conclusions. To achieve the aims of the analysis, the research methodology and design to conduct this study are explained and discussed in the following chapter.

3 Research Methodology and Design

Review of the literature in Chapter 2 led to the theoretical framework and hypothesis to engage with the research questions posed in this study. To move towards investigating the research questions, this chapter explains and discusses the methodology underlying the research process and the design of the study. The research methodology and design draw from social sciences methodology, with some inclinations towards a certain research philosophy and assumptions adopted by the researcher, such as positivism and objectivism. The first section explains in more detail about research philosophy and assumptions which serve as the basis for the research and relevant research traditions in social science which correspond to the approach taken in this study.

The second section explores the research design which is used to approach the research questions. Multiple research methods are used to address different elements of the research questions. One of the research questions concerning the impact of devolution of revenue-raising power on local revenue mobilisation necessitates a large-n analysis using nation-wide data of variables, while the other question requires a detailed observation of processes through the experience of actors involved in the process. The decision to employ a mix of quantitative and qualitative methods in this study resonates with other previous studies, such as Faguet (2012), in the context of multilevel government system and public administration.

Following that, section three and section four discuss in more detail about the quantitative and qualitative analyses which are carried out in this study. The first research question in this thesis asks about the impact of a recent policy change and it

is to be analysed using econometric analysis. The specification of the econometric analysis, such as the estimator used and the underlying assumptions, is discussed further in the third section. Then, the fourth section discusses the qualitative analyses of institutions and the case studies. It discusses the secondary data sources for institutional analysis and the reasonings and parameters which are considered for the case studies. Then, the fifth section explains about data sources which are used for the analysis in this study, which constitute primary and secondary data.

The sixth section discusses ethical considerations which are involved in the research. Engagement with research participants may expose them to various kinds of problems or inconvenience. Furthermore, there can be bias from the researcher's own experience or social identity. The way how those issues are addressed in this study is presented in the section. After that, in the seventh section, the researcher reflects on the impact of the COVID-19 pandemic on the data collection process. The situation at the time posed some unusual challenges, but there were also positive lessons to be learned from the experience. Lastly, the final section summarises the elements of the research methodology and discusses how those elements are used to inform the research.

3.1 Research Philosophy

Research in social science can follow different methodological paths depending on its objectives and the context on which the research is carried out. Structuring the research philosophy and assumptions underpinning the research helps the researcher to maintain consistency in investigating the research questions, at the very least in accordance to a standard of quality which is acknowledged by a part of social science research community. Moreover, it can be a reference to the readers to understand and appreciate the arguments and evidence in a systematic manner.

This research follows a tradition generally employed in economics and other social science discipline, which is known as positivism. In this tradition, observations are based on phenomena and knowledge confirmed by the senses (Bryman, 2016, p. 24). Likewise, such observations can also be the basis to confirm, or reject theories according to principle of falsifiability (Gerring, 2012, p. 61). Aspects of positivism are often thought to draw parallel from natural science and this is also reflected in the approach taken by researchers adopting this tradition (Bryman, 2016, pp. 25-26). As a result, statistical methods are often employed to test theories or to confirm causal relationship in a topic being studied. This does not preclude qualitative methods from being employed, because qualitative methods can also provide evidence based on positivist criteria (Gerring, 2012; Trampusch and Palier, 2016; Skarbek, 2020). Following positivism as an epistemological position, the ontological position adopted in this research is objectivism, which positions the researcher as independent of the social phenomena being observed (Bryman, 2016, pp. 28-30). As such, this research aims to be objective in conducting the analysis.

In doing the analysis, there is an emphasis on individuals as actors in any given social interaction. These individuals act in a way which is in line with a form of rationality, based on considering assumed costs and benefits in their decisions. Decisions which are visibly attributed to organisations are analysed in the context of individual decision makers who contribute to those decisions (Udehn, 2002; Hodgson, 2007). Taking this approach allows decisions at individual and organisational level to be associated with and compared against individuals' self-interest, which can be diverse such as maximisation of net wealth or political autonomy (as exemplified in Levi (1988)). Following that, various possible dimensions and interactions corresponding with self-interest can be considered when assessing potential costs and benefits facing individuals, as has been argued by others such as Fehr and Falk (2002).

Throughout different parts of this thesis, there are allusions or direct references to models, usually constructed by researchers in economics or political science. Models are an abstraction of the real world focusing on a set of parameters to facilitate understanding of a topic or phenomena being studied. Models have been used as a style of reasoning in social science, as a way to support and validate arguments made by researchers (Morgan, 2012; Gerring, 2012). While models may not explain everything there is in a topic or phenomena, models can provide a typical representation of key aspects of a phenomenon and show how a particular theorisation works within the context accompanying the study. Deriving understanding from models can help in shaping the research to be more selective and focused.

Institutions are treated as rules which can affect costs incurred by individuals or constrain decision made by individuals. Following a previous tradition in analysing institutions (North, 1990; Crawford and Ostrom, 1995; Alston et al., 2018), identifying institutions needs to consider the existence of both formal and informal types of rules. While institutions may not universally influence individuals' rationality and decisions, they can serve as 'focal points' which make certain alternatives more visible to individuals or facilitate collective actions (Hadfield and Weingast, 2014). In the political arena, individuals' perspectives on strategic choice are expected to account for the existing institutions and their perceptible credibility. Section 3.4.1 discusses in more detail the approach taken in this study in regards to analysing institutions and their possible interactions with individuals' decisions.

There are elements of both deductive and inductive approach in different phases of this research. Firstly, a deductive approach involves theorisation and development of hypotheses based on the existing literature and theory-testing (Bryman, 2016, pp. 21-22). The deductive elements in this study are demonstrated in the quantitative analysis and affirming theoretical expectation of qualitative analysis. Secondly, an inductive approach involves drawing inferences from observations

obtained in the research towards the development or modification of the theory (Bryman, 2016, pp. 22-23) The inductive elements appears when the findings of qualitative analysis are used to modify the initial hypothesis and theoretical expectation.

Elements of research philosophy discussed in this section inform the approach taken by the researcher in studying the research questions. Parts of the research design are developed to provide information and observations confirmed by the senses and the researcher positions himself as independent of the phenomena. The researcher derives understanding from models in exploring and comparing typical expectations of a situation in a given context and identifying boundaries and parameters for a phenomena. Institutions are treated as rules which can affect actors' decision making through their individual cost and benefit considerations. All of these aspects are reflected in the decisions made by the researcher in designing and carrying out the research.

3.2 Research Design

Researching decentralisation exhibits many complexities that can affect the generalisability and the depth to which such research aspires. Generalisability is usually obtained through researching with many cases or extensive data in a quantitative study, so it requires reliable data which can be compared across cases. However, because decentralisation is implemented in different ways and has different interactions with various elements in a given polity, achieving generalisability across different country settings may need to omit many variables or addressing very broad questions without sufficient attention to the influence of the details involved, especially relating processes happening in each country. Meanwhile, gaining understanding of detailed nuances at subnational level often requires qualitative evidence that examines many variables and relatively less control compared to

quantitative analysis as qualitative data is often unstructured and may not be readily comparable across cases. Faguet (2009, 2012) demonstrates an approach combining quantitative and qualitative methods in his study of decentralisation in Bolivia. He develops a theoretical model of local government responsiveness and accountability, tests that theory using statistical analyses (quantitative method) and provides detailed observations of what was happening between government, civil society and business in different local governments in Bolivia. He argues that a careful combination of quantitative and qualitative method can provide analytical rigour, generalisability, and a presentation of nuances regarding the implementation of decentralisation in a country context.

Looking at the literature regarding social science research methods, the purposes and merits of both quantitative approach and qualitative approach have been widely discussed. Bryman (2016, pp. 148-149) introduces quantitative research as an approach which relates more to a deductive process, drawing many of its elements from natural science and preferred by researchers embracing positivism. Beyond those characteristics, a quantitative approach can potentially provide inferences on causality and generalisability of results (Bryman, 2016, pp. 162-165). Gerring (2012, pp. 362-366) emphasises the use of quantitative methods as a strategy for causal inference, as quantitative methods facilitate analysis of a large sample which can provide for enough variation to improve confidence on the validity of the research. For qualitative approaches, Bryman (2016, p. 375) notes the close relation to an inductive process and how qualitative approaches are preferred by researchers embracing interpretivism (valuing much about the interpretation of the world by individuals) and constructionism (positioning individuals as interrelated with and influencing the social phenomena). However, others have also argued about how qualitative approach is a useful method to researchers adopting positivism and objectivism. Gerring (2012, pp. 362-363) for example argues that a qualitative approach is useful in studying causal mechanisms, a view which has also been expressed by Rohlfing (2012). As an

illustration of how qualitative approaches can be amenable to different ontological and epistemological position, Trampusch and Palier (2016) discuss various ways to employ the specific technique of process tracing. Moreover, there has been a growing use of qualitative approach in economics, a discipline in which most studies traditionally employed quantitative approaches (Starr, 2014). Discussions in the literature show that both quantitative and qualitative approaches can be employed by studies embracing research philosophy in line with the ones adopted in this study.

The research questions posed in Chapter 1 guide the research design to be used in this study. There are two aims of the research: identifying and estimating the treatment effect of a revenue reform (if any) and uncovering how that effect come to be amidst different strategic choices facing decision makers, signalled by the surrounding institutional arrangements and contextual factors. These aims are to be fulfilled by using a range of data and analytical techniques making the study a mixed-method approach with both quantitative and qualitative data. Mixed-method research can provide evidence which allows the researcher to present a more generalisable conclusion with elaborate analysis on a research topic (Bryman, 2016, pp. 638-640). In addition, the use of different research methods can help the result from one method to inform the preparation and deployment of the other method (Greene *et al.*, 1989; Bryman, 2006; Molina-Azorin *et al.*, 2017). Relevant to the context of this study, a quantitative approach can estimate treatment effects from large-n observational data, while qualitative approach can provide observations to describe and explain the significance of the context which are not captured by quantitative data (Honig, 2018; Seawright, 2016). Lastly, using quantitative and qualitative approaches also allows for triangulation, a means to identify possible bias and verify results, between both analyses (Greene *et al.*, 1989; Bryman, 2006; Gibson, 2017).

This research thus uses a combination of quantitative method and qualitative method to approach the research questions. It seeks to estimate treatment effects from

observed regularities and patterns which emerge from the analysis. A cross-case analysis is done using quantitative method which allow analysis of the treatment effects of the reform to the treated units. Qualitative analysis is carried out to uncover the relationship between the institutional arrangements governing decentralisation and the extent of treatment effects of the reform and as a triangulation of the results of quantitative analysis. Seawright (2016) outlines possible integrations of quantitative and qualitative methods, especially for studying causality, which can provide value when each method bolsters the other, or to use the strength of one research method to cover the weakness of the other. This study follows a similar motivation as a quantitative study cannot provide sufficient explanation about details regarding the process which lead to the outcome, and qualitative study cannot provide generalisable inference about treatment effects across many different units, hence the adoption of the mixed-methods approach in this study.

The quantitative approach in this research involves an evaluation of observational data relevant to the research. The revenue reform which is investigated in this research implies a situation where there was a “treatment” being done to a local government (the unit of analysis). Statistical analysis is then used to analyse the outcome for the “treated” local governments after the reform had been implemented and compare it to the “untreated” local governments. For observational data such as the one used in this study, the researcher constructs the data set from various sources but does not control or manipulate the data generation process. The qualitative approach in this research constitutes data collection from primary and secondary sources to be evaluated using a set of established criteria. Primary data collected from interviews enables observations from actors about the process being studied. Secondary data collected from official documents and archives facilitates observations regarding the institutional environment surrounding the process. These observations focus on variables which are not amenable to quantitative measurements and are expected to show details which complement and enrich analysis from quantitative

approach. The criteria used in the qualitative approach are established from discussions in the theoretical literature. More details about the quantitative and qualitative approaches used in this study are discussed in Section 3.3 and 3.4.

The issue of external validity can arise when findings from a single country study are generalised without taking into account contextual factors affecting the research. This is not to say that such findings are devoid of value for analysing different country context. Faguet (2009, p. 31) asserts that decentralisation brought shocks which reorient 'local processes' and 'sum of the effects of these local dynamics' to produce the outcomes. This study seeks to understand how this reorientation happened and interact with revenue reform which in turn translated into reform outcomes. Therefore, the empirical aim of this study is to investigate, in a given country context, the extent of the impact from devolution of revenue-raising power through the change it exerts to the local dynamics, by modifying the incentives faced by subnational leaders in their revenue mobilisation. The expected results of the study may benefit analysis in a different country context by providing probable patterns of processes that link devolution of revenue raising power to outcomes of subnational revenue mobilisation. In summary, aside from caution and limitation in generalisability, it is viewed that a single country study examining different possibilities of processes can give valuable contribution to the literature and serve as a foundation for further comparative case studies when more evidence of the same kind from different countries is available.

3.3 Quantitative Method: Econometric Analysis

In approaching the question about impact of a revenue devolution in Indonesia, quantitative methods are employed to deal with many data points and assess the outcome of a policy change. Drawing from the literature of method for impact evaluation, there is a diversity of quantitative methods to assess impact of a policy

change or a social intervention. The use of randomised control trials (RCT) is often viewed to produce a credible evaluation result (White, 2013; Gertler *et al.*, 2016). RCT emulates the conduct of an experiment which is done in natural science, with distinct target and control groups and random assignments of each object of intervention into one of the groups. With that setting, the outcome of the intervention can be calculated as the differences between the target and control groups. However, RCT require the researcher to control the assignment mechanism and the reality in the field may not allow that in many circumstances (e.g. random assignment of units is not allowed or not viable from ethical reasons). In those circumstances, researchers can use observational studies and use different estimators to do impact evaluation (Keele, 2015; Gertler *et al.*, 2016).

Considering the implementation of revenue devolution in Indonesia, the quantitative analysis is conducted using an estimation method from econometrics. The devolution of land and building tax in Indonesia and its phased implementation in municipalities (*kabupaten* and *kota*) provide a setting for an event-based study which allow estimation of treatment effects. This estimation is done by comparing pre-treatment and post-treatment outcomes using difference-in-differences estimator (Angrist and Pischke, 2009; Angrist and Pischke, 2015). A difference-in-differences estimator is also used in other contexts as a method of impact evaluation, especially when the researcher has little information about the treatment assignment mechanism (Gertler *et al.*, 2016, pp. 129-142). There are also applications of difference-in-differences estimators in public economics, management and public administration research (Pomeranz, 2017; Fredriksson and de Oliveira, 2019; Dague and Lahey, 2019). The estimator is viewed to fit the context of the research and allow the researcher to estimate treatment outcomes.

Difference-in-differences estimators enable comparison between the outcomes over time between units in the treatment group and units in the control group. An

earlier application of this method is Card and Krueger (1994), in which the authors compare the change in wages over time between a state which implemented a new minimum wage policy (New Jersey) to another state which did not underwent a policy change (Pennsylvania). Therefore, in an analysis using the difference-in-differences method, units which undergo the treatment are classed as the treatment group and units which do not participate in the treatment are classed as the control group. The difference-in-differences estimator facilitates calculation of the change in outcome over time experienced by units in the treatment groups, facilitates calculation of the change in outcome over time experienced by units in the control groups, and facilitates calculation of the difference between the change in outcome over time in those two group categories. The result of the calculation is the average effect of the treatment for the treated units.

To conduct the analysis using difference-in-differences in this study, there are several steps which are done. First, the outcome of interest is observed by obtaining the value from the data set, which we denote as $Y(I, t)$, or the outcome for *kabupaten* and *kota* i at time t . Next, in the period before *kabupaten* and *kota* implement the land and building tax administration, we can assign the value for the treatment as 0, denoted as $D(i, t)$, so for each *kabupaten* and *kota* i at time t , it is denoted as $D(i, t) = 0$ before implementing the reform. After implementing the reform, the value for the treatment becomes 1, so it is denoted as $D(i, t) = 1$ for each *kabupaten* and *kota* which implements the reform at time t . It can be said that *kabupaten* and *kota* which take the value $D(i, t) = 1$ are being grouped into the treatment group, while *kabupaten* and *kota* which take the value $D(i, t) = 0$ are being grouped into the control group. A series of covariates and time and unit fixed effects is included to construct the model as follows:

$$Y_{it} = \beta T D_{it} + \delta Z_{it} + \mu_i + \varepsilon_{it}$$

where Y_{it} is the outcome of interest, a variable of subnational revenue, which is defined as own-source revenue per capita and own-source revenue per total

subnational revenue. D_{it} is the treatment variable, where β_T is an estimation of the average treatment effect. Z_{it} is a set of covariates, for example gross regional domestic product (GRDP) per capita and population. μ_i is unit fixed effects which control for individual characteristics of subnational units which do not change over time. The analysis aims to analyse the extent of treatment effects of the devolution of land and building tax to revenue mobilisation at subnational level. The hypothesis proposed is ‘*devolution of a new revenue-raising power in Indonesia increases subnational revenue*’.

It is important to note the assumptions and limitations underlying the analysis using a difference-in-differences estimator. To start, the estimation rests on the assumption that there is a parallel trend between units in the treatment group and the control group before undergoing treatment. In the context of this research, that means the values of the outcome variable for all units in both control and treatment groups before the treatment move in parallel with each other before implementing the reform and following the same trend over time. The parallel trend before the treatment shows support to the assumption that the outcome variable in control and treatment groups would continue to follow the same trend in the absence of treatment. It satisfies the condition to consider the units in the control group as a counterfactual for the change in outcome over time for the units in the treatment group (Pomeranz, 2017, pp. 27-29). This parallel trend assumption can be checked by comparing changes in the outcomes for a period of time before the treatment. This study discusses parallel trend assumption in section 5.2. Next, the limitation in the estimation is related to possible bias of not including relevant covariates which can affect the outcome. It is important to account for relevant variables to avoid omitted variable bias. Therefore, covariates are included in the analysis.

3.4 Qualitative Method: Analysis of Intergovernmental Institutions and Case Studies of Subnational Unit

The qualitative analysis in this study is carried out in two parts. The first one is an analysis of the institutional arrangements governing decentralisation in Indonesia to clarify the political conditions under that framework in different time periods and, if any, its change over time. Intergovernmental fiscal and political relations between central and local government are argued to have influence on revenue mobilisation at local level, hence the focus on intergovernmental institutions. Taking inspiration from previous studies, the qualitative method for the purpose of institutional analysis requires the researcher to observe characteristics of institutions as formally stated in regulations and official documents, as well as deviations and variations that might arise in their implementation (Siddiki, 2014; Skarbek, 2020). The analytical process also draws from previous studies analysing federal institutions (Montinola *et al.*, 1995; Weingast, 2008).

The second part of the qualitative analysis is carried out through case studies of individual local government, which complement the empirical analysis in the quantitative phase. Case studies are expected to support econometric analysis by complementing econometric limitations which stem from the nature of the data available (Honig, 2018). Case studies also have a purpose as a means of triangulation, which can then clarify the analytical process in the quantitative phase and the other part of qualitative analysis in this study (Baker and Gil, 2012). Evidence from the case studies in this study provide detailed explanation about decision making in local governments and the factors considered by decision makers, especially relating local revenue mobilisation. The following two subsections discuss the methods for each part of the qualitative analysis.

3.4.1 Institutional analysis

Based on the discussion on chapter 2, intergovernmental institutions are understood as various laws and rules which organise the relationship between the central government and local governments. For the purpose of this study, focus is given to intergovernmental institutions which can affect three particular aspects relating local autonomy: responsibility of each level of government, authority of decision making, and access to financial resources and political offices. The first step of the process is to identify and collect the relevant public documents pertaining laws and rules which affect the aspects mentioned above.

An institutional analysis on laws and regulations needs to consider the possibility of actors changing the laws and regulations to fit their objectives. Politicians can attempt to make new laws or change the existing laws, therefore, how rule making is regulated needs to be clarified. Previous analyses have called for attention to this issue in various forms. Brennan and Buchanan (1985) argue that rules can be chosen by individuals who act as political agents, which alludes to the significance of constitutions which can constrain political agents. Ostrom (2011, p. 11) acknowledges a specific action arena called the ‘constitutional tier’ which is an arena where ‘decisions are made about who is eligible to participate in policymaking and about the rules that will be used to undertake policymaking’. Discussions in previous studies show that laws which themselves regulate the development of new laws or the change of existing laws need to be specially analysed. Therefore, for this study, laws and regulatory provisions which affect particular aspects concerning local autonomy, as mentioned in the previous paragraph, are analysed alongside the constitution and laws which regulate the formulation of new laws. The analysis is then carried out by collecting laws which influence decentralisation in Indonesia and evaluating them using a framework from the literature.

This institutional data is then evaluated using a framework for institutional analysis. The framework follows Crawford and Ostrom's 'grammar of institutions' (McGinnis, 2011, p. 177; Crawford and Ostrom, 1995; Alston et al., 2018, pp. 34-42) to decompose rules delineated in those laws into separate components such as follows (description following Alston et al. (2018, p. 35)):

- Attributes: To whom does the rule apply?
- Deontic: Does the rule permit, oblige, or forbid an action?
- Aim: To which action is the rule assigned?
- Conditions: When and where is the rule applied?
- Or else: What are the consequences for not following the rule? Who enforces the rule

Analysing the rules in the Indonesian constitution and laws is useful to define the boundary of autonomy and constraint facing political actors and decision makers at central and subnational level. The institutional grammar has been used in other studies to understand the core elements of laws and policies (Siddiki *et al.*, 2011; Siddiki *et al.*, 2012). In the analysis, this thesis is particularly interested in which rule in the Indonesian constitutions and laws that permit, oblige, or forbid actors at central and subnational level in doing something, especially related to the aspects which link to local autonomy.

There are many possible individual actors to which the effect of rules can be analysed, but emphasis is given in this study to political leaders and public officials. Political leaders and public officials are in the strongest position to influence policy and public decision making. Moreover, following the theoretical literature on second generation fiscal federalism (Weingast, 2014; Weingast, 2009), tensions between politicians at central and subnational level are argued to influence the scope of political conditions underlying federalism, which then affect incentives of subnational

politicians. This also resonates with the framing of subnational political authority as 'property rights' where credibility and sustainability are affected by the surrounding institutions (Salter and Young, 2019; Salter, 2015).

This analysis only provide observation on formal rules which implementation can be different in practice. Siddiki *et al.* (2011, p. 99) suggest that the analysis using institutional grammar could benefit from other data collection methods such as interviews, to understand how actors related to policy making interpret policy and act on it. Previous studies analysing institutions also consider the use of secondary data and historical documents (Alston *et al.*, 1996). Therefore, in this thesis, data from official reports, journal articles, and media coverage is used to provide empirical observation regarding implementation of these laws. This secondary data is then supplemented by primary data from interviews which provides observation on how formal rules affect decision making and policy implementation.

Following the discussion in this section, several aspects of intergovernmental relations can be evaluated. First, it can be inferred whether politicians at central level can influence decision making at local level (and vice versa) and how strong that influence is (e.g. veto power). Second, it can also be inferred whether politicians in different level of governments have influence in their counterpart for access to political offices. Third, the scope of responsibility of politicians in each level of governments, which then translate into public expenditures, can be defined. Fourth, availability of access to financial and non-financial resources for politicians in each level of governments can be identified. Next, the case studies and interview methods are discussed in the following section.

3.4.2 Case studies

Analysing the process of revenue mobilisation using case studies enables observations relating factors which are not captured by quantitative variables. The quantitative

analysis provides an estimation of average treatment effects for the treated units, but more understanding can be obtained by analysing the process to infer how those treatment effects become realised amidst existing institutional arrangements and contextual factors. Bryman (2016, pp. 394-396) posits that a qualitative approach allows the researcher to observe from the perspective of individuals directly involved at the process at hand and to emphasise on context and process. In studies involving organisations, the values of a qualitative approach as posited by Bryman are embedded in the objectives of case study method, which are to provide ‘a detailed and rich description of the situation’ and to inform about areas which are not amenable to the current approach in economic modelling (Baker and Gil, 2012, pp. 208-209). In studies with an element of causal inference, a case study is useful in explaining causal processes and factors which contribute to the outcome, especially when the causal effects has been assessed by a cross-case analysis (Rohlfing, 2012, pp. 12-15). Those reasons discussed in the literature resonate with the objective of this current study relating to the second research question, which is to understand the contribution of institutional arrangements and contextual factors in the outcome of a revenue devolution in Indonesia.

To explore how the existing institutional arrangements and contextual factors contribute to the outcome of revenue devolution, focus is given to subnational units which implemented the reform. Cases are selected from a list of municipalities which opted to do the reform in 2011-2013 period. Case selection considers cases which vary in a relevant background factor while undergoing a similar reform. There is an interest in this study to explore whether local governments with varying types of revenue sources available experience similar processes in their revenue mobilisation. An exploratory most-different design case selection fits this objective (Gerring, 2016, pp. 84-88). The background factor which is used as a case selection factor is natural resource endowment. Natural resource endowments can affect the degree of economic activity and the extent of central government’s influence in the jurisdiction, especially

considering that central government controls State-Owned Enterprises operating in sectors related to natural resources (e.g. forestry, general mining, oil, gas) (Agustina *et al.*, 2012; Kim, 2021). This decision is also consistent with the idea proposed by Honig (2018), where he emphasises on the usefulness of case selection which focuses on time-invariant or slow-moving variables, as it can provide valuable insights which complement findings from quantitative analysis. Time-invariant or slow-moving variables pose some challenges to be analysed with quantitative method because of their collinearity with fixed effect estimator or lack of variation over time, which support the case for case study analysis.

Following the discussion above, municipal case studies are selected from the population of municipalities which implemented the reform in the 2011-2013 period. Data on Natural Resource Revenue Sharing Transfer received by the municipalities in the year before the reform is used to sort those municipalities based on the fund they received. There are 122 municipalities undertaking the reform in that period, but five of those municipalities have missing data on Natural Resource Revenue Sharing Transfer, which means the case selection is done from 117 municipalities in the list. Two municipal cases are selected, one municipality from the top 25 per cent recipient of Natural Resources Revenue Sharing Transfer, the other one from the bottom 25 per cent of the list. By the request of research participants in relation to protecting their anonymity, especially the ones who are officials at local governments, the name of each municipality is not disclosed here. Instead, the selected high resource case study municipality is labelled Municipality A, and the low resource municipality is labelled Municipality B. This approach is a similar practice to that of other studies such as Ang (2016) where the names of the unit of government are presented using coded names or pseudonyms. In that particular study, the names of the county where Ang undertook her research were presented using pseudonyms such as 'Upstart County' (p. 29) and 'Blessed County' (p. 184).

Municipalities A and B are representative cases in reform outcomes in that they both implemented the devolution of property tax in the 2011-2013 period. Municipality A is located in Sumatra island and has substantial natural resource endowments, especially in forestry products, oil and gas. Palm oil production plays an important role in the local economy, with companies building their factories there. As also reflected in the amount of Natural Resources Revenue Sharing Transfer it receives each year, Municipality A is one of the top producers of oil and natural gas in Indonesia. Municipality A spans an area of just below 2,000 km², with recent population in the range of between 250,000 and 320,000 people.

Municipality B is located in the island of Kalimantan (or Borneo), has a smaller natural resource endowments than Municipality A. It is known more for its bustling commerce, with agriculture, agroindustry, and trade forming important parts of the local economy. Retail shops and shopping centres can be seen throughout the city. The municipality is densely populated with recent population ranging between 550,000 and 650,000 people while the municipality spans an area below 1,000 km². With their distinctive characteristics, Municipality A and Municipality B are quite similar in their total GRDP, which is in the range between IDR 20 trillion and IDR 30 trillion.

Table 3.1 presents the summary of the budget in Municipality A and Municipality B for the year 2021 as published in the local regulation of each municipality. When the interviews were carried out in 2022, the 2021 budget year had passed and the 2021 budget provides the then most recent information about the revenue and expenditure condition in the municipalities. From Table 3.1, it can be seen that the revenues and expenditure in Municipality B are higher than in Municipality A. However, it should be noted that those two municipalities have different level of population and if the population in the municipalities is taken into

account, the amount of revenues per capita and expenditures per capita are higher in Municipality A than in Municipality B.

Table 3.1. Budgetary Data for Municipalities A and B for the year 2021

No.	Budgetary items	Municipality A	Municipality B
A	Local Revenues		
A.1	Own-source revenues	345,724	538,008
A.1.1	Local taxes	163,180	358,500
A.1.2	Local user charges	39,199	38,760
A.1.3	Income from separated local entities	2,600	35,240
A.1.4	Other own-source revenues	140,745	105,508
A.2	Intergovernmental transfers	795,339	1,164,863
A.3	Other local revenues	39,963	67,511
	Total Local Revenues	1,181,026	1,770,382
B	Local Expenditures		
B.1	Operational expenditures	1,073,637	1,397,450
B.2	Capital expenditures	165,619	422,162
B.3	Fund reserved for unexpected expenditure	7,086	50,002
	Total Local Expenditures	1,246,342	1,869,614
	Budget Surplus/Deficit	-65,316	-99,232
C	Financing	65,316	99,232

Source: Local Regulation of Municipality A and Municipality B, year 2021. Numbers are in million IDR.

In both municipalities, local revenues in 2021 still mostly relied on intergovernmental transfers, although own-source revenues also comprised between 29-30 per cent of local revenues. Significant components of local taxes in Municipality A in 2021 were property tax which contributed to 52 per cent of local taxes, electricity tax which contributed to 26.5 per cent of local taxes, and property transfer tax which contributed to 11 per cent of local taxes. In Municipality B, property transfer tax was

a significant component of local taxes which contributed to 30 per cent of local taxes. In addition, electricity tax contributed 25 per cent of local taxes, and restaurant tax contributed 18 per cent of local taxes. Municipality B managed to obtain more revenues from restaurant tax and hotel tax than Municipality A, as Municipality B collected around IDR68 billion from both of those taxes while Municipality A only collected around IDR13 billion.

Observations regarding experience of subnational revenue mobilisation and the implementation and enforcement of rules are obtained through interviews, historical data and official reports. Interviews are carried out with public officials from central government and local governments as research participants. Public officials directly interact with the process in the government and work within an environment influenced by political discourses (Wu and Savić, 2010; Widner, 2022). In semi-structured interviews, the researcher prepares a list of questions to guide the interview process, but the research participants have flexibility in responding to the questions and the researcher can ask follow up questions not listed in the interview guide (Bryman, 2016, pp. 671-672). As the institutional analysis component in this study provides evidence on the scope of decision making at local level based on formal rules, the evidence from interviews is expected to provide empirical evidence for the decision making process. In this regard, formal rules act as a boundary of behaviour or the institutions-in-form, while information of process implementation from the practitioners act as a confirmation or adjustment to that boundary which also clarify if there are other informal norms at play or the institutions-in-use (Crawford and Ostrom, 1995; Siddiki *et al.*, 2022). The interviews are carried out remotely using online modes of communication (Bryman, 2016, pp. 490-492) in response to the situation during the COVID-19 pandemic. More details on the conduct of interviews are discussed in section 3.7 which reflects on the data collection process.

Organisation and analysis of data from interviews are informed by the theory while also being aware to emerging themes brought by the participants' response. Transcriptions of interviews are treated as 'products of predefined research questions and or predetermined research objectives', which are shaped by the research objectives more than influencing the objectives, and follows a mostly deductive process (Jenks, 2018, p. 9). Data from interviews is organised into several themes which correspond to alternative choices of revenue at local level and various factors considered by policy makers (Bryman, 2016, pp. 587-589). Emerging themes are identified when research participant's response highlights a new factor which adds more detail to explaining the phenomenon. An example of this is the discussion in section 6.3.3 about the role of community in property tax collection.

The process sequence of local fiscal decision making in Indonesia also informs the analysis of data from interviews. The area of local fiscal decision making which is the main interest of this study is regarding local revenue decision, where results are reflected in the local governments' annual budget. A systematic analysis of process can show the relative influence of various factors on the decisions or actions taken by actors which are relevant to the outcome of interest (Hall, 2006, p. 29; Skarbek, 2020, pp. 8-10). This approach resonates with analysis on action situations, which are 'social spaces where individuals interact' (Ostrom, 2011, p. 11) or the "black box" where policy choices are made' (McGinnis, 2011, p. 172) which are included in the Institutional Analysis and Development framework. Following ideas from that literature on methods, the analysis of data from interviews in this study presents factors and institutional influence which affect local revenue decisions taken by decision makers.

3.5 Data Sources

There are different sources of secondary data used in this research. Secondary data concerning statistical analysis uses the database from Indonesia Database for Policy and Economic Research (INDO-DAPOER) from World Bank Group and published official data from the government. The data from INDO-DAPOER includes financial information (e.g. subnational own-source revenue, intergovernmental transfers), economic and social indicators (e.g. Gross Regional Domestic Product). The published official data from the government comprises the timing of reform for each subnational unit and various laws regulating decentralisation in Indonesia. Information on relevant historical events is also collected from secondary sources such as reports from non governmental organisations (NGOs) and media outlets.

For data relating laws and regulatory provisions, this study uses official documents from the government of Indonesia. The Supreme Audit Agency of the Republic of Indonesia (*Badan Pemeriksa Keuangan Republik Indonesia/BPK-RI*) has an online database of laws and regulations enacted by the government. This database, *Database Peraturan Jaringan dan Dokumentasi Informasi Hukum (JDIH) BPK* (JDIH-BPK hereafter), contains various laws enacted by the central government (by the legislature at national level, the president, or the ministers and the heads of central agency) and subnational government (by the legislature or the executive branch at subnational level). Another online repository of Indonesian laws at the Ministry of State Secretariat (*Kementerian Sekretariat Negara/Kemensetneg*), JDIH-Kemensetneg, was also consulted to get the laws which were not available at JDIH-BPK. The laws and regulations collected from the database are:

1. The Indonesian Constitution (UUD 1945, fourth amendment);
2. Law 10/2004, Law 12/2011, and Law 15/2019 on Formation of Laws and Regulations;

3. Law 22/1999, Law 32/2004, Law 12/2008, and Law 23/2014 on Subnational Governments;
4. Law 25/1999 and Law 33/2004 on Fiscal Balance between National and Subnational Governments;
5. Law 27/2009, Law 17/2014, Law 42/2014, Law 2/2018, Law 13/2019 on Legislatures (National Assembly, People's Representative Council, Regional Representative Council, and Subnational Legislatures).

These laws directly influence decentralisation in Indonesia, either by structuring relations between central and subnational governments or defining the scope of activities and authority for each level of government. The constitution and the laws of Formation of Laws and Regulations also structure the possibility of central and local actors to behave towards changing the existing laws. Each of those laws above has consequences to possible actions which can be taken by individuals, especially political leaders at central and subnational level.

Primary data used in this research is collected through interviews of government officials. Interviews are conducted to actors which understand and deal with subnational revenue mobilisation and subnational policymaking, from central government and local governments. A category of interviewees is as follows:

1. Central government: Officials with work experience in Financial and Development Supervisory Agency, officials with work experience in Ministry of Home Affairs;
2. Local governments: Officials with work experience in local secretariat, officials with work experience in revenue units, officials with work experience in planning units, officials with work experience in sectoral agencies at local level (e.g. local education authority, local health authority).

Interviews are carried out to 22 officials from the central and local governments. Out of that total number, 10 interviewees are from the central government and 12 interviewees are from the local governments. Out of the 10 central officials interviewed, 7 of them work at the branch offices in the regions. The research participants have between six and twenty one years of work experience in the government.

3.6 Research Ethics

There are three important considerations regarding research ethics which are relevant to this study. Firstly, the researcher ensures that research participants engage in the research voluntarily without any outside influence. To do that, the researcher provides a consent form to be completed by research participants so that research participants can decide whether to participate in the research and to what extent. Secondly, the research puts importance on the safety of research participants. The research participants are public officials, and therefore they were cautious about the effect of what they had said as part of their participation in this study. The researcher ensures anonymity of research participants so that no one can attribute responses given to any of the research participants. Thirdly, the research may be influenced by the researcher's positionality, and this can affect both the researcher and participants. From the researcher's side, positionality may result in a certain bias which influence the analysis being done. From the participants' side, researcher's positionality and identity may affect the response given by research participants.

Regarding consent and voluntary participation in this study, the researcher ensured that research participants were sufficiently informed about how the data would be used in the research and how it might inform the research. Research participants were given a participant information sheet which explained about data collection from interviews and data management. Research participants also received

explanation from the researcher about how the data collected from interviews would be triangulated with and complemented by data from other secondary sources and the results from the quantitative analysis. After research participants were informed about their rights and agreed to participate in the research, they were asked to sign the participant consent form to confirm their voluntary participation in this study.

Anonymity of research participants and confidentiality of their responses are addressed carefully to ensure the safety of the research participants. The safety of the research participants was a factor which can influence participation in the research. Taking into account the fact that the research participants were public officials, this study identifies and addresses some key points which relate to their concerns regarding their identity. The pilot study conducted before the actual interviews were useful to identify these key points. This study ensures research participants' anonymity by disassociating their personal information (e.g. name, email) from the data before the analysis. Each research participant was given a coded identifier (e.g. Interviewee C01, LA04, LB02) after the interview, and then the data for the analysis did not contain any personal information of the participants. In addition, professional information about research participants (e.g. job role, organisation name) was modified to only contain the relevant information about the area in which they work (e.g. planning agency, audit agency, and so on). Furthermore, the name of the two municipalities was also referred as Municipality A and Municipality B to prevent identification by other Indonesian public officials (more explanation on this appears in Section 3.7). Therefore, an illustration of participant's reference information in the data is 'Interviewee LA04 (participant's ID), line manager (participant's job role), finance agency'. The participant information sheet given to participants contains information about how anonymity of participants and confidentiality of response were addressed, and the researcher provided additional explanation during the interviews.

The researcher conducting the interviews was affiliated to Financial and Development Supervisory Agency (*Badan Pengawasan Keuangan dan Pembangunan/BPKP*), a central government internal audit agency. Some activities of BPKP address the area of local public financial management, which could be a concern for the research participants and may also affect the view of the researcher in the analysis. Some participants did ask about whether the researcher had an affiliation to any government or private sector agency. The researcher explained his position to those participants (Mason-Bish, 2019) and also informed that there were procedures in place to ensure participants' anonymity and confidentiality of their responses, and also about other analyses being conducted as part of the study, so that they could be assured to respond candidly based on their own experience. An output of this study (the PhD Thesis) will be accessible to the general public in the future, but with those aforementioned anonymity and triangulation procedures the participants can be assured regarding the safety of participants and objectivity of the analysis. The researcher also agreed to participants' request to schedule the interview at the time deemed suitable by the participants (further discussion on this in Section 3.7). Regarding the risk of bias from the researcher's side, the researcher uses only the data collected from the interviews, data provided by research participants and secondary data which was publicly available to inform the analysis in this study.

The researcher's affiliation to a government agency may also affect the way research participants respond to the interview questions. Research participants may not want to disclose weaknesses or mismanagement of processes related to the area being asked. An example of interview question which may relate to this issue is 'What is the most reliable own-revenue source for local governments?'. Research participants from the local government may want to answer the question in a way that do not encourage further question about the detail of own-revenue sources in that local government, if that local government does have a weakness in managing parts of its own-source revenues. The researcher approached this kind of question by preparing

financial data of other local governments (from INDO-DAPOER) which can be perceived as weak in various parts of their revenue management. While asking the question, the researcher mentioned, as needed, that other local governments had had difficulties in dealing with some parts of their own-source revenue. That way, the gravity of the possible weakness decreased and it could encourage research participants to answer the question in more detail. In addition, the researcher also brought financial data of that local government to triangulate or as additional evidence to be shown to the research participants as needed (Gibson, 2017).

There is also another possibility where research participants resort to normative answers which conform to conventional expectation in the procedures and regulations. An example of interview question which may relate to this issue might be 'How limiting are intergovernmental transfers to local governments?'. Research participants from the central government may want to answer the question as described in the laws, which may provide the central government with a degree of control and the reasoning behind it. To approach this kind of question, the researcher also prepared other expressions which ask around the area of the question (Roulston and Choi, 2018), for example: 'Are intergovernmental transfers only used for items predetermined by central government?' or 'Is there any case where intergovernmental transfers cannot be fully used by local governments?'. The researcher also compared the answers from research participants in the central government and local government as a means of triangulation (Gibson, 2017).

Research participants may also want to be credited for their answers, possibly because they may have done something or may have said something which could be perceived as a positive action. In practice, this did not occur during the interviews because the researcher approached the research participants directly and did not access the participants through their organisations. To the best of the researcher's knowledge, research participants did not disclose their participation in this study to

their respective organisations and colleagues because their participation was not done through the ‘official’ channel. In this kind of situation, the option to be anonymous is often preferred by research participants, as they cannot be the target of blame because of participating in a research without informing the organisation in which they worked. For the local governments, anonymity is even more important as research participants can be identified if their job role and the municipality’s name is known. Recruiting participants for this study proved to be quite challenging because of the surrounding situation (COVID-19), but the researcher managed to approach appropriate research participants who were willing to be interviewed.

3.7 Reflection on Data Collection

Some parts of the research were affected by the COVID-19 pandemic. Because of the pandemic, qualitative data collection could not be done in the field as initially planned, but was done through virtual interviews. Virtual interviews enabled interaction between researcher and participants without direct contact and was quite efficient in terms of research cost. However, there were some difficulties encountered during virtual interviews. Because of the different time zone between the location of the researcher and the participants, scheduling an interview was quite difficult as both the researcher and participants need to find the schedules which fit each of them. In addition, during the COVID-19 pandemic, research participants were not too keen to participate in the interviews as they had to adapt with a different work environment and protocol compared to the situation before the pandemic, and they might need to do additional activities which were pandemic-related. Furthermore, internet network stability was also a problem, because the internet coverage or broadband speed may be insufficient or unstable at times, so that communication may be hindered. In this kind of situation, some steps which were taken include the switch from video call to voice call to reduce the data needed through the internet.

The semi-structured interviews for this study were carried out between March and October 2022. Between December 2021 and February 2022, the researcher conducted pilot interviews where respondents were Indonesian people with experience working in the government in Indonesia (either at central or subnational level). From these pilot interviews, the researcher was able to assess how interviewees responded to the questions and whether there were ambiguities resulting from the wording or structure of the questions. Based on the responses to the pilot interviews, some adjustments were made to the list of questions which included changes in the wording (to provide greater clarity to the interviewees) and sequencing of questions (to progress more naturally from general questions to more specific ones). In semi-structured interviews, the researcher has the opportunity to ask follow-up questions which allow further exploration on a particular response. The researcher used this opportunity to get a more detailed response on topics such as the role of human resource management and community support on local revenue mobilisation, which was not a particular focus initially.

The initial plan for primary data collection was to do fieldwork in Jakarta, the capital city, and, for the municipal case studies, to interview research participants from both central and local governments. The period when the interviews were carried out was during the COVID-19 pandemic, where there were restrictions in international travels and different domestic travel protocols between countries. The pandemic situation also affected the risk assessment process in the university which was carried out when a researcher considered to do a primary data collection through fieldwork outside the United Kingdom. Because the municipalities in Indonesia were scattered on the country's many islands, domestic travel to the municipal case studies in Indonesia could involve a series of local quarantines between travels, which would then make fieldwork time-consuming and costly. Therefore, to address these issues, the researcher decided to do the interviews virtually.

The decision to carry out the interviews virtually brought some positive results in terms of data collection, while there were also identifiable weaknesses compared to face-to-face interviews. During the period when the interviews were carried out, interviewees (or the researcher) might not be available to meet in person because they needed to quarantine (because of a confirmed COVID-19 infection or public health advice which is given because of the result of contact tracing). Conducting the interviews virtually allow the researcher and participants to discuss even though any one of them is in quarantine. Because of safety reasons of the research participants, when the research participants were unwell or unfit to be interviewed, the researcher rescheduled the interviews to a later date. Virtual interviews also enabled the interviews to be carried out in a way which could be more relaxed and private from the interviewees' perspective, as they could choose the suitable place and time where they can be interviewed without interference from work or their other personal activities. As a result of this, almost all of the interviews were done outside the working hours of the research participants.

Some challenges and weaknesses arise even with virtual or telephone interviews. The long distance interviews for this study were carried out through communication software, such as WhatsApp and Zoom, whichever more convenient from the participants' perspective. Most of the participants preferred WhatsApp as a platform to communicate with the researcher because the software was readily available to each research participant and the research participants have greater familiarity with the software. Therefore, these long distance interviews relied on internet connection, which was an issue in some of the interviews. For local officials which were located in the municipalities, there were many instances where they did not have a good internet connection to maintain a stable video call. To maintain a quality communication in those instances, the researcher and participants turned off their videos and communicate only by audio instead. With this communication protocol, the interviews could be carried out successfully. The researcher could not

fully observe facial expression and body language of the interviewees when video was enabled, let alone when the interviews relied on audio communication only. This challenge has also been noted by other researchers conducting long distance interviews (Bryman, 2016; Roulston and Choi, 2018). However, a long distance interview is still a reasonable method for data collection because validity of the data can be supported by triangulation procedure between data from interviews and data from other primary and secondary sources used in this study.

3.8 Conclusion

This study addresses the research questions through a set of analysis. The research design in the study is informed by elements of research philosophy and analytical assumptions adopted by the researcher. A mix of quantitative and qualitative method is employed to approach multiple research objectives posed by the research questions. To understand the effect of a revenue devolution on local revenue mobilisation, the researcher carries out a quantitative analysis using difference-in-differences estimator. A difference-in-differences estimator is suitable to use because of the nature of the reform where municipalities implemented the reform not at the same time. That analysis rests on the assumption that there had been a parallel trend over time, relating revenue outcome variables, between municipalities in the treatment and control group before the reform was implemented.

To understand how institutional and contextual factors influence subnational revenue mobilisation, the researcher carries out a qualitative analysis on intergovernmental institutions and municipal cases. An analysis on laws and regulations focusing on how they enable and constrain actors, both central and subnational, is carried out using the institutional grammar. This analysis focuses on the implication of formal rules to actions which can be taken by central and subnational actors in relation to the three particular aspects of local autonomy:

responsibility of each level of government, authority of decision making, and access to financial resources and political offices. The scope of decision making of central and subnational actors can be identified from this analysis. However, delineation of scope of decision making in formal rules can be different from its actual implementation.

The researcher then analyses further two municipal case studies to understand obtain understanding on the surrounding context and process which lead to the outcome. Case selection is done by using natural resource endowment as a selection factor between cases in the population of municipalities implementing the reform in the 2011-2013 period. Interviews are carried out to public officials at central government and municipalities, putting a particular importance on the process of local fiscal decision making. Data from interviews is organised into themes informed by theory, process sequence and emergent findings. This allows the researcher to identify factors surrounding the revenue decision making process which enable the achievement of the desirable (or undesirable) outcome.

This study uses various data from secondary and primary data sources. Data for quantitative analysis is obtained from INDO-DAPOER database which is published by the World Bank. Data for qualitative analysis comes from historical documents, media reports, laws and regulations, and interviews. This data is then organised into thematic categories and analysed. Following the methods discussed in this chapter, the changes of institutional arrangements and intergovernmental relations in Indonesia in the 1999-2014 period are discussed in the next chapter.

4 Changes in Decentralisation and Intergovernmental Relations in Indonesia

Since Indonesia undertook its decentralisation reform twenty years ago, there have been several adjustments to the institutional arrangements governing decentralisation. These adjustments have been featured in the media as well, in the form of news articles or op-eds, especially when there is a significant policy change. In recent years, there were articles in the media regarding subnational policy on property taxes (The Jakarta Post, 2018; The Jakarta Post, 2019). Those accounts reflected the policy debates happening in the government and the attention they brought in the society. Changes to the institutional arrangements of decentralisation in Indonesia modified the relationship between central and local government in the 1999-2014 period. All of those adjustments have been reflected in the relationship between central and subnational political leaders, between central officials and subnational political leaders, between central and subnational officials, and between subnational politicians in different branches of government (i.e. executive and legislative). Intergovernmental relations were affected especially in the division of service responsibilities, intergovernmental transfers, decision making authority and access to political offices.

This chapter discusses an overview of Indonesian multilevel government system and the changes in the institutional arrangements in different time periods, specifically in the 1999-2014 period. It also discusses the situation and institutional arrangements before that specific period as there were many differences in central-local relations between before the year 1999 and after. Laws and regulations which regulate intergovernmental relations and authority of central and local officials are

identified and analysed to understand their implications for the autonomy of subnational political leaders and officials. In doing so, inferences over the credibility of local policy making and the need for local own-source revenue and how it changes over the period can be made. The analysis of the laws and regulations clarifies the boundary of local autonomy at least as presented in those formal legal instruments. This, in turn, enables the researcher to present the organisational environment in which the process of subnational revenue mobilisation and policy making happened. From the result of the analysis, relevant contextual factors are identified and important explanations about what leads to the outcome of revenue devolution are drawn.

The following section discusses the historical context which leads to the decision to adopt a decentralised government structure in Indonesia. The decision to decentralise was situated within the wider political and economic environment at the time which policy makers faced. The second section discusses the Indonesian constitution and identifies relevant Indonesian laws which regulate the implementation of decentralisation. Constitution has its importance as a focal point which guides and constrains the development of more detailed laws and regulations. The constitution also limits the extent to which the central government is able to act whenever differences occur between central and subnational policy makers. Furthermore, identifying laws which influence the shape of decentralisation in Indonesia allows the researcher to focus on those laws and the changes that had happened to them over the period between 1999 and 2015, during which the most recent revenue devolution was carried out. Those laws contain various rules in the fiscal and political sphere organise the relationship between the central and local governments in Indonesia.

Afterwards, the sections that follow focus on different time periods while maintaining focus on the changes in laws which influence various aspects such as

delineation of responsibility, authority of decision making, and access to financial resources and political offices. These various aspects underwent some changes over time, and those changes determined the boundary of local autonomy. Identifying the boundary of local autonomy is important to this research because it contributes to explaining how critical various revenue sources are to local governments. Devolution of power to raise revenue is expected to increase the scope of fiscal decision making of local policy makers, but it is only meaningful when there is some need to mobilise more revenue at local level. The last section in this chapter presents the conclusions based on the analysis carried out in the preceding sections and how it may affect the outcome of the revenue devolution.

The analysis carried out in this chapter examines the scope of autonomy based on the laws and regulations and how they changed over time. As discussed in section 3.4.1, analysis of the formal rules and how they change is important to establish the formal scope of autonomy and whether there have been successful efforts from decision makers to modify that scope of autonomy. This formal scope of autonomy becomes a reference to be compared with the scope of autonomy in practice which were observed by central and local officials in chapter 6.

4.1 Historical Context Leading to Decentralisation in Indonesia

Before analysing the changing institutional arrangements governing decentralisation in Indonesia throughout different periods, it is important to examine the context within which the decentralisation process is situated. The enactment of decentralisation policy in Indonesia was in part a response to political and economic issues which were salient in the pre-decentralised Indonesia and this context is discussed in this section. Decentralisation in 1999 did devolve various aspects of responsibilities and resources to subnational governments at provincial and municipal level, but subnational governments in Indonesia, at least some of them, had also

experienced a period where they had been given some additional responsibilities and control of resources before the year 1999. Assignments were given from central government to provincial and municipal governments, mostly similar to a deconcentration arrangement discussed in section 2.2, to accomplish particular objectives concerning programmatic state-led development which was promoted and controlled by the central government. In addition, there was also an element of territorial and political control which prevented subnational governments to be empowered during that period.

Indonesia claimed its independence in 1945, but economic growth in the country was rather unstable until the early 1970s. This has led many analysts to be rather pessimistic on the country's economic trajectory alongside other countries in Asia (e.g. van Zanden and Marks, 2012). Policy making before 1970 in Indonesia was notable for conflicts of ideologies, both in economic and political dimension, which did not allow a sustained development policy. Budgetary expenditures had experienced faster growth than budgetary revenues, which led to an increase in budgetary deficit, debt to GDP ratio, and inflation (Booth, 2016, p. 42). In the political arena, there were fluctuating opinions about communism which resulted in various revolts and a documented coup attempts (Vu, 2010, pp. 63-66). Furthermore, there was also prominent anti-Western element to Indonesian foreign policy, which also contributed to the withdrawal of Indonesia from the United Nations between 1965 and 1966. There were also instances of the Indonesian government taking over Dutch-owned private companies, and British and American companies between 1957-1966 period (Lindblad, 2015, pp. 219-220; Booth, 2016, pp. 45-46). The political situation enabled the then President, Soekarno to have decision-making power concentrated in the executive branch of government.

When power shifted from Soekarno to the Soeharto regime in the late 1960s, there were also changes in the country's overall development policy. Soeharto

employed a team of economic advisors educated in the United States to map out the country's path to development, with priorities to stabilise and rehabilitate the Indonesian economy (Vu, 2010, p. 66; van Zanden and Marks, 2012, pp. 168-170). The government took a different stance in economic policy and enabled the financial sector to be more developed to attract foreign direct investment (Lindblad, 2015, pp. 219-222). The policy led Indonesia to record a significant increase in economic growth, averaging up to eight per cent annually between 1967 and 1981 period, and Indonesia also received windfall gains from the increase in world oil prices during the period (Booth, 2016, p. 66). The government sought to develop the agricultural sector by providing supporting policies, such as subsidies to fertilisers, while also looking for opportunities to move towards industrialisation (Henley, 2012). The economic situation between the late 1970s to mid-1990s was often seen as part of the success of the Soeharto regime and its economic team.

Accompanying the development strategy carried out by the government during Soeharto's regime was a tighter control on politics and policy making to maintain the political stability of the regime. Political participation was limited and the number of political parties was restricted to three political parties: *Partai Persatuan Pembangunan* (PPP), *Partai Demokrasi Indonesia* (PDI), and *Golongan Karya* (Golkar) (Hadiz, 2000; Vu, 2010; Bertrand, 2013). The armed forces, *Angkatan Bersenjata Republik Indonesia* (ABRI), were assigned across the country and they held important positions in the government from the national level down to the village level (Bertrand, 2013, pp. 50-52). Rooms for political discourse and discussion on government policy was restricted, especially with government control of broadcasting media. State-owned television and radio companies were the main media companies and main sources of information for the Indonesian public until the late 1980s. Policy making was being discussed and decided by central ministries and agencies and the president played a dominant role in allocation of resources.

Development policy between the late 1960s and mid 1990s was carried out by central policy makers to address various social and economic issues. To address issues relating to poverty, there were policies aimed at farmers and agricultural workers such as continued subsidies for fertilisers (Henley, 2012). Inequality between regions was an issue that the government aimed to address as well, through policies such as infrastructure development (Davidson, 2015). The government adopted an approach where central policy makers developed both five-year plans and annual plans for the country's development. State-owned enterprises (SOEs) were used as an extension of the state to intervene in the economy as providers of a variety of goods and utility services, such as oil and electricity. With this, the government took an active role in coordinating development policy in Indonesia. This approach contributed to shifting Indonesia's path towards industrialisation, with a recorded increase in sectoral allocation of GDP in manufacturing sector from 9.4 per cent in 1971 to 24.2 per cent in 1995 (Booth, 2016, p. 68).

The policy making approach adopted by the Indonesian government provided the president at that time with a high degree of discretion to manage the country's financial resources and allocate them. The president's children had become active players in the economy, controlling companies operating in the Indonesia's major sector, including in toll roads (Davidson, 2015, pp. 61-68). With that much discretion, the president could also divert resources to allocate rents to his political backers and allies in the private sector. The country during the period between late 1960s to mid 1990s has been regarded to have significant and rising fiscal power and taxation capacity compared to other developing countries in Southeast Asia (Slater, 2010; van Zanden and Marks, 2012). Moreover, the government also received additional financial resources from foreign aid and natural resource revenues, especially oil and gas.

The government also created an environment of surveillance and control which was reflected in the Indonesian public sector. Scholars such as Liddle (1977), Hadiz (2000) and Bertrand (2013) have noted the significant role of the military in the Indonesian public sector in the period, which allowed active and retired military officers to hold decision making roles in public offices and governmental units at various levels of government. This arrangement facilitated the Soeharto regime in exerting territorial control over regions in Indonesia and administrative control on the implementation of national directives at provincial and local level. On the territorial control, the Ministry of Home Affairs had officials overseeing detailed activities at subnational level down to village level. Similarly, the Ministry of Defence and Security also had territorial offices in parallel with those of Ministry of Home Affairs (Liddle, 1977, p. 105). On the administrative side, there was centralised control on human resources with the Ministry of Home Affairs holding authority over employees of subnational governments (King, 1988, pp. 253-254).

Some efforts to provide more decision making autonomy to officials at subnational level were discussed and attempted during Soeharto's government, often influenced by external development partners. However, studies that documented these attempts often argued that those efforts had many elements which deviated from the conventional academic and policy discourses on decentralisation back at the time (Smoke and Lewis, 1996; Devas, 1997). Rondinelli and Nellis (1986) noted that many variations of decentralisation were adopted by various developing countries in the 1970s and 1980s. This is also the case in Indonesia where the central government was reluctant to relinquish a significant extent of decision making power to governmental units at subnational level. What happened was few changes in the managerial side of the government which resulted in modest changes towards how government do activities at subnational level. This has led some analysts to view the decentralisation in Indonesia between the 1970s to early 1990s as a decentralisation with many constraints (Ranis and Stewart, 1994; Smoke and Lewis, 1996; Devas, 1997).

Decentralisation in that period was a limited experiment accompanied with different opinions among central ministries and agencies, which were translated into the adopted design of decentralisation back then.

Formal regulatory provision regarding a form of decentralisation in Indonesia in the 1970s was set out in Law 5/1974 on Principles of Government at Subnational Level. This regulation set out the framework for governmental units at provincial and local level. While subnational governments in that law were referred to as autonomous region (or *daerah otonom* in the Indonesian term), the scope of discretionary decision making for provincial and local governments was not that significant. Devas (1997, pp. 354-356) notes that there were many ambiguous and unclear terms used in the law which could create multiple interpretations. According to that law, subnational governmental units in Indonesia were divided into two levels: Level I (*Daerah Tingkat I/Dati I*) at provincial level and Level II (*Daerah Tingkat II/Dati II*) at local level. These subnational governmental units were supposed to have flexibility in managing governmental activities, but the law did not delineate responsibilities clearly between different levels of government (Ranis and Stewart, 1994, pp. 43-45; Devas, 1997, p. 355).

The authority of the central government in steering the implementation of decentralisation as regulated under Law 5/1974 was reflected in the prominent role of the president in making various decisions. Funding support for provincial and local governments was decided through presidential executive decisions, termed as Presidential Instructions (*Instruksi Presiden/Inpres*). These Inpres were the legal basis for some intergovernmental transfers from the central to subnational governments. Ranis and Stewart (1994, pp. 46-47) note that there were two types of Inpres: the General Inpres and Specific Inpres. The differences between these two types of Inpres lie on the constraints they had on spending decisions at subnational level. The General Inpres was partly used to fund infrastructure projects such as road maintenance and

irrigation and some other projects which had been approved by central decision makers. The Specific Inpres was earmarked by the central government, usually for sectoral allocations such as education and health, but subnational governments had only limited scope for decision making on this type of Inpres fund. Another central transfer to subnational governments was the *Subsidi Daerah Otonom*/SDO (autonomous regional subsidies) which financed salaries for subnational officials and a small part for operating costs, and therefore, again, did not give much decision making power to subnational governments because of the central control over human resources (Ranis and Stewart, 1994, pp. 46-47; Devas, 1997, pp. 356-357).

Only in the 1990s did the Indonesian government experiment with a different decentralisation arrangement. In the period between 1995 and 1996 the government assigned 26 pilot subnational units at municipal level (or Dati II) to be given an extended responsibility for some functions which had previously been carried out by local offices of central ministries and agencies. However, Devas (1997, p. 359) notes that the extent of real decision making powers transferred to the 26 municipalities was rather low as it only comprised less substantial government functions such as trade and cooperatives rather than more significant services like education or healthcare. Moreover, there was a lack of central government's trust of local governments' technical capacity to undertake many governmental functions (Smoke and Lewis, 1996, p. 1287). This piloting exercise however did introduce the participating municipalities to an expanded responsibility and potentially prepared for possible further reforms in the future.

Another point of note in the period of Soeharto regime was the insurgencies and protests in the Indonesian regions. Aceh, Irian Jaya (or Indonesian Papua), and East Timor were noted to have secessionist tendencies to which the government response was to deploy the military in those regions (Bertrand, 2013, p. 55). In 1974, there was a large riot which involved thousands of students and the military was

involved to engage with the situation (Vu, 2010, p. 67; Bertrand, 2013, p. 55). The government in that period had to deal with these political problems which were also related to government's decisions in the economy and political arena. Political pressure against the government did not reduce and that pressure built up towards the later years of the regime in the late 1990s.

The combination of internal and external factors contributed to the decision of the Indonesian government to adopt a more genuine approach on decentralisation. The 1997 Asian financial crisis affected Indonesia greatly with significant impact to the country's economy and citizens. At the same time, there was political tension in the capital of Indonesia as there were massive protests regarding the economic situation and corruption which were perceived to be rampant in the Soeharto regime. In 1998, the exchange rate of the Indonesian rupiah to the US dollar fell to below ten thousand rupiah per dollar and the Indonesian economy contracted by over thirteen per cent (Booth, 2016, pp. 90-91). At that time, president Soeharto was also facing re-election and in March 1998 to be the president for another term. This was followed by massive protests by university students and people who urged the government to be reformed (Fitriani *et al.*, 2005, p. 60; Bertrand, 2013, p. 64). In the aftermath of the situation, the president stepped down from his position in May 1998 and the then vice-president B. J. Habibie rose to be the president.

During the Habibie presidency, the country started to embark on a new decentralisation reform. The government faced threats of secessions from the regions, especially after East Timor (or Timor Leste) succeeded in claiming independence through a referendum. Laws concerning decentralisation were quickly drafted with the aim to be quickly implementable, which resulted in the enactment of Law 22/1999 (on Subnational Governments) and Law 25/1999 (on Intergovernmental Relations). These laws were then followed by proposals of proliferation of new provinces and municipalities (Fitriani *et al.*, 2005). The short period of decentralisation in Indonesia

from the drafting of the laws and their implementation which provide a significant portion of autonomy to subnational governments made the Indonesian decentralisation to be called by many as big bang decentralisation. Parallel to the changes in relationship between the central and subnational governments in Indonesia, there were also efforts to amend the Indonesian constitution to institutionalise the new decentralised government system in Indonesia. The next section discusses the provisions in the Indonesian constitution and other laws which can affect the implementation of decentralisation in Indonesia.

4.2 Decentralisation in Indonesian Constitution and Laws

Indonesia started to engage in decentralisation in 1999, at a time where there was a political change from a regime which was considered as authoritarian to a more democratic one (Aspinall and Fealy, 2003). Prior to 1999, the government structure, as discussed in the preceding section, was highly centralised, with the highest executive authority held by the president as the head of state and the head of government. All activities in the government could be traced to the policy of the president and his cabinet, and there was little room for discretion provided to bureaucrats occupying the offices in the lower tier of governments, mostly located in provincial capitals (tier 1 of subnational units/Dati I) and in *kabupaten* or *kota* (tier 2 of subnational units/Dati II). Compared to that time, the situation at present is now significantly different after a series of reforms which make the country more decentralised. Currently, the government structure in the executive branch can be categorised into three different levels of government: central (or national) government, led by the president; provincial government, led by an elected governor; and *kabupaten/kota* government, led by either an elected *bupati* or an elected *walikota* (Republic of Indonesia, 2002). The terms Dati I and Dati II are not officially used anymore and governors, *bupati* and *walikota* are elected by voters in their respective provincial and municipal jurisdictions. In 2019, there were 34 provinces, and 508-

514 *kabupaten* and *kota* (number may vary, because 6 *kabupaten/kota* have just undergone a proliferation process). The difference in characteristics between *kabupaten* and *kota* is not delineated formally, but generally *kabupaten* have a relatively larger physical area than *kota*, and a relatively larger portion of rural area, while *kota* tends to have a higher proportion of urban area in its jurisdiction.

4.2.1 *Decentralisation in the Indonesian constitution*

Features of the decentralisation system implemented in Indonesia can be traced in the Indonesian constitution (the Undang-Undang Dasar (UUD) 1945, or 1945 Constitution hereafter) and various laws (referring to *Undang-Undang* (UU) in Indonesia). The 1945 Constitution (Republic of Indonesia, 2002) delineates separation of powers and the scope of authority between different branches of government (legislative, executive, judicial). Multilevel government and intergovernmental relations are included in the articles involving scope of authority of the executive branch. Laws in Indonesia are direct derivations and further specifications of various articles in the 1945 Constitution (Republic of Indonesia, 2004b). Therefore, the organisation of government stipulated in the constitution is regulated in further detail through laws. By examining the 1945 Constitution and various laws, researchers can understand more about the design and potential implications of institutional arrangements of decentralisation in Indonesia. Between 1999 and 2002 period, there were amendments to the 1945 Constitution, and the latest iteration of the constitution is the 1945 Constitution after the fourth amendment in 2002.

Laws in Indonesia affect decentralisation through different routes, directly and indirectly. There are laws which specifically regulate decentralisation and intergovernmental relations, stating different responsibilities of central and subnational governments, intergovernmental transfers, and revenue assignments such as Law 22/1999 on Subnational Governments and Law 25/1999 on Fiscal Balance between Central and Subnational Governments (Republic of Indonesia, 1999b;

Republic of Indonesia, 1999c). There are also other laws which mainly regulate other matters but have implications for intergovernmental relations, such as Law 4/1999 on Legislatures and Law 10/2004 on Formation of Laws and Regulations (Republic of Indonesia, 1999a; Republic of Indonesia, 2004b). Of this latter category, this study is interested in the ones which widely influence the ability of central actors to intervene in decision making at local level or the ability of local actors to intervene in decision making at national level. Those laws comprise the Law on Legislation and the Law on Legislatures.

The 1945 Constitution frames the position of subnational governments in the Indonesian multilevel government system. There are three articles in the constitution which directly regulate subnational governments and their relation to the government at national level. Article 18 outlines the formal division of government and jurisdiction, describing the provincial and municipal governments, access to political offices at those levels of government, and the general principle of subnational autonomy. Article 18A outlines the general principle of intergovernmental relations which comprise formal authority, fiscal, service provision, and natural resource management. Article 18B acknowledges the existence of special regions and indigenous norms as parts of the unitary government in Indonesia (Republic of Indonesia, 2002). These three articles were included in the 1945 Constitution through the second amendment which was enacted on August 2000.

This set of constitutional provisions in articles 18, 18A and 18B is the basis for further laws on decentralisation in Indonesia. In Article 18, decentralisation is framed as a division of an Indonesian unitary state into three levels of government. The mention of a unitary state in Article 18 can be referred back to Article 1 of the 1945 Constitution which formally affirms Indonesia as a unitary state with republic as its form of government (Republic of Indonesia, 2002). This particular mention of a unitary state is argued to reflect a sense of distaste from the Indonesian public and

policy makers towards federal state which were often associated to the perceived imposition of a federal form of government by the Dutch in the period of 1949-1950 (Ferrazzi, 2000, pp. 66-67). In addition, Article 18 also states that political offices at subnational level (e.g. subnational legislatures, subnational political leaders) are filled through an election. Therefore, Article 18 sets the legal basis for further laws governing the structure of government, such as Law 32/2004 on Subnational Governments. Article 18A discusses intergovernmental relations, which then sets the legal basis for further laws such as Law 33/2004 on Fiscal Balance between Central and Subnational Governments. Lastly, Article 18B discusses possible unique features of some subnational governments to be incorporated to the form of government and intergovernmental relations (such as the historical significance of the Special Region of Yogyakarta and the monarchy in that region). This then sets the legal basis for the implementation of particularistic decentralisation arrangements in some specific regions (e.g. Aceh, Yogyakarta and Papua), of which examples are Law 11/2006, Law 35/2008 and Law 13/2012. Each of those laws regulate a unique arrangements for Aceh, Papua and West Papua, and Yogyakarta, respectively (Republic of Indonesia, 2006; 2008; 2012).

Another area regulated in the 1945 Constitution which also relates with subnational governments is regarding the Regional Representative Council (*Dewan Perwakilan Daerah*/DPD). Article 22C outlines the representation system in the Council where each member represents a province and the number of councillors in the Council. Article 22D outlines the authority of the Council as part of the legislative branch of government, which include the rights to discuss laws relating to subnational governments and regional autonomy, and the relation of the Council to the other 'council' in the legislative branch, which is the People's Representative Council (*Dewan Perwakilan Rakyat*/DPR) (Republic of Indonesia, 2002). These two articles were included in the 1945 Constitution through the third amendment which was enacted on November 2001. Article 22C and Article 22D set the legal basis for subsequent laws

concerning the Regional Representative Council and its position in the national legislature (Republic of Indonesia, 2003b; Republic of Indonesia, 2009a)

Those provisions in the 1945 Constitution touch upon the general principle on which Indonesian decentralisation is designed, and they also provide a focal point for further discussions in the legislation of other subsequent laws. When legislators draft a law governing decentralisation, decisions regarding the scope of authority of local decision makers are expected to always involve Article 18 of the 1945 Constitution, which explicitly reasserts Indonesia as a unitary state, after Article 1 in the constitution explicitly expresses the same thing. With those provisions in the constitution, there is an implicit expectation of the president as the holder of highest executive power in the government. This expectation carries some weight which is reflected on the laws relating subnational governments and intergovernmental relations.

The 1945 Constitution underwent a series of amendments in the period between 1999 and 2002. The current form of the constitution which exists today is the result of the fourth amendment (*Amandemen IV*). When Indonesia started its decentralisation in 1999, many components of the current institutional arrangements regarding decentralisation had not existed. Adjustments to the decentralisation system were implemented gradually over time and the first set of laws which regulate decentralisation after the fourth amendment of the 1945 Constitution was enacted in the 2003-2004 period. Some analysts stated that the scope of authority of local political leaders was somewhat narrowed after the fourth amendment (McLeod and MacIntyre, 2007; Aspinall and Mietzner, 2010), which is also a topic to be examined further in the following sections of this chapter.

The credibility of the 1945 Constitution in influencing legislation of future laws regarding decentralisation and intergovernmental relations rests upon its enforcement and stability. For enforcement, the Constitutional Court in Indonesia

holds the authority to judge and decide if members of the public put a request for a judicial review of a law (or a set of laws) (Republic of Indonesia, 2002, Article 24 C; Republic of Indonesia, 2003c). This request can be carried out as long as the requesters feel that their constitutional rights are violated by the law being reviewed. Nine judges in the Constitutional Court will then provide a ruling towards that request. A judicial review process can result in the abolition of a law or of any articles in a law. By this process, the credibility of the 1945 Constitution is potentially preserved with subsequent laws being challenged only when there is anyone able to demonstrate a violation towards individuals' or groups' constitutional rights.

Further amendments to the 1945 Constitution require action from various political actors in the People's Consultative Assembly (*Majelis Permusyawaratan Rakyat*/MPR) (Republic of Indonesia, 2002, Article 37). The People's Consultative Assembly is a governing body in the legislative branch which comprises the members of the People's Representative Council and the Regional Representative Council. Currently, there are 560 members of the People's Representative Council and 132 members of the Regional Representative Council, totalling to 692 members of the People's Consultative Assembly. An amendment to the 1945 Constitution needs to be proposed by one third of the members (or equal to 231 members). Next, the amendment needs to be discussed in the Assembly's session with at least two-thirds of the members (462 members) present. To proceed, the amendment needs to be agreed by 50 per cent plus one member of the total Assembly's members (or equal to 347 members). This stipulation for constitutional amendment resulted in no further changes made to the 1945 Constitution after the fourth amendment was completed in 2002.

In summary, the Indonesian constitution does include some regulatory provisions which can influence the functioning of a multilevel government system in Indonesia by framing the scope of regulatory provisions of subsequent laws. The 1945

Constitution asserts Indonesia as a unitary state, which preclude the possibility of a federal state. The form of Indonesian multilevel government system is framed in the constitution with the president as the holder of highest executive power in the government. In addition to this, the constitution also states that access to political offices is decided through an election. The legal basis to accommodate regional interests in the drafting of laws concerning subnational governments and intergovernmental relations is also set out through the organisational provision of the Regional Representative Council in the national legislature. All in all, the 1945 Constitution has some influence on the scope of decision making of local decision makers through setting out the legal basis for subsequent laws which regulate decentralisation and intergovernmental relations in Indonesia in greater detail.

4.2.2 Examining laws relevant to the decentralisation in Indonesia

Law on Legislation affects the credibility of local regulations and their relative position towards various laws and regulations enacted at central level. The first Law on Legislation was enacted in 2004, then it was fully amended in 2011 and underwent a partial amendment to some of its articles in 2019. The Law on Legislation stipulates the hierarchy of laws and regulations in Indonesia, which comprise the ones enacted at central level and the ones enacted at subnational level. In the 2004 version, the regulations enacted at central level comprise the 1945 Constitution, laws (and Special Government Regulation in replacement of a law/*Peraturan Pemerintah Pengganti Undang-Undang/Perpu*), government regulation (*Peraturan Pemerintah/PP*), and presidential regulation (*Peraturan Presiden/Perpres*) (Republic of Indonesia, 2004b). The regulations enacted at subnational level comprises provincial regulation and municipal regulation, and they stand at the lowest positions in the hierarchy of laws and regulations. Provincial regulation and municipal regulation are enacted as a follow-up of stipulations in the laws at the higher position in the hierarchy. The legislation for provincial regulation and municipal regulation involves local political

actors in the Provincial People's Representative Council (*DPRD Provinsi*), Municipal People's Representative Council (*DPRD Kabupaten/DPRD Kota*), the governor in the respective province, and head of municipality in the respective municipality. Provincial regulation and municipal regulation can be a subject for a judicial review process if eligible members of the public put a request. The Supreme Court will then judge and provide a ruling for this request.

However, the judicial review process through the Supreme Court was only introduced in 2011, in the second iteration of the Law on Legislation (Republic of Indonesia, 2011). Before the enactment of Law 12/2011, there were many instances of provincial regulation and municipal regulation being abolished or cancelled by central government, specifically by the Minister of Home Affairs. This brought serious consequences to the credibility and sustainability of public policy at provincial and local level. For example, many local governments introduced new revenue instruments in the form of taxes and charges during the period 1999-2004, and almost all of the municipal regulations which become the legal basis of such instruments were abolished by the Minister of Home Affairs. Another policy area which became a concern was regarding business licensing at local level (Lewis, 2003b). Some local governments introduced new business licensing mechanisms for various sectors (e.g. mining, fisheries, trade), which were used as both control of externalities and as revenue instruments in local governments' jurisdiction (Crouch, 2010). These business licensing procedures include user fees which need to be paid by service users and the legal basis for the user fees was municipal regulations. While a selection process may emerge as a response to this – businesses may move to a different jurisdiction which is deemed more suitable for their operations – the central government focused more on the distortion it could potentially bring to the aggregate investment at national level. Hence, the central government responded by abolishing those municipal regulations relating to business licensing and implemented a new Law on Investments which narrowed the scope of local government's policy regarding business licensing.

The Law on Legislatures has undergone many amendment processes, as it regulates the authority of legislatures both on central and subnational levels. Its first iteration after Soeharto's fall from power was in 1999, which was then fully amended in 2003, 2009, and 2014, and partially amended in 2014, 2018, and 2019 (Republic of Indonesia, 1999a; Republic of Indonesia, 2003b; Republic of Indonesia, 2009a; Republic of Indonesia, 2018; Republic of Indonesia, 2014a; Republic of Indonesia, 2014c; Republic of Indonesia, 2019). The first iteration in 1999 provided the structure and authority of subnational legislatures (*DPRD Provinsi/Kabupaten/Kota*). The 2003 version was the first to introduce the Regional Representative Council and its authority in the national legislatures. The seemingly numerous amendment processes for this law are also affected by the changing landscape of the Indonesian decentralisation. Discussion relating to this law will be set out in more detail in the following sections, putting it in the context of the changes in the institutional arrangements of decentralisation in Indonesia.

In summary, the 1945 Constitution and the Law on Legislation position the central government as the holder of the ultimate legitimacy in the executive branch of government. Repeated mentions of unitary structure and the higher hierarchical position of regulations promulgated by the central government provide scope for central political leaders in the executive to supersede decision making at local level. There are representatives of subnational governments in the national legislatures, but the 1945 Constitution only gives a narrow scope of authority to them and they are only consulted in the discussions regarding laws directly affecting decentralisation and intergovernmental relations. Next, the changes in Law on Subnational Governments, Law on Fiscal Balance between National and Subnational Governments, and Law on Legislatures are examined to understand how the general principles are derived in practice.

4.3 Political Power, Public Goods and Service Provision before 1999

Since its independence in 1945, Indonesia has adopted different ways to organise its government. There was a brief period where a federal structure had been considered, but the unitary form of government prevailed and is formally recognised in the 1945 Constitution. The Soeharto regime, which was in power from the late 1960s to 1998, maintained this unitary form and implemented a centralised bureaucratic structure in the government. It brought implications to local leadership, autonomy, and accountability during the period, which characterised public goods and service provision at local level (Aspinall and Fealy, 2003). This section will discuss the period before decentralisation was implemented, highlighting the situation relating fiscal authority, relationship between central and local leaders, organisational relationship of local officials, and decision making at local level.

Fiscal authority in the period between late 1960s and 1998 was held by the central government. The Minister of Finance was responsible for the national budget (*Anggaran Pendapatan dan Belanja Negara/APBN*) as a whole, with the scope ranging from public expenditure managed by the central ministries and agencies to spending delivered by local government office at various villages. There was little scope of decision making for local officials in terms of identification and selection of expenditure, as what can be done was submitting a proposal through the communication line in the bureaucracy to be considered by officials in the central government.

There were also limited options for officials in the subnational government units in terms of the revenue side. Financial resources were only available as allocated in the national budget through each central government ministries and agencies towards their respective subnational units at local (and provincial) level. This fiscal relationship between national and subnational units reflects the situation where local staff were a part of the central government administration as a whole, and local units

were parts of the central government structure. Therefore, local officials were responsible for revenue collections, but not for the decision over revenue instruments used at a specific local jurisdiction (Lewis, 2005). Every public revenue instrument was designed and decided at the Ministry of Finance.

With a centralised government structure, there was no real independence and autonomy in terms of decision making at subnational level. The President held the highest authority in the executive branch, and the position of local political leaders (*bupati/walikota*) was as the subordinates of central government. The Provincial People's Representative Council and the Municipal People Representative's Council existed as agencies with limited oversight functions, and at the time they could only give feedback to the report submitted by governors (at provincial level) and municipal leaders (at local level). There is a substantial difference in the roles of these Councils between pre-1999 and post-1999 period. The Councils in the pre-1999 period were seen more as a part of the executive at subnational level, considering their limited authority.

Every final decision regarding policy making was made at the central level. This positioned local officials more as implementers of policy rather than being involved in the design and development of policy. Implementation guidance was also developed and decided by central officials, which created implementation problems in some local contexts (Dasgupta and Beard, 2007). Inclusion of local considerations in policy making took time because, if anyone at local level had something to propose, they needed to go through the official bureaucratic channels. Local officials were still involved in identification of beneficiaries for the government's social programmes, but the identification mechanisms and the selection of interventions were decided at central level.

The centralised structure of the Indonesian government during this period put sovereignty in the hands of central political actors and officials. The hierarchy

between central and subnational government was clearly defined, putting subnational leaders and officials as subordinates of the government bureaucratic system with the highest authority held by government officials at the capital (McLeod and MacIntyre, 2007). Subnational autonomy was practically non-existent; central political actors and officials held the final decision for policy making in every sector. There were no observed restrictions on mobility of citizens or capital, but human resource management in the government was also centrally-led so that allocation was decided by central officials. A centralised public financial management was observed, which meant that issues regarding budget constraints for subnational government were managed and controlled by the central fiscal policy authority, which was the Minister of Finance. All of these features were formally institutionalised in the Laws at the time, which was also consistent with the then existing stipulations in the 1945 Constitution.

Under such circumstances, revenue mobilisation at subnational level was a matter of meeting targets decided by central officials and detached from local policy considerations. There was no urgent need for subnational officials to exert meaningful efforts or innovate, because the revenues collected would be reallocated by central officials through the national budget. Policies were also decided by central officials, so there was a possibility for jurisdictions or subnational units to be less active depending on the sectoral or spatial priorities of central officials at the time. However, as public personnel administration was also centralised, performance of local officials could affect their career progression (Synnerstrom, 2007). Job-related incentives existed, as they did in general workplace settings.

Centralised government structure and line of command made access to local offices in the executive branch of government a matter of hierarchical decision. The general public was not directly involved in the recruitment of local officials and local officials did not have any responsibility to report to the public or its representatives. Local officials reported to their superior in a set line of command, which would report

upward until it reached the highest executive position, be it a minister or head of central government agency.

Political offices existed at provincial and local legislatures (Provincial and Municipal People's Representative Council/DPRD), with access to these offices determined by political parties and by central officials' appointment. There were three political parties in the period between 1977 to 1998: *Partai Persatuan Pembangunan*/United Development Party (PPP), *Golongan Karya*/Functional Groups (Golkar), and *Partai Demokrasi Indonesia*/Indonesian Democratic Party (PDI). These parties competed in the legislative elections and they would then select a number of councillors to fill the seats, which number was based on the parties' vote share in the elections. The seats filled with this mechanism was only for seats reserved for the Political Group (*Golongan Politik*), one of two groups existed in the Councils. The other seats in the Councils were reserved for the Functional Groups (*Golongan Karya* or Golkar), amounted to 20 per cent of total seats in the Councils. Councillors for these Functional Group seats were appointed by the Minister of Home Affairs. These councillors comprised members of Indonesian National Armed Forces (*Angkatan Bersenjata Republik Indonesia*/ABRI) and various other organisations acknowledged by the Minister of Home Affairs. The Minister of Defence was also involved in the selection of councillors coming from the National Armed Forces. Within the system, Functional Groups were able to gain a significant number of seats in the legislature. The Golkar participated in the legislative elections as a political party, and on top of that Golkar also received 20 per cent allocation of additional seats.

Councillors in provincial and local legislatures would nominate and select local political leaders in the executive branch, together with officials in the higher hierarchy. Minister of Home Affairs was involved in the discussion to nominate candidates for governor (provincial leader) and select the governor. The provincial

governor was involved in the discussion to nominate candidates for municipal leader and select the leader.

There was a significant involvement of higher-level officials in the access for political offices. This condition made the credibility of subnational policy highly dependent on the consent of officials at the higher level of government. Disagreements on policy position between officials at different level would be resolved hierarchically, which tend to favour policies supported by central government. Local political leaders could not expect to see immediate effects from proposing policies with considerations of local citizens inside the jurisdiction. Policy proposals would be moderated and adjusted with considerations of prevailing interests at the national level.

Organisation of the state in Indonesia before 1999 provided central political actors and officials with a strong authority in the government. Decisions regarding financial and human resources was determined by central officials. Central leaders had the final say on public policy and expenditure decisions. Central political actors and higher-level political leaders were influential in selecting leaders at lower level of government. Hierarchical structure in the government incentivised subnational leaders to follow and support decisions taken by central leaders, and to implement them in accordance with central leaders' expectation. All of these decrease the importance of revenue mobilisation for local leaders, apart from being another target set by central leaders. More efforts in mobilising revenue would not translate into higher discretion in policy, and there was no immediate effect from subnational policy proposals which can be expected as well.

4.4 Early Period of Decentralisation (1999-2003)

Indonesia started to embark in the path towards decentralisation in 1999, not long after a change in regime. The fall of Soeharto regime in 1998 was followed by a series of events which triggered various responses by political actors at national and local

levels. The government led by President Baharuddin Jusuf Habibie had to deal with the Asian Financial Crisis and the results of the East Timor Referendum amidst growing demand for autonomy from local political elites (Holtzappel and Ramstedt, 2009; Hadiz, 2010). The national political arena was also busy with discussions regarding amendment of the 1945 Constitution to reorganise the political system in the country, reformulating relationship between branches of government and widening citizens' access and engagement to politics. What resulted from those were a set of new laws stipulating a decentralised government system which provided more autonomy and authority to subnational leaders. The new laws relating decentralisation and subnational governments can be seen as a provisional measure at the time, while a more thorough political process would follow (Ellis, 2007).

The increase in autonomy and authority was stipulated in Law 22/1999 on Subnational Governments and Law 25/1999 on Fiscal Balance between Central and Subnational Governments. The Law on Subnational Governments delineated new autonomy to be held by provincial and municipal government, while it also provided a mechanism for proliferation of new subnational units, should they be needed. There were many demands for new municipalities and, in some cases, new provinces, which came widely from almost all areas in Indonesia (Fitriani *et al.*, 2005). The secession of East Timor motivated regional and local elites to pursue new terms for relationship between central and subnational governments (Aspinall and Fealy, 2003). The Law on Fiscal Balance provided a supposedly new framework for fiscal relationship between central and subnational governments, as the new system of decentralised government structure need to be supported by adequate financing mechanism. As both of these laws were enacted more as a response to the political dynamics in the period than an objective attempt to reorganise the government, the provisions stipulated within them still roughly correspond to elements of the previous centralised system. This was reflected in the limited scope of financing resources identified in the Law on Fiscal

Balance and the lack of detail regarding mechanism of intergovernmental transfers (Republic of Indonesia, 1999b; Republic of Indonesia, 1999c).

Law 25/1999 on Fiscal Balance provided a mechanism which prioritised a quick calculation relating the amount of revenue sharing and intergovernmental transfers. There was a crude formula for revenue sharing which allocate revenue collected from property tax and natural resources (forestry, mining, fisheries) to subnational governments, ranging from 80-90%, while the other 10-20% was allocated to the central government. Revenue collected from the oil and gas sector was still mostly allocated to the central government (85% and 70%, respectively) and subnational governments retained the rest. Other intergovernmental transfers comprise of the General Allocation Fund and Special Allocation Fund. The General Allocation Fund was an unconditional transfer which allocation was influenced by a weighting formula determined by the central government. The Special Allocation Fund was a transfer given to fund specific needs of subnational governments (e.g. projects in a sector prioritised by central government) (Alm *et al.*, 2004). Both the General and Special Allocation Funds were allocated mostly to municipalities rather than provinces.

These changes coming from implementing decentralisation were not adequately supported by the existing public financial management system. The national budget was still roughly the same compared to the period before decentralisation, with small changes in the budget items to accommodate the needs for intergovernmental transfers. Central government still had a considerable influence on government activities at subnational level, through deconcentration and discretionary assistance (*Tugas Perbantuan/TP*) grants. These two grants financed activities at subnational level, with scope and specificity of projects decided by central officials (Lewis, 2005). Subnational budgets (*Anggaran Pendapatan dan Belanja Daerah/APBD*) were introduced, which process was made simple enough to be

implemented by subnational officials. However, with the new system, subnational political leaders were able to make decisions more independently compared to the previous period.

Law 22/1999 on Subnational Governments also provided a delineation of responsibility between central and subnational governments. In principle, subnational governments were responsible for all areas of government affairs, with exception of some specific areas which were stipulated to be the responsibility of the central government (Republic of Indonesia, 1999b). The central government was responsible for five main areas: foreign affairs, defence and security, judiciary, national macroeconomic (monetary and fiscal) policy, and religion. However, there were also some other areas held by the central government, which included national development policy and evaluation, fiscal transfers, public administration, governments' human resources management, natural resources management, strategic technology, environmental conservation, and national standardisation. This delineation of responsibility allowed subnational governments to exercise their authority in deciding various economic and social policy with less intervention from central officials or political actors. The new autonomy held by subnational governments permitted identification and selection of beneficiaries and mechanisms of subnational government's social programmes being done by subnational officials and political actors.

The new Law also brought some changes to political offices at subnational level. The structure of political offices at subnational level which had existed in the previous period was retained. However, Law 22/1999 lessened the involvement of central and higher-level government officials in the access to those political office, which was also covered in more detail in Law 4/1999 on Legislatures. The majority of councillors in subnational legislatures were selected by political parties which competed in a legislative election, amounted to 90 per cent of the seats. The other 10

per cent of the seats was reserved for members of Indonesian National Armed Forces (ABRI), which were appointed by the leader of ABRI (Republic of Indonesia, 1999a, articles 18 and 25). The number of political parties flourished after the change in regime, with 48 political parties competing in the 1999 legislative election. This more competitive election environment greatly diminished the influence of central officials in the subnational political arena and encouraged the emergence of subnational political actors. Councillors in the provincial and local legislatures would then nominate and select subnational political leaders in the executive branch, but this time without involvement of higher-level officials (Republic of Indonesia, 1999b).

Apart from the lessened influence of central actors at subnational level, organisation of the state in Indonesia in the 1999-2003 period did not undergo substantial changes from the previous period. Formal authority which can be exercised by subnational political actors was still somewhat limited, but the changes in the political arena support the perception of widened political inclusion and greater public engagement in politics. This, in turn, enabled subnational political leaders to present various policy proposals to the public, although not all of them were realisable within the existing institutional arrangements (Crouch, 2010). In this early period of transition, central officials and political actors also did not restrain subnational governments much even though they still have the legal support to do so (Patunru and Rahman, 2014). The experience of decentralising government in this early years became a foundation for a general framework of decentralisation in the 1945 Constitution. The articles on the 1945 Constitution (articles 18, 18A, and 18B) regarding subnational governments and their relationship with the central government were enacted on August 2000 as part of the second amendment. The articles regarding the Regional Representative Council (articles 22C and 22D) in the 1945 Constitution were enacted on November 2001 as part of the third amendment. They would then allow the enactment of further Laws which provide a more detailed institutional arrangements for decentralisation in Indonesia.

4.5 Further Fiscal and Political Decentralisation (2004-2010)

After the third amendment of the 1945 Constitution on November 2001, it took a few more years to enact the laws which regulate decentralisation in greater detail. Another set of amendment was done to the 1945 Constitution on August 2002, focussed on issues relating to the executive branch, monetary authority, social issues and rules regarding future amendments to the constitution. This was then followed by a new Law on Legislatures, which restructured legislative authority at all levels of government (Republic of Indonesia, 2003b). This new Law was an important one as it removed the stipulations regarding reserved seats in the legislatures, so that all the seats would be filled through elections. Its implication on the political landscape can be associated with the increased political activities and popularity of new political figures at subnational level (Mietzner, 2014). New names emerged in the discussions regarding local political leadership and there were many popular figures recruited by political parties to be candidates in elections (Aspinall and Mietzner, 2010).

Another important regulation for the groundwork of decentralisation in Indonesia was the Law 17/2003 on Public Finance and Law 1/2004 on State Treasury, which clarified issues relating public financial management. These Laws stipulated the development of the national public financial management system, which ascertained the position and responsibility of national and subnational governments. In these, subnational governments' budgetary system was organised as a part of the national budgetary system, and the financial reporting requirements was regulated (Republic of Indonesia, 2003a; Republic of Indonesia, 2004a). Roles of executive and legislative branch of government were also stipulated in detail. All in all, this Law provided a more comprehensible delineation of authority and responsibility between different levels and branches of government regarding public finance, which in turn allowed subnational political leaders to be empowered and more independent in their policy decisions.

Law 32/2004, a new Law on Subnational Governments, was enacted in 2004 replacing the previous Law 22/1999. This Law provided a more detailed regulations regarding subnational autonomy and authority in 240 articles, far more than 134 articles in the previous Law. Stipulation on mechanisms relating subnational political decisions and public finance contributed to the expanded details. With the clarified authority of subnational executive and legislative branch in the 1945 Constitution, Law 17/2003 and Law 1/2004, subnational budgetary and decision making processes were situated within a clearer framework. The organisation of multilevel government system seemed to have reached its stable form, with a clear delineation of authority and responsibility which were deemed acceptable by national and local elites. Less ambiguity in the regulations can however also result in less authority for subnational governments, and there are some who have commented in that direction (Holtzappel and Ramstedt, 2009; Tomsa, 2015). However, greater clarity was needed for subnational politicians to act confidently and independently, as they can gauge the scope of their authority.

Law 32/2004 allowed subnational politicians to exercise decision making in a more independent manner in accordance to the area which was defined in the Law. Chapter III of Law 32/2004 (articles 10-18) divided governmental authority between central, provincial, and municipal governments. The central government held authority in foreign affairs, national defence, national security, judiciary, national monetary and fiscal policy, and religion, which means that there was no substantial change here. Authority in other sectors was mostly given to the municipal level, while the provincial level held responsibility on activities spanning across municipality boundaries. As public service provision was expected to be done mostly by municipalities, the head of municipality became a political position with significant autonomy and responsibility. To ensure the quality of public service provision in municipalities, the central government published a set of Minimum Service Standards as a reference for quality. These standards achieved different effects across

municipalities, but they also allowed central government officials to express their opinions about service delivery at local level (Roudo, 2018).

Law 32/2004 also allowed central government to intervene further in policy making at subnational level. Chapter VI of the Law 32/2004 discussed about Municipal Regulation, an instrument for subnational policy making. This Municipal Regulation was proposed by either the head of municipality or the municipal legislature, and could be enacted after being discussed by both of them. However, the central government, through a Presidential Regulation, retained the authority to cancel a Municipal Regulation if the central government deemed the regulation to be in conflict with other regulations placed higher in the hierarchy. In response to this, heads of municipality can submit a motion to the Supreme Court if there is any objection to the cancellation of the Municipal Regulation. The Supreme Court will have the final say whether decisions in the Presidential Regulation would be in effect. If the Presidential Regulation is overturned by the Supreme Court, then the Municipal Regulation will be enacted as normal (Republic of Indonesia, 2004d).

On the fiscal side, there was a change in the regulation in the form of Law 33/2004 on Fiscal Balance between Central and Subnational Governments. With respect to the enactment of Law 17/2003 and Law 1/2004, fiscal relationships between central, provincial, and municipal governments were clarified in much greater detail. Compared to the previous Law 25/1999 which had 33 articles, Law 33/2004 comprised 110 articles. Revenue sharing from natural resources was formally disaggregated further into different sectors (forestry, general mining, fishery, crude oil, natural gas, and geothermal), each with its own formula for revenue sharing. There was also a more detailed regulation about allocation of revenue sharing between provincial and municipal governments. While in some parts Law 33/2004 continued the revenue sharing arrangements stipulated in Law 25/1999, the new articles

included in the new law presented more clarity to subnational politicians about financial resources under their disposal.

Other intergovernmental transfers were also regulated in greater detail in the Law 33/2004. The General Allocation Fund was allocated in a more technocratic way compared to the previous mechanism. In the new law, there were considerations of fiscal gap and base allocation in determining the amount of General Allocation Fund for each subnational government (in both provincial and municipal level) (Republic of Indonesia, 2004e). Consideration of base allocation included the number of civil servants working in the subnational government. This would have implications in government's human resource management as the number of civil servants partially determined the amount of central resources transferred to subnational governments. Therefore, the central government retained the final decision in the number of civil servants to be recruited by subnational governments in each fiscal period.

Similarly, the regulation regarding the Special Allocation Fund also underwent much clarification and explanation. In Law 33/2004, there was an explicit requirement for subnational governments to provide a matching fund amounted to 10% from the Special Allocation Fund received. There was an exception to this rule, which applies to subnational governments with less fiscal resources. These subnational governments did not need to provide a matching fund. There was also a stipulation about technical criteria for Special Allocation Fund, which were decided by sectoral ministries in the central government (Republic of Indonesia, 2004e).

Law 32/2004 also introduced changes in political offices at subnational level, both in the executive and legislative branch. The most notable change was the introduction of election for the offices of governor and head of municipality. In the previous Law 22/1999, subnational political leaders in the executive branch had been nominated and selected by councillors at subnational level. With this change, local citizens were able to directly participate in leadership selection. This election

mechanism started to take effect in 2005, when the first head of municipality was elected into office (Erb and Sulistiyanto, 2009). For subnational legislatures, all of the councillor seats were filled through election and there was no 'reserved' seats under Law 32/2004. This brought more autonomy to political actors at subnational level, and central government did not take part in subnational leadership selection anymore.

There were some areas where the central government retained substantial control under Law 32/2004 and Law 33/2004. Human resource management of civil servants was still heavily controlled by the central government. Law 32/2004 provided the Minister of Home Affairs with authority over transfer of human resources between municipalities in different provinces or from offices at subnational governments to the one in the central government. Employees of local governments continue to be part of the national civil service. Recruitment of new civil servants was also subject to central government's approval. This would impede mobility of civil servants to some extent and also limit the options of subnational political leaders in mobilising human resources. In terms of fiscal resources, subnational borrowing was also monitored and regulated in detail through Governmental Regulation (Republic of Indonesia, 2004e). This strict stance on subnational borrowing has some support in the literature, as there is evidence that subnational governments may behave fiscally irresponsible when they have soft budget constraint (Rodden, 2005).

The Law 32/2004 and Law 33/2004 marked a new phase in the organisation of the state in Indonesia. There was a greater clarity regarding formal authority of subnational political leaders. Explanations regarding intergovernmental transfers was also provided in much detail compared to the previous set of laws. Access to political offices was decided by popular demand of the public. All these changes allowed subnational political leaders to identify and select policy which suits local needs in a more independent manner compared to the period under the previous set of laws. Those changes also instilled more confidence in subnational political actors in

exercising their authority. Amidst all this, central government retained substantial control in human resource management and subnational borrowing. The central government also had a possible veto action against policy decided at subnational level in the form of Provincial Regulation and Municipal Regulation, but subnational governments were also given a response option to challenge this veto through the Supreme Court. Most of the changes brought about by the new set of laws provided more authority and autonomy to subnational political actors, although there were a greater detail of central control as well in a few areas.

4.6 Increased Subnational Fiscal Authority (2011-2015)

After several years of decentralisation under Law 32/2004 and Law 33/2004, the next substantial change in decentralisation framework came in 2009. That year, Law 28/2009 on Subnational Taxes and Charges was enacted, providing a detailed regulation on subnational revenues, especially the ones from own sources. The new law identified the types of subnational tax in provincial and municipal level and explicitly forbade subnational political leaders to introduce other types of tax not provided in that same law. In the early period of decentralisation, subnational governments were quite active in enacting Provincial Regulation and Municipal Regulation relating revenues (Lewis, 2003b), and the central government abolished a substantial number of those regulations. Stipulations in the new Law 28/2009 was meant to prevent subnational political leaders from enacting a revenue policy which could be detrimental to local economy. In turn, Law 28/2009 regulated in great detail about types of taxes and charges available to subnational governments, providing 5 types of taxes at provincial level and 11 types of taxes at municipal level, and 30 types of charges at both levels.

Another change from the enactment of the new law was the new authority of municipal government to regulate and collect land and building tax (*Pajak Bumi dan*

Bangunan – Pedesaan dan Perkotaan or PBB-P2). PBB-P2 is a variant of property tax in Indonesia, which had been administered by the central government before the new Law came into effect, specifically by the Directorate General of Taxes in the Ministry of Finance. After the enactment of Law 28/2009, municipalities were given a freedom to decide when to implement this law in a 4-year transition period (until 31 December 2013). This devolution of PBB-P2 would have an impact to the revenue generated by subnational governments. In the previous arrangement, municipalities only received 64.8% of the amount PBB-P2 collected in their jurisdictions by the Directorate General of Taxes. Those municipalities might get an additional amount from the revenue sharing transfer, up to 10% of the amount PBB-P2 collected (the additional amount of which can vary between different subnational governments and over time). Under the new Law, municipalities received 100% of the amount PBB-P2 collected in their jurisdictions (Republic of Indonesia, 2009b). However, a portion of revenue sharing transfer which was previously funded from up to 10% of the amount PBB-P2 stopped, so in that respect there was a loss of revenue from transfers as well after the reform.

Subnational governments varied in their responses to this devolution of PBB-P2. Not all of them quickly took the administration of PBB-P2. In 2011, there was only one municipality which took on the administration of PBB-P2. In 2012, there were 17 municipalities, which were followed by 104 municipalities in 2013. Lastly, in 2014 334 municipalities took the authority to manage PBB-P2 (von Haldenwang, 2017, p.136). Complexities in managing PBB-P2 were argued as the reason behind the reluctance of subnational politicians in taking control of the revenue. The amount of arrears for PBB-P2 at the time Law 28/2009 was enacted was also quite significant.

The new Law 28/2009 introduces a coordinated fiscal structure of own-source revenues for subnational governments. While it does not allow subnational governments to expand its own-source revenues beyond the ones stipulated by the central government, subnational governments can opt to use less than the types of

own-source revenues available to them. In this respect, the central government provided a room for subnational politicians to compete in collecting revenues only at the level necessary for providing the agreed level of public goods and services. There was no change in the regulation relating intergovernmental transfers, the Law 33/2004 was still in effect. Overall, the Law 28/2009 provided a new source of revenue for municipalities while still retained fiscal support from the central government in intergovernmental transfers.

In 2014, another change was enacted in the form of Law 23/2014 on Subnational Governments. Once again, the organisation of the state in Indonesia was restructured, affecting authority of government at different levels. The new Law introduced a new category of responsibility called ‘concurrent governmental issues’ which referred to areas of policy which were shared between the central and subnational governments (Republic of Indonesia, 2014b). The enactment of the new Law also strengthened some aspects of authority at provincial level, putting provincial governments responsible for public goods and service provision located across two or more municipal jurisdictions and some selected sectors. Municipal governments lost a significant part of their authority in sectors such as forestry, fisheries, energy and mineral resources. The Law also provided an appendix with an extensive list of issues divided as a specific authority of the central, provincial, and municipal governments. Many of the authority over issues on the list were allocated to the central and provincial governments.

Another notable component of Law 23/2014 was the stipulations regarding the authority of central government and governors to abolish Municipal Regulation. Governors were put in a role as a representative of the central government and were provided with the authority to abolish regulations which were in conflict with other regulations placed higher in the hierarchy. However, several municipal political leaders submitted a judicial review to the Constitutional Court regarding this

stipulation, and the ruling stated that some phrases in article 251 point (2), (3), (4) and (8) as unconstitutional. The effect of the ruling is governors cannot abolish Municipal Regulation. Abolishment of Municipal Regulation can only be done through the Supreme Court.

After the new set of regulations in Law 28/2009 and Law 23/2014, decentralisation in Indonesia underwent another change. Subnational revenues were regulated in great detail, specifying the types of taxes and charges available to be collected by provincial and municipal government. Municipal governments obtained a significant control over the management of PBB-P2, which can be used as an important revenue source. Municipal governments also lost some authorities in several sectors, while provincial governments obtained new sectoral authorities. There was no substantial change in access to political offices at subnational level.

4.7 Conclusion

In the 1999-2015 period, the Indonesian decentralisation framework underwent many changes with varying implications to intergovernmental relations. This study is specifically interested in the changes on fiscal authority, local political leaders' access to financial resources, credibility of local policy decisions, and access to political offices that occurred in response to these changes. These aspects shape the scope of autonomy of local leaders, which then influence their need for revenue. Therefore, the existing fiscal and political institutions can influence the outcome of subnational revenue reform in Indonesia.

In terms of fiscal authority, changes in the Laws enabled a greater scope of decision making by local political leaders. Before 1999, the subnational budget was a component of the national budget, and budgetary allocations were decided at national level. After decentralisation was implemented and public financial management was regulated, local leaders were provided with credible authority in budgetary

allocations, which enabled them to shift financial resources to support their policy decisions. Subnational budgets were separated from the national budget, which allowed greater independence in annual planning process. Political mechanisms were created to allow budgetary deliberations between local leaders and legislatures, with little or no involvement of central officials. Local leaders and legislatures can identify and select budgetary priorities and allocate funding from the financial resources available to them.

Similarly, local politicians were provided with greater access to financial resources during the period. Before decentralisation was implemented, local governments relied on funds allocated by central politicians and officials. After decentralisation, local leaders were provided with the authority to create revenue instruments, although this was not without limitation. The new Law in 2009 set out the types of revenue which can be created by local governments. On the other hand, local governments were also supported through intergovernmental transfers. These intergovernmental transfers were allocated by the central government, and the policy priorities for capital expenditures from these transfers were also decided by the ministries at central government. The recent Law provided local leaders with a new authority to administer property tax, which broadened their access to financial resources. Local leaders and legislatures are able to identify and select new own-source revenues as long as they are within the scope regulated by Law 28/2009, and they can use intergovernmental transfers according to the guidelines set by the central government.

Local policy making is an area where there can be disagreements between central and local governments after decentralisation is implemented. There were times where national and local priorities differ, and at those times it is important to determine which priority is able to push through. Repeated mentions of the concept of the unitary state in the earlier phase of decentralisation legitimated central

government in retaining the authority to cancel decisions made at local level. However, in recent years, there was a greater clarity in the delineation of authority and responsibility between central government, provincial government, and local government. The last iteration of the Law on Subnational Governments provides local leaders with a reduced scope of decision making, but the delineation of authority and responsibility is still clear. Municipal Regulation can only be cancelled through the Supreme Court. This allows local leaders and legislatures to develop and enact policies without intervention from central government as long as they are within the area regulated in the Law. However, central government can still indirectly influence local policy making by providing funding support to policy which addresses national priorities. Human resource management of civil servants is also controlled by the central government. Apart from that, local policy making can be seen as credible by citizens and local constituency.

Access to political offices at subnational level saw the decrease in involvement of central officials during the period. Before decentralisation, decision makers were appointed by the central government. In the most recent iteration of the Law discussed here, access to political offices are obtained through the election process. This allowed local citizens to identify and select political leaders in the executive and legislative branch at local level.

The impact of the devolution of revenue-raising powers, which is the focus of this study, happened within the existing fiscal and political institutions discussed in this chapter. Intergovernmental fiscal and political relations are expected to have some influence in the outcome of the reform. The analysis from the laws shows that there is an increase in subnational autonomy in fiscal authority and policy making, but the scope of subnational authority is also limited in some areas. This condition can restrain the effect of the reform to be more modest than the expectation. Therefore, how local governments use its new revenue-raising powers cannot be easily

predicted only from the analysis in this chapter, because it requires observations on the actions taken by local actors and possible responses given by central actors. These issues are investigated further in the following chapters.

5 Econometric Evidence: Examining Subnational Revenue Mobilisation in a Decentralised Indonesia

One of the research questions which motivated this study concerns the impact of devolution of revenue-raising power on subnational revenue mobilisation in Indonesia. The theory discussed in Chapter 2 suggests that broader revenue assignments to local governments can motivate them to be more active in mobilising revenue from inside their jurisdictions. In this chapter, that proposition is subjected to detailed quantitative analysis for Indonesian municipalities. In the previous chapter, changes in decentralisation and intergovernmental relations in Indonesia were set out, showing the institutional changes in the period leading to the property tax devolution reforms which were initiated from 2011. Decentralisation reforms prior to 2011 provided subnational governments with a broader fiscal authority and an increased scope of decision making authority, although there was also room for the central government to intervene in local decisions. That analysis highlights possible constraints and motivating factors which can influence the behaviour of local politicians and officials. In this chapter, data on public finance, especially regarding local finance and intergovernmental transfers, is used to further analyse the impact of decentralisation reform relating to subnational revenue,.

This chapter explains the econometric analysis performed to estimate the average treatment effect of devolution of property tax in Indonesia in the municipalities implementing the reform. The first section presents the variables used and how they are relevant for the current analysis. The hypotheses and summary statistics of variables are also presented in that section. The next section discusses the trends of revenue variables in municipalities in two groups: the ones which

implemented the reform and the ones which did not adopt the reform in the 2011-2013 period. A parallel trend between both groups satisfies the assumption of constant differences between municipalities implementing the reform and the other set of municipalities not implementing the reform, which underlies the econometric analysis performed.

The third section is where the effects of reform are analysed. The proportion of local own-source revenue in total local revenue and total own-source revenue per capita in municipalities were examined to examine the impact of the reform. The results from the analysis are discussed in the next section, which provides interpretations of the results and discusses how they link with previous studies. Next, alternative subsamples and variables are also analysed, showing how sensitive the results are to changes in the sample of observed units and variables. Results from the estimations in this study are all presented here. The conclusion of the analyses in this chapter is discussed in the last section. That section reviews the results in view of the two hypotheses presented in this chapter and what is still not known based on the analysis.

5.1 Variables of Interest

Subnational own-source revenue in Indonesia comes from various local taxes and charges collected by local governments. As the devolution of property tax brought changes at the municipality level, revenue data at that level is analysed. Although disaggregated own-source revenues data at municipality level in the 1999-2013 period is not available for most of the municipalities implementing the reform, the changes after the reform are reflected in other data relating subnational own-source revenues. Thus, although it is not possible to directly analyse the change in the level of property tax or user charges collected, the change in total subnational own-source revenue can be observed.

The outcome of interest is measured using two variables: the proportion of local own-source revenues in total local revenue and the level of local own-source revenues per capita. Considering the hypothesis that the devolution of PBB-P2 is expected to increase local own-source revenue and decrease the amount of intergovernmental transfers from the Revenue Sharing Fund, the proportion of local own-source revenues in total local revenue is expected to have increased after municipalities implemented the devolution of property tax. Likewise, a greater amount of revenue from PBB-P2 managed by local governments is expected to increase the amount of local own-source revenues per capita. This increase in the proportion of local own-source revenues and the level of local own-source revenues per capita is reflected in the budgetary data of each local government. Therefore, the hypotheses for this study are:

1. Local governments which implemented the decentralisation reform will have a higher proportion of local own-source revenues in total local revenue compared to those which did not implement the reform.
2. Local governments which implemented the reform will have a higher amount of local own-source revenues per capita compared to those which did not implement the reform.

There is also a possibility that the average outcome of the reform deviates from expectations. An increase in legal authority does not always translate into greater autonomy. Gomes (2012) notes the mismatch between fiscal autonomy and spending decision making in Brazilian local governments which can bias the observation regarding local governments' autonomy. Jia *et al.* (2020) finds that a reform to improve tax autonomy in Chinese local governments in the 1995-2014 period reduces local tax collection. This finding in the Chinese context appears to be driven by the increase of intergovernmental transfers. Therefore, evaluating the outcome of such

reform in detail, as is carried out in this chapter, will show the dynamics in subnational revenue mobilisation with regards to the institutional environment.

The panel data set used in this study consists of data at local government level (*kabupaten* and *kota*) in 1999-2014 period. The data is taken from the Indonesia Database for Policy and Economic Research (INDO-DAPOER) which is compiled by the World Bank Group. The data for DKI Jakarta, the capital city of Indonesia, is not included in the analysis, as DKI Jakarta is categorised as a province. To construct the reform dummy variables (*TREATID* and *REFORMDUM*), data is collected from previous studies and data published by official sources (e.g. Ministry of Finance).

The proportion of local own-source revenues in total local revenue is defined as the ratio of local own-source revenues to total local revenue in a municipality. Both data of local own-source revenues and total local revenue are available from INDO-DAPOER. This variable has been used in previous studies, such as Canare and Francisco (2019), as a reflection on how significant own-source revenues are for local governments and to show the degree of fiscal autonomy. The variable is suitable to be used in the current analysis because an increase in local own-source revenue, no matter whether it comes in the form of property tax, user charges, or in other ways, is likely to increase the proportion of local own-source revenue in total local revenue.

Local own-source revenues per capita is defined as the ratio of local own-source revenues to population in a municipality. Population data is obtained from INDO-DAPOER. The proportion of own-source revenues in total local revenue is expected to show changes in local own-source revenues relative to total local revenue, but it can also be affected by changes in other local revenue sources. The level of local own-source revenues per capita shows changes in local own-source revenues relative to the population, which complements the measurement of the proportion of own-source revenues in total local revenue. From the level of local own-source revenues per capita, the changes in the level of own-source revenues as an effect of the reform

can be observed. Also, from the proportion of own-source revenues in total local revenue, it can be inferred whether the changes in local own-source revenue is relatively influential compared to changes in other local revenue sources.

The summary statistics are set out in Table 5.1. Various intergovernmental transfers are used as covariates in this study. Two main intergovernmental transfers which were allocated to all local governments, To further analyse the impact of decentralisation reform relating subnational revenue, the Special Allocation Fund (DAK) and to further analyse the impact of decentralisation reform relating subnational revenue, the General Allocation Fund (DAU) are used as control variables because they provide alternative sources of financing for local governments. In the analysis DAK per capita and DAU per capita are used because the allocated amount of DAU and DAK can vary greatly between municipalities and to capture the average amount from an individual's point of reference. DAK funds local expenditures in sectors such as: education, health, public works, and environment. DAU is a complementary funding source for personnel expenditure. Revenue Sharing Fund (DBH) from natural resources per capita controls for local governments which have an endowment of natural resources such as forestry, general mining, fishery, oil, gas, and geothermal energy in their area. This control variable does not differentiate between different natural resources, but can be seen as fit for the purpose of the analysis as the types of natural resource endowment differ widely in municipalities. As an illustration, some municipalities which have mineral mines in their area receive a high amount of general mining DBH, but receive a low amount (or none) of the DBH of other natural resources, while some other municipalities which are located in coastal areas have a high amount of fishery DBH and a low amount (or none) of other DBH. The focus of the analysis is the amount of other financial resources available to municipalities, so a variable showing whether a municipality receives funding from DBH associated with natural resources is sufficient.

GDP per capita controls for economic growth and is also a measure of the economic activity in the municipality. Municipalities draw their own-source revenues from their jurisdiction, and many of those revenues relate to the degree of economic activity. As an example, taxes to local business are likely to be higher when there are more local businesses in the jurisdiction. Total population and the number of people in the population who live below the poverty line control for social situation in the local governments' jurisdiction. Variables which are used to estimate reform are TREATID and REFORMDUM, which are formulated manually from previous studies and official sources.

Table 5.1. Summary statistics

Variable	Obs.	Mean	Std. Dev	Min	Max
Proportion of Own Source Revenue in Local Revenue (%)	5,983	0.06890	0.06481	0.00004	0.80574
Own Source Revenue per capita (IDR)	5,945	115,064.00	190,516.70	0	5,211,151.00
TREATID (<i>dummy variable</i>)	9,154	0.23968	0.42691	0	1
REFORMDUM (<i>dummy variable</i>)	9,154	0.30894	0.46208	0	1
DAK per capita (IDR)	5,861	170,175.20	331,705.00	0	7,670,455.00
DAU per capita (IDR)	5,971	1,246,043.00	1,879,090.00	0	34,100,000.00
DBH from natural resources (IDR)	5,345	224,081.90	1,047,274.00	0	40,200,000.00
Total GDP (IDR)	6,527	6,178,180.00	13,100,000.00	35,350.00	306,000,000.00
Population below poverty line (number of people)	6,143	78,031.28	92,072.93	1,000	987,300
Total population (number of people)	6,295	512,432.30	565,697.10	6,144	5,202,097

Source: Author's calculation based on data from INDO-DAPOER

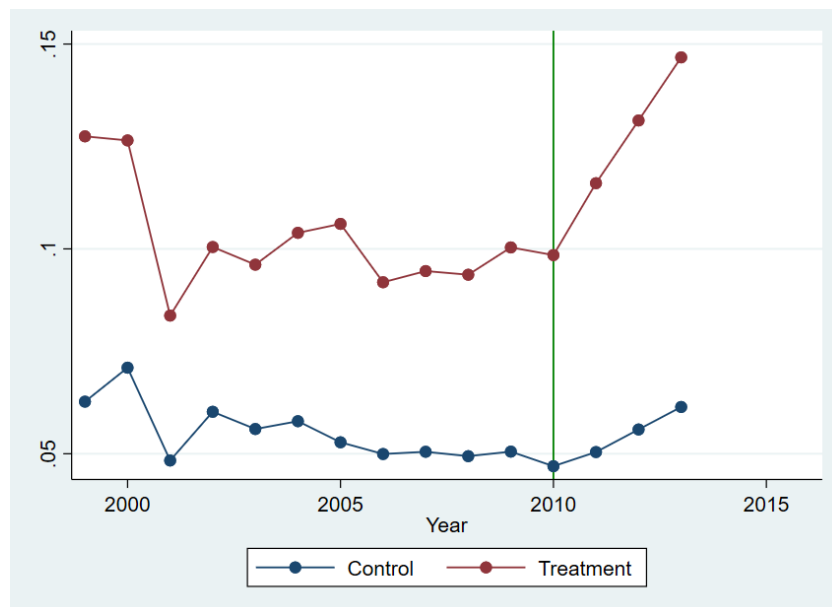
5.2 Parallel Trend Assumption

Difference-in-differences analysis is used in this study to examine the effect of the devolution of property tax on local revenues. As discussed in more detail in Chapter 3, section 3.3, municipalities implementing the reform in the 2011-2013 period was as the 'treatment' group, while municipalities which did not implement the reform during that period was categorised as the 'control' group. The analysis compares changes in municipalities in the treatment and control group after the reform. The difference-in-differences analysis assumes that the units in the control group and the

treatment group have a similar result of outcome before the treatment. This will be shown by comparing the group's annual average between municipalities in control and treatment groups in the period under observation (1999-2013). In each group, the data from each unit is calculated as an annual average, and this value will be graphed in Figure 5-1.

Figure 5-1 therefore illustrates the time trends of average proportion of own-source revenues for local governments in the control and treatment groups. The proportion of own-source revenues is calculated by dividing local own-source revenues with total local revenue. The plotted blue line shows the average proportion of own-source revenues in local governments which did not implement the reform in the period 1999-2013. The plotted red line depicts the corresponding average proportion of own-source revenue for local governments which did implement the reform in the period under observation. The vertical green line signifies the year before the reform was implemented, which is in the year 2010.

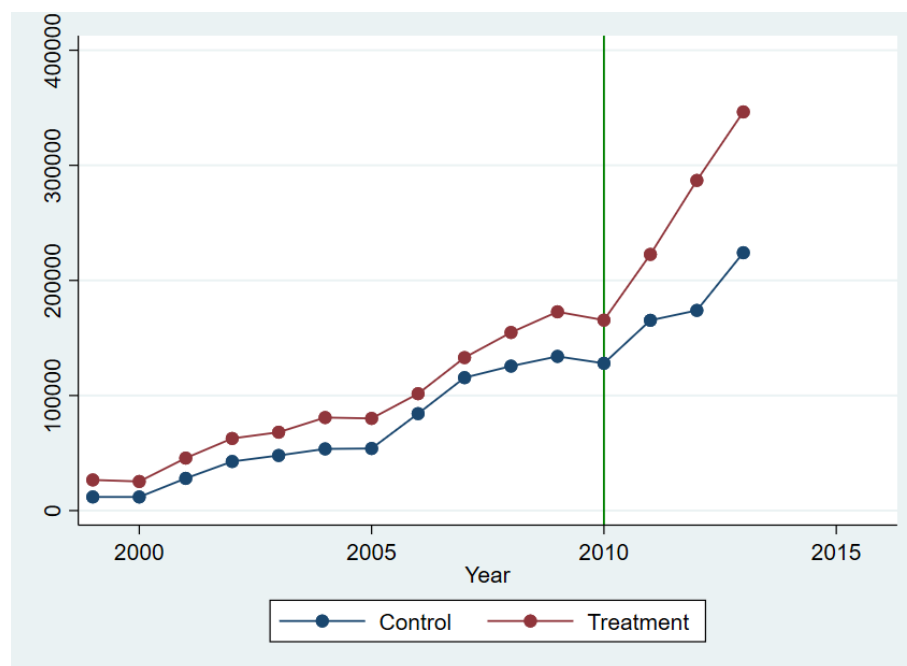
Figure 5-1. Trends in Proportion of Own-source revenue in Local Governments



Source: Author's calculation

Figure 5-2 illustrates the time trends of average local own-source revenues per capita in the control and treatment groups. Local own-source revenues per capita is calculated by dividing local own-source revenues by population in each local government. The plotted blue line shows the average local own-source revenue per capita for the subnational units which did not implement the reform in the period 1999-2013. The plotted red line depicts the corresponding average local own-source revenues per capita for local governments which did implement the reform in the period under observation. The vertical green line signifies the year before the reform was implemented, which is in the year 2010.

Figure 5-2. Trends in Local Own-source revenue per capita



Source: Author's calculation

From Figure 5-1, it can be seen that the trend in the average proportion of own-source revenues in local governments moves in quite a parallel fashion in both groups before the reform, which suggests that it is feasible to estimate the reform outcome using difference-in-differences (Angrist and Pischke, 2015). Similarly, Figure 5-2 also shows that the trend in average local own-source revenues per capita follows

the same graphical pattern in the control and treatment groups. This also suggests that the effects of the reform on local own-source revenues per capita can be estimated using difference-in-differences. A further observation to the trend movement suggests that the reform has effects on the implementing local governments, as the trends between control and treatment groups follow a different trajectory after the reform is introduced.

5.3 Effects of Reform

The data is analysed using difference-in-differences estimation to estimate the effects of reform. The effect of the reform to the proportion of local own-source revenue in total local revenue is shown in Table 5.2. It can be seen that after the revenue reform, the proportion of own-source revenue in total local revenue for local governments in the treatment group increases on average to at least 5.6%. When the effect is estimated with covariates, the average effect of the reform is 8.3%. The number of observations decreases from 5,983 to 4,300 when covariates are included, this is because some covariates are not available for each unit and each year in the period under observation. Estimation using fixed effects in the model also shows an average increase of 7.2%. Even so, there is an increase of R-squared value in the estimation with covariates, which indicates that the estimation with covariates is a better fit to the model.

Table 5.2. Effect of reform to proportion of own-source revenue in total local revenue

	Proportion of own source revenue in local revenue (%)			
	(1)	(2)	(3)	(4)
Effect of reform	5.6*** (0.6)	8.3*** (1.2)	4.3*** (0.3)	7.2*** (0.6)
Covariates	No	Yes	No	Yes
Fixed effects	No	No	Yes	Yes
Observations	5,983	4,300	5,983	4,300
R-squared	0.16	0.35	0.03	0.27

*Source: Author's calculation. ***) Statistically significant at the 1% level.*

From the results in Table 5.2 and Table 5.3, the average effects of the reform are seen to be positive in both proportion of own-source revenues in total local revenue and local own-source revenues per capita. This indicates the ability of local governments to make positive use of the new revenue-raising power as a source of local financing. Next, it can be seen in Table 5.3 that the reform also introduces a positive effect on local own-source revenue per capita. Local own-source revenue per capita for local governments in the treatment group increases, with the average effect being an increase of IDR130,000. The number of observations decreases from 5,945 to 4,313 when covariates are included, but the R-squared value increases which indicates the estimation with covariates is a better fit to the model. Estimation using fixed effects also shows an average increase in the range of IDR130,000.

Table 5.3. Effect of reform to local own-source revenue per capita

	Local own source revenue per capita (IDR)			
	(1)	(2)	(3)	(4)
Effect of reform	130,000*** (18,000)	170,000*** (37,000)	132,685*** (12,569)	130,053*** (28,604)
Covariates	No	Yes	No	Yes
Fixed effects	No	No	Yes	Yes
Observations	5,945	4,313	5,945	4,313
R-squared	0.08	0.36	0.07	0.32

*Source: Author's calculation. ***) Statistically significant at the 1% level.*

The average proportion of own-source revenue in total local revenue in the treatment group after the reform is 13.13%, which is consistent with the observation in Gonschorek and Schulze (2018, p. 146) where they argue that the aggregate own-source revenue was around 10-16 per cent in the 2011-2016 period based on the data from the Ministry of Finance. Considering that the reform is expected to increase local own-source revenues and decrease total DBH from taxation (i.e. taxation revenue sharing), it is possible that local governments have not used their newly-acquired revenue-raising powers effectively. However, if the estimated effects are compared with the mean values summarised in the previous section (Section 5.1), the effects appear to be pronounced in terms of how much they had increased. For proportion of own-source revenues, the mean value is 6.48%. The average increase of 7.2 per cent from the reform equates to more than 110% increase of the mean value. The mean value for local own-source revenues per capita is IDR115,064.00. The average increase of IDR130,000 from the reform equates to more than 110% increase of the mean value. Both of the revenue variables analysed here increased considerably in comparison with their initial mean values. Qualitative evidence from interviews in the next chapter suggests that local officials do regard local own-source revenues (from

property taxes and also from other local taxes and charges) as important and that they successfully take measures to use these revenue sources. This means that this trend of increase in local own-source revenue is something that will continue in the future.

Another aspect that can be observed from the reform is how this may affect subnational units with lower initial values of both proportion of own-source revenues and local own-source revenues per capita. From Figure 5-1 and Figure 5-2, it can be seen that the local governments in the treatment group had higher proportion of own-source revenues and higher value of local own-source revenues per capita than the local governments in the control group. This indicates that the local governments which implemented the reform earlier are the ones with higher capacity in local revenue mobilisation, as they were able to sustain a relatively higher proportion of own-source revenues and local own-source revenues per capita between 1999 and 2010 compared to the ones in the control group. The graphs suggest that the gap between local governments in the control and treatment groups became wider, and this gap can be problematic for local governments with lower capacity in fiscal management. Those local governments cannot increase their fiscal autonomy and the condition of having a lower proportion of own-source revenues and local own-source revenues per capita can persist for a long time. However, all the other municipalities which had not implemented the reform in the 2011-2013 period were required to implement it starting from the year 2014 onward. Therefore, there is an expectation that eventually all local governments in Indonesia would experience an increase in proportion of own-source revenues and local own-source revenues per capita, although there is still the question on whether the gap between municipalities in the treatment and control group would become wider or narrower. The analysis in this thesis does not cover the municipalities which implemented the reform after the year 2013 because of the data limitation in the INDO-DAPOER data set. Future research can examine these municipalities with different methods because of the lack of subnational units in the control group from the year 2014 and after.

5.4 Interpretation and Discussions of Results

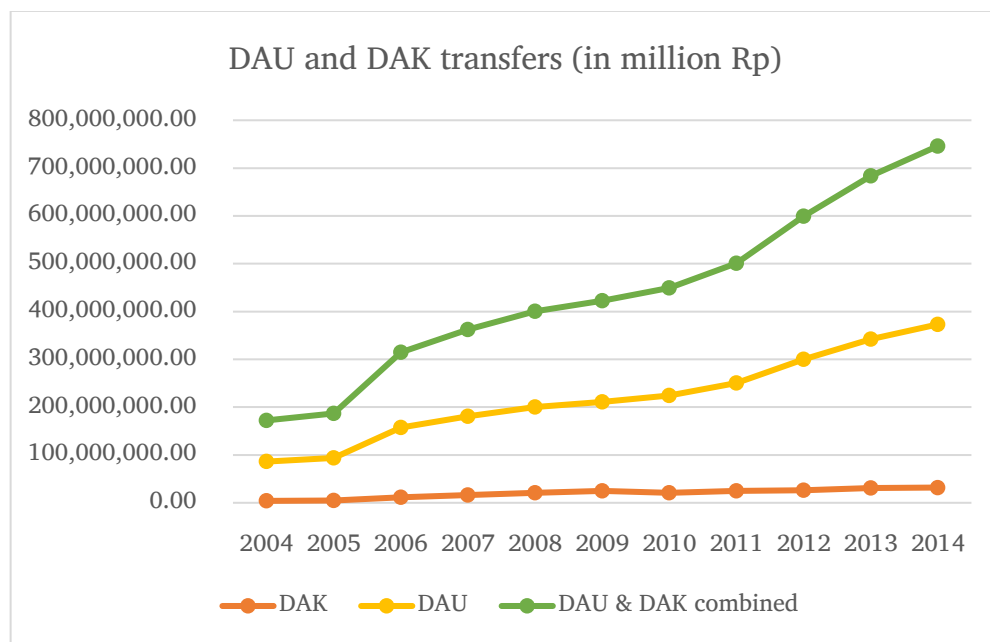
The results of the difference-in-differences analysis show that both proportion of own-source revenue in total local revenue and local own-source revenue per capita increased after the reform. These results should be seen in relation to the contextual situation surrounding of the reform. For example, seen in relation to the wider context of local fiscal management which can include central government interventions regarding local expenditure decisions, in relation to how the central government might provide additional financial support at local level based on a set of criteria and in relation to how local revenue efforts might contradict other objectives set by the central government. Some studies have touched upon this issue of how local revenue interacts with other aspects in local finance or decentralisation in Indonesia, with many of them mentioning how municipalities had a relatively low level of own-source revenues which needed improvement and there were factors at central or local level involved in the process (Lewis, 2003a; Lewis, 2006; von Haldenwang, 2017; Vidyattama, 2021). This section discusses the results from the econometric analysis with consideration of the wider context and findings from previous studies, both in the context of Indonesia and internationally.

Devolution of property tax (PBB-P2) in Indonesia increases the autonomy of municipalities in managing revenue from property, with some constraints. The Indonesian municipalities were given legal authority to set tax rates, update registers, assess property values, conduct monitoring and enforce compliance by the law regarding subnational taxes and charges which were promulgated in 2009. However, there were also some limits imposed by the central government on this. First, the areas used for plantation, forestry, and the mining sector are excluded from municipalities' authority on PBB-P2. Property tax for those sectors is categorised differently as *Pajak Bumi dan Bangunan Perkebunan, Perhutanan, dan Pertambangan* (PBB-P3) and is managed by the central government. Second, there is a cap for the rate of PBB-P2,

which is at 0.3%. This means that municipalities have little scope for upward rate adjustment in PBB-P2. Both of these possible constraints receive some attention from scholars and policymakers, but so far studies on Indonesia have not provided an explanation of the effects of such constraints in relation to local governments revenue. An exception to this is von Haldenwang *et al.* (2015), which discusses various functions relating property tax collection including the limitations relating PBB-P3 and the cap for PBB-P2 tax rate. In that study, qualitative evidence from six municipal case studies in Indonesia reveals that local officials desired a wider range of devolution (which would include PBB-P3) but they were also hesitant about the possibility of a higher cap for PBB-P2 rate (which would be more than 0.3%). In von Haldenwang *et al.* (2015) and von Haldenwang (2017), both of those factors are associated with ‘political cost’ at the local level, which can result in political punishment from voters in the jurisdiction to local politicians. At this point, both of these limitations can become contributing factors to local governments not using their new revenue raising power to its full potential.

Another factor which can influence subnational revenue mobilisation is the increase in the allocation of intergovernmental transfers. While the devolution of property tax decreased taxation revenue sharing transfer received by each municipality, the other intergovernmental transfers (General Allocation Fund/DAU and Special Allocation Fund/DAK) were not directly affected. Data from the audited financial statement of the Government of Indonesia shows that there was an increasing trend for DAU and DAK allocated by the central government in the 2004-2014 period. This can be seen further in Figure 5-3.

Figure 5-3. Trends of DAU and DAK transfers in 2004-2014 period



Source: Author's calculation from audited financial statements of the Government of Indonesia, 2004-2014

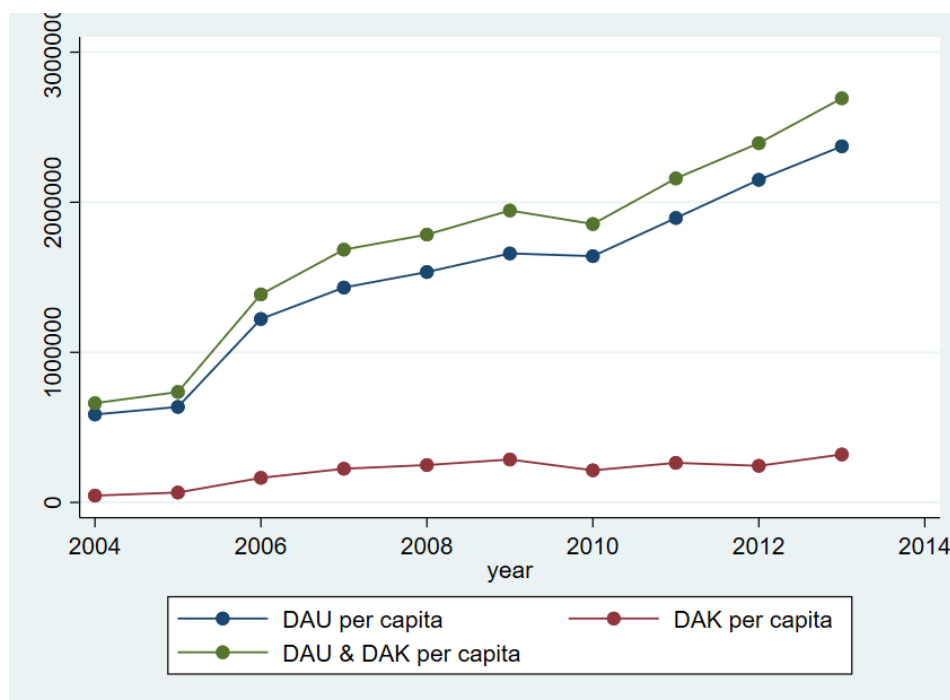
As can be seen in Figure 5-3, the total amount of DAU and DAK transferred to subnational governments increased for more than 300% between 2004 and 2014. In the 2004 financial statement, the central government reported DAU transfers amounted to IDR82.13 billion and DAK transfers amounted to IDR4.04 billion. A decade later, the central government reported DAU transfers amounted to IDR341.22 billion and DAK transfers amounted to IDR31.89 billion. Taking DAU and DAK together, the central government transferred IDR86.17 billion in 2004 and IDR373.11 billion in 2014. This trend continued in the following years, as can be observed in the 2018 financial statement: the central government provided DAU transfers amounted to IDR401.49 billion and DAK transfers amounted to IDR173.45 billion, with a total transfer of both amounted to IDR574.94 billion.

This increasing trend of DAU and DAK transfers provided subnational governments with more financial resources from the central government. These transfers reported in the central government's financial statement were allocated to

both the provincial and municipal level. To see how this transfer of resources was realised at the municipal level, it is useful to check the municipal financial data in INDODAPOER data set. The data set facilitates observations between 1999-2013 period, and the average DAU per capita and DAK per capita in the 2004-2013 period is presented in Figure 5-4.

Figure 5-4 shows that there was indeed an increasing trend for average DAU and DAK transfers received by municipalities in the 2004-2013 period. The mean of DAK transfers per capita in municipalities increased 600 per cent throughout the period, from IDR45.43 thousand in 2004 to IDR319.63 thousand in 2013. The mean of DAU transfers per capita in municipalities increased 300 per cent, from IDR586.15 thousand in 2004 to IDR2,372.91 thousand in 2013. The mean of combined DAU and DAK transfers in municipalities increased 307 per cent from IDR661.34 thousand in 2004 to IDR2,692.54 thousand in 2013. In the wider literature, the increased amount of transfers received by subnational governments has been associated with a decrease in the motivation of local governments towards mobilising their own-source revenues. Jia *et al.* (2020) find in the context of China that the reform which coincided with an increase in fiscal transfers from central government resulted in a lower tax collection effort. There are also other studies which document possible negative relationships between intergovernmental transfers and subnational revenue, such as Mogues and Benin (2012) in the context of Ghana and Panda (2009) in the context of India.

Figure 5-4. Average DAU and DAK received by municipalities in 2004-2013 period



Source: Author's calculation

Both observations from the central government's financial statement and the calculation of transfers per capita in municipalities in the 2004-2013 period confirm that municipalities received an increased level of financial support before and during the implementation of reform. This can influence the attitude of local politicians and officials towards the new revenue raising power. Several other studies noted the general increase in intergovernmental transfers to subnational governments in Indonesia over time since early 2000. Lewis (2014, pp. 142-143) presents the trend for proportion of various revenue sources in Indonesian local governments between 2001 and 2009, although it does not differentiate between provincial and municipal governments. In von Haldenwang (2017, pp. 131, 142), budget figures at the national level are used to analyse the growth of central government transfers. Gonschorek and Schulze (2018, pp. 146-148) show how intergovernmental transfers remain a major source of finance for municipalities, with the analysis focusing on the proportion of various revenue sources between 2011 and 2016. In Vidyattama (2021), there is a

discussion about the distribution of the proportion of local governments' self-generated revenues in selected years, with the focus on highlighting the variation between different subgroups of municipalities. The analysis presented in this chapter extends the analyses carried out in those previous studies by presenting the effects of devolution of property tax to municipalities and showing the trends of selected transfers to municipalities in the 2004-2013 period based on the data from INDODAPOER and audited financial statements of the central government.

5.5 Sensitivity Analysis and Robustness Checks

This section sets out the results of sensitivity analyses and robustness checks conducted using the data.

5.5.1 Analysis excluding municipalities receiving nonstandard transfers

Some subnational governments in Indonesia received intergovernmental transfers different from the ones which have been discussed in the previous analysis in this chapter. There are regions which are recognised to have a distinction based on historical reasons, and these regions are provided with additional transfers. In the period of analysis (1999-2013), these regions comprise provincial and municipal governments in four provinces: Aceh, the Special Region of Yogyakarta, Papua, and West Papua. Provincial and municipal governments in Aceh province receive a Special Autonomy Fund (*Dana Otonomi Khusus/DOK*) based on Law 18/2001 and Law 11/2006 which regulate special autonomy in Aceh (Republic of Indonesia, 2001a; Republic of Indonesia, 2006). Provincial and municipal governments in Papua and West Papua receive DOK based on Law 21/2001 and Law 35/2008 which regulate special autonomy in Papua and West Papua (Republic of Indonesia, 2001b; Republic of Indonesia, 2008). Lastly, Provincial and municipal governments in the Special Region of Yogyakarta receive the Yogyakarta Special Fund (*Dana Keistimewaan Yogyakarta/DKY*) based on Law 13/2012 which regulates particularities regarding the

Special Region of Yogyakarta (Republic of Indonesia, 2012). All of these transfers are exclusive to these provinces, and no other provincial and municipal governments receive such transfers.

It is important to observe whether the effects of reform are sensitive to additional transfers received by subnational governments in Aceh, the Special Region of Yogyakarta, Papua, and West Papua. Using these additional transfers as control variables is not feasible because there are no other provincial and municipal governments which receive such transfers, which then result in a significantly limited number of observations. Therefore, an alternative sample is used in which excludes municipalities in those four provinces. Another point of note is that the Yogyakarta Special Fund was implemented for the first time in 2013, which is also the latest period of observation in the INDODAPOER data set. There is also a possibility that the Yogyakarta Special Fund does not have any effect on the reform outcomes. To account for this, the analysis is performed using two alternative samples: the first sample excludes municipal governments in all four provinces and the second one excludes municipal governments in three provinces (Aceh, Papua, and West Papua).

Table 5.4 and Table 5.5 present the effects of reform if the difference-in-differences estimation is carried out excluding municipalities in provinces which receive DOK and DKY. As mentioned previously, DOK and DKY are particular transfers which are not allocated to other municipalities. Therefore, municipalities in Aceh, Papua, and West Papua have an additional access towards financial resources in the form of DOK, while municipalities in Yogyakarta have access towards DKY.

Table 5.4. Effect of reform to proportion of own-source revenue in total local revenue excluding municipalities in selected provinces

	Proportion of own source revenue in local revenue (%)			
	Excluding 3 provinces		Excluding 4 provinces	
	(1)	(2)	(3)	(4)
Effect of reform	8.3*** (1.2)	7.2*** (0.6)	7.8*** (1.2)	7.2*** (0.6)
Covariates	Yes	Yes	Yes	Yes
Fixed effects	No	Yes	No	Yes
Observations	3,844	3,844	3,794	3,794
R-squared	0.34	0.30	0.33	0.30

*Source: Author's calculation. ***) Statistically significant at the 1% level.*

In Table 5.4, it can be seen that the outcomes on the proportion of own-source revenue in total local revenue is still positive, with an average increase for local governments in treatment group to at least 7.2% when municipalities in Aceh, Papua, and West Papua are excluded. When municipalities in Yogyakarta is also excluded, the result is still positive, with an average increase of at least 7.2%. In Table 5.5, the outcomes on local own-source revenue per capita is also positive, with an average increase for local governments in treatment group to at least IDR128,000 when municipalities in Aceh, Papua, and West Papua are excluded. Excluding also municipalities in Yogyakarta, the result is still positive, with an average increase of IDR105,000. The analysis presented in Table 5.4 and Table 5.5 shows that the outcome is still positive for the effect of increased own-source revenue with municipalities in some provinces which receive nonstandard transfers excluded.

Table 5.5. Effect of reform to local own-source revenue per capita excluding municipalities in selected provinces

	Local own source revenue per capita (IDR)			
	Excluding 3 provinces		Excluding 4 provinces	
	(1)	(2)	(3)	(4)
Effect of reform	170,000*** (36,000)	128,072*** (26,435)	150,000*** (37,000)	105,874*** (27,315)
Covariates	Yes	Yes	Yes	Yes
Fixed effects	No	Yes	No	Yes
Observations	3,853	3,853	3,803	3,803
R-squared	0.38	0.33	0.38	0.33

*Source: Author's calculation. ***) Statistically significant at the 1% level.*

5.5.2 Analysis using an alternative outcome of interest

In this section, the analysis using another alternative outcome variable is presented. Some studies use the ratio of revenue to Gross Regional Domestic Product to measure 'tax effort' (Cyan *et al.*, 2014). Therefore, it is useful to see whether the previous analyses presented above is sensitive to the choice of outcome variables. Here, the ratio of own-source revenue to Gross Regional Domestic Product is used as an alternative variable. The specifications are the same as in the previous analysis, the estimation is done using difference-in-differences with covariates and fixed effects. Analysing the effect this way provides further evidence on the effect of the reform to local tax effort in municipalities in Indonesia. The result is presented in Table 5.6.

From Table 5.6, it can be seen that an estimation using the same covariates shows a similar positive outcome in explaining the ratio of own-source revenue to Gross Regional Domestic Product, a measure of tax effort, after the devolution of property tax. The average increase is 0.4 to 1.1 per cent for the ratio of own-source

revenue to GRDP for the municipalities implementing the reform in the period of observation.

Table 5.6. Effect of reform to ratio of own-source revenue to GRDP

	Ratio of own source revenue to GRDP (%)	
	(1)	(2)
Effect of reform	1.1*** (0.3)	0.4** (0.6)
Covariates	Yes	Yes
Fixed effects	No	Yes
Observations	4,313	4,313
R-squared	0.15	0.06

*Source: Author's calculation. ***) Statistically significant at the 1% level. **) Statistically significant at the 5% level.*

This further supports the findings presented in the previous sections, where the reform increases the proportion of own-source revenue in local revenue and local own-source revenue per capita in the municipalities implementing the reform.

5.6 Conclusion

This chapter has presented the analyses and findings regarding the impact of revenue devolution to revenue mobilisation in Indonesia. The evidence in this chapter suggests answers which relate to the first research question regarding the impact of revenue devolution on subnational revenue mobilisation in Indonesia. Results from the estimation show that the devolution of new revenue-raising powers in the 2011-2013 period had the effect of increasing the proportion of own-source revenues in total local revenue for the municipalities which benefitted from the decentralisation reforms. Moreover, the reform also brought the effect of increasing average local revenues per

capita in those municipalities. Both of those effects also remain important when the municipalities in provinces receiving nonstandard transfers are excluded from the estimations. These results represent a successful reform if it is judged by whether it causes an upward change in local revenue variables. This chapter therefore confirms the hypothesis that devolution of new revenue sources will lead to an average increase of subnational revenue mobilisation, a hypothesis based on the previous discussions of Oates (1972, 1999, 2008), Weingast (1995, 2009, 2014), Hines and Thaler (1995) and Rodden (2005, 2019).

While there is an evidence of increase in various revenue variables, discussing the outcome of the reform with consideration of the institutional context brought a question about the efficacy of the reform. The reform brought about a new space for fiscal autonomy, but the rules which structure intergovernmental fiscal and political relations in Indonesia do seem to have influence in the use of the new local autonomy. From Chapter 4, it is known that the central government still has ways to influence local decision making and is especially influential in decisions regarding human resource management at the local level. Moreover, there is a constraint on the tax ratio which can be decided by local governments. With the small scope of changes in local decision making, there is an indication that the effect of the reform is restrained and it could be potentially higher than what was found in this study with further relaxation of these constraints. In addition, the increased amount of intergovernmental transfers during the period of reform provides an additional funding source to local governments which can be an alternative to own-source revenues.

Another finding from the analysis relates to important disparities between municipalities in Indonesia regarding revenue mobilisation. The trend of revenue variables in the 1999-2013 period shows that municipalities which undertook the early reform during 2011-2013 had had a higher proportion of own-source revenue

and local own-source revenue per capita before the reform. This brings attention to the variation of local capacity in revenue mobilisation where some municipalities were more successful in managing their own-source revenue compared to others. All of the municipalities eventually implemented the reform after 2013, but it is interesting to see that the ones which were the early implementers became the ones with better local revenue outcomes. From the current data, it is yet to be seen whether this gap is narrowed or widened in the following years after the reform, an issue of which can be a subject for another study. Even so, qualitative analysis in this study identifies important factors considered by local officials regarding revenue mobilisation and their experience with the new revenue source. The discussion in Chapter 6 that the effects of devolution of property tax on local revenue were moderated by the institutional arrangements and contextual factors.

Analysing observations from central and local actors is necessary to understand more about the policy dynamics regarding subnational revenue mobilisation. Qualitative data regarding the experience of local revenue mobilisation and intergovernmental transfers can reveal how they work in practice and complement the analysis in this chapter. In the next chapter, the data collected from interviews and secondary sources is analysed to provide more understanding regarding the interplay of various factors in the process of local revenue mobilisation.

6 Explaining Actors' Behaviour under Existing Intergovernmental Fiscal and Political Institutions in Indonesia

Although much has been learned from the quantitative analysis of Chapter 5, there is scope to supplement this knowledge by applying qualitative methods. The quantitative analysis shows that the devolution of property tax in the 2011-2013 period resulted in an increase in local governments' proportion of own-source revenues and local own-source revenues per capita in the implementing municipalities. However, it is still unclear about how the institutional arrangements and contextual factors contribute to the observed outcomes. The theoretical discussion in Chapter 2 showed an expectation that actors' perceptions, behaviour and decisions will respond to the opportunities and constraints they have from the rules influencing the decision making process. An investigation of these perceptions, behaviour and decisions cannot rely solely on quantitative data because it may not be able to capture the thought process of the actors involved in the process.

As discussed in Chapter 3, a qualitative study can provide observations on how institutions influence actors' perceptions, behaviour and decisions in more detail. While the results of the quantitative analysis have provided explanations about the effects of devolution on local revenue variables, those conclusions need to be rounded out by hearing from a sample of the actors involved, specifically local and central officials. In this chapter, local and central officials are interviewed to obtain their views on the workings of intergovernmental fiscal and political institutions and decision making processes, specifically relating local revenues and other fiscal-related decisions. This chapter therefore addresses the questions of how these actors perceive

intergovernmental relations and local revenues to understand more about institutional and contextual factors affecting local revenue mobilisation.

This chapter examines a small set of case studies of municipality finance in Indonesia, it presents observations obtained from interviews to central and local officials, and also secondary data from official documents and media outlets. The next section presents the municipal case studies and differences between them. The sections that follow provide observations obtained from interviews and secondary data, and discuss how they explain the process of local decision making and revenue mobilisation. From the discussion, the role of institutional arrangements and contextual factors can be clarified. The conclusion of the analysis in this chapter is discussed in the last section.

6.1 Municipal Case Studies

This study investigates two municipal cases. It seeks to understand more about the process of subnational revenue mobilisation and what changes have been brought by the decentralisation reforms detailed in Chapter 4. The case study municipalities are selected from a list of those which implemented the revenue reform in the 2011-2013 period. The institutional arrangements of decentralisation in Indonesia open the possibility for variations in municipalities' revenue mobilisation experience. The two case studies analysed here are typical cases in terms of reform outcomes, but they differ in their profile of natural resource endowments. Municipality A is a municipality with significant natural resource endowments, receiving a high proportion of Natural Resource Revenue Sharing Transfer (DBH) each year. Municipality B has a low level of natural resource endowments, which is also reflected in the DBH it receives each year. Municipalities A and B are parts of different provinces.

Analysing these cases is aimed at contributing to an understanding of how natural resource endowments affect revenue mobilisation. As set out in detail in

Chapter 4, the Indonesian central government holds substantial authority in local finance matters. It has particular authority in managing various aspects that can be associated with natural resource endowments. For example, the central government retains the authority to manage property tax for plantation, forestry, and mining sectors, also known as *Pajak Bumi dan Bangunan Perkebunan, Perhutanan, dan Pertambangan* (PBB-P3). This PBB-P3 is more important in municipalities with large areas of plantation, forestry, or mining sector activities. The central government is also the majority shareholder for state-owned enterprises – SOEs (*Badan Usaha Milik Negara*/BUMN), with some SOEs operating in plantations, forestry, mining, oil and gas, sectors related to allocation of DBH.

Municipalities A and B have some important differences. Municipality A annually received more than IDR540,000 in natural resource revenue sharing per capita in the period between 2000 and 2010. In own-source revenue per capita, it ranged between IDR29,635 and IDR219,480 in the same period. The proportion of own-source revenue in local revenue was between 2.23% and 7.95% in 2000-2010. In contrast, Municipality B annually received between IDR283.55 and IDR4,408.44 in natural resource revenue sharing per capita in the period between 2000 and 2010. In own-source revenue per capita, it ranged between IDR18,474 and IDR157,487 in the same period. The proportion of own-source revenue in local revenue was therefore higher than Municipality A, lying between 8.89% and 13.28% in 2000-2011. Detailed data for these variables is shown in Table 6.1.

The aim in collecting observations from these two municipalities is to examine revenue mobilisation and policy making experience from the perspective of local officials. This perspective is then complemented by the views from central officials regarding public financial management in local governments and an analysis of interactions between central and local governments. Inference on how

intergovernmental political and fiscal institutions affect local revenue mobilisation is made and this analysis also draws from official documents, laws and media reports.

The qualitative analysis carried out in this study is aimed to further explain the details about actors and processes which relate with the workings of institutions governing intergovernmental relations. The scope of decision of local actors in the fiscal and political sphere in the regulation was identified and outlined in Chapter 4. It is important to understand whether what happens in practice is consistent with the formal rules or deviates from them to some extent. Qualitative analysis in this chapter can also provide more understanding about the role of time-invariant or slow-moving variables such as natural resource endowments. Lastly, the findings from qualitative analysis can provide clarifications on the existing theoretical model about decentralisation, whether all the important elements in practice has been captured by the model.

Table 6.1 Key Data for Municipalities A and B

Municipality/Variables	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Municipality A											
Natural Resource Revenue Sharing per capita (IDR)	N/A	637,896.10	546,677.70	606,169.30	873,522.60	1,297,908.00	1,861,841.00	1,316,870.00	1,681,744.00	1,093,158.00	1,655,000.00
Own Source Revenue per capita (IDR)	N/A	29,635.94	68,590.31	61,750.02	77,016.90	86,239.41	191,398.40	196,596.90	174,425.00	178,531.20	219,480.10
Proportion of Own Source Revenue in Local Revenue	5.27%	2.23%	5.21%	4.03%	4.68%	4.07%	6.64%	7.49%	6.25%	7.53%	7.95%
Municipality B											
Natural Resource Revenue Sharing per capita (IDR)	283.55	328.81	3,821.48	N/A	2,086.12	1,843.05	4,408.44	N/A	4,361.84	1,887.81	2,170.40
Own Source Revenue per capita (IDR)	18,474.44	42,568.86	60,748.08	63,291.87	71,396.82	83,877.83	96,706.07	112,528.10	123,013.40	124,924.10	157,487.30
Proportion of Own Source Revenue in Local Revenue	10.02%	8.89%	11.34%	11.36%	12.29%	13.28%	10.22%	10.41%	10.37%	9.90%	11.41%

Source: Author's calculation based on INDO-DAPOER data set.

6.2 Sources of Revenue for Local Government

6.2.1 *Own-source revenue*

Recalling the discussion in Chapter Four, sources of revenue for local government in Indonesia can be categorised into two types: own-source revenues and intergovernmental transfers. Own-source revenues come from revenue mobilisation inside the jurisdiction of local governments, whereas intergovernmental transfers are allocated by the central government. Theoretically speaking, local officials have more flexibility regarding expenditure decisions funded by own-source revenues. However, there is also a possibility that the central government provides wider scope of alternatives regarding expenditure decisions for intergovernmental transfers. Furthermore, one type of intergovernmental transfer is affected by natural resource endowments in the local jurisdiction, namely the Revenue Sharing Fund (*Dana Bagi Hasil*/DBH).

From the interviews, it is observed that local officials in the observed cases are generally in agreement regarding the significance of own-source revenue in the local budget (*Anggaran Pendapatan dan Belanja Daerah*/APBD). Both Municipality A and B have intergovernmental transfers as their main source of funding, as can be seen in Table 6.1. Nevertheless, the officials also consider own-source revenue as an important component which involves various local actors and requires support from political leaders. One officer in Municipality B commented:

‘Of course we need to take own-source revenue seriously! We can see that many of our government activities are still financed by transfers from the central government, but we made a lot of effort in encouraging revenue generation from our own soil. There are many people involved, community leaders, political leaders, the citizens, local businesses. The mayor plays an active role here, because he disseminates this [revenue] to the local

taxpayers [individuals and businesses] by highlighting specific projects which have been funded in the past.’ (LB4)

Similar to the view from the official above, an officer in Municipality A also recognised the accountability link between own-source revenue and expenditure decisions made by political leaders and local officials. Greater autonomy in allocating expenditures funded by own-source revenue is viewed as a source of confidence for local politicians and officials.

‘We can be more confident when we talk about activities funded by own-source revenues. We took great care to manage those revenues, and the people would remember what we do in the following year, so we planned for the expenditure carefully.’ (LA4)

Views from other local officials corroborate the perspectives presented above. The officials realised that own-source revenue does not constitute a dominant portion in the local budget, but its significance in local policies and activities comes from the greater autonomy regarding expenditure decisions. There is also an awareness regarding accountability, given that political leaders and local officials presented successful projects in the preceding year to encourage tax compliance, while being cautious about presenting future projects. In each calendar year, there are meetings between local officials and communities to discuss local government’s plan in the following year. These meetings are viewed by officials as an arena to promote local government revenue mobilisation and an opportunity for local stakeholders to participate in and criticise local policy decisions.

Regarding own-source revenue reliability, local officials in the observed cases viewed it as something which depends on the efforts of local government as an organisation and support from local stakeholders. External factors such as the national economic situation and central government project decisions were identified as other

contributing factors for own-source revenue mobilisation. A municipal officer in Municipality B commented:

‘We can predict the level of own-source revenue for the following year reasonably well. For property tax, it is quite stable from year to year. Restaurant and hotel taxes are quite similar. It depends on our efforts as well, how much we can invest to collect this revenue. We need capable manpower, good system, support from the locals. It also depends on the economy; in an unusual situation such as now [the pandemic], the circumstances are different.’ (LB4)

For local budgeting purposes, own-source revenue is viewed as a reliable source, because it is quite predictable. However, local officials also acknowledged the difficulty in raising the level of own-source revenue in a short period, as it needs investments in human resources and systems such as information technology. In the interviews, the majority of the local officials agreed that there were opportunities to manoeuvre regarding own-source revenue, even though those did not appear to be that much in terms of property tax administration. The central government establishes a ceiling for property tax rate, which is 0.3% of the sale value of the property. As is the case in both Municipalities A and B, many local governments in Indonesia run at the 0.2% constraint for property tax in their jurisdiction, the initial property tax rate before it is devolved to local governments, and this was also confirmed by central officials during interviews. That rate is at a manageable level to be paid by citizens from various income groups, and central officials consider that the rate is enough to provide additional fiscal autonomy to the local governments.

6.2.2 Intergovernmental transfers

As noted, intergovernmental transfers are the main source of financing for most local governments in Indonesia and these transfers are crucial in realising local policies and activities. As discussed in Chapter 4, there are three major categories of

intergovernmental transfer which are given to most local governments in Indonesia: the General Allocation Fund (DAU), the Special Allocation Fund (DAK), and the Revenue Sharing Transfer (DBH). The DAU is an equalisation grant given to local governments in Indonesia to support their fiscal capacity and is allocated based on a formula set by the Ministry of Finance. The formula for DAU considers factors such as estimated expenditure for salary, population, area, gross regional domestic product, own-source revenue, and revenue sharing transfer. The DAK is a programme grant linked with sectoral priorities at the national level. Central government allocates DAK, informed by the targets specified in the National Medium Term Development Plan (*Rencana Pembangunan Jangka Menengah Nasional/RPJMN*). Sectoral ministries decide the expenditure necessary to achieve those targets in the form of programmes and activities. Each local government receives an amount of DAK allocated in different sectors, i.e. education, health, infrastructure, and others. The DBH is a revenue sharing transfer allocated based on a set formula decided by the central government. The rate of revenue sharing transfer differs between various categories of DBH. For example, the revenue sharing rate for income tax (*Pajak Penghasilan/PPH*) is 8.4% for each municipality where the taxpayers are listed, while the revenue sharing rate for fisheries is 80% for all municipalities. Therefore, a combination of income tax and natural resource revenues will determine the amount of revenue sharing transfer received by a municipality.

Local officials in municipalities A and B share a similar sentiment to each other regarding intergovernmental transfers, although there are also differences in the experience between those municipalities regarding revenue sharing transfer. For DAU, local officials thought that there was not much scope for interventions by local governments and the DAU worked quite well as a source of financing. The DAU is both predictable and reliable, and there had been no issues in the past regarding DAU allocation and disbursement in either municipality.

In contrast, the local officials' perception on DAK is somewhat mixed because there were possible mismatches between national and local priorities. As expressed by an officer in Municipality B:

'We are grateful for the funds [DAK] given by the central government, but we have to say that the restriction put on the usage [DAK] limits our ability to address the urgent local needs, occasionally. We wanted to fix a school which was in a ghastly condition, but the guidance for the fund usage did not allow that, so we allocated the fund for another use. It still had its use, but it would be ideal if it could be used for our most urgent needs.' (LB3)

Some other officers in both municipalities expressed a similar sentiment during the interviews. There were times where local officials hoped that the funding from the central government could be used for some other expenditures which were higher in the list of local priorities. This possible mismatch between national and local priorities was also acknowledged by some central officials. An auditor from the central government commented:

'Well, we can see that in some periods, in some local governments, there was an amount of DAK funding left unused. This happened more often in the earlier years of decentralisation. There were many causes to this: ..., another one was the specification relating sectoral priorities in the local governments, ...' (C1)

Such a lack of use of DAK funding may be the result of a strong conflict between central and local priorities. It is noted that Oates (1972, 1999) has argued that local priorities are more likely to reflect local citizens' preferences. Although such differences between national and local sectoral priorities can affect the usage of DAK, it is comforting to note that according to interviewees such situations do not occur that frequently. The level of conflict discussed by interviewees was at a level where expenditure details are concerned (e.g. whether to use the money to allow extensive repair or to provide laboratory equipment for schools) rather than political ideology

like the issue discussed in other studies. For example, Eaton (2015, 2017) examines cases in Peru, Ecuador and Bolivia and finds that subnational officials can be in a position to challenge the policy regime because of differences in ideology (e.g. whether to involve private sector in public service provision or let local governments directly provide public service). That did not occur in the Indonesian cases discussed here. Therefore, those instances in Indonesia only resulted in mild policy responses from municipalities: either they did not use the allocated funds or they proposed adjustments for the use of fund in the next budget period.

The technical guidance for DAK usage is published by the sectoral ministries in the central government. For example: DAK usage for education follows the guidance published by the Ministry of Education. This guidance provides a list of activities which can be funded by DAK in a specific sector. Although this limits what DAK can be spent on, there are channels for local governments to submit their priorities for what is to be included in the list. Before publishing the guidance, sectoral ministries collect a category of activities submitted by the local governments in each respective sector. These submitted activities therefore will usually include various local priorities. Another channel for influencing types of expenditure that will be supported by the central government is through the National Meeting for the National Development Plan (*Musyawarah Perencanaan Pembangunan Nasional/Musrenbangnas*). This meeting is held annually to gather national and local officers to discuss the development plan for the following budget year (thus, for example *Musrenbangnas* in 2010 discussed the development plan for 2011). This result of this meeting is used in the development of national priorities, and can further affect the list of activities included in DAK fund usage guidance.

Despite the possibilities of mismatch between national and local priorities, DAK is still viewed as a predictable and reliable source of funding by officials in both municipalities. The amount of funds disbursed and its timing can be used by local

governments to develop an implementable annual budget. There is no particular concern about DAK hindering local development, nor about DAK preventing an important local activity from being realised.

Both municipalities studied here differ in their profile of natural resource endowments, which result in different perception of officials regarding revenue sharing transfer. Local officials in Municipality A which had more natural resource endowments perceive natural resource revenue sharing transfer as a helpful addition of financial resources to finance government activities at local level. On the other hand, local officials in Municipality B which had less natural resource endowments are more familiar with other types of revenue sharing transfer. The perception of the former is reflected in the comment of a planning officer in Municipality A:

‘We are blessed with a wealth of natural resources, and this blessing is helpful to develop this municipality. We have a lot of programmes formulated for various things: infrastructure, education, social welfare, and others. If you come here, you can see how this city prospers, and natural resource revenue sharing contribute much to it.’ (LA1)

In the above interview, the officer acknowledged that the existence of natural resources inside the jurisdiction had provided several economic benefits. Not only does it allow additional revenue sharing transfer (DBH) from the government, it also stimulates economic activity in the region. Many new businesses emerged in the oil and plantation sectors, which then could translate into additional revenue through other local business taxes. The local economic development strategy in Municipality A has long been centred around its natural resources, which leads the other local officials there to also appreciate their benefits to local revenue. Furthermore, DBH provides more flexibility compared to DAK in its possible use. This allows a wider scope of use for the fund which is highly appreciated by local officials and, by extension, local politicians.

Officials in Municipality B, in contrast, did not have much to say regarding natural resource revenue sharing transfer and were rather more focused on income tax revenue sharing transfer. They perceived that the local economy was centred around other sectors (trading and retail), which led them to focus more on revenue sources linked to those sectors, such as income tax revenue sharing transfer and local business taxes. A finance officer in Municipality B commented:

‘We don’t receive that much in natural resource revenue sharing, but we receive quite an amount from the income tax revenue sharing. Rather than worrying about how natural resources might be depleted in the future, we have to think more about our taxpayers, citizens in this city.’ (LB5)

In the interviews, other officials in Municipality B also agreed that the nonexistence of natural resources in the jurisdiction does not hinder them from implementing local government’s programmes and policies. They appreciated the fact that the municipality received the income tax revenue sharing transfer as its main revenue source from DBH and worked around that in developing their revenue mobilisation strategy.

What emerges from interviews in both municipalities is the fact that revenue sharing transfer provides flexibility in developing plans for expenditure. Municipalities with a good level of natural resource endowments benefit from this mainly through the natural resources revenue sharing, as shown in Municipality A. Other municipalities with less to no natural resource endowments can focus on their income tax revenue sharing, in line with the comments of Municipality B officials. In neither municipality did officials have complaints regarding the amount or disbursement timing of both types of revenue sharing transfer, suggesting that both types of transfer are perceived as predictable and reliable sources of funding.

Although, as discussed in Chapter 2, page 30, theoretical discussion favours greater local revenue mobilisation to allow greater autonomy, a higher level of grants

can provide a sufficient degree of autonomy as well. The evidence reflected in the interviews and secondary data in Indonesia shows that intergovernmental transfers can be predictable and reliable without hindering local governments from implementing local programmes and activities. There are examples in other countries in a certain period where intergovernmental transfers show patterns following a particular political logic, for example in Ghana (Banful, 2011), Senegal (Caldeira, 2011), or Mexico (Diaz-Cayeros, 2006). The evidence from the Indonesian municipal case studies does not seem to reflect those instances in other countries, at least to an extent where if any of such patterns exist, they do not affect the implementation of local policies. Furthermore, it was noted that local governments have sufficient degree of discretion in the use of intergovernmental transfers.

Despite the evidence discussed in the last paragraph, existing rules dictated that funding from intergovernmental transfers is still subject to central government's control, at least for a number of aspects. During 2006-2013, for DAU, the central government decided the formula to allocate the DAU. Moreover, central government ministries decided the final category of activities which can be funded by DAK. For DBH, it was central government that decided the formula to calculate the proportion of revenue sharing for each level of subnational government. Local officials' comments suggest that there was no substantial deviation regarding intergovernmental transfers from the amount declared by the central government in the national budget, and thus, in practice payments from DAK and DAU resulted in relatively predictable and reliable disbursements of transfer fund. In contrast, central officials view the existing arrangements for intergovernmental transfer as operating to limit the risk of local governments' mismanagement or malfeasance. A central official commented:

'Local governments need to work on their governance and accountability. The current arrangement for intergovernmental transfers may be ideal, considering that some [local governments] still lack capacity while some others maybe more capable.' (C4)

Central officials observed an uneven capacity in local governments to manage public finance, which they saw as justifying an extended control by central government over financial matters. This issue is further discussed in Section 6.4.

It can be seen that the variety of intergovernmental transfers has provided local governments with predictable and reliable sources of finance. In each of DAU, DAK, and DBH there is a certain element of central government control, but it is not at a level that local governments view the control as being onerous. As a result, local governments value these transfers highly and work around the mechanism of each transfer in order to be able to use the funding for local advantage, in conjunction with their own-source revenues. This is discussed further in the section that follows.

6.3 Decision Making for Various Sources of Revenue at Local Level

6.3.1 Constraints and opportunities from intergovernmental transfers

Intergovernmental transfers come with a set of rules which can narrow the scope of decisions of local governments. This issue is discussed briefly in Section 6.2.2 above. Gonschorek and Schulze (2018) explain various types of intergovernmental transfer in Indonesia in much detail, and therefore only select elements of intergovernmental transfer are discussed here. The features relevant to the research here are the transfers which were consistently allocated each year to most, if not all, local governments. These transfers are the DAU (General Allocation Fund), the DAK (Special Allocation Fund) and the DBH (Revenue Sharing Fund).

In the interviews, local officials gave relatively more attention to DAK than DAU and DBH, as for DAK there was more potential for conflicting decisions there between central and local governments. DAU usage was perceived to be rather unrestricted, although much of this fund was used to support personnel expenditure, i.e. salary, in both municipalities. Perceptions about DBH were also similar in that

there was relatively more flexibility towards its usage, although the amount received varied widely between municipalities. There were suggestions from central officials to focus the DBH usage on infrastructure, but those suggestions were treated as another input for local governments to decide. DAK usage, in contrast, was more strictly regulated by the central government, as the sectoral ministries were the ones who decided what kind of activities were eligible to be financed by DAK. This could potentially create problems for municipalities if they did not have similar areas of concerns to the concerns conceived by the central ministries. The general perception was that DAU and DBH did not interfere with local governments' ability to identify and select activities to be financed, while DAK had the risk of affecting that ability.

This specific feature of DAK which includes involvement by central ministries encouraged local officials to develop an adaptive mechanism. Local officials realised that there would be some views in the central government which cater to local needs. After all, central ministries' decisions would affect all municipalities, so those decisions were not too specific or particularly too restrictive. Local politicians were particularly aware of this and encouraged local officials to actively find the links between local preferences and centrally-defined priorities. A planning officer from Municipality B commented:

‘We need to be smart in our planning. There are some areas where national and local priorities align, and we need to use that wisely for this municipality’s development. Those areas can be supported by central government funding, while for other areas, we need to use our own efforts.’
(LB3)

This might lead to some re-labelling of activities to be in line with national priorities. After local officials identify local preferences for publicly-funded programmes and activities, they need to connect those to the category defined by central ministries.

Another strategy which was mentioned by local officials in the interviews is to give suggestions to central ministries and agencies regarding the category of activities to be financed by DAK. There is an annual development planning process in Indonesia where one of the objectives is to gather views and suggestions regarding priorities to be financed in the next budget year. This process involves representatives from various groups, such as local governments, central ministries and agencies, and representatives from academia, businesses, and civil society. It is called the *Musyawarah Perencanaan Pembangunan Nasional* (Musrenbangnas – National Development Planning Meeting). A part of the process which involves local governments, requires local governments to submit categories of activities which need to be addressed at local level. This list of activities is then analysed by the central ministries, mainly by the sectoral ministries but also with some involvement of the Ministry of National Development Planning. This process is called *Penyusunan Rencana Kerja Pemerintah* (Formulation of RKP). Through this process, there was an opportunity for local governments to influence ministries' decision regarding DAK for the next budget year. Moreover, local politicians and citizens could also play a role in influencing national priorities by voicing their opinions through their representatives at the People's Representative Council (DPR). Local politicians could interact with their colleagues from the same political party, and when councillors visit their constituency citizens might stress some local issues to be addressed at national level. An officer from Municipality A in education commented:

'I think there are similar areas prioritised at national and local level. I mean, citizens here have representatives at national level as well. We also coordinate with central officials through various fora, and I think some of the priorities listed in the guidance reflect what we have voiced through those fora.' (LA5)

In principle, local officials and politicians had the opportunity to influence identification of activities at national level. They could put activities which had been

identified through planning process at local level into the list defined by the central ministries.

From the perspective of central officials, the control exerted by central government was needed and still left local governments with sufficient autonomy for policy making. They observed that local governments might have different rationales in identifying local priorities, and there was a sense that some rationales might occasionally be in conflict with the rationale used by central officials. In the end, local governments could use their own-source revenues to address local priorities which were not in the centrally-defined list, and this would also force local governments to be more aware in matching their identification with local preferences. An auditor in central government commented:

‘The bottom line, local governments are given a set of financial resources, and it is up to them to use those to address local priorities. Unfortunately, some local governments work under a different reasoning in deciding the priorities.’ (C6)

There was a perception that local governments might not be competent or efficient in their identification process, which could be seen to justify limitations present in the current level of fiscal autonomy. In the interviews, central officials were also confident that the central government’s identification would be able to identify local needs in so far as those needs were reflected in many local governments.

Decisions on how intergovernmental transfers may be used can sometime be constrained by rules defined by the central government. These constraints can materialise in the formula to decide the amount of allocation, in the earmarking regarding the use of the fund, or in other types of constraining rule provision. Moreover, those rules can create problems whereby transfers could not always be used to fund priorities which have been identified by local politicians and officials. However, intergovernmental transfers in Indonesia provided a mechanism to mitigate

effects of mismatched identification of priorities between national and local governments. This is provided through a formal process where local governments can propose a category of activities to be included in the centrally-defined list, a list of which would be used as a reference for the usage of transfers. In addition, some activities on that list may have aligned with locally-identified priorities. In this instance, local governments can match their identified activities with the category in the list to be able to use transfer fund to finance said activities.

6.3.2 Approaching taxpayers for revenue

Local governments have a relatively wider scope of decision-making in dealing with own-source revenues than with intergovernmental transfers. A local government can have a set combination of taxes and charges to be imposed and service supplied in its jurisdiction, which may induce citizens and businesses to select the appropriate local governments for them (Tiebout, 1956). Just before the property tax devolution in Indonesia, Law 28/2009 regarding Subnational Taxes and Charges outlined the framework for local governments in administering their own-source revenues. There are 11 types of local tax and 30 types of user charges which can potentially be collected by local governments (Republic of Indonesia, 2009b). Therefore, local own-source revenues in Indonesia were relatively less restricted in terms of their implementation.

Interviews with local officials show that there was a belief that local governments work around a similar set of revenue sources, but this did not translate into interjurisdictional competition. Rather, the perception was more towards similarities of policy and how taxpayers might have the same experience elsewhere in Indonesia. A finance officer from Municipality A commented:

‘I think the taxes and charges we have here are not too different from those that exist in other local governments. Our neighbour [an adjacent municipality] also collects property tax, for sure. There are also parking

charges both here and there, hotel taxes, restaurant taxes. I would like to think that those are standard revenue sources for local governments, and the citizens expect that to be the case.’ (LA4)

This perception is interesting because categories of own-source revenue in Municipality A and Municipality B do show some similarities to some extent, based on the data from the 2021 budget year. However, there are also a number of revenue categories in Municipality A which do not correspond to categories in Municipality B. This suggests that there was a lack of detailed understanding towards revenue policy in other municipalities at the local officials’ level. Revenue policy in Municipality A might have been decided without considering much about alternative sets of policy which was implemented in other municipalities. It is possible that the existence of a general list of local revenue sources in Law 28/2009 induced local officials to speculate about policy similarities between different municipalities. The knowledge about the high proportion of intergovernmental transfers in local finance throughout Indonesia also did not help local officials to think towards policy variations.

Even though local officials in the case study municipalities do not think of local revenue policy as a possible source of competitive advantage between different municipalities, there was a certain amount of attention given towards taxpayers’ opinions. Local officials in Municipality B noticed that the local political leader was quite concerned about revenue policy and the revenue-expenditure link. There was a sense of local ownership towards own-source revenues, as the policy regarding which types of revenue and charge collected was decided at local level without much interference from the central government. A finance officer in Municipality B commented:

‘Our mayor cares about views from the citizens and businesses regarding the revenues we collected from them. That is why we always remind them about what we do with that money, to maintain their cooperation.’ (LB5)

This resonates with the theoretical discussion in the literature which highlights the association between revenue and accountability (Pöschl and Weingast, 2015; Rodden, 2019). Local officials perceived that there was a greater scrutiny given by citizens and businesses towards own-source revenues, which tended to make local governments to be more careful in using those revenues. Moreover, the benefits from investment of own-source revenues in previous years could become evidence to encourage tax compliance in the future.

6.3.3 Support from the community

Another important aspect which deserves further attention is regarding support from the taxpayers' side associated with compliance. Some revenue sources at local level are charged and/or collected in parallel with accompanying business transactions. One example of these is restaurant tax, where in most cases providers include that tax in the bill charged to customers. Another example is user charges associated with licensing. The revenue will be charged and collected when applicants submit their request for a license. For property tax, the amount is charged at the beginning of the year (January or February) with the payment deadline in Semester 2 of the same year (i.e. August or September). The process for property tax requires a different approach to ensure compliance compared to the restaurant tax and licensing charges. Property tax is discussed next.

In the interviews, local officials pointed out that community support is a critical success factor for property tax collection. There had been a good deal of campaigning done in Municipalities A and B to show to taxpayers the importance of paying property tax, but local officials could not contact each individual taxpayer to ensure tax compliance. In this situation, they received support from local community leaders, which were located closer to the taxpayers. These community leaders were already involved in other administrative processes such as providing request letters for citizens who needed their first identity card, or in issuing letters of

acknowledgement for people temporarily residing in the village. Community leaders were highly regarded by their community, so their support was valuable specifically for encouraging tax compliance. A finance officer in Municipality B commented:

‘For property tax, we feel grateful because of the assistance from local community leaders. They work on the ground; they know their community, often at a personal level; they have influence in convincing the taxpayers to pay.’ (LA6)

Because of their importance, Municipality B officials regarded community leaders as strategic partners for a property tax campaign. The local revenue authority held meetings with these community leaders to disseminate the general policy for local taxes, especially property tax (PBB-P2) and vehicle tax. Different agencies in the local government also did similar activities to disseminate other local government programmes in which community leaders’ support would be a key factor.

This coordination between local government and community leaders regarding property tax had become easier since the property tax was devolved to municipalities. When PBB-P2 was managed by the central government, there was less communication between the revenue authority and community leaders. Community leaders were given an information pack to encourage citizens in their community to pay their taxes. However, the explanation given in the information pack was less detailed compared to the one provided in local government’s dissemination meetings. The local government could engage more with community leaders because there were many local programmes which allowed local officials to have more interaction with local community leaders. There were more opportunities for community leaders to ask questions and clarify details. Local officials also received feedback and suggestions for programmes in the next budget year, although the officials also pointed out that not all of those suggestions could be adopted.

6.4 Local Government Capacity in Financial Management

6.4.1 *Local public financial management: what the audit reports said*

Capacity issues have been an enduring problem for local governments in Indonesia since the implementation of decentralisation. In the pre-decentralisation period, most policy and budgetary decisions were made by central officials, including those to be implemented at local level. Local officials worked as a line of management under central government, with less experience in activities such as budgetary decision-making and resource allocation for a whole local government scope. Reporting mechanisms were also not as comprehensive as they could be because the Indonesian government uses cash-basis accounting which does not require a detailed presentation on government's assets. Furthermore, the central government retained many skilled human resources when local governments were given new autonomy and responsibility as part of the decentralisation reform. As a result, there was a lack of skilled human resources to undertake activities related to policy making and public financial management.

The lack of capacity in public financial management at subnational level was apparent when each local government's financial statements were subject to an audit by the Supreme Audit Agency (*Badan Pemeriksa Keuangan/BPK*). BPK started to conduct audits to local governments after the set of laws on public financial management was enacted in the 2003-2004 period. Central officials in the interviews took note of this weakness in local governments and were particularly cautious about transferring much authority and autonomy to local level. An auditor in the central government commented:

'In the past, many local governments received a disclaimer of opinion from the Supreme Audit Agency. Public financial management was messy, it was hard to see.' (C2)

The audit opinions issued by BPK were categorised into four types which relate to the degree of conformity to the government accounting standard and principles. Unqualified opinion and qualified opinion reflected full conformity and there was conformity in most aspects with minor issues, respectively. In contrast, the other two types of audit opinion were given for local governments which had major issues in their financial management. A disclaimer of opinion was given when there was a severe limitation of scope for the audit done by BPK. An adverse opinion was given when there was an indication that the financial statements include pervasive misstatements or misrepresentation of the government's financial information. Local governments which received a disclaimer of opinion or an adverse opinion, therefore, had issues with their public financial management processes.

The perception about weak public financial management in local government was reflected in the data of audit opinion from BPK in the 2006-2012 period. BPK publishes a report summarising the audits conducted in each semester of the year, where the report in 2012 and 2013 documented BPK's audit opinion on the financial statements of municipalities in 2006-2012. This can be seen in more detail in Table 6.2, which uses BPK reports as source documents.

Table 6.2 shows that there was a large portion of municipalities which received a disclaimer of opinion or an adverse opinion from BPK. The evidence from BPK audit reports corroborates the view from central officials about the weakness relating public financial management in local governments when the property tax administration was devolved to municipalities.

Table 6.2 Audit Opinion of BPK to Municipalities in 2006-2012

No	Year	Number of municipalities receiving Disclaimer of Opinion or Adverse Opinion from BPK	Number of municipalities audited by BPK	Percentage
1	2006	125	430	29.07%
2	2007	171	436	39.22%
3	2008	140	452	30.97%
4	2009	151	471	32.06%
5	2010	142	489	29.04%
6	2011	104	491	21.18%
7	2012	79	490	16.12%

Source: Author's calculation from BPK RI (2012) and BPK RI (2013). Data for the period 2006-2009 was taken from BPK RI (2012). Data for the period 2010-2012 was taken from BPK RI (2013).

Problems in local governments' public financial management in the 2006-2012 period include administrative issues and financial loss. In BPK RI (2013, p. 31), it was explained that issues such as 'weak fixed asset and inventory management' and 'material weakness in asset administration' contributed to the high number of local governments' financial statements which did not receive an unqualified opinion from BPK. Weakness in internal control also widespread in local governments' financial management processes, as stated in BPK RI (2013):

'In local governments, most internal control weakness was related to accounting and reporting control which amounted to 568 cases. Those cases include inaccurate or deficient recording of transactions, reporting processes which did not follow the guidelines, inadequate planning of activities, and government agencies which did not have formal SOP for a procedure or a chain of procedure.' (p. 32)

With such issues being reported by auditors from BPK, there was a justification for central officials wanting to exert an extended control towards the use of financial resources.

6.4.2 Hesitation from the centre

In addition to the audit report from BPK, some other studies have also discussed under-developed local government financial management which was reflected in various ways. Sjahrir et al. (2014) argue that administrative overspending was widespread among municipalities in Indonesia and, based on qualitative evidence in media, their article included a number of observations on ‘misappropriation’ of funds and corruption cases in local governments. McLeod and Harun (2014) examine the difficulties experienced by Indonesian local governments in adopting the accrual-basis accounting standard, which resonates with accounting and reporting weaknesses discussed in BPK RI (2012, 2013). In the 1999-2012 period, it is evident that local governments were struggling with adapting to new processes and responsibilities to which they needed to adhere as part of their increased autonomy.

This evidence of weakness in local governments made central officials hesitate to provide greater autonomy to local governments. In the literature, there are discussions about risks and negative aspects which might occur in the implementation of decentralisation, such as in Prud'homme (1995) and Treisman (2007). Therefore, the strategy was to give partial autonomy accompanied with capacity building programmes to local governments. There was an expectation that capacity issues could be remediated over time and local governments would be ready to manage a wider range of decision making processes. A central government official commented:

‘If you deal with financial management issues, you would be aware of the weaknesses in the local governments. The central government provided capacity building programmes, and these helped to improve capacity issues

to some extent. Compared to the past decade, we have seen improvements, although these vary between local governments.’ (C7)

When this central official talked about improvements, she referred to a more recent period, which was around 2018 onward. Local public financial management improved much after two decades of decentralisation in Indonesia. However, there was still a sense of superiority towards local governments shared among central officials interviewed. Policy decisions at local level were seen as inconsistent and contradicting the national development plan at times, especially in activities such as improving public health or attracting investment.

Some evidence of improvement in local governments can be observed from the audit report published by BPK in recent period. From Table 6.2, an indication of improvement is shown in the 2009-2012 period, where there was a declining trend in the proportion of municipalities which received a disclaimer of opinion or adverse opinion from BPK from 32.06% to 16.12%. In a BPK report published in 2019, the number of municipalities receiving a disclaimer of opinion or an adverse opinion went down to a mere 13 out of 508 municipalities which were audited by the BPK or equal to 2.56% (BPK RI, 2019, p. 93). In that report, steps and activities which have been implemented by local government include verification and validation of account receivables, tracing and stocktaking of local governments’ fixed and current assets, and enacting of new accounting policies for certain categories of transaction (BPK RI, 2019, pp. 93-96). It took some time for local governments to improve their public financial management, partially because there were constraints for human resource management at local level. Human resource management is discussed next.

6.4.3 Concerns and constraints towards improvement at local level

As a part of local public financial management, revenue mobilisation needs support from adequate and skilled human resources. In the period 2010-2014, the recently

devolved property tax introduced a set of skills which was required for successful revenue mobilisation. This is reflected in the interviews to local officials, where many of them agreed that local staff was not adequately prepared to support property tax management. A finance officer in Municipality B commented:

‘Of course the start was a bit hard, property tax administration needed some skills in estimating the revenues to be collected, calculating the arrears, while many staff here were not adequately trained to do that. The way to improve was through the training provided by the various central agencies, like the Ministry of Finance and Financial and Development Supervisory Agency.’ (LB5)

While it was widely known in local governments that they need more trained staff to successfully manage property tax, there were limited options available in terms of human resources. Human resource management in the public sector was heavily controlled by the central government, which limited local governments’ ability to hire new staff. Training in property tax management was provided by the Ministry of Finance, but spaces were limited. With more than 500 municipalities across Indonesia, each municipality in the case study could only send up to two members of staff annually.

One of the reasons motivating the central government to retain control in human resource management was related to financial implications. The formula used for the calculation of DAU allocated to municipalities put local governments’ personnel expenditure (i.e. salary) as a factor in determining the DAU amount allocated to local governments. A larger number of staff in a municipality could result in a higher personnel expenditure which then resulted in an increase of DAU allocated to that municipality. This put the central government under an obligation to bear a part of the cost of recruiting new local staff. To mitigate the financial implications for central government, recruitment of civil servants was carried out nationally, whereby the numbers of new local staff to be recruited have to undergo analysis and approval

by the central government, specifically by the National Civil Service Agency (*Badan Kepegawaian Negara/BKN*).

As a result of restricted human resource management, local governments took time to develop their capacity in public financial management. A finance officer in Municipality A commented:

‘We do not have the capacity to manage finance from the start, we developed this over the years. Accountants were quite rare back then in this local government, and we needed some time to develop the human resources for public financial management. We cannot hire staff easily, because staff recruitment is controlled by the central government. This process [of capacity building] took time.’ (LA4)

Local officials had a view that there was an improvement in local capacity in public financial management over time. This view resonated with the assessment given in the 2019 BPK report. With a couple of local staff from each authority participating in training provided by central ministries and agencies each year, the number of staff with relevant skills has increased.

It is concluded that when the property tax was devolved in 2010-2014, local governments faced problems in local capacity and restrictions in human resource management. Local staff was not adequately prepared to undertake property tax management as there was a set of skills needed for the process. Recruitment of new local staff was restricted by central government’s control. In this particular area of human resource management, the central government made the final decision. Training was also limited in numbers, which further restricted the options available to local governments in terms of capacity building.

6.5 Significance of Local Government to Central Government Policy

6.5.1 *The central government's idealised form of local support*

Central and subnational governments in Indonesia develop a work plan for each budget year. This work plan explains the programmes and activities to be funded in the year and is an important component in the budgetary process. In theory, the annual planning processes at central and subnational level are separated from each other, which means that they can be carried out simultaneously. However, for activities funded by intergovernmental transfers, subnational governments require information from central ministries and agencies to be able to identify and match the central programmes with local priorities. In developing its annual work plan (*Rencana Kerja Pemerintah/RKP*), central government refers to long- and medium-term planning documents which are formulated and determined by central politicians and officials, such as the national long-term development plan (*Rencana Pembangunan Jangka Panjang Nasional/RPJPN*) and the national medium-term development plan (*Rencana Pembangunan Jangka Menengah Nasional/RPJMN*). The RPJPN covers a period of twenty years and the RPJMN covers a period of five years (Republic of Indonesia, 2004c; 2007).

The central government presents its view on regional development in the RPJMN, this also sets out its sectoral priorities and its focus for subnational governments in the five-year period. Since the RPJMN in 2004-2009 period, the priority has focused on public and environmental health, maritime and islands, and empowerment of villages and peripheral regions (Republic of Indonesia, 2005; 2010; 2015). Addressing regional disparities and inequalities has also been included as a priority for all the published RPJMN after decentralisation. For the disparity and inequality, various references were made to economic growth and gross regional domestic product, poverty, unemployment, and investment generated in the regions.

Prescription of regional development included in the central planning documents encourages central officials to associate local governments with a set of roles. Focus on the economy pushes the idea of regional specialisation and on how national economic growth is related with flourishing economy at subnational level. In the interviews, there were certain expectations of local governments expressed by central officials, as a central planning officer commented:

‘The development plan is carefully formulated, and we expect that this document is appreciated at the local level as well. We have municipalities which function as agricultural centres, industrial areas, trading hubs. If they can serve those functions well, it means a lot to the achievement of national objectives.’ (C10)

This sentiment above is shared widely by the respondents from the central government. They specifically highlighted how local programmes and activities can often be disconnected from the national objectives. Local sectoral policy did not correspond to its sectoral counterpart at central government. Nationally, these incidents of mismatch occurred quite frequently in many local governments. An auditor from the central government commented about performance of local governments:

“When we traced it back to the local government’s planning documents, it was unclear whether local officials had referred to the national planning documents [RPJMN, RKP]. We would find some relevant keywords here and there, but they did not translate into local government’s programmes and activities.” (C7)

Central officials had a view that local governments should make their contribution to national development, but local governments translated their roles in a flexible manner.

For the expected roles of local governments, the central government provided support through various modes of financing. Most sectoral activities received allocated funds through DAK, while there was also other funding through discretionary transfers or direct central expenditure in the region. Some central government ministries and agencies had regional offices throughout Indonesia, and their main responsibilities included carrying out central government expenditure. An example of this was the Ministry of Public Works (*Kementerian Pekerjaan Umum*), which directly managed road infrastructure projects which were included in the ‘national road’ category.

The views of central officials presented above relate to the strategy taken by local officials to match central and local priorities discussed in Section 6.3.1. Local officials in Municipalities A and B commented about how they tried to identify and match local priorities with the list given by the central government. This process can result in a good matching of central and local priorities, if the activities identified by local government do align with central priorities. However, this can also result in a token gesture from local officials to rename the activities with labels which match central’s concerns. The central government did not have a credible mechanism to punish or respond in a timely manner, because every mistake was only identified ex-post through audit or evaluation activities.

6.5.2 The localised view of municipalities’ contribution

At local level, politicians and officials have their own perspectives about the value of each municipality to the central government. They understand municipalities as units with unique and varying characteristics. As such, each municipality has its own way to contribute to the national objectives, while also addressing concerns of local citizens and businesses. In the interviews, local officials highlighted the features which they believed to be valuable for the central government. For Municipality A, this was natural resource endowments. Officials in Municipality B put forward the municipality’s role in agriculture.

Many officials in Municipality A believed that the existence of natural resources there had been invaluable for the central government. Natural resources have been an important source of revenue for government, with central government collecting revenue from natural resources before redistributing a portion of that revenue to subnational governments. An officer at the local secretariat in Municipality A commented:

‘As a municipality with natural resources, this city is important to the central government. Through our natural resources, we can generate financial resources which can be used for various activities at the national level. Central government needs us [this municipality] to develop the national economy and to provide financial resources which can support other municipalities as well.’ (LA3)

Because of the municipality’s role, planning and finance officers in Municipality A were quite certain that the central government would commit to an adequate amount of intergovernmental transfers in each given year. They did not only think about the DBH which is related to natural resources, but also about DAU and DAK. Allocation of transfer funds which did not follow the formula would provoke a response from municipalities. There were several instances in recent times where municipal leaders voiced their protests regarding suspension of transfer funds and regarding the formula used to calculate transfer allocations (Anggela, 2022; Rachman, 2022; Media Indonesia, 2023).

The role of Municipality B in the national economy became a source of confidence to officials in that municipality. An officer at the local secretariat in Municipality B commented:

‘This city means something to the central government, we are certain of it. We contribute to the national economy and supply agricultural products to other municipalities.’ (LB1)

That same official viewed his municipality, Municipality B as a city which played an important role in the agriculture sector at national level. This corresponds to the view of central officials in Section 6.5.1 regarding particular roles of municipalities in national development. By consistently fulfilling that role, Municipality B could satisfy central politicians and officials. This would then translate into a reliable and predictable allocation of transfers from the central government. Another official in Municipality B, a planning officer, also expressed a similar view, and they used an example of a border city which played a role in national defence. Even though a border city could be relatively less populated which could make public service provision less efficient, nevertheless its existence was important to central government so that the city needed to be adequately supported with financial resources.

Views from local officials provide an important insight about the source of confidence in local governments regarding the reliability of intergovernmental transfers. Each municipality is expected to play a role in national development policy. The role can vary between local governments, but this role is valued by the central government, as remarked upon by local officials and presented in many documents relating national development planning. Fulfilment of the role in national development policy is expected to entail financial resources, which are provided by the central government through many types of intergovernmental transfers. With much of the financial resources controlled by the central government, local governments justify their need for intergovernmental transfers through their prescribed role in the national development plan.

6.5.3 Mismatch of values between central and local governments

The interviews also show a contrast between central and local officials in the way they perceive good performance. Views from central officials were informed by official reports and analyses which encompass many municipalities. In contrast, views from local officials emphasised a much narrower experience of other municipalities,

consisting only of the municipalities in the same province or narrower than that. This can have implications in how decentralisation functions in Indonesia.

At municipal level, officials look at a set of indicators in determining the level of performance. For example, a planning officer in Municipality B commented:

‘I think we are the leading municipality in this province. We perform quite well across different categories, such as development level, regional economy. I’m not sure about which other municipalities perform well at the national level.’ (LB3)

From the comment, it can be observed that indicators related to development level and economic growth are viewed as important. The comment from that officer also indicates the possibility that municipalities do not compare themselves with other local governments. The officer showed confidence about municipalities’ performance, but she could not identify other municipalities which may be at a similar level of performance nationally. The planning officer in Municipality A showed a different view regarding performance:

‘We perform well when we can achieve our targets. These vary across different sectors. For other municipalities, we don’t really know, because they have different targets compared to ours. Our targets were developed through political processes, so they are important to the mayor and to the citizens.’ (LA1)

For that officer, performance comprises the achievement of development targets which have been discussed by politicians. With that perspective, comparison with other municipalities becomes difficult to make, because each municipality has its own specific targets. A similar point between the views in Municipality A and Municipality B is the apparent lack of concern for interjurisdictional competition, local officials in both municipalities did not seem to be aware of the performance of other municipalities in terms of development or government programmes. This is interesting

because interjurisdictional competition has been discussed theoretically as a part of decentralisation.

From the perspective of central officials, performance is standardised and comparable between local governments. Assessments and evaluations conducted by various central ministries and agencies are sources of information regarding local governments' performance. An auditor from the central government commented:

‘Good performance can be reflected in the audit report, the annual performance report, and various development indicators. All of those vary widely between local governments, but we can see the top municipalities in a list published annually.’ (C1)

The comment shows that the central government has a list of municipalities ranked by their performance. However, this list and its ranking are not seen as having that much importance by the local officials in the interviews, because those officials did not use this information to inform their policy making.

From the interviews, it can be concluded that there is no widely agreed yardstick with which local governments' performance can be evaluated. Officials from the central government emphasised a set of performance metrics and results from evaluations and assessments conducted by central ministries and agencies. Officials at local level care more about what transpires locally and something which is more relatable to the local citizens. This can influence the state of interjurisdictional competition which is theorised as an aspect of decentralisation. Arguably, more competition between local governments would attract new citizens and businesses to relocate inside the municipalities.

6.6 Conclusion

Based on the interviews and other secondary data analysed in this chapter, there are several points which can be concluded upon. Firstly, scope of decision making of local

officials is an important consideration for local revenue decisions. Both own-source revenues and intergovernmental transfers were seen as predictable and reliable revenue sources by local officials. Local officials could estimate the revenue level and the effort they need to exert for local own-source revenues, and they were confident about intergovernmental transfers' credibility because of the perceived safeguard in place in the law and regulations. Local officials in the interviews favoured revenue sources which allow a wider range of decisions and which allow local governments to identify and select the target for the usage of the revenue. However, strict central guidance in which activities to be funded by intergovernmental transfers was not seen as a problem by local officials. Instead, the local governments found that to be a helpful mechanism to match central and local priorities because the guidance included a wide range of alternatives to be matched with local preferences, and local officials could also propose activities to be funded in the next budget year into the list defined by the central government.

Secondly, when the reform was implemented in 2010-2014, local governments had a generally low capacity in public financial management. A proportion of local governments in Indonesia struggled with managing their budget and reporting their financial position. This capacity issue made property tax management more challenging compared to other own-source revenues in that period. Moreover, centrally-imposed human resource constraints were an important part of the picture here as it reduced local governments' ability to recruit new staff. Those constraints were there as a control mechanism for central government to maintain predictability and sustainability of DAU, an intergovernmental transfer which component was affected by the number of local governments' staff. Therefore, local governments could only rely on trainings mostly provided by the central government. As a result, capacity building process in the area of public financial management took more time and it influenced local governments' ability to implement property tax management when it was devolved to local level.

Thirdly, there is a contrast in how central and local officials viewed the role of local governments in national development. Central government formalised this expectation of local governments' role into planning documents (RPJPN, RPJMN, RKP) which included national directions for regional development. The expectation of local governments' role helped to add confidence regarding intergovernmental transfers' predictability and reliability from the perspective of local officials. However, central government's expectation did not fully correspond to local priorities, as local officials were more attentive to discourses dominating at the local level. Variation in local priorities also influenced local governments' view about their peers, as local officials believed that each local government might have different role in national development. This is also apparent in the views of local officials regarding natural resource endowments and additional revenue sharing coming from them; those natural resources and the revenue sharing transfer funds are elements which form the particularities and define the role of each local government. The mismatch in central and local perspectives and between local governments regarding local governments' role in national development may weaken interjurisdictional competition in Indonesia's decentralisation.

The findings presented in this chapter have implications to the process of subnational revenue mobilisation. Local politicians in Indonesia can be more motivated to collect own-source revenues when they have specific expenditures which are locally important but cannot be included in the category to be funded by intergovernmental transfers. Because those specific local expenditures are parts of local governments' authority, local politicians can use it as part of their political campaigns to appeal to citizens and businesses inside the jurisdiction. Next, the capacity building process which is slower than it could be is likely to hinder local governments' efforts in improving their own-source revenue mobilisation. Meanwhile, the apparent lack of intergovernmental competition is likely to make local

governments disengage with the idea of competing with other local governments in the area of revenue mobilisation.

Based on the evidence from qualitative analysis, the institutional arrangements regarding decentralisation and contextual factors in Indonesia have moderated revenue mobilisation efforts in municipalities. Rules regarding intergovernmental transfers allow for a generous and reliable amount of funding, which then allows politicians at local level to use the fund to finance most of the local public goods and services. The rules regarding allocation of those transfers enable local decision makers to be autonomous in allocating which activities are to be supported by transfers, and those decision makers can also propose their preferred activities to be put into the list of expenditure category for transfers defined by the central government. With this, the need to mobilise own-source revenues primarily arises to enable local decision makers to address local expenditures and priorities which cannot be funded by intergovernmental transfers. Therefore, revenue mobilisation at local level in Indonesia is conditioned by the mismatch between locally-defined priorities (which were identified and selected by local actors) and centrally-defined categories of activities (which were identified and selected by central actors). The more gaps there are between locally-defined priorities and centrally-defined priorities, the fewer are the activities which municipalities can rely on being supported by intergovernmental transfers. Municipalities with natural resource endowments receive more funding from the natural resources revenue sharing fund and have less funding restraints. In these municipalities, *ceteris paribus*, there is relatively less need to mobilise own-source revenues.

With the conclusion as presented above, it is argued that that the observed effects of the devolution of property tax in Indonesia had been moderated by the institutional arrangements regarding decentralisation and contextual factors. The analysis in Chapter 4 had raised an idea towards the possibility of this kind of restraint,

and the qualitative analysis in this chapter has confirmed it. Municipalities implementing the reform in 2011-2013 period could potentially raise more own-source revenues, but they resorted to the observed fairly-low level because local politicians and officials were facilitated to choose a level of local tax which was politically more acceptable at the local level than a higher local tax. Nevertheless, the analysis in Chapter 5 showed an overall increase of revenue variables after the reform. This indicates that there was heterogeneity of preferences at local level which could not be fully identified by the central government through their decisions on activities to be funded by intergovernmental transfers.

Lastly, it should also be noted that the moderation coming from the institutional arrangements and contextual factors in Indonesia have supported another objective from a policy standpoint. This moderation allows the central government to partially control the scope of decisions relating to local expenditure and human resource management, either for benevolent or self-interested reasons. This can help to prevent too much misallocation of financial resources or crisis in the national budget because of uncontrollable local staff recruitments, but it can also be a way for central decision makers to force their agenda to be implemented at local level.

7 Conclusions and Research Implications

This thesis has investigated the impact of a subnational revenue reform in the context of decentralisation in Indonesia. It relates to the discussion in the literature on providing greater revenue-raising powers to governments at subnational level in developing countries, which has received an increasing attention in the academia and policy-oriented domain (Pöschl and Weingast, 2015; Weingast, 2009; Junquera-Varela *et al.*, 2017; Platz *et al.*, 2017). Many in the literature have acknowledged the contextual influence within which subnational governments operate, which justifies the pursuit of greater understanding of subnational revenue mobilisation in particular countries such as Indonesia. It is important to understand the institutional arrangements regarding decentralisation in order to examine how intergovernmental relations between different levels of government feed into decisions regarding subnational revenue at local level.

This study has examined different aspects of decentralisation and subnational revenue mobilisation, showing the institutional and contextual factors surrounding the reform which relate to the subnational revenue outcome. Chapter 4 analysed the rules in the constitution and various laws which formally structure decentralisation and intergovernmental fiscal and political relations in Indonesia. It showed how subnational autonomy had changed in the 1999-2015 period and has provided explanations regarding the institutional environment during the period of revenue reform in 2011-2013. Chapter 5 employed econometric analyses to test empirically the impact of devolution of new revenue-raising powers in 2011-2013 on subnational revenue variables in municipalities implementing the reform. Evidence from the quantitative methods provided understanding regarding the impact of reform, but less

about the factors and processes which led to that outcome. Chapter 6 examined municipal case studies, collected and analysed observations from actors in different levels of government and relevant secondary sources to uncover more about factors and processes. It provided a more detailed understanding about the relative importance between various sources of local revenue and what public officials do in regards to local revenue management.

The first two sections in this chapter review and summarise the findings of this thesis and relate those findings to the discussion in the literature. They bring together and integrate the findings from the chapters 4, 5 and 6. Drawing from those, section 7.3 summarises the research contributions from this study to the existing literature. Next, section 7.4 discusses the policy implications of the findings. The last section in this chapter identifies and suggests areas for future research deriving from the findings and discussions in this thesis.

7.1 Impact of Devolution of Revenue-raising Power on Subnational Revenue Mobilisation in Indonesia

The first research question in this thesis asks about the impact of devolution of revenue-raising power on local revenue mobilisation in Indonesia. Indonesia underwent a devolution of revenue-raising power in the period between 2011-2013 which brought an increase to subnational revenue in municipalities. A quantitative analysis using nation-wide secondary data from INDO-DAPOER showed that there was an average increase of proportion of own-source revenue in the municipalities undertaking the reform. The average increase was more than 110% of the mean value of the proportion of own-source revenue. The same increase was observed in local own-source revenue per capita in the same municipalities. This finding holds when the analysis was extended by excluding some municipalities with alternative unique sources of fund (Special Autonomy Fund/DOK and Yogyakarta Special Fund/DKY)

and when using an alternative outcome of interest (ratio of own-source revenue to GRDP).

This finding is interesting considering the institutional arrangements regarding decentralisation in Indonesia during the reform. The Indonesian constitution and laws enabled substantial subnational autonomy in fiscal authority and policy making, while also imposed limitations in some areas. Such limitations can have influence in the effect of the reform, making it more modest than the expectations. For example, local governments were only allowed to set the tax ratio for property tax up to 0.3 per cent. In addition, the central government controlled human resource management in the public sector, which made it difficult for local governments to improve their capacity in public financial management. This way, local governments were prevented from taking a drastic change on property tax management.

Furthermore, the decentralisation reform was accompanied by an increase in the amount of intergovernmental transfers allocated to municipalities in Indonesia (von Haldenwang, 2017). In a previous study using China as a context, such situation was found to produce a different result from the one that is found in this study. In this study of Indonesia, decentralisation of property tax was found to result in increased local revenue mobilisation. However, in a study of China, subnational revenue mobilisation was found to be lower as a result of an increase in intergovernmental transfers received by subnational governments (Jia *et al.*, 2020). This study also analysed further evidence on the institutional arrangements regarding decentralisation in Indonesia to understand the perception from various actors regarding intergovernmental fiscal and political relations in Indonesia, which is discussed further in the following section.

The quantitative analysis also showed that there were differences between municipalities in Indonesia in regard to local revenue mobilisation. Municipalities

which were earlier in undertaking the reform and thus undertook it in the 2011-2013 period had already been more successful in mobilising their own-source revenue before the reform. This was evident in the trend of proportion of own-source revenue and trend of local own-source revenue per capita in the 1999-2013 period. This indicates an uneven local capacity in managing revenue mobilisation, which can be an issue going forward. The qualitative analysis in this study adds some insights about factors considered by local officials regarding revenue mobilisation and variation in local capacity, which are discussed in the following section.

The qualitative phase of the research showed that local officials had regarded own-source revenues, including the newly devolved revenue instruments, as important components in their local revenue management. Own-source revenues can be a source of confidence to local politicians and officials, and such confidence stems from the greater autonomy held by those actors in allocating expenditures as funded by their own-source revenues. Both of the municipal case studies have intergovernmental transfers as their main source of funding, but local officials confirmed that own-source revenues were important in their local budget and highly regarded by local politicians. Property tax is an important component of own-source revenue and difficulties in managing property tax were mentioned by local officials, which also partly contributed to their decisions to keep the property tax rate on a similar level to that before the reform. Central officials also confirmed that there were many municipalities which had kept the property tax rate at the initial rate before the reform as opposed to increasing it to the maximum allowed rate. This further confirms that the effect of the reform was subject to restraints in local capacity as local governments were not convinced to use their new revenue-raising power to its full potential as reflected in the maximum allowed rate. Potential of political backlash and weakness in local capacity were some factors behind this lack of conviction.

7.2 The Role of Institutional Arrangements and Contextual Factors in Subnational Revenue Mobilisation

Between 1999-2013, changes in institutional arrangements regarding decentralisation in Indonesia enabled several things. An analysis of the laws and regulations shows an increase in local autonomy in many different aspects. Over the period, subnational political leaders had a greater scope of decision making in the fiscal dimension. Budgetary decisions shifted from being decided by central officials and politicians to being decided by local officials and politicians. Moreover, there was an increase in the access to financial resources: local leaders were provided with the authority to create revenue instruments while also receiving support through intergovernmental transfers. In addition, there was also a greater clarity regarding the authority and responsibility of local governments which allowed local politicians to determine policy without central interventions. Some central controls still existed in the area of human resource management, but local policy making was credible so that it could be relied upon by citizens and businesses inside the jurisdiction. Lastly, appointment to political offices at local level was obtained through the election process, which allowed citizens to identify and select local political leaders both in the executive and the legislature. While there was an increase in autonomy as noted above, the central government could still indirectly influence policy making in sectoral programme decisions and budget allocations through the funding support it provided. Transfers from central government mostly came with guidance on funding allocation, which includes a list of eligible programmes and activities to be funded through those transfers.

Central controls, as noted above, were linked to the central government's efforts to secure its fiscal situation. For almost all local governments, salaries for local staff were still heavily supported by central government through DAU, which then justified a need for central government to control human resource management. An

unchecked level of recruitment at local level could result in a less predictable local salary expenditure which would affect the fund allocation in DAU. Evidence from the interviews also uncovers central officials' lack of confidence in capacity for human resource management at local level, especially relating to public financial management. This lack of confidence was not without reason, because audit opinions from the Supreme Audit Agency in the period 2006-2012 did refer to weaknesses in local public financial management.

The lack of local capacity and restrictions in human resource management affected the implementation of property tax management in municipalities. Local staff was not fully ready to undertake property tax management because it involved a new set of skills. Local governments could not freely recruit the necessary new local staff as central government made the final decisions in this area. Capacity building options were also limited as only a few places for local staff in training were offered by the central government. The secondary data also showed that not many municipalities (less than 25 per cent) had been interested in adopting the local management of property tax reform earlier in the 2011-2013 period, which reflected the hesitation of local officials to undertake the reform. This further underlines the importance of human resource capacity and the time needed for capacity building as key elements in reform adoption and implementation.

In that kind of environment, both own-source revenues and intergovernmental transfers were seen as predictable and reliable revenue sources by local governments. Local officials could predict own-source revenues well for their local budgeting purpose, while also noting that raising the level of own-source revenues would require long-term investments, particularly in human resources and information systems. The newly-devolved property tax provided additional fiscal autonomy even at the initial rate before the devolution, which was also the level seen as acceptable by citizens. Intergovernmental transfers were also predictable and reliable in the sense that there

were no last-minute or politically-motivated adjustments observed by local officials. This allowed local governments to value those transfers highly and rely on them as a major component in the local budget (APBD). Central control in the form of guidance for fund allocation still allowed local governments to propose activities into the list defined by central government or to match locally-identified priorities with a category in that list. Therefore, local governments can use each transfer to their advantage in conjunction with their own-source revenues.

Views at the local level regarding reliability of intergovernmental transfers can also be linked to constitutional and law provisions regarding unitary state structure. From section 4.1, it is known that there was a framing of Indonesia as a unitary state, emphasised in the 1945 Constitution and the Law on Legislation. One derivation of that framing is the primacy of national development objectives as observed in the evidence from interviews in section 6.5. Both officials at central and local level confirmed that local governments should play their role in achieving national objectives, and reliable intergovernmental transfers was a part of the process. This also included the understanding that some resource-rich municipalities have a different role compared to others which have relatively less natural resources. Perception on details about local governments' role differed between central and local officials as discussed below, but that did not translate into differences in perception relating to the reliability of intergovernmental transfers.

Instead, differences in views between central and local officials were more pronounced in relation to local governments' performance. Officials from the central government emphasised a set of performance metrics and results, and such assessments were also conducted by central ministries and agencies. In contrast, local officials prioritised local realities and issues which were more relatable to citizens. This resulted in the lack of use of performance information from central government to inform local policy making. Furthermore, this mismatch can affect

interjurisdictional competition between local governments, as each local government claims different areas of performance.

In conclusion, this study shows that the institutional arrangements regarding decentralisation in Indonesia moderates contextual differences between municipalities in subnational revenue mobilisation. Differences in natural resource endowments, while translating into a higher amount of total transfers to some municipalities, did not affect perception of local officials regarding own-source revenues and intergovernmental transfers. Both sources of revenue were regarded as important components in the local budget with their predictability and reliability. The constitution, various laws, and the national development plan act as focal points for local governments regarding their roles in national development and for central government's commitment of financial support. Concerns regarding local capacity, which could be addressed better by more economically developed municipalities, were subjected to central control in human resource management and as such, relied heavily on centrally-promoted solutions such as training and capacity building programmes. Heterogeneity of preferences at local level was accommodated through providing a wide category for activities funded through intergovernmental transfers and opening a space for local officials to put their priorities into the list.

The moderation of contextual differences in municipalities as discussed above stemming from the institutional arrangements may also influence resource allocation decision in some local governments and reduce interjurisdictional competition. Because local governments need to follow central guidance on the use of intergovernmental transfers, local governments which are more developed economically may be inclined to divert their financial resources to areas where central government support is emphasised. Local politicians can always refer to central priorities or national objectives to justify this diversion of financial resources. This will not prevent those local governments from addressing most local needs and

preferences, because there are mechanisms to accommodate those preferences to be funded through intergovernmental transfers. However, this will prevent local governments to allocate funding from central transfers to some other specific local preferences which are already identified but are not seen as a priority by the central government. Central policy makers focus more on categories of activity which resonate with the need of many local governments than the ones which cater only to the need of a few number of local governments. On the other hand, additional financial support from the central government can make it easier to local governments to implement a policy.

Arguably, this moderation and the above-discussed ambiguity in parameters for local performance can reduce competition between municipalities. In theory, subnational units may provide a unique combination of public goods, public services, and regulatory environment to attract citizens and businesses. Those subnational units will compete widely between them through their policy mix. With institutional arrangements such as in Indonesia, subnational units have more financial support in the areas decided for them by the central governments based on the prescribed role of those subnational units in the national development plan. It may result in an over-similarity of subnational units based on the areas of support they receive from the central government.

7.3 Research Contributions

The research agenda pursued by this thesis has generated a set of research contributions. Evidence presented in the thesis speaks to multiple areas of literature and academic discussions. This section further elaborates those contributions and shows how the findings further the research in the existing literature.

7.3.1 Empirical contribution

Firstly, this thesis has shown how the outcome of a revenue devolution is affected by the existing contextual factors, rules and processes influencing the scope of revenue decisions of local politicians. In the case of Indonesia, there was a change to intergovernmental fiscal institutions, specifically regarding the devolution of property tax management to the local level. This particular devolution increased the overall scope of revenue decisions for local politicians and officials through giving them a set of new rights, such as to set a certain rate for property tax, to conduct valuation of properties, and to encourage compliance through public campaigns. At the same time, this devolution did not change the scope for decisions of local politicians and officials regarding the use of intergovernmental transfers. The amount of intergovernmental transfers from the tax revenue sharing fund did decrease, but local governments could still supplement the amount they generated from the property tax revenue they collected. In addition, local politicians retained the autonomy which they possessed to propose activities to be funded through another type of intergovernmental transfer, which was the Special Allocation Fund/DAK.

However, drawing from public documents (e.g. constitution and laws) and interviews to public officials, the thesis identifies also multiple areas where the result from an apparent change in rules translates into less *de facto* autonomy to local actors because of the influence of other rules and processes. This is apparent in subnational revenue mobilisation in Indonesia, where local governments' *de facto* autonomy was constrained in several areas. They received new revenue instruments in the form of property tax, but the ceiling for the tax rate was set by the central government and human resource management at local level was strictly regulated. In addition, intergovernmental transfers in Indonesia were regulated with guidance from central ministries and agencies, but there was a space for local governments to match the categories in the guidance with locally-identified priorities or to put their priorities

into the guidance before it was published. In this particular area, local governments *de facto* autonomy was actually facilitated by the rules which govern the process of defining activities to be funded. Furthermore, by discussing the interaction between fiscal and political institutions, specifically regarding property tax, intergovernmental transfers, and decision making authority between central and local governments, this thesis extends a recent discussion regarding the interaction between different elements of fiscal institutions such as in Gomes (2012). Another important contribution of empirical evidence is the identification by this thesis of the constraint to local capacity improvements resulting from the way in which human resource management in the public sector was organised, which speaks to the discussion in Smoke (2014; 2015b) which argued that human resource as an important component of local capacity. Interaction between institutions in different domains is sometimes overlooked in discussing local revenue mobilisation, yet it can explain relevant factors which facilitate and restrain the reform. The interaction between fiscal decentralisation and centralised elements of human resources policy is an important example identified in this thesis, which resulted in an additional constraint to local governments in improving their capacity.

Secondly, this thesis has provided an extended account regarding local revenue mobilisation and how intergovernmental relations contribute to the process in Indonesia. In this area of research, another study has discussed the effect of revenue devolution in the context of China (Jia *et al.*, 2020). The findings in this thesis contrast with the findings of the study by Jia *et al.* (2020). Jia *et al.* (2020) found that increased central transfers in China reduced local tax enforcement, whereas this thesis shows that an increase in the allocation of intergovernmental transfers can still result in positive outcomes on the effect of revenue devolution and explain the institutional environment where such outcome happens. The qualitative analysis in this thesis shows that central transfers cannot be fully used to address local preferences because of the mismatch between national priorities and local preferences. This mismatch

motivates municipalities in Indonesia to improve their local revenue mobilisation from the reform, unlike the one found in Jia *et al.* (2020). At the same time, while rules governing the process of intergovernmental transfers can result in a narrower scope of decisions for local governments, this thesis has established that there are conditions such as the ones observed in the case of Indonesia where pockets of local autonomy can exist and are facilitated by the rules. Investigating these rules regarding intergovernmental transfers in other country contexts may explain more about variation of effects between countries regarding devolution of revenue.

In the wider literature, there have also been many discussions on how intergovernmental fiscal relations (e.g. intergovernmental transfers, fiscal rules, and others) affect local revenues in the context of other countries, recent examples such as Mogues and Benin (2012) and Masaki (2018). Those studies argue that intergovernmental transfers can demotivate or motivate local revenues in different country contexts. As discussed above, this thesis argues that the detail in the intergovernmental fiscal institutions, such as rules governing the use of central transfers, are important elements to explain the direction of the effect from intergovernmental transfers to local revenues. Furthermore, a recent study also argues that intergovernmental transfers in Indonesia do not appear to create perverse incentives to fiscal behaviour regarding own-source revenues in Indonesia, but the study does not provide detailed evidence about what happens at local level (Lewis and Smoke, 2017). A consideration of evidence in this thesis provides support to the arguments in Lewis and Smoke (2017) that intergovernmental transfers do not weaken incentives to local revenue mobilisation. Further, this thesis adds to Lewis and Smoke's work by presenting evidence regarding elements in the institutional arrangements which moderate *de facto* fiscal and policy autonomy. This moderation then translates to local officials' perception of policies which can be easily implemented and to autonomy in action. As observed in the municipal case studies, both intergovernmental transfers and own-source revenues can serve political purposes in

a slightly different way. Local preferences for activities which align with activities also preferred by other municipalities have the possibility to be suggested as additions into the list of activities to be funded by intergovernmental transfers. Rules regarding allocation of intergovernmental transfers enable local governments to propose a category of activities or to match some activities to a centrally-defined category. Local decision makers can then use own-source revenues to finance activities which are highly specific or which gain much attention in the jurisdiction, but which do not qualify for central support.

Thirdly, this thesis has clarified considerations which support the reliability of own-source revenues and intergovernmental transfers at local level and how those considerations shape revenue mobilisation. Local government in the case studies benefits from a good level of autonomy in deciding where to allocate and spend the funds from own-source revenues. This autonomy further encourages local politicians to campaign for compliance with local own-source revenue policies by linking the spending history of the municipality with the collection of own-source revenues. They can argue that property tax enabled local governments to address specific local preferences such as improvement of schools or health post infrastructure at an area inside the jurisdiction. Local governments can also be assured regarding intergovernmental transfers' reliability because of extant mechanisms which ensure a degree of local autonomy in spending the fund and local governments' confidence on its role in supporting national development objectives which sustain the allocation of transfers at a desirable level.

If local governments face too many constraints in spending the fund from own-source revenues or intergovernmental transfers, local fiscal autonomy is reduced and it may result in reduced revenue mobilisation. For example, unreliable intergovernmental transfers can result in lower revenue collection as established by Gomes and Lehmann (2016) in the context of Brazil although arguably unreliable

intergovernmental transfers can also result in strengthened local tax collection as observed in the context of Sierra Leone (Jibao and Prichard, 2015). The findings in this thesis show that existing institutional arrangements in Indonesia enable local governments to decide areas for spending both from intergovernmental transfers and own-source revenues, which provide reliability to own-source revenues and intergovernmental transfers. Because intergovernmental transfers in Indonesia are reliable and can be allocated by local politicians to finance some areas of local preference, own-source revenues can then be used to finance other activities with high local political salience, which then be a source of motivation to local politicians to mobilise own-source revenues. In summary, this thesis establishes that in Indonesia the collection of local own-source revenues is reinforced by the institutional arrangements which combine to support a stronger link between spending decisions and political accountability.

7.3.2 Theoretical contribution

This thesis asserts the importance of specifying what types of local autonomy there are regarding various processes of identification and selection in a decentralised government structure. In the fiscal sphere, this involves the ability of local political leaders to decide on budgetary decisions such as the identification and selection of how much funding to be allocated, which types of revenue sources to be used and what level of revenues to be collected. In the political sphere, this involves whether those political leaders came into office by being identified and selected solely by decision makers in the central government or by a local election and whether political decisions which have gone through the process of identification and selection by local political leaders can be ruled out or vetoed by central decision makers. In Indonesia in recent years the balance has shifted towards elected local leaders with significant decision making powers which are not easily intervened by the central government. Investigating intergovernmental relations in those areas is especially important in the

context of decentralisation as how central-local relations is structured shapes the authority of government at one level over the other and thereby influencing the credibility of decisions taken by each government unit from the citizens' perspective. This thesis shows that rules on the use of intergovernmental transfers provide more local autonomy if there are opportunities for local governments to propose activities to be funded by transfers or to match locally-identified activities with centrally-defined category. This has led local decision makers in Indonesia to view intergovernmental transfers as sources of revenue which provide autonomy in selecting its use. Local decision makers has also become more selective in mobilising local own-source revenue and its usage.

Clarifying the scope of decisions of various actors in policy making under a given set of decentralisation arrangements is critical to understanding *de facto* autonomy as discussed above. The literature addresses this in part through a series of perspectives. Literature in the first generation theory of fiscal federalism discusses scope of decisions more broadly in terms of how actors at local level can better address local preferences, without discussing much about specific points where the decisions are made to address local preferences (Tiebout, 1956; Oates, 1972). Literature in the second generation theory of fiscal federalism provides more exploration on conditions which enable actors at local level to address local preferences (Weingast, 1995; Seabright, 1996). This thesis takes those previous discussions further by tracing how fiscal and political institutions limit the number of factors which are considered in local fiscal decision making, specifically about the level of revenue mobilisation. Rules regarding the use of intergovernmental transfers in Indonesia which allow local political leaders to match some local priorities with the centrally-defined category of activities relieve the pressure to fund those local priorities with local own-source revenues. Local political leaders view intergovernmental transfers as reliable because there are also fiscal rules which mandate a certain percentage of the national budget component to be transferred by central government to the subnational level. In effect,

this reliability enables local political leaders to be less strenuous in mobilising own-source revenues. Regarding decision making at local level, the autonomy of elected political leaders is protected by the constitution and the laws, therefore strengthening the link between fiscal decisions and local political accountability. In effect, decisions regarding local taxes and revenues are attributed to local political leaders, which is likely to prevent those leaders to raise the tax rate unless it can be justified with some important local preferences. This thesis makes a theoretical contribution by showing how these various forces combine to enable local leaders to actively mobilise their own-source revenues while still being attentive to political discourse regarding an increased local tax rate.

A key element to the discussion in this thesis is the link between intergovernmental relations and credibility of decisions made by local governments to local voters in the jurisdiction. When central government can narrow the scope of decisions or override the decisions made by local governments, the credibility of decisions made by local decision makers is undermined from the local voters perspective because identification and selection of policies and beneficiaries cannot be fully carried out by local governments. Local decision makers can be prevented from carrying out policies which they have promised. Literature in the area of health systems has provided a closely-related discussion on ‘decision space’ of local authorities (Bossert, 1998; Bossert and Beauvais, 2002; Bossert, 2015). This strand of literature argues that local authorities cannot be held fully accountable for slow improvement in health outcomes if those local authorities only had limited discretionary decision making powers. The findings in this thesis resonate with some ideas from that literature and show how scope of decisions in the fiscal and political spheres matters for local revenue decision-making.

Complexity of policy decisions can differ based on the scope of demand for public goods and services in a jurisdiction. Citizens may demand simple local public

goods and services such as repair of a school or an improved local road in one local government and more varied local public goods such as complex irrigation systems or disaster's early warning system in another. Correct identification and selection by central decision-makers (regarding amount of funding to be allocated and where to allocate) is more likely in the case of simple public goods than in the case of more varied and complex public goods. Therefore, in the case of more complex public goods, there can be a greater role for fiscal autonomy which enables local government to address a wider range of local preferences. This relates to the discussion in the theory of fiscal federalism regarding heterogeneity of local preferences and how local governments can be more efficient in addressing them. This thesis has shown that intergovernmental institutions can be used to address the gap between central decisions and local priorities by allowing local governments to propose activities to be included in the category of activities funded by the central government. Including a mechanism to reconcile local priorities with decisions made by central government can moderate the gap between central and local governments regarding policy identification and selection.

Finally, a combination of fiscal and political autonomy facilitates local governments' revenue mobilisation. Central government sometimes justifies retaining control for reasons such as preventing malfeasance at local level or mitigating fiscal risk at national level (Rodden, 2005; Wibbels, 2005). Earlier studies have discussed alternatives between providing most fiscal autonomy at local level and providing autonomy only for selected fiscal aspects (such as: more expenditure decentralisation but less revenue decentralisation). However, inside the notion of local autonomy there is an interlinked scope of decision making across different dimensions. Local revenue mobilisation rests on a degree of autonomy in the fiscal and political spheres. This thesis shows that autonomy in proposing activities to be funded by intergovernmental transfers enables local governments in Indonesia to be less strenuous in mobilising their own-source revenues. In the policy making area, the inability of the central

government to directly intervene on local decision making provides local governments with the political legitimacy in deciding the funding for specific local preferences. Therefore, adjusting the scope of local autonomy in either fiscal or political sphere can be expected to increase (or to decrease) the degree of control retained by the central government, which then affects local governments' needs to mobilise revenue.

7.3.3 Methodological contribution

This study reinforces the call for studying decentralisation through a country and supplementing quantitative research with in-depth case study work through interviews in multiple case studies at local level. While many insights can be generated from cross-country studies, the fine details and variation of institutional environment between countries are often overlooked. A number of country case studies has demonstrated that decentralisation in practice works differently from expectations inferred from secondary data and observation of formal rules. Understanding the institutional environment in a country where decentralisation is implemented is important because domestic politics may feed into the formation of intergovernmental institutions (Faguet and Shami, 2022). This is especially more so in the context of developing countries, in which political factors may not fully relate to some existing theoretical discussions (Bardhan and Mookherjee, 2006; Weingast, 2014). This thesis has contributed to explain how institutional arrangements governing decentralisation are factors which lead to variation in local revenue outcome by providing evidence on the outcome of property tax devolution in Indonesia and how it contrasts with the outcome of a similar reform in China. By focusing on a specific country, details regarding the working of institutions and political factors can be better understood, including the contribution of time-invariant or slow-moving variables.

Moreover, deepening the analysis through observations at local level allows for tracing how intergovernmental institutions work and are perceived by actors at local level. In studying decentralisation, these are valuable because they show whether

those institutions are credible and consistently enforced at local level, also with the possibility of inducing a variation of practice at local level. Even within a country, there can be different effects of decentralisation across different subnational units (Faguet, 2012). As the implementation of reform can interact with various factors (Andrews, 2012), it is important to investigate both at the national and local level to better understand the effect of reform in the context of decentralisation. Exploring multiple cases at local level enables a wider range of observations because there can be factors which correspond to some local characteristics (e.g. cultural values and traditions). This thesis has explored municipal cases in Indonesia which have different characteristics in natural resource endowments, which then influence the perception of local officials regarding local revenues. Local variations such as in natural resource endowments and perception of local officials are factors which cannot be easily observed through secondary data or by analysing only at the national level. Therefore, this thesis emphasises the value of studying decentralisation at local level.

In studying local revenue mobilisation under a decentralised government structure, there is value in investigating autonomy in terms of policy identification and selection across different sectors. Each rule can affect who are the ones responsible for policy identification, which then affects the alternatives of policy available to choose. Each rule can also affect the process of policy selection, which then affect the credibility of decisions made by local politicians. Considering only the rules affecting aggregate budgetary choices (e.g. how much fund should be allocated in a sector) can overlook other choices which contribute to fiscal decisions as a whole (e.g. on which to allocate within a sector). Analysing aggregate budgetary choices has their value in understanding some fiscal decisions (Rodden, 2005), but providing analysis on other dimensions prove to be useful as well in providing more information which lead to fiscal decisions. Explaining autonomy up to this level of detail shows the effective range of decisions able to be made by local politicians, and highlights considerations which relevant to their decisions and affect local revenue mobilisation. This thesis has

contributed to work championing this approach by Ostrom (2011), Siddiki *et al.* (2011), Alston *et al.* (2018) and Siddiki *et al.* (2022) which look towards how rules affect decisions made by actors. This thesis shows that rules on the use of intergovernmental transfers can be a place to provide autonomy and constraint on local decisions.

This study shows the value on examining both actors and processes in explaining the effect of institutions and institutional change relating local revenue decisions. Previous studies have argued about the importance of examining actors to understand the effect of an institutional change (Bates, 1998; Levi and Weingast, 2022). Others have also argued about how processes and sequences are important in programme evaluations (Bennett, 2022). By examining both relevant elements of actors and processes in this study, this thesis provides an understanding of the roles and pressures facing each actor (at central and local level) and in which processes and scope of decisions matter in regards to local revenue mobilisation. Combining examinations on actors (such as central and local officials) and processes (such as local budgetary decisions regarding funding allocation and sources of funding) also allow a clarification on existing theoretical models and their observable implications, which is deemed to be valuable in studying an organised unit (Baker and Gil, 2012). Therefore, this thesis has outlined the relevant actors, processes, and comparisons with existing theoretical models which can be used to further study of subnational revenue mobilisation.

7.4 Policy Implications

Decentralisation is still a policy option where policy advice can sometimes be less detailed or ambiguous. When policy makers consider embarking on decentralisation, they are likely looking for an appropriate design model for decentralisation. Many policy makers might worry about the ‘dangers of decentralisation’, which make them

cautious about going forward with decentralisation (Prud'homme, 1995). Some policy considerations have been presented by previous researchers and scholars, but the appropriateness of these will be influenced by the contextual factors in the particular country. Evidence from this study supports the provision of autonomy in different degrees across sectors. There is a justification in Indonesia to put more central control in areas which can affect national fiscal stability such as human resource management and more local autonomy in areas which benefit from more local political legitimacy such as deciding activities to be funded in the local budget and sources of funding for those activities. However, central control in human resource management in the government proved to be restricting human resource mobility which then made local capacity improvement more difficult. Relaxing some degree of restrictions in human resource management, such as by facilitating transfer of personnel across governmental units (both at central and subnational level), can benefit the government without significantly impacting the national budget. With improved human resource mobility, each governmental unit can offer roles and positions to be filled by civil servants currently serving in another unit. Local governments can attract experienced civil servants which can then contribute to local capacity improvement.

Findings in this study allow some specifications regarding policy advice on subnational revenue mobilisation. Previous studies have discussed various considerations regarding how intergovernmental transfers should be designed (Boadway and Shah, 2007; Pöschl and Weingast, 2015). The more recent advice emphasises the need for more fiscal autonomy at local level, so that local governments can be more accountable to local voters inside their jurisdiction. However, efforts to encourage more local autonomy may not always be politically desired inside a country. Evidence from Indonesia shows that there is a justification for an increased central control and local autonomy in different policy areas which affect revenue mobilisation. Central control in human resources can prevent local governments from unchecked expenditure in personnel, which is linked to the national fiscal situation.

In contrast, constraint to local decisions on property tax rate prevents able local governments from mobilising more own-source revenues. The practice in Indonesia can be a middle-ground between providing full local autonomy or full central control. It is interesting to think that this autonomy and control spectrum can be considered not only directly within the policy areas (e.g. revenue mobilisation, health systems), but also indirectly through areas which influence how decentralisation is implemented (e.g. human mobility, capital mobility). Learning from this, modifying autonomy and control in various areas should be linked to the policy objectives being sought. For instance, in the Indonesian example, central government retained control over human resource management in the public sector, which is one factor which relates to the policy objective of supporting national fiscal stability although it also hinders another policy objective which is facilitating opportunities for local innovation. In that case, the government valued national fiscal stability more than local innovation, which is why such central control can be justified and sustained.

This study offers another idea to address intergovernmental competition and local accountability. Intergovernmental competition can be useful if it can motivate local governments to provide the optimal set of policy for their local constituency. Ambiguous and unclear performance parameters in Indonesia at the local level leave local governments to be isolated from the performance of their peer units, therefore decreasing the motivation to innovate. There can be a case for the central government to provide information about public goods and services provision and revenue mobilisation in all subnational units. At one end, that kind of information can be a focal point for citizens and businesses in critically deciding the location which can provide the most favourable mix of policies for them. At the other end, that information can encourage local governments to be more attentive to their policy mix on the provision of public goods and services and revenue mobilisation.

7.5 Limitations of the Research

Even though this research has been carefully designed to address research questions pertaining intergovernmental relations and local revenue mobilisation, it is important to underscore some features in this study in order not to overextend the conclusion. The data used for the quantitative analysis was historical data from the period between the year 1999 and 2014, and a period of time has passed since the last year covered in the data set. From analysing that data set, the author can estimate the impact of the reform at that period, but further changes which have happened since then cannot be covered by that analysis. The qualitative analysis allows a snapshot of a more recent situation which then provides a point to which the historical data can be linked and extrapolated, although that analysis also cannot uncover all the relevant facts between the period of the reform and the period of the interviews. Therefore, between those two periods, there can be additional contributing factors affecting the recent situation which are not identified in this study.

This study uses two municipal case studies with natural resource endowments as a distinguishing characteristic. The decision to use those contrasting case studies allows analysis on how access to other financial resources can affect revenue mobilisation and allows understanding of the perceptions and behaviours of public officials varies with regard to the abundance of or the scarcity of natural resources. There are possibly other variations in municipal characteristics which may affect revenue mobilisation or interact with natural resource endowments which may not be captured by the two municipal case studies in this research. Taking that possibility into account, the realities portrayed by the two municipal case studies should be treated as plausible pathways or outcomes with the awareness that there can be other influencing factors in different municipalities which may then result in different pathways or outcomes.

Considering the researcher's experience in working in Indonesia and especially in the area of public financial management, the issue of researcher's positionality needs to be addressed. Positionality concerns about how the researcher's social identity, including professional background, may influence the position adopted by the researcher in the given study (Jacobson and Mustafa, 2019; Wilson *et al.*, 2022). Prior experience in the country or sector may introduce bias to the researcher or to research participants when they answered the interview questions. As also discussed in section 3.6, the researcher consulted various references and triangulated the evidence from different sources before arriving at conclusions. Whenever the research participants enquired about whether the researcher was affiliated to any government agency, the researcher explained his position as a government official taking a study leave, and therefore the interviews would only be used for the purpose of the research and not for government purposes.

The researcher has taken steps to mitigate the risk of positionality affecting data collection and analysis by questioning assumptions regarding local revenue mobilisation and public financial management. As an example, many auditors from the central government share a normative view that more central control on local budget benefits both the central and local governments. In this study, that view was questioned and challenged by comparing it with discussion in the literature and with data from interviews. Moreover, the research design approached the research questions based on the discussion in the literature and the existing theory, and the researcher self-reflects at different phase of the research about how his positionality might influence the argument and conclusions. However, even with the steps taken by the researcher, there is always a possibility that some limited impact may remain.

7.6 Possibilities for Future Research

Findings in this study resonate with some strands in the literature which can motivate some future studies on the degree of local autonomy, intergovernmental relations, and accountability. Firstly, it can be fruitful to analyse further temporal change in local autonomy in Indonesia and other countries to understand what other factors there are which facilitate local governments to realise more autonomy in their fiscal and political space. This study shows that local autonomy encompasses various dimensions and sectors, and there can be various political and economic considerations behind where to provide autonomy, and how much. It places emphasis on autonomy in deciding funding allocation and how central government cannot intervene on local decision making process. In addition, autonomy can change over time, responding to the changes in the surrounding environment. Faguet and Shami (2022) argue that providing more local autonomy can be driven by the politicians' needs to respond to political problems. Political situations are expected to be different between countries, so there is a justification to study the realities in different countries which led to a certain outcome in local fiscal and political autonomy.

Secondly, there is value in studying whether different configurations of intergovernmental relations encourage credit-claiming or blame avoidance by either central or local officials. Responsibility of each level of government may be clear in the formal regulations, but less clear from the perspective of citizens. This may encourage public officials to weight their responsibility relative to officials at a different level of government, and shift the blame from the implementation of an unpopular policy to another level, or claim the credit from a popular policy enacted by another level. Niedzwiecki (2016) discusses this possibility in the context of social policies in Brazil. In this thesis, the mechanism to influence categories of activities to be funded by intergovernmental transfers opens possibilities for credit-claiming or blame avoidance because there is an involvement of both levels of government in the

process. As this area is contingent on the details of intergovernmental relations in specific countries and policy areas, further investigations on different contexts are needed.

Thirdly, there is also value in exploring another dimension of accountability in terms of how officials in each level of government perceive their range of accountability and how this should be presented. Unclear or ambiguous responsibilities in a decentralised government structure can also result in misperception of accountability of central and local actors which leave some policy areas to be mismanaged or unaddressed. Institutions which structure responsibilities of central and local officials are likely to be incomplete because they do not constitute all of the contingencies that might happen. Officials at each level of government can also be constrained in their activities, which affect their capabilities to implement policies. At individual level, there has been discussions on whether different types of capability may require different angles in thinking about individual responsibility (Shoemaker, 2015). Taking ideas from that to approach the issues about accountability in multilevel government setting may prove to be fruitful. The research of this thesis suggests that adoption of clear and explicit lines of accountability should be a policy objective.

Appendix: Participant Information Sheet (English)

Participant Information Sheet

You have been invited to participate in this PhD research project:

Research Project Title : Intergovernmental Relations and Dynamics of Subnational Revenue Mobilisation in a Decentralised Indonesia

PhD Researcher : Bella Rifaldi

Supervisor : Mr Simon De Lay

Research Institution : University of Birmingham, United Kingdom

You are invited to participate because of your professional role, which enable you to have knowledge about decentralisation and local financial management in Indonesia. It is up to you to decide whether or not to take part. If you decide to take part you will be able to keep a copy of this information sheet and you should indicate your agreement in the consent form. You are able to withdraw from the project during one-month period following the date of the interview. You do not have to give a reason to withdraw and this decision will not be made known to anyone other than the PhD researcher and supervisor named above. If you do not exercise the right to withdraw within the stated period, your data will be used in the research.

As a research participant, you will be asked a series of questions in an interview. You are free to refuse to answer any of the questions that may make you uncomfortable. The interview process may be recorded, and these recordings will be destroyed after the research concludes. Notes of the interview will be kept throughout the research and be destroyed 5 years after the research concludes. All or part of the content of your interview may be used in publications or other media that we may produce. All the information that is collected about you during the course of the research will be kept strictly confidential, and will only be accessible to the PhD researcher and supervisor named above. You, and your institution, will not be able to be identified or identifiable in any publications or other media. Any data collected in the interview will be stored in a digital document format protected by passwords and other relevant security processes and technologies. Data collected may be shared in a codified form to allow reuse by the research team. These codified data will not allow any individuals or their institutions to be identified or identifiable.

Participation in this research is not anticipated to cause you any disadvantage or discomfort. Although there is no direct benefit for individuals participating in the research, it is hoped that the research result will provide some insights in areas related to participants' professional work. A brief summary of the initial research results will be shared with you upon completion of the research. Your participation will not affect your current or future relations with the University of Birmingham.

This research project has been reviewed by the Social Sciences Ethical Review Committee, University of Birmingham. If you have further questions regarding the research or rights of research participant, you can contact Bella Rifaldi (b.rifaldi@pgr.bham.ac.uk). Alternatively, you can contact Mr Simon De Lay (s.e.de-lay@bham.ac.uk).

If you have/encounter any condition which makes it difficult for you to process material in the interview process, please notify the researcher. You have been given a copy of this information sheet for your record.

Appendix 2: Participant Information Sheet (in Indonesian)

Lembar Informasi Partisipasi Penelitian

Anda telah diundang untuk berpartisipasi dalam penelitian tingkat doktoral sebagai berikut:

Judul Penelitian : Intergovernmental Relations and Dynamics of Subnational Revenue Mobilisation in a Decentralised Indonesia
Peneliti PhD : Bella Rifaldi
Pembimbing : Mr Simon De Lay
Universitas : University of Birmingham, United Kingdom

Anda diundang untuk berpartisipasi berdasarkan pekerjaan dan profesi yang dijalani, yang memberikan pemahaman mengenai desentralisasi dan manajemen keuangan pemerintah daerah di Indonesia. Anda bebas memutuskan untuk berpartisipasi dalam penelitian atau tidak. Jika anda memutuskan untuk berpartisipasi dalam penelitian, maka anda dapat menyimpan salinan lembar informasi ini dan anda harus menandatangani Lembar Peretujuan. Anda dapat mengundurkan diri dari penelitian paling lambat satu bulan setelah tanggal wawancara. Anda tidak perlu menyatakan alasan pengunduran diri dan keputusan anda tidak akan diberitahukan kepada orang lain selain Peneliti PhD dan Pembimbing yang disebutkan di atas. Jika anda tidak mengajukan pengunduran diri selama periode yang ditentukan, maka data anda akan digunakan dalam penelitian.

Sebagai partisipan penelitian, anda akan ditanyai oleh peneliti terkait topik yang diteliti. Anda bebas untuk menolak menjawab pertanyaan yang membuat anda tidak nyaman. Proses wawancara dapat direkam, dan rekaman ini akan dimusnahkan setelah penelitian berakhir. Catatan wawancara akan disimpan selama periode penelitian dan dimusnahkan 5 tahun setelah penelitian berakhir. Semua atau sebagian dari hasil wawancara anda dapat digunakan dalam publikasi atau media lain yang dihasilkan berdasarkan penelitian ini. Segala informasi mengenai anda yang dikumpulkan selama periode penelitian bersifat *confidential* dan hanya dapat diakses oleh Peneliti PhD dan Pembimbing yang disebutkan di atas. Anda dan lembaga afiliasi anda tidak akan diidentifikasi di publikasi atau media manapun. Seluruh data yang didapat selama wawancara akan disimpan dalam format dokumen digital yang dilindungi dengan *password* dan proses pengamanan serta teknologi yang relevan. Data yang dikumpulkan dapat dibagi dalam format yang terkodefikasi untuk memungkinkan penggunaan kembali oleh tim Peneliti. Data terkodefikasi tersebut tidak akan mengidentifikasi individu/lembaga tertentu.

Keikutsertaan dalam penelitian ini diharapkan tidak menyebabkan ketidaknyamanan bagi anda. Meskipun tidak ada manfaat langsung bagi individu yang ikut serta dalam penelitian, hasil penelitian ini diharapkan dapat memberikan perspektif yang berhubungan dengan bidang pekerjaan partisipan penelitian. Ringkasan hasil penelitian awal akan dibagikan kepada anda setelah penelitian berakhir. Keikutsertaan anda tidak mempengaruhi hubungan anda dengan University of Birmingham, baik sekarang maupun di masa yang akan datang.

Penelitian ini telah melalui proses review oleh Social Sciences Ethical Review Committee, University of Birmingham. Jika anda memiliki pertanyaan lebih lanjut mengenai penelitian ini atau hak partisipan penelitian, anda dapat menghubungi Bella Rifaldi (b.rifaldi@pgr.bham.ac.uk). Anda juga dapat menghubungi Mr Simon De Lay (s.e.de-lay@bham.ac.uk).

Jika anda memiliki/menjumpai situasi yang menyulitkan anda untuk memahami materi selama proses wawancara, mohon menginformasikan kepada Peneliti. Anda telah diberikan salinan lembar informasi ini untuk keperluan anda.

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