Development and Governance

Ronald L. Holzhacker
Rafael Wittek
Johan Woltjer *Editors*

Decentralization and Governance in Indonesia

Springer

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Preface

About the SInGA Research Program on Governance and Sustainable Society

We wish to dedicate this volume to all those involved in research on governance and a sustainable future for Indonesia. Our particular gratitude goes to members of the research team on good governance at the University of Groningen, including the Indonesian partners and Ph.D. researchers involved. We hope that the current research on Indonesia and the collective efforts presented here will be of benefit for Indonesian society in the coming decades.

The editors of this volume have designed an integrated program for mid-level policy officials from Indonesia pursuing a Ph.D. degree at the University of Groningen participating in the World Bank's SPIRIT program (Scholarship Program for Strengthening the Reforming Institution) and other scholarship programs established by the Indonesian and Dutch governments. A key objective has been to offer advanced capacity building for the integration of theoretical and empirical perspectives on governance, especially suitable for civil servants moving into leadership positions within the national ministries of Indonesia, lecturers at Indonesian universities, and leaders from important civil society organizations. While the Ph.D. candidates have individual research projects spanning four years of research, there has been a high level of collaboration across the research team and interdisciplinary supervision by various departments within the university and key partnership universities in Indonesia. The results of this research are presented in Ph.D. dissertations, in scientific journals, and in this edited volume.

The program was established with the enthusiastic support of the Central Executive Board (CvB) of the University of Groningen and its President, Professor Sibrand Poppema. In addition, the faculties and research schools of the editors of this volume, the Faculty of Arts, the Faculty of Behavioral and Social Sciences, and the Faculty of Spatial Sciences have also been very supportive and provided additional resources. The initial launch of the program and its ongoing success in maintaining close contacts with stakeholders in Indonesia is due to the great diligence of Mr. Tim Zwaagstra, Program Manager for Southeast Asia of the Research and Valorisation office of the University of Groningen. The interdisciplinary, interfaculty nature of the research program is fostered by its home in the Globalisation Studies Groningen (GSG) institute of the University, led by its Director Prof. Joost Herman. We would also like to thank the great efforts of Tienke Koning, Director of the Ubbo Emmius Fund, in support of the SInGA program.

Earlier versions of many of the papers in this volume were presented at the Spirit Indonesia Groningen (SInGA) conference on governance and sustainable society, held from April 9–10, 2014, in Groningen, The Netherlands. This conference was organized with the financial and logistical assistance of one of the university's focal research areas 'Sustainable Society.' We wish to thank Prof. Oscar Couwenberg, Academic Director, and Sharon Smit, Managing Director, of the Sustainable Society core research area for their support. The Ph.D. candidates presented articles related to their research and received comments from a distinguished range of invited guests. Key note presentations were delivered by Rudolf Treffers, (former) Executive Director of the World Bank, and Theo Thomas, World Bank official in Jakarta and Brussels. The conference was opened by the University President Sibrand Poppema and her Excellency Retno Marsudi, Indonesian Ambassador to the Kingdom of The Netherlands, currently the Foreign Minister of Indonesia.

Regular exchanges continue between the University of Groningen and Indonesia, and at partner universities to discuss governance and sustainable society research. For example, Ronald Holzhacker delivered a series of lectures related to this research program at Gadjah Mada University in Yogyakarta and visited the University of Indonesia in Jakarta, during the summer of 2014. It is our intention to further disseminate this kind of research with a view to improving our understanding of well-being for present and future generations in Indonesia. It is also our intention to demonstrate the role of decentralized governance beyond Indonesia. Recruitment is ongoing for new Ph.D. candidates to join our governance and sustainable research program, recently expanded beyond Indonesia to include countries in Southeast Asia and ASEAN. The book launch for this edited volume is to take place at the fall conference 'Governance and Sustainable Society in Southeast Asia' November 18–20, 2015, at the Royal Netherlands Academy of Arts and Sciences (KNAW) and the Rijksmuseum Amsterdam.

Ronald L. Holzhacker
Rafael Wittek
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Part I
Theoretical Reflections on Decentralization and Governance for Sustainable Society

Chapter 1
Decentralization and Governance for Sustainable Society in Indonesia

Ronald L. Holzhacker, Rafael Wittek and Johan Woltjer

Indonesia, over the past two decades, has embarked on a process of decentralization as part of a broader process of democratization, which followed earlier periods of centralized governance and authoritarian rule across the archipelago. The purpose of this book is to explore the connections between governance and sustainable society in a wide variety of policy fields in Indonesia and how reforming governance structures may contribute to societal benefits and the creation of a long-term sustainable society. The structures created may be characterized as a variable form of multi-governance, with varying types of relationships between the central government and newly empowered local governments.

The decentralization process in Indonesia entails new fiscal and financial relationships, political responsibilities, policy making latitude, involvement by citizens and civil society organizations, and accountability mechanisms, which vary by policy area. In certain policy areas and in particular regions or localities, this has led to increased policy performance by giving local governments the authority and power to tailor national goals to local circumstances, using local knowledge, expertise, and democratic input from the citizens to increase responsiveness. In other policy areas or in particular regions however, decentralization has likely resulted in a loss of expertise from the national government and

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diminished oversight and accountability to the center, with little gain in citizen input and local democratic control.

Indonesia is a middle-income developing country, with special challenges of economic development and governance structure. Many institutions of global governance, like the World Bank, have promoted the idea that certain principles of governance are beneficial for the promotion of economic growth and development, which they have labeled “good governance.” These principles include such concepts as political stability, government effectiveness, rule of law, regulatory quality, and the control of corruption, but also transparency and the involvement of citizens in decision making. Recently, scholars have begun to explore the links between ideas of good governance and broader benefits to society, like inclusive growth and improved access to health and education, which may facilitate entering a broad trajectory of societal change and effective governance for the creation and innovation necessary for a sustainable society for present and future generations. A sustainable society may be understood as one that ensures well-being for present and future generations. It is a society where governance arrangements are in place, so resources are carefully managed and individuals have opportunities to develop themselves in freedom.

Consequently, we are interested in studying practices of governance in particular policy fields and the links to societal benefits, from economic growth and development, to education and health improvements. The expectation is that entering a trajectory of societal and governance innovation will lead to broad societal benefits and the creation of a sustainable society fostering growth and beneficial societal development, thus avoiding the middle-income trap of stagnant growth and societal development. Institution building is critical to this process.

This introductory chapter is structured as follows. Section 1 gives a short overview of the decentralization efforts of the Indonesian government. Section 2 links these developments to the general discussion on sustainable society and introduces the general analytical framework of the research program behind this volume. Sections 3–6 discuss the four main elements of this analytical framework: modes, objectives, mechanisms, and outcomes of governance. These sections link to previous research on multi-level governance (Sect. 3), sustainable development goals (Sect. 4), and the theoretical foundations of the framework (Sect. 5) and introduce a general conceptual framework of governance outcomes, including types of governance failures (Sect. 6) Governance failure. Section 7 highlights key assumptions and findings of the different chapters in this volume and positions them within the analytical framework. Section 8 gives a summary overview of the organization of the volume and its nine chapters, and Sect. 9 concludes.

1 Decentralization in Indonesia

Since declaring national independence following the Second World War, the Indonesian state has wrestled with attempts to pursue strategies of both centralization and decentralization. The desire for a strong central state emerged from attempts to maintain national unity over the vast archipelago, with a large population with great religious, cultural, and ethnic diversity. At times, this focus on a strong central state was a response to secessionist tendencies in certain regions, for example in Sumatra and Sulawasi in the 1950s, as well as in Aceh and other regions in the decades since. However, the diversity of the society and the human and natural resource endowments across the country also suggested a policy of decentralization "since the wide range of resources and needs means that centralized decision making alone cannot be sufficiently sensitive to local factors" (Ranis and Stewart 1994). Thus, early on scholars have aimed to "assess the impact on social and economic development of moves toward greater decentralization" in Indonesia (Ibid.). Therefore, it is likely that entering the trajectory of a middle-income developing country with a diverse economy, with a need for foreign capital and expertise, and desire to raise education and social standards to confront growing disparities across the country requires an effective decentralization strategy.

Even during the autocratic era when President Suharto held almost complete authority, and other governing bodies were seen to take little more than rubber-stamp decisions, changes at the local level were foreseen. For example, the 1974 Basic Law No. 5 was an attempt at constitutional change to provide more responsibility at levels below the national, at the provincial, district, subdistrict, and village levels.

The more recent first and second rounds of decentralization occurred during the democratic era have had more impact on decentralization and have taken place within the broader context of democratization. The first decentralization began in 1999 when Law No. 22/1999 was passed. The law granted the central government and local governments to spend two years preparing for the implementation of the decentralization. The second wave of decentralization began in 2004 when Law No. 32/2004 was passed to replace the previous law from 1999.

The political and economic crisis in Indonesia in 1997 (see, e.g., Forrester and May 1999) rapidly accelerated the process of decentralization and changed the relationship between the central government and the provincial and local governments. After President Suharto stepped down from being in power for more than 30 years, President Habibie began to respond to pressure from societies outside of Java that had felt unfairly treated by the previous regime (Suwondo 2002). He introduced Law No. 22/1999, which replaced the hierarchical governance system that linked local governments to the center with one that granted local governments greater autonomy. The law provided that mayors and district heads be selected by local assemblies, which meant that local government would become more democratic and accountable to the local population. Fiscal arrangements between the center and periphery also changed considerably, with the ending of central funding of regional civil servant salaries and a detailed array of development grants ("Inpres Instruksi President"—Presidential instruction), replaced by a single block system known as the General Purpose Fund ("Dana Alokasi Umum"—DAU) (Silver et al. 2001). Indonesia has a very centralized tax system, which means that the emphasis on "transfers from the central government to regional governments is the determining factor in local fiscal capacity"

(Silver et al. 2001, p. 345). A key concern of many commentators is "whether local governments are capable of assuming the level of responsibility and discretion necessitated by a block grant system" (Ibid., p. 346). It is also clear that fiscal decentralization implies a still centrally coordinated distribution of funds.

The new President of Indonesia, Joko Widodo, universally known as Jokowi, took office on October 20, 2014. This was a historical occasion for the country and for any democracy, marking the very first time that one popularly elected leader, Susilo Bambang Yudhoyono, stepped down and handed over power to another democratically elected leader. Jokowi emerged not from Indonesia's political and business elites, but from the *reformasi* movement that toppled the Suharto dictatorship over 16 years ago. A hallmark of this reform agenda has been the continued decentralization of policy making toward the local level from the past authoritarian center.

Overall, Indonesian decentralization has been central to its policies since the end of the 1990s. The main shift involved is one from relocating principal administrative powers from central government directly to local government rule. Legislative changes on administrative and fiscal reform have mainly focused on practical objectives for decentralization. The objective has been to bring public services closer to the people: Government is to be more responsive to local needs. Political considerations have also played a role in these changes. National political leaders have generally believed that devolving central government authority to decentralized administration will reduce the effect of separatist sentiments (Fitriani et al. 2005). An accelerator of decentralization was the 1997 economic and political crisis in Indonesia (Silver and Sofhani 2008). In general, support for decentralization has been widespread and characterized by a radical transformation of central–local relations, particularly in 1999 and the immediate years thereafter.

These decentralization policies have created a demanding agenda for capacity building at the local level (municipalities, districts) during the last decade and have also left little room for coordinated governance arrangements at regional levels (Hudalah et al. 2014; Miharja and Woltjer 2010). The consequence is that decentralized governance in Indonesia involves varying degrees of development, including local egoism and institutional fragmentation. In the field of urban planning, for example, urbanized local government agencies have been establishing local institutions and even "kingdoms of their own" (Firman 2009). Districts have a tendency to execute development policies themselves, such as on roads or water provision, thereby ignoring a wider need to coordinate these essential services and infrastructure with adjacent areas.

The context of this volume, therefore, is one of a rather fragmented institutional landscape and a practice on decentralization as a work in progress. Our understanding points to a need for strengthening of sustainable arrangements at all levels of governance in Indonesia: at the increasingly remote yet coordinative national level, at the local district level with more or less independent and diverging "local kings," and at the regional gap in between. A wide variety of innovations in governance are emerging at all of these levels.

2 Decentralization and Sustainable Society

The great interest among scholars and policy makers in governance and sustainable development is an indication that it is widely perceived that governance matters a great deal in the transition to sustainable development. The influential Brundtland Commission (1987) established by UN resolution defined sustainable development as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (Ibid.). The debate since has focused on exploring the interplay between different principles of sustainable development, such as "improving intergenerational and intra-generational equity; alleviating chronic poverty; encouraging public participation in decision making; observing important environmental limits to growth…" (Jordan 2008, 20). The international community has continued to discuss and elaborate on these dimensions of sustainable society, and noted that the principles at times may sharply conflict with one another, thus requiring systems of governance to resolve conflicts and to coordinate (Ibid., also see United Nations Agenda 21 [UN 1992), and the Report of the World Summit on Sustainable Development (UN 2002)]. There has been a continuing scholarly interest in exploring the links between governance and sustainable society. For example, a recent volume titled *Challenges to Democratic Governance in Developing Countries* focuses in particular on the "problems of democratic governance and corruption in these countries as the key issue in sustainable development" (Mudacumura and Morcol 2014).

Indonesia has been active in the global governance discussion for sustainable society. The state is contributing to the High-Level Political Forum on Sustainable Development, which was launched during Rio+20. For example, the Indonesian State Minister of Environment, Prof. Balthasar Kambuaya, presented a statement on sustainable consumption and production (SCP) as part of the High-Level Forum. The Minister stressed that SCP is central to meeting the social development goals (SDGs), because it moves from commitments to targeted actions. The Minister stated that SCP has been integrated into the country's National Development Planning for the coming period 2015–2019 (Ministry of Environment 2014). The Foreign Ministry of Indonesia recently released a statement to the Working Group of Sustainable Development Goals in New York reflecting upon the proposed focus areas to be discussed for possible inclusion in the SDGs (Ministry of Foreign Affairs 2014). The statement declared that the SDGs should "carry forth the spirit of the current MDGs" (Millennium Development Goals) and should "consistently link with the provision of adequate means of implementation" (Ibid.) of the goals.

Hence, as is the case in many other countries, Indonesia's current decentralization trajectory is an attempt to build a more sustainable society through changing essential elements of its governance structures. These changes affect practically all of its policy domains and administrative levels of decision making. Such an endeavor is not only challenging for policy makers, but also challenging for social and political scientists who seek to understand the pathways between decentralization and its (un)intended societal-level outcomes. Much progress has been made, particularly through recent advances in the study of multi-level governance. We build on these advances but suggest that this macro-perspective will be of limited use to come to grips with the complexities of the phenomena, unless it is combined with a theoretical micro-foundation (Wittek 2007). That is, we suggest to analyze decentralization and its societal impact in terms of a micro–macro problem and use analytical sociology's social mechanism reasoning (Hedström and Bearman 2009) to solve it. This means that the assumed macro-level relationship between decentralization and a sustainable society needs to be explained by specifying (1) how the changing modes of governance affect the preferences and constraints of relevant decision makers (the macro–micro link or situational mechanism), (2) how these individual-level preferences and constraints affect the decisions and actions of these stakeholders, in particular with regard to their ability to cooperate and create shared value (the micro–micro link or action-generating mechanism), and (3) how and under which conditions these outcomes at the micro-level contribute to building a sustainable society (the micro–macro link or aggregation mechanism). Figure 1 presents a schematic summary of this analytical framework.

In other words, in order to understand why specific changes in a governance structure are effective or not, it is essential to reconstruct the three pathways through which these effects will arise. The nine chapters in this volume demonstrate the explanatory power of this analytical framework by illustrating the large variation in how these pathways can take shape. In the remainder of this introductory chapter, we first introduce the main components of our analytical framework and then position the different chapters within it.

3 Governance Modes: Multi-level Structures

The idea of governance refers to the economic, political, and social institutions (i.e., the rules) by which authority in a country is exercised (Kaufman et al. 2010). Governance typically includes legal and social structures, and processes

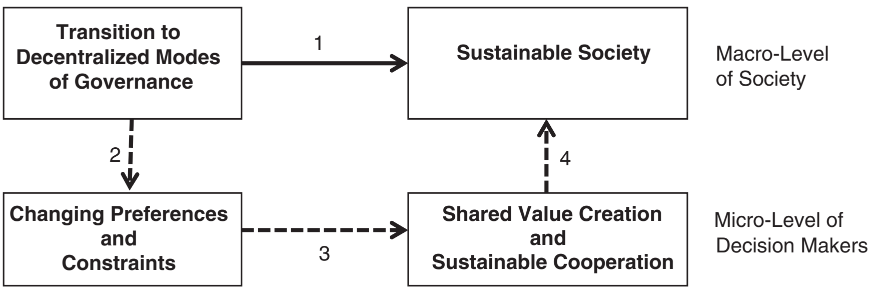

Fig. 1 Analytical framework: a macro–micro–macro model of decentralization and sustainable society

of citizens and groups articulating their interests, exercising their rights, taking responsibilities, and achieving agreement. Governance occurs at various levels: international, national, regional, and local.

In this book, we focus on multi-level governance to better understand the changing relationship and modes of governance in Indonesia between the central government and local governments and between the stakeholders and citizens. First, it is clear that the decentralization processes in Indonesia have resulted in shared and overlapping competences between the national and local levels of government. Second, while this is a loss of control by the national government, it may ultimately lead to gains in the effectiveness of policy by making it more amenable to local circumstances. In addition, the loss of direct control may be ameliorated by accountability mechanisms to assure national standards and objectives are pursued. Thirdly, local governments in Indonesia are increasingly involved in lobbying and influence seeking at the national level, involving both formal institutions and associations and networks.

There are two lobbying mechanisms that have been created within the decentralized system to link the levels of government. First, the Regional Representative Council (Dewan Perwakilan Daerah—DPD) is an upper house of parliament, which deals with bills on "regional autonomy, the relationship of central and local government, formation, expansion and merger of regions, management of natural resources and other economic resources, and Bills related to the financial balance between the center and the regions." The DPD members are elected directly by the people during the general election and they serve as senators. Each province has four elected senators (see Republic of Indonesia, Senate 2015).

The other mechanisms providing linkage have less formal power but are nonetheless influential in the decentralized system. There is the Association of Provincial Governments (Asosiasi Pemerintah Provinsi Indonesia—APPI), the Association of City Governments (Asosiasi Pemerintah Kota Seluruh Indonesia—APEKSI), and the Association of District Governments (Asosiasi Pemerintah Kabupaten Seluruh Indonesia—APKASI). APPI is an association of provincial governments in which the membership consists of 34 governors, while APEKSI is an association of mayors and APKASI is an association of the heads of districts in Indonesia.

The municipalities are also at times involved in the creation of transnational networks with other municipalities outside the nation-state, to exchange information, expertise, and best practices. There is a rich literature on the increasing role that the processes of transnationalization are having on governance arrangements (see, e.g., Bruszt and Holzhacker 2009).

Our focus on multi-level governance (Hooghe and Marks 2001) is concerned with three main modes of governing: hierarchies, networks, and markets. There has been a focus on networks as a preferred mode of governing, emerging as a bridging and coordinating mechanism between the hierarchies of government and the operation of markets. Multi-level governance is often involved in the hierarchical and network processes, linking the international level to regional, national, and local governance levels, so that policy development and implementation may be better suited to local conditions and more responsive to local citizens and their needs. Global governance increasingly impacts the lives of individual citizens and is an integral part of the overall governance scheme necessary to create sustainable societies. International organizations such as the United Nations and the World Bank are important institutions in the global system, as are regional institutions such as the European Union (EU) and the Association of Southeast Asian Nations (ASEAN). However, the created governance system is most effective when it is not solely based on top-down initiatives, but relies instead on the involvement of whole set of institutions spanning regional, national, and local governments, relevant stakeholders, and civil society. The emerging institutional framework is complex and combines hierarchical and non-hierarchical network structures.

Multi-level governance is often involved as a state decentralizes policy making. For example, Indonesia has decentralized its primary healthcare system so that it may be more responsive to local needs and improve health outcomes. During this process, key questions emerge about accountability to the center and the maintenance of national standards, while opening opportunities for local innovation, adaptation, and responsiveness to local needs. In the area of the environment, regional transnational municipal network initiatives are assisting Southeast Asian cities in contributing to their state's international climate change commitments. This is a form of governance innovation focused on regional networks of local government, contributing to national commitments made in international fora. In the area of human rights, for example, the states in Southeast Asia cooperate within the regional human rights mechanisms of ASEAN, with many of their National Human Rights Institutions (NHRI) also networking and exchanging best practices in the Asia Pacific Forum (APF) of NHRIs.

Since the fall of Suharto's authoritarian New Order regime in 1998, scholars have been discussing the problems with democratization in Indonesia. A recent volume by Aspinall and Mietzner (2010) identifies three broad schools of thought in this regard. First, there is a group of scholars arguing that "despite institutional reforms, democratic change has been superficial, with core structures of power remaining unchanged," most importantly the oligarchic elites (Ibid., p. 1). Here, they cite the work of Robison and Hadiz (2004) and Bourdeau (2009). The second group of scholars believes that Indonesia has done exceptionally well in consolidating its democracy, especially from a comparative viewpoint across the globe and Southeast Asia in particular, citing the work of MacIntrye and Ramage (2008). Finally, other authors have taken a middle ground emphasizing that while Indonesia has made democratic progress, it remains crippled by severe structural problems, most notably corruption and weak law enforcement (ibid., p. 2). For this perspective, they cite Davidson (2009) and Aspinall (2010). This middle position also includes authors like Widodo (2010), who establish that although the guidelines and formal procedures for accountability within the Indonesian government are in place, the implementation in practice of accountability guidelines has not yet been wholly successful.

We feel we also belong to this middle ground of thinking on democracy in Indonesia. We believe that after nearly 20 years since the dissolution of the New

Order regime, continued economic growth and a strengthened state apparatus and multi-level governance, combined with new committed leadership in Jakarta, means that democratic consolidation has advanced and will continue in Indonesia.

4 Governance Objectives: Indonesia's Priorities in International Context

The concept of governance has not just attracted the interest of academics, but has also sparked a real and active discussion within nations and international organizations. Indonesia has made commitments with international organizations, which recognize and further delineate the country's focus on governance issues. Here, we will provide an overview of the positions of the United Nations, the World Bank, the EU, and the ASEAN on the challenges facing Indonesia and the possible policy solutions. Table 1 summarizes governance priorities embedded in recent policies at the United Nations Partnership for Development (UNPDF), the World

Table 1 An overview of governance priorities in recent international policies

	Key suggestions, objectives
United Nations Partnership for Development (UNPDF Framework 2011–2015 Indonesia 2010)	1. "Acceleration of Physical Infrastructure Development." Includes the following: food security (e.g., land rights, agricultural zones, adaption to climate change), infrastructure (e.g., economic growth, just social development), energy (e.g., restructuring state-owned enterprises, increasing supply capacity, renewable energy), and "left-behind areas" (e.g., infrastructure to increase welfare)
	2. "Improving Soft Infrastructure." Includes the following: reform of the bureaucracy and governance (e.g., state, apparatus, regional autonomy, human resources, regulations, law enforcement), investment and business climate (e.g., legal certainty, procedural simplification, economic zones)
	3. "Strengthening of Social Infrastructure." Includes the following: education (e.g., access and enrollment rates, access to university education, comprehensive education), health (e.g., public health, healthy living places, clean water), poverty reduction (e.g., income distribution, empowerment, economic opportunities), environment and management of natural disasters (e.g., climate change, controlling degradation of the environment, early warning systems)
	4. "Development of Creativity," including culture and technological innovation

(continued)

Table 1 (continued)

	Key suggestions, objectives
World Bank (World Bank Development Policy Review 2014)	1. "A stronger Center of Government to manage the policy process and resolve policy conflicts"
	2. "Streamlined bureaucracy for enhanced accountability"
	3. "More strategic management of human resources across the public administration"
	4. "Better planning and budgeting procedures to deliver improved results with public spending"
	5. "Stronger accountability for service delivery at the local level"
European Union (Council of the European Union 2009)	1. "Cooperation in trade and investment" (e.g., trade facilitation)
	2. "Cooperation in other sectors" (e.g., economic policy dialogue, industrial policy and SME cooperation, science and technology, energy, transport, education and culture, human rights, the environment, agriculture and rural development, marine and fisheries, and health)
	3. "Civil society" (e.g., role and potential contribution of organized civil society, especially academics)
	4. "Modernization of the public administration" (e.g., improving organizational efficiency, increasing institutions' effectiveness in service delivery, transparent management of public resources)
Association of Southeast Asian Nations (Framework for Equitable Economic Development 2011; ASEAN-EU Development Cooperation Agreement 2015)	1. "Enable regional economic integration based on the principles of inclusive and sustainable growth, poverty alleviation and narrowing the development gap within and between all ASEAN Member States"
	2. "Connectivity through sustainable and inclusive economic integration and trade"
	3. "Climate change, environment and disaster management"
	4. "A comprehensive dialogue facility"

Bank, the European Union (EU), and the Association of Southeast Asian Nations (ASEAN).

Overall, we see that the international community, in agreement with Indonesia, places a good deal of importance on the development of democracy, civil society, and public administration in the country. A strong, general emphasis is on economic opportunity and choice, and well-being-oriented aspects of a sustainable society.

The new Indonesian government has recently presented its plans in the Medium-Term National Development Plan 2015–2019 (Minister of National Development Planning 2015). The plan is a very detailed blueprint prepared by the Indonesia Minister of National Development Planning, Mr. Andrinof Chaniago. It lays out six broad goals for the government to pursue in the period ahead to create a better Indonesia: enhancing economic competitiveness, improving the quality of human resources, deriving greater benefits from the maritime sector, increasing the quality of economic growth, restoring the damaged environment, and promoting civil society.

Our research team had the opportunity to meet with the Minister at the Indonesian Embassy in The Hague on March 7, 2015, to hear and question the plans of the new government. Chaniago explained that the plan is an attempt to translate the newly elected Indonesian President's vision, mission, and priorities into action. It will guide Indonesia's National Development Planning for the coming five years, from 2015 to 2019, during President Joko Widodo's period in office. Chaniago noted that the plan was developed by combining political and technocratic approaches, whereby the political agenda offered during the president's election campaign was framed to fit the current situation and government capacity (Chaniago 2015).

The Minister noted that the Government of Indonesia is focused on efforts to "enhance competitiveness, productivity and growth, as well as inter-sectoral and inter-regional balance, fairness and equity" (Ibid.). According to the national plan, the manufacturing and processing sectors' share of contribution to GNP is planned to increase significantly, replacing a portion of the shares currently coming from the extraction and construction (property) sectors. Additionally, the government has set targets and indicators so that the share of GDP produced by the Indonesian islands beyond Java will increase by 2019. Finally, he explained that new targets and indicators have been formulated to focus on addressing inequality, poverty, unemployment, social development, and the development of a constructive, development mentality among the Indonesian people (Ibid.).

5 Governance Mechanisms: Neo-Institutional Approaches

Governance structures are instruments to achieve policy goals. These structures are the result of deliberate institutional design and emergent social and informal conventions. Formal governance structures are attempts to shape the preferences and constraints of relevant decision makers. If designed properly, they influence individual decision making in such a manner that the resulting actions contribute to realizing the underlying policy goals.

The design of formal institutions usually rests on (implicit) assumptions about what drives human decision making and behavior. During the past decades, these assumptions have increasingly been shaped by the so-called institutional turn in the social sciences (Evans 2005). This turn comes in an economic and a

Table 2 Neo-institutional approaches to governance: summary overview

Approach	Theories	Main behavioral challenge for governance	Solutions induced by decentralization	Intended outcome
Neo-institutional economics	• Agency theory • Transaction cost theory	• Moral hazard • Information asymmetry • Asset specificity	• Interest alignment • Decision space • Accountability through monitoring and sanctioning	• Rule compliance • Intelligent effort • Effective coordination
Neo-institutional sociology	• Social capital theory • Cultural theory	• Strong patron–client relations, cliques, and old boy networks • Strong in-group solidarity, obligations, and reciprocity • Illegitimacy	• Open networks, weak ties, overlap, and brokerage • Civil society, participation • "Weak" solidarity	• Joint production motivation • Shared value creation

sociological variant. While both emphasize the importance of institutions as the major tool for creating social welfare, they differ with regard to their assumptions about what drives human behavior and consequently also with regard to what constitute the major problems institutions should solve and how they should do this. Table 2 summarizes some key elements of both frameworks.

The impact of neo-institutional economics—most notably of principal agent and transaction cost reasoning—on policy design can hardly be underestimated, and this perspective also informs several chapters in this book. According to this framework, the major challenge for a governance structure is to prevent or mitigate opportunistic behavior, for instance agents exploiting either their information advantage at the expense of their principal (the "moral hazard" problem in agency theory) or their exchange partner's dependence on them (the "holdup" problem in transaction cost reasoning). This approach advocates two main solutions to solve these problems: aligning the interests of principals and agents, and implementing a system that monitors, controls, and sanctions the agent's performance. An example for interest alignment is a performance contingent pay or promotion scheme, backed by a system of performance evaluation. The key idea behind both these solutions is simple: Since agents are human and therefore mostly motivated by selfish motives, they will most likely act on behalf of a principal if they (a) are sufficiently incentivized to do so, (b) have the necessary resources and decision space, and (c) are held individually accountable for their actions. In the Indonesian public sector and elsewhere, formal governance structures during decentralization were transformed according to these principles with the aim to achieve improvements in many domains, like higher rule compliance of government officials and corporations, better coordination between government entities at all levels, more efficient and reliable public service provision, and entrepreneurship leading to innovation and intelligent effort of its leaders.

In sociology, the New Institutionalism stresses the importance of cultural and relational embeddedness: Human action is always context dependent, and their preferences and opportunities are strongly influenced by cultural rules, norms, and beliefs on the one hand and their social–structural environment (e.g., their social networks) on the other hand. These informal norms and networks can function as a major resource for individuals and groups ("social capital"), but they also can pose a severe challenge for the effectiveness of formal governance structures. When informal norms and expectations are insufficiently aligned with or even competing against formal rules, the latter will lack the legitimacy that any institution needs to be effective. This may further be exacerbated when these formal rules have to be implemented in highly cohesive social settings, characterized by close-knit cliques with vested interests in the status quo and strong mutual solidarity. The transformation of governance structures during decentralization trajectories often has the explicit purpose to overcome these social and cultural obstacles. The idea is that the changes in the formal institutional arrangements will also facilitate the necessary transformations in the domain of informal norms and network structures. For example, a social fabric that is dominated by patron–client relations, strong in-group solidarity, and particularism will be gradually replaced by a civil society, with multiple overlapping networks, active participation, and weak solidarity, such as norms facilitating fruitful exchanges not only within, but also between groups (Lindenberg 1988).

Variants of these neo-institutional approaches also inform the theoretical reasoning behind the nine chapters in this volume. Some of them take the economic variant as their point of departure (Wijayati, Putra, Kuswanto, Miharti, Muttaqin), whereas others are more strongly rooted in the sociological version (Sondang Silitonga, Wiharani, Hazenberg) or combine the two (Kusumawanti).

6 Governance Outcomes: A Conceptual Framework

Governance structures can fail, because they produce unintended outcomes. With regard to building sustainable societies, they can fail in both the ends and the means to achieve them. First, a major precondition for sustainable society is that governance structures move from a one-sided emphasis on economic welfare toward a more balanced set of goals, including also the social and environmental domain ("People, Planet, Profit"). This idea has also been referred to as shared value creation (Porter and Kramer 2011). Shared value creation can have many faces, with the distinction between economic and social values representing two of its most important dimensions. The idea behind this theory, as popularized by Porter and Kramer (2011), is that governance structures geared to achieve both economic and social/normative goals will yield higher levels of profits and social welfare than institutional arrangements that attempt to maximize only one of these dimensions.

Table 3 Typology of governance outcomes

Sustainable cooperation ("means")	Shared value creation ("ends")	
	Low	High
Low	I	II
High	III	IV

Second, governance structures may fail in their selection of the appropriate means for value creation. There are many examples of governance structures that are very effective in creating value, as the well-known example of bonus incentives has shown. The same holds for arrangements to induce *shared* value creation, as the emerging template of social enterprises shows hybrid organizational forms that aim to be competitive in the market, while pursuing a societal purpose. All forms of governance at some point need to induce some degree of cooperation in order to create value, be it employees complying with company rules, citizens paying their taxes, different ministries collaborating in a complex policy case, or corporations respecting environmental regulations. The question is, however, to what degree these forms of value creation through cooperation are short-lived or indeed sustainable. We define sustainable cooperation as the durable joint production of mutual benefits, with *durable* meaning that cooperation is resilient against external shocks and endogenous decay (Wittek et al. 2013). For example, in the financial sector, governance relying strongly on bonus incentives was effective to elicit the commitment of its workforce, but with its focus on short-term gains, this form of eliciting cooperation turned out to be highly self-destructive and therefore not sustainable.

Cross-classifying the aforementioned means–ends distinction of governance (see Table 3) allows us to identify to which degree a governance structure is likely to fail in building a sustainable society.

First, there are governance structures that are geared toward value creation in a single welfare domain (e.g., economic) and that do not take particular precautions to ensure the cooperative arrangements necessary to achieve this are sustainable (Quadrant I). We consider these governance structures as least likely to succeed in building sustainable societies. The reason is that one-sided maximization of specific social welfare outcomes, be it economic growth or human development, is not only self-undermining in the long run, but also subject to legitimacy conflicts. Combined with an inherently instable cooperation base, Quadrant I governance is less suited as a template for sustainable society. Ironically, most of our current templates of governance fall into Quadrant I. For example, one of the most widespread measures of societal welfare, GDP, focuses on economic value creation and neglects social and environmental value. Similarly, the most widespread forms of organizational governance make use of incentive alignment, eliciting short-term profit maximization through cooperative relations with an increasingly limited time horizon (e.g., short-term contracts). Many large-scale decentralization trajectories aiming for sustainable society through good governance reflect attempts to replace Quadrant I governance by one of the other three forms.

Second, a governance structure for sustainable society may be successful in creating shared value, but it may fail in grounding shared value creation in sustainable forms of cooperation. Conversely, governance structures may be highly successful in bringing about sustainable cooperation, but they may fail in creating shared value for society. We assume that compared to Quadrant I governance, both types of governance are a step in the right direction when it comes to building sustainable societies. In fact, case studies and analyses presented in this volume show that many decentralization-induced changes either reflect transitions toward Quadrant II or Quadrant III governance, or may benefit from such a transition. For example, Putra et al.'s case study of the metropolitan transport system in Jakarta identifies sustainable intergovernmental relations between local and provincial levels as a crucial precondition for an effective and efficient functioning of the system. Here, a Quadrant I structure that nourished authority conflicts and parochialism gradually moved toward a Quadrant III structure which enabled sustainable cooperation. Similarly, what the countless inclusive growth measures have in common is that they urge to incorporate both economic and non-economic dimensions of growth. That is, the transition from economic growth to inclusive growth reflects a move from Quadrant I governance toward Quadrant III governance: shared value creation at the level of societies.

Finally, we posit that sustainable societies require Quadrant IV governance structures: institutional arrangements that enable shared value creation through sustainable cooperation. As the contributions to this volume illustrate, designing and implementing governance structures that are able to reach this outcome can be considered as one of the major challenges for any government.

One example of the difficulties to achieve Quadrant IV outcomes—shared value creation through sustainable cooperation—can be found in the context of urban governance innovation at the regional level. Governance here typically involves the need for coordination between local government agencies on specific issues like urban development, healthcare provision, water management, garbage processing, and public transport—a clear issue of shared value creation. At the same time, existing coordination arrangements in Indonesia often lack well-defined institutional design. A more formalized option for regional coordination does exist through so-called regional development coordinating bodies, such as Badan Kerjasama Pembangunan (BKSP), but these too typically have limited authority and usually suffer from a lack of capacity to adequately harmonize fragmented local initiatives. Despite recent well-known interlocal government cooperation arrangements for urban regions like *Jabodetabek* (Greater Jakarta) and *Kartamantul* (Greater Yogyakarta), these structures currently fail to ensure sustainable cooperation between the different stakeholders. Overall, consolidation and coordination between local governments, aimed at sustainable urban development, remains a fundamental challenge (Laquian 2005).

An illustrative case of the resulting fragmented urban governance is greater Jakarta. Jakarta is a fast-growing city region of global importance, featuring substantial urban sprawl, expansion, and deconcentration (Murakami et al. 2003). It is one of the most suburbanized metropolitan areas in the world. Industrial land development and privately run suburban industrial centers in particular have become a key feature of urbanization in Greater Jakarta (Hudalah et al. 2013). These industrial centers have become increasingly specialized in their function and are located far beyond the traditional central city. In combination with large-scale housing development featuring new towns (Shatkin 2008; Winarso and Firman 2002), Jakarta truly has a large-scale polycentric metropolitan structure.

Importantly, this structure with its large-scale private land development stretches well beyond the formal government boundaries of the Jakarta central district and even the Jakarta metropolitan area (Goldblum and Wong 2000). Greater Jakarta consists of Jakarta as the metropolitan core, surrounded by its suburbs including *kotas* (municipalities) and *kabupatens* (districts) adjacent to Jakarta. Clearly, urban patterns have outgrown traditional central city governments. Metropolitan phenomena like mobility or water supply are crosscutting the central city and adjacent municipalities and districts, and, therefore, are crosscutting decentralized local governance arrangements. Under decentralization, urban governance is fragmented and lacks cooperation at the regional level. The consequences for sustainability include social segregation, inequality, and reduced environmental quality (Hudalah and Firman 2012), resulting in a need to improve the capacity of the suburban local government and metropolitan governance.

It remains to be seen to what degree these developments are detrimental or conducive to shared value creation and sustainable cooperation. In order to better understand under which conditions decentralization can be a tool to achieve shared value creation through sustainable cooperation (outcomes in Quadrant IV), it is necessary to gain a more systematic and detailed insight into the unintended effects of specific interventions and how these may be prevented or mitigated. That is, we need to closely examine the potential decentralization-induced governance failure and its possible solutions. Each of the nine chapters in this volume presents examples for these mechanisms. The next section provides a short summary overview.

7 Decentralization, Governance Failures, and Solutions

The chapters in this book contain many fine-grained examples illustrating the unintended consequences of decentralization-induced changes in the governance structures. They also shed some light on possible solutions to these failures. This section can only provide a bird's-eye overview of some of the main findings.

Five chapters mainly center on governance failure due to problems of sustainable cooperation (see Table 4). Sondang Silitonga addresses corruption of public officials, which still is a major threat to building a trustworthy and efficient public service and state bureaucracy. She finds that though the decentralization in the formal governance structure had potentially beneficial effects on accountability and control, these seem to have been partially neutralized by agents building or drawing on different informal social capital structures to support their rent extracting

Table 4 Governance failure examples: sustainable cooperation

Policy domain (chapter)	Antecedent	Outcome (governance failures)	Example solutions	Type of solution
Public service (Sondang Silitonga)	Shifting social capital base	Inefficient and untrustworthy public service provision through corruption of public officials	Increased transparency in local governance, enforcement of regulatory law, social control	Organizational (Q III)
Urban environmental policy (Wiharani)	Climate change on a global scale	International and national commitments, need for local action	Transnational municipal networks	Organizational (Q III)
Urban transport (Putra)	Poor intergovernmental relations	Inefficient metropolitan transport	Interlocal government cooperation agency, BKSP	Organizational (Q III)
Economic growth (Kuswanto)	Poor intergovernmental relations	Decline in foreign investment	One-stop services offices (PTSP)	Organizational (Q III)
Economic growth (Wijayati)	Weak corporate governance	Inefficient resource allocation through corporate corruption	Disclosure requirements, limits to tenure and multiple directorships, increased number and quality of accountants	Legal–organizational (Q III)

activities. Potential solutions to this governance failure are a further increase in the transparency of governance, stronger enforcement of the rules, and facilitating informal social control. Next, Wiharani focuses on environmental problems such as reducing the emission of greenhouse gases which are a subject of international treaty, but which require extensive action by local governments and cooperation among stakeholders to meet national targets. Here, the establishment of transnational municipal networks may assist in creating sustainable cooperation among cities to learn from each other's successes or failures.

Putra analyzes the large-scale inefficiencies in the metropolitan transport system in Jakarta. One of the obstacles to improve the efficiency of the system are poor intergovernmental relations, which in turn are the result of local governments fearing a loss of their authority. The institutionalization of interlocal government cooperation at the meso-level (BKSP) has the potential to facilitate sustainable cooperation. Kuswanto focuses on the deterioration of the climate for foreign direct investments. Again, poor intergovernmental relationships seem to be one of the major obstacles. Here, some success in improving cooperation could be booked through the establishment of one-stop services offices (PTSP). Wijayati's chapter suggests that weak corporate governance structures facilitate firm-level corruption, which leads to inefficient resource allocation and is detrimental to economic growth. Based on a detailed comparison with the corporate governance structures of Malaysia and Thailand, she suggests that stronger disclosure requirements, restrictions on tenure and multiple directorships, and an increased number and quality of accountants may alleviate these problems.

In the remaining four chapters, the key issue of shared value creation is addressed (see Table 5). Hazenberg points to the restricted conceptualization of the theoretical construct and empirical indicators for "good governance". Current approaches are characterized by economic consequentialism and definitional vagueness. As a result, the construct fails as a valid and reliable instrument for policy evaluation. A potential solution for this problem is to adopt a sustainability and international legal human rights perspective to normatively ground the concept. Kusumwati's chapter extends the well-known criticism of a one-sided conceptualization of "economic growth" to the current efforts to construct an index of "inclusive growth". These efforts rest on arbitrary indicators and weighing procedures, and suffer from aggregation bias. The chapter presents a statistical–methodological solution that allows more reliable construction of indices through the incorporation of cause–effect estimates. Miharti's chapter argues that the strong regional and local disparities in the performance of the health system are due to the new governance structure not succeeding in triggering sufficient local-level innovation in the health sector. Drawing on a variety of best-practice cases, she concludes that this may be resolved by strengthening community participation, organizational capacity, and interorganizational learning. Muttaqin shows that since the decentralization, variations in educational attainment at the municipal level have increased. He argues that the beneficial effects of decentralization are susceptible to shifting voter priorities and resource competition between different policy domains. Human capacity building and municipality development may be potential remedies.

Table 5 Governance failure examples: shared value creation

Policy domain (chapter)	Antecedent	Outcome (governance failures)	Example solutions	Type of solution (quadrant)
Defining good governance (Hazenberg)	Economic consequentialism and definitional vagueness of good governance	Failed instrument for policy evaluation	International legal human rights, normative foundation	Methodological (Q II)
Measuring inclusive growth (Kusumwati)	Arbitrary indicators and weighting, aggregation bias	Non-inclusive growth	Simultaneous and structural equation modeling	Legal–normative (Q II)
Primary health care (Miharti)	Insufficient healthcare innovation	Regional and local disparities in health	Organizational capacity building at PHC level	Organizational (Q II)
Primary education (Muttaqin)	Shifting voter priorities, competition between policy domains	Intermunicipal disparities in educational attainment	Human capacity building at municipal level	Organizational (Q II)

In sum, the examples of governance failure in this book show that the design and implementation of governance structures for sustainable society in Indonesia is a work in progress. At the national level, we see coordinative and distributive governance emerging, aimed at strengthening national standards for governance and distributing development capacities and (financial) resources. National governance seems to be increasingly locally informed. Local capacities are reinforced in municipalities and districts. There is clear attention for capacity building at an increasingly independent local level. Nonetheless, we see a need to further strengthen the capacities of local government. It seems also clear that government capacity, both in terms of financial and human capital, is generally deficient and may be contributing to inconsistencies in implementation and weaker enforcement and control. The role of the local public sector, for example in urban planning and development, is also vulnerable in comparison with the private sector. Institutions will need to be made more resilient, and new institutions need to be designed.

8 Organization of the Book

This book addresses the issues of governance and decentralization in Indonesia and the impact this has on the society and the creation of a sustainable society in a wide variety of policy areas. It is evident that these policy areas are also the areas that the Indonesian government and international partners believe are essential for Indonesia to focus on as it continues to advance as a middle-income developing country. The book is organized into four main parts, beginning with theoretical reflections on decentralization and governance for sustainable society, followed by three empirical sections: decentralization and policy making, challenges of decentralization for cities to create sustainable futures, and governance to limit opportunities for corruption in decentralized environments.

More specifically, the empirical research by the research team focuses on the following topics: decentralization in the governance of primary health clinics in Indonesia and improvements in health outcomes, decentralization and improving access and quality in education, managing inbound investment to contribute to regional development policy, governance of economic growth to include inclusive growth strategies, institutional design and governance for metropolitan transport in Jakarta, improving environmental governance through transnational municipal networks, the role of leadership in promoting ethical behavior and good governance within institutions, and effective corporate governance and the control of corruption. For each of these studies, an implicit link is drawn between the contribution that governance in the policy sector is making to beneficial societal impacts and the creation of a sustainable society.

We will now briefly introduce each chapter in the book and its main conclusions. Chapter 2 of this volume serves, alongside this introduction, as part of the theoretical reflections on decentralization and governance for sustainable society. Thus, Chapter 2 by Jilles Hazenburg is a critical reflection on the concept of "good governance." He argues that the concept of good governance suffers from vagueness and that its contestation is often the result of an overly economic outlook. In response to these problems, he argues that a sounder, normative foundation to the concept of good governance should be built, focused on the fundamental values that governance should aim and adhere to, in order to be called "good." He states that the fundamental values embodied in international legal human rights norms would be a good beginning to this consideration. He also argues that status egalitarianism (treating individuals as fundamentally equal) and well-being for individuals and generations into the indefinite future should be more fully incorporated into the concept of good governance for creating a sustainable society.

The second part of the book turns to empirical research and focuses on decentralization and policy making in particular policy sectors in Indonesia. The third chapter focuses on decentralization and primary healthcare innovation. Suwatin Miharti et al. use decision space theory to explain variation in healthcare performance following the decentralization era in the country. She finds that whereas some districts had the organizational capacity to use the expanded opportunities which decentralization brought to improve health outcomes, for some districts decentralization may have brought a loss of expertise from the center and lower health outcomes. In the best cases, decentralization serves to enable innovation and improve health accessibility and acceptance. However, the capacity to innovate varies widely across districts, which results in large differences in health performance across districts. Finally, from a multi-level governance perspective, she concludes that even at times when innovation is encouraged, accountability to the center is necessary to ensure national targets, balanced health staff distribution, and balanced health spending.

The fourth chapter of the book by Tatang Muttaqin et al. is focused on the impact of decentralization on educational attainment in Indonesia. Muttaqin finds that while educational attainment measured by analyzing the mean years of schooling across the districts in the country has increased in the decentralization era, regional variations in educational attainment have also grown. Here, there is a clear urban/rural split, where rural areas and less developed municipalities have lagged in improving educational attainment. In terms of the efforts to create a sustainable society, his findings suggest that the government places particular focus on increasing educational attainment in these rural areas and less developed municipalities.

Chapter 5 of this volume, by Kuswanto et al., focuses on the governance of foreign direct investment in Indonesia and uses a multi-level governance approach to analyze the relationship between the central government ministries and local governments in guiding FDI. He finds that decentralization has led to a greater focus on the integration of FDI into regional development plans and a concern for the societal impact of FDI. He notes that without clear mechanisms of intergovernmental relations to manage FDI, devolution could lead to a deterioration of the investment climate, so the country would become less attractive to FDI. He concludes by stating that the change in the governance arrangements for FDI to give greater power to local governments has resulted in a better balance between economic development, social development, and economic protection.

In the final chapter of this part, Chapter 6 by Laksmi Kusumwati et al., the concept of inclusive growth comes into focus. She surveys the innovations that have been made to move beyond GNP as a measure of growth to include broader measures and asks how these concepts may help to provide a better understanding of the economic development process in an emerging middle-income economy like Indonesia. She finds that the government of Indonesia considers inclusive growth important for assuring the sustainability of development. Under decentralization, not only national governments, but also local governments have responsibilities to ensure inclusive growth in their societies.

The third part of the book addresses the challenges of decentralization for cities to create sustainable futures. Here, Chapter 7 by Taufiq Hidayat Putra et al. is focused on institutional design and governance for metropolitan governance. While decentralization in many policy areas may have created opportunities for local control and innovation, decentralization has created great coordination difficulties in developing a regional transport strategy for major metropolitan areas consisting of many different local governments, such as in the mega city Jakarta. In other words, even though decentralization has arguably provided local governments with greater authority and opportunity to tailor policy making to the local area in certain policy areas, decentralization to local governments also presents great coordination problems for local governments in providing transport across major urban areas. Putra concludes by stating that designing cooperative arrangements that preserve the autonomy of actors will be most effective in developing a regional public mass transit, and not the more coercive measures that force cooperation, as these are likely to fail politically. One strategy he suggests is the creation of an institutional body mandated to consolidate the political decisions coming from the local governments involved, with a clear division of labor and authority of the actors involved. He believes this can lead to a more sustainable society, because an accepted, legitimate, and effective metropolitan governance will have the backing of its citizens, as it eases their daily commute and offers transport by public transport instead of private automobile.

Chapter 8 by Annisa Paramita Wiharani et al. discusses environmental governance and transnational municipal networks. Wiharani examines how cities are increasingly reaching out across borders to form transnational municipal networks to exchange best practices and consult on addressing environmental issues in their communities. Decentralization has provided cities with a greater authority to cooperate with other cities and institutions abroad, including transnational municipal networks. Decentralization in Indonesia has especially transformed the environmental governance in terms of the implementation of policy, which benefits from a transfer of knowledge, expertise, and technology within these networks. These networks of cities are, in turn, beneficial for assisting nation-states in meeting their international environmental commitments, like climate change agreements. Thus, multi-level governance, which classically focuses on the governance arrangements between levels of government and the involvement of citizens and other stakeholders, is extended here to include municipal networking and building institutions to exchange best practices to improve planning and implementation of their local environmental policies. This results in local environmental gains and steps toward the creation of a sustainable society in the city and region and also contributes to national and international goals.

The final section of the book, part four, is focused on governance to limit opportunities for corruption in a decentralized environment. Chapter 9 by Mala Sondang Silitonga takes a social capital perspective, which informs the climate in which corruption is viewed as acceptable or unacceptable within a given institutional context. She first notes that previous research indicates that the shift of formal power from the central government to regional governments has increased the opportunities for actors at the local level to be involved in corruption. She argues that informal processes are important for initiating and sustaining corruptive transactions, and these processes may be modified by leadership initiatives within institutions to change the norms of behavior and strengthen the social capital of groups and individuals to resist corruption and assure transparent decision making. She concludes by finding that without government transparency, enforcement of regulatory law, and greater citizen control, it will be difficult to control the occurrence of corruption.

Finally, Chapter 10 by Nureni Wijayati et al. focuses on corporate governance and corruption in Southeast Asia, in a comparative study of Indonesia, Malaysia, and Thailand. She begins by noting that weak corporate governance was deemed a crucial factor in deepening the financial and economic crisis in the region in the late 1990s. Her study aims to demonstrate how a strong corporate governance institutionalist framework helps to reduce a country's level of corruption. She focuses on three aspects of corporate governance, which control opportunities for wide-scale corporate corruption: shareholder rights, the quality of the board of directors, and accounting, auditing, and transparency standards. She concludes that the Indonesian corporate governance framework is less stringent than in Malaysia and Thailand, which provides a favorable environment for corruption to persist in the country.

9 Conclusions

Indonesia is changing rapidly. This volume focused on the interplay between the macro-level changes as they followed in the wake of two decades of decentralization efforts in Indonesia and the micro-level decision-making processes in both the public and the private realm. Through explicating these macro–micro links in a variety of policy domains, the research reported in this book offers several distinct contributions to enhance our understanding of the impact of Indonesia's decentralization efforts on improving the sustainability of its society (Table 6).

At the macro-level of Indonesian society, we identify three important trends to understand the on-going process of decentralization and governance in Indonesia. First, our research in a wide variety of policy fields identifies an emerging variable geometry multi-level system within the formal government arrangements with local governments which are legally codified, include fiscal transfers, and involve formal accountability mechanisms. Earlier phases of decentralization foresaw a more uniform arrangement between the central and local governments. Later experience (and disappointment with the results) led to a reassessment and the creation of a greater variety of formal relationships and operational mechanisms between levels of government. This was partially due to the political reality of dealing with locally elected mayors and councils for the first time, and part of this was due to the experience with the interaction of the bureaucracies, which varied by policy area. A key challenge ahead is further development of the accountability mechanisms between the national and local levels, which takes into account the regional

Table 6 Decentralization and governance, and the challenges ahead

Mode of governance	Decentralization trend	Challenges ahead
Formal governance	Variable geometry multi-level governance	Strengthening accountability mechanisms
Informal governance	Hierarchy to network governance	Strengthening citizen and civil society input
Shared value creation and sustainable cooperation	From economic growth to inclusive growth	Increase effectiveness of governance
		Diffusion beyond Jakarta metro- to regional cities and rural areas
		Creation of sustainable society for future generations

and local variations and the political will expressed in the local democracy and national goals and standards.

Secondly, in terms of informal governance, we find a trend away from strictly hierarchical arrangements toward various networking arrangements. Depending on the policy area involved, there are varying degrees of input by citizens and civil society organizations at the national and local levels in Indonesia. In addition, we find various networking relationships emerging and strengthening in the country to the international community. There is an increase in the involvement, consultation, and joint goal setting by regional institutions like ASEAN and by the international community like the UN and the World Bank. In addition, networks linking cities in Indonesia to transnational municipal networks across the region have increased. The challenges ahead are to increase the input of citizen preferences and involvement of civil society organizations in the governing process and create institutions, processes, and norms that limit the opportunity for corruption.

Thirdly, our research notes a trend toward shared value creation and sustainable cooperation in government policy. Whereas earlier periods of policy making focused more exclusively on economic growth, there has recently been an increased focus on inclusive and sustainable growth involving broader parts of the society, as well as policies toward improving cooperation among and between government agencies and other societal stakeholders. This process has been apparent since at least the Indonesian government's response to the Asian financial crisis, but we expect this focus to accelerate under the new Indonesian government, based not only on the rhetoric of the election campaign, but also on the revised policy plans of the new government noted in the new five-year plan.

At the micro-level of decision-making processes, our contribution consists in the introduction of a general conceptual framework for the analysis of governance failure and a theory-based in-depth investigation of the pathways leading to such failures, as well as to their prevention and mitigation. We believe that this volume demonstrates the need for and fruitfulness of such a social mechanism approach in assessing the effectiveness or failure of different modes of governance. Another lesson to be drawn from the various chapters is that this explanatory strategy should be grounded in a sound behavioral theory, which is able to incorporate both self-interest and social preference motives of individual decision makers. More specifically, the majority of governance failures reported occur in the realm of building and maintaining cooperative relationships (e.g., between and within government agencies) and in the domain of intrinsic values concerning what citizens consider legitimate ends to strive for (e.g., inclusive as opposed to a narrow focus on economic growth). With many of the current structures in place being designed according to the principles of neo-institutional economic theory, policy makers and scholars may indeed benefit from the insights generated on the emergence and dynamics of informal governance structures.

Finally, it should be noted that the majority of solutions of governance failures reported in this book are organizational in nature. That is, they relate to very specific interventions in the design of authority relations, the distribution of responsibilities, workflow interdependencies, the implementation of procedures for coordination, communication, monitoring, and control, and fostering climates of mutual trust. Whereas some of these organizational changes required major restructuring efforts, others could be realized with relatively modest investments. Such relatively low-cost organizational pathways to compliant reform implementation reflect patterns found in other countries (Nieto Morales et al. 2015), and strengthening organizational capacity at all levels seems to be a promising avenue also for Indonesia's reform agenda.

We expect this book will be influential in both the academic and the policy communities that are interested in the links between patterns of governance and societal outcomes. Across many different policy areas, there is a distinct lack of research on the effectiveness of various governance structures and the linkages of accountability and responsibility of various levels of government to societal outcomes. There is a real need for this kind of research in middle-income developing countries, which are undergoing rapid change in their economies, governance systems, and societies. The editors and authors of this book would like to dedicate this book to the present and future generations of Indonesians who wish to live in a peaceful, growing, equitable, and democratic society.

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Chapter 2
Good Governance Contested: Exploring Human Rights and Sustainability as Normative Goals

Jilles L.J. Hazenberg

Abstract The governance of a society should ideally lead to its sustainability. This chapter sets out to shed light on the notions of good governance and sustainability that are, though often described as problematically vague, generally accepted goals of development. Good governance, by definition, proposes to be a guide towards the better execution and exercise of authority, power and rule making. Through an analysis of the most prominent uses of good governance in international development, an argument is given for the appreciation of the normative dimension of good governance: of what the good is. An assessment of critique levelled against the concept of good governance establishes that it suffers from vagueness and contestation. It will be argued that these problems are, at least minimally, due to the lack of normative foundation and overly economic outlook. A normative dimension should provide fundamental values that governance should adhere to for it to be called good. Furthermore, the argument is put forward that the concept of good governance is best grounded in the fundamental values underlying international legal human rights and the concept of social sustainability. The convergence of the values of status-egalitarianism, well-being and futurity establish the normative goal of good governance: to respect, protect and further status-egalitarianism and well-being into the indefinite future.

Keywords Good governance · Human rights · Social sustainability · Status-egalitarianism

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1 Introduction

The governance of a society should ideally lead to its sustainability. While many types of governance exist, this chapter will deal with only one of them: the public governance of a country. Governance is thus understood as the manner in which power is exercised in the management of public affairs and a country's social and economic resources. It is unclear, however, what manner of exercise or execution of power will contribute to a sustainable society. Moreover, it is unclear what precisely constitutes a sustainable society itself. This is at least partly due to the vagueness surrounding the concepts of governance and sustainability. This chapter will attempt to shed light on the concept of good governance towards a sustainable society. It focuses on the notion of good governance used in the international discourse on the social, political and economic development of countries. Good governance proposes to be a guide towards the better exercise or execution of power. Starting by assessing the widely used World Bank's governance indicators, an argument is given for the appreciation of the normative dimension of good governance: of what the good is.

To establish a firmer link between governance and a sustainable society, the central question this chapter sets out to answer is what fundamental values should be adhered to for governance to be evaluated as good. Answering this question can guide policy-makers and international organizations in evaluating policies on a more fundamental normative level through assessing their contribution to social sustainability. The chapter is divided into five sections. The first section will introduce the concepts of governance and good governance diachronically, i.e. based on their historical emergence and current literature. The second section analyses two strains of critique levelled against the practice of governance measurement through, primarily the World Bank's, governance indicators. These critiques establish the problems of vagueness and contestation concerning the concept of good governance. It will be argued that these problems can, at least minimally, be attributed to a lack of normative foundation and focus on outcomes. The third and fourth sections will deliver a positive argument in favour of informing the concept of good governance with the fundamental values underlying international legal human rights and the concept of social sustainability. Furthermore, it will show how these fundamental values can contribute to turning the practice of measuring governance towards a more consistent and normatively justified tool of policy prescriptions and evaluations. Finally, the fifth section offers a retort to the two strains of critique identified in the second section. The framework proposed is thus delineated along two lines. First, it concerns the normative grounding of good governance rather than its practical implementation. This theoretical argument concerns what the good in good governance is; this is assumed to be fundamental in contributing to the practical side of good governance in evaluating and proposing policy measures and in balancing trade-offs. Second, though the following will be critical in the current discourse and practice of good governance, the proposed framework is to be read as supplementing rather than replacing the current practice of good governance in international development.

2 Governance, Good Governance and Development

The notion of good governance plays a pivotal role in the international discourse on the social, political and economic development of countries after the Cold War's demise (hereafter: development discourse). The end of the Cold War brought with it the institutional[1] realization that the structural adjustment programmes (SAPs) issued by the Bretton Woods Institutions in the 1980s were failing. The SAPs effectively led to a race to the bottom in developing countries.[2] The SAPs comprised loans to developing nations conditioned by large-scale economic reforms. These reforms primarily consisted of large-scale privatization, a downscaling of government bureaucracies, opening the economy and promoting the influx of private and foreign capital into the economy. Despite assuming that such reforms would foster rapid growth,[3] the consequences of these reforms amounted to a downward spiral starting with capital-flight followed by increased borrowing by, often authoritarian, governments, increasing the indebtedness of societies leading to economic stagnation and recession.[4]

Recognizing the failure of the SAPs in the late 1980s led to a re-appreciation of the larger role that the government should play in shaping the right conditions for economic development. This explains the divergence between the most common concepts of governance and good governance, as it is used within the development discourse and institutional global governance. The first concepts of governance shift focus away from pure government-centred and hierarchical action towards the broader and expanding context in which rules and policies are drafted, implemented and adhered to in this globalizing world with the involvement of private actors, both in the form of public- and private-governance, (e.g. public–private partnerships) and through purely private governance. Typical examples of such private modes of governance are codes of conduct, certification and the sharing of best practices. As such, governance is best depicted as a move away from the state.[5] The second notion, good governance, has, at least within the development

[1]Critique voiced from various sources did exist long before.

[2]For an overview of the contents and a critique of the SAPs see Greenaway and Morrissey (1993, 241–261) and Schatz (1994, 679–692).

[3]As was the experience in the West in those years.

[4]This is commonly referred to as the unjustifiable borrowing privilege of authoritarian leaders. See Pogge (2008).

[5]Conception of governance along these lines are found in the academic fields of constitutional economics, social sciences, political science. For an overview and interpretations of these concepts in constitutional economics see Williamson (1979, 1985). Within social sciences see De Alcántara (1998) and within political science Bevir (2010, 2011) and Rhodes (1997).

discourse, a much stronger tie to government performance. Due to the re-appreciation of the role governments, especially in developing countries, play in shaping the right conditions for development and in setting the rules, good governance is used as a tool to assess government policies and effectiveness. This chapter concerns the second concept only. However, this does not imply that the argument presented here only applies to governance by government for two reasons. First, the core of the argument presented here can be transferred to analyse issues related to governance in the wider sense. Second, both conceptions of governance are essentially outcome based.[6] Conceptions differ in their descriptions of the place and manner in which these outcomes are, and ought to be, produced but are all concerned with the quality of ends. Good governance, however, ought to be an evaluative concept of both the outcome of governance and the means through which it is achieved and is, therefore, not necessarily limited to the evaluation of means and ends produced by a single actor, government in the present case. Hence, though not presented here as such, given the theme of the book, the framework in which to interpret good governance presented here can be transferred to private and public−private modes of governance.

Diachronically good governance can be seen as the successor of SAPs in conditioning aid to developing countries. Whereas the SAPs had a strong focus on economic liberalization, their lack of success put greater emphasis on the steering role that the governments can and should play. The World Bank was pivotal in establishing the concept of good governance and employing it to assess government rule and condition developmental aid accordingly. Subsequently, a wide variety of actors (supranational institutions, national governments and non-governmental organizations (NGOs)) have used notions of good governance in their own assessment of developing countries' governments and economies, and in conditioning aid and foreign investments. There is, however, lack of uniformity between the notions of good governance employed by different actors. This section will introduce the most prominent notions and works towards a consistent depiction of their content.

According to the World Bank, *governance* refers to the "process through which power is exercised to manage the collective affairs" and economic and social recourses of a country, nation, community or economy (World Bank 1994; Gisselquist 2012, 4).[7] Good governance, in turn, refers to the propriety of the manner in which this process is executed. Leading in the assessment of this execution are the World Bank's governance indicators[8] which played, and still play, a major

[6]Within political sciences concerning the wider notion of governance, this is often depicted with reference to the notion of output-legitimacy.

[7]The World Bank, UN, IMF (http://www.imf.org/external/np/exr/facts/gov.htm and http://www.imf.org/external/pubs/ft/exrp/govern/govindex.htm) and European Union (for the most elaborate statement by the EU see the White Paper on Governance: http://europa.eu/legislation_summaries/institutional_affairs/decisionmaking_process/l10109_en.htm) all work with similar definitions of good governance.

[8]See www.govindicators.org.

role in depicting six areas to assess the ‘goodness’ of a country’s governance. These areas are: (1) voice and accountability, (2) political stability and absence of violence, (3) government effectiveness, (4) regulatory quality, (5) rule of law and (6) control of corruption. Many other institutions have added further indicators or areas of assessment of their own. For instance, the United Nations Development Programme (UNDP) has a more prominent role for democracy. Moreover, many states, especially in Europe, add respect for human rights into the content of good governance (Gisselquist 2012, 23–27).[9]

This disparity between areas in which to assess the goodness of governance has led Gisselquist (2012) to incorporate the different definitions of good governance into seven core components: (1) democracy and representation, (2) human rights, (3) rule of law, (4) efficient and effective public management and (5) transparency and accountability. These five components are furthermore said to foster (6) developmental objectives through the prescription of a varying range of (7) social and economic policies such as returning elections and secure private property arrangements. The first and second components of Gisselquist’s definition require some further explanation. Democracy and representation are mentioned as such mainly by political organizations (e.g. national governments, the European Union, UN and NGOs). In contrast, the first component of the World Bank definition, voice and accountability, is a formulation frequented within financial institutions, like the World Bank and IMF, in order to refrain from interfering with political processes. However, these notions can generally be taken to refer the democratic institutions. In the definitions by, mainly, European governments, human rights are an explicit component of good governance while they are much less appealed to within supranational institutions.[10]

These definitions of good governance intend to provide the framework through which development can be evaluated and fostered. In practice, the World Bank’s indicators are the leading tool to assess the quality of a country’s governance. However, over the years and parallel to the successful spreading of the use of the concept of good governance, the amount of criticism towards this concept has been growing. Two strains of interrelated critique can be distilled and will be discussed in the next section. The first strain is related to the practice of the concept: its definitional vagueness, the validity of assumptions and what these imply for institutional proponents of good governance. The second strain concerns the economic outlook of good governance, constituting a more theoretical challenge to the economic consequentialism embedded in the evaluation of the ends that good governance ought to produce. The prominent position of international financial institutions creates an outlook primarily concerned with outcomes measurable

[9]To a great extent, this can be explained by the area in which the Bretton Woods institutions can issue prescriptions. These cannot be political, and thus the governance indicators can be seen as an attempt to depoliticize a political concept. See also: Doornbos (2001, 95).

[10]For an excellent overview of definitions and the role Human Rights play in definitions compare Table 2 and Table 3 of Gisselquist (2012, 23–27).

in economic terms. Consequently, the goal of development is framed in terms of economic growth. The first strain intends to undermine the practical relationship between good governance and development in the economic sense. The second strain directly argues against this economic focus on the aim of development. The next section is devoted to their analysis.

3 Criticism Against the Concept of Good Governance; Good Governance Versus Economic Growth

Two practical issues comprise the first strain of critique raised towards the concept of good governance while the second strain is of a more theoretical nature. Since the second strain clarifies the roots of the practical critique, it will be discussed first. The theoretical critique revolves around the development that good governance is meant to foster (Doornbos 2001; Grindle 2004, 2007; Kurtz and Schrank 2007; Gisselquist 2012). Due to being rooted in international financial institutions the ends of good governance are frequently depicted and evaluated in economic terms. Extending the reach of markets is, for instance, still at the core of the World Bank's vision and good governance should enable building institutions for markets as to foster growth (World Bank 2002). Consequently, the measurement of good governance is often depicted in terms of economic growth in developing countries. The critique against this is obvious and often heard from both academia and other supranational institutions. For instance, the UN high commissioner on human rights stated that good governance involves building institutions that respect human rights.[11] Furthermore, the UN more broadly defines development in terms of human well-being rather than in purely economic terms.

The critics' point is clear: good governance concerns more than achieving economic ends. However, supranational institutions like the UN fail to deliver a workable alternative definition of what constitutes good governance. For instance, improving human well-being might well be a defendable end of development, but what constitutes well-being? Is it meeting subsistence, constituting social respect, institutional respect for and protection of human rights, or a democratic constitution? Moreover, if one of these interpretations or all together, what is the justification? These are questions left unanswered causing more practical criticisms of the concept that will be briefly discussed.

The practical strain of critique can be divided into two. First, critics have pointed to the vagueness and conceptual brevity of good governance itself and especially the indicators that are used to measure it. Second, the causal relationships between the economic vision on development and individual components

[11] See: www.ohchr.org/en/Issues/Development/GoodGovernance/Pages/GoodGovernanceIndex.aspx (last visited on 22-9-2014).

of good governance are contested. The problem of conceptual brevity is forcefully brought forward by Gisselquist (2012, 14), who argues that even though conceptual brevity is not necessarily problematic, "it is so in this case because of the clearly contested nature of good governance and the complexity of its components". For instance, the World Bank's governance indicators, to date the most extensively used and developed tools in governance evaluation, are open to many different interpretations due to their lack of substance. What *government effectiveness* entails is not clear-cut but somehow it is still measured. There is a lack of parsimony concerning good governance and its components; their meaning is endless. As Langbein and Knack (2010) show, the different indicators are so interrelated that their measurement says little about actual performance. According to these researchers, the governance indicators list six separate components that due to their vagueness could be joined together to form just one or be eliminated entirely.

Kaufmann et al. (2007, 23–24), the authors of the governance indicators, have responded to these critics by arguing that their objections are "definitional nitpicking, furthering intellectual satisfaction" rather than achieving the end of development. Even though there is truth in the statement that the intellectual endeavour of constructing consistent concepts should not necessarily precede practical action, in this case the lack of parsimony and coherence is troublesome. It has led to cases in which a commitment to good governance can justify a wide range of outcomes that often oppose each other. A good example is the involvement of the UK Department for International Development (DFID) in Rwanda and the critique of Human Rights Watch (HRW) of their policies. The DFID claimed to be committed to good governance while HRW heavily criticized its policy because of the lack of improvement made on human rights observance and the transparency and responsiveness of governance (Human Rights Watch 2011, 6; Gisselquist 2012, 14). The DFID could rebut by pointing to the economic advances and institutional strengthening in Rwanda through its policies. One cause of such a situation where opposing views can both consistently refer to good governance as justifying the opposing policies is, at least partly, the vagueness and lack of parsimony of the end to be achieved and the means employed.

The problem of causal relations is brought forward by authors such as Andrews (2008), Langbein and Knack (2010), Grindle (2004, 2007) and Gisselquist (2012), who argue that institutions like the World Bank do not abide by their own terms in promoting and evaluating good governance. The consequentialism enclosed in the concept is shaky. Good governance is an evaluative concept regarding the outcomes of development. These outcomes are, within the most prominent conception, depicted in economic terms thereby constituting a prescription for policies fostering economic development. In other words, the components of good governance are not good in itself but, at least partly, instrumentally good. However, if good governance is supposed to foster economic growth, why are indicators such as voice and accountability included in the evaluation? It is not clear that democratic governance enhances economic development and the cases that run counter are afloat. For instance, Vietnam has seen many years of economic growth without any increase in democratic governance. This argument also holds in the opposite direction; if good governance means, promoting democratic institutions, amongst others, why do countries like the United Arab Emirates and Bahrein, lacking democratic institutions, score so high on the over-all governance indicators? (see Footnote 5).

These lines of critique cause confusion. As Andrews (2008, 380) stated, good governance implies so many things it is like "telling developing countries that the best way to develop is to become developed". The inclusion of a whole range of policies, values and institutions implies that the outcome of good governance strives to include more than economic evaluation of ends but, moreover, the normative evaluation of both the end and the means employed towards its achievement. For instance, human rights protection and democratization are often included whether they contribute to economic growth or not. On balance, if, good governance refers to all these aspects, such as economic growth, human rights and democratization simultaneously, it is next to impossible to translate it into policies and measurements. The challenge is to integrate these normative conceptions into the evaluation of both means and ends rather than with sole regard to outcomes. For example, decentralization might improve effectiveness, local democracy and accountability, as commonly assumed, but can decrease growth; more transparency might foster accountability but it could also increase inefficiency due to the amount of information that needs to be processed through bureaucracies. As such, the idea of good governance as a prescription for policy is comparable to Finkelstein's (1995, 398) spaghetti bowl in the sense that no one can possibly know what is connected to what. The next section intends to untangle this concept and focus on its normative aspect in order to reconstruct it in such a manner that the concept is no longer open to the mentioned strains of critique.

4 The Good of Governance: Towards a New Framework

The previous section urges a more fundamental concern regarding the *good* that good governance evaluates and the development it depicts. Due to its lack of concreteness, the link between good governance and development, as presented by different institutions, is nothing more than a belief because it is far from clear what type of development good governance aims for. Furthermore, from the literature critical on the institutional use of good governance rises a concern with the flexibility of the concept in appealing to diverse interests, goals and policies. The good governance discourse opens itself to the above critique due to its lack of normative goal setting; there is no clear understanding of its aim and why that aim and the means towards it are normatively good. Consequently, good governance appears to be failing as instrument evaluating policy because it lacks a consistent conception of what is meant by the good of governance. This section will explore this normative caveat.

A leading institution like the World Bank depicts development primarily in terms of enabling economic growth. However, the policies prescribed through good governance do not necessarily lead to economic growth, or at least not in the most efficient and effective manner (Kurtz and Schrank 2007; Gisselquist 2012). Other institutions equate good governance with democratic governance but if this is the case, the good should be found in the intrinsic worth of democratic governance, which can be done, and not just as a means to achieve development. Neither justification is consistently put forward.[12] In its simplest form within the concept of good governance, there appears to be a mismatch between the means, such as democratic institutions, and the end, such as economic prosperity, of development. It provides little guidance in evaluating the ends set and the means employed towards its achievement. The concept lacks a normative basis that has intrinsic rather than solely instrumental worth, whether the derivative policies are the most effective or fastest way to development or not, in order to evaluate both means and ends. Such normative goal-setting requires a different mode of reasoning than the prescription and instrumental evaluation of policies does. First, it needs to form a conception of what sort of development good governance should strive for in isolation of existing policies and institutional arrangements of developing countries. Second, it needs to justify this conception with reference to moral conceptions in a consistent manner. Third, such a goal can only be legitimately set, which implies that the morals it appeals to and the type of development it furthers must be theoretically legitimized to anyone (Universalist) or those affected by it (all-affected).

The previous places limits on the scope of the argument forwarded in the remainder of this chapter. The argument functions on an abstract, normative level rather than the level of practice in order to inform the evaluative concept of good governance with context-independent values in assessing the exercise and execution of power. Thereby it intends to reconstruct the evaluative concept of good governance by incorporating a normative component that supplements its instrumental focus on ends and, ultimately, enables a more consistent and critical policy evaluation. Despite its elasticity and lack of consensus as to its meaning, good governance is a powerful concept in the international development discourse in general and more specifically in donor-country relations. Looking at it from a purely semantic standpoint, good governance is a normative statement on the manner in which power is exercised or executed. *Good* refers to a statement not only about the quality of exercise or execution from a practical standpoint: is it effective, efficient, accountable and so forth, but also on why these aims and the means to its achievement are normatively good in relation to the exercise or execution of power.

Without such a normative basis, the concept of good governance is of great use in "persuasion, political debate and all form of rhetoric" (Simon 1946, 53), but less helpful in evaluating governance as normatively good in a legitimate and

[12]For instance, the UNDP (2002, 3) uses an intriguingly circular argument stating that human rights and democracy promote development because "enjoying political freedom and participating in the decisions that shape one's life are fundamental human rights". In this statement, there is no argument explaining either why these are fundamental rights or how democratic governance promotes development.

justifiable manner. In the following, it will be argued that two concepts already present in the international development discourse can be used in formulating normative bases for good governance: social sustainability and human rights. Social sustainability depicts the end of governance as sustainable development and human rights, the legitimate values that constitute a threshold on both the employed means and the end of sustainable development. With such a normative basis, the two above-described strains of criticism can be fruitfully countered.

4.1 Sustainability and International Legal Human Rights[13]

To search for the normative grounds of good governance in places as contested as good governance itself appears puzzling. Sustainability and international legal human rights, however, can perform this function through a relatively uncontroversial interpretation of the values expressed by those concepts. Sustainability and human rights are often included in conceptions of development. An investigation and new interpretation of those concepts is, therefore, appropriate when considering the normativity of good governance. However, both sustainability and human rights exist in multiple conceptions and it matters whether it is economic or social sustainability or human rights in a moral or legal context that is discussed. This section clarifies the interpretations of sustainability and human rights in this chapter and the relation between them before moving to the substantive normative argument on the good of good governance in the next.

The idea of sustainability has a strong dual focus on natural limits of growth and futurity. Furthermore, a sustainable society or sustainable development is a widely accepted goal of international development. Since the Brundtland commission published its influential report *Our Common Future* (WCED 1987) and coined the term "sustainable development," the notion of futurity has been central in developmental concerns. Futurity exemplifies the notion that development is not solely concerned with short-term improvements in economic growth, but also with improvements that are lasting and cater the needs of everyone in which priority should be given to the worst off in societies (WCED 1987, 41). According to the commission's highly influential definition, "sustainable development is development that meets the needs of the present without compromising the ability of

[13]The term *international legal human rights* is borrowed from Allen Buchanan (2013). In his work, it functions as an argument against the mirroring view of human rights which sees codified human rights as the legal mirror of an antecedent moral right. Differentiating between moral and legal human rights in this paper enables circumventing the discussion regarding the moral foundations of human rights because a mirroring view is neither a sufficient nor necessary conditions for the practice of international legal human rights to exist and continue to exist. Though I am sympathetic to Buchanan's argument regarding the status of theories which seek to justify human rights through reference to underlying moral rights the argument presented here is fully compatible with a mirroring view. See Footnote 12.

future generations to meet theirs" (WCED 1987, 41). Similarly, to good governance, there is no clear and uncontested meaning of sustainability and neither will there be argued for one within this chapter. Alternatively, advantage will be taken from the general acceptance of the value of futurity. As such, sustainable development can inform and supplement the evaluative concept of good governance with both a clearer depiction and a stronger focus on long-term development, i.e. sustainable development. Moreover, it places two intuitive limits on how to achieve it, within environmental limits and without compromising the ability of individuals to meet their needs.

The use of international legal human rights requires explanation in discussions of normative grounding since human rights in their philosophical understanding of moral rights (hereafter: moral human rights) seem intuitively better equipped to perform the task of normative goal-setting. Moral human rights refer to natural rights individuals have in virtue of their humanity that exists outside of any institutional arrangement.[14] Furthermore, moral human rights are those rights that assign duties on specific others to take the actions necessary for others to enjoy the content of the mentioned right. These duties can entail both positive and negative tasks. International legal human rights, on the other hand, are human rights that individuals have through the various national or international sources of human rights such as declarations, treaties and charters and through the judicial interpretations of these documents. They are distinct from moral rights in the sense that a legal human right does not need a corresponding natural human right for it to exist.[15] Furthermore, legal human rights have institutional legitimacy where moral human rights have to be legitimized by bottom-up moral reasoning.

Favouring legal human rights over moral human rights in providing good governance with a normative basis has two great benefits. First, the legal discourse has the significant advantage that it enables appeals to normative considerations from an accepted institutional position. Claims about substantive moral norms are tied to foundational controversies that are nearly unresolvable. An appeal to international legal human rights thus enables one to make appeals to values and moral norms from an institutionally accepted position without stirring up foundational controversies. Furthermore, the institutional embedding of legal human rights, besides circumventing foundational moral contestation, has the advantage of catering to pluralist concerns. Unlike moral human rights, legal human rights can be justified from many different ethical perspectives and there is no need to

[14]For a prominent advocate of this view see: Griffin (2008) in which he argues that only moral human rights can ground legal human rights.

[15]This does not necessarily say anything about their legitimacy since the factual situation that something is never settles the question whether it ought to be. Here I will, however, remain silent regarding the question whether corresponding moral rights are required to legitimize the existing legal rights since it is beyond the scope of this chapter. Thus the view that 'legal human rights' simply acknowledge the 'moral human rights' we have in virtue of our humanity is still wholly plausible within the argument put forward in this chapter.

further discuss the 'best' moral justification for any right since many can exist, and in these multiple justifications, the values expressed by legal human rights remain valid. Relying on a plural justification, legal human rights are better equipped against charges of parochialism and can provide normative grounds to good governance without having to engage in foundational debates while being able to appeal to universally justifiable values. These advantages of the legal human rights framework will be discussed further in the next section.

The social aspects of sustainability, nurturing human development and advancing it into the future, is, at minimum, best captured with respect to legal human rights for two reasons. First, legal rights have longevity to them that both public and private policies do not possess. They must be respected, protected and provided for by the relevant actors for as long the rights exist, and it is very improbable that the legal sources of human rights will cease to exist. Therefore, the futurity captured by the idea of sustainability is best transposed to practice through a legal framework. Second, one striking feature of the idea of sustainability is that due to its vagueness, it is relatively benign for a multitude of actors, public but especially private, to commit to. The openness of the concept "represent[s] an important political opportunity" (Robinson 2004, 374) has also given rise to cosmetic and superficial sustainability measures. Interpreting the goal of social sustainability through the different duties legal human rights create brings with it a more substantive commitment to, at minimum, protect the rights of individuals. This is not to say that the idea of sustainability only represents human rights protection; the concept is broader and assigns duties to a wider range of actors than human rights do.[16] However, at minimum, a non-legal commitment not to interfere with the fundamental rights of individuals by all actors is a necessary component of a sustainable society. This does not imply that all actors are under perfect positive human right duties but rather that a lack of respect from human rights by all actors infringes upon the sustainability of a society. It seems counterintuitive, for instance, to conceive of any society worth of the adjective sustainable, if it leaves basic rights severely under-protected and infringed upon a regular basis.

4.2 Good Governance, Status-Egalitarianism and Well-Being

This section will argue that in order to give the concept of good governance more substantive and consistent meaning outside of economic instrumentalism, it needs to refer to certain normative values that can inform the practical side of the

[16]Within international legal human rights states are specified as duty-bearer. Moreover, the duties specified by legal human rights are perfect duties, otherwise no right exists. The concept of sustainability, on the other hand, functions well with imperfect duties that apply to a much broader range of actors than the perfect human rights duties falling on states alone.

concept with context-independent worth. Such context-independent worth appeals to values not tied to any particular context or practicality. It thereby supplements the concept of good governance with a strong normative dimension beyond its instrumental goal-oriented evaluations. This will benefit the idea of good governance by informing it with normative values from an independent standpoint, making it less prone to critique aimed at the consequentialist economic reasoning behind many good governance measures. Moreover, it will also alter the shape of good governance, moving it away from economic concerns to a more human-centred conception of growth and development.[17]

Asking the question what aim of good governance after its consequentialist sequence of economic growth has run out is as necessary as it is dangerous. On the one hand, it is necessary because it is of fundamental concern to people living in developing countries whose lives are shaped by the enforcement of good governance measures; it needs to be clarified and justified. On the other hand, it is dangerous because it can lead into the terrain of essentially contested utopias, which often have certain illiberal tendencies. In order to avoid entering this terrain, the notion of sustainability and international legal human rights were already introduced. These are institutionally accepted values that can both confer legitimacy, in the case of legal human rights, and provide a goal, both sustainability and legal human rights, to the concept of good governance. The chief function of international legal human rights is to curb the sovereignty of states by posing universal constraints on their conduct as primary coercive institution. The other functions, as recently argued for by Buchanan (2013, 68), of international legal human rights are to "constrain sovereignty for the purposes of affirming and promoting the equal basic status of all people and helping to ensure that all have the opportunity to lead a minimally good or decent life by providing protections and resources that are generally needed for such a life".

The system of international legal human rights thus protects two fundamental values for individuals as social beings:[18] (1) their equal status and a (2) minimum of equal well-being. These two functions, the status-egalitarian and well-being function, are reflected in the system of international legal human rights. Through a brief elaboration of the content of the status-egalitarian and the well-being function, this section will show how these values can provide the normative ground for good governance. Ultimately, it will be argued that these values must be considered in evaluating the exercise or execution of power and in promoting both the end of development and the proposed means to achieve it, thereby placing a limit on what constitutes good governance.

Status-egalitarianism implies the equal standing of individuals before institutions. It refers to the function that human rights play in affirming such basic equal

[17]The present argument is thus not one replacing the 'old' framework for a 'new' one but argues for supplementing the current framework with a normative dimension.

[18]Here Buchanan's (2013) interpretation of the functions of our system of international legal human rights is followed.

standing of all reflected in the universality of human rights: everyone has these rights regardless of sex, race, contribution, belief, etc. Furthermore, these rights have the same content and weight for everyone. Consequently, states have the duty to ensure that all citizens enjoy the content of these rights by guaranteeing, among other possible measures, equality before the law and adopting strong rights against discrimination. Separate from this status-egalitarian function is the well-being function of legal human rights. From the Universal Declaration (United Nations 1948) onwards, the system of international legal human rights has required states to perform positive duties to promote the well-being of its citizens. These include rights to social security, rest and leisure, an adequate standard of living including food, shelter and education. As Buchanan (2013, 32–36) notes, it is important to distinguish these two functions of legal human rights because, as is often done, a focus on the well-being function alone can justify very discriminatory practices. Thus, proponents of a very minimal interpretation of human rights as subsistence rights must also affirm the status-egalitarian function, and include the corresponding rights into their conception.[19] Otherwise, the content and/or weight of the welfare rights can differ amongst individuals. Despite the fundamental importance of these values in limiting the sovereignty of states, its relation with the concept of good governance might not be clear from the onset.

Status-egalitarianism and well-being, as values underlying the system of international legal human rights, are appropriate and needed norms in formulating the aim and welfare of governance for two reasons. They are appropriate because they converge with existing notions of good governance and needed in providing the normative grounds necessary to make its measures consistent and justifiable. The core components of good governance, as the World Bank formulates them, are (1) voice and accountability, (2) political stability and absence of violence, (3) government effectiveness, (4) regulatory quality, (5) Rule of law and (6) control of corruption. Other diverging concepts of good governance include human rights. Focussing on the World Bank's conception is justified due to its dominant role in the discourse. Moreover, a focus on the World Bank's conception shows how the argument put forward does not simply equate good governance with human rights protection, but recognizes both as instruments capable of promoting the same values. Status-egalitarianism can be viewed as representing and grounding a number of good governance components. Status-egalitarianism is promoted through equal democratic politics (Voice and Accountability), equal treatment for the law (Rule of Law) and the equal treatment by government officials (Control of Corruption). The well-being function can be furthermore seen as grounding and being enforced by political stability and the absence of violence; a precondition to a minimally good life. The same is true of government effectiveness and regulatory quality; without these, the values of status-egalitarianism and well-being cannot be brought to fruition. This convergence shows that the values underlying the system of

[19]Two prominent examples of such minimal well-being approaches are: Shue (1980) and Nickel (1987).

international legal human rights are appropriately reflected by the measures, even though minimally, depicted in the discourse of good governance.

The previous established the convergence between the values underlying international legal human rights and the components of good governance. However, now the question arises concerning what these values provide content-wise or practically in evaluating governance. One might object this merely constitutes the legalization of good governance by presenting it as part of the system of international legal human rights. To this, the reply must be a strong negative one. There is a fundamental difference between the discourse of international development in which good governance plays an important role and the legal discourse of international human rights. The latter is a *legal* framework and the former a *development* framework. In other words, good governance is not reduced to a human rights enforcement tool but can be interpreted in such a way that it represents and is grounded by the same normative values and performing the function of protecting, respecting and furthering these values. Governance is, furthermore, a broader notion than legal human rights. Good governance concerns all policies that a government enacts (see Footnote 2), fostering economic growth, minimalize unemployment, etc. and not just human rights. Moreover, most of these are not human rights concerns, (i.e. there is no[20] human right to economic growth or an increasing share of GDP) and fare well under the current framework. However, the converging normative values of legal human rights and good governance put important constraints upon the policies governments enact, i.e. on their governance.

In this sense, it is helpful to think of status-egalitarianism and the well-being function as the evaluative threshold of good governance requiring evaluating its components (ends) and the path towards it from a normative standpoint besides the dominant instrumental line of reasoning. The rough contours that these values sketch protect rights of individuals as social beings into the future, catering the need for sustainable development. As such, it constitutes the type of development aimed for; to respect, protect and further the values of status-egalitarianism and well-being into the indefinite future.[21] Consequently, policies and practices undermining these values cannot be deemed ‘good’ within this amended framework. Therefore, rather than the equation of good governance with human rights protection, as done by the Human Rights Council of Australia (1995) and the office of the High Commissioner on human rights,[22] good governance works towards respect of the same underlying values. Practically, this will mean that it leads to more robust protection of human rights among a wide-range of outcomes since the development discourse is not one concerned solely with human rights protection.

[20]Moral nor legal.

[21]It is conceded that an instrumental evaluation in terms of economic prosperity is an essential component since economic growth is crucial to development.

[22]See: www.ohchr.org/en/Issues/Development/GoodGovernance/Pages/GoodGovernanceIndex.aspx.

With regard to the economic consequentialism in current measurements of governance, the values of status-egalitarianism and well-being build the fundament on which it can be normatively grounded. As stated, much of the indicators are used as instrumental to the greater good of economic development. Grounded in the values underlying international (legal) human rights the instrumentality of the concept is reduced since appeals must be made to both normative values and economic consequences. Thus, democratic institution building, for instance, is included and justified for its ability to establish equal standing rather than because of its presumed economic beneficial consequences. Moreover, economically beneficial measures must be justified in reference to the normative foundation thus; for instance, a call for privatization must evaluate consequences with respect to the values of status-egalitarianism and well-being. Content-wise grounding the concept of good governance in the content-independent normative values underlying international legal human rights places more emphasis on human development as opposed to economic or institutional development. It promises to be a powerful tool to assess governments with respect to these values. Furthermore, if any proposed policy interferes with human rights, it can be seen as indication of 'bad' governance since it fails to respect, protect and further the underlying values. Moreover, the concept of good governance leads to more consistent measures due to the exclusion of policies undermining either one of the values or legal human rights in general.

With regard to the legitimacy of this normative basis, international (legal) human rights can, and must, play a double role. Just as states increase their own internal legitimacy through signing and ratifying human rights treaties, international developmental policies grounded in the same values as international (legal) human rights confers legitimacy to these policies directly.[23] In the next section, I will briefly discuss this practical impact and what room for political debate concerning policies there is left.

5 Good Governance: Policy Evaluation

Good governance, as sketched within the reconstructed framework, is an anthropocentric rather than economic conception of development. The governance of a country's social and economic resources is to further the well-being of its citizens and to establish their legal and cultural equality. Good governance places restrictions upon governance and pressures rule-makers to sufficiently justify their policies and international organizations to explain and justify their policy prescriptions and evaluations. For instance, in the currently dominant conceptions of good governance, decentralization is often taken as an example of good governance

[23] For a more elaborate statement on this legitimizing function of human rights see Buchanan (2013, 263–267).

because it brings rule-making closer to the people, thereby increasing voice and accountability as well as effectiveness. However, these measures often lack justification beyond an appeal to assumptions concerning the effects of decentralization. Normative foundations can function as a safeguard against such beliefs. Both the means towards and the end of decentralization might improve effectiveness in certain situation but can undermine respecting status-egalitarianism and protecting well-being when local courts and parliaments are given more power. Some of these local communities might not have the legal infrastructure to guarantee access to justice for all, or a country might well undermine the well-being of people due to the local inabilities to guarantee basic health care when its government decentralizes its already minimal and inadequate healthcare in order to improve its services. Grounding good governance puts limits on the consequentialist means-end reasoning by subjecting both means and ends to normative evaluation.

Besides more clearly defining the outcome of good governance envisages, the proposed framework provides better tools to NGOs to perform their power of oversight. Grounded in the values underlying international (legal) human rights, the proposed framework better equips them to subject government practice to evaluation and criticism. For instance, a country like Rwanda has limited state capacity, a very small number of human rights are respected, and minimal individual well-being. After receiving aid conditioned by good governance prescriptions, it is more than likely that human rights will remain under-protected for the simple reason that a whole state apparatus, including a minimal welfare-state, has to be in place to respect and protect human rights. While NGOs often criticize states and donors for failing to respect human rights, within this framework, these NGOs can more carefully assess whether the good promoted through these donor-relationships respects, protects and further status-egalitarianism and well-being. As such, the framework enables NGOs, besides the much needed naming and shaming, to deliver more constructive critiques in assessing whether the governance promoted through international institutions and implemented by governments of developing countries is worthy of the adjective ‘good’.

In this framework, however, one might claim that there is no room for politics, i.e. for substantial choices to be made concerning the policies a government intends to implement because the aim of policy is imposed top-down. However, by making explicit that the values of status-egalitarianism and well-being can be respected, protected and furthered through a wide-range of policies, there is ample room for political bargaining. A strong (neo-) liberal approach to development, i.e. the prescription of large-scale privatization, decentralization and strong reliance on development through market mechanisms, is often said to undermine the well-being of the worst off in society. Although it is true that such measures tend to increase inequality, it can be argued that these measures also promote the well-being of all because the worst are often left better off than their original position. While this vision on development is not necessarily in conflict with the values of status-egalitarianism and well-being, it is true that increasing inequality tends to disrupt societies and increase the likelihood of instability.

The opposite also holds; a more left-wing approach to development can go a long way without undermining status-egalitarianism and is often better equipped to promote equal minimal well-being in the form of a modest welfare-state. However, such approaches are also prone to undermine status-egalitarianism when large amounts of welfare are redistributed fostering social unrest. As such, good governance grounded by status-egalitarianism and well-being can be implemented through a wide-range of policies and those are up to political bargaining and compromise through democratic politics. The contribution of the reconstructed framework is the need to evaluate and justify policies on a moral as well as economic consequential basis. It thereby constitutes a fuller understanding of what good governance is.

6 Conclusions

This chapter set out to uncover the fundamental values governance should adhere to in order for it to be called good. In conclusion, we can return to the two strains of critique levelled against good governance: (1) the practical side of the concept, especially its definitional vagueness and (2) on the economic consequentialism of good governance and lack of aim besides economic growth. These critiques challenged defining economic growth as good in itself. This chapter has been sympathetic to both these strains but added a more constructive argument to the discussion. With the reconstructed framework, the two strains of critique can be responded to in a constructive manner.

The first strain of criticism can be fruitfully addressed through the proposed framework for two reasons. First, the concept of good governance is grounded in normative values and thereby defines a common fundamental denominator. Though not proposing a fixed content of the concept, such an endeavour would be impossible and undesirable,[24] the framework lessens the burden of vagueness by grounding good governance in normative values constitutive of the good, thereby enabling a better measurement of it. Second, the strong focus, through legal human rights and a concern with sustainability, supplies good governance with an egalitarian human centred core. Thus, despite any remaining definitional vagueness, the aims are defined more clearly and the outcome of economic growth is no longer sufficient to count as good governance. Moreover, the inclusion of non-economic indicators, such as voice and accountability, are justified by appeal to normative values rather than assumed economic outcomes. In general, the proposed normative basis is concerned with human well-being and such a basis reduces the space in which definitions can be proposed since they must refer to these values or argue for new ones.

[24] This is impossible because of the wide-range of actors that have to agree upon such a definition and undesirable due to closing the opportunity to appeal to a wide-range of actors.

The root of the second strain of critique, the economic consequentialism, lies in the mandate of the World Bank and the IMF which are obliged to refrain from interfering with political processes and focus solely on economic matters. The interpretation of this mandate has grown wider over the years in response to increasing awareness of the role the state plays in fostering economic growth and prosperity. However, the concept of good governance prescribes policies to areas conducive to more than economic growth. Therefore, the reconstructed framework justifies the challenges against the economic outlook because it interferes with social policies directed at other aims than economic growth. The framework, with its grounding in legal human rights and sustainability through rights protection, exchanges this economic goal for a normative one. The good that governance aims to achieve is no longer exhausted by economic prosperity but by respecting, protecting and furthering values of status-egalitarianism and well-being into the indefinite future. These fundamental values function as a verification on policy prescription directed at economic improvement and the measurement of the good no longer has to rely on economic consequentialism but on a broader human understanding of development.

The framework, however, leaves a number of questions unanswered and opens up paths of further research. First, the limits of the normative additions to the framework must be restated. The theoretical distance to practice of the reconstructed framework is concerned in the first place with clarifying the concept of good governance rather than its practice though it intends to inform this practice and substantially reform it. Second, the governance of a country and policy implementation is always a balancing act in which trade-offs have to be made. The proposed additions put a threshold on good governance measures as a whole, rather than providing a clear tool in balancing interests. The practical implication of this reconstruction must, therefore, be assessed critically in future research.

In conclusion, the proposed novel interpretation of sustainability and the normative values underlying our system of international legal human rights has the ability to overcome the critique against both the concept and practice of good governance. The argument put forward is that the aim of good governance goes beyond the often criticized economic outlook supplementing it with enabling respect, protection and furthering status-egalitarianism and well-being into the indefinite future. This normative goal provides good governance with a more consistent and less economical consequentialist practice and successfully counters the main sources of criticism directed against the institutional practice of good governance, thereby constituting the good that governance should aim for, adhere to and evaluate from.

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Part II
Decentralization and Policy Making

Chapter 3
Decentralization and Primary Health Care Innovations in Indonesia

Suwatin Miharti, Ronald L. Holzhacker and Rafael Wittek

Abstract A well-functioning primary health care system (PHCS) is fundamental for a nation's overall health performance. PHCSs are designed to improve universal access to health care, which likely leads to healthier communities, higher quality of care, and a more effective and efficient health care system. The present chapter investigates how the two large-scale decentralization waves in Indonesia affected the processes, product and structural innovations in its PHCS. We argue that adequate organizational capacity and local level innovations are a major requirement to improve the performance of a PHCS. The study uses the decision space approach (DSA) to analyse the impact of decentralization on the decision space, accountability mechanisms and organizational capacity to facilitate health improvement. To achieve the aim, first, the study uses institutional analysis to describe the transformation of the decision space and accountability mechanism from the first and second waves of decentralization based on changes to laws and regulations. Second, the study investigates the sequence of innovation of PHCS by analysing studies on cases of innovation in the two waves of decentralization. The study found that the first wave of decentralization in Indonesia resulted in institutional changes that were detrimental to innovation. Whereas discretion for

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local-level decision makers increased compared to the situation under the former centralized system, requirements for accountability did not. This pattern was reversed during the second wave of decentralization, suggesting that the conditions for innovation have improved. The cases of successful innovation share a specific combination of initiative, commitment and social capital of a key decision maker as a fundamental enabler of innovation.

Keywords Primary health care · Decentralization · Local government · Innovation · Decision space · Accountability mechanism · Organizational capacity

1 Introduction

A well-functioning primary health care system (PHCS) is a fundamental precondition for a nation's overall health performance. PHCSs are designed to improve universal access to health care, which in turn leads to healthier communities (Starfield et al. 2005), higher quality of care (Kringos et al. 2010) and a more effective and efficient health care system (Kruk et al. 2010). Consequently, many countries conduct public health reforms in an attempt to strengthen their PHCS (OECD 2012). Such reforms in the health sector are often embedded in a broader context of large-scale decentralization (Bossert 1998; Jimenez-Rubio 2011a, b; Trubek and Das 2003). However, relatively little is known about how decentralization affects the performance of a PHCS.

The present chapter investigates how the two large-scale decentralization waves in Indonesia affected one specific aspect of the country's health sector performance: its potential to introduce process, product, and structural innovations in its PHCS. We argue that local level innovations are a major requirement to improve the performance of a PHCS. Drawing on an in-depth analysis of institutional changes between the two phases of decentralization and selected case studies, we show that the first wave of decentralization in Indonesia actually resulted in institutional changes that were detrimental for innovation. Whereas discretion for local-level decision makers increased compared to the situation in the centralized system, but requirements for accountability did not. This pattern was reversed during the second wave of decentralization, suggesting that the conditions for innovation have improved. The rare cases of innovation, which did occur in both waves, share a specific combination of initiative, commitment, and social capital of a key decision maker.

In theory, decentralization enables public sector decision makers and providers to responsively adapt to dynamic local conditions (Arrow 1963), particularly in highly complex settings like the health sector (Plsek and Greenhalgh 2001; Mitchel and Bossert 2010). In practice, decentralization is a multi-dimensional phenomenon that complicates an assessment of its impact on health care performance (Jimenez-Rubio 2010; Martínez and Rodríguez-Zamora 2011). At least three policy domains are at the core of decentralization efforts (Cheema and Rondinelli 2007). First, administrative decentralization increases the local government's policy-making power. Second, fiscal decentralization entitles local governments to collect revenue and decide about its allocation. Finally, political decentralization in the form of direct elections of the head of the local executive body significantly increases community members' voice and influence on the local political system (Cheema and Rondinelli 2007).

Despite the multi-dimensional nature of this phenomenon, most studies focused on the impact of fiscal decentralization only, arguing that fiscal decentralization is the best indicator to measure the degree of decentralization (Jimenez-Rubio 2011a, b). Many of these studies have indeed found a positive relationship between the degree of fiscal decentralization and a variety of health outcomes. For example, fiscal decentralization reduced infant mortality in several countries, including China, India and OECD countries (e.g. Jimenez-Rubio 2011a, b). Other studies showed that fiscal decentralization can have positive effects if specific conditions are present, like an institutional capacity to respond to local ethno-linguistic fractionalization (Robalino et al. 2001), recruitment of more physicians (Cantarero and Pascual 2007) and improved socio-economic condition of localities (Soto et al. 2012).

Though this research has made much progress in improving our understanding of the effect of decentralization on the performance of the health care system, several gaps still remain. First, evidence on the impact of fiscal decentralization on health is still mixed, since there are also studies that did not find any link between decentralization and improvement of health performance (Martínez and Rodríguez-Zamora 2011). Second, these studies also show that the effect of fiscal decentralization is contingent upon administrative and political decentralization. However, due to the almost exclusive focus on fiscal decentralization, little is known about the impact of administrative and political decentralization. Third, previous research neglected to answer the question under which conditions will decentralization result in local health care system innovations, which is the key for improving overall health care performance (Bossert 1998).

1.1 Research Question

We define innovation as "the intentional introduction and application within a role, group, or organization, of ideas, process, product and procedures new to the relevant unit of adoption, designed to significantly benefit the individual, the group or wider society" (West 1990). This definition extends the conceptualization of innovation as the application of new products, to innovation as the attempt to improve the performance of the health care system through new processes and structures. Product innovation is related to new types of service to a Community Health Centre's (CHC) stakeholders (such as services for aging people, specialist clinic). Process innovation refers to new delivery methods (e.g. payment procedures), and structure innovation relates to the creation of new internal and external infrastructures. Such innovations can occur both at the level of the district, and at the level of the organization (i.e. the PHCs).

Consequently, our main research question reads "Under which conditions does decentralization of the Indonesian public health sector favour innovations at the district and organization (CHC) level?"

1.2 Social and Scientific Significance

Improving access to health care is one of the major challenges of any country's attempt to build a more sustainable society, and many observers consider persistent or even increasing socio-economic inequalities in health as one of the major threats for a country's social and economic development. However, policy makers still have to rely on very limited evidence on which to base their decisions. Decentralization provides them with the decision space for more effective health care institutions. On the other hand, the increased autonomy and discretion also confronts them with the problem of having to choose from a large set of potential interventions. For many of these possible interventions, little to no systematic information is available concerning the context conditions under which they might be effective and efficient, nor are the mechanisms through which they work well-understood (Fleuren et al. 2004). The present study contributes to closing this gap.

1.3 Research Methods and Data

Indonesia's two waves of decentralization create the opportunity for a detailed comparative examination of how different institutional arrangements may affect health care innovation within the same socio-cultural context. Our analytical strategy, therefore, consists of two elements. First, we use the tools of comparative institutional analysis to map how key institutional dimensions in the health sector changed from the first to the second wave of decentralization. In order to identify these key dimensions, we build on the Decision Space Approach (DSA), a theoretical framework that was developed to analyse the effects of decentralization (Bossert 1998; Mitchel and Bossert 2010; Bossert and Mitchell 2011). Policy documents and administrative regulations are our major source for applying this framework to the Indonesian case. Second, given the paucity of health care innovations in the Indonesian system, we submit the few cases where innovation reportedly did occur upon closer scrutiny. In this case analytic step, our strategy is to uncover possible commonalities in the conditions for and the pathways to innovation during both waves of decentralization. Our main data sources for this step are earlier case study descriptions and media accounts.

In what follows, we first give some background information on Indonesia's PHCS and the main elements of decentralization. We then sketch our analytical framework, the DSA, followed by sections on institutional analysis and case analysis. We conclude with a discussion of the innovation potential of the current Indonesian health care system.

2 Indonesia's Primary Health Care System under Decentralization

2.1 The Primary Health Care System

The Indonesian health care system was designed to implement the constitutional mandate to maintain and protect citizens' health status by providing accessible health care for all. CHCs are a major tool to achieve these outcomes. They provide primary health care that includes curative and preventive care, carry out information campaigns and empowers communities to play an active role in the health sector.

Within the local government structure, CHCs fall under the responsibility of the Department of Health (DoH), which also coordinates their activities. The DoH, in turn, reports their performance to the Ministry of Health (MoH) . Local governments facilitate CHCs through allocating funds for health staff and facilities. Health staff may include physicians, midwives, nurses, pharmacists, nutritionist, public health practitioners and administrative staff, while health facilities may include buildings, medical devices, laboratories, ambulances and pharmacies. Due to variations in local government policies and other local conditions, CHCs may differ considerably with regard to number and type of health staff and facilities.

CHCs are established at the sub-district (Kecamatan) level, based on a service coverage ranging from 10,000 to 30,000 inhabitants. CHCs may have auxiliary CHCs at the village level to enable them reach out to the community in the villages. In areas with large distances to the nearest hospital, CHCs are equipped with a small number of beds (about 10) for in-patient care, and with motorized vehicles for visits in remote areas.

Two major reforms were carried out in the PHCS. During the first reform in 2004, the central government obliged local governments to provide health insurance for the poor (Law 40/2004 on the national social security system). Fiscal transfers from the central government flanked this measure. The law increased local governments' decision space with regard to how to implement health policies. Also in 2004, a decree by the MoH granted CHCs with the authority to propose their own programmes and budget allocation, based on the health needs of their community and the capacities of their CHC. Furthermore, every local government was required to allocate at least 5 % of its total budget to the health sector.

The second reform started in 2014, when the central government changed the out-of-pocket payment system to the universal coverage system. In this system, all citizens with health problems first have to visit the CHC. In case the patient requires further medical care, the CHC will refer the patient to the appropriate hospital. The system is implemented by the Social Security Management Agency (Badan Penyelenggara Jaminan Sosial), which manages health insurance for all citizens (Law 24/2011).

2.2 Two Waves of Decentralization

Indonesia has implemented two waves of decentralization, the first wave started in 2000 and ended when the second wave started in 2004, the second wave continues up to present. In the following, we briefly describe them, focusing on their differences. The descriptions are based on the law on local governments (Law 22/1999 and Law 32/2004), the law on financial balance between central and local governments (Law 25/2000 and Law 34/2004), and government regulations on structuring local government organizations (PP 8/2000, PP 38/2004, PP 41/2007).

2.2.1 Political Decentralization

In the first wave, elected members of the local council had the authority to elect and to impeach the mayor/governor and vice mayor/governor. There was an annual accountability report from the mayor to the local council. If the mayor's performance failed to satisfy the expectation of the local council, it could impeach the mayor. During the second wave, the local community directly elected the mayor and governors. Local councils had the authority to propose impeachment of the mayor/governor, but this now required legal proof by the Supreme Court, confirming that the mayor/governors had violated the rules. The final decision concerning the impeachment was with the president.

During both waves, the local council had the authority to approve or disapprove of local policy and regulations, including local strategic planning and budget allocations.

2.2.2 Administrative Decentralization

During the first wave, the central government transferred all sectorial decision space to the local governments. They now had the authority to establish and design new local government organizations, without any restrictions on number, size and function.

During the second wave, the possibility to establish new local government organizations was now limited by local revenue, population, the width of local jurisdiction, and other unique characteristics of a local government.

The first wave enabled local governments to hire new employees on a contract basis, and promote and transfer employees between institutions in the local government. During the second wave however, the central government banned these practices in order to limit local government expenditures.

2.2.3 Fiscal Decentralization

During the first wave, the law on financial balance allowed local governments to determine local taxes and levies to increase local revenue, without restrictions on the type and extent of these taxes. Central government amended the law on financial balance in the second wave that applied detailed restrictions on local taxes and complex anti-corruption procedure.

3 Analytical Framework: The Decision Space Approach

The link between decentralization and performance DSA of the health sector refers to macro-level phenomena. Following the social mechanism logic as advocated by Analytical Sociology (Hedstrom and Udehn 2009), we use a theory of action that explicates the mechanisms linking the macro-level of societal phenomena with the micro-level of individual decisions and actions (see Fig. 1) the DSA. This approach draws on principal agent reasoning. It argues that decentralization changes the degree of decision space, accountability and organizational capacity that decision makers have in order to develop effective innovations. The micro-level actions aggregate to macro-level outcomes. Our study focuses on the micro-level, specifying the interplay between the decision space, accountability and organizational capacity and their impact on local health care innovations.

The DSA is one of the few general analytical frameworks explicating how decentralization affects policy outcomes through changing preferences and constraints of local decision makers. It proposes that decentralization has the potential to improve health care outcomes. The idea is that decentralization bestows more decision space to local decision makers, allowing them to be more responsive to local conditions and community health needs (Bossert 1998). However, decision space alone will not suffice unless complemented by appropriate accountability mechanisms (Mitchel and Bossert 2010) and the organizational capacity to implement decisions (Bossert and Mitchell 2011). Decision space and accountability requirements are exogenously given institutional boundary conditions within which local-level decision makers need to operate. The dimension on which they can exert some influence is the capacity of their organization. Organizations that succeed to increase their capacity have a higher chance to be more effective and efficient. We argue that a significant increase of a CHC's capacity requires some

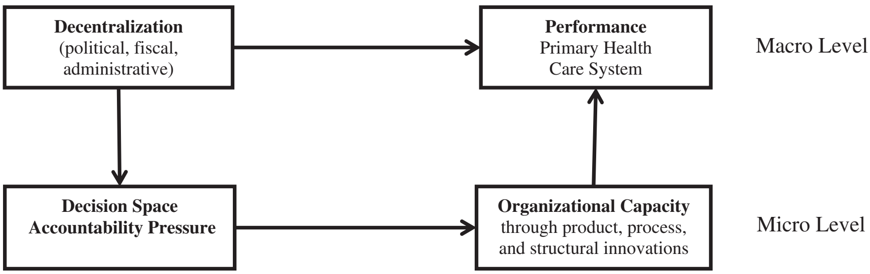

Fig. 1 Conceptual model

degree of product, process, and structural innovation. Hence, the core question becomes to what degree the changes in decision space and accountability has favoured or inhibited innovative expansion of organizational capacity.

3.1 Decision Space

Decision space refers to “the range of effective choice that is allowed by the central authorities (the principal) to be utilized by local authorities (the agents)” (Bossert 1998). For example, decision space can vary to the degree that a district can determine its own health strategic planning, budgeting, human resources, and service/organization delivery. Within this decision space, “local authorities may make innovative choices that are different from the choices they made before decentralization and different from directed change that the central authorities impose on localities which have not been decentralized” (Bossert 1998). Decentralization increases the decision space of lower-level administrators, though the degree of decision space that an administrator has can differ considerably across different sub-domains. In order to have an accurate picture of the decision space, it is important to disentangle the various decision-making domains (e.g. finances, human resource management etc.) and their specific indicators.

3.2 Accountability Pressure

Accountability refers to an agent’s obligation to explicate and substantiate his or her conduct to a principal or other stakeholders, who can raise queries and allocate sanctions (Black 2008). Accountability mechanisms apply to the administrative, political and fiscal domain, and ensure that decision makers are more responsive to local health needs. Decentralization tends to increase accountability of lower-level administrators, where the Central Government pushes local governments to achieve specific health targets effectively, in order to improve health performance at the national level (Bossert and Mitchell 2011). When assessing accountability pressures, one has to distinguish between two dimensions (Bossert and Mitchell 2011): “accountability for what” refers to the different decision-making domains and “accountability to whom” refers to the underlying hierarchical arrangement (Yilmaz et al. 2008, 2009). There are three categories that included “accountability to whom”. (1) Upward accountability implies that the decision maker has to report to upper-level government organizations, e.g. a local government being accountable to central government. (2) Downward accountability involves situations in which the decision maker is responsible to a lower-level entity, e.g. local government being accountable to the community. (3) Horizontal accountability refers to accountability to peer players, e.g. a local government being accountable to the local council.

3.3 Organizational Capacity

Organizational capacity relates to the question whether the resources and processes at the disposal of local administrators are sufficient to make and implement good decisions. Indicators of organizational capacity are organizational resources (e.g. adequacy of funds, infrastructure and staff), and processes (e.g. evaluation, monitoring and reporting to the national level), as well as human capital (e.g. individual training, education and experience). Unlike accountability and decision space—which are "externally" given—local decision makers have discretion to influence the capacity of their organizations. They are in a position to alter the structures, processes, products, and services of their organization in order to make it more effective and efficient (West 1990; Varkey et al. 2008; Omachonu and Einspruch 2010). Such innovations have the potential to increase organizational capacity and improve its health care functions (Omachonu and Einspruch 2010; Varkey et al. 2008). Hence, in line with earlier applications of the DSA (Bossert 1998), we consider product, process, and structural innovations as important correlates of organizational capacity.

4 Decentralization and Health System Innovation in Indonesia Institutional Analysis

In this section, we analyse to what degree decision space and accountability, the two most important institutional boundary conditions for health care innovations, differed between the two waves of decentralization.

4.1 Decision Space

Building on previous applications of DSA to health care innovation (Mitchel and Bossert 2010; Bossert and Mitchell 2011; Bossert 1998), we distinguish five major decision space categories. Within each of these categories, we used, where possible, the indicators that also previous studies had applied. Where necessary, we adapted them to the specific context of CHCs in Indonesia (for a definition of each of these indicators, see Table 1): (1) Strategic planning; (2) Service organization (required programmes, hospital autonomy, insurance plans, procurement of goods); (3) Human resources (contracting, civil service); (4) Financial management (expenditures, sources of revenue); (5) Governance rules (structure and design of facility boards, district offices and community participation).

For each indicator and for both waves of decentralization, we determine whether the decision space is narrow, moderate or wide. The decision space with regard to a specific indicator is narrow if the organization or district has no

Table 1 Description of decision Space domains

Decentralization types	Decision space domains	Description
Fiscal	Expenditures	Ability to determine budgetary allocations (including planning, budgeting, and execution)
	Revenues	Authority to use funds raised from all levels of the system (including intergovernmental transfers, own-source revenues, income from user fees and contracts, borrowing)
Political	Strategic planning	Ability to accommodate local community health needs into health policy and program at the local level that differs from policy and programs of the central government
Administrative	*Service organization*	
	Required programs	Ability to modify implementation of national programs
	Health Centre autonomy	Ability of health centers to be independently managed (including discretion over all health sector functions within health centers)
	Insurance plans	Ability to create, manage, and or replicate local insurance mechanisms (for example determine service coverage/minimum packages; introduce community based health insurance)
	Procurements of goods	Ability to procure goods and services
	HRM	
	Civil service	Ability to decide over compensation packages (for example, basic salaries, allowances); determine terms of employment (for example, including recruitment, appointment, transfer, promotion and termination)
	Contracting	Authority to define the range of permissible contracting options
	Governance rules	
	The health department	The ability to structure and design the function of the health department
	The health centres	The ability to structure and design the function of health centers

Source adapted from Bossert (1998), Mitchel and Bossert (2010), Bossert and Mitchell (2011)

discretion, because the decision-making authority rests entirely at the upper level. The decision space is wide if the local government faces (almost) no restrictions that would constrain the range of alternatives. The decision space is moderate if the local government or organization faces restrictions, but nevertheless also has some autonomy in taking decisions.

One indicator measured decision space with regard to strategic planning. Decision space was wide during the first wave, because the law permitted local governments to formulate the strategic planning themselves and did not impose further constraints. During the second wave, a government regulation added restrictions. It mandated that the strategic planning in local government had to be in line with the strategic planning at the national level. Since local governments still had the discretion to determine their own strategic planning, we classify the decision space during the second wave as moderate.

In the domain of service organization, for three out of four indicators, decision space was wide during the first wave, but dropped to moderate during the second wave. Local governments faced no constraints with regard to programming and the insurance plans they wanted to implement; moreover, the central government's requirements concerning standardization of procurement were very loose. During the second wave, decision space on these three dimensions of the service organization decreased to moderate, because central government narrowed down the range of options from which local governments could choose. We observe the reverse pattern for one of the indicators, CHC autonomy, however. Here, decision space was narrow during the first wave, when CHCs had a uniform structure and functions, determined by the central government. Decision space on this dimension increased to wide during the second wave, when these restrictions were eliminated.

Two indicators measure decision space with regard to human resources. First, civil service represents the ability of local governments to determine compensation packages, like salaries and allowances, terms of employment, recruitment, appointment, transfer, promotion and termination of employment contracts. Second, contracting represents the range of permissible contracting options. For civil service, decision space was narrow during the first wave, because the local government had to implement the compensation package regulations of the central government. During the second wave, the decision space grew to moderate when local governments were granted the right to introduce performance related incentives. We observe a reverse pattern for the second indicator, contracting of employees, however. Decision space was moderate during the first wave, but it decreased to narrow during the second phase in 2005 when the central government completely banned contracting employees, in order to limit the growing number of civil servants.

With regard to fiscal management, local governments' decision space declined from wide to moderate on both indicators, revenues and expenditures. During the first phase, local governments faced no restrictions concerning the amount of local taxes and their allocation. On the contrary, during the second phase, the central government imposed rigid regulations concerning the type of taxes that could be levied, and it also defined a minimum amount that had to be allocated to the health sector.

Finally, two indicators measure decision space with regard to governance rules. Decision space to design the structure of the health department was wide in the first wave while moderate in the second wave, because the central government standardized the number and size of local government organizations. We observe the opposite pattern with regard to the decision space to design the structure of the

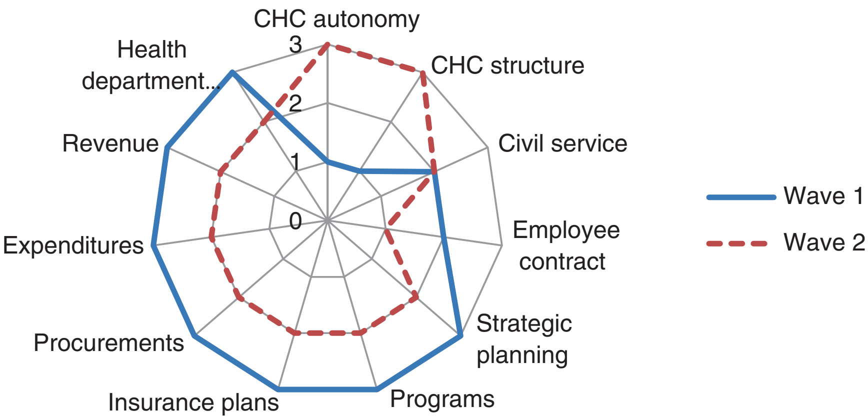

Fig. 2 Changes in decision space from the first to the second wave of decentralization

CHC, which was narrow during the first wave, but wide during the second wave when previous restrictions concerning the structure and function of local CHCs were removed.

Figure 2 summarizes the patterns for all eleven indicators. We use numerical weight in the analysis to trace the change of decision space from the first to the second wave of decentralization. The highest score is “3” for wide decision space, score “2” for moderate decision space, and score “1” for narrow decision space. Overall, we observe that from the first to the second wave, decision space declined in eight of the eleven domains. In all but one of the cases, the change involved the introduction of some restrictions in a situation in which local decision makers had very little constraints (wide decision space). In two domains, decision space increased, and considerably so autonomy and structure of the CHC augmented from “narrow” to “wide”. In sum, the second wave of decentralization resulted in a reduction of decision space compared to the first wave.

4.2 Accountability Pressure

Previous studies suggest a link between innovation and the type and degree of accountability pressures that decision makers face (Fleuren et al. 2004; Lansisalmi et al. 2006; Varkey et al. 2008). For the Indonesian context, we distinguish between high, medium and low accountability pressures based on three types of underlying hierarchical arrangements.

First, most local governments still depend on the upper level of government for a major part of their funding. Given this dependence and central government’s opportunities to reinforce and sanction (Fleuren et al. 2004), we consider arrangements containing upward accountability as involving the highest level of accountability pressure.

Second, due to political decentralization, local decisions makers also have political motives. Local government officials have an interest in maintaining their electorate

(Lansisalmi et al. 2006), and for CHC leaders to stay in function, their CHCs need to meet high performance demands from their local communities (Varkey et al. 2008). Hence, downward accountability requirements—from local government to the community—can still create quite some pressure. We classify the presence of downward accountability requirement as medium accountability pressure, because for the involved decision makers, the potential consequences of non-compliance (e.g. in terms of direct sanctions) are less immediate than compared to upward accountability.

Finally, horizontal accountability involves interaction between the mayor and the local council. It usually applies in contexts where regulations have to be drafted (Fleuren et al. 2004). Compared to upward and downward accountability requirements, we consider horizontal accountability arrangements as exerting the least accountability pressure.

Note that a specific decision domain can be subject to multiple accountability arrangements at the same time. In many cases, a decision maker is accountable to both higher and lower levels. We assume that in such cases, accountability pressures add up, since it implies an increase in the number of stakeholders to which the decision maker has to report. Therefore, for the purposes of our analysis, we attach numerical weights to the three types of accountability arrangements, with the highest score "3" for upward accountability, an intermediate score "2" for downward accountability, and the lowest score "1" for horizontal accountability. Consequently, the maximum score for accountability pressure in a decision-making domain is "6", representing a situation in which a decision maker is upwardly, downwardly, and horizontally accountable. The lowest score is "1", representing a situation in which the decision maker is only horizontally accountable. In what follows, we assess (changes in) accountability pressures in the eleven decision-making domains as they were discussed in the previous section.

First, with regard to strategic planning, accountability pressure during the first wave was restricted to the local council scrutinizing the local executive body; it was based on horizontal accountability only, resulting in the lowest score ("1") on our accountability pressure scale. Accountability pressures increased drastically during the second wave, when both upward and downward pressures flanked horizontal accountability requirements. First, a law on public information now obliged local government to publish their strategic planning on the official website. Furthermore, since the introduction of direct elections, local communities now paid special attention to what degree elected officials indeed had kept the promises they made during their election campaigns (downward accountability). Second, a new law now required central and local government to share authority on strategic planning. This significantly increased the central government's influence on and control over the strategic planning process of local governments. With all three types of accountability arrangements in place, the accountability pressure during the second wave cumulates to the highest score on our scale ("6").

Second, we observe an increase in accountability pressure also in the domain of service organization. This is due to the fact that all indicators in this domain, upward accountability in the form of tighter standardization and regulations guiding implementation, was added during the second wave. Required programmes increased (from “4” to “6”) because the second wave added downward accountability—citizens being able to exert pressure on local governments to realize the programmes promised during their electoral campaigns—to the upward and horizontal accountability established during the first wave. During the second wave, accountability pressure on CHCs grew (from “3” to “5”), resulting in lower CHC autonomy: CHCs receive funding from the MoH and implement central government programmes. Furthermore, accountability pressures concerning the procurement of goods increased (from “4” to “6”), since during the second wave, the procurement procedure requires local governments to publicly announce each step on their website, thereby adding downward accountability requirements to the upward and horizontal accountability pressure in place since the first wave. Accountability concerning insurance plans also increased (from “1” to “4”). While the first wave involved only horizontal arrangement, the second wave added both horizontal and upward arrangement, since central government obliged local government to provide health insurance for the poor.

Third, both indicators in the field of human resources reflect increasing accountability pressures. During the second wave, local governments lost the authorization to contract health staff, which is now restricted by the central government. The same holds for the right to manage the civil service. In both cases, accountability pressure rose from only horizontal accountability (score “1”), to both horizontal and upward accountability (“4”).

Fourth, in the domain of financial management, we observe an increase in accountability pressure with regard to the approval of the budget planning, expenditures and revenue. During the first wave, it involved upward and horizontal accountability arrangements (score “4”), while in the second wave it involved upward, downward, and horizontal accountability (score “6”). Local governments are currently required to announce their budget of expenditures and revenue to the community by uploading this information on the official website of the local government, enabling the local community to scrutinize the financial management.

Finally, accountability pressure also increased in the domain of governance rules, with control over the structure of CHCs and the structure of the Health Departments switching back from horizontal accountability in the first wave (score “1”), to upward accountability towards the central government in the second wave (score “3”).

All in all, we see a notable increase in accountability pressure from the first to the second wave of decentralization in nine of the eleven indicators (see Fig. 3). From the second wave, the highest pressure rests on strategic planning, required programmes, expenditure, and CHC autonomy. Only in one case, insurance plans, did the accountability pressures decline to the minimal level (horizontal accountability).

4.3 Institutional Analysis: Summary Conclusions

The Decision Space Analysis has allowed us to decompose the institutional frameworks governing the health sector during the two waves of decentralization into

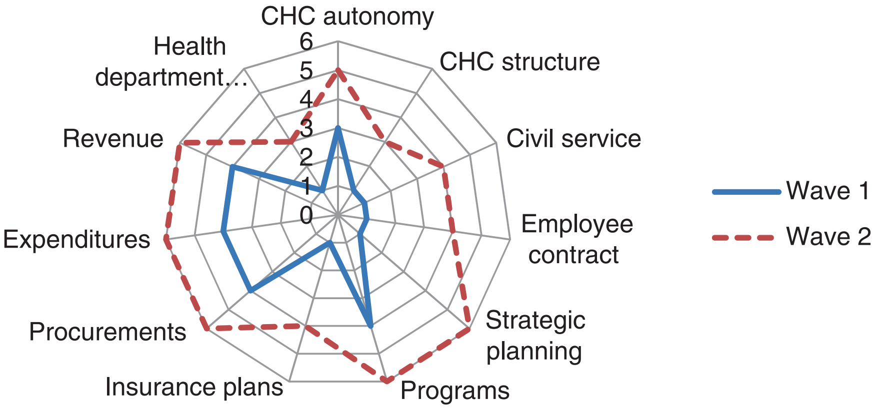

Fig. 3 Changes in accountability pressure from the first to the second wave of decentralization

its two major operational dimensions: the degree of discretion (or decision space), and the degree of accountability that local level decision makers face. Our analysis yields three main insights.

First, the two institutional frameworks of decentralization differ significantly from each other. In fact, we observe a double movement, taking place from the first to the second wave. It consists of an overall reduction of decision space, combined with an overall increase in accountability pressure.

Second, there is one notable exception to the reduction of decision space, and this is related to the autonomy and structure of the CHCs; here, the trend is reversed: maximum discretion is transferred to local decision makers.

Third, our analysis reveals that compared to the indicators for political and administrative decentralization, the two indicators measuring fiscal decentralization (expenditures and revenues) show a relatively smaller degree of change, both with regard to accountability pressures and decision space. This is particularly noteworthy given the strong and almost exclusive focus on fiscal decentralization that has dominated research up until now. The major adjustments took place in the domains of political and administrative decentralization, and they may also be among the more prominent opportunity structures for improving the capacity of health care organizations through product, process and structural innovation. This is what we turn to in the next section.

5 Decentralization and Health System Innovation in Indonesia: Case Analysis

The previous section demonstrated that the institutional conditions for improving organizational capacity through health care innovation changed from the first to the second wave of decentralization. During the first wave, local-level decision makers had little room and incentive to execute innovations, and while district level players had the discretion, a weak accountability system apparently kept them from investing and instigating innovation. Conditions for local-level players changed during the second wave, with accountability pressures mounting and discretion decreasing in some domains, but increasing in others—most notably with regard to autonomy and structure of the CHC.

Given these changes in the institutional contexts, two questions arose. First, how was it possible that some districts and CHCs succeeded in realizing exemplary innovations, despite the problematic institutional context? Second, are there some general patterns that these successful innovation cases share?

In this section, we attempt to give some tentative answers to these questions by examining some well-documented cases of health care innovation in Indonesia. The purpose of our case analytic approach is to gain deeper and a more detailed insight into the social, political and economic context and processes behind the innovations. More specifically, we are interested in the kind of innovations that were realized, their antecedents, how they relate to the changes in decision space and accountability pressures, and their outcomes in terms of enhancing organizational health care capacity and performance.

With the exception of one well-known district level case (Jembrana), there is relatively little documentation on health care innovations in Indonesia during the first wave of decentralization. There is some reason to assume that this lack of information reflects the paucity of actual innovation attempts during this period. The situation, however, changes during the second wave. We assume that this reflects increased decision space to design the programmes and define the budget, as it was granted to CHCS at the start of the second wave decentralization (2004).

For our case analysis, we draw on two studies investigating innovation at CHC-level (Anggraeny 2013; Rachmawati and Suprapto 2010), and an official blog that describes innovation at the CHC of Mojoagung. The report by the Ministry of Administrative Reform the Republic of Indonesia provides too little detail for our purposes.

We will present six short vignettes on innovations that significantly improved organizational health care capacity. Three of them cover the district level (for a summary overview, see Table 2), and three cover the CHC level (see Table 3). With the exception of the Jembrana case at district level, all of the cases emerged during the second phase of decentralization (i.e. after 2004). For each case, we first sketch the type of innovation that was realized, and how it affected organizational capacity. We then explore its potential antecedents.

5.1 District Level Innovations

5.1.1 Universal Health Insurance Coverage (Jembrana)

Health care innovations during the first wave of decentralization were very rare. This makes the Jembrana case particularly interesting. This case is quite well-known at national level (Korupsi 2008; Trisnantoro et al. 2012). Organizations

Table 2 District level health care innovation cases—summary overview

		Case 1: Jembrana	Case 2: Surakarta, Jakarta, Bandung, Kulon, Progo, Manado	Case 3: Pemalang
Background	Period	Initiated 2001, implemented 2003, still ongoing		Initiated in 2004, terminated in 2005
	Trigger	Initiated by the mayor	Central government policy on national social security; Fiscal transfer to partly finance the insurance	National health vision to decrease the infant and maternal mortality rates
	Enabling conditions	Commitment from the mayor and efficiency	Availability of successful template (Jembrana) for replication; mayor's commitment and creativity to design the method and finance the uncovered insurance by fiscal transfer	Mayor's commitment
	Methods	Bureaucracy reform; downsizing; cooperation with private hospitals and clinics	Minimum health budget at least 5 % for each local government	Continuation of foreign aid project
Innovation	Product	Universal coverage system	Health insurance for targeted people	Midwife voucher
	Process	Different process for financing primary health care	Reimbursement or direct subsidy	Reimbursement
	Structure	New local government institution function to provide the health insurance	New institution to manage health insurance	–
Outcomes	Capacity	Increase the quality of health facilities; Increase the accessibility of health care for all	Increase the accessibility of health care for all	Increase the number of midwives
	Performance	–	–	Increase the accessibility of midwife service

Table 3 Community health centre innovation cases—summary overview

		Case 4: Jagir	Case 5: Mojoagung	Case 6: East Java
Background	Period			
	Trigger	Initiated by head of CHC	Initiation of the CHC's manager	Triggered by national health vision related to MDGs
	Enabling conditions	Concern to the condition of old technology application	Skill to recognize the health problems and potential contribution from external actors	Commitment of the mayor
	Methods	Finance reallocation to medical devices	Partnership with the Pertamina "national oil enterprise"; partnership with university and community	Involve public participation as health care volunteer; increase the number of health staff and distribute them more evenly
Innovation	Product	Health service for the aging people, specialists, and teenagers	Cataract surgery and care post-surgery	24 h prenatal and maternal care
	Process	The use of new technology for diagnoses	–	–
	Structure	New clinics	–	Increase number of PODES
Outcomes	Capacity	The increase of health care quality and quantity of health staffs	–	Increasing number of midwives and trained traditional midwives
	Performance	The increase of health care process quality	Solve the problem of poor patients with cataract; solve the problem of worm diseases	More accessible natal care

at the central government level, ministries, NGOs, high-level officials from other districts, and researchers visited Jembrana to learn from the practice. Jembrana acquired national fame because it was the first district to abolish the out-of-pocket system in favour of a universal coverage health insurance [*Jaminan Kesehatan Jembrana* (JKJ)]. This product innovation was initiated in 2001, implemented in 2003, and is currently still active. Additional innovations accompanied this programme, for example a process innovation which consisted of a new system for financing primary health care.

The creation of a new local government organization, *Badan Penyelenggara JKJ* or Bapel, to administer health insurance was a major structural innovation. It has a key role in the implementation of JKJ. It applies tight standardization procedures and strict verification of claims, in order to assure that the funds for medication reach those citizens who are indeed entitled to them. Each month Bapel processes thousands of individual insurance claims. It handles registration and re-registration of thousands of members, and it manages the payment of claims and the contracts between the local government and other health institutions, such as CHCs, public and private clinics, and hospitals.

Together, the product, process and structural innovations have resulted in a significant improvement of CHC capacity and have improved accessibility of other health facilities like public and private hospitals and private clinics participating in JKJ (World Bank 2006). These measures increased health access for the poor and resulted in higher levels of patient satisfaction. Furthermore, the capacity of PHCS facilities has improved: CHC buildings were enlarged and laboratories and in-patient facilities were created.

Next we ask, how were these innovations implemented, and what conditions made this possible? Implementing the JKJ conveyed many challenges. One of the major obstacles certainly was the relative lack of funds, particularly if compared to other districts in the Island of Bali. Therefore, Mayor Winasa, a medical professional, university professor and dentist, used two main strategies to implement health system reforms.

First, he downsized and restructured local governments, reducing the number of district organizations from 24 to 17. This yielded an annual savings of Rp. 2–3 billion (US$ 200–300,000). The mayor used these savings to finance the health reform (World Bank 2006).

Second, he initiated an administrative reform by stipulating regulations on local civil servants disciplines and incentives, procurement system that enables retrenchment in government spending, and the use of information technology to enhance the transparency and connections between parts of the system in local government that also prevent the corruption practices in using the JKJ fund (Korupsi 2008; Trisnantoro et al. 2012; World Bank 2006).

The increase of decision space in the wake of the first wave of decentralization provided the necessary discretion for the interventions. With wide authority to determine the strategic planning, Jembrana used the opportunity to formulate its own strategic plans, which differed from those in the national health system. In the domain of service organization, Jembrana freely defined its new insurance plan, literally reinvented its health facilities, and restructured its buildings. It also loosened the rigid standards that regulated procurement procedures of in-patient facilities. Furthermore, new human resource policies were introduced. Civil servants were now rewarded according to their performance, and Jembrana also invested in the recruitment of well-trained health professionals to staff the new Bapel organization and other health organizations. Finally, Jembrana also modified some of its governance rules, in particular with regard to the new local health insurance managed by Bapel. These rules facilitated both contract agreement with health care providers, and the verification of health care claims, thereby preventing fraud by health care providers.

All these changes were possible because the first wave of decentralization abolished many of the rigid standards of central government. However, this increase in decision space also applied to all other districts in Indonesia, of which the vast majority did not embark on any innovation trajectory to expand their organizational capacities.

What made Jembrana special? In addition to the mayor's initiative and creativity in shaping new programmes and freeing the necessary funds, networking was a major enabling condition behind the success of Jembrana's initiative (Korupsi 2008; World Bank 2006). The mayor successfully activated and managed collaborative networks with professionals and local councils, like the director of the district hospital, the managers of CHCs, and the managers of Bapel. He successfully lobbied the local council to approve his programmes, and also succeeded in motivating the civil servants to implement the reform.

Though the JKJ faced severe challenges, it proved to be sustainable. However, it was only during the second wave of decentralization that other districts started to emulate Jembrana's model, and now, universal health insurance coverage has become part of the national health system.

5.1.2 Health Insurance (Several Districts)

With the second wave of decentralization, while the decision space partially declined, the accountability pressures went up across the board. Based on the law on the National Social Security System, enacted in 2004, the MoH launched a programme for health insurance for the poor in 2007. According to the decree, every district has the authority to design and implement health insurance for the communities in its area and can build on fiscal transfers from central government for this purpose—but every district was obliged to implement this policy. This change may be one of the reasons why we observe an increase in health care innovations also in other districts, several of which started to adapt Jembrana's health insurance model for their purposes. For example, Surakarta-Central Java and Jakarta introduced health insurance for the poor, and Badung-Bali introduced a 24-h CHC service. In 2011, the Province of Bali introduced health insurance for the wider community (Based on Governor Decree delivered in 2008). Other local governments developed innovative health insurance not only for the poor but for all citizens, such as the city of Makassar (Dwicaksono et al. 2012), Manado (Ministry of Administrative Reform the Republic of Indonesia 2014), and the district of Kulonprogo (Ministry of Administrative Reform the Republic of Indonesia 2014).

5.1.3 Midwife Coupon Service (Pemalang)

In 2004, the district of Pemalang introduced a midwife coupon service. Here, midwives—who can be civil servants or operate as individual entrepreneurs—are paid based on how many coupons they collect. The service started as a pilot project that was initiated by central government with funds from a World Bank loan. Its aim was to encourage women from poor households to visit midwives during pregnancy and for the delivery. The programme was successful since it increased the number and, in result, the availability of midwives, thereby considerably improving organizational capacity. However, for unclear reasons, the programme was terminated by central government, in the midst of its implementation. Nevertheless, Pemalang continued this programme, using its local government budget, but ended it in 2005, because it overlapped with the Health Insurance for Poor programme.

The Pemalang case is interesting because it reflects an innovation that started as an initiative from central government, rather than growing out of the district itself. However, as in the Jembrana case, its continuation is mainly due to the mayor's commitment and success in reallocating local funds for this project.

5.2 Community Health Centre Innovations

5.2.1 New Technology and New Services (Jagir)

Process innovation at the CHC of Jagir (Surabaya city, East Java), took the form of implementing new technologies for diagnosis, like computer ultrasonography (USG), a complete and state-of-the-art dental unit, and a photometer (Anggraeny 2013). The initiative for scaling up medical technology came from the head of the CHC, who was concerned about the out-dated material in the centre. In order to be able to purchase better and more modern equipments, he decided to reallocate funds for this purpose.

CHC of Jagir also introduced a variety of product innovations in the form of new services: (1) Specialist practices, e.g. for dermatology and venereal diseases, gynaecology, or degenerative diseases, hypertension, diabetes mellitus, and cancer, (2) extension of opening hours, (3) teenage counselling by professional psychologists, (4) a "neighbourhoods programme" in which neighbourhood communities receive coaching related to disease prevention and handling health problems in their community, and (5) in-patient care.

Finally, structural innovations consisted of the creation of new clinics providing special care for the elderly. The clinics also contain a unit for health services and are active in the field of health promotion.

5.2.2 Partnership and Collaboration (Mojoagung)

In 2012, the CHC of Mojoagung received the MoH award for Best Performing Health Institution for its activities in the field of health promotion and disease prevention. This CHC had implemented two kinds of product innovations (http://puskesmasmojoagung.wordpress.com). First, it offered cataract surgery and free after-surgery treatment. This initiative represented an annual social responsibility activity, and was funded in the context of a partnership programme with PERTAMINA State's Oil Enterprise. Second, a programme to fight endemic worm disease was introduced.

As in the Jagir case, the initiative for this innovation came from the head of the CHC, who was puzzled by the high incidence of worm disease in the community. He took a soil sample and brought it to the nearby university laboratory. The results showed that the soil was contaminated with cow waste. To solve this problem, he initiated a programme to install biogas energy based on cow waste that use the cow waste as the material to produce electricity. The use of the biogas installation prevented the soil contamination that caused worm disease. This project was realized in the context of a partnership programme with Airlangga University in Surabaya. It also could build on strong participation by the local community, whose members collectively were willing to buy installation material and to learn how to maintain it. In turn, the university agreed to set up the biogas installation for free.

5.2.3 Obstetric and Neonatal Emergency Service Innovation, PONED (Several CHCs East Java)

In 2004, the MoH initiated a programme providing basic obstetric and neonatal emergency services (PONED). A study (Rachmawati and Suprapto 2010) of three districts in the Province of East Java (Jombang, Ngawi, and Sampang) provides detailed insights into its implementation, outcomes and success factors.

The purpose of this programme was to reduce infant and maternal mortality rates. The main tool to achieve this objective was a structural innovation, consisting of the creation of new health posts (PONED) in villages. PONEDs were separate administrative entities, and its health staff did not overlap with CHC staff. As a result, this innovation could only be implemented in regions where CHCs already had sufficient health staff. This was flanked by investments from the government, who offered health staff for delivery and infant care, and to train medics, midwives, traditional midwives and nurses, all of whom had to be on standby for 24 h, 7 days a week. This product innovation significantly increased organizational capacity, allowing delivering 24-h prenatal and maternal care.

Active community participation during all phases (planning, construction, and running of PONED) was an integral element of the programme. Two measures in particular were important for its success. First, through empowering village midwives, effective cooperation and interaction between the community and PONED became possible. Second, professional marketing teams increased community awareness through information campaigns about PONED, encouraging community members to make use of its services.

5.3 Case Analysis: Summary Conclusions

The case vignettes presented above are neither exhaustive nor representative for health care innovation in Indonesia. Nevertheless, these examples shed some more light on how the changes in decision space and accountability pressures might have affected a health organization's inclination to initiate capacity-enhancing innovations. We see two noteworthy patterns.

First, it seems that the surprising lack of innovation during the first phase is due to a very unfortunate combination of circumstances. Despite the fact that decision space increased in most domains, compared to the centralization era, it remained restricted in two crucial areas: CHCs had very limited autonomy to determine both their own structure and their own functions. In combination with very low accountability pressures, this institutional structure impeded serious innovation attempts: the system relied on horizontal accountability only. With the mayor depending on the local council, community interests became less salient in shaping local health policies. The Jembrana case is a noteworthy exception and a case in point: its success is largely due to the mayor's strong commitment, professional background and personal networks, which allowed him to overcome these obstacles. During the second wave, when accountability pressures increased but CHCs also were granted more autonomy, capacity-enhancing innovations started to proliferate at the CHC level as well, and they indeed showed quite some variation. The case material suggests that the institutional arrangements during the second wave of decentralization created favourable conditions for capacity-enhancing innovations at the level of CHCs. With the CHC in many domains now also being accountable to the local community, it has a stronger incentive to use its autonomy to adapt to the local health needs. Each CHC may face a variety of health problems, which also require different solutions. This also holds for national level programmes like PONEDs, since it is built on participative structures that allow local governments effectively adjusting to local conditions.

Second, the mobilization of additional resources has been a major enabling condition for most local governments. Adequate funding, or lack thereof, though important, is only one element in this context. During the first wave of decentralization, about half of all local governments spent more than 60 % of their budget to pay for the salary of civil servants. During the second wave, the central government alleviated the problem through fiscal transfers, and the requirement to allocate at least 5 % of local government budgets to the health sector. Nevertheless, in several of the cases, re-allocation of internal funds towards the new initiatives was a major precondition for launching innovations. This usually required some massive internal restructuring, a process that not every CHC management may be willing or able to launch. Enlisting the support of external stakeholders (e.g. in the form of sharing expertise or providing subsidies) also proved to be crucial, as the Mojoagung case shows. In those cases where CHCs managed to secure outside support, their leaders either could draw on extensive personal networks, or had the social skills to cultivate them.

6 Conclusion

There are many factors affecting organizational innovations in the health sector (Fleuren et al. 2004). Our study, which focused on some of the institutional conditions that may facilitate or impede such innovations, allows for some general tentative observations.

First, the DSA proved to be particularly useful to map the changes in the institutional contexts, because it allowed disentangling key decision and accountability domains. Our institutional analysis showed that arrangements during the first and the second wave of decentralization differ considerably, and that there is also quite some variation in decision space and accountability across different domains during each phase. Whereas during the first phase, decision space was wide across most domains, autonomy of CHCs remained very low, creating a major stumbling block for capacity-enhancing innovations. Since the second wave of decentralization, the institutional framework has increased accountability pressures in combination with more decision autonomy with regard to CHC structure and function, but somewhat lower decision space in the remaining domains. This combination seems to be favourable for capacity-enhancing innovations at CHC-level.

Second, our case analysis revealed that successful innovation initiatives were often built on the presence and cultivation of cooperative social networks, both with external and internal stakeholders. In the upper echelons, personal connections facilitated lobbying key decision makers in the system. Lower down in the hierarchy, social networks of CHC management, health staff and community members contributed to build the trust and commitment that was necessary for carrying out the sometimes major restructurings required to implement an innovation. Since these networking capacities most likely differ considerably across CHCs, they may be one of the possible conditions explaining variation in their innovation potential.

Future research may benefit from our study in at least two ways. First, we found that increased organizational efficiency is one key ingredient of successful capacity-enhancing innovation. However, efficiency itself may be part of daily decision space use in providing health service, particularly for health care service providers like CHCs. Hence, an in-depth study on decision-making processes at CHC level may be a fruitful endeavour.

Second, our case studies showed the crucial role of mobilizing external stakeholders to contribute to health care provision. However, little is known about how management and employees of CHCs manage to activate sustainable collaborative networks that serve in improving organizational capacity.

To conclude, in the year 2015, Indonesia has 548 local governments (Ministry of Home Affairs' Decree, 39/2015), and approximately 9815 CHCs. The degree to which they will be able to deliver effective health care in the future will strongly depend on their ability to successfully adapt to local circumstances. Finding innovative methods to improve their organizational capacity will remain a crucial element to achieve this objective.

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Chapter 4
The Impact of Decentralization on Educational Attainment in Indonesia

Tatang Muttaqin, Marijtje van Duijn, Liesbet Heyse and Rafael Wittek

Abstract This study contributes to our knowledge on the impact of decentralization of the education sector in Indonesia. We extend existing research by examining the influence of both municipal factors and other explanatory variables on educational attainment in Indonesia. We focus on mean years of schooling as an indicator of educational attainment. We hypothesize that after decentralization, (1) educational attainment is higher compared to the pre-decentralization era, (2) regional variations in educational attainment will have increased, and (3) the fiscal capacity, degree of urbanization, and development will be higher, the higher the municipality's mean year of schooling. The latter is also expected for the newly created municipalities of the past years. We test the hypotheses with panel data on 5,541,983 respondents aggregated to 3880 observations nested in 491 districts/cities nested in 32 provinces for the pre- and post-decentralization era. The results reveal the following. First, after decentralization, the length of schooling slightly increased, but progress in the length of schooling has slowed down a bit. Second, educational attainment variation between provinces slightly decreased,

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but the variation among municipalities increased. Third, the degree of municipalities' development and urbanization has a significantly positive impact on improving educational attainment, while the fiscal capacity and the status of being a new municipality do not have a significant effect on extending the length of schooling. Our findings suggest that especially rural areas and less developed municipalities have lagged behind in the attempt to improve Indonesia's educational attainment.

Keywords Decentralization · Educational attainment · Regional variations · Local government · Indonesia

1 Introduction

Decentralization has become a global phenomenon that has taken place in more than 80 % of the world's countries, in both developed and developing countries (Manor 1999). Many donor agencies and development institutions promote decentralization as a major element in good governance efforts (Berg-Schlosser 2004). From a good governance perspective, decentralization entails bottom-up planning as a strategy to capture and address local needs and aspirations (Johnson 2001; Devas 2002), and to achieve responsiveness and accountability of policy makers to local citizens (Crook and Manor 1998). Reasons to implement decentralization are diverse, ranging from international economic pressures to internal demands for increased citizen participation (Duncan 2007).

For a long time, Indonesia was one of the most centralized nations in Asia (e.g. Budiman 1988; Mackie and MacIntyre 1994; Nordholt 2003). This situation changed dramatically when the Indonesian government initiated a decentralization wave in 2001. The country was decentralized in the hope to realize a modern, decentralized administrative system that would accelerate the improvement of public services, particularly in the education field (BEC-TF 2010).

Since the 1990s, education has been an increasingly important policy domain in Indonesia. Education is perceived as crucial to the country's economic transition from an agricultural to an industrial economy that increasingly depends on the skills of employees (Jeon 2011). In addition, Indonesia is a socially and ethnically diverse country, with over 300 distinctive ethnic groups and 742 different languages and dialects (UNESCO 2011). Universal education is assumed critical to strengthen social cohesion among citizens, which in turn is important to maintain political stability as well as sustainable economic growth (UNESCO 2011).

The decentralization of education was expected to become a stepping stone to improved educational outcomes in Indonesia. In the decentralization literature, there are two perspectives on the link between decentralization of education and educational outcomes. Proponents of the first perspective argue and present evidence for a positive effect of education decentralization, such as Heredia-Ortiz

(2007). In Indonesia, for example, Simatupang (2009) showed that on average, most education outcomes significantly changed for the better after decentralization. Moreover, local governments were found to respond better to local needs for education services, as indicated by improvements in the national average years of schooling, adult literacy rates, female literacy rates, and lower high school dropout rates. In addition, several evaluation findings showed that decentralization leads to service provision practices that are closer to the local people's needs (Usman 2001; UNDP 2002; Sumarto et al. 2004). However, proponents of the second perspective present studies showing that decentralization has a negative impact on educational outcomes [see, for instance, Treisman (2000)]. In the Indonesian case, Kristiansen and Pratikno (2006), for example, presented evidence that decentralization of education almost tripled the school costs. Consequently, parents may be asked to pay more for their children's education, which may lead to school dropout. Others added that after one decade of decentralization in education, Indonesia's education service is still not satisfactory because of a lack of competence of the education district offices, which will also hamper educational outcomes (Haryanto 2010).

In sum, previous studies produced inconsistent and contradicting evidence on the impact of decentralization on improving one particular educational outcome in Indonesia, namely years of educational attainment. This study aims to explain these inconsistent findings by focusing on the variation in educational services and outcomes in the various administrative levels that came into existence with Indonesia's decentralized system of governance.

We assume that decentralization enables the local government to properly respond to local demands to improve government accountability and to innovate and advance their effectiveness in the educational field, which may lead to improved adults' educational attainment and thus to a sustainable society. However, next to the positive effects, decentralization may have negative effects on educational outcomes, depending on the functioning of the lower administrative levels as a new actor in educational service provision. Therefore, decentralization does not necessarily have a positive impact on educational attainment; this depends on regional characteristics and a local government's implementation capacity and quality. For example, the reduced power and information position of the central education ministry could lead to system collapse (Madeira 2012). Decentralization can also lead to confusion over education management and policy implementation, which can negatively affect educational effectiveness and efficiency (Treisman 2000). Nevertheless, if planned and implemented properly, decentralization has the potential to improve education services, and thus educational attainment, connecting local level aspirations and preferences. Likewise, decentralization can also strengthen accountability because it provides robust incentives for local administrative levels to work towards better education services. Decentralization is thus likely to generate differential effects on educational attainment in the various regional and local levels.

2 Research Questions

Given that the decentralization process in Indonesia led to more autonomy in educational policymaking and implementation, we assume that regional differences and variation in local authorities' capacities to manage the education system have increased. The main research question of this chapter is, therefore, as follows: *To what extent did the decentralization of Indonesia's educational sector affect (variability in) educational attainment at the provincial and municipal levels?*

In this study, educational attainment is operationalized by the length of schooling received. The two subquestions that guide this paper are as follows: (1) to what extent did length of schooling change before and after decentralization and (2) to what extent does length of schooling vary within and between local administrative levels?

In the remainder of this chapter, we first discuss both the social and scientific contribution of this paper, followed by the research design and methodology. Before presenting the theoretical framework and hypotheses, we briefly describe the setting of educational decentralization in Indonesia. We then discuss the empirical findings in relation to the research question and hypotheses and close with the conclusion and recommendations.

3 Social and Scientific Significance

Indonesia is an interesting decentralization case to study since it implemented the decentralized system as a "big bang" (World Bank 2003). It changed from one of the most centralized countries to one of the most decentralized in the world, after it bestowed power and authority from the central government to the local level (Nordholt 2003). This big bang of decentralization allows the study of its impact on service provision in the educational sector.

This chapter contributes to the existing literature on decentralization in education by presenting a before and after analysis of the impact of decentralization on changes in educational attainment in Indonesia. We use panel data of the pre-decentralization era (1996–1999) and the post-decentralization (with direct elections) era (2008–2011). The scientific relevance of this study is thus in analysing the effect of decentralization on regional inequality. Despite a considerable number of studies on the impact of decentralization on educational attainment, to our knowledge no explicit exploration of the conditions under which decentralization may have positive and/or negative effects on educational attainment has been carried out in Indonesia.

The societal relevance of the study is to provide insights that may be helpful in developing tailor-made policy interventions aimed at improving educational attainment in specific regional situations in Indonesia. These insights are important for creating effective and targeted government interventions as part of Indonesia's good governance ambitions in terms of voice and accountability as well as government effectiveness, which are both important for World Bank good governance indicators (Kaufmann et al. 2009). Voice and accountability capture perceptions of the extent to which the citizens are able to participate in selecting their government. Government effectiveness captures perceptions of the quality of public services, the quality of policy formulation, and implementation (Kaufmann et al. 2009).

4 Research Design and Methodology

In the following sections, we first present a review of the international literature on decentralization in the Indonesian context and then develop three hypotheses that will guide subsequent statistical analyses. We employ both descriptive statistics and multilevel regression analyses (see, e.g. Snijders and Bosker 2012). Looking at the nature of decentralization, which involves a multilevel government structure, we need to consider these various levels in our analysis to comprehend the effects of decentralization at these levels.

Even though decentralization in Indonesia mainly pertains to the district and city level, the impact at the province level is also critical because, since 2008, the central government has mandated governors as central representatives to coordinate among districts and cities. We take into account the impact and interdependence of these various levels (municipalities and provinces), where each province consists of several municipalities. We included different time points related to the two decentralization phases: four years before decentralization from 1996 to 1999 and four years after decentralization with democratization (2008–2011). In this manner, we can study the change in educational attainment measured by the length of schooling from the pre-decentralization period to the post-decentralization period and the development in the length of schooling over the years as expressed by the mean length of schooling and the correlation matrix. We tested the impact of four important factors affecting educational attainment: the municipalities' fiscal capacity, the proportion of urban area, the municipalities' type and level of development, and the municipalities' establishment (i.e. whether new or not). Moreover, we tested the stability of the effect of the control variables over time, by including so-called cross-level interactions (Snijders and Bosker 2012).

5 Decentralization and Education in Indonesia

The concept of decentralization is broad and varied. Rondinelli and Nellis (1986 p. 5) define decentralization as "the transfer of responsibility for planning, management, and the raising allocation of resources from the central government and its agencies to field units of government agencies, subordinate units of levels of government, semi-autonomous public authorities or corporations, area-wide, regional or functional authorities, or non-governmental private or voluntary organizations". Likewise, Mawhood (1983) simply defines decentralization as the devolution of power from central to local governments, whereas others define it more precisely as a transfer of authority and responsibility for public functions from the central government to subordinate or quasi-independent government organizations (Cohen and Uphoff 1997; Litvack et al. 1998; UNDP 1999).

Conceptually, there are different types of decentralization, depending on the degree of autonomy granted to the local level (for a discussion of these types sees Uphoff 1997; Litvack et al. 1998; UNDP 1999). The World Bank (2004) categorized the decentralization process in Indonesia as *devolution*, which is defined as a transfer of authority through which the central government moves responsibility and certain functions to quasi-autonomous units of local governments that are beyond its direct control. Devolution is considered the most rigorous type of decentralization (Cohen and Peterson 1999)

The way in which the Indonesian education system is based on the decentralization policy is described in both Regional Government Law and Regional Fiscal Balance Law [Republic of Indonesia (RI) 2004].[1] These laws rearrange the roles, functions, and responsibilities among government levels, and they were a starting point to implement direct elections. While steps towards decentralization were already taken in 2001, it was not until 2004 that the governors, mayors, and heads of district were given even more autonomy due to the introduction of direct elections at the local level (Sjahrir and Kis-Katos 2011). Direct elections demand that local leaders not only take into account the orders of the central government but also consider the aspiration of the voters. Consequently, decentralization gives more opportunities for local governments to exercise their decision-making authority to pursue their objectives.

The introduction of direct elections stimulated all local leader candidates to offer attractive promises in their campaigns, including a commitment to abolish education fees, so that voters elect them. Free education, therefore, has appeared as a prominent topic in almost all local political contests since. Several studies conclude that in direct elections, education has usually become a strategy for candidates to gain popular votes (Sifuna 2005; Oketch and Rolleston 2007).

In the decentralized system, the central government annually allocates more than 32 % of the government expenditure to the provinces, districts, and cities [Ministry of Finance (MoF) 2012]. Such allocation provides more options for local governments to improve public services, particularly in the education sector, because it is stated in the constitution that governments (central, provincial, district, and municipal level) are obliged to allocate a minimum of 20 % to the education sector (RI 2002). Moreover, the local governments also received transfers of enormous human resources: more than 2.6 million public servants are currently working at the lower level (World Bank 2003), of which the majority work in the education sector, such as teachers, principals, and staff of local education offices.

The Constitution of Indonesia states that every citizen shall have the fundamental right to obtain education (RI 1945). Operationally, the Indonesian education

[1]The Regional Government Law No. 32/2004 and Regional Fiscal Balance Law No. 33/2004.

system is based on Law no. 20/2003 of the National Education System that integrates various types of education, including general, technical, and vocational, and madrasah (religious) schools, both formal and non-formal (RI 2003). Under this law, formal education is defined by the following: (1) pre-primary education for the age 4–6, (2) six-year primary education for ages 7–12, (3) three-year lower secondary education for ages 13–15, (4) three-year upper secondary education for ages 16–18, and (5) higher (tertiary) education (Law no. 20/2003).

The government initially launched a six-year compulsory education requirement in 1984, which was followed by introducing a nine-year compulsory education system in 1994 (Arina 2011). Currently, the decentralized education system deals with more than 50 million students ranging from primary to senior secondary education in 247,383 schools with more than 42 million pupils enroled in compulsory education [Central Bureau of Statistics or (CBS) 2013]. Tertiary education is centrally administered, and it consists of 5 million students in 3815 public and private higher education institutions (CBS 2013).

After more than one decade of education decentralization, the inputs of the education sector have consistently increased, especially after the fully decentralized system was implemented with almost all local government leaders being directly elected. This is indicated by an increasing number of schools from 227,481 in 2005/2006 (as a point of departure for the initiation of direct elections) to 231,823 in 2008 when all the local governments' leaders were directly elected. This growth in the number of schools continued to be 234,771 in 2009/2010 and 247,383 in 2011/2012 (CBS 2013).

The fact that the government provided the funds to establish more schools as a way to improve access to education also resulted in rising enrolment rates both in compulsory education (pupil age 7–15 years) and in years beyond compulsory education. For example, school enrolment rates of pupils in the age of 7–12 years consistently increased from 95 % before the decentralized system in 1999 to 98 % in 2012. Likewise, school enrolment rates of pupils in the age of 13–15 years rose tremendously from 79 % in 1999 to almost 90 % in 2012. Also, school enrolment rates of pupils between the ages of 16 and 18 years increased considerably from 51 % to almost 61 % (CBS 2013). To conclude, at the national level, overall access to education improved after one decade of decentralization.

6 Theory and Hypotheses

Theoretical work about the impact of government decentralization dates back to the early 1970s. Oates (1972) introduced the preference-matching argument, reasoning that decentralization will improve allocative efficiency by bringing greater diversity into the supply of public services, because decentralization allows serving a diverse set of preferences for public goods. Oates (1972) and Tiebout (1956) also argued that decentralization leads to an efficient provision of public goods because local preferences are better served than in the case of centralization.

The basic assumption behind such claims is that decentralization stimulates political accountability, which will have a positive effect on government efficiency. Elections provide accountability through two different, although related, effects. First, it creates a selection effect, since voters can decide not to re-elect incompetent incumbents. Second, it promotes an incentive and discipline effect, since unsuccessful incumbents have an incentive to improve the quality of government in order to increase the probability of re-election (Besley and Smart 2007). Due to these two effects, it is assumed that decentralization and direct elections enable local people to choose local government leaders who are responsive and accountable. In turn, these local leaders will have an incentive to absorb local preferences and to develop tailor-made policies and programmes. Decentralization is thus assumed to lead to informational advantages on the side of local governments (Hayek 1948), as well as to more attention to preference heterogeneity and to more opportunities to control agency problems (Tommasi and Weinschelbaum 1999; Bardhan 2002).

Increased local government resources will positively reinforce this process, because it gives local governments even more autonomy to design and plan tailor-made educational programmes and to promote local government ownership, which is important to strengthen local government control (Simatupang 2009). The resulting tailor-made educational programmes, based on appropriate control, are expected to lead to improved educational outcomes (Sjahrir and Kis-Katos 2011), because these programmes can incorporate the social, cultural, and geographical diversity in municipalities, which was neglected in the centralization era due to a one-size-fits-all development policy.

The above arguments align with Faguet and Sanchez' findings (2006) that showed decentralization improved public school enrolment in Colombia. Their study also showed that in highly autonomous districts characterized by less central government control, enrolment rates increased, while in districts with greater control from the central government enrolment rates declined. Similarly, for the Argentinian case, Habibi et al. (2001) found that decentralization had a positive and significant impact on enrolment rates. This led them to conclude that decentralization is positive for education because it allows local governments to raise more of their own resources, which is conducive to improving educational output. Therefore, the first hypothesis reads:

H1 Compared to the pre-decentralization era, the progress in the mean length of schooling is higher overall after decentralizing Indonesia's educational sector.

Whereas we expect that overall more progress will be made in educational attainment, in terms of an increasing length of schooling after decentralization, decentralization can also have a negative effect by creating more regional variation. We expect that some regions will benefit more than others from the decentralization process for the following reasons. First, transferring the decision-making authority closer to local people might only generally yield positive results if the local government's capacity is adequate. The other way around, the benefit of decentralization may be weakened when local governments lack technical capabilities. For example, Galiani and Schargrodsky's findings (2002) showed that the effect of decentralization on educational outcomes in Argentina is generally positive, but that its impact is stronger in provinces that are fiscally better managed. Conversely, the impact is negative for schools located in poor provinces with lower fiscal capacity.

Second, although local people's aspirations regarding public services might be similar, the local voters' preferences in policy domains may vary depending on local characteristics. For instance, in some districts, most people might favour a better transportation infrastructure over a better education system, while in other districts one may prioritize the education sector. These assorted decisions may influence the success of public services, such as education. It implies that if local governments based on voters' preferences place education services as the highest priority, education service delivery is more likely to improve. On the other hand, if local governments do not emphasize education services, the results may be the opposite.

Third, local governments differ in terms of resources and constraints that may affect education services (Kaiser et al. 2006). For example, some municipalities, which have revenue sharing from oil and mining, generate much more revenue that can be spent on education, while other municipalities do not have this source of income. In terms of governance, variations among municipalities may thus influence the effectiveness to provide better educational services.

To summarize, local governments' disparities regarding voters' preferences, decision-making and implementation capacity, and resources and constraints may intensify regional variations in educational outcomes, such as educational attainment. We therefore expect that after implementing decentralization, variability in the length of schooling between municipalities and between provinces increases. Thus, the second hypothesis reads:

H2 Compared to the pre-decentralization era, regional variation in education attainment both in municipal and provincial levels is higher after decentralizing Indonesia's educational sector.

As we argued, the effect of decentralization on educational attainment is expected to be influenced by a local government's capacity, such as human, financial, and information resources, and infrastructure (Williamson et al. 2003). Various aspects matter in this regard, the first one being fiscal capacity.[2] Subroto (2007) found, for example, that the decentralized system increased fiscal capacities of municipalities in Indonesia and thus may increase local government education expenditure. However, Subroto (2007) found that decentralization increased disparities in education expenditures per student, which thus enlarges the gaps in fiscal capacities for education across municipalities.

[2]According to Ministry of Finance decree No. 54/PMK.07/2014, fiscal capacity refers to an overview of each region's financial capacity which is reflected through the general revenue in Local Government Budget (excluding Special Allocation Fund, Emergency Fund, old loans, and other revenues restricted for financing certain expenses) to fund the government's duty net of personnel expenditures and the number of poor people.

The capacity of municipalities is influenced by other characteristics as well. Whether a municipality is urban or rural, for example, may relate to lower per capita cost of providing education service (Jayasuriya and Wodon 2003). Kessides (2005) argues that efficiency would be better in urban than rural areas because monitoring may be easier in urban areas. Urban areas also often have better infrastructure and facilities, such as good transportation. This facilitates short travel distances to school, which stimulates education attainment (Johansone 2010). In addition, living in urban areas provides better reinforcement for students' school completion. Therefore, we predict that the type of municipality administration and level of the socio-economic development effect on the education service.

Furthermore, referring to the Regional Government Law No. 32/2004 and the Ministry for the Development of Disadvantaged Regions (MDDR) decree on list of underdeveloped districts, we assume that cities have more resources than district as indicated by gross regional product (GRP) (Halim 2004). In addition, Prud'homme (1995) points out that economic activity and average income in a city are larger than those in a district. Moreover, in terms of socio-economic circumstances, the government defines that an underdeveloped district is in general worse than a developed district (MDDR 2011).

Fourth, local government proliferation policy, including at municipality, might influence on variations in capacity of the municipality. We expect that municipality proliferation is matter whether a municipality is newly established or not.[3] Studies on the impact of local government (municipality) establishment and formation have varied in terms of their conclusions about the possible outcomes of establishing new municipalities (Brancati 2006). In the Indonesian context, Qibthiyyah (2008) shows that the impact of the creation of new local governments is not uniform across the effected local governments. Her findings show support for the existence of improved education outcomes in new local governments as represented by a reduction in the dropout rate. Qibthiyyah (2008) explains that the presence of spillover may be signalled by a relatively worse outcome in the originating municipalities during the post-event of municipality creation in contrast to outcome improvement in the new municipalities. The findings also imply the creation of new municipalities tend to improve service delivery from higher accountability and higher intergovernmental transfers.

Based on the above, we decided to include four proxies into our analysis that provide information about a municipality's capacity: (1) the local government's fiscal capacity; (2) the proportion of urban area (urbanization), which influences the economies of scale; (3) the type of municipality administration and level of the socio-economic development; and (4) the type of new municipality establishment. The third hypothesis expects:

[3]In the context of Indonesian, decentralization intertwines with a policy to create new municipalities, i.e. the creation of new local governments, one part of the decentralization program in Indonesia. According to Harmantyo (2011), a number of municipalities have increased from 319 in 1999 to 524 in 2010.

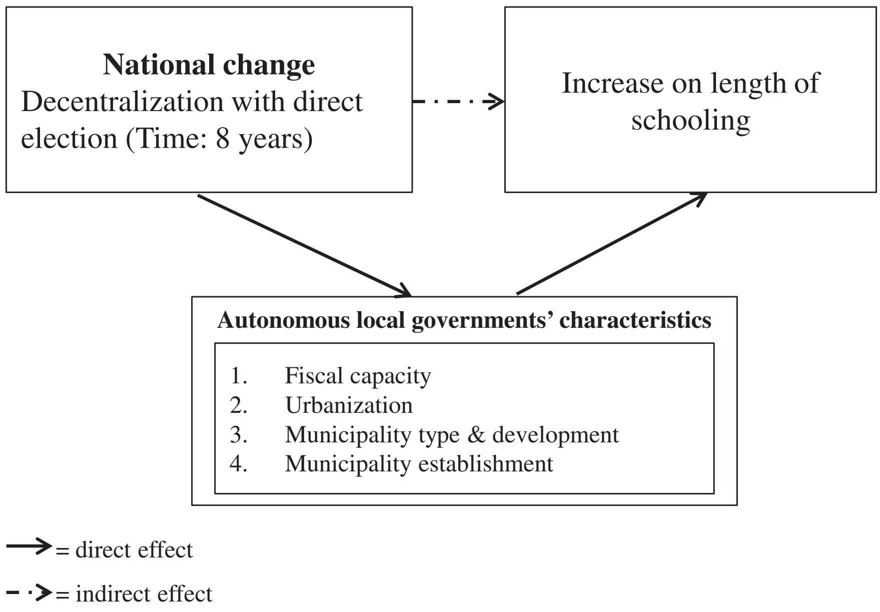

Fig. 1 Theoretical framework

H3 The higher the fiscal capacity, the degree of urbanization and development, and for new municipalities, the longer the municipality's mean year of schooling.

Based on those arguments, the theoretical framework could be systemized in Fig. 1.

7 Data and Method

7.1 Data and Measurements

The most important source of data for our analysis was a rich, annual nationwide survey: the National Socio-economic Survey (NSS) from the *Indonesia Central Bureau of Statistics* (CBS). The NSS is a nationwide survey conducted to gather basic social and economic information as a main source of monitoring indicators of social and economic development in Indonesia. During 1963–1978, it was conducted every two years, and then, it was done on an annual basis until 1992. Since 1992, in addition to the basic social and economic questionnaire (the Core), an additional questionnaire was introduced which gathers more detailed information on special interest topics (the Module). The NSS Core is conducted on an annual basis in July, while the NSS Module is conducted every three years in July. The

NSS Core annually covers eight indices: demography, health, education, labour, fertility and family planning, housing, and consumption (CBS 2013).

We combined the NSS data with data on municipality development from the Ministry for the Development of Disadvantaged Regions (MDDR) in 2011 and from a database of newly created municipalities from the Ministry of Home Affairs (MoHA), which was updated and adjusted for 2008–2011 (MoHA 2012). We selected data at four time points before decentralization (1996–1999) and four time points after decentralization (2008–2011). Additionally, we employed a fiscal capacity index from the Ministry of Finance (MoF). We exclude all municipalities in the Jakarta Province because these are not autonomous entities, as they are centrally managed by the province as part of its metropolitan character. Thus, we constructed panel data that contain four years before decentralization and four years after decentralization, based on 5,541,983 pupils in 491 municipalities (districts/cities), nested in 32 provinces.

7.2 Variables

Educational attainment is operationalized by the length of schooling measured by the average number of years of education received by people aged 15 and older, using official durations of each level (Barro and Lee 2010), weighted with CBS population weights. We constructed the annual municipalities' length of schooling from the NSS datasets by combining the questions: (1) highest education completed and (2) highest school grade ever achieved or is currently attending. We then converted them into years of education, ranging from: 0 for no schooling; 0–6 for primary school grades; 6–9 for junior secondary school grades; 9–12 for senior high school grades; 13–15 for higher vocational education (diploma I, II, and III); and 16 for bachelor and more.

Decentralization period indicates the calendar years 2008–2011, to facilitate the comparison of average length year of schooling in municipalities before and after decentralization. In addition, we constructed eight dummy variables pertaining to four years before decentralization (1996–1999) and four years after decentralization (2008–2011).

Fiscal capacity as defined by the MoF is classified in four ordinal categories: low fiscal capacity (index ≤ 0.5) as 1; middle fiscal capacity ($0.5 < \text{index} < 1$) as 2; high fiscal capacity ($1 \leq \text{index} < 2$) as 3; and the highest fiscal capacity (index ≥ 2) as 4. Data on the fiscal capacity is only available after decentralization because before decentralization, the local governments were not autonomous entities. Moreover, due to the calculation method, the index criteria changed over time. We therefore only utilized the fiscal capacity in one year (2010) using criteria on the basis of the local government's own-source revenue (*pendapatan asli daerah*, PAD) + revenue sharing fund (*dana bagi hasil*, DBH) + general allocation fund (*dana alokasi umum*, DAU) + other revenues + personnel expenditure/the number of poor population.

Urbanization is annually measured by the proportion of urban area in the municipalities. This is coded 0–1, with zero referring to a municipality with mainly rural area and one for a municipality with mainly urban area (from NSS 1996–1999 and NSS 2008–2011).

Municipality's type and level of development represents the socio-economic level of development in 2011, with a code 0 for the least developed district; 1 for a developed district; and 2 for the city administration area (MoHA 2012; MDDR 2011).

Municipality's establishment from 2008–2011 is coded 0 for an old municipality and 1 for a newly established municipality (MoHA 2012).

7.3 Statistical Analysis Plan

The first step in the analysis was to describe the development in the average length years of schooling over the years before and after decentralization, both at the municipal and provincial levels. After presenting descriptive statistics, we conducted a three-level (year, municipality, and province) regression analysis in MLwiN 2.30 (Rasbash et al. 2014) with correlated (random) year effects (a "fully multivariate" model, see chapter 16, Snijders and Bosker 2012). This modelling approach allowed us to take into account the hierarchical nature of our data and to test the hypotheses of period (at the year level) and municipalities.

After assessing the overall mean and variances at the three levels in the so-called null model (without any covariates), we included the parameters for eight years (with 1996 as the reference year) to estimate the progress of schooling over time in Model 1. Then, in Model 2, we incorporated the contextual factors at the municipality level, which allowed us to estimate the effects of fiscal capacity, urbanization, municipality's type and status, and municipality establishment. In a third model, we employed cross-level interactions to test the difference in (effects on) progress of educational attainment after the education decentralization. This model turned out not to be an improvement over Model 2 in terms of meaningful effects and by comparing their deviances to assess the relative fit of the models by means of a chi-square test (see for a further explanation Snijders and Bosker 2012). Therefore, the estimates of the third model are not presented.

In the next sections, we first show descriptive statistics and then turn to testing the hypotheses by interpreting the results of Models 1 and 2.

7.4 Descriptive Results

Table 1 presents descriptive statistics for the average length of schooling at the municipal level before decentralization, starting at 6.41 years of schooling (SD 1.36) in 1996 to 7.38 years of schooling (SD 1.58) in 1999. Meanwhile, after

Table 1 Descriptive statistics

Variables	Years	Min	Max	Mean/*mode*	SD
Municipality level (N = 491)					
- Mean year of schooling	1996	2.1	10.5	6.41	1.36
	1997	2.3	10.5	6.66	1.37
	1998	2.5	12.1	7.27	1.57
	1999	2.8	12.2	7.38	1.58
	2008	1.7	12.0	7.70	1.48
	2009	1.0	12.1	7.88	1.58
	2010	0.5	12.3	8.00	1.56
	2011	0.9	12.2	7.98	1.57
- Urbanization	1996	0.0	1.0	0.28	0.26
	1997	0.0	1.0	0.28	0.26
	1998	0.0	1.0	0.28	0.26
	1999	0.0	1.0	0.30	0.27
	2008	0.0	1.0	0.36	0.31
	2009	0.0	1.0	0.36	0.32
	2010	0.0	1.0	0.37	0.31
	2011	0.0	1.0	0.36	0.31
- Fiscal capacity	All years	1.0	4.0	1.90 *1.00*	1.06
- Type and development	All years	0.0	2.0	0.81 *1.00*	0.73
- Establishment (new)	All years	0.0	1.0	0.41	0.49
Province level (N = 32)					
- Mean year of schooling	1996	4.9	7.8	6.66	0.77
	1997	5.4	8.2	6.92	0.73
	1998	5.9	8.8	7.58	0.77
	1999	6.0	9.1	7.73	0.87
	2008	6.5	9.0	7.93	0.69
	2009	6.6	9.6	8.14	0.74
	2010	6.5	9.7	8.28	0.78
	2011	6.0	9.9	8.28	0.81

$N_{level\ 1=3928}$; $N_{level2=491}$; $N_{level3=32}$

decentralization, the mean year of schooling at the municipal level was 7.70 (SD 1.48) in 2008 and increased to 8.0 (SD 1.56) in 2010. Then, it decreased to 7.98 years (SD 1.57) in 2011. In addition, the variation of the length of schooling consistently increases before decentralization, but it fluctuates after decentralization.

At the provincial level, before decentralization, the mean year of schooling consistently increased from 6.66 (SD 0.77) in 1996 to 7.73 (SD 0.87) in 1999. After decentralization, it similarly rose from 7.93 (SD 0.69) in 2008 to 8.28 (SD 0.81) in

2011. At provincial level, the pattern is slightly different with the municipal level: both variations of the length of schooling before and after decentralization grow constantly. Moreover, variability at the municipal level is higher than at provincial level as is clearly shown by the standard deviations.

The fiscal capacity of municipalities is mainly low with an average of 1.9 on a scale from 1 to 4. Meanwhile, the percentage of urbanized municipalities went up from 28 % in 1996 to 36 % in 2011. Urbanized municipality variations slightly increased from 0.07 before decentralization to 0.10 after decentralization. Additionally, the variable type of administration and status of development indicate mainly developed municipalities (mode = 1). The majority (59 %) of the 491 municipalities are old established municipalities, which are already existed before decentralization. The rest (41 %) are newly created municipalities, proliferated after decentralization

7.5 Multilevel Analysis

The null model presented in Table 2 shows that on average, Indonesian citizens received approximately 7.5 years of schooling. Based on the presented variances (in the random part in the table), the differences between municipalities are largest (59 %, see footnote 1 in Table 2), followed by differences between the years (27 %). The differences between provinces are relatively low (14 %). Extending the model with separate parameters for all years shows that there is indeed an increase in educational attainment from approximately 6.5 years of schooling in 1996 (the intercept of Model 1 in Table 2) to approximately 8 years in 2011 (6.479 + 1.571). Moreover, Model 1 reveals smaller differences between municipalities in the earlier two years before decentralization, (the random part of Table 2 shows variances of approximately 1.4 for 1996 and 1997) compared to the other years with estimated variance equal to approximately two. Model 1 is an improvement over the simple null model, as is confirmed by the decrease in deviance from 10,973.1 (Null Model) to 5842.3 (Model 1).[4] After including the four explanatory variables (fiscal capacity, urbanization, municipality's type and status, and municipality establishment), the values of the variances significantly decline ranging from approximately 0.6–0.9. The deviance difference between Model 1 and Model 2 was 884.9. This difference is significant when tested against a chi-squared distribution test with five degrees of freedom (corresponding to the five added fixed parameters). The effects of urbanization and type of the municipality were both significant.

[4]The difference in deviance of 5130.8 is tested with a chi-squared distribution with 35 degrees of freedom (df, the number of added parameters, 7 'fixed' year effects, and 28 'random' correlations, see Table 3).

Table 2 Multivariate multilevel regression analysis of mean years of schooling

	Null model[a]		Model 1[b]		Model 2[c]	
	Coeff.	S.E.	Coeff.	S.E.	Coeff.	S.E.
Fixed part						
Intercepts	7.479***	0.123	6.479***	0.121	6.390***	0.129
Level 1: Years						
Years: 1996 (ref.)						
1997			0.248***	0.016	0.235***	0.016
1998			0.854***	0.019	0.840***	0.019
1999			0.971***	0.026	0.918***	0.025
2008			1.292***	0.037	1.086***	0.027
2009			1.470***	0.041	1.266***	0.032
2010			1.590***	0.038	1.358***	0.031
2011			1.571***	0.040	1.354***	0.032
Level 2: Municipalities						
Fiscal capacity						
(Fiscal-gm)					0.023	0.018
Urbanized municipalities (%)						
(Urban-gm)					2.553***	0.082
Municipalities' type: Less developed (ref.)						
Developed district					0.304***	0.087
City					0.493***	0.101
Municipalities' establishment: Old municipality (ref.)						
New municipality					−0.007	0.069
Random Part						
Level 3: Province	0.357	0.120	0.361	0.107	0.366	0.100
Level 2: Municipality	1.486	0.104				
Level 1: Years	0.665	0.016				
1996/1996			1.431	0.093	0.549	0.036
1997/1997			1.462	0.095	0.599	0.039
1998/1998			2.096	0.136	0.913	0.060
1999/1999			2.092	0.136	0.916	0.060
2008/2008			1.814	0.118	0.690	0.045
2009/2009			2.038	0.133	0.937	0.061
2010/2010			2.036	0.132	0.905	0.059
2011/2011			1.962	0.128	0.855	0.056
*−2*loglikelihood*	11,034.1		5926.9		5042.0	

Table 2 (continued)

$N_{\text{level 1=3,928}}$; $N_{\text{level2=491}}$; $N_{\text{level3=32}}$

Note *$p < 0.05$, **$p < 0.01$, ***$p < 0.001$

[a]We calculate variances in mean year of schooling from null model: (1) level 1 (years) is 27 % (0.665/[0.357 + 1.486 + 0.665]); (2) level 2 (municipalities) is 59 % (1.486/[0.357 + 1.486 + 0.665]); and (3) level 3 (provinces) is 14 % (0.357/[0.357 + 1.486 + 0.665])

[b]We construct dummy variable for years with 1996 as reference, the estimate coefficients (β) increased from 0.248 in 1997 to 1.571 in 2011. Mean year of schooling in 1996 is 6.48 years, and the highest change is from 6.728 (6.48 + 0.248) in 1997 to 7.334 (6.48 + 0.854) in 1998

[c]From Model 2, we can see that if in 2011 the length of schooling average is about 8 years, the average length of schooling is as follows: 10.6 years (8 + 2.553) for people living in urban area, 8.3 years (8 + 0.304) for people in developed district, and 8.5 years (8 + 0.493) for people in city area. Random slopes in Model 2 showed that variations over years are wide ranging from low to high variations. For example, the low variations are 0.549 and 0.599 in 1996 and 1997, while the high variations before decentralization are 0.913 (1998) and 0.916 (1999) and after decentralization are 0.690 (2008), 0.937 (2009), 0.905 (2010), 0.855 (2011)

Overall, the trend in the length of schooling at the municipal level shows a constant increase where the aggregate improvement after decentralization (2008–2011) is smaller than before decentralization (1996–1999). Table 2 reports the incremental increase of the length of schooling from 0.25 years in 1997 to 0.97 years in 1999 and from 1.29 years in 2008 to 1.57 years in 2011. During the four years before decentralization, the mean length of schooling at municipal level amplified by approximately 1 year with an annual increase of 0.32 years. On the other hand, for the duration of four years after decentralization, it increased by about 0.28 years, which is annually only 0.09 years.

Our first hypothesis proposed that compared to the pre-decentralization era, the progress in the length of schooling is higher after decentralizing Indonesia's educational sector. Although the length of schooling slightly increased, the progress in the length of schooling declined in the post-decentralization era. Both Models 1 and 2 in Table 2 provide clear evidence to refute this hypothesis, indicating a progress of approximately 0.9 in the pre-decentralization era and approximately 0.3 in the post-decentralization era.

The next hypothesis proposed that compared to the pre-decentralization era, regional variability in education attainment will be higher after decentralizing Indonesian's educational sector. The descriptive statistics in Table 1 indicate that before decentralization, the standard deviation of the length of schooling at the municipal level is overall slightly higher after decentralization by about 1.5 than before decentralization, where 1996 and 1997 have a standard deviation of 1.4. On the other hand, the average standard deviation of the length of schooling at the provincial level after decentralization is equal or even slightly lower than before decentralization (approximately 0.75).

The only partial support of the descriptive results for hypothesis 2 is confirmed by the estimates for the variances in the multilevel analysis, revealing the lowest variances in the pre-decentralization years 1996 and 1997, in both Models 1 and 2. In summary, results partially support the hypothesis that compared to the pre-decentralization era, variation in education attainment at municipal level is higher

Table 3 Estimated correlation matrix of mean years of schooling in pre- and post- decentralization years, based on Model 2

Years[a]	1996	1997	1998	1999	2008	2009	2010	2011
1996	1							
1997	0.897	1						
1998	0.908	0.927	1					
1999	0.825	0.807	0.864	1				
2008	0.726	0.722	0.723	0.680	1			
2009	0.692	0.687	0.665	0.615	0.813	1		
2010	0.706	0.713	0.688	0.633	0.842	0.832	1	
2011	0.671	0.673	0.657	0.598	0.836	0.818	0.910	1

$N = 3928$

[a]Random slopes' correlations are strong both before decentralization (cf. correlations between 1999 and 1996, 1997, and 1998 are 0.825, 0.807, and 0.864) and after decentralization (e.g. Correlations between 2008 and 2009, 2010, and 2011 are 0.813, 0.842, and 0.836)

after decentralizing Indonesian's educational sector, but the variation at provincial level is slightly lower.

For further interpretation of the pattern in variability, we can inspect the correlation matrix as shown in Table 3, which clearly demonstrates that the correlations between the years are high, the more so within the pre-decentralization and post-decentralization periods than between the two periods. The high correlations show that it is unlikely that the length of schooling will change drastically from one year to the next; the somewhat lower correlations between the periods show a lower association between mean measurements of mean length of schooling that are at least 12 years apart (and hence more change).

The last hypothesis suggests that the higher the fiscal capacity, the degree of urbanization, and development, and for new municipalities, the higher the municipality's mean year of schooling. The findings partially support this hypothesis as illustrated by Model 2. It shows that the level of urbanization, the type of administration, and development status of the municipalities have a significantly positive impact on the average length of schooling. Urbanization enables people at the municipality level to lengthen their schooling by maximally 2.6 years when comparing fully (100 %) urban municipalities to completely rural areas (0 % urbanization). In addition, the municipal type and development status have a significantly positive impact on the length of schooling of about 0.3 years in a developed district and 0.5 years in a city administration compared to a less developed municipality. It implies that if in 2011 the length of schooling average is about 8 years, the average length of schooling is 10.6 years for people living in urban areas, 8.3 years for people in developed districts, and 8.5 for people in city areas. This finding shows that urbanization has the largest effect on educational attainment. On the other hand, the municipalities' fiscal capacity and the newly created municipalities do not have a significant effect on the mean length of schooling. Moreover, whereas the municipalities' fiscal capacity has a positive direction, the direction of the newly created municipalities has negative effect on the mean length of schooling. This means that the higher the municipalities' fiscal capacity is related to increase the average number of years of schooling, but the government policy to proliferate municipalities is linked to deteriorate the average number of years of education.

8 Conclusion and Discussion

Decentralization is expected to stimulate accountability and to empower local and subnational governments. Accountability as part of good governance is expected to enable local governments to improve their services in the educational sector. This study expands research on the impact of decentralization of Indonesia's education sector using a multilevel government approach. The handful of earlier studies examining the impact of the decentralized education system in Indonesia has mainly focused on one particular administrative level and neglected the hierarchical structure of Indonesia's administrative and government systems. Taking into account the nature of decentralization and its resulting multilevel government structure, by focusing on these various levels, help us better comprehend the effects of decentralization on educational attainment in Indonesia.

This study analysed the impact of decentralization on educational attainment comparing two waves of administrative and political changes in the Indonesian government system. This endeavour enabled us to disentangle educational progress in relation to the centralization era and the decentralization era with direct elections (democratization). We thereby extended existing research by examining the influence of municipal factors and other determinants by using panel data from 5,541,983 respondents aggregated to 3880 observations, nested in 491 districts/cities, nested in 32 provinces for the pre- and post-decentralization era.

8.1 Summary of Findings

In line with our theoretical expectations, our findings suggest that the length of schooling consistently improved both in the centralization and decentralization era. However, the progress in mean years of schooling after decentralization was smaller than before decentralization. Additionally, substantial variability in mean length of schooling is also observed after decentralization, even when taking into account municipality characteristics, such as urbanization. This implies that decentralization is not a guarantee for improving educational attainment because of trade-offs between intended and unintended consequences. Decentralization may increase accountability and empower local governments to provide better education services but only if local governments have the capacity to do so. Therefore, decentralization increased people's educational attainment in some municipalities but not in others. Moreover, the mean years of schooling even decreased after decentralization in some municipalities.

Two of the four investigated municipality characteristics were shown to improve the length of schooling. The level of urbanization and the development status of a municipality have a significantly positive impact on the mean length of schooling. From this, we conclude that urbanization and municipality development, which is represented by a better infrastructure, more job opportunities, and better health care, have a positive impact on improving quality of living in a municipality, as shown by others (cf. Filmer and Pritchett 2001). This might be due to the fact, as argued by Buchmann and Brakewood (2000), that higher levels of development are more likely in urbanized districts, which often have better road and transport infrastructure and better educational opportunities. These increased educational opportunities likely lead to an increase in the length of schooling.

The municipalities' fiscal capacity or whether they are newly established municipalities does not have a significant impact on improving the people' average length of schooling at the municipal level after taking into account indicators of urbanization. Analyses from the World Bank (2008) suggest that net enrolment rates are positively correlated with education spending per student and with education spending as a share of overall municipality spending. However, the municipalities' fiscal capacity, the measure used in this chapter, does not always represent the education expenditure per student. The World Bank (2008) found that poor municipalities spend a larger proportion of their budgets in the educational sector than those in some of the richest municipalities do. The 40 % of the poorest districts spend approximately 35.4 % of their budget on education, while the richer districts spend 31.5 %. Therefore, poorer municipalities are not necessarily lagging behind in education expenditure per capita. In addition, the amount of educational expenditure is not sufficient to improve educational access. It also depends on how the local government utilizes the education expenditure, which is related to the human capacity available at the local government level to improve the quality of education service. An improvement in education service in its turn will attract more people to lengthen their schooling (Hofman and Kaiser 2006).

8.2 Unexpected Findings, Limitations, and Avenues for Future Research

Two unexpected findings deserve further discussion. First, we conclude that the progress of change decreased after decentralization. Why this progress is slower after decentralization can be explained by Bardhan's adapted theory of decentralization for developing countries (2002). First, centralization can create economies of scale with regard to overhead and facilities. For example, a centralized system can be more economically efficient in purchasing materials for building a large number of new schools as a method to provide more access to education. Second, decentralization implicitly assumes that allocated funds automatically reach the beneficiaries. This assumption needs to be qualified with the spending quality and the capacity of public bureaucrats at the local level. Third, a World Bank's study (2008) exposed that although municipalities spend the majority of the total education budget, these expenditures are mostly non-discretionary routine expenditures (75.2 %), the majority being personnel spending. Therefore, although municipalities spend a substantial share of expenditures in the education sector, they actually have very little fiscal autonomy for expenditures to implement tailor-made programmes. Finally, progress of length of schooling becomes more difficult to improve when the schooling has already been achieved to a substantial level.

Second, our findings also reveal that decentralization increased the variability in the mean length of schooling between municipalities, but not among the provinces. These findings could be elucidated by Nordholt's argument (2003) that decentralization in Indonesia bestowed power and authority from the central government to the municipal level as an autonomous entity. Consequently, the roles of provinces are limited especially in the education sector because the primary and secondary schools are directly managed by the municipalities. Moreover, local government autonomy enabled the municipality to tailor their programme to accelerate education attainment. However, the municipalities are diverse in terms of resources and constraints, which enlarged the variations in improving educational service (Hofman and Kaiser 2006). For instance, some municipalities received substantial revenue, such as revenue sharing from oil, mining, and several local taxes, while other municipalities did not have such additional income. Moreover, in terms of governance, the varied capacities of the local governments had consequences for the effectiveness of the implementation of a tailor-made educational programme. As a result, some municipalities benefitted more from decentralization, while others were not able to benefit optimally from decentralization (Galiani and Schargrodsky 2002).

Finally, a number of limitations to this study and avenues for future research deserve further discussion. Firstly, due to the nature of our data at the municipal and provincial levels which were constructed from individual survey data from different years, these findings do not reveal the microlevel pattern. An avenue for research would be to conduct analyses at the microlevel, such as household and individual levels to disentangle a comprehensive portrait of the impact of education decentralization. Secondly, the new municipalities and new provinces data before decentralization are proxies because those municipalities and provinces were still part of other municipalities and provinces during the centralization era. Future studies could employ more fine-grained measures of the data for newly created local governments, both municipalities and provinces. Third, other contextual aspects such as education expenditure could be examined to determine in more detail the configuration of constraints and opportunities regarding educational access. Finally, future work might also take on a two-sided perspective on government supply and people demand of education and their simultaneous interaction.

Despite these limitations, the current study presents new results and draws a comprehensive picture of educational attainment in Indonesia at both the municipal and the provincial levels. Our results show similarities as well as differences between the eras of centralization and decentralization with democratization that might be useful for further improving Indonesia's decentralization policy. One consideration based on our analysis is how to define the role of the central, provincial, and municipal levels within the multilevel system in handling educational service delivery with the aim of reducing regional discrepancies. This critical issue relates to the question how the central government can define better interventions, both in the domains of finance and technical assistance, to reduce these regional disparities. Our study seems to indicate that the central government's interventions need to be prioritized to predominantly rural area and less developed municipalities.

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Chapter 5
Decentralization, Foreign Direct Investment and Development in Indonesia

K. Kuswanto, Herman W. Hoen and Ronald L. Holzhacker

Abstract As the role of Foreign Direct Investment (FDI) in development becomes increasingly significant, the concern of many policy makers is not only to attract FDI but also to ensure that the society and future generations gain broad benefits from the FDI. Hence, the United Nations Conference for Trade and Development (UNCTAD) developed the Investment Policy Framework for Sustainable Development (IPFSD) as guidance for countries to achieve sustainable development from FDI. Using the IPFSD, this paper examines the investment policies of Indonesia under centralized and various decentralization periods and describes the relationships among government levels in implementing the policies which guide FDI. From the examination, we found that the investment policies in Indonesia have been directed to achieve sustainable development gradually. Furthermore, the intergovernmental relationships that have changed due to the decentralization process have become crucial to the effectiveness of investment policies for the society. During the centralized period, the performance of inward FDI was good, but citizen input and participation in the policy process was weak. In the first wave of decentralization, local governments gained significant powers from the central government to guide FDI. However, the great devolution of power to local governments without

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clear mechanisms of intergovernmental relations and accountability led to a deterioration of the investment climate and made the policies less effective. Finally, during the second wave of decentralization, the central government has taken responsibility in the FDI management process but still provides more room for local governments to participate in the development process. Hence, cooperation between national and local government is more enhanced during this period to guide FDI.

Keywords Foreign direct investment · Decentralization · Investment climate · Sustainable development · Intergovernmental relations · Investment policy framework for sustainable development

1 Introduction

Foreign Direct Investment (FDI) may have both positive and negative impacts on development. FDI has positive impacts on economic development because it contributes to accelerating and enhancing economic growth (Blostrom and Kokko 1998). Rodriguez and Clare (1996) and Graham and Krugman (1991) also suggest that the FDI increases productivity and access to external markets, expands international production network, encourages transfer of technology, skill, and knowledge, and reduces the unemployment rate. Despite those positive impacts, FDI also brings some negative consequences to host countries such as the increase of polluting goods and local dependency on foreign capital, and the destruction of local small enterprises (OECD 2001; Pavlinek 2004). Since FDI brings both positive and negative impacts to development, the recent concerns of many policy makers is not only to attract as much FDI as possible, but also to ensure that the FDI is beneficial to the broader society and future generations.

As the concept of sustainable development and FDI has become a hot topic recently, a study about FDI policy is very relevant especially for developing countries. Sustainable development is a development that meets both the needs of present people and the needs of future generations (WCED 1987). Among middle-income developing countries, Indonesia is an interesting country to study FDI. With abundant natural resources, low labour costs, a large population base, and good economic conditions, Indonesia has been considered one of the most attractive countries for investment in Asia, receiving \$18.85 billion in FDI in 2013 (UNCTAD 2013). Regardless of the good performance of inward FDI in Indonesia, the contribution of this FDI to development in Indonesia remains unclear. Some studies found that the FDI has positive contributions to development in Indonesia (Parjiono 2003; Lipsey and Sjolhom 2002). For instance, Parjiono (2003) found that inward FDI contributes to an acceleration in economic growth, and Lipsey and Sjolhom (2002) found that foreign companies paid higher salaries than domestic ones. On the other hand, some studies found that the inward FDI has made little contribution to regional development in Indonesia (Effendi and Soemantri 2003; Sodik and Nuryadin 2005). Likewise, Thee (2001) found that Indonesia was not successfully taking advantage of FDI projects to promote development. Departing

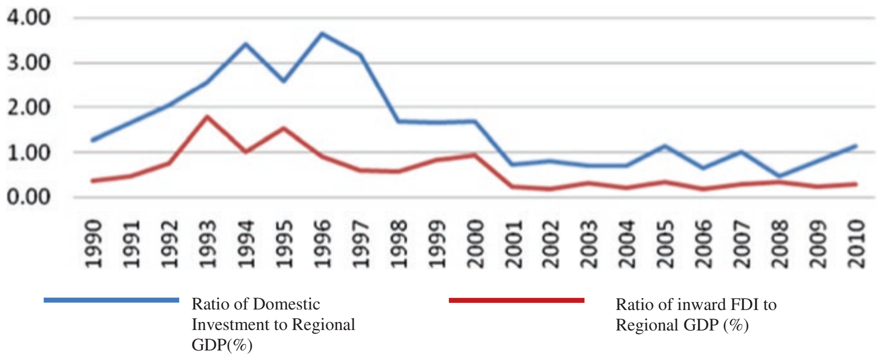

Fig. 1 Trend of inward FDI and domestic investment in Indonesia, 1990–2010. *Source* KADIN (2012)

from those empirical studies, we are interested in examining the FDI policy in Indonesia in relation to the concept of sustainable development.

This study also attempts to analyse the impact of the governance system on the implementation of investment policy. It follows the fact that Indonesia has been implementing decentralization since 2001 and some surprising facts related to FDI have arisen. Decentralization aims to reduce regional inequality and to improve local economic performance by increasing the role of local government in economic development, including managing FDI. However, some institutional problems such as corruption, overlapping regulation, over-taxation, and policy fragmentation have become more prominent during the decentralization era (LPEM UI[1] 2002a; World Bank 2005; Kuncoro 2006). Data from KADIN[2] (2012) illustrates that despite the increase of inflow FDI to Indonesia during the decentralization era, the contribution of inward FDI to regional development remains low. While the total amount of inward FDI going to regions has increased, the ratio of total amount inward FDI to regional GDP has decreased (see Fig. 1). Moreover, data from the BKPM[3] (2013) shows that the distribution of FDI project is concentrated in the Java and Bali regions, despite the decentralized system.

Departing from this situation, here we present an empirical study on how the inward FDI is managed in Indonesia under different types of governance system. More specifically, it describes the policy changes in Indonesia under the centralized and decentralized systems and the changed relationship between local and

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[1]LPEM UI is the University of Indonesian Research Center for Economic and Social Development in Indonesia; information can be seen in http://www.lpem.org/?page_id=35.

[2]KADIN is Indonesian Chambers of Commerce and Industry, an umbrella organization of the Indonesian business chambers and associations, information can be seen in http://www.bsd-kadin.org/about/kadin.

[3]BKPM is the National Investment Coordinating Board of the Republic of Indonesia which is responsible for coordinating domestic and foreign direct investment in Indonesia. Information is available at http://www4.bkpm.go.id/contents/general/2/about-us#.VFdiQ6NgW70.

central government. This study is unique because many other studies on FDI and decentralization focus on statistical analysis and emphasize economic aspects of FDI. For instance, Yong (2008), Kalamova (2008), and Kessing et al. (2007) examine the relationship between decentralization and FDI using econometric models and only consider the overall quantity of inward FDI. Different from those studies, this study explains the policy development and relationship between stakeholders in formulating and implementing policy under different governance systems. Hence, we not only emphasize the quantity of inward FDI, but also consider the impact of FDI on the welfare of citizens and the fate of future generations.

2 Research Questions

This chapter answers the following research question: **How have the investment policies and intergovernmental relations changed over time in Indonesia?** Moreover, it answers two major sub-questions:

1. How have the policies related to FDI changed under the centralized and decentralized eras in term of sustainable development?
2. How have the intergovernmental relationships between the national and local governments changed under the centralized and decentralized eras?

3 Social and Scientific Significance

This research aims to make a positive contribution both socially and scientifically to the existing literature on FDI. Scientifically, it contributes to the debate about the impact of decentralization on FDI. Some political scientists argue that decentralization brings positive impacts to FDI because it increases citizens' participation, social accountability, and public spending effectiveness, and reduces the monopolistic behaviour of national governments (Barry 1995; Tiebout 1956). On the other hand, some economists suggest that decentralization leads to coordination failure, over-taxation, and fragmented policies among levels of government (Kessing et al. 2007; Kalamova 2008). This paper contributes to provide empirical evidence on how decentralization has had an impact on the FDI in both direct and indirect ways. While decentralization may cause coordination failure, over-taxation, and fragmentation policy, clearer intergovernmental relation mechanisms can assist in solving these problems. Therefore, this paper contributes to the application of the multi-level governance literature to Indonesia.

In terms of the social significance of this research, it will support policy makers in gaining a better understanding of the political economy aspects of FDI. This paper analyses how central and local government interact to achieve more sustainable development from FDI. It will also scrutinize some policies from the aspect of sustainable development in Indonesia.

4 Research Design and Methodology

This paper provides an empirical analysis of the investment policy changes under different types of governance systems and the change of relationships between local and central government over time in Indonesia. In order to do this, the qualitative research methodology is employed through a literature review and policy document analysis. We use the Investment Policy Framework for Sustainable Development (IPFSD) developed by the United Nations Conference for Trade and Development (UNCTAD) to analyse the investment policies over time. In addition, we use intergovernmental theory to analyse the relationship between the local and central government over time. We analyse the relationship between governments by examining the interest of each level of government, the role of each level, and the legal coordination mechanism between levels in the multi-level system.

The paper is organized into seven sections. Section 2 described the research questions; Sect. 3 explained the social and scientific significance of the paper; Sect. 4 reviewed the research design and methodology; and now Sect. 5 will review the literature and theoretical framework; Sect. 6 will explain the discussion and analysis; and finally, Sect. 7 will conclude this study.

5 Literature Review

This section provides a theoretical framework on the relationship between FDI and sustainable development. Furthermore, it also provides an overview of the concept of decentralization, sustainable development and intergovernmental relations and how those concepts are interrelated to each other.

5.1 Foreign Direct Investment and Sustainable Development

FDI has many different meanings. FDI is an investment by foreign enterprises in one economy in order to obtain lasting interest in another country (OECD 2008). Another definition from the International Monetary Fund (1997) is "*the FDI is an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise*" (p 86). Based on these definitions, we generalize the FDI which is an investment made by foreign entities to another country which involves the ability to control the management of the enterprises

Nowadays, the concept of sustainable development has become an important topic in development. The World Commission on Environment and Development (1987) defines sustainable development as a development that meets not only the needs of the people today but also the needs of future generations. FDI has strong relationships with three parts of sustainable development: the economy, the environment, and the social development (OECD 2001). Currently, many countries have intensified their investment promotion, liberalized their economy, and provided financial incentives to attract FDI. In line with these efforts, it is necessary to protect the citizens and future generation from negative consequences of the increase in FDI. The United Nations has provided guidance by issuing the IPFSD.[4] Below is description of the concept of FDI and sustainable development and the necessary intervention polices to achieve sustainable development.

5.1.1 FDI and Economic Development

FDI can enhance economic growth of host countries when Multinational Companies (MNCs) spill-over their productivity to domestic enterprises which comes from technology transfers, knowledge transfers, and other MNCs—domestic enterprises linkages (Rodriguez-Clare 1996; Caves 1971; Blostroom and Kokko 1998). The productivity spill-over mechanism can be explained as follows: (1) the MNCs possess a superior technology and management which local firms can capture from knowledge sharing and technical/management training undertaken by the MNCs. Therefore, it can increase the value added of workers and productivity of local firms; (2) the MNCs possess international networks so that local firms are able to expand their business networks. Hence, productivity of local firms will also grow; (3) the existence of MNCs in host country increases local industrial competitiveness so that it can improve local firms' productivity; and (4) the existence of foreign firms decreases the dependency of local firms on government budgets because the FDI provides external financial sources for development (Blostroom and Kokko 1998).

However, without any proper policies, the FDI can harm local community and domestic enterprises because it increases local dependency to foreign capital and destroys small and medium enterprises (Pavlinek 2004). In order to minimize negative consequences of the FDI, a strong institutional framework and good investment climate are necessary to create an institutional setting that enables local citizens to participate in the investment policy development process and create better development (UNCTAD 2012). More specifically, UNCTAD (2012) mentioned that "investment policy should be developed involving all stakeholders and embedded in an institutional framework based on the rule of law that adheres to high standards of public governance and ensure predictable, efficient and transparent procedures for investors" (UNCTAD 2012, p 11). In addition, the government shall determine the criteria for approving FDI projects based on the potential of the jobs which can be created, the technology which can be transferred, the infrastructure which can be developed, and the business linkages which can be

[4]The IPFSD is the Investment Policy Framework for Sustainable Development, a framework developed by the United Nation Conference on Trade and Development.

generated (UNCTAD 2012). In fact, despite high amounts of inward FDI, many developing countries are not successfully receiving the full benefits from FDI because of weak institutions (OECD 2001).

5.1.2 FDI and Social Development

FDI has significant impacts on social development. Many studies confirm that FDI may reduce unemployment, increase the Human Development Index (HDI), and raise wages of host country citizens (Moran 2011; Colen et al. 2008). Baghirzade (2012) argues that the FDI in the twelve Commonwealth of Independent States (CIS) can promote social development especially by increasing the human development in those countries. Colen et al. (2008) found that FDI significantly contributes to reducing income inequality and poverty. The OECD (2001) determines that the social effects of foreign investment can be examined in two areas: FDI can create employment and FDI can exacerbate differences in income distribution and equality. Therefore, the existence of a proper labour regulation in a country is very significant.

Although FDI has positive impacts on social development, some studies found that FDI also harms poor people, increases income inequality, creates human and labour rights violation by MNCs, and reduces wage standards because the MNCs may lobby the government to lower labour standards (Mosley and Uno 2007; Letnes 2002; Galagher and Andres 2008). The negative impact of FDI on social development arises from the weak labour standard regulation or enforcement in a country.

Since FDI has both positive and negative impacts on social development, policy interventions are necessary through appropriate investment policies and other related policies which are coherent with the goal of sustainable development (UNCTAD 2012). There are two related policies that are important and will lead to coherence of the investment policy: the labour market regulation and the corporate social responsibility regulation. According to the IPFSD, the labour market regulations shall meet some criteria as follows: (1) the labour market regulation should support job creation objectives of investment policy, but the employees' rights should also be protected; (2) international labour standards should be adopted by the country; (3) the transfer of skills should be encouraged; and (4) regulations should give priority to increase the productive capacity of the labour force by FDI (UNCTAD 2012). Another related policy that is important is the corporate social responsibility obligation embedded in the investment process. In order to achieve sustainable development, the government should encourage compliance with high standards of responsible investment (UNCTAD 2012). Collen et al. (2008) argue that government should do more to regulate MNCs' responsibilities for social development (i.e. regulations on labour wage, corporate social responsibilities and protection of human rights law, etc.).

5.1.3 FDI and Environmental Protection

FDI may have significant impacts on the environment. The OECD (2001) argued that while FDI may lead to increased pollution due to industrial activities, it may improve structural efficiencies for environmental investment when it is paired with a strong environmental regulatory framework. Cole et al. (2006) found that FDI has a positive relationship to environmental regulation in a host country. Some studies found that some MNCs have a lower impact on pollution compared to domestic firms, but some others have a higher impact (Galagher and Zarkhy 2007).

As the FDI brings both positive and negative impacts to the environment, a strong environmental regulation framework must exist to reduce negative impacts of inward FDI. The OECD (2001) explains that the implementation and enforcement of adequate environmental regulations are very important in limiting environmental damage. Furthermore, the OECD (2001) also states that consistent law enforcement of environmental regulations is more preferable for investors than the relaxation of environmental standards. According to the IPFSD, in order to minimize negative effects of FDI toward environmental quality, environmental impact assessment should be part of investment policies; environmental norms should be transparent, non-discriminatory, predictable, and stable; and foreign enterprises should be encouraged to adhere to international standards (UNCTAD 2012).

After discussing the impact of FDI on sustainable development and some necessary intervention policies which should be in place, we focus on the circumstance when the governance is more decentralized. In a centralized system, the central government can easily execute the policy and plan, but in a decentralized system when local governments gain larger authority to manage investment locally, additional governance issues arise. Later, we discuss how decentralization can influence FDI and sustainable development.

5.2 Decentralization, FDI and Sustainable Development

Before we discuss decentralization and FDI, we need to understand what the definition is of decentralization. We use the definition of decentralization developed by Cheema and Rondinelli (2007), who argue that decentralization is a set of policies regarding the transfer of power, authority, and responsibilities within the government and within society. In this study, we use administrative and political decentralization as the model of our analysis. Administrative decentralization is the distribution of authority and responsibility from the national to local governments or semiautonomous public agencies through a twinning arrangement across the national border (Cheema and Rondinelli 2007). Furthermore, political decentralization is devolution of powers and authority to the local unit of government by allowing participation of civil society organizations in the public decision making process and in selecting the political representative (Cheema and Rondinelli 2007).

In relation to FDI, the implementation of a decentralized system can enhance FDI on the one hand, but on the other hand, it may decrease FDI in that country. The horizontal aspect of decentralization, the increased regional competition to win investment, has positive impacts on FDI (Kessing et al. 2007). Due to the regional competition under the decentralized system, the regional governments are encouraged to provide incentives and a good investment climate in order to attract foreign capital, which is necessary for development (Kessing et al. 2007). Furthermore, the decentralization reduces the probability of government misbehaviour because the government becomes more accountable under decentralization system and public spending becomes more efficient (Tiebout 1956). The decentralization also increases citizen participation in the development process so that the policy result becomes more sustainable and conflicts will be reduced.

However, the vertical aspect of decentralization may reduce the inward FDI because it creates vertical disintegration in the decision making process, increases rivalry between the different tiers, and creates coordination failures. Furthermore, it may cause over-taxation, and moral hazards problems from joint accountability (Kessing et al. 2007). Furthermore, Kalamova (2008) argues that the increased number of government tiers under decentralization system leads to excessive bureaucracy and over-regulation. Political decentralization can hamper the implementation of investment project because coordination between different independent government levels is more difficult and the voting power at the local level takes more time (Kalamova 2008). These negative effects of decentralization on the FDI are mainly caused by the coordination problems between levels of government. Therefore, the discussion about the intergovernmental relations mechanism is crucial to minimize these problems.

5.3 Intergovernmental Relations

The clear mechanism of intergovernmental relations can help to overcome some possible deficiencies of decentralization. In order to minimize negative consequences of decentralization on FDI, Kessing et al. (2007) suggest that the number of government layers should not be overly expanded and a clear coordination mechanism should be developed (Kessing et al. 2007). Furthermore, Kalamova (2008) suggests that the remedy for coordination failure, over-taxation, and over-regulation in decentralization is the reduction of hierarchical structure of government and the improvement of intergovernmental relations by assigning clear and separate responsibility to each specific layer.

Intergovernmental relations are processes of which governments within a political system interact (Phillimore 2013). Wright (1988) defines intergovernmental relations as an interacting network of institutions at the national and the

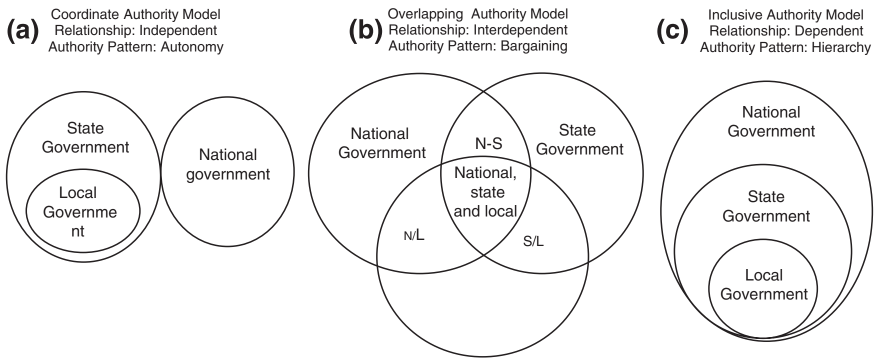

Fig. 2 Model of intergovernmental relations. *Source* Wright (1988). Understanding intergovernmental relations, Third Edition, California

local levels that enable those institutions to cooperate within a single institutional arrangement. From those perspectives, we define the intergovernmental relations as a process or institution of which all levels of government can cooperate to achieve common goals. Hence, the intergovernmental relation is more than the distribution of authorities but also the mechanism of cooperation among level of governments.

There are two mechanisms of interaction between level of government: formal and informal (Phillimore 2013). Formal mechanism is a mechanism that is stated in the formal regulations such as the constitution, statutes, agreements, and other formal mechanisms. Informal mechanisms are those mechanisms that are not stated in the formal regulation such unspoken rules, conventions, or principles accepted among all levels of governments. This article scrutinizes the formal mechanism of intergovernmental relations in Indonesia in relation with the implementation of investment policies to achieve more sustainable development.

Furthermore, looking from the formal mechanism of intergovernmental relations, there are three models of intergovernmental relations (Wright 1988) as shown in Fig. 2.

5.3.1 Coordinate Authority Model

The coordinate authority model is characterized by a distinct boundary separating the national and state government, with the local government included within state governments (Wright 1988). The power relations between national and state government can be described as independent and autonomous; thus national and state government are equally powerful. When there are conflicts between national and state/local government, there is a third party who acts as arbiter and usually a Supreme Court to take the final decision.

5.3.2 Overlapping Authority Model

The middle model presented in Fig. 2, the overlapping authority model, is different from previous model, because it does not emphasize the formal hierarchy, but rather the function. The characteristics of this model are as follows: (1) that some functions and authorities involve national, state, and local government; (2) that there is no area of autonomy that is fully independent and having full discretion without considering other jurisdictions; and (3) that the power relation is based on the bargaining.

5.3.3 Inclusive Authority Model

The inclusive authority model is characterized by abolishing state/local/national boundaries, where state/local governments are inside the national jurisdiction. If a national government wants to expand its power, it just reduces the authority of local/state government or enlarges the power of national government with or without reducing local/state power. In this model, the national government is more powerful than the state/local government, so when conflicts occur, the national government will win.

Based on the previous literature review, we develop a conceptual framework that will be used as a basis for the analysis (see Fig. 3). In fact, FDI brings both positive and negative impacts to development. Using IPFSD, there are several strategies to achieve a more sustainable development. However, under the decentralization system when the authorities are dispersed to local levels, the policies themselves are not sufficient. The effectiveness of the policies is dependent on the cooperation among all levels of government officials, so that intergovernmental relations are an important factor to achieve a more sustainable development.

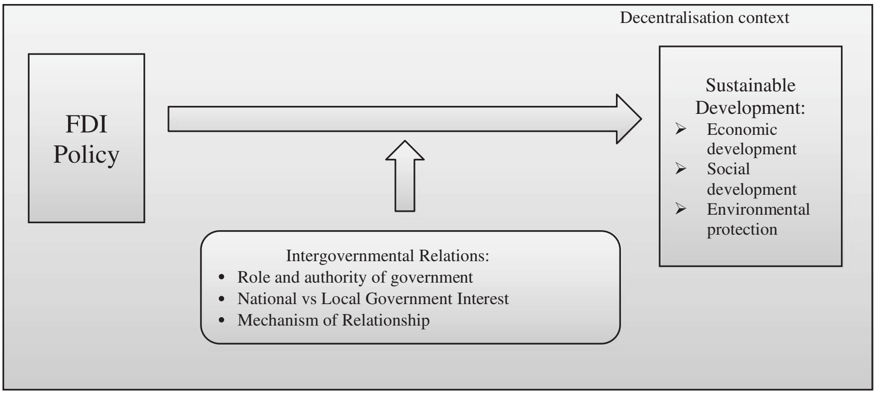

Fig. 3 Conceptual framework

6 Discussion and Analysis

This paper examines the investment and related investment policies in Indonesia over time using the IPFSD approach. The examination aims to understand how the Indonesian government achieves sustainable development from FDI. This paper also discusses the intergovernmental relations especially in the implementation of the policies. The discussion describes how the intergovernmental relations play an important role in the effectiveness of the policy. We divided the periods into three time periods: the Centralized Era (1967–1998), the First Wave of Decentralization (1999–2003), and the Second Wave of Decentralization (2004–present).

6.1 The Investment Policies in Indonesia

6.1.1 The Centralized Era (1967–1998)

During this period, all the FDI processes were managed by the central government and the local governments were seen only as beneficiaries. The regulations on the procedure of foreign investment were changed four times during this period. The latest version for this period was the Presidential Decree No. 97 Year 1993. According to the decree, the foreign investment application was granted by the President (Presidential Decree 97/1993).[5] In order to manage FDI, the body BKPM[6] was created, which functioned to provide advice, to guide and administer the FDI, and to monitor the implementation of the investment project. The body was also responsible for granting the domestic investment applications. The local governments provided some non-investment permits such as building permits and nuisance permits.[7] Hence, the President's office played a substantial role in the FDI management process.

In 1998, the President had decentralized the authorities to grant FDI to the BKPM (Presidential Decree 115 Year 1998).[8] The authority was decentralized to the BKPM to increase the effectiveness and reduce the time of the application procedure, in order to attract more small and medium foreign enterprises to invest in Indonesia. In addition, according to the decree, the BKPM was authorized to grant FDI projects with values of $100 million or less. Therefore, the BKPM had a

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[5]Presidential Decree No. 97 Year 1993 on Procedure of Investment is a regulation which regulates the procedure and mechanism of domestic and foreign investment in Indonesia.

[6]BKPM is the National Investment Coordinating Board of the Republic of Indonesia which is responsible to coordinate domestic and foreign direct investment in Indonesia. Information can be seen in http://www4.bkpm.go.id/contents/general/2/about-us#.VFdiQ6NgW70.

[7]Nuisance permit is a permit given by local government to ensure that the business operation does not disturb the surrounding neighbourhood.

[8]Presidential Decree No. 115 Year 1998 on Procedure of Investment.

stronger role at this time. Local governments in this period, on the contrary, remained powerless with little authority to guide FDI projects.

We argue that during this period, the concept of sustainable development had not yet become a serious concern of many policy makers. The concern of policy makers was more on the efforts to attract as much FDI as possible. The introduction of the Foreign Investment Law in 1967 started the market liberalization process (OECD 2010). The law did not explicitly mention the sustainable development as the main objective of FDI. The law paid more attention to the efforts to attract foreign capital. Hill (1988) argued that, historically, the FIL 1967 was introduced to improve the country's credibility to international business and to attract foreign capital by providing many incentives. The law also focused on the guarantee from the government to protect foreign companies from nationalization; to treat domestic and foreign companies equally; and to provide financial incentives to foreign companies. The law opened many sectors for foreign companies, except ten strategic sectors: ports development, electricity production, transition and distribution, aviation, education, drinking water and irrigation, railway system, nuclear technology, press media, and arsenal industry. In this time period, the obligations of foreign companies for knowledge transfer to local companies and corporate social responsibilities were not explicitly mentioned in the law.

In terms of economic development, the policies to promote linkage from the FDI as guided by UNCTAD remained limited. According to the IPFSD, the investment regulations shall generate FDI to promote linkage between foreign companies and domestic enterprises, and the good public governance shall exist in order to ensure that FDI can generate economic wealth (UNTAD 2012). In 1980s, in order to promote linkage, the government limited FDI to several strategic sectors, required foreign investors to divest some of their money in local companies, and restricted the number of foreign workers to support the transfer of technology (Hill 1988). However, in 1994, those limitations were eliminated by Government Regulation No. 20 Year 1994. Hence, specific intervention policy to ensure domestic enterprises taking advantages from the FDI was absent when the divestment requirement is eliminated and foreign ownership in the nine strategic sectors that were previously closed for FDI is allowed.

In terms of social development, according to the IPFSD, the foreign companies shall be mandated with the social obligation and the labour regulations should support job creations and protect the workers (UNCTAD, 2012). Nevertheless, a policy that mandated social responsibilities for companies did not exist at that time. In fact, there were no policies that mandated the social corporate responsibilities and the transfer of skill and technologies as part of the MNCs obligation. The FIL 1967 was not explicitly mentioned the obligations, and the Manpower Law 1969 did not mandate the transfer of skilled requirement and the increase of labour skilled attached as the foreign companies obligations. Furthermore, while the system was centralized, there was no legal mechanism for local people to participate in the development process; hence, local voices were less accommodated.

In terms of environmental protection, the environmental impact assessment shall be part of the investment procedure and the environmental standard shall adhere to international standards of environmental protections (UNCTAD 2012).

However, during this period, the environmental impact assessment was yet not part of the investment procedure process. The Environmental Law 1982 did not mandate the environmental impacts assessment as part of the investment procedure. Furthermore, according to the Government Regulations on the procedure of foreign investments, the environmental impact assessment was not part of the requirements for the investment. Therefore, the environmental issue was not yet a serious concern of many policy makers.

Since the focus of the policies was to attract FDI, Indonesia received a large amount of inward FDI but failed to gain sustained positive impacts from the development. In 1996, the net inflow FDI was $5.59 billion, which was double from what it was in the 1970s, at $2.7 billion. Indonesia ranked 17th in the world and 3rd in the Southeast Asia for the largest recipient of FDI (ADB 2013). FDI had positive impacts on the economic growth at that time, where the economic growth was 7 % annually (Tambunan 2013). However, despite the national economic growth, a study found that local firms were not able to take full advantage, especially in upgrading the technology capacities from the existence of FDI, due to the unclear investment policy (Thee 2006). Furthermore, Takii (2005) found that in the manufacturing sectors from 1990 to 1995, the technological level of local firms was not adequate to facilitate large spill-over technology from foreign companies to domestic ones; hence, the productivity spill-over was small.

6.1.2 First Wave of Decentralization (1999–2003)

After the economic crisis in 1997, Indonesia began to embark on several major reforms to its intergovernmental system. One of the reforms was decentralization, the transfer of authority, and responsibility from the central to the local government, to manage regional economic development. The changed governance system was followed by several investment policies modifications. When previously the central government took all responsibility and authority to manage FDI, in 1999, the FDI management was decentralized to the provincial government. According to the Government Regulation No. 117 Year 1999, the Ministry of Investment/Head of National Investment Board decentralized the authorities to grant FDI to the Governor. In fact, the Regional Autonomy Law 1999 also mandated all duties and authorities retained by central government were transferred to regencies or municipalities excluding these six affairs: monetary, judicial system, national security, national defence, foreign, and religious affairs (Law No. 22 Year 1999).

During this period, the government tried to balance between bringing back investment to Indonesia and achieving more sustainable development. Simultaneously, the liberalization policies were continued, but several investment policies became stricter. In economic development, there were some efforts to protect the domestic enterprises by limiting the foreign investment in some sectors through Presidential Decree No. 96 Year 2000 on the Negative List of Investment. The Decree prohibited foreign investment in the following sectors: the forestry and plantation sectors (germ-plasma seeding, natural forest right to conserve, forest logging contractor), the public transportation sectors (bus/taxi and public transportation), the trade sectors (all trade sectors except big scale trade sectors such as mall, supermarket, department store, wholesaler, etc.), and the communication sectors (radio, television, multimedia, and printing media, film/movie). In addition, there were 33 sectors reserved only for domestic small and medium enterprises. These policies were taken in order to promote linkage between foreign and domestic enterprises.

On the other hand, in order to increase the national competitiveness and to attract FDI to Indonesia, some public governance reforms were taken. Rajenthran (2002) argues that the focus of the new government was to bring investors back to Indonesia by streamlining procedures, revising the negative list of investments, providing more incentives, and privatizing some states enterprises. Furthermore, the government also enacted the Competition Law of 1999 in order to eradicate previous monopoly created by state enterprises, and introduced the Property Right Laws such as the patent law, the brand law, the copy-right law, and the industrial design law to eradicate piracy. It also established the Corruption Eradication Commission to combat massive corruption practices in many sectors. These policies were directed to improve the public governance of Indonesia.

In terms of social development, one indication that the sustainable development became a concern of policy makers is the enactment of Law 21 Year 2000. This law allowed for the creation of labour unions. The significant impacts of the law can be seen in the provision of wage determination. Under the new law, in order to determine the minimum wage standard, the government shall facilitate the companies' representatives and the labour union representatives, so that the voice of workers was heard. However, the obligation for companies especially foreign companies to help the people nearby their project area through Corporate Social Responsibilities had not yet been embedded in the investment policies.

In terms of environmental policy, the environmental impact assessment shall be part of the investment procedure (UNCTAD 2012). The government has embedded the environmental impact assessment in the investment procedure. The government issued Government Regulation No. 27 Year 1999 on Environmental Impact Analysis. The regulation mandated all companies shall conduct an environmental impact analysis assessment as part of the investment procedure. Furthermore, the government also enacted Law 41 Year 1999 on the forestry which limited the economic activities in protected areas. To summarize, we found that a series of policies were taken to achieve more sustainable developments from FDI.

Although many policy makers have already been aware of the sustainable development, the impact of the policies was not sufficiently well perceived since Indonesia was still struggling with economic crisis. In fact, due to uncertain economic situation, the FDI performance also was not positive. From 1998 to 2003, Indonesia experienced negative inflow of FDI. In 2000, the net inflow of FDI reached $ 4.5 billion (ADB 2013). This means that Indonesia was not attractive for investors, so that many foreign investors moved their investments to other countries. In terms of the contribution of FDI on the economic growth, the data shows that the inward FDI stock as percentage of GDP declined from 2.2 % in 1995 to 0.3 % in 2003 (ADB 2013).

6.1.3 Second Wave of Decentralization (2004–Present)

After a series of evaluations, the regional autonomy law was changed into Law No. 32 Year 2004. According to this law, excluding six absolute affairs retained by the central government (i.e. monetary, judicial system, national security, national defence, foreign affairs, and religious affairs), the remaining areas of government policy are distributed to all levels of governments based on three criteria: externalities, accountabilities, and efficiencies. The criteria of externalities mean that the authority is shared among levels of governments by considering the scale impacts. The criteria of accountability mean that the authorities are shared based on their closeness to the citizens, and the criteria of efficiency mean that the authorities are shared based on the cost and time effectiveness (Regional Autonomy Law 2004).

In terms of FDI management processes, the authority to approve FDI projects was taken back to the central government (Head of BKPM Decree No. 58/SK/2004). Furthermore, all the foreign investment application must first go through the National Investment Board (BKPM). The central government grants both the principal investment permits[9] and operational investment permits[10] for FDI through the one-stop services office. In this office, all ministries delegate their authority to grant investment permits in their sector so that the investors only need to meet in one office to apply for their investment permits.

In this period, sustainable development has become a serious concern of many policy makers in Indonesia. Sustainable development became one of the objectives in the investment policy, and it is mentioned explicitly in the Investment Law 2007. More specifically, the law mentions that the objectives of investment are to increase national economic growth, to create jobs, to enhance sustainable development, to increase national competitiveness and technology capacity, to support local enterprises, and to improve people welfare (Article 1, verse 2 Investment Law 2007). Furthermore, the IPFSD mentions that investment policies should be geared toward the realization of national sustainable development goals and the government shall create a strategic investment plan to achieve sustainable development (UNCTAD 2012). In fact, Indonesia has developed a national strategic investment plan. The plan determines seven grounded policy of Investment: (1) improvement in the investment climate; (2) wider distribution of investment projects across the country; (3) prioritization of investment in food, infrastructure and energy sectors; (4) promotion of green investment; (5) empowerment of small and medium enterprises; (6) facilitating and providing incentives for FDI; and (7) increased investment promotion.

Although the sustainable development has been considered as an important aspect in the investment policy, there is no specific intervention policy to promote linkage between foreign and domestic enterprises. Furthermore, the government has focused on the improvement of the quality of the institutional framework and continued market

[9]A principal permit is a permit given by national/provincial/district governments that should be held by the company wishing to establish a business in Indonesia.

[10]Operational investment permit is a permit given by the national/provincial/district governments that should be held by company to operate their business in Indonesia.

liberalization to increase FDI. The government issued regulation on the Negative List of Investment which now has opened all sectors except the arsenal industry for foreign investment, and increases the maximum equity up to 95 % foreign ownership in several sectors. In order to improve the quality of institution, the government launched the One Stop Services integrated with electronic system for investment licenses and non-licenses services by issuing Presidential Decree No. 27 Year 2009 on one-stop service (Tambunan 2013). Furthermore, some regulations were also introduced to attract FDI such as freedom of public information law[11] and public services law.[12]

In terms of social development, there are significant efforts that have been undertaken by the government. The government revised labour law[13] that increased the role of local governments to determine the wage standard in the regions. Furthermore, the role of labour union has become stronger under the new law and also the role of chamber of commerce has been strengthened. Furthermore, the Corporate Social Responsibility is embedded into a company's obligation and the obligation is mentioned in the Company Law.[14] Therefore, through these laws, the FDI is expected to beneficial for not only the economic development but also the local citizens.

In terms of environment protection, the government has revised the environment law.[15] In the new law, all companies, both domestic and foreign companies, must obtain environmental permits as part of the investment procedure. In order to obtain the investment permit, the foreign companies shall conduct an environmental impact analysis which is assessed by the environmental agency at the local level. Furthermore, all regions shall conduct an environmental strategic plan as part of the Regional Land Use Plan in order to limit the investments which destroy the quality of the environment.

During this period, FDI performance improved significantly. It reached $924.7 billion USD in 2012 (ADB 2013). As a result, Indonesia became once again one of the most attractive countries for foreign investment, ranked 79 in the world, higher than its regional middle-income peers, Malaysia, Thailand, and the Philippines. UNCTAD (2013) put Indonesia as the fourth of the top five countries to receive the most FDI in East and Southeast Asian regions in 2012.

6.2 Implementation Policies and Intergovernmental Relations

Investment policies in Indonesia have changed during these three periods of time as discussed in the previous section. In this section, we discuss the change in the

[11]Law No. 14 Year 2008 on the Open Information for Public.

[12]Law No. 25 Year 2009 on the Public Services.

[13]Law No. 13 Year 2003 on Manpower.

[14]Law No. 40 Year 2007 on Company Law that mentions the obligation of companies to do CSR.

[15]Law No. 32 Year 2009 on Environmental Management.

relationship between national and local government before and after decentralization. We explain intergovernmental relations by examining the roles of each level of government, mechanisms of interaction, and the intergovernmental relations model.

6.2.1 Centralized Periods (1967–1998)

As mentioned in the previous section, during the centralized period, the FDI was fully managed by the central government. Therefore, we argue that intergovernmental relationships can be categorized as "**the inclusive authority model**" as seen previously in Fig. 2. The model is characterized by abolishing of state/local/national boundary, placing state/local governments inside the national jurisdiction (Wright 1988). In this period, the central government played a central role in managing FDI, and the Provincial and municipal/district governments were subjected to decisions made by central government. In term of procedures for FDI, the investment permit was granted by the President, and the application was screened and verified by the BKPM as the central government body. According to the procedure of investment regulations, the roles of local governments were limited to provide only the nuisance permit[16] and building permit. The central government is only body which determined the location of investment project.

The government structure also showed us that the central government played a dominant role in managing FDI. According to the Presidential Decree No. 26 Year 1980, the Regional Investment Coordinating Agency (BKPMD) was created to administer domestic but not foreign investment at the regional level. The Head of BKPMD was appointed by Governor with approval of the Minister of Home Affairs and the Head of BKPM. The Head of BKPMD was subordinate to the Governor, but the Governor could not freely control the activities because all activities and regional investment policies shall be consulted and coordinated to central government through the BKPM.[17] Hence, the BKPMD was actually the only branch of central government at regional level. Morfit (1986) in Hidayat (2008) found that the roles of central government agency in the regions or regional branches were more dominant than the regional government's body. Therefore, the mechanism of intergovernmental relations was hierarchical, in which the central government was more dominant than provincial and district governments.

6.2.2 The First Wave of Decentralization (1999–2003)

In 1999, the central government decentralized the authorities to grant FDI permits to Head of provincial government, the Governor. Looking at these mechanisms,

[16]Nuisance permit is a permit given by local government to ensure that the business operation does not disturb the surrounding neighbourhood.

[17]Presidential Decree No. 26 Year 1980 article 8.

we argue that the intergovernmental relation model follows "**the coordinate authority model**". The coordinate authority model is characterized by distinct boundaries between the national governments and the local/state government, in which local government are included within state governments (Wright 1988). During this period, the Governor possessed the power to grant foreign investment permits. According to the Presidential Decree No. 117 Year 1999, the provincial government was also able to determine the regional investment policy and develop regional investment procedures.

The governance structure was also significantly changed, especially relating to the role of local governments in managing FDI. According to the Presidential Decree on the procedure of investment, the BKPMD, a regional investment body, was not only able to grant the domestic investment permits but was also able to grant FDI permits. At the same time, the BKPMD was able to issue some financial facilitation for FDI, such as issuing the Import Identification Number, foreign employees' permit which previously was the authority of the BKPM. The Head of BKPMD was responsible to the Governor of the province and was not the subordinate of the BKPM, central body which managed the FDI. In short, the provincial government became an independent body which was able to determine the regional investment policy with little intervention from the central government.

However, the change of governance structure was not followed by a clear mechanism of intergovernmental relationships. Two regulations that defined each level of the government's functions in managing FDI were in conflict with each other. The Government Regulation No. 25 Year 2000 on division of power between levels of governments and Foreign Investment Law 1967 showed that the central government through BKPM was the only body which was authorized to grant FDI and not the provincial governments. On the other hand, in accordance with the Presidential Decree No. 117 Year 1999, FDI management was decentralized to the provincial government. This situation led to the confusion among stakeholders.

The unclear intergovernmental relationship mechanism made the cooperation among government levels less feasible. For example, the local and central government acted differently to the foreign investors. On the one hand, as the focus of the new government's economic development was to improve the economic conditions after hit by crisis, the central government tried to enhance the current existing FDI projects and to attract as much FDI as possible by offering some incentives and reducing the business cost (Rajenthran 2002). On the other hand, in contrast to the central government, local governments attempted to maximize the existing FDI projects by increasing the taxes, which means increased the business cost and made foreign companies moved from Indonesia to other countries. In fact, under the decentralized system, the local government was able to impose taxes for any investment projects in the regions by enacting local regulations. In 2000 for instance, PT Newmont Minahasa Raya, an American company, was shut down by the local government because it refused to pay local taxes. On the other hand, due to the economic condition, the central government wanted to keep the company in Indonesia. In fact, 13 other foreign companies in the oil sector had to stop their operations due to similar actions by other local governments. (*Jakarta Post*

20/June/00). Due to the local governments' action to impose taxes on the investment projects, KADIN requested the central government to abolish 1,006 local regulations related to local taxes for investors (Patunru and Wardhani 2008).

The situation mentioned above resulted in a deterioration of the investment climate. A study conducted by Asian Development Bank and World Bank (2005) found that decentralization deteriorated the investment climate in Indonesia. Another study conducted by LPEM UI[18] (2002a) also confirmed that decentralization worsened the investment climate and increased the cost of doing business in Indonesia. From this study, local political instability, labour problems, local taxes, and corruption increased the cost of doing business in Indonesia. Furthermore, Kuncoro (2006) found that the massive decentralization had also increased the number of corruption and bribery. Asian Development Bank and World Bank survey (2005) obtained the fact that the large foreign firms must pay an irregular payment up to 15.8 % of total investment to receive the contract. Furthermore, the illegal payments by companies reached up to 4.6 % of total sales. Therefore, due to the conflict, all the policies were not implemented properly.

6.2.3 The Second Wave of Decentralization (2004–Present)

In 2004, due to uncertain condition caused by conflicts between levels of government, the regional autonomy law was changed. According to the new regional autonomy law and the Head of BKPM decree, the authority to approve the FDI projects, which had been given to local governments, was retaken back to the central government. We argue that the intergovernmental relations after the second wave of decentralization follows "**the inclusive authority model**". The provincial and district governments are part of central government and must follow national policy. The central government now plays a dominant role in managing FDI. However, different from the situation during the centralized era, the provincial and district/local governments are given larger discretion in terms of determining regional investment policy under BKPM supervision and coordination. The cooperation among districts or among provincial governments is encouraged and the functions are distributed among various levels of government. The distribution becomes more complex as explained in Table 1.

As the distribution of function is based on three criteria (externalities, efficiencies, and accountability), the coordination mechanism becomes more complex. Although the FDI is managed centrally, according to the regulation on Procedure of Investment,[19] the local government retains authority for granting the nuisance

[18]LPEM UI is a Research Center of Economic Development in University of Indonesia.

[19]Head of BKPM regulation No. 5 Year 2013 on Procedure of Investment that substitute Head of BKPM regulation No. 12 Year 2009 that substitute Head of BKPM regulation No. 1/P/2008 and substitute Head of BKPM regulation No. 57/SK/2004.

Table 1 Distribution of the government's function in investment sectors

No	Functions or authorities	National government	Provincial government	District/local governments
1	Stipulating investment policy	• Develop and stipulate the national investment policy (foreign and domestic investment)	• Develop and stipulate the regional investment policy (domestic investment)	• Develop and stipulate the investment policy at district level (domestic investment)
2	Investment promotion	• Develop and stipulate the national investment promotion plan • Coordinate the investment promotion activities in foreign countries	• Investment promotion of local potential asset at regional level	• Investment promotion of local potential asset at district level
3	Investment license services	• Implement the national one-stop services for investment and provide guidance for regional/local one-stop services for investment • Provide investment permits for foreign investment include FDI • Provide investment permits for domestic investment (high technology investment, high risk and strategic investment, investment that across provincial boundary, investment that related to the national security) • Provide non-investment licenses such as incentives for foreign investment and domestic investment	• Implement the one-stop services for investment at the provincial level • Provide investment permits for domestic investment (the investment involve two or more districts; the investment that is decentralized by BKPM to governor • Provide non-investment licenses such as incentives for domestic investment	• Implement the one-stop services for investment at district/municipality level • Provide investment permits for domestic investment at district area • Provide non-investment licenses such as incentives domestic Investment
4	Monitoring the implementation of FDI	• Monitoring implementation of FDI project at national level	• Monitoring implementation of FDI project at the provincial level	• Monitoring implementation of FDI project at the district level
5	Information system	• Develop an national information system for investment	• Develop an provincial information system for investment	• Develop an provincial information system for investment

Source Government Regulation No. 38 Year 2007 on Distribution of function and authorities between national–local governments permits,[20] building permits, and environmental permits.[21] After received the approval from the BKPM, all foreign investors shall obtain operational permits, and in order to obtain the operational permits, the foreign investors must show the locational permits. The local government of where the investment project located is able to approve or reject the project by issuing the locational permits based on the environment assessment and the social impacts of the FDI.

The local governments also retain authority to issue regulations related to labour wages, environmental and land use development plans, and corporate social responsibility for any investment projects in their region. In relation to the labour policy, the central government has determined the procedure of determining minimum wage standards in the regions. In accordance with the labour law,[22] the provincial/district government is responsible to determine minimum wage standards in their region and to increase productivity of local workforce by providing training. Each local government must create a Local Wage Council which consists of representative of the business community, labour unions, and the local government. The creation of the body aims to increase the welfare of employees at the same time increasing the capacity of the workforce. Furthermore, the investment law[23] and the company law[24] allows provincial/district government to enforce the company's obligation to take corporate social responsibility in their regions, including all foreign corporations.

In order to protect the environment, the company shall apply for the environmental permit as part of the operational permit (Environment Law 2009). The provincial/district government issues the environmental permit when the investment meets the environmental standard developed by both central and local governments. Furthermore, according to environmental law,[25] the provincial/district government also has the authority to determine the land use planning and to issue environmental permits. Therefore, trough the land use planning, the local government can control the investment projects in their region.

Currently, the central government has fully decentralized the authority to manage foreign investment to several regions which are categorized as Special Economic Regions (SER) or Free Trade Zones (FTZ) and which have an outstanding one-stop service office. Recently, there were six regions that were categorized as SER and FTZ and received full authority to manage the FDI in their regions: FTZ Batam, FTZ Bintan, FTZ Karimun, SER Tanjung Lesung, and SER Sei Mangkei.

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[20]Nuisance permit is a permit given by local government to ensure that the business operation does not disturb the surrounding neighbourhood.

[21]Environmental permit is a permit given by local government to ensure that the business operation does not disturb the environmental quality.

[22]Law No. 13 year 2003 on Manpower.

[23]Law No. 25 Year 2007 on Investment.

[24]Law No. 40 Year 2007 on Limited Corporation.

[25]Law No. 32 Year 2009 on Environment.

With the central government playing a dominant role in the FDI management process and the regional governments retaining important authority, the coordination mechanism becomes more complex. Below is an example of the coordination mechanism in the implementation of the one-stop service office project.

Mechanism of Intergovernmental Relations through the One-Stop Services Office

The investment climate in Indonesia remains an important issue for economic development. One of the significant policies to reduce business costs is the implementation of the one-stop service office in every region, namely PTSP.[26] There are three main objectives of this policy: (1) establishment of the one-stop service office for investment in every region; (2) the PTSP office is equipped with electronic system for investment information and licensing service (SPIPISE); and (3) the approval authority for business application that is owned by Head of Regencies must be decentralized to the Head of PTSP.

In order to achieve these goals, cooperation between the national government and local government must be enhanced. The national government provides guidance, develops a standard, and monitors the performance of regional PTSP. Three national agencies, the BKPM, the Ministry of Home Affairs (MoHA), and the Ministry of Apparatus and Bureaucratic Reform (MENPAN), are all working together. The BKPM functions to develop national standards and procedures of investment and provides both technical and managerial assistance to local PTSP offices. The MoHA functions to monitor the achievements of local governments in implementing PTSP, and finally the MENPAN functions to provide assistance in terms of organizational and human resources management PTSP offices. The local governments play the role of the implementing agency of PTSP at the regional level and must follow the standard that has been developed by the national government.

There are two mechanisms of cooperation in the intergovernmental relations. First, the central government provides grants for provincial government to monitor and assist the implementation of PTSP at the district level, namely "De-concentration Fund". The purpose of the grants is (1) to increase the role of provincial governments to monitor and evaluate PTSP at the district level; (2) to facilitate the establishment of PTSP at the district level; (3) to assist the organizational and human resources development of PTSP at the district level; (4) to monitor and evaluate the PTSP at the district level; and (5) to coordinate of the implementation of PTSP. On average, each province receives 500 million IDR per year of that grant (MoHA 2013). The mechanism effectively encourages local governments to establish a one-stop service office in their region.

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[26]PTSP acronym for Pelayanan Terpadu Satu Pintu is the One Stop Service.

Table 2 Regional investment award winner

Year	Best district	Best municipalities	Best provinces
2009	1. Purwakarta 2. Sidoarjo 3. Sragen	1. Yogyakarta 2. Cimahi 3. Bandung	–
2010	1. Sragen 2. Sidoarjo 3. Purwakarta	1. Cimahi 2. Pekalongan 3. Bitung	1. East Java 2. South Sumatera 3. West Java
2011	1. Rokan Hulu 2. Indragiri Hulu 3. Ogan Komering Ilir	1. Pare-Pare 2. Dumai 3. Surakarta	1. Aceh 2. Central Java 3. West Kalimantan 4. South Sulawesi 5. Central Sulawesi 6. North Sulawesi 7. West Sulawesi
2012	1. Sragen 2. Purwakarta 3. Trenggalek	1. Palembang 2. Semarang 3. Salatiga	1. East Java 2. West Sumatera 3. West Java
2013	1. Ogan Komering Ilir 2. Lamongan 3. Rokan Hulu	1. Payakumbuh 2. Tarakan 3. Pare-Pare	1. East Java 2. West Java 3. East Kalimantan

Source BKPM 2014

Second, the BKPM provides the Investment Award to regions which perform well in PTSP. The award is given as an appreciation to the local governments' commitment to improve the investment climate. Table 2 shows the data about the districts which receive the regional investment award.

These mechanisms are successfully encouraging local governments to use the best regions as a benchmark for improving their own PTSP. Currently, most of the objectives of PTSP are successfully achieved. In fact, 31 out 33 provinces have established the one-stop services office and have implemented SPIPISE. In addition, 90 % of regencies/municipalities (460 regencies) have established PTSP Office. However, only 32 % (116 regions) of them have implemented SPIPISE (MoHA 2013) and only a few head of local governments have decentralized this approval authority to the head of the PTSP office. The PTSP programme results in an improvement of the Ease of Doing Business index in Indonesia. Data World Bank on the Ease of Doing Business (2014) shows that the average time of starting business reduced significantly from 168 days in 2004 to only 48 days in 2014. The cost of doing business in Indonesia also significantly reduced from 136 % of total income per-capita in 2004 to only 20.5 % of total income per-capita in 2014. Furthermore, investors obtain the construction permit 10 days earlier and these are 181 % cheaper than in 2004 (World Bank 2014).

7 Conclusion

In conclusion, the investment policies in Indonesia have been directed to achieve more sustainable development, albeit gradually. Furthermore, the change of the governance system from centralized to the more decentralized system has also changed the intergovernmental relationship in the way of FDI was managed in Indonesia. During centralized era, the sustainable development was not the main objective of the investment policies. As a result, although FDI had a positive impact on the economic growth, local citizens and domestic firms did not take full advantage of its existence. After FDI was decentralized to the local governments in the first wave of decentralization, the sustainable development in developing the investment policies increasingly became a serious concern of many policy makers. Several policy changes have been made in order to achieve sustainable development from FDI. Furthermore, during the second wave of decentralization, sustainable development became an ultimate goal of the investment policies in Indonesia.

Although the policies have been directed to achieve sustainable development, the implementation of these policies is highly affected by the intergovernmental relations. In fact, the intergovernmental relationships changed due to decentralization process. In the centralized era, the intergovernmental relations followed the inclusive authority model, in which the national government played a dominant role in managing the FDI. Although the coordination between the levels of government was good, the citizen participation was less accommodated. In the first wave of decentralization, the intergovernmental relations followed “the coordinate authority model”, in which the provincial and local governments were more powerful than before. However, great devolution power to the local governments in managing FDI without clear mechanism of intergovernmental relations led to a deterioration of the investment climate. In the second wave of decentralization, the intergovernmental relations followed “the inclusive authority model”, in which the central government was more dominant than province and local governments. In contrast to the centralized era, the central government provided more room for local governments to participate in the development process. Hence, cooperation between the national and local governments was more enhanced during this period.

Appendix 1

Table of FDI policy for sustainable development in Indonesia

No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
1.	*Policy to attract FDI*				
	(a) Investment regulation and promotion	1. Openness and avoiding investment protectionism 2. Ownership restriction should be justified by legitimate national policy and should be clearly specified, and the registration of ownership should be secure and effective 3. Screening procedure of investment entry and establishment should be conducted following pre-established objective criteria 4. Government should avoid direct or indirect intrusion in business management and respect the freedom of operations of private companies	Indonesia embarked upon a new liberalism of investment policy in accordance with Law No. 1 Year 1967 on Foreign Investment Law. It followed the guideline which can be described below • It opened many fields for investment, only ten strategic sectors were closed to FDI i.e., ports development; electricity production, transition and distribution; telecommunication; education; aviation; water drinking; railway; nuclear technology; press; and arsenal industry • It provided similar treatment between domestic and foreign enterprises	After the economic crisis in 1997, and several negative sentiments toward foreign investment, Indonesia revisited the investment law. However, the priority of government was to bring the investors back to Indonesia to drive its economy. Law No. 1 Year 1967 remained the basis of Investment Policy so that openness, ownership restriction, similar treatment between national and foreign enterprises and protection from expropriation remained a concern of the government The government issued Presidential Decree No. 96 Year 2000 on Negative List of Investment which mentioned that the business fields closed to FDI were	During the second wave of decentralization, liberalization policy is continued. The parliament enacted Law No. 25 Year 2007 on Investment as basis of Investment Law • The only business field closed for FDI is arsenal industry and others industries mentioned by laws • No difference between domestic and foreign investment • Guarantee for FDI from expropriation and nationalization

(continued)

(continued)

No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
		5. Similar treatment between foreign and domestic enterprises 6. Protection from expropriation and nationalization	• It explicitly stated that the government was prohibited from nationalizing and expropriation action In order to attract more FDI, the government enacted Government Regulation No. 20. Year 1994 on share-holding ownership on FDI which widened its openness regulation • It allowed full foreign ownership • From ten "strategic sectors" closed to FDI under previous law, only arsenal industry was kept close for FDI. The other nine strategic sectors were opened for FDI (ports, energy sector, telecommunication, shipping, civil aviation, water supply, railways, nuclear power and media)	• Forestry and plantation sectors: germ-plasm seeding, natural forest right to conserve; forest logging contractor • Transportation sectors: bus/taxi and public transportation; • Trade sectors: all trade sectors except big scale trade sectors such as mall, supermarket, department store, wholesaler, etc. • Communication sectors: radio, television, multimedia, and printing media, film/movie	Furthermore, the government enacted Presidential Regulation No. 76 Year 2007 on criteria and requirements for the determination of business field closed and open with conditions to investment • Criteria for industry closed for FI are health, safety, national security, environmental protection, culture and moral protection and national interest • Criteria to determine industry which open with some restriction: natural resources protection, small and medium domestic enterprises, production and distribution control; technology capacities; domestic shareholding participation; cooperation between government and enterprises

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No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
			• The divestment requirement was eliminated At that time the focus of government was to attract FDI and to maintain its economic conditions by emphasizing industrialization projects		Several regulations on the negative list of investment are enacted such as Presidential Regulation No. 77 Year 2007 that amended by Presidential Regulation No. 111 Year 2007 and amended by Presidential Regulation No. 36/2010 and lastly amended by Presidential Regulation No. 39 year 2014 on Negative List of Investment • All sectors are open for FDI • The maximum equity of 95 % foreign ownership in energy sectors (previously only 49 %) • Maximum 49 % foreign ownership for ports development and • 95 % foreign ownership for Public Private Partnership • Minimum investment only $250,000 (previously $1,000,000)

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No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
	(b) Investment related policies	1. Trade and financial incentives	1. Indonesia provided many financial incentives to attract FDI	1. Indonesia provided financial incentives for FDI	1. Indonesia provides financial incentives for FDI through Government Regulation No. 62/2008 on tax facilities for investment: Tax allowance for 23 sub-sectors in 77 business fields; and Government Regulation 94/2010 Tax holiday is entitled for pioneering industries Tax deduction of 30 % total investment values
		2. Intellectual property rights laws and regulations	2. Law to protect intellectual property rights were exist such as Law No. 12 Year 1997 juncto Law No. 6 Year 1982 on Copy rights; Law No. 6 Year 1989 on Patent and Law No. 19 Year 1992 on Brand	2. Some regulations related to intellectual property rights are enacted: Law No. 41 Year 2001 on Patent; Law No. 15 Year 2001 on Brand; Law No. 19 Year 2002 on Copy Rights; Law No. 31 Year 2000 on Industrial Design	2. Focusing on the implementation of the regulation on intellectual property rights

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No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
		3. Competition laws and regulations	3. The competition law were not exist	3. Enactment of competition Law No. 5 Year 1999 and establishment of the commission for the supervision of business competition (KPPU). The law contains prohibition on oligopolistic practice, price fixing and discrimination; prohibited activities such as monopoly, market controlling, tender collusion; and prohibition of dominant position	3. After enactment of competition policy, enforcement of law becomes serious concern of KPPU
		4. Reducing the business cost and eliminate barrier	–	Presidential Decree No. 29 Year 2004 on Investment Procedure through One Stop Service	President regulation No. 10 Year 2008 on electronic system usage in national single windows. implementation In order to reduce the business cost and Presidential Decree No. 27/2009 on one stop services

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No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
		5. Predictable and secure access to land	• The basis of law is Law No. 5 Year 1960 on Agrarian • In order to make predictable, the government enacted Presidential Decree No. 97 Year 1993 which mentioned that locational permits includes right to land, the process takes only 12 days, and investors can be granted right to use land for 35 years, Right to Use Building for 30 years	• In 1999, the government issued Head of National Land Agency Decree No. 2 Year 1999 mentioned: (1) locational permits is also right to use land; (2) locational permits were not necessary for business expansion; (3) the locational permits were granted by regent/mayor	• Law No. 25 Year 2007 expanded the right to use land from 35 to 95 years, right to use building from 30 to 80 years

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No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
2.	*Policy to generate economic wealth*				
	(a) Investment regulation to generate economic wealth by encouraging the promotion of linkage between foreign and domestic enterprises	1. Government should actively nurture and facilitate business linkage between national companies and foreign investors 2. Government should consider: (1) direct intermediation between national-foreign investors; (2) support national companies to upgrade the technology; (3) establishment of national norms and standards; (4) selective FDI targeting; (5) incentives for foreign investors to assist in upgrading SME	There is no specific intervention policy to ensure that domestic enterprises take benefit from the existence of FDI	In order to protect domestic enterprises and increase transfer of technology, knowledge and skill government enacted Presidential Decree No. 96 Year 2000 1. Prohibit foreign participation in sectors: radio, television broadcasting, printing, logging activities, public transportation, inter-island shipping services, trade and supporting services 2. Foreign entities may participate through joint venture (20 %) with domestic entities and only limited to 26 sectors 3. 33 sectors were reserved for only domestic enterprises 4. Joint venture is mandatory 5. Foreign participation in forest concession is not allowed However, special policies to nurture and facilitate business linkage did not exist	There is no specific intervention policy to ensure that domestic enterprises take benefit from the existence of FDI

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No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
		3. Mandatory practice to promote linkage such as joint-venture requirement 4. Explicit responsibility and accountability should be assigned to IPA to nurture and promote business linkage 5. Specific policies should encourage business to offer training to employees			
	(b) Investment related policy to generate economic wealth				
	(1) Public Governance and Institutions	1. In implementation of investment policy, the government should have integrity, independent regulatory institutions, accountable, transparent and predictable, and service oriented bureaucracy	Indonesia has Anti Corruption law, which is Law No. 3 Year 1971 on Corruption, however, the law is not well implemented due to the patrimonial practices	Since economic crisis, the corruption became big concern so that the government enacted Law No. 20 Year 2001 on Corruption and established Commission for Eradication of Corruption through Law No. 30 Year 2002 on Commission for Eradication of Corruption	In order to reduce the business cost and Presidential Decree No. 27/2009 on One Stop Services Law No. 14/2008 on Freedom of public information to increase the social accountability of public governance and transparency of government activities

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No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
		2. Close cooperation and good communication between agencies and investors 3. Government should adopt anti-corruption legislation and fight corruption		Beside that, improvement of investment climates was the top priority agenda for the government, but not significantly reduce the doing business cost	Law 37/2008 on Ombudsman and Law 25/2009 on Public Services to increase social accountability of public governance
3.	*Policy to support social development*				
	(a) Investment related Policy to sup-port social development				
	(1) Labour Market Regulation	1. Labour market regulation should support job creation objectives in investment policy but the employees should be protected from abusive labour practices 2. Country need to guarantee internationally recognized labour standard i.e. child labour, right to collective representation	Law No. 14 Year 1969 on Manpower and Government Regulation No. 8 Year 1981 on Protection of Wage do not specify the protection of labour beside related to wage, do not mandate the training and transfer of skilled.	In order to protect the labour, law No 21 Year 2000 on Labour Union allow labour force to form labour union	Law No. 13 Year 2003 on Manpower regulated wage aspect, training aspect and synchronize with ILO standard 1. Wage policy is determined by considering Decent Living Index 2. Wage policy is determined by head of regions (Bupati/walikota/governor) 3. Every regions can conduct vocational training to increase labour productivity

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No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
		3. Adjustment costs or friction caused by shifting productive capacity and employment to priority investment area 4. Transfer of skill should be encouraged			
	(2) Corporate Social Responsibility	1. Government should encourage compliance with high standards of responsible investment and corporate behaviour	The mandatory obligation to do Corporate Social Responsibility was not mentioned in the law	The mandatory obligation to do Corporate Social Responsibility was not mentioned in the law	Law No. 40 Year 2007 on Limited Companies and Law No. 25 Year 2007 mandated all companies to compensate people surrounding manufacture through corporate social responsibility and all companies should follow good corporate governance practices Government regulation No. 47 Year 2012 on corporate social responsibility

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No	Variables	Guidelines for investment policy framework for sustainable development (UNCTAD)	Centralized era (1967–1998)	First wave of decentralization (1999–2003)	Second wave of decentralization (2004–present)
4.	*Environmental protection*				
	(a) Investment related policy to protect environment	1. Environmental impact assessment (EIA) should be part of investment procedure 2. Foreign investors should adhere to international standards of environmental protection and committed not to engage in environmental dumping	Law No. 4 Year 1982 on Environment did not explicitly mandated environmental impact assessment as part of investment procedure.	Law No. 23 Year 1997 on environmental management has explicitly stated the principle of sustainable development. environmental impact assessment was part of the investment procedure The Law No. 41 Year 1999 on forestry is also able to protect the degradation of environment. However, the effectiveness of the law was questionable due to lack of law enforcement Government Regulation No. 27 Year 1999 on environmental impact analysis mandated all EIA shall be done by companies as part of investment procedure	Law No. 32 Year 2009 on Environment 1. Every companies shall conduct Environmental Analysis Impact and it is evaluated by local/national government 2. Every FDI shall receive environmental permits 3. Operational permits is given in accordance with land use planning which must consider environmental strategic study 4. Every business operation are subject to environmental audit 5. Ministry of environment has bigger authority to issue some licenses, to do audit and law enforcement

Source UNCTAD (2012) data created by Kuswanto

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Chapter 6
The Inclusive Growth Concept: Strengths, Weaknesses, and a Research Agenda for Indonesia

Pande Nyoman Laksmi Kusumawati, J. Paul Elhorst and Jakob de Haan

Abstract In the last decade, inclusive growth, a broader concept of economic growth came into vogue among international organizations and countries' policy makers. This paper reviews recent studies on inclusive growth addressing the following issues: which indicators have been considered, how they have been combined, and to which extent can existing research on inclusive growth provide a better understanding of the economic development process in an emerging economy like Indonesia. Many studies use one index and a single-equation approach to measure the determinants of inclusive growth. This paper suggests an alternative approach for future research that can shed more light on (the drivers of) (the different components of) inclusive growth, i.e. using a simultaneous equations model or a structural equation modelling approach. We can, thereby, provide better analyses and policy recommendations to achieve inclusive growth.

Keywords Economic growth · Inclusive growth · Measurement · Structural equations · Indonesia

1 Introduction

Development has been equated with economic growth for a long time. Unfortunately, high economic growth is often not accompanied by less income

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inequality and lower poverty. For example, high economic growth in Great Britain during the industrial revolution was not followed by improvements in life expectancy and infant mortality (Crafts 1997). Similarly, the more recent increase of economic growth in India was not accompanied by a decreasing mortality rate, and less income, and gender inequality (UNDP 2005). Likewise, while economic growth has led to a rise in the average standards of living, it has also led to worries about the environmental consequences. There has been much debate over whether or not it is possible to achieve economic growth without unsustainably degrading the environment (see, for instance, Czech 2013). For many years, the earth's limited natural resource base was viewed as an important source of constraints to growth. Nowadays, the focus has shifted from concern for the ultimate exhaustion of natural resources to climate change and poor environmental quality due to emissions of industrial production (see, for instance, Nordhaus 2013). The view that economic growth may have negative environmental consequences, such as climate change and poor environmental quality, is widely shared. However, even though there is a link between GDP growth and emissions, this relationship is not linear. For instance, Ekins (2000) compares the GDP growth with the increase in emissions of several pollutants in seven developed countries between 1970 and 1993, and finds that while the GDP rose between 50 and 150 % across these countries, emissions increased by less than the GDP in the majority of them (relative decoupling) and fell in the others (absolute decoupling). Moreover, climate change and environmental quality may also affect economic growth. Several recent studies have examined the link between climate change and economic outcomes, including economic growth. According to Dell et al. (Dell et al. (2014: 770), the estimates of these studies "provide rigorous econometric evidence that weather—temperature, precipitation, and events such as windstorms and droughts—has manifold effects on economic activity. Poor economies appear particularly vulnerable to detrimental weather effects, while certain demographic groups, such as children and the elderly, appear especially sensitive on health-related dimensions". Likewise, several other recent studies have explored the relationship between environmental quality and economic growth. Summarizing the results of this research, Greenstone and Jack (2015: 21) conclude that "these papers indicate that the health burden of air and water pollution in developing countries are substantial and that the productivity and income effects may also be important".

For all these reasons, international organizations and policy makers started focusing on broader concepts of economic growth. Clearly, broader concepts of economic growth, especially concerning pro-poor growth aiming to deliver higher-income gains for lower-income groups next to stimulating economic growth, have been discussed before. But recently, broader concepts of economic growth became known as inclusive growth. In 2004, the United Nations Development Program (UNDP) established the International Policy Centre for Inclusive Growth (IPC-IG) research group, which specifically focuses on inclusive growth issues. Moreover, in its 2020 strategy, the Asian Development Bank (ADB 2008) put inclusive growth explicitly on its agenda. The 2006 India development policy review was entitled "Inclusive Growth and Service Delivery: Building on India's Success". Furthermore, India included inclusive growth as an objective in its eleventh five-year plan.

The concept of inclusive growth has also become part of Indonesia's medium–term development plan for the period 2010–2014 (Bappenas 2010). This plan states that the realized economic growth rate of around six percent per year over the period 2004–2008 is inadequate in order to realize the goal of a prosperous Indonesia, since many communities are left behind and not able to benefit from economic growth (Bappenas 2010: I. 18). For this reason, main national development targets have also been formulated for education, health, food, energy, and infrastructure (Bappenas 2010: I. 44–45).

Despite the increasing popularity of the inclusive growth concept, both its definition and measurement are still under discussion. Initially, inclusive growth was defined as growth that benefits the entire society. This is a rather broad and imprecise definition. Later, international organizations and policy makers started to define inclusive growth based on their own policy strategies. For instance, the World Bank (WB 2008) considers inclusive growth as the growth that gives societies opportunities to be more productive and creative. The Organization for Economic Co-operation and Development (OECD 2014) argues that to have inclusive growth, a country needs strong economic growth which induces improvements not only in outcomes but also in living standards and people's quality of life. Although more specific, these concepts of inclusive growth are still rather broad and imprecise. Therefore, many studies try to describe inclusive growth more precisely and try to measure it. While some studies identify inclusive growth as growth that reduces poverty (Habito 2009), other studies define inclusive growth as the relation between growth and equity (Anand et al. 2013; Balakrishnan et al. 2013) or between growth and opportunities (Ali and Son 2007), or they try to capture even more components of economic development (McKinley 2010).

Based on the discussion above, this study addresses four main issues: (1) which components of inclusive growth have international organizations and recent studies considered; (2) which methodologies have been applied to analyse inclusive growth; (3) to what extent can studies on inclusive growth provide a better understanding of the economic development process in an emerging economy like Indonesia; and (4) how can inclusive growth be analysed in future studies.

The complexity of the inclusive growth concept as well as the disagreement on the components to be covered and the proper indicators of these components impede future studies on inclusive growth. Therefore, this paper elaborates on both the definition and the measurement of inclusive growth. A better understanding of (the drivers of) inclusive growth may contribute to better policy recommendations to achieve inclusive growth.

The literature that will be covered consists of official documents from the (ADB), the (WB), the (OECD), the International Monetary Fund (IMF), and official websites of the United Nation Development Program (UNDP) and the European Union (EU). In addition, individual contributions to the scientific literature focusing on inclusive growth and studies focusing on Indonesia's development will be considered.

This chapter is structured as follows. Section 2 provides an overview of the inclusive growth concept used by different international organizations. Section 3 discusses the main methodological problems of the inclusive growth concept. Section 4 zooms in on Indonesia's development problems. Section 5 suggests two approaches for future research that can shed more light on the determinants of inclusive growth, and finally Sect. 6 concludes the chapter.

2 Definition and Measurement of Inclusive Growth

Table 1 gives an overview of the inclusive growth concept as suggested by different international organizations. It should be stressed that this table reflects our own interpretation of the inclusive growth concept, obtained by reading official documents published by these organizations and by consulting their websites. Since the definition of the inclusive growth concept is sometimes broad and difficult to summarize in one sentence, the key terms used by these organizations are also reported. Table 1 demonstrates that the inclusive growth concepts used by the different international organizations tend to cover both income and non-income components of development and vary widely.

This image is strengthened by Table 2 showing how frequently different components are included in the inclusive growth concept. Both poverty and inequality in addition to the level of welfare measured by GDP per capita appear to be popular components of income, while commonly used components of non-income growth are employment, health, and education. Less popular non-income growth components appear to be social safety nets, good government and institutions, and investment barriers. It is quite remarkable that environmental indicators are generally not included, even though there are good reasons to consider them as argued in Sect. 1.

Arguments put forward by different studies to include the components reported in Table 2 are the following. According to Felipe (2012), inclusive growth is achieved when all members of society participate in and contribute to the growth process on an equal basis regardless of their individual circumstances. This means that inclusive growth is synonymous with the lack of involuntary unemployment. By having a job, people will not only receive wages but will also feel they are important and contributing to society. Moreover, having a job makes people more creative. Unemployment and underemployment cause both economic costs (loss of potential income, output and tax revenues, and deterioration of labour skills and productivity) and social costs (poverty, misery, malnutrition, and injustice). Ramos et al. (2013) take a similar view: only when being employed can people participate and contribute to the economy. Bhalla (2007) argues, however, that full employment is not sufficient for inclusive growth. Since poor people tend to have lower levels of education and health, and as a result lower levels of productivity and wages, they face difficulties when trying to escape poverty. Apart from poverty and inequality, inclusive growth should therefore also cover education and health. This view is shared by Tang (2008), who points out that poor people do not benefit from economic development due to their disadvantaged position.

Table 1 Overview of the inclusive growth concept by international organization

International organization	Definition of inclusive growth	Key terms
World Bank (http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,contentMDK:21870580pagePK:64166689piPK:64166646~theSitePK:469043,00.html)	Rapid pace of growth is unquestionably necessary for substantial poverty reduction, but for this growth to be sustainable in the long run, it should be broad-based across sectors, and inclusive of the large part of a country's labour force	– Economic growth – Poverty – Employment
ADB (The 2020 strategy)	Growth with equality of opportunity provided by having high sustainable growth that creates opportunities, broader access for members of society to participate in and benefit from growth, and strength social safety nets to avoid deficiency	– Economic growth – Equal opportunity – Broader access for participate – Strength social safety nets
IMF (IMF 2011)	Growth that is not associated with an increase in inequality	– Economic growth – Income distribution of the poor and the rich
EU Commission (Europe 2020)	Growth with a high employment economy delivering economic, social, and territorial cohesion	– Economic growth – Employment – Education – Poverty
UNDP (http://www.ipc-undp.org/pages/newsite/menu/inclusive/whatisinclusivegrowth.jsp?active=1)	Growth that provides both equality in income distribution and opportunity to participate and have benefit from growth for society	– Economic growth – Equality in income distribution – Opportunity to participate and have benefit from growth.
OECD (2014)	Growth that creates opportunity for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms fairly across society	– Economic growth – Household income – Health status – Jobs

Source Authors' own interpretation of international organizations' official documents and websites

Table 2 Inclusive growth: overview of components included by different international organizations and different studies

Study	Income		Non-Income							
	Poverty	Inequality	Employment	Infrastructure	Education	Health	Gender	Social safety nets	Good Gov and Inst	Investment Barriers
ADB (FIGI 2013)	√	√	√	√	√	√	√	√	√	
World Bank	√		√							
IMF (2011)		√								
EU (2015)	√		√		√					
UNDP		√	√							
OECD		√	√			√				
Ramos et al. (2013)	√	√	√							
McKinley (2010)	√	√	√	√	√	√	√	√		
Habito (2009)	√			√	√	√				
Balakrishnan et al. (2013)		√								
Anand et al. (2013, 2014)		√								
David and Petri (2013)		√								
Adedeji et al. (2013)					√	√				
Ianchovichina and Lundstrom (2009)	√		√	√	√	√			√	√
Tang (2008)	√									
Ali (2007)	√		√	√	√	√	√	√	√	
Ali and Son (2007)					√	√				
Bhalla (2007)	√	√	√			√				
Chakrabarti (2013)			√							
Felipe (2012)			√							

Source Authors' own interpretation of international organizations' official documents and websites

According to the OECD (2013, 2014), household income, having a job, and health status are the three most salient components of inclusive growth. Although this organization initially identified eleven monetary and non-monetary dimensions as essential for people's well-being, among which income and wealth, jobs, skills and education, health, social connections, environmental quality, and security, not all of these dimensions are measurable or have a clear link to policy. Furthermore, the three selected components also overlap or partly cover other dimensions. By having resources in the form of income or wealth, people are able to satisfy their basic needs and can prefer under which circumstances they would like to live. It also protects them against economic and personal risks. By having a job, people can earn a living, develop new skills and abilities, and actively participate in a wide range of social activities. By being healthy, the probability of having a job increases. Apart from this, healthiness is highly valued by most people anyway. The OECD (2014) provides for each of these components an indicator, namely household real disposable income, the average rate of unemployment, and life expectancy, respectively.

Table 3 provides more information on the methodology that different studies use to analyse inclusive growth. A few of the studies are descriptive (Ianchovichina and Lundstrom 2009; Tang 2008; Bhalla 2007). They discuss the development of several indicators of inclusive growth for one or a set of countries over a particular period to judge whether the economic situation has improved. It is important to make a distinction here between components and indicators. Inclusive growth is a latent variable meaning that it cannot be directly observed but only be inferred (often through statistical methods) from other variables that are observed (directly measured). However, the variables included in inclusive growth are often also latent constructs, such as poverty and inequality, which in turn depend on observable variables. To distinguish them, the term *components* is used to represent latent constructs that are included in inclusive growth and the term *indicators* to represent observable variables of these latent constructs. Figure 1 illustrates this distinction. For example, in the descriptive study of ADB (2013), the development of 20 different indicators is described under the heading of nine different components (see Table 3).

Several studies try to reduce the different components and indicators to one single index, using fixed weights, statistical or mathematical techniques, or a theoretical approach. McKinley (2010) reduces 23 indicators representing nine components to one single index by rescaling each indicator from 0 to 10 and then summing them up based on fixed weights. A weight of 25 % is given to economic growth, 15 % to employment and to sanitation and water, 10 % to poverty, inequality, and social safety nets, and 5 % to gender, health, and education. These weights are partly based on data availability. Ramos et al. (2013) uses a normalization procedure to reduce data on poverty, inequality, and employment to a single index of inclusive growth. Anand et al. (2013, 2014) employ a social mobility curve to model the relationship between income growth and income distribution. This social mobility curve, which may change over time due to changes in income

Table 3 Inclusive growth: overview of indicators and methodology applied by international organizations and recent studies

Study	Components	Indicators
ADB (2013) (FIGI)	Poverty	1. Proportion of population living below $2 a-day at 2005 PPP$
	Inequality	2. Ratio of income or consumption of the highest quintile to lowest quintile
	Employment	3. Employment-to-population ratio, youth (aged 15–24 years) 4. Number of own-account and contributing family workers (per wage and salaried workers)
	Health	5. Under-five mortality rate per 1000 live births 6. Diphtheria, tetanus toxoid, and pertussis (DTP3) immunization coverage among 1-year old (%)
	Education	7. Average years of total schooling, adults (aged 25 years and over) 8. School life expectancy, primary to tertiary (years) 9. Pupil–teacher ratio (primary)
	Infrastructure	10. Electricity consumption (per capita KWh) 11. Number of cellular phone subscriptions (per 100 people) 12. Proportion of population using an improved drinking water source 13. Proportion of population using an improved sanitation facility
	Gender	14. Gender parity in primary education 15. Gender parity in labour force participation (aged 15 years and over) 16. Percentage of seats held by women in national parliament
	Social Safety Nets	17. Social security expenditure on health as a percentage of government expenditure on health
	Good Governance and Institutions	18. Voice and accountability 19. Government effectiveness 20. Corruption
OECD (2014) (Making Inclusive Growth Happen 2014)	Income and Wealth	1. Average household income
	Employment	2. Average rate of unemployment
	Health	3. Life expectancy
EU (EC 2015)	Poverty	1. Number of people living below national poverty lines
	Employment	2. Employment rate of population aged 20–64 years
	Education	3. The share of early school 4. The share of the population aged 30–34 having completed tertiary education

(continued)

Table 3 (continued)

Study	Components	Indicators
McKinley (2010)	Poverty	1. The proportion of the population living below nationality determined poverty lines 2. The proportion of the population living below \$2.5 per day per person international poverty line in 2005 prices
	Inequality	3. The GINI coefficient 4. The income share of the poorest 60 % of the population
	Employment	5. Share of the employed in industry 6. Share of own-account workers and formally unpaid family workers in total employment
	Health	7. Under-five mortality rate 8. Mortality rate under age 40 9. Percentage of those under age five who are underweight
	Education	10. Net primary enrolment ratio 11. Net secondary enrolment ratio
	Infrastructure	12. Proportion of the population with access to electricity 13. Number of mobile phone subscribers per 100 people
	Sanitation and Water	14. Proportion of the population with access to safe water 15. Proportion of the population with access to adequate sanitation
	Gender	16. The ratio of literate females to literate males among those aged 15–24 years 17. The ratio of girls to boys in secondary education 18. The percentage of births attended by skilled health personnel 19. The share of women in non-agricultural wage employment
	Social Safety Nets	20. The total expenditures on all social protection programmes as a ratio to GDP 21. The number of beneficiaries of social protection programmes as a ratio to the reference populations for key target groups 22. The number of social protection beneficiaries who are poor as a ratio to the total poor population 23. The average social protection expenditure for each poor person as a ratio to the poverty line

(continued)

Table 3 (continued)

Study	Components	Indicators
Habito (2009)	Poverty	1. Income poverty headcount 2. Proportion of people living below $1.25 a-day yardstick
	Health	3. Probability at birth of not surviving to age 40 4. Percentage of children under weight for age
	Education	5. Adult literacy rate
	Infrastructure	6. Percentage of population without sustainable access to an improved water source
Ianchovichina and Lundstrom (2009)	Poverty	1. Poverty headcount index
	Inequality	2. Mean shares if household income by source, income quintile rural and urban
	Employment	3. Number of people employed by sector in rural and urban areas 4. Structure of farming sector
	Health	5. Access health facilities 6. The HIV/AIDS epidemic
	Education	7. Mean years of schooling of household head 8. Percentage of households with access to education facilities within 5 km 9. Ratio between emigration rate of skilled (% of all skilled) to tertiary educated (migrants and non-migrants) per 100 population of source country
	Infrastructure	10. Access to air transport 11. Number of household with access to facilities within 5 km for food market, input market, post office, public transport, public phone, and internet café
	Investment	12. Interest rate spreads 13. Capital credit ratio 14. Real cost of capital 15. Gross capital formation ratio to GDP 16. Aid (% of gross capital formation) 17. FDI net flow 18. Gross domestic savings (% GDP) 19. Nominal rate of assistance (indirect cost to agriculture)
	Good Governance and Institution	20. World Bank governance indicators
Balakrishnan et al. (2013)	Inequality	1. Average incomes of the poorest fifth of society 2. Average incomes of the richest fifth of the society
Anand et al. (2013, 2014)	Inequality	1. Income per capita for cumulative share of population

(continued)

Table 3 (continued)

Study	Components	Indicators
Adedeji et al. (2013)	Health	1. Access to health services for groups of income
	Education	2. Access to primary school enrolment for group income of people 3. Access to secondary school enrolment for group income of people
Ramos et al. (2013)	Poverty	1. Headcount ratio at $2 a-day PPP
	Inequality	2. GINI coefficient
	Employment	3. Employment-to-population ratio (EPR) 15+
Tang (2008)	Poverty	1. National poverty line 2. Share of population below the $1-a-day 3. Share of population below the $2-a-day 4. Poverty indices
Ali and Son (2007)	Education	1. Share of children currently attending primary schools 2. Share of children currently attending secondary schools
	Health	3. Share of population that have access to health facilities—hospital and clinics 4. Share of population that have access to health facilities—private hospital
Bhalla (2007)	Inequality	1. Gini ratio and Changes in Gini ratio for India's rural and urban
	Poverty	2. Absolute number of poor people and changes in absolute numbers in rural and urban 3. Head count poverty ratio and changes in head count poverty in rural and urban 4. Headcount poverty ratio by major states in India 5. Rural headcount poverty ratio in specified sectors 6. Person below poverty line among rural household by principal industry group 7. Poverty ratio by employment status
	Health	8. Children under three years who are underweight by major states in India
	Employment	9. Employment growth rates rural and urban in specified sectors 10. Employment growth rates formal and informal sectors

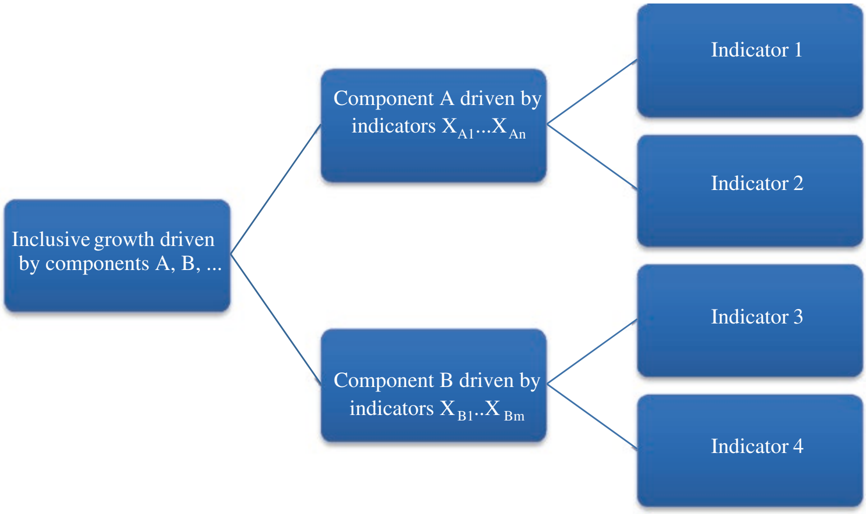

Fig. 1 Inclusive growth is a latent variable explained by other latent variables, denoted as components, inferred from observable indicators

growth and income distribution, is then used to determine a measure for inclusive growth and to regress this measure on a set of explanatory variables (GDP per capita lagged in time, education, availability of infrastructure, macro-economic conditions, investment, and government consumption) using data of 143 countries over the period 1970–2010. A similar approach is used by Habito (2009). He analyses the degree to which poverty is reduced by economic growth depending on four components, each measured by one or two indicators, using data for 10 Asian countries over the period 1990–1996 and 15 Asian countries over the period 2000–2008. Other studies following this kind of approach where the inclusive growth concept is further explained using a single equation approach are of Anand et al. (2013, 2014), Adedeji et al. (2013), and Ali and Son (2007).

Finally, some other studies attempt to explain one or more of the components of inclusive growth. For instance, Balakhrisnan (2013) regresses the bottom and the top quintile income shares of the income distribution on GDP per capita income and an additional set of components (indicators): income (household income), employment (share of labour income to GDP, shares of employment in agriculture, manufacturing and services, and some interaction terms between these variables and income), education (education spending, percentage of people aged over 15 years of age having secondary education, average years of schooling, and interaction terms between these educational indicators and income), health (health spending), and financial openness (financial openness, financial reform index, and interaction terms with income). Inclusive growth is achieved if the income inequality between these two quintiles diminishes.

One exception to the setup of the above-mentioned studies is the OECD (2014) report, which considers only three components/indicators and provides separate estimates for each of them. Since one dependent variable is assumed not to affect the other, while the error terms in the different equations are assumed to be correlated, the model is estimated by seemingly unrelated regressions (SUR).

3 Methodological Problems in Analysing Inclusive Growth

The rather arbitrary method of using particular indicators of inclusive growth, sometimes rather arbitrary weighting scheme that is used to reduce different indicators of inclusive growth to one single index, and the aggregation bias that might occur by not analysing the different indicators separately are the main drawbacks of using a single index and applying a single equation approach to analyse this index.

First, inclusive growth is a latent variable consisting of several components that are also latent constructs. The basic question is which components and which indicators of these components to include. In the previous section, it was shown that there are large differences in this respect.

Second, transforming these indicators and components to one index is a challenge and it is questionable whether or not this is even useful. A composite index may lead to loss of information and could provide misleading policy recommendations if an index is poorly constructed or misinterpreted (Jollands et al. 2003; OECD 2008; Marozzi 2014). The main reason to consider inclusive growth was to gain a broader view on the economic conditions of a particular country. By translating this information back to one single index, this broader view might be lost again. Moreover, McGillivray (1991) found that there is a positive correlation among education, health, and income per capita determining the Human Development Index (HDI). This means that these indicators of economic development when covered by inclusive growth will also have close relations with each other and therefore will be partly redundant. Consequently, highly correlated indicators need to receive lower weights when combined with other indicators of economic development. To determine these weights, they may set by the researcher themselves, but preferably, they are derived from probability distributions to avoid arbitrariness a statistical approach.

Some studies provide an index to measure inclusive growth. Ramos et al. (2013) developed an index combining poverty, inequality, and employment by taking the average of these three components. However, according to Sagar and Najam (1998), this aggregation approach is biased if these components are not substitutes. Moreover, McKinley (2010) sets different weights to inclusive growth indicators based on their importance and data availability. However, giving different weights to different components or indicators of these components will be difficult because of the subjectivity and lack of theory to determine the weights.

The third problem is a potential aggregation bias. If, for instance, a particular indicator has a negative impact on one component and a positive impact on another component, the result of the overall impact on inclusive growth will be nearly zero. Consequently, it might be erroneously concluded that this indicator is not an important determinant of inclusive growth. It is clear that these problems may lead to incorrect interpretation, and a turn to ineffective policies.

4 Indonesia's Development

Inclusive growth became a widespread concept among many countries. In contrast to many developed countries, several developing countries realized high economic growth rates during the last decade, but unfortunately many groups in society and numerous regions were not able to benefit from this. For these reasons, many developing countries, including Indonesia, formulated broader policy targets. This section focuses on Indonesia's development plans and the results that have been realized based on descriptive data and result from previous studies on inclusive growth. Section 5 offers an alternative approach for analysing inclusive growth that we suggest for future research on inclusive growth.

4.1 An Overview of Indonesia's Development Planning

The development planning strategy of Indonesia consists of three parts. The first part is the national long-term development plan (known as Pembangunan Jangka Panjang Nasional, PJPN). This plan represents the vision and mission of Indonesia's long-term goals based on Indonesia's Constitution. The current plan covers the period 2005–2025. The second part of Indonesia's development planning strategy consists of the national medium-term development plan (Pembangunan Jangka Menengah Nasional, PJMN) describing the President's vision and mission for the next five years, keeping in line with the goals of the long-term development plan. The last part includes the government's working plan (Rencana Kerja Pemerintah, RKP), which gives further details of the medium-term development plan that will be conducted in each year.

Figure 2 shows that Indonesia has just completed its second medium-term development plan for the period 2010–2014. The goals of this development plan were to consolidate Indonesia's reform process, to increase the quality of human resources, to build up more capacity in science and technology, and to strengthen the country's competitive position. Moreover, five national development agendas were addressed to realize the national medium-term development plan's mission. The first of these five agendas focused on economic development and an increase of people's welfare. The fifth of these agendas focused on development which is inclusive and just, defined as development that is actively carried out by all of

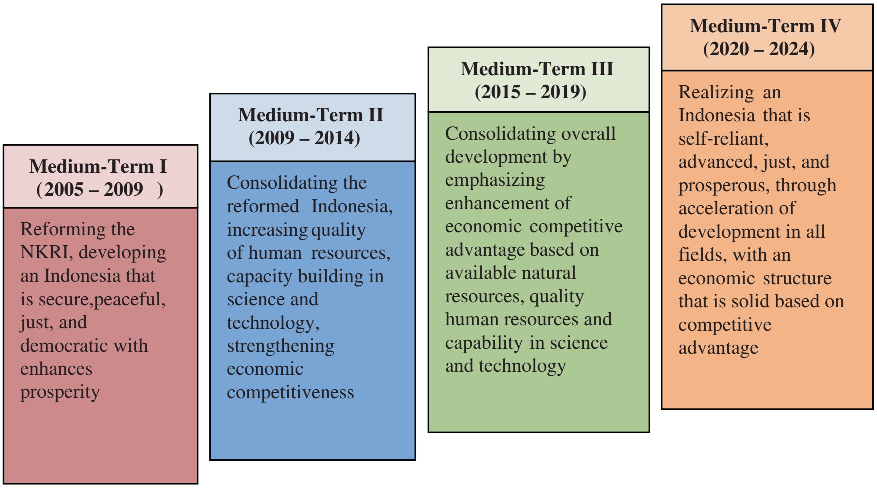

Fig. 2 Stages of National Long-Term Development Plan (2005–2025). *Source* Bappenas (2010)

the people, and whose fruits come to the benefit of all people. The other agendas focus on good governance, democracy, and law enforcement. Finally, to formulate these agendas in a more operational way, eleven national priorities are considered: reform of the bureaucracy and governance; education; health; reducing poverty; food security; infrastructure; investment climate and business climate; energy; environment and management of natural disasters; left-behind, frontier, outermost, and post-conflict areas; and culture, creativity, and technological innovation. The advantage of working with priorities rather than agendas is that it will be easier to implement the priorities and to measure the output of priorities.

Since Indonesia's inclusive growth concept focuses on education, health, food, energy, and infrastructure, the paragraphs below will discuss those areas in more detail.

4.2 *Indonesia's Inclusive Growth: Results from Recent Studies*

Figure 3 depicts basic trends on economic growth, education, health, and poverty, and shows that Indonesia's economic growth rate rose from 0.8 % in 1999 to 6.3 % in 2012. This increase, which was mainly driven by the manufacturing and service sectors, pushed poverty back considerably; the number of people living in poverty reduced from 23.4 % in 1999 to 12.0 % in 2012. It also had a positive effect on the educational attainment of the population and the health status. The illiteracy rate of people aged between 15 and 44, which is one indicator of

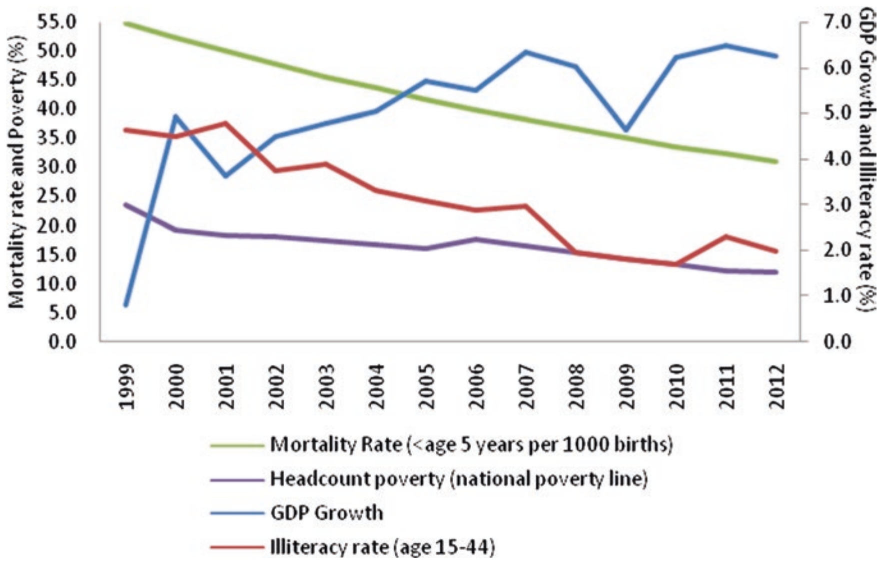

Fig. 3 Trends of economic growth, education, health, and poverty. *Source* Authors' compilation from national statistic and WDI

education, fell from 4.6 % in 1999 to 2.0 % in 2012. One reason for this was the implementation of the mandatory nine-year primary education programme. The mortality rate of children under five years of age per 1000 live births, one indicator of health, declined from 55 in 1999 to 31 in 2012. This improvement was enhanced by the programme to provide basic immunization to 90 % of the infants in 2014. Despite these improvements, Indonesia still faces many income distribution problems.

There are two types of inequalities that may be considered: vertical and horizontal (McKinley 2010). Vertical inequality stands for the gap in the income distribution between the poorest and the richest, whereas horizontal poverty reflects income inequality across regions or sectors. Based on data provided by National Statistic Agency (BPS), eventhough Indonesian's economic growth increased from 5.67 percent in 2007 to 6.30 percent in 2012, the Gini index measuring vertical poverty also increased from 0.36 in 2007 to 0.41 in 2012, with large differences among regions within Indonesia. Table 4 shows that the Gini index measuring horizontal inequality ranged from 0.26 in the region of Kepulauan Bangka Belitung to 0.41 in the region of Papua in 2007. Just as the national trend, this range increased to 0.29 and 0.44, respectively, for the same two regions in 2012. It illustrates that these intra-regional disparities in income inequality are quite stable despite the several policy measures implemented to tackle them.

Similar results of higher income inequality despite poverty reduction or improvements to other inclusive growth components were found by studies

Table 4 Income inequality among regions in 2007 and 2012

Province	Gini index		GRDP growth	
	2007	2012	2007	2012
Aceh	0.27	0.32	−2.36	5.20
Sumatera Utara	0.31	0.33	6.90	6.22
Sumatera Barat	0.31	0.36	6.34	6.35
Riau	0.32	0.40	3.41	3.55
Kepulauan Riau	0.30	0.35	7.01	8.21
Jambi	0.31	0.34	6.82	7.44
Sumatera Selatan	0.32	0.40	5.84	6.01
Kepulauan Bangka Belitung	0.26	0.29	4.54	5.72
Bengkulu	0.34	0.35	6.46	6.61
Lampung	0.39	0.36	5.94	6.48
DKI Jakarta	0.34	0.42	6.44	6.53
Jawa Barat	0.34	0.41	6.48	6.21
Banten	0.37	0.39	6.04	6.15
Jawa Tengah	0.33	0.38	5.59	6.34
DI Yogyakarta	0.37	0.43	4.31	5.32
JawaTimur	0.34	0.36	6.11	7.27
Bali	0.33	0.43	5.92	6.65
Nusa Tenggara Barat	0.33	0.35	4.91	-1.12
Nusa Tenggara Timur	0.35	0.36	5.15	5.42
Kalimantan Barat	0.31	0.38	6.02	5.83
Kalimantan Tengah	0.30	0.33	6.06	6.69
Kalimantan Selatan	0.34	0.38	6.01	5.73
Kalimantan Timur	0.33	0.36	1.84	3.98
Sulawesi Utara	0.32	0.43	6.47	7.86
Gorontalo	0.39	0.44	7.51	7.71
Sulawesi Tengah	0.32	0.40	7.99	9.27
Sulawesi Selatan	0.37	0.41	6.34	8.37
Sulawesi Barat	0.31	0.31	7.43	10.32
Sulawesi Tenggara	0.35	0.40	7.96	10.41
Maluku	0.33	0.38	5.62	7.81
Maluku Utara	0.33	0.34	6.01	6.67
Papua	0.41	0.44	4.34	1.08
Papua Barat	0.30	0.43	6.95	15.84
Indonesia	**0.36**	**0.41**	**5.67**	**6.30**

Note GRDP is Gross Regional Domestic Product
Source National Statistic Agency (BPS)

discussed in Sect. 2. By considering the sensitivity of growth with respect to poverty and inequality, Dartanto (2014) found that during the 1990s and the 2000s not only the impact of growth on poverty started to slow down, but also the impact of growth on inequality, which is positive rather than negative, increased. He also recorded that structural change, sectoral wage disparities, and misallocation of fiscal and monetary policies negatively affected Indonesia's concept of inclusive growth. Indonesia's economy is mainly driven by the manufacturing and service sectors, while the poor people mainly live in rural areas and work in the agricultural sector. The lower productivity in the agricultural sector compared to the manufacturing and services sectors explains why the income levels of people employed in the agricultural sector stay behind. Furthermore, higher-income families have benefited from government expenditure allocated to oil fuel subsidies more than lower-income families. Likewise, Anand et al. (2013) report that over the period 1990–2005, Indonesia's average annual economic growth rate exceeded the pace with which equality decreased, 2.9 versus 0.5 %, since higher-income people benefited most from Indonesia's economic progress.

One of the studies on Indonesian inclusive growth which considers a broader concept of poverty Habito (2009) finds that the elasticity of head count poverty with respect to growth amounts to −1.65 over the period 2000–2006. This means that an increase of economic growth by one percent leads to a reduction of 1.65 % in the number of people living below a poverty line. Table 5 shows that this is the highest elasticity compared to other Asian countries over that period. However, when considering a broader concept of poverty, such as the human poverty index (HPI) covering a long and healthy life, knowledge, and a decent standard of living,

Table 5 Ranking of countries based on elasticity of growth on headcount poverty (left) and the Human Poverty Index (HPI) (right) Index

Country	Headcount poverty	Country	HPI
Indonesia	−1.65	Malaysia	−1.46
Pakistan	−1.64	Singapore	−1.23
PRC	−1.31	Thailand	−1.19
Malaysia	−0.81	Vietnam	−1.18
Thailand	−0.76	Nepal	−1.02
Vietnam	−0.64	Mongolia	−0.90
Sri Lanka	−0.59	PRC	−0.79
Nepal	−0.52	Cambodia	−0.58
Bangladesh	−0.47	Pakistan	−0.55
Cambodia	−0.16	Philippines	−0.49
India	−0.16	Bangladesh	−0.37
Philippines	0.15	India	−0.32
Mongolia	1.86	Myanmar	−0.29
Singapore	NA	Indonesia	−0.28
Myanmar	NA	Sri Lanka	−0.13

Source Habito (2009)

Indonesia drops to the penultimate position. This is because Indonesia's growth appeared to be less inclusive compared to other Asian countries, especially with respect to education and health improvements for the poor. According to Habito (2009), the impact of economic growth on poverty reduction is caused by three factors: sectoral changes in employment, the composition of public investments, and the quality of governance. In many Asian countries, and also in Indonesia, poverty declined due to employment opportunities offered by the manufacturing sector. However, poverty reduction also benefited from government expenditures on education and health and from good governance. According to Habito (2009), Indonesia performed poorly on these latter two factors in comparison to other Asian countries.

Combining more components of inclusive growth is also conducted to analyse Indonesia's inclusive growth. McKinley (2010) combines 23 indicators into one single index of inclusive growth for Bangladesh, Cambodia, India, Indonesia, the Philippines, and Uzbekistan. The index for Indonesia of 4.40 is very low; all other countries, except for the Philippines, perform better. According to this study, Indonesia's progress is unsatisfactory especially with respect to poverty and access to sanitation and water.

In conclusion, we may say that Indonesia's growth has only partly been inclusive over the period 1999–2012. Inclusive growth components showing (marginal) improvements are poverty, education, and health, but compared to other Asian countries, Indonesia could have done better. Moreover, inequality increased rather than decreased, since especially the higher-income groups benefited from Indonesia's economic progress, while the poor, mainly living in rural areas and working in the agricultural sector, were left behind. In addition, improvements in the quality of governance are needed. Poor quality of governance may cause well-intentioned policies to have no impact due to ineffective services (Filmer and Pritchett 1997), bribes, corrupt officials, and miss-procurement (Klomp and de Haan 2008). However, this analysis of Indonesia's inclusive growth performance is based on descriptive statistics and a survey of the results from previous studies, which generally combine indicators of inclusive growth into a single index. As argued in Sect. 3, existing approaches for analysing inclusive growth ignore simultaneity and the multidimensional character of inclusive growth. Therefore, some alternative approaches to address these shortcomings in future research will be discussed below.

5 Further Research on Inclusive Growth

Inclusive growth is a multidimensional, latent variable. This implies that approaches as used by most previous studies are problematic. Therefore, two alternative approaches will be proposed for further research on inclusive growth: a simultaneous equations model and a structural equation model.

First, in order to cover income and other dimensions of inclusive growth simultaneously, a simultaneous equations model can be applied. A simultaneous equations model, if based on theoretical relations behind the components of inclusive growth, will provide a better understanding of the several dimensions of inclusive growth and their relationships. These theoretical relations may be taken from economic theory, but due to dissatisfaction with the rather narrow definition of economic growth within the economics discipline, other disciplines should also be considered. Furthermore, the selection of the components that are considered in a particular study should also depend on the objective of that study, and whether or not they are measurable, do not overlap, and have a clear link with policy.

As pointed out before, the OECD's concept of inclusive growth focuses on household income, labour (in particular unemployment), and health (in particular life expectancy). The OECD (2014) analyses these components by applying the (SUR) method. Under this method, it is assumed that all the regressors are independent variables, explaining the term "Unrelated". Nevertheless, SUR uses the correlations among the errors in different equations to improve the efficiency of the coefficient estimates, explaining the term "Seemingly". However, the assumption that all regressors are independent is problematic, as the drivers of one particular component of inclusive growth may include one or more other dimensions of inclusive growth. For instance, health may be driven by income and income inequality (Klomp and de Haan 2009), while income inequality is driven by income as well (Barro 2000). Therefore, the SUR method might not be the proper method for analysing inclusive growth.

Endogeneity problems, discussed above, require a simultaneous equations model. Drawing on Wooldridge (2002), such a model can be written as

$$
\begin{aligned}
y_{it1} &= \propto_1 y_{\mathrm{it2}} + \propto_2 y_{\mathrm{it3}} + \ldots + \propto_{\mathrm{n}} y_{\mathrm{itn}} + z_{\mathrm{it1}}\eta_1 + a_{\mathrm{i1}} + u_{\mathrm{it1}} \\
y_{\mathrm{it2}} &= \beta_1 y_{\mathrm{it1}} + \beta_2 y_{\mathrm{it3}} + \ldots + \beta_{\mathrm{n}} y_{\mathrm{itn}} + z_{\mathrm{it2}}\eta_2 + a_{\mathrm{i2}} + u_{\mathrm{it2}} \\
y_{\mathrm{it3}} &= \gamma_1 y_{\mathrm{it1}} + \gamma_2 y_{\mathrm{it2}} + \ldots + \gamma_{\mathrm{n}} y_{\mathrm{itn}} + z_{\mathrm{it3}}\eta_3 + a_{\mathrm{i3}} + u_{\mathrm{it3}} \\
&\vdots \qquad\qquad \vdots \qquad\qquad\qquad \vdots \qquad\qquad\qquad \vdots \\
y_{\mathrm{itn}} &= \lambda_1 y_{\mathrm{it1}} + \lambda_2 y_{\mathrm{it2}} + \lambda_3 y_{\mathrm{it3}} + \ldots + \lambda_{\mathrm{n}-1} y_{\mathrm{itn}-1} + z_{\mathrm{itn}}\eta_{\mathrm{n}} + a_{\mathrm{in}} + u_{\mathrm{itn}}
\end{aligned}
$$

where i refers to countries, t refers to time periods, a_{i1} up to a_{in} are time-invariant unit-specific effects, $z_{\mathrm{it1}}\eta_1$ up to $z_{\mathrm{itn}}\eta_{\mathrm{n}}$ reflect a set of exogenous explanatory variables in each equation, while y_{it1} up to y_{itn} are endogenous explanatory variables. For example, based on our summary of the literature, employment, education, and health could be regarded as non-income components of inclusive growth, and income, income inequality, and poverty as income components of inclusive growth, and these components could be treated as endogenous variables.

The specification of each equation in this model should be based on theory and previous empirical studies, taking into account that causality may potentially run in both directions. For example, although Klomp and de Haan (2009, 2013) point out that income per capita is positively related to education and health of labour (through its impact on labour productivity), there may also be a causal relationship between GDP growth and education (Danacica et al. 2010) and GDP growth and health (Li and Huang 2009).

The other alternative approach that could be applied is the structural equation model (SEM). Figure 1 illustrates that inclusive growth is a latent variable meaning that it cannot directly be observed but only be inferred from other variables. However, many of these variables cannot be observed either, since they are also latent constructs. This implies that the explanation of inclusive growth consists of two stages. First, observable indicators are required to construct the latent constructs explaining inclusive growth, and second, a regression model is needed in which inclusive growth is taken to depend on these latent constructs. Whereas the simultaneous equations model only covers the second stage, since it assumed that the explanatory variables are observable, the structural equation model covers both stages and thus generalizes the simultaneous equations model.

Unlike the simultaneous equations approach, the structural equation model approach uses factor analysis in the first stage and combines this with multiple regression analyses in the second stage (Hoyle 2011). Components of inclusive growth are considered to be latent variables dependent on different indicators. To reduce the number of these indicators, a factor analysis is applied. In the regression part, the relationship between the components and inclusive growth is determined.

To illustrate this approach, we draw on Klomp and de Haan (2009, 2013). Again, the same six dimensions of inclusive growth as used above can be considered: the non-income components (employment, education, and health) and the income components (income, income inequality, and poverty) as shown in Fig. 4.

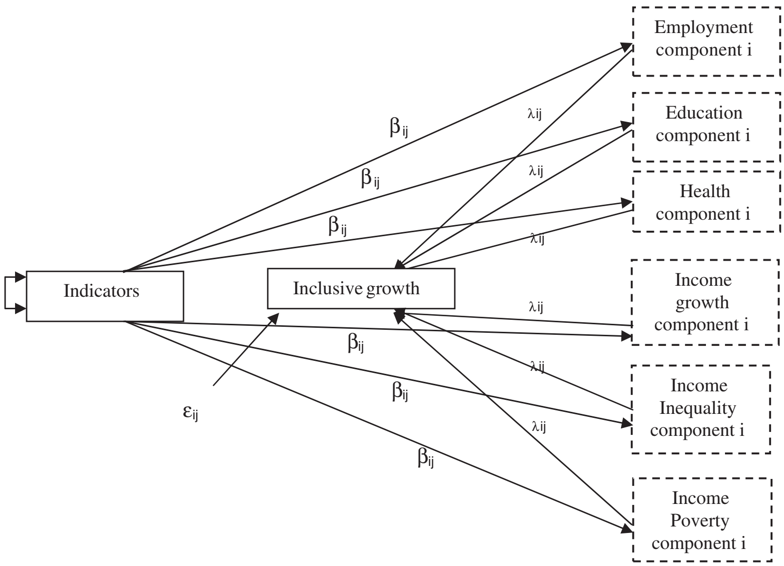

Fig. 4 Path diagram structural equation model for inclusive growth analyses. *Source* Adopted and adjusted from Klomp and de Haan (2009, 2013)

For each component other than income, several indicators can be used. The factor analysis can be employed to examine the underlying and common information from all indicators in each dimension (Lattin et al. 2003). The path diagram for the analysis is shown in Fig. 4. The dashed squares represent the components of inclusive growth, while $\lambda_{ij}s$ represent the strength of the effects and $\beta_{ij}s$ are the estimated coefficients. The components of inclusive growth may be correlated, which is shown by the arrows from and to the determinant variables.

6 Conclusions

There is no consensus in the literature yet on the precise definition and measurement of inclusive growth. Even though inclusive growth generally stands for economic growth that benefits the entire society, international organizations generally transform the concept in such a manner that it fits best with their own preferred economic policy strategies. In policy strategies and existing studies on inclusive growth, employment, poverty, education, health, and income inequality are the most frequently identified dimensions of inclusive growth apart from economic growth. Moreover, for each dimension of inclusive growth, several indicators have been proposed by recent studies. All this illustrates that inclusive growth is a multidimensional latent variable, which has income and non-income dimensions. However, an important challenge is data availability, determining the number of dimensions that can be considered in measuring inclusive growth, notably in cross-country studies. Another challenge is also to bring in environmental components or indicators. Although the view that economic growth may have negative environmental consequences, these have generally not been included (yet) in inclusive growth studies.

Analyses of (the drivers of) inclusive growth should deal with this multidimensional latent variable characteristic of inclusive growth, as well as with simultaneity. Most recent studies on inclusive growth applied data description or used an aggregate index of inclusive growth, possibly in combination with a single equation model, thereby ignoring the requirements for proper inclusive growth analysis. This also applies to previous studies of Indonesia's inclusive growth which have been discussed in the paper.

In this paper, we propose two alternative methodologies to analyse inclusive growth: simultaneous equations and structural equation modelling. Due to their complexity, these alternative approaches have not been applied in this paper, but in future studies, they could be applied to Indonesia, thereby providing a more accurate analysis of (the drivers of) inclusive growth and a better basis for policy advice.

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Part III
Challenges of Decentralization for Cities to Create Sustainable Futures

Chapter 7
Metropolitan Governance and Institutional Design: Transportation in the Jakarta Metropolitan Region

Taufiq Hidayat Putra, Johan Woltjer and Wendy Guan Zhen Tan

Abstract In the Jakarta Metropolitan Region (JMR), the lack of coordination and appropriate governance has resulted in paralyzing traffic jams at the metropolitan scale that cannot be resolved by a single government entity. The issue of metropolitan governance is especially crucial here as the JMR lacks an established and formally predesigned system of governance (e.g., in a constitution or other legal regulations). Instead, it relies on the interaction, coordination, and cooperation of a multitude of different stakeholders, ranging from local and regional authorities to private entities and citizens. This chapter offers a discussion on the various governance approaches relating to an appropriate institutional design required for transportation issues at the metropolitan scale. The case used is a regional Bus Rapid Transit (BRT) system as an extension to the metropolitan transport system. Institutional design analysis is applied to the case and three possible improvements, (i) a “Megapolitan” concept, (ii) a regional spatial plan, and (iii) inter-local government cooperation, were identified that correspond to current debates on metropolitan governance approaches of regionalism, localism, and new regionalism. The findings, which are relevant to similar metropolitan regions, suggest that

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(i) improvements at the meso-level of institutional design are more readily accepted and effective than improvements at the macro-level and (ii) the appropriate institutional design for governing metropolitan transportation in the JMR requires enhanced coordination and cooperation amongst four important actors: local governments, the regional agency, the central government, and private companies.

Keywords Metropolitan governance · Institutional design · Jakarta · Metropolitan transportation

1 Challenges of Governing Metropolitan Transportation

Transportation issues, such as capacity or extension requirements of road and public transport networks, are best resolved at the metropolitan scale and require appropriate forms and approaches of governance for resolution. The Jakarta Metropolitan Region (JMR) is an example wherein the current governance structure is unable to address the pressing transportation issues at the metropolitan scale and therefore metropolitan governance must be considered. Here, *metropolitan governance* is a crucial point for resolving issues related to metropolitan transportation and is defined as the interaction, coordination, and cooperation process the involved actors take to provide and produce regional infrastructures and services (Feiock 2009, 2013). Comprehensive and integrated transportation services and infrastructure require "good" governance to overcome their tendency for a fragmented and sectorial context, created by the fact that actors involved are limited by their own authority and capacity. Differing models of metropolitan governance could guide policy makers and urban planners in diverging directions on decisions about public transportation networks or toll roads. In other words, metropolitan governance influences the delivery of urban planning (Alexander 2006).

A key problem is that metropolitan regions in many countries include autonomous local public agencies, which are simultaneously functionally connected through transportation. Metropolitan regions do not, as a rule, have adequate institutional arrangements for solving and addressing these kinds of regional matters (Miller and Lee 2009). The notion of metropolitan governance, therefore, has generated fundamental debate, both academically and in planning practice, on the question of which institutional arrangements will deliver good governance. Good governance issues such as government effectiveness and regulatory quality (Kaufmann et al. 2010) are key to providing and producing transportation services and infrastructures for urban areas.

1.1 Jakarta Metropolitan Region

This chapter showcases the institutional preferences of fragmented transportation actors in the case of JMR of Indonesia for forming appropriate metropolitan governance at the regional scale (see Fig. 1). The JMR, like other regions in the world, generally faces challenges in solving regional problems or addressing issues on

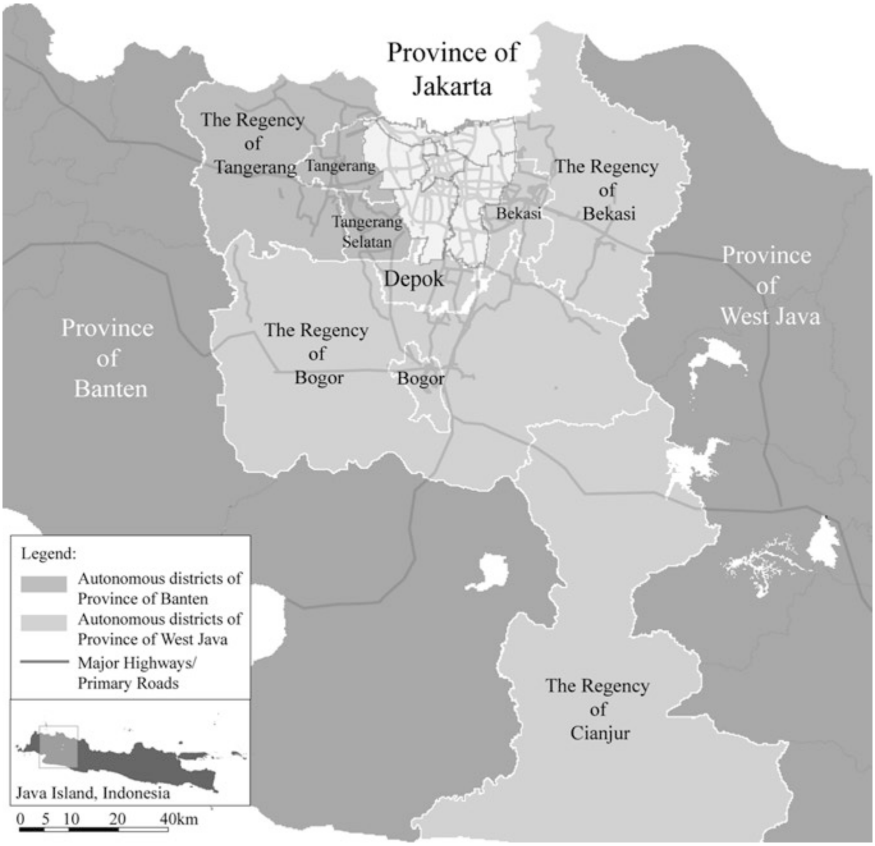

Fig. 1 Map of Jakarta metropolitan region and its constituents

a regional scale: these include floods, garbage disposal management, economic competition, manpower and labor wages, water management, and other issues in addition to transportation that involve local governments and other regional actors. The JMR suffers from the specific regional transportation problem of traffic jams. The worst traffic jams occur in Jakarta, the core area of the JMR and the economic, social, and political center of the region and nation. This problem is exacerbated by the high volume of commuters traveling from the districts adjacent to Jakarta. The 2004 Study on Integrated Transportation Master Plan for Jabodetabek II (SITRAMP) facilitated by Bappenas and JICA, revealed that traffic jams generated a total economic loss of IDR 5,500 billion (equivalent of US $ 618 million when study was conducted in January 2003), comprised of IDR 3,000 billion (US $ 337 million) in vehicle operating costs and IDR 2,500 billion (US $ 281 million) in travel time. Moreover, the study also predicted that if the situation does not improve soon, that loss will increase to IDR 65,000 billion (US $ 7,303 million) by 2020, comprised of IDR 36,900 billion (US $ 4,146 million) in longer travel time and IDR 28,100 billion (US $ 3,157 million) in additional vehicle operating costs. The SITRAMP report also recommended several policies, such as (1) promotion of public transportation use, (2) alleviation of traffic congestion, (3) reduction of air pollutants and traffic noise, and (4) reduction of transportation accidents and improvements in security (Bappenas and JICA 2004).

Jakarta's provincial government cannot resolve this problem on its own. It needs to coordinate and cooperate with other actors, such as other district governments, other provincial governments, and the central government, to reduce traffic caused by commuters who come from districts surrounding Jakarta and to develop a regional public mass transportation system. Appropriate metropolitan governance is a crucial issue because it is not only important to effectively provide and produce a regional public mass transportation system, but also to have that arrangement accepted by those regional actors from which support is required. In the case of the JMR, the establishment of appropriate metropolitan governance is particularly pressing as it directly affects the outcomes produced in the transportation system.

Decentralization and local autonomy policies from the early 2000s impacted development at the regional scale. At that time, the JMR was even more fragmented: it consisted of six non-autonomous districts in the Province of Jakarta and nine autonomous districts within two other provinces. These local governments tend to focus on development within administrative boundaries, but lack focus on development at the regional scale. This conflicts with transportation issues that are typically regional in nature. This kind of fragmentation occurs not only among local governments, but some evidence suggests that it also occurs among central agencies managing this region (Kawaguchi et al. 2013). Fragmentation can contribute to lowered government effectiveness, which is detrimental for citizens in the region. Therefore, a lack of regional development, specifically in metropolitan governance issues, should be taken into account.

1.2 Appropriate Institutional Design

Government effectiveness is one dimension of good governance associated with discussions about the quality of public services, policy formulation, and implementation (Kaufmann et al. 2010). Metropolitan governance arrangements should fit contextual circumstances, particularly so that they can enhance government effectiveness, including the ability to provide and produce services and infrastructure at the metropolitan scale. Furthermore, effective metropolitan governance could contribute to sustainable development (Wheeler 2000). Effective metropolitan governance could also enhance the quality of metropolitan transportation, ensuring it is designed to reduce traffic jams in the JMR, leading to decreased pollution and reduced economic loss.

The object of analysis within this case is the extended service area development of TransJakarta Bus Rapid Transit (TJ BRT) from within Jakarta's borders to adjacent districts as a measure to deal with JMR's traffic problems. The service area expansion of TJ BRT is a good example, representing intensive debates on the question of what could be an effective model of metropolitan governance in the JMR. This understanding will lead to a context-appropriate institutional design. Institutional design analysis is applied to this case study. Metropolitan governance requires appropriate institutional design for planning and executing metropolitan transportation development, particularly when the provision and production of infrastructures and services are fragmented. Institutional design facilitates the ability of actors—not only governments, but also others, such as civil societies and private entities—to reduce the effect of some institutional barriers to create a situation that is more conducive to attaining the formulated goals. Metropolitan governance in the JMR consists of local government agencies with mutual interaction and coordination through general legislation. Therefore, the emphasis mainly lies on institutional design for macro-level arrangements such as general guidelines, and inter-organizational arrangements at the meso-levels instead of micro-level arrangements such as task forces, working groups, and committees.

Given the growing amount of metropolitan regions in the world, our society needs a better understanding of how actors (e.g., local governments, the central government, private entities, and civil societies) effectively provide and produce services and infrastructures at a metropolitan scale, linking different administrative authorities. In a case like the JMR, similar to other metropolitan regions in Indonesia, metropolitan governance is not legally clearly defined and the actors involved are often fragmented (Firman 2008). Focusing on transportation issues can enhance the understanding of appropriate models of metropolitan governance. This can, in turn, be applied to other regional issues in the JMR or even other urban areas. This chapter, therefore, proposes to explore what could be an appropriate institutional design for governing metropolitan transportation in the JMR. Here, appropriate institutional design refers to design that contributes to forming metropolitan governance that is accepted politically and can effectively implement policy and planning.

1.3 Research Design and Methodology

A qualitative methodology is applied, focusing on the metropolitan transportation institution of the JMR and its context of governance to understand what an appropriate institutional design could be. Relevant theories on institutional design and metropolitan governance were consulted and a proposed framework of institutional analysis has been applied to the case of JMR. The proposed framework is applied to empirical evidence collected through a triangulation of interviews and desktop research of policy documents and previous studies. This is followed by an analysis of previous and current institutional arrangements of the TJ BRT expansion. The chapter then concludes with discussions regarding what is an appropriate institutional arrangement and at what level institutional design is effective.

The TJ BRT is a public transportation solution serving a total of 241 km of roadways (Adiwinarto 2013). The TJ BRT is designed to serve the region around Jakarta and resolve transportation problems such as traffic jams and citizen mobility

(Adiwinarto 2013). The TJ BRT was selected as a case study because of its progress made towards full implementation in comparison to other systems and, more importantly, the incorporation of inter-jurisdictional issues within this process.

Data collection was carried out to obtain relevant data for analysis; desktop data collection included Internet-based research and in-depth interviews of several key experts including:

1. The Head of the BKSP Jabodetabekjur Secretariat (the regional agency for the JMR)
2. A Section Head at the Ministry of Transport
3. A Division Head at the National Development Planning Agency
4. A Division Head at the Transport Department of Jakarta Provincial Government
5. A Division Head at the Transport Department of Tangerang Municipality
6. A Division Head at the Development Planning Agency of Tangerang Municipality
7. A Division Head at the Development Planning Agency of Depok Municipality
8. A Section Head at the Development Planning Agency of Bekasi Municipality
9. A Division Head at the TJ BRT Unit (a Jakarta Public Service Agency).

Most data was collected from online newspapers articles and literature, policy documents, and previous research. We reviewed articles published in four online national newspapers (www.kompas.com, www.tempo.co.id, www.detik.com, and www.thejakartapost.com) between 2005 and 2013, and collected 49 articles related to the discourse of "Megapolitan" (a term for metropolitan governance proposed by the Governor), regional spatial planning, and inter-local government cooperation. In addition, we reviewed articles published in two online national newspapers (www.kompas.com and www.tempo.co.id) between 2008 and 2013, and collected 2454 articles about the TJ BRT. While there are many newspapers in Indonesia, only four newspapers were selected because they are nationwide and perceived to be credible. The time periods were selected based on when the debates had occurred and availability of the article.

The collected policy documents vary from planning issues (spatial plan and transportation plan) to government arrangements (e.g., Law of Local Government No. 32 year 2004). The collection of previous research mostly discusses transportation issues in the JMR (e.g., Badan Perencanaan Pembangunan Nasional [Bappenas] and Japan International Cooperation Agency [JICA] 2004, The Coordinating Ministry of Economic Affairs, The Republic of Indonesia [CMEA] and JICA 2012, The Institute for Transportation and Development Policy [ITDP] studies, and other related academic articles). An especially important source is the book written by Sutiyoso, the Governor of Jakarta of two terms (1997–2002, 2002–2007). In this book, he explains the "Megapolitan" concept that he had proposed to govern the JMR during his administration. He attempted to accommodate this concept in the revision of a new law on a special status for the Province of Jakarta as the capital city of Indonesia. Therefore, we treated textual data from this book and relevant information in newspapers as main sources to be explored and analyzed for the identification of preferences and perspectives of relevant actors. The preferences and perspectives were classified within the discourse of the Megapolitan concept, regional spatial planning, and inter-local government cooperation and then conceptualized within the institutional design approach. The research approach was confirmed as part of the triangulation method by examining events that occurred (e.g., a political decision passed into law, government policies included in regulations, or products like the extended development of TJ BRT) and then connecting them to the article stipulated in the law or the regulation to be verified. The triangulation process which connected newspaper articles, literature, policy documents, and previous research was an appropriate and accurate method to confirm the empirical evidence which was then identified, classified, and conceptualized. To analyze the collected data, institutional analysis framed within the institutional design approach was applied, specifically at the macro and meso-levels. Previously identified institutions and the actors' improvements were at the core of our analysis. The analysis also included institutions related to current metropolitan transportation in the JMR that may be more appropriate for the actors involved. The analysis identified the actors' preferences and perspectives, the events and their relationships, and then constructed, reconstructed, and classified them into several parts of analysis.

2 Combining Metropolitan Governance and Institutional Design

This theoretical framework connecting metropolitan governance and institutional design is used to examine the case study. Metropolitan governance literature discusses the approaches are that used to develop transportation in a metropolitan region. The institutional design perspective facilitates the framing of those approaches into several classifications ranging from the macro to the meso-levels. Institutional design is also useful as a perspective that supports efforts to transform an idea into implementation where improvements made by actors could be identified and mapped systematically. Next, the concept and definitions of metropolitan governance and institutional design are explained leading toward the theoretical framework used to analyze the case study.

2.1 Metropolitan Governance

There are several intensive debates on metropolitan governance: what kind is more effective and accepted to implement in a metropolitan region; should that be done in a centralized or decentralized manner, or should we use a mix of those approaches; and should metropolitan governance be formal, informal, or a mix of both? In practice, the discussion about metropolitan governance involves coordination capacity and the mechanism preference. Coordination capacity is related to the capacity to address and solve the degrees of externalities. Coordination mechanism preference refers to the preference for adopting the transaction costs that emerge within the interaction between involved actors.

Similarly, there are various definitions of metropolitan governance, covering regionalism, localism/public choice and new regionalism (Yaro and Ronderos 2011). These variations in definitions are a result of the different focus on which level of scale should conduct governance in order to achieve efficiency. The regionalism perspective concludes that a metropolitan region, consisting of some basic local governments, should be managed by the regional government (Ostrom et al. 1961; Gottman 1957, 1995). Proponents of this school of thought argue that efficiency of the provision and production of infrastructures and services can be reached if all local governments within a region are consolidated to meet economies of scale. This perspective encourages the establishment of a strong metropolitan government for a metropolitan region. The second perspective, in contrast to the previous one, is a localism or public choice approach that focuses on providing and producing services and infrastructures within local government administrative boundaries. Supporters of this idea believe that efficiency can be obtained when every local government competes with each other to serve their own citizens. Competition among local governments generates the ability of people to 'vote with their feet' and move easily to another, perhaps better place and thus impacting on general elections outcomes (Tiebout 1956). The third perspective, new regionalism, promotes inter-local government cooperation and pragmatism (Yaro and Ronderos 2011; Savitch and Vogel 2000a, b). With new regionalism, regional problems can be solved without reducing the authority of institutional actors involved and aid in achieving economies of scale.

The previously discussed perspectives link to other debates on which approach is more effective and more accepted for governing a metropolitan region, whether through a centralized or decentralized approach. Centralized and decentralized approach options have been important since Thomas Jefferson, one of America's earliest leaders, established the idea that a local government has to be independent and autonomous to provide space for citizens to participate in democracy, to be active in municipal meetings, and to be involved in governance (Hamilton et al. 2004). An arrangement or a governance approach that is set up and applied within a country, state, or province contributes to how local government functions. In a federal system, like the United States, various models of metropolitan governance are generated by local government constitutions (Oakerson and Parks 1989; Hamilton et al. 2004). A local government constitution provides space to local governments within a region to innovate and establish some models of relationships internally and externally. The influential factor for these models of metropolitan governance is whether a decentralized or centralized governance approach is applied (Hamilton et al. 2004). Those approaches are similar in administrative and political considerations, which also generate several models of metropolitan governance. To date, at least 17 models related to these considerations have been identified (Walker 1987).

Based on economic considerations, the fact that provision and production of transportation infrastructure could generate a deeper knowledge about how metropolitan actors work to meet citizens' demands on a metropolitan scale is acknowledged. Provision and production are two important stages in realizing metropolitan services and infrastructures. The term provision refers to the responsibility for the quality and volume of services (and infrastructures) and ensuring that those services are financed and executed (Davey 1993 in Harpham and Boateng 1997, p. 66). Provision also describes which goods and services are provided through public means, which private activities should be regulated, how much public revenue should be raised and how to raise it, and how production should be arranged and monitored (Parks and Oakerson 2000). The term production refers to infrastructure and services are delivered after decisions about volume and quality have been made (Davey 1993 in Harpham and Boateng 1997, p. 66) and how to transform input resources in a way that results in a product or renders a service (Parks and Oakerson 2000). The understanding of the differences between provision and production becomes more meaningful when faced with a several-decades-long trend in which private entities are involved in production and civil societies are included in a public debate about the provision of public goods. Osborne (1993) discussed the importance of dividing the government's role into steering and rowing roles with which to enhance a government's performance. He also introduced the idea of an entrepreneur government that encourages the involvement of private entities in producing services and infrastructures.

This separation triggers a distinction between the role of government and that of private entities and civil societies, providing an opportunity to identify different understandings about formal, informal, and mixed arrangements. In many countries, these arrangements depend on constitutional and related laws that regulate democracy, freedom of speech and the freedom to organize transparency, accountability, public procurement systems, and other related rules. In a metropolitan governance context, this generates formal, informal, or mixed governance arrangements that provide and produce metropolitan services and infrastructures.

The actors involved also consider the embedded transaction costs and the degree of collective action problems. Transaction costs are a friction of the economy (Williamson 1985) and are barriers for inter-local governmental coordination and cooperation (Feiock 2009, 2012). Transaction cost can be expressed as the "… comparative cost of planning, adapting, and monitoring task completion under alternative governance structures" (Williamson 1985, p. 2). It is a crucial factor that contributes to the form of governance. Two extreme forms of governance are that of the competitive market (political and economic) and a single hierarchical organization. The competitive market is when transaction costs are low in impact, interdependence, and uncertainty. In contrast, a single hierarchical organization (i.e., the public bureau and the corporate firm) generates a high impact, high interdependence, and high uncertainty. This single organization form is better than the competitive market form because it can reduce transaction costs and avoid hazards (Alexander 2001).

Within the context of metropolitan governance involving collaborations among individual local governments, the consideration of transaction costs is related not only to the forms of governance, but also to the considerations around entering or exiting any collaboration. High transaction costs occur when an arrangement has consequences that include eliminating independent authorities such as centralization through governmental authority, disrupting current governance activities, creating uncertainties about the balance of authority among actors, and shifting the inter-organizational problem to an intra-organizational problem (Whitford 2010 in Feiock 2013, p. 400). In addition, in spite of the fact that the establishment of a regional authority enhances efficient urban policy, these consolidation efforts have failed in most cases in the United States (Feiock 2009). Instead, a collaboration that does not reduce actors' autonomy is the most likely to be chosen. It could be formed as an informal network, a voluntary relationship, which, as a consequence, has low transaction costs. This informal network both preserves autonomy and makes it easier for actors to enter and exit the collaboration (Feiock 2012, 2013).

Moreover, within the context of metropolitan governance, Lowery (2000) emphasized the spillover problems/effects or externalities that could result from local government policies that have impacts across jurisdictions. Spill-over problems/effects could also be seen as losses or benefits (Ostrom et al. 1961). Furthermore, Feiock (2009) referred to spill-over problems/effects as collective action problems that relate to the difficulties actors within a region face in matching public goods and services to citizens' demands on multiple scales. Collective action problems are divided into three categories: horizontal, vertical, and functional (Feiock 2012). A horizontal collective problem makes it difficult to produce goods and services that cross jurisdictions or other boundaries. A vertical collective problem occurs between actors at different levels of government who produce similar policy objectives. Finally, a functional collective problem is the result of conflicts between service, policy, and resource systems that arises due to externalities between policy arenas and functional areas. These approaches in representing services and infrastructures that should be provided in a region are used in this analysis. The nature of services and infrastructures are an important consideration in the analysis of the actors involved when making decisions or arrangements (Feiock 2012).

In summation, several aspects that contribute to the metropolitan governance are:

1. Metropolitan governance approaches (centralized, decentralized, or mixed)
2. Metropolitan governance arrangements (formal, informal, or mixed)
3. Coordination mechanisms influenced by the degree of transaction costs (high/low)
4. Coordination capacity to capture collective action problems (externalities or spill-over problems).

2.2 Institutional Design

Institutions are important as they dictate the space in which relevant actors consider whether to perform an action or not. North (1991) defined *institutions* as man-made constraints that configure social, political, and economic interaction.

Institutions include both informal constraints (e.g., sanctions, taboos, customs, traditions, codes of conduct) and formal rules (e.g., constitutions, laws, property rights). North (1991) also revealed that institutions provide incentive structure for an economy. Institutions are important elements that deserve societal consideration and research focus, through, for example, their contribution to the achievement of regional development (Rodriguez-Pose 2013).

To understand metropolitan governance, one must consider the specific fit of institutions as determined by every aspects of the development of new regional services and infrastructure beyond that of the existing natural and man-made resources in a region. Actors involved in metropolitan governance consider coordination costs when addressing metropolitan-scale issues. Within the metropolitan governance context, planners provide and produce metropolitan transportation services and infrastructures to solve problems, such as regional traffic jams. The planner's purpose also requires him or her to pay attention to the institutions involved (Alexander 2006). The lack of an institution contributes to the ineffectiveness of planning (Gualini 2001). Therefore, a plan needs an appropriate institutional design to support its purpose in order to support realization.

Institutional design pertaining to the which, how and what of institutions is required to implement a desired outcome (Alexander 2006, p. 4) and is defined as;

> the devising and realization of rules, procedures, and organizational structures that will enable and constrain behaviour and action so as to accord with held values, achieve desired objectives, or execute given tasks.

It ranges from the macro to the meso and on to the micro-level. At the macro-level (the highest level), governance (constitution and related laws) is the main issue. Governance is not only government, but also the relation and form of all the actors involved. In some instances, discussions at this level also include a program, project, or policy with an impact that is felt nationwide or even over a larger area, such as the Code of Hammurabi, the Code of Napoleon, or Roosevelt's New Deal program. The body of knowledge of governance at the macro-level that fits with planning and institutional design is termed institutional economic knowledge (Alexander 2006). At this level, the appropriate question is "what are the appropriate forms of governance for the identified task in the relevant context?" (Alexander 2007, p. 53).

Discussions at the meso-level of institutional design focus on coordination. This level involves the institutional design of the planning and implementation of structures and processes. It also covers the issue of creation or utilization of inter-organizational networks, the establishment of new organizations or the transformation of existing ones, and the development and deployment of incentives and constraints in the form of laws, regulations, and resources used to develop and apply policies, programs, projects, and plans. Analysis of coordination at this level involves inter-organizational coordination, an element for institutional design architecture. This is "the process of concerting the decisions and actions of several—sometimes many—organizations, for a purpose or undertaking that could not be accomplished by any one organization acting alone" (Alexander 1995,

p. 67). In line with the governance at the macro-level that applies institutional economics, at the meso-level this is based on transaction cost economics that contribute to the structure of forms of governance (Alexander 2006).

Alexander (2006) also mentioned that the planners mostly function at the meso-level in the various fields of transportation planning, infrastructure planning, land development, housing, social and human services, public–private partnership, local economic development, urban revitalization. Within these fields, planners develop a plan and ensure its effective implementation within a specific time schedule. Next to planners, almost everyone else who has a position that involves managing an organization is responsible for ensuring effective achievement. These processes involve institutional design. In addition, the meso-level of institutional design focuses on the question "(what)… frameworks, system, or structures 'fit' the institutional design setting and tasks?"(Alexander 2007, p. 53).

Finally, the micro-level of institutional design emphasizes discussions about agency. It includes discussions about intra-organizational design, organizational subunits and small semi-formal or informal social units (e.g., committees, teams, task forces, work groups). Agent theory could be useful in the analysis of this level (Alexander 2006). The application of the analysis at this level could, for example, involve the analysis of a contracted bus company's performance issues in relation to its public agency.

Alexander (2006) identified two approaches of institutional design in practice. First, institutional design is not like other design activities, such as architecture, that require the best knowledge, intuition, and contextual experience. Institutional design should be collectively developed (Alexander 2006). Requirements may constrain people's ability to share knowledge, but the three levels of analysis (macro, meso and micro) are "technologies" that could assist people in understanding and identifying a problem and formulating a solution in a specific context. This technology generates the second approach to institutional design: it is an interactive process or dialogue between collective "micro-constitutional" decisions in a much needed heuristic approach (Alexander 2006).

2.3 Theoretical Framework

The various models of metropolitan governance that exist around the world result from the different constitutions and related laws, and different arrangement of actors involved in interaction and coordination. Unlike local governments, metropolitan regions are not political entities (Miller and Lee 2009). Generally, there is no set political structure as a city begins to grow and expand into surrounding district areas, becoming a core of a region. Local governments and other actors exist within a region and are involved in metropolitan governance. These include the central or federal government (particularly in a metropolitan region where the capital state is located or in a region of national importance), provincial or state government, private entities, and civil societies. Metropolitan governance can involve

Table 1 Connections between levels of institutional design and aspects of metropolitan governance

Level of institutional design	Aspects of metropolitan governance	Contributing factors
Macro	1. Governance approaches (centralized, decentralized, mixed) 2. Governance arrangements (formal, informal, mixed)	Constitution and related laws
Meso	1. Coordination of mechanisms of preference 2. Coordination of capacity	Transaction costs and capacity of interorganizational coordination

a wider range of actors because the term "governance" has a broader meaning than "government" as it includes a decision-making process.

According to literature, there is a correspondence between institutional design and metropolitan governance (see Table 1). The macro-level of institutional design concentrates on discussing governance. Contributing factors include the constitution and related laws that link up with the governance institution models (centralized, decentralized, or mixed) in a metropolitan region. The macro-level includes governance arrangements that can be formal, informal, or mixed. At a macro-level, the governance arrangement provides a space for actors to interact, coordinate, and cooperate. At the meso-level, the focus shifts to discussing coordination. Contributing factors, such as transaction cost theory and inter-organizational coordination (Alexander 1998), connect with coordination mechanisms in metropolitan governance, which in turn considers both factors. The meso-level includes coordination capacity, particularly the capacity to address the magnitude of spillover problems. When institutional design is an interactive process, the quality of coordination is influenced by the space provided by governance arrangement at a macro-level. This illustrates a link between the macro and meso-levels.

A theoretical framework combining metropolitan governance and institutions design and illustrating their relationship as based on the above discussions is developed (see Fig. 2). Institutional design is an interactive process that may be heuristic and contributes to the formation of some aspects of metropolitan governance. Institutional design contributes to metropolitan governance, such as through an approach (centralized, decentralized, or mixed), or arrangement (formal, informal, or mixed). Institutional design also provides coordination capacity for addressing several degrees of collective action problems, and accommodating several classes of transaction costs. The first two items relate to the macro-level and the latter two relate to the meso-level of institutional design. The composite of those aspects influence actors involved to develop metropolitan transportation services and infrastructures. Furthermore, evaluation of the quality of metropolitan transportation developments provides feedback to metropolitan governance. Improvement may be related and impact one or more of the aspects that are part of institutional design at the macro-level, meso-level, or both.

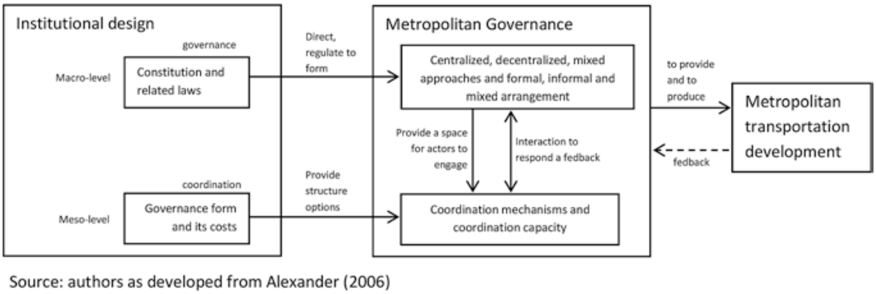

Fig. 2 Theoretical framework combining metropolitan governance and institutional design for transportation development. *Source* Authors as developed from Alexander (2006)

3 Transportation in the Jakarta Metropolitan Region

Development of public mass transportation at a regional scale is important for a metropolitan region like the JMR. Public mass transportation systems serve an entire region's mobility and support its strategic economic, social, and political roles within a national landscape. The development of a better metropolitan transportation system in the JMR is crucial as it is an area with acute traffic jams and a worsening situation having economic and social impacts. Unfortunately, this situation is compounded by the fragmentation of actors that made it more difficult to reach a solution. Many actors were involved in metropolitan transportation development in the JMR: the Ministry of Transportation, the Ministry of Public Works, the Ministry of National Development Planning, the Ministry of Environment, the Ministry of Finance, the Provincial Department of Transportation in three different provinces (Jakarta, West Java, and Banten), the Provincial Department of Public Work in three different provinces (Jakarta, West Java, and Banten), the Regional Development Planning Agency in three different provinces (Jakarta, West Java, and Banten), the District Department of Transportation, the District Department of Public Works, and the District Development Planning Agency in nine different districts (Tangerang Regency, South Tangerang Municipality, Tangerang Municipality in the Province of Banten, and Depok Municipality, Bogor Municipality, Bekasi Municipality, Bogor Regency, Bekasi Regency and Cianjur Regency in the Province of West Java), the Association of Land Transportation Owners and Operators (Organda), and the BKSP Jabodetabek (the JMR inter-local government cooperation agency). This fragmentation was also reflected in the coordination failures amongst actors involved in the horizontal, vertical, and functional aspects of governance (Bappenas and JICA 2004).

The Provincial Government of Jakarta developed a bus rapid transit (BRT) system to deal with the above issues. This is a dedicated bus route transportation system specifically designed to improve citizens' mobility in metropolitan areas or large cities by increasing frequency and capacity. It functions with dedicated lines or routes integrated with designated bus stops, specific type of buses, and programmed schedules that link a number of strategic areas within a region, served by an intelligent transportation systems to coordinate information. The advantages of BRT are (1) reduced travel time, (2) the possibility to reduce private vehicle use, (3) reduced air pollution, and (4) the possibility to develop a system integrated with other transit modes such as a train or light rail. In addition, developing BRT instead of another transit mode helps to (1) supports activities in the central business district, (2) be implemented quickly and incrementally, (3) be less costly than rail transit, (4) be more effectively serve and adapt to different environments between suburban and core areas, (5) provide quality performance, (6) be more suited to linking with extended rail transit service areas, and (7) be integrated with the environment to foster economic development and transit, and pedestrian design (Levinson et al. 2002). This explains the popularity of BRT around the world in both developed and developing countries, such as Ottawa (Canada), Boston (United States), Brisbane (Australia), Amsterdam, Eindhoven, Rotterdam, and The Hague (the Netherlands), Bogota (Colombia), Guangzhou and Taipei (China), Tehran (Iran), Istanbul (Turkey), Mexico City (Mexico), and Sao Paulo, Rio de Janeiro, Belo Horizonte, Recife, and Curitiba (Brazil) (Hidalgo 2012; Levinson et al. 2002; Veeneman and Koppenjan 2010).

The institutional arrangements of these metropolitan areas that provide and produce BRT differ from each other even within the same country (e.g., in the Netherlands). For instance, BRT in Bogota, Colombia is mainly managed through a public-private partnership: the central and local governments are responsible for delivering infrastructure, busways, and stations, and for planning and controlling operations while private entities are contracted to acquire and operate the vehicles and some supporting infrastructures (Turner et al. 2012, p. 12). In the Netherlands, BRT is managed differently in each of the four cities (Veeneman and Koppenjan 2010). In Amsterdam, BRT was developed through close collaboration between an operator, the province, and a regional authority with national and provincial funding. In Rotterdam, one district (the Municipality of Capelle) plays an important role in managing BRT for the regional authority similar to The Hague, which as a municipality also takes responsibility for managing the regional authority. However, a different type of management is applied in Eindhoven and the Veldhoven area. There, the regional authority takes the lead. This is also the case in Boston (United States), where the BRT is managed by the Massachusetts Bay Transportation Authority, which operates mass transit services such as buses, streetcars, and rapid transit lines, and which contracts Amtrak to operate commuter railroad services (Gomez-Ibanez 1996). These illustrations show that there are various models of metropolitan governance related to transportation and BRT.

The JMR had different and dynamic experiences in developing its BRT system—TJ BRT, locally known as the busway. This study identifies three phases of improvements for developing TJ BRT through (1) the Megapolitan proposal, (2) JMR spatial plan, and (3) inter-local government cooperation. These improvements have been identified and examined through the lens of institutional design.

3.1 Improvement Phase 1: The 'Megapolitan' Proposal (2005–2007)

Traffic jams in Jakarta are a critical and acute problem. Two important studies by Indonesia Infrastructure Initiative (INDII), the Australian Aid (AUSAid), CMEA, and JICA have identified the cause of the traffic problem to be a result of an imbalance between road development on the supply side and growth in the number of daily vehicles. These studies predicted that without necessary measures, gridlock would occur in 2014 due to the increase in the number of daily commuters from districts surrounding Jakarta who work in the Province of Jakarta (CMEA and JICA 2012, INDII-AUSAid 2011).

In order to reduce traffic jams around the Province of Jakarta, the provincial government cooperated with private companies to develop the BRT system. The first corridor has been in operation since 2004. While the system was designed to serve 12 corridors from 2004 to 2007, only seven corridors were completed. However, Akbar (2012) pointed out that the system served around 300,000 passengers per day in 2012. Moreover, this was also an improvement because the regular buses in use before the TJ BRT had a number of weaknesses such as not following a predictable schedule, not stopping at bus stops, not stopping at all once the bus was full, sitting and waiting to collect more passengers delaying those already on the bus, and competing for passengers at the curb side in a dangerous way. Moreover, the buses were deteriorated thus creating air pollution and serving as sites of petty crime (ITDP 2005). This old-fashioned bus service was transformed and made more efficient on some routes. It successfully supports citizens' mobility, reduces traffic jams in Jakarta's main corridor, and decreases air pollution. In relation to supporting global sustainable development and the clean air campaign, the TJ BRT contributed to the Provincial Government of Jakarta, winning the Air Quality Management Champion Award of the Clean Air Initiative for Asian Cities in 2006 (Soehodho 2011).

Although successful, the TJ BRT only served limited areas of Jakarta, while commuters from surrounding districts contributed to traffic jams. In response to those commuters (see Table 2), specifically to reduce the number of private vehicles they used, the Provincial Government of Jakarta proposed extending the service coverage area by integrating the surrounding district governments under one consolidated management. This was an idea, introduced by Sutiyoso, the Governor of the Province of Jakarta for two terms (1997–2002 and 2002–2007) as a part of the Megapolitan concept. In fact, it was a revitalization of an idea proposed by Ali Sadikin, the Governor of Jakarta from 1966 to 1977, to consolidate the region. Sutiyoso (2007) believed that the JMR would be better served by one responsible organization, established to reduce the ineffectiveness of inter-local government cooperation. His idea was to integrate the region around management of issues, such as transportation, floods, and waste management. He later modified it to integrate those issues through regional spatial planning. He tried to use this concept to solve traffic jams by expanding service area of mass transit systems (e.g., the

Table 2 Daily commuter trips from districts surrounding the province of Jakarta

District	Province	Region	Number of daily commuter trips (thousands)		Increase (%)
			2002	2010	
Tangerang municipality	Banten	West part	247	344	39
Tangerang selatan municipality	Banten				
Tangerang regency	Banten				
Depok municipality	West Java	South part	234	338	44
Bogor municipality	West Java				
Bogor regency	West Java				
Bekasi municipality	West Java	East part	262	423	62
Bekasi regency	West Java				
Total			743	1105	49

Source Adapted from the Coordinating Ministry of Economic Affairs of the Republic of Indonesia and Japan International Cooperation Agency (JICA), (JUTPI Study 2012)

monorail and TJ BRT) from within the municipality of Jakarta towards other surrounding districts (Sutiyoso 2007).

The Megapolitan concept was inspired by Megalopolis, as introduced by Gottman (1957) to describe a large region on the north-eastern seaboard of the United States where urbanization functionally connected some areas (e.g., Boston, New York, Philadelphia, and Washington, D.C.). He proposed the establishment of a specific institutional arrangement: treating that extensive region as a unit in which interstate compacts might arise to solve transportation problems (Gottman 1957). Sutiyoso's concept was intended to be accommodated in a new law or an amendment of the Law of the Province of Jakarta as the Capital City of the Republic of Indonesia. This is classified as a regionalism approach, focused on strengthening a regional government (Yaro and Ronderos 2011).

Traditionally, the JMR has been governed through an inter-local government cooperation agency: the Badan Kerja Sama Pembangunan Jabodetabekjur (the BKSP Jabodetabekjur), formally established in 1993, with an initial stage of this cooperation starting in 1975 (BKSP Jabodetabekjur 2007). The BKSP Jabodetabekjur had some tasks related to integrating, synchronizing, and simplifying all aspects of programs. It consults with the central government about the development of the JMR and its implementation plan. This task was difficult to achieve because this agency had little authority (Firman and Dharmapatni 1994). This region also experiences development problems related to having low revenue and excessive charges decreasing its competitiveness. During the Suharto era (prior to the reform movement), these were not significant problems because the powerful central government could either offer political solutions or take over the control. In spite of these weaknesses, the BKSP Jabodetabekjur has been politically accepted (Firman 2008).

To overcome the ineffectiveness of the BKSP Jabodetabekjur, Sutiyoso offered four options for managing the region. The first option, the Megapolitan concept, was realized through a new special province and led by the Governor of Jakarta. The second option was to enhance the performance of the inter-local government cooperation agency. The third was to allow one of the current ministers in the cabinet to lead the region (e.g., the Minister of Public Works, the Minister of Home Affairs, or the Minister of National Development Planning), or to allow the president to appoint a new minister, the Minister of Megapolitan, to govern the region. Finally, the fourth option was to form a new authority that included sectoral authorities such as a transportation authority (Sutiyoso 2007).

> We have met frequently, but I want to institutionalize and strengthen it through the law. The own-local revenue will not be taken over, a regent is still the regent, and also the mayor. The busway (the TJ BRT) could be proposed to reach Tangerang, the monorail to reach Bekasi and the subway to reach Depok. (Sutiyoso, the Governor of Jakarta 1997-2002, 2002-2007, quoted from Mahbub (2006), translated from Indonesian)

Sutiyoso argued that this was still a decentralized approach in which local governments have their own authority. However, implicit in the proposal was the idea that the Provincial Government of Jakarta was designed to become a main actor with a role in the entirety of the JMR in providing and producing metropolitan services and infrastructures. Based on this designed authority, the Provincial Government of Jakarta would extend the services of the TJ BRT and other public mass transportation systems, such as monorail and subway, from within the municipality of Jakarta to municipalities in the surrounding districts. To support this idea further and to declare his readiness and confidence, Sutiyoso also endorsed the Macro Transport Scheme (the Province of Jakarta 2007). The success of the TJ BRT development in reducing traffic in the municipality of Jakarta was credited as the selling point for this scheme.

Even though some district governments supported the Megapolitan proposal, the governors of West Java and Banten rejected it. Both governors perceived it as a reduction of their authority, annexing districts into the authority of the Province of Jakarta, thus significantly decreasing their own provincial revenue as each district contributed significantly through the vehicle tax. Opponents also argued that it is better to govern the region through a regional spatial plan than through consolidation of the local governments into one authority. They supported the idea in general but since regional problems are common problems, these should be addressed with some sort of collective action instead of a created metropolitan government that would reduce their direct authority.

> *I absolutely agree if the concept is intended to improve people's well-being rather than take over administration. We have a plan and vision for this region, so it will be better if the (Megapolitan) concept does not affect the administrative powers.* (Danny Setiawan, the Governor of West Java from 2003-2008, quoted from Sufa 2006)

In the second option, the concept acknowledged existing regional governance but unfortunately influential actors had the perception that the mechanisms would reduce the authority of local governments. Since the concept did not cohere with other existing laws, the proposal was rejected not only by the Governor of West Java and the Governor of Banten, but also by some ministers. This idea actually involved a political reform. The existing law about local government (Law No. 32/2004) emphasized the decentralization of local government and encouraged inter-local government cooperation in solving inter-jurisdictional problems. Finally, this proposal failed politically when the parliament did not turn this concept into the new law.

Based on an institutional design framework, this proposal tried to improve the approach to governance by moving from a decentralized approach to a mixed approach with elements of centralization and decentralization. A decentralized approach preserves local autonomy with the local government as the main actor in providing and producing public goods. A mixed approach promotes the consolidation of local autonomy by centralizing power in a single authority at the local government level. Regionalism proponents believed that this would enhance effectiveness and efficiency because a new, larger entity and a unified organization would elevate economic scale and reduce transaction costs. In spite of these advantages, this Megapolitan proposal failed because the improvement needed to transform the metropolitan governance model would require a political change. This process also incorporated some efforts such as lobbying, an opinion war played out in the newspapers and media, demonstrations, intensive debates, and bargaining that could change national or regional political configurations. These efforts are classified as having high transaction costs. Feiock (2009) mentioned that an action that is perceived to reduce the authority of some actors could be classified as a high transaction cost, a barrier to creating close coordination amongst metropolitan actors. Moreover, "the transaction costs of entering or exiting a relationship are highest with collaborative arrangements mandated through governmental authority and lowest with collaborative arrangements based on voluntary relationship and social constraints" (Feiock 2013, p. 401).

3.2 Improvement Phase 2: The Spatial Plan of the JMR (2008–2012)

This analysis is not intended to evaluate the performance of spatial planning, but to identify the possibility offered for governing the JMR region. As mentioned before, the Megapolitan proposal failed. The actors involved preferred to govern the JMR through a spatial plan rather than taking a political approach. At the same time as those intensive discussions were taking place, JMR was preparing its spatial plan. It was commonly perceived as a tool for mitigating regional floods after a big flood hit the JMR in 2002. Both the governors of West Java and Banten encouraged the central government to issue this spatial plan. The Minister of Public Works coordinated formulation of this spatial plan. Later, in 2008, it was officially launched through President Regulation No. 54 (The Republic of Indonesia 2008). The JMR spatial plan addresses a number of issues: not only flood mitigation, but also spatial structures and spatial patterns, transportation and water supply. Related to the transportation issue, this plan also organizes public mass transport, such as the BRT, train, monorail, and highways. This spatial plan is dedicated to developing a regional transportation system that creates synergy among transportation modes while considering the origin and destination of central activities in the region (land use).

> Merely developing an integrated spatial planning, it is not a matter because it does not change an administrative status. (Danny Setiawan, Governor of West Java from 2003-2008, quoted from Muttaqien (2006); translated from Indonesian)

This spatial plan was perceived as a win-win solution for governing the JMR, when compared to the Megapolitan concept. All the involved local governments within the region accepted this spatial plan politically because it did not reduce local autonomy or the authority of local governments. This presidential regulation gave the Minister of Public Works the authority to coordinate technical spatial planning for this region and it explicitly accommodates the existing metropolitan governance model. Inter-organizational coordination and inter-local government cooperation within the region are facilitated by an inter-local government cooperation agency. Each local government in the region operates this spatial plan and it preserves their autonomy. This approach could be classified as localism or public choice (Yaro and Ronderos 2011).

Interestingly, even though the spatial plan was most preferred by the actors involved, the current metropolitan transportation development has been not based on that spatial plan. For example, the recent discourses on the monorail development plans, such as lines from Cibubur in Depok Municipality to Cawang in Jakarta, and also from Sentul in Bogor Regency to Kampung Rambutan in Jakarta, are based on profit calculations from a project initiator. These new plans were not provided for in the JMR development spatial plan. This spatial plan also did not accommodate the extension of the TJ BRT in which its service area was to be operationalized within the border area of Jakarta. Furthermore, it did not clearly state which actor was responsible for developing metropolitan transport. Despite these gaps, this regional spatial plan was successful in reducing regional political tension and can be seen as a transition that generated further improvement.

Planning is a property of organization and the transaction costs theory of planning could explain the link among inter-organizational systems (Alexander 1992). The regional spatial plan resulted from a process of coordination between local governments within the JMR and the central government. Based on an institutional design approach, they are more likely to choose coordination as the discussion core of the meso-level. Actors perceived that coordination through regional spatial planning development had lower transaction costs than consolidation of the region, which reduces the authority of actors involved. Coordination was more accepted than a direct political approach.

4 Improvement Phase 3: Strengthening Inter-local Governmental Cooperation, Supported by the Central Government (2012–Now)

The current metropolitan governance approach in the JMR preserves decentralization and local autonomy. This form of metropolitan governance accepts the political role of the regional agency (i.e., the BKSP Jabodetabekjur). Fragmented actors prefer to apply the regional spatial plan as a tool to improve metropolitan governance. Unfortunately, the provided spatial plan still lacks details about developing metropolitan transport. This regional spatial plan does not accommodate the extended service area of the TJ BRT from within the municipality of Jakarta to adjacent districts and does not anticipate the dynamic situation, such as monorail development. Instead, it is part of the provision stage. The region requires increased provision and production of services and infrastructures.

Recently, extension of the TJ BRT from the municipality of Jakarta to the surrounding districts has flourished. The extension is also known as the Busway/the TJ BRT-integrated Border Transit (locally, APTB = Angkutan Perbatasan Terintegrasi Busway). This new TJ BRT serves some corridors that connect Jakarta to some strategic locations such as Bekasi Municipality, Bogor Municipality, Bogor Regency, Tangerang Regency, and South Tangerang Municipality. It was also designed to cover Depok Municipality. Textual data mentioned that the Jakarta Transport Department had played a role in implementing this extension, which was made easier after the Governor of West Java encouraged the services of TJ BRT to reach some JMR districts in West Java. This request was endorsed at an official BKSP Jabodetabekjur forum meeting. The BKSP Jabodetabekjur acted on this request by communicating and coordinating transportation agencies in the region. As the owner of TJ BRT, the Transport Department of Jakarta is required to meet this demand. This effort was supported by the Ministry of Public Work, which also assisted in the building of a new line (e.g., one that connected Pulogadung in the Jakarta area to Bekasi Municipality) and the Ministry of Transportation which developed supporting facilities.

The current metropolitan transportation developments of the monorail, the TJ BRT and other infrastructure developments have been accommodated by the Ministry of Transportation. In 2013, the ministry officially launched the General Plan of Public Mass Transport Infrastructures in the Jakarta Bogor Depok Tangerang and Bekasi (the JMR administration excluding the Regency of Cianjur) (The Republic of Indonesia 2013). This general plan applies to road-based and rail-based public transit infrastructures, multimodal integration, financial requirements (indicative amount), financial source arrangements (public and private), and development time horizons (2013–2014, 2014–2020 and 2020–2030). This may be the first comprehensive plan for public transportation development covering almost the entire area of the JMR.

These extended services demonstrate that the actors involved rely on a meso-level improvement focused on coordinationeffectiveness. When the provision issue is clearly accepted by actors involved, the improvement moves to implementation

Table 3 Institutional improvements of metropolitan transportation development

Level	Focus	Institutional improvement	Metropolitan governance approaches	Result	Contributing factors
Macro	Governance	The 'Megapolitan' concept incorporated into an amendment of the Law of Jakarta	Regionalism	Rejected	This political reform generated a high transaction cost. It failed because this proposal was perceived to reduce the authority of surrounding local governments who would have been impacted by the proposal
Meso	Coordination	The development spatial plan of the Jakarta metropolitan region	Localism/public choice	Accepted, but not effective in guiding the extended development of TJ BRT	1. This spatial plan does not intervene and reduce the local governments' authority. It supports inter-local governmental cooperation 2. This plan clearly states that public mass transportation would be built to connect Jakarta to surrounded districts 3. This plan lacks any accommodation of the extended development of TJ BRT from within the province of Jakarta to surrounding districts 4. This plan has no clearly defined institution that is responsible for developing regional public mass transportation systems 5. Although there are gaps, this spatial plan succeeded in decreasing regional political tension and may also generate further improvement
Meso	Coordination	Strengthened inter-local governmental cooperation and supported by the regional agency and the central government	New regionalism	Accepted and more effective	1. The governance approach that preserves local autonomy has not been changed 2. As an inter-local government cooperation agency, the BKSP Jabodetabekjur is an organization that is accepted politically by local governments and has a specific role in the provision stage of metropolitan transportation decision 3. The BKSP Jabodetabekjur is also active in coordinating and deploying decided-upon tasks to other agencies in the region 4. There is strong support from the central government

Source Authors

in the production stage. The prominent role of the BKSP Jabodetabekjur and the Jakarta Transport Department in coordinating the extension of TJ BRT service areas fills a gap in the regional spatial plan. That coordination does not require a change of governance approach. Moreover, it still preserves local autonomy and uses the space provided by the applied governance approach to utilize the opportunity. Based on the political consensus in the BKSP forum meeting, the BKSP Jabodetabekjur and the Jakarta Transport Department actively play roles in enhancing inter-local government cooperation around regional transport. The department arranges and deploys the decided-upon tasks to other relevant actors (e.g., it coordinates surrounding district transportation departments in preparing bus terminals and dedicated lines within their administration). The department also prepares procurement for operators and makes contracts with bus operators (private companies). Therefore, the third improvement strengthens the second improvement. Within metropolitan governance debates, this improvement could be classified as new regionalism (Yaro and Ronderos 2011).

4.1 Analysis

Findings indicate a need to have an agency that is able and capable of implementing the decided-upon tasks. However, it is still unclear whether this is the case, particularly in identifying another benefit offered by the Jakarta Transport Department to its colleague agencies in districts surrounding Jakarta. This study also found competition among actors (e.g., the Ministry of Transport, the Province Government of Jakarta, and the regional agency, the BKSP Jabodetabekjur) for extending the coverage area of TJ BRT from the province of Jakarta to the region. There is competition between other actors: (1) between the Ministry of Transport and the Jakarta Transport Department, in terms of the actor responsible for issuing a permit for an inter-provincial bus, such as TJ BRT and APTB, and (2) between the Ministry of Transport and the BKSP Jabodetabekjur, in terms of the actor responsible for arranging and bundling a cooperation agreement for the extended area of TJ BRT and APTB. This competition results from a lack of clearly defined organization around who is responsible for regional transportation. However, the findings identify that coordination at the meso-level of institutional design should be strengthen by the capacity of actors involved to achieve the decided-upon task. Findings are summarized in Table 3.

5 Appropriate Governance for Metropolitan Transportation

This chapter has discussed initiatives of actors involved in providing and producing metropolitan transportation through good governance and appropriate institutional design. Good governance for metropolitan transportation turned out to typically include improved government effectiveness through supra-local cooperation and improved regulatory quality for regional coordination. The JMR case study points to three actual efforts or phases in policy practice to establish appropriate institutional arrangements. The first effort involved the Megapolitan concept, which attempted to improve the governance approach in the JMR. The second effort implied improvement through formulating a formal regional spatial plan. The third effort was enhanced inter-local governmental cooperation supported by the central government. Two later improvements occurred at the meso-level, with a focus on coordination.

5.1 Effective Governance and Regional Coordination

The notion of institutional design was used to identify and classify the three initial improvements. The first improvement was proposed through the macro-level of institutional design, while the second and third improvements were proposed through the meso-level of institutional design. This study suggests that improvements at the meso-level, focusing on inter-organizational coordination, are more preferable than improvement at the macro-level, which focuses on general governance guidance. Coordination is perceived to incorporate fewer transaction costs than comprehensive governance reform. Governance reform in the context of urban transportation is generally perceived to reduce local autonomy and involve high transaction costs, which are barriers for cooperation (Feiock 2009). The JMR case suggests that government effectiveness (i.e., in the actual development of metropolitan transportation infrastructure and services) lies in improved regional coordination.

Four factors contributing to the current development of TJ BRT were also identified:

1. the governance approach preserving local autonomy has not changed,
2. the role of the BKSP Jabodetabekjur as the inter-local government cooperation agency for the JMR is accepted politically by local governments and it has a specific role in the provision stage of metropolitan region transportation decision making,
3. the BKSP Jabodetabekjur is also active in coordinating and deploying decided-upon tasks to other agencies in the region, and
4. there is strong support from the central government.

5.2 Appropriate Institutional Design

Based on those factors as indicated by the findings and the analysis, the appropriate institutional design for metropolitan transportation development in the JMR is as follows:

1. At the macro-level, governance involves a mix of decentralized and centralized approaches, which is acknowledged by local government authorities and supported by the central government. The governance arrangement should also be an informal arrangement. This means that provisional decisions are made by a public entity (in this case, the BKSP Jabodetabekjur), which then is further implemented in the production stage by another entity, in this case local governments (the Provincial Government of Jakarta/the Jakarta Transportation Department and surrounding district governments of Jakarta).
2. At the meso-level, the coordination mechanism preferred by actors involved in the region is inter-local government cooperation that is supported by the central government and the regional agency. This mechanism is perceived to generate lower transaction costs than regional integration. The required coordination capacity mainly involves capacities to address collective action problems. These capacities refer to the nature of metropolitan transportation services and infrastructures, covering mixed externalities of actors involved, resulting from horizontal, vertical, and functional externalities.

Even though the actors see meso-level improvements as more probable than macro-level improvements, there are actually other options at the meso-level. One alternative improvement would establish coordination for strategic decisions and implementation. This would however require an agency with the ability and the capacity to deploy the previously decided-upon tasks to other agencies and to establish implementation commitments from the other agencies. Therefore, the institutional design required to support planners in safeguarding effectiveness and realizing plans is not only located in arrangements at the macro and meso-levels, but also in the capable actor. Even though the existing Law of Local Government (the Law No. 32/2004), the government regulation of local government cooperation (Government Regulation No. 50/2007) and other ministry decrees promote inter-local government cooperation, this study demonstrates that political and legal aspects should be followed up by capacity building for coordination and cooperation. It is important to remain aware that an actor's capacity could also be supported by private entities (in this case, bus operators).

According to the forms of governance derived from the transaction cost theory, this theory suggests that a unified and hierarchical governance arrangement that integrates horizontally or vertically within a single organization could be created to minimize transaction costs among actors involved (Alexander 2001). In the case of TJ BRT development, this could involve high transaction costs due to actors who are politically fragmented. To reduce high transaction costs, the Government of Jakarta proposed the Megapolitan concept as an embodiment of the single organization, but the other actors rejected this concept because they believed it reduced their authority. This shows that the unified and hierarchical form could not be implanted in the JMR.

Regarding the role of appropriate institutional design, this chapter concludes that in governing metropolitan transportation in the JMR it may enhance coordination and cooperation (see Table 4). Closed coordination and cooperation for

Table 4 Appropriate governance for metropolitan transportation in the JMR

Elements	Roles and actors
Actors	1. Autonomous local governments (provincial, municipalities, and regencies) 2. The regional agency (inter-local governmental cooperation agency/the BKSP Jabodetabekjur) 3. The central government 4. Private companies
Make decisions, arrangements and regulations (provision)	1. Regional decisions and arrangements = the regional agency 2. Regulations (policy and planning) = the central government
Implementation (production)	1. Execution = local governments and the central government 2. Private companies' support in operating the implementation

Source Authors

the region involves four actors: local governments, the central government, the regional agency, and private companies. They could divide roles that connect them through two functions: provision and production. Provision refers to decision-making, arrangement, and regulation (Ostrom et al. 1993). Regional decisions and arrangements are the responsibility of the regional agency while regulations consisting of regional policy and planning rest with the central government. Production refers to implementation and execution to realize services and infrastructures. Local governments and the central government take the role of implementation and execution as supported by private companies selected through a legal procurement mechanism stipulated in public-private partnership. In this stage, attention should be paid to the role of a local government agency that are be capable of translating decisions into execution. This agency coordinates and cooperates with other agencies in other local governments to implement regional decisions. Actor coordination and participation are, therefore, crucial factors as well (Voogd and Woltjer 2007).

5.3 Metropolitan Transportation Governance: Meso-level Institutional Arrangements and Actor Coordination

Finding proper fit in terms of governance and institutional arrangements is an essential component of metropolitan governance debates (Alexander 2006, 2007; Marsden and May 2006; Rodriguez-Pose 2013). This is important when sustainable transportation systems are desired (Rietveld and Stough 2004). JMR covers a large service area that crosses over a multitude of constituent municipalities, regencies, and provinces, and only serves to compound the issue of finding a good fit. This is a crucial factor when considering the context specificity of a region is related to the appropriate institutional arrangement (Stead 2003). The analysis suggests that (i) improvements at the meso-level of institutional design are more readily accepted and effective than improvements at the macro-level and (ii) the appropriate institutional design for governing metropolitan transportation in the JMR requires enhanced coordination and cooperation among four important actors—local governments, the regional agency, the central government, and private companies. These findings, therefore, offer valuable lessons to focus on meso-level institutional arrangements and actor coordination for metropolitan regions around the world that suffer from similar political fragmentation around the metropolitan governance of transportation.

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Chapter 8
Environmental Governance by Transnational Municipal Networks: The Case of Indonesian Cities

Annisa Paramita Wiharani and Ronald Holzhacker

Abstract Global environmental governance has developed a multi-layer of government from the global to the local. Transnational Municipal Networks (TMNs) are a newly emerging form of organization within global environmental governance. The TMNs are an institutional mechanism to enhance how local governments address environmental problems. Previous empirical research on these networks focused on the European context. There is little research about TMNs conducted in a country undergoing government reform and decentralization. Decentralization seeks to create an effective system of governance in which local governments attain greater authority. Here, we examine the impact of TMNs in Southeast Asia, particularly in the cities of Yogyakarta and Wakatobi in Indonesia. Referring to the TMNs and decentralization arrangements, we analyze the role of TMNs in enabling cities to play a significant role in establishing environmental policy in their region. We conclude that if local governments maximize the role of the TMNs in environmental policy, the local government will contribute to the development of a sustainable society agenda and contribute more to the state fulfilling its national environmental goals and international commitments.

Keywords Transnational municipal networks · Environmental governance · Local government · Decentralization · Sustainable city · Indonesia

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1 Introduction

The persistent environmental crises around the world have elevated the need to formulate clear strategies for environmental reform. The convention on climate change has taken a long path through the international community. Since 1992, the Kyoto Protocol has been the one and only binding international treaty on climate change. Indonesia has made significant national commitments such as reducing emissions in international environmental agreements. To reach these goals and obligations of the national government, the involvement of local governments is paramount. The Indonesian government will be unable to meet its international commitments to address environmental problems without more explicit action at the subnational level. Much of the policy framework requires implementation at the local level, because the local government is at the forefront of the process. This condition is in line with the decentralization process that started in the Reformation era in 1999. The decentralization frameworks in Indonesia have enabled the local governments to have a greater authority to pursue change in this area and are increasing their capacity to act in an environmentally friendly manner.

This chapter focuses on an analysis of the role of Transnational Municipal Networks (TMNs) in environmental policies at the city level. In our theoretical framework, we begin with a discussion of the term "transnational network" as an organizational form, which is unlike typical intergovernmental or nongovernmental organizations (NGOs). Previous research about TMNs, particularly the work by Kern and Bulkeley (2009), will be used as the primary approach to analyzing how TMN systems work. TMNs have assisted local governments to emerge as critical actors in global environmental governance. In this chapter, we also examine the decentralized governance system in Indonesia in which regional TMNs are engaged. The regional divisions work with specific projects in accordance with the conditions of the city in each region.

This chapter mainly deals with the intense role of the TMNs in two cities in Indonesia, which participate in two different transnational networks. The first city, the city of Yogyakarta is participating in the Local Renewables South–South Cooperation Program, part of the International Council for Local Environmental Initiatives (ICLEI) . The other city, Wakatobi, participates in the Partnership for Democratic Local Governance in South East Asia (DELGOSEA) , which is part of the United Cities Local Governments, Asia Pacific (UCLG-ASPAC) program. The chapter concludes that the decentralized governance system in Indonesia has enlarged local governments' opportunities to participate in transnational networks to improve environmental policymaking and implementation.

The transnational networks employ a pilot project system, in which cities may learn what works from others and apply it to their own city. The pilot project system is one of the key motivations to participate in such a network. This chapter also aims to improve the study of international relations (IR) studies, with an emphasis on the role of the transnational network in aiding the subnational level in achieving national and international objectives related to the environment.

1.1 Research Question

The chapter, therefore, aims to answer two questions. First, empirically, how do TMNs assist cities in improving their environmental performance and support the nation states in meeting their (inter)national environmental agreements? Second, how have selected cities in Indonesia used TMNs to improve their environmental performance under the decentralization scheme? The authors argue that the TMNs are important emerging actors within global environmental governance. Currently, TMNs have become one of the important variables in the policy process for environmental issues. If national governments need to reinforce climate change regulation, increasing the intensity of effective coordination between actors in international, national, and local governance within the decision-making process is essential.

1.2 Scientific and Social Significance

This chapter will contribute to the study of global environmental governance in three ways. First, the scientific significance of this research involves further development of the idea of the term transnational network within the IR discipline. While the existing research regarding cities' involvement in TMNs has focused on the European context, here the analysis examines the role of the TMNs in assisting cities in Southeast Asia, particularly in Indonesia. TMNs facilitate several programs that assist cities in addressing their particular needs and problems. In fact, TMNs have played a significant role in encouraging policy learning processes and policy change for environmental issues. Decentralization has opened up opportunities for local governments to have horizontal cooperation with other cities and vertical cooperation with the international community.

Second, this chapter will contribute to the exchange of ideas concerning the pilot projects as a scheme for learning best practices from other cities under similar conditions. The other benefit is the hope that the entire society of the city will experience and be involved in some particular environmental program. A continuation of the environmental program in those cities will give a significant contribution to the national government to meet their national environmental commitments. If the number of cities that join a network increases and they implement projects that have proven to work in other cities, then there is an increased possibility that Indonesia will meet its national environmental commitments. This effort is also part of the Indonesian government's objectives to achieve sustainable development. According to the World Bank (2015), one of the pillars of sustainable development is that environmental stewardship should carry across all sectors of development. Cities facing rapid urbanization, for example should embrace low-carbon growth and expand public transportation options (World Bank 2015). The third contribution of this chapter is the exploration of how decentralization in Indonesia has resulted in the local government moving nearer to the society. The local government is more likely to understand the needs and difficulties of society. The decentralization policy over the last ten years as stipulated in Law No. 32 of 2004 on Regional Government also encourages the establishment of inter-regional cooperation, both nationally and internationally. The policy has challenged the local governments to be more reactive to the needs of the society and provide opportunities for society involvement. In sum, this study aims to explain how the decentralization experienced in Indonesia has encouraged local governments to join TMNs to achieve sustainable development and a sustainable society.

1.3 Research Design and Methodology

This research is conducted in two steps. The first step is the analysis of the theoretical framework related to defining terms of the TMNs and the previous empirical research related to TMN systems. It covers various resources such as books, journal articles, and websites. There are two subtopics in this literature review, which consist of (1) the definition of TMNs as a transnational organization, and (2) the governance system of the TMNs. The entire literature review will produce a comprehensive assessment of the current state of studies about the TMNs in the policy process, especially in the environmental policy area. The next part will apply this theoretical framework to see how the TMNs work in the two Indonesian cities in practice.

The second step is to describe the data collection methods (interviews and primary documents available digitally) followed by an analysis of each of the TMNs and its program employed by Wakatobi and Yogyakarta. This provides a detailed analysis of the process of the TMNs and its contribution to the environmental policy and protection in the region. This part will also cover various resources such as information from the websites of the networks and the cities, and supporting data from interviews conducted with Wakatobi and Yogyakarta local government representatives. The interviewees are good representatives to examine the case deeply because they not only serve as a local government officer, but also as a project coordinator from the networks to the cities. Furthermore, the study explores whether or not society has benefited from the presence of TMNs by creating a better living environment. It also observes whether or not the TMNs can improve community involvement in environmental protection and policy processes. In addition, this research will enquire whether the local government believes that decentralization and the ability to join TMNs creates opportunities for improving the local environment.

2 Theoretical Framework

The theoretical framework will begin with an understanding of the previous approaches to analyze transnational organizations in general. The following sections will focus on particular empirical research about TMNs in Europe, including the governance system of the TMNs. Previous research about the TMNs approach took place in the European Union (EU), which has different situation than in Southeast Asia. Therefore, this chapter will combine these previous approaches with the recent developments in Indonesia, especially within the decentralized governance system.

2.1 What Are Transnational Municipal Networks?

The most important concept that needs to be defined here are TMNs, which have been subject to an extensive range of discussion among scholars. TMNs are a new paradigm of transnational organization in IR studies.[1] The main difference lies in the actors involved within the transnational organization. Traditionally, many IR scholars maintained that states are the primary actor in the world politics (Krasner 1983). Therefore, in order to conceptualize TMNs, we suggest the necessity to refine the conventional concepts that assume the predominance of states. This new form of governance is interesting to elaborate further, even though we cannot dismiss the role of states in the international system, where subnational levels of governments are the active members in these international organizations. Furthermore, the emergence of these transnational organizations engaged in the subnational level may be increasing the role of the local government within national governance system. Eventually, the subnational level is emerging as one of the important actors in global environmental governance.

Scholars from various fields of studies (Rosenau and Czempiel 1992; Risse-Kappen 1995; Newell 2000; Bulkeley et al. 2003; Betsill and Bulkeley 2004; Toly 2008; Kern and Bulkeley 2009) have provided several definitions of transnational organizations. While early definitions of transnational organizations involved the contribution to policy-making, they did not explicitly focus on the environment. Rosenau (2006a, b), in his book about global governance, included the emergence of transnational organizations and described it as something that represents a non-hierarchical system, in which both the organization and the member have an equal position. Later, Bulkeley et al. (2003) also conceptualized the TMNs as encompassing a new political space, which defines the sphere of environmental governance.

The term TMNs involves the study of governance associated with the decision-making process and authority involving international, national, and subnational governments. Some scholars also have tried to explore the emerging role of TMNs

[1]The term new paradigm is intended to clarify the differences in traditional concepts previously developed in the study of IR. Although transnational organizations have a long-standing place in the literature (see Barber 2013), the emergence of the transnational municipal network phenomenon is different from transnational corporations (TNCs) and from NGOs in the environmental arena, which is an organization which concentrates on media attention and mass mobilization.

particularly on environmental issues, within the EU. Betsill and Bulkeley (2004) conceptualized the TMNs as one of the significant actors within global environmental governance through one of the city networks in Europe, the Cities for Climate Protection (CCP). Their work is mainly focused on how the CCP works in Europe using six cities as case studies. The CCP is used as one of the examples of the growing number of the transnational networks in the environment that involves local government. By placing the local government as a potential actor within global environmental governance, not only the cities but also the states may address the sustainable development agenda (Betsill and Bulkeley 2006; Keiner and Kim 2007). In line with that, TMNs are distinct occurrences that have placed local governments as a stronger player in the forefront of the process of global sustainability networks. As cities are responsible for 75 % of global energy consumption and 80 % of greenhouse gas emissions, policymakers may now join forces and place cities at the top of the sustainable development agenda (Satterthwaite 2008). Local government are often in a pivotal position to adapt and to mitigate the result of environmental problems.

The more recent attention upon the cities and TMNs has focused on the characteristics of the TMNs and the governing system of the TMNs particularly under the context of the EU (Kern and Bulkeley 2009). In the literature, the term TMNs tends to be used to refer to networks with a significant influence from the EU. The key characteristics of the TMNs can be listed as follows (Table 1):

Based on the table above, the first characteristic indicates that cities, which are a member of TMNs, remain autonomous and independent. Autonomous means cities may decide whether they want to remain in or leave a network. There is no compulsion from the TMNs to force their members to stay in the network. Therefore, the position of the cities is also independent, without any interference from the TMNs, and thus it is described as voluntary membership. The second characteristic represents the horizontal, non-hierarchical cooperation within the EU. Previously, cities or subnational governments related primarily vertically with their respective national government. The European cities have become more engaged transnationally and involved in transnational networks to share knowledge and experience across the continent. The TMNs also have a non-hierarchical form of organization, meaning that to accomplish their goals, TMNs are relying on a different form of authority, namely persuasion and showcasing good examples, instead of top–down compulsion.

The third characteristic of the TMNs defines the scheme for decision making that lead to the implementation of the program within the TMNs system. This third characteristic, is strongly related to the cooperation scheme designed by

Table 1 The characteristics of transnational municipal networks

• Cities are autonomous and in voluntary membership
• Horizontal, non-hierarchical organization
• Direct implementation of the decision-making within the networks

Source Kern (2001) in Keiner and Kim (2007)

TMNs to its members since the beginning. If the member agrees with the program devised by the TMNs, then the program will be directly implemented by the city. In their empirical research depicted in the literature, most of the time members are in agreement about implementing the TMNs program. Even so, there might be some adjustments here and there, as every city is different. This definition is created to distinguish TMNs from environmental NGOs, which focus on lobbying and mass mobilization to implement their program.

2.2 The Governance System of the TMNs

Besides these characteristics, Kern and Bulkeley (2009) also emphasize the governance system that TMNs have developed. In their empirical research in several cities and TMNs in Europe, they identify two distinct types of governance systems and classified them as internal and external governance. The classification provides a basis for a better understanding of the mechanisms of the TMNs and its impacts on their members. The following is the detailed classification of the governance system of the TMNs (Table 2):

According to the table above, TMNs have developed a unique form of governing. The governance system is a means to persuade and facilitate the member cities to achieve their objectives, as the TMNs share the goals of local governments to improve the environmental protection program and confront environmental problems. Both internal and external governance represent how the TMNs of the environment function, particularly in the context of Europe. The internal governance strives to maintain the network to achieve its goals for their members and describes how the TMNs work within their organization. The first variable within the internal governance system is "information and communication." TMNs will go to various lengths to locate members by means of offering an appealing program such as a pilot cities program. TMNs will select best practice cities to implement their program based on several indicators. The success story about best practices created by the TMNs will be disseminated to other cities in the region to draw the attention of other cities, which may want to become a member or to be a pilot city. Learning from what works in other cities is a primary goal for both the network and the cities. When cities have certain similarities in terms

Table 2 Internal and external governance of TMNs

Internal governance	External governance
• Information and communication	• Influence toward governmental organizations
• Funding and cooperation	• Interdependence with non-governmental organizations and other TMNs
• Recognition, benchmarking and certification	• Intermediation toward member cities

Sources Kern and Bulkeley (2009)

of governance and environmental problems, they are likely to be more eager to become a member of the network.

The second variable for the internal governance of TMNs is "funding and cooperation", which TMNs must undertake to provide means for the cities attempting to implement and replicate the program in their city. Therefore, TMNs facilitate the cooperation between cities and provide additional financial resources. Funding has always been a major issue in any policy implementation relating to the environment, especially in developing countries. For example, local governments in developing countries may place economic concerns above other issues. They tend to not to put environmental issues as the primary concern in their local policy planning. Therefore, the role of the TMNs in funding and sharing environmental solutions is crucial to success.

The third variable within internal governance, "recognition, benchmarking, and certification," is an additional strategy to encourage members to actively join the networks and reward success. Kern and Bulkeley (2009) referring to Lehtonen (2005), note that this form of certification is often a useful tool in raising standards and achieving compliance. Performance-based awards might also draw the attention of other cities, countries, and societies around the world.

The characteristics of external governance, in comparison, focus on the interaction of the network with other stakeholders. These activities support the internal governance of the TMN by responding to external pressures and strategically positioning the operation of the network in the multi-level environmental governance system. The first indicator for the external governance of TMNs is "influence toward governmental organizations." According to the empirical research of Kern and Bulkeley (2009), TMNs are present in every discussion related to the environmental within EU bodies to persuade stakeholders and the international community to raise environmental awareness. TMNs also attempt to influence stakeholders to be more active in addressing environmental problems to provide financial resources, as environment policies are often rather expensive to implement.

The second variable related to external governance is "interdependence" and describes how one TMN often cooperates or even competes with other TMNs and NGOs. Kern and Bulkeley (2009), for instance, discuss the cooperation between TMNs, and between TMNs and local NGOs, in the search for the best mechanisms for finding environmental solutions in cities. The cooperation has created interdependence between the stakeholders involved as they shape their goals to achieve network objectives. They also discuss instances of competition between TMNs in seeking new members. Often, a city joins numerous networks at the same time. Their membership in several TMNs may lead to competition between the TMNs drawing the attention of city governments in selecting and implementing environmental programs. Therefore, TMNs may increase their own capacity to realize network objectives by also dealing with other TMNs, especially when their programs share similar interests.

The third variable is the "intermediation" between a network and its members. Intermediation refers to the relationship between the TMNs and an intermediary actor often a policy entrepreneur with local political support. If the intermediary actor is influential in the local policy, there is a better chance that TMNs initiatives will be noticed and implemented within the city. Political support at the local level and the existence of policy entrepreneurs are crucial for the external governing capacity of a network because they can influence policy changes and decisions on the ground and provide a means for change. Therefore, the intermediation process within external governance is necessary to increasing the number of programs that can be implemented and the variety of goals which can be achieved by the network.

One of the fundamental purposes of TMNs is to increase the opportunities for the city members to learn about best practices in other cities. Those opportunities are a vital motivation for the city's involvement in the networks (Kern and Bulkeley 2009). The TMNs have the capability to integrate cities in a collaborative activity that lead to cooperation across the network and capacity building within the city. In the area of environmental protection policy, the local government is always at the forefront of policy implementation. Local governments are most likely already acquainted with the existing problems and societal needs, while the central government may take steps to provide support. At this point the role of the local agreement in dealing with the environmental problems and the mechanism is important. The national government, which is burdened by the international commitment from the moment it ratifies the pledge, requires concrete results from environmental programs, which can only be achieved by the engagement of local governments. Collectively, this chapter outlines a critical role for both the TMNs and local government and highlight the need for further empirical research to deepen the analysis.

3 Analysis

The analysis below is divided into four parts; first, this section will depict decentralization and the opportunity of cities within decentralization to engage in environmental issues in Indonesia. Second, this research will explore the case study of the role of TMNs in Wakatobi in achieving environmental goals. Third, this research will examine the case study of the role of TMNs in Yogyakarta in achieving their environmental goals. Finally, a comparison of the operation of the TMNs in the two cities in Indonesia will be given. Each of these sections is derived from the previous theoretical framework. As explained earlier, the study will include the detailed characteristics of the TMNs based on the indicators within internal governance (information and communication, funding and cooperation, and recognition, benchmarking and certification) and external governance (influence, interdependence, and intermediation). We have conducted interviews with the project managers in Wakatobi and Yogyakarta. The interview questions are closely related to the previous theoretical framework. During the interview, respondents were asked to reflect on the TMNs governance system in their cities and the impact of decentralization in terms of the opportunities of the city to join transnational networks abroad and to achieve environmental gains.

3.1 Decentralized Governance and Environmental Policy in Indonesia

Much of the current literature on TMNs pays particular attention to cities within the EU. We suggest analyzing such networks in a different region, Southeast Asia, and in particular, Indonesia. Having seen how the TMNs work and the system that involves the local government as a member of these networks, it may be relevant to examine the governance system in Indonesia. Similar to other Southeast Asian countries, Indonesia has embraced decentralization in the past decade (Green 2005). We examine the decentralization system in Indonesia to provide a theoretical foundation for the analysis part and to describe how decentralization has had an impact on how TMNs work in the country. During the 1990s, decentralization and local government reform have become among the most widespread trends in Asian countries. The spread of democracy in the developing world has contributed to this decentralization. As countries democratize, subnational levels of government often gain control of decision-making processes. Decentralization may allow local governments to acquire a degree of regional autonomy that leads to wider policy-making opportunities. These broader opportunities may result in cities under a decentralization scheme to have greater authority to cooperate with other cities or institutions abroad, including TMNs.

Previous research has indicated that decentralization has a positive impact on the institutional mechanisms for strengthening local governments and improving performance (Smoke 2001; Kulipossa 2004; Faguet 2014). Some scholars argue that decentralization may lead to greater government effectiveness and to a more equitable allocation of resources (Agrawal and Ribot 1999; Meynen and Doornbos 2002; Schragger 2010). This argument relates to the fact that in many developing countries, decentralization has been seen as a promising scheme for restructuring traditional approaches of centralized control. The promising developments may be seen in particular in the area of gains in efficiency and responsiveness to public opinion. Bird and Vaillancourt (1998), Schneider (2003) have confirmed the effectiveness of decentralization in many developing countries. Decentralization has been adopted as a mechanism to try to escape from the ineffectiveness of central bureaucracies, and to address a broad range of critical issues such as weak institutions and lack of accountability and transparency in policy-making. Decentralization is often associated with a wide range of political, economic, and administrative advantages including, among others, greater public participation (Blair 2000; Agrawal and Ribot 1999; Crook 2003), accountability, and responsiveness (World Bank 1999).

Nevertheless, some scholars, including Lessmann and Markwardt (2010), Palmer and Engel (2007), Casson and Obidzinski (2002), Devas (1997), perceive that decentralization at some point is inefficient and even destructive instead of being beneficial. Decentralization may create opportunities for the local elites and interest groups to manipulate the system to their benefit in the local area (Batterbury and Fernando 2006). Several of these studies focused on environmental governance have linked decentralization with environmental problems, particularly in forest management such as illegal logging. In the case of Indonesia, scholars point out the weak representative decision-making processes that are far behind the creation of accountable institutions (Casson and Obidzinski 2002; McCarthy 2004; Ribot et al. 2006; Tacconi 2007; Wollenberg et al. 2006; Karsenty and Ongolo 2012; Engel and Palmer 2006; Brockhaus et al. 2012).

Other scholars believe decentralization may lead to greater government effectiveness and provide for a more equitable allocation of resources (Ribot et al. 2006). At the same time, decentralization may promote good governance aspects of enabling local citizen participation, democratic elections, and financial and political equity (Green 2005). Thus, we are interested in examining how decentralization in Indonesia has provided local governments with greater autonomy, and allowed local officials to identify local environmental problems, and improved their potential capacity to seek environmental solutions by joining TMNs.

Indonesia, experienced a change of the pattern of development of the region after the reformation wave in 1998. This phenomenon is a consequence of the policy change from a centralized to decentralized system. The decentralization in Indonesia has had a very broad impact. One of the impact is included the changing pattern of the creation of a growing number of cities following decentralization.[2] As mentioned above, previous research about Indonesian environmental problems has focused on inefficiency and problems in implementation. Environmental law in Indonesia has been reformed numerous times to improve governance in this area. Before decentralization started, the Indonesia government established certain laws in regards to environmental management, of which the principal Law was No. 4, 1982, entitled the 'Principal Terms of Environmental Management.' After the International Rio Declaration on Environment and Development, issued during the Earth Summit in 1992, the Indonesian government revised the previous law. The Rio Summit was implemented by Indonesia in the National Agenda 21, which highlights the important role of local government action and has become an important mechanism for promoting sustainable development strategies at the municipal level (UN 1992). In response to a growing variety of needs that were not properly addressed in the Law No. 4 of 1982, the government issued the new law No 23, 1997, which also introduced the term sustainable development into Indonesian law. The new law was also intended to enhance transparency, public access to the benefits of natural resources, and environmental justice.

Further detailed discussions on the contents of the articles contained in the legislation led to Law No. 25, 2000. The revisions include natural resources management to seek progress in the field of the environment being incorporated into the national sustainable development agenda, as a matter of law. The detailed article within this law is also related to Tap MPR No. XV/MPR/1998 (decree of the

[2]According to the Ministry of Home Affairs, the number of autonomous cities and municipalities in Indonesia before decentralization was 293, and at the end of 2014 increased to 508 (Kemendagri 2014a, b).

people's consultative assembly), focused on equal development and resource utilization between the central and local governments. The national government then declared the criteria for the fair distribution of power through government regulation, by Republic of Indonesia No. 38, 2007. According to this regulation, local government affairs consist of some primary areas of policy-making that are obligatory and others that are optional. Environmental issues are part of the obligatory affairs related to the essential services that the local government must provide for their society. The purpose of this regulation may be linked to efficiency and the prevention of overlapping authority. Thus in the case of environmental problems, when events occur, the level of government closest to the problem is deemed the most competent to address the issue.

The central government has a formal legal basis for managing international cooperation through Law No. 37, 1999 about foreign affairs, and Law No. 22, 1999 about regional autonomy. As a result, cities may enhance their position in the global arena by their involvement in various transnational organizations. Government legislation that addresses local government authority and foreign affairs is stipulated in Law No. 32 of 2004. Based on this law, local governments have been given broad authority, except for areas that are reserved to be national government affairs: foreign policy, defence, security, judicial, monetary, national fiscal, and religion. The cooperation between local government and TMNs are thus not involved in any of these policy areas.

In Indonesia, local governments are joined together in two local government associations, the Association of Indonesian Municipalities (APEKSI) and the Association of District Governments of Indonesia (APKASI). These city associations supported the Indonesian local governments' involvement in TMNs. Decentralization has allowed Indonesian municipalities to not only be able to exchange ideas within Indonesia, but also be able to work together with the cities in other countries.

3.2 The Wakatobi Experience Under the DELGOSEA Program

Wakatobi is part of the Southeast Sulawesi Province, which is one of the areas that has the highest marine biodiversity in the world. The name of Wakatobi is an acronym for four islands namely Wangi-Wangi, Kaledupa, Tomia, and Binongko. As a city, Wakatobi has an archipelago area in which 97 % of its territory is ocean and only 3 % is land, and the leading economic sectors are eco-tourism and the fishing industry (DELGOSEA 2011a, b). Wakatobi is particularly well known for its coral triangle and in 2012 the United Nations Educational, Scientific, and Cultural Organization (UNESCO) declared parts of Wakatobi as a new biosphere reserve (UNESCO 2012). With that clear view from the international community, the local government of Wakatobi is increasingly aware of its sea resources and is concerned about environmental protection.

3.2.1 TMNs and Decentralized Governance in Wakatobi

The Wakatobi government has developed new policies in relation to the tourism sector and in raising public awareness around environmental issues. The ability to make policy in this area has been enhanced by changing policies at the national level, which have emphasized autonomy and the decentralization of authority. The city of Wakatobi is recognized as a new autonomous region through Law No. 29/2003. The Wakatobi government has taken full advantage of decentralization. According to an interview with Ir. Abdul Manan M.Sc.,[3] the Indonesian municipal association APKASI nominated Wakatobi to join the "Partnership for DELGOSEA", a DELGOSEA pilot project related to a low-carbon city initiative. Subsequently, after Wakatobi was nominated by the APKASI, they proposed their Low Carbon city program and were selected as one of the pilot cities to find the best solutions for their environmental problems.

Amongst the largest environmental challenges in Wakatobi faces is waste management. Surprisingly, many people do not recognize that waste management greatly affects greenhouse gas emissions that lead to global warming. The waste issue is strongly related to energy consumption, one of the leading causes of climate change. There are five types of impacts of waste management to consider: (1) landfill methane emissions, (2) reduction in industrial energy use and emissions due to recycling and waste reduction, (3) energy recovery from waste (4) carbon capture in forests due to decreased demand for virgin paper, and (5) the energy used in the long-distance transport of waste (Ackerman 2010).

When waste is uncontrolled, it has a great impact on the society with severe consequences for sanitation and public health. Moreover, the waste decay in landfills gradually releases both carbon and methane, with methane being a greater contributor to global warming than carbon (Ackerman 2010). The waste problem in Wakatobi comes from both the city's inhabitant and the shipping lanes offshore passing the city. The society of Wakatobi uses not only the land for waste disposal, but also the surrounding sea area as a waste reservoir (Manan 2014). Meanwhile, the busy shipping routes are overflowing with sewage from the remnants of fuel and food consumption on the water. The main strategy of the program is to promote awareness and change the community's attitude, enhance coordination and integration amongst stakeholders, and develop regulations and facilities for waste processing.

DELGOSEA is one of the projects of the foremost transnational organization for local government, United Cities Local Government (UCLG) in the Asia-Pacific region (UCLG-ASPAC). The regional section also provides institutional support and policies for their geographical area. The UCLG ASPAC office is based in Jakarta, Indonesia and is the largest office of UCLG with more than 7000

[3]Ir. Abdul Manan M.Sc., is the head of the DELGOSEA working group in Wakatobi. He also served as the Head of the Regional Development Planning Agency, Wakatobi municipality. He has provided most of the information and data concerning Wakatobi in this chapter during an interview completed on 20 November, 2014.

connections to local governments (UCLG ASPAC 2014). UCLG facilitates the local governments to create stronger communities, sharing their knowledge and technology. One of the particular aims of DELGOSEA is to design and establish a sustainable network of local governments for the replication of success stories from best practices identified by pilot cities within Southeast Asia (DELGOSEA 2014). Wakatobi has been a member of UCLG-ASPAC since 2010 and was selected as one of the pilot cities in the DELGOSEA program. In 2015, Wakatobi will host the UCLG-ASPAC executive and council meetings as part of an international seminar on the topic of creating a low-carbon society, one of the projects DELGOSEA wishes to scale up across the region (Manan 2014).

Wakatobi is eager to implement its environmental protection program with the support of DELGOSEA. In the interview, Abdul Manan said that the city is very glad to be selected as one of the pilot cities, and that will be of great assistance in implementing a comprehensive environmental program. He also emphasizes that joining the network is one of the perceived benefits of decentralization. In the interview, Manan said, "decentralization provides numerous advantages so that we can cooperate with many cities and overseas institutions consistently." He also added, "before decentralization, Wakatobi was only a subdistrict of the municipality of Buton, and now after the decentralization system has been applied, we are an independent, autonomous district" giving us new opportunities to cooperate abroad (Manan 2014).

As mentioned in the theoretical framework, the key characteristics of TMNs, as introduced by Kern and Bulkeley (2009), focus on three indicators: voluntary membership, polycentric and non-hierarchical organization, and direct implementation. Several findings of the current study on Southeast Asia have found evidence that varies from the previous empirical research. Voluntary membership means that city has the authority to stay in or to leave the network. In the previous empirical research, it is very clear that the TMNs there have a more permanent, on-going membership system, one based on voluntary membership. On the other hand, in DELGOSEA, the members of the program are pilot cities based on project-based programs of the UCLG, thus membership only lasts for the lifetime of the project. During the running of the project, the pilot cities may not leave the network as they are bound by the agreement with the network. The steep road that must be taken to become a member and be selected as a pilot city encourages cities such as Wakatobi to remain in the network and continue to make environmental progress.

The second characteristic depicts the system within TMNs as polycentric and non-hierarchical. Once again, it is important to emphasize that the involvement of Wakatobi as one of the pilot cities of DELGOSEA is inseparable from the decentralization system of Indonesia. The relationships fostered by Wakatobi as a new authority are not limited to the vertical relationship with the national government, but also extends horizontally to other cities and institutions abroad. An example of this is the horizontal nature of the funding of the program. The environmental projects in DELGOSEA are financed by the European Commission and the Konrad-Adenauer-Stiftung (KAS) of Germany, with a contribution from Wakatobi's own local budget.

The third characteristic of TMNs is related to the direct implementation of the network's programs, and this works similarly in the networks of both Southeast Asia and Europe. DELGOSEA has various environmental programs as part of their network, and Wakatobi proposed to implement particular parts of the program. More specifically, Wakatobi proposed to the network to become a Low Carbon pilot City replicating programs of the network's best practice city in this policy area, Muangklang Thailand. Wakatobi is working under the TMN's Thematic Area 3, which is the Inclusive Urban Public Services area, and in particular on the Low Carbon City Program. DELGOSEA has facilitated Wakatobi in replicating both the waste management program and seawater purification program, and raising environmental awareness in the society, with some adjustments to meet local conditions. Thus, the best practices replication project design was developed with careful adjustments made with regard to the political, economic, social, and local culture of Wakatobi. These adjustments were necessary, given the fact that the Wakatobi area is dominated by sea (97 %) with little land area, which is very different from the situation in Muangklang. Having defined how the TMNs work in decentralized governance, we now move on to discuss the governing system within DELGOSEA during the pilot cities project in Wakatobi.

3.2.2 The Internal Governance of the TMNs in Wakatobi

Prior studies have suggested it is important to examine the three components of the internal governance system of TMNs. The first component is the "information and communication" dissemination about the pilot cities program. DELGOSEA held events for electing pilot cities to share the detailed selection procedures and requirements to join the network. With the growth of regional autonomy, the communication and cooperation between the Wakatobi government and DELGOSEA has been facilitated by the central government. For example, Wakatobi first met with the UCLG-ASPAC team during a presentation held by the Ministry of Internal Affairs in Jakarta, facilitated by the APKASI (Manan 2014). DELGOSEA's ability to engage with APKASI is also one of the communication strategies to reach out to local governments, because this local government association is considered to fully understand the potential of each of its members. After being selected, Wakatobi became a pilot project engaged in learning from the experiences of another best practice city, Muangklang, Thailand, related to a low-carbon city program. The recruitment system of the pilot cities shows the success of the information dissemination created by DELGOSEA. For instance, Wakatobi had to write a solid proposal to meet DELGOSEA's expectations as a pilot city. These results match those observed in earlier studies, as the TMNs thoroughly promoted the pilot cities program to attract other cities to join their network. This scheme has had a large impact on the administration of Wakatobi and has assisted the local society to make concrete steps toward creating a sustainable city. As Wakatobi strived to be selected as a pilot city, they tried to do their best to improve their local governance system and environmental policy making in accordance with the requirements of the TMN.

The second variable of the internal governance of TMNs is “funding and cooperation”. DELGOSEA is a program that is designed to facilitate the improvement of municipal performance regarding environmental protection. One of the facilitation programs is designed to provide financial resources to enable local action. In the European context, the EU is involved in partially funding the city networks. Wakatobi in Indonesia and Muangklang in Thailand are independent cities that are not closely linked through a supranational organization such as the EU (even though these cities are a part of states that are members of ASEAN). The funding system in Southeast Asia is thus based on contributions from DELGOSEA and the pilot cities, and not from a regional supranational organization. In the case of Wakatobi, the funding of the program comes from both DELGOSEA and the Wakatobi local government budget. Therefore, one of the interesting findings is that DELGOSEA must seek out compatible local governments to join their system, which also have a budget to invest in the program. TMNs must somehow find a local government that has the capability and willingness to share the financial burden with the network. In terms of the cooperation between the TMN and cities beyond the provisions for financial sharing, DELGOSEA conducts monitoring and evaluation to ensure the program runs as planned and is successful. The formal control occurs every three months with an implementation progress report sent to the Working Group of DELGOSEA.

The third variable within internal governance is “recognition, benchmarking and certification”. In terms of recognition, there is no performance award for the overall best pilot city. DELGOSEA selects best practices cities in four different thematic areas.[4] The benchmarking program uses a performance-based strategy. The benchmarking is slightly different from the depiction in TMNs in Europe but broadly similar. The benchmark within DELGOSEA project involves Wakatobi as a pilot city linked with Muangklang, the winner of the best practices city in terms of the quality of the liveable environment. Wakatobi replicated the project design, with the primary purpose focused on seawater clarity through better solid waste management. The replication of the project design was constructed by adapting it to Wakatobi’s circumstances, since the geographical conditions in Muangklang and the relation of the city to the sea is quite different from Wakatobi. However, with some adjustments, Wakatobi could replicate the low-carbon city program from Muangklang. The clarity of Wakatobi seawater and the quality of its ecosystem is pursued by Wakatobi as part of its goal of seeking sustainable development.

Although there was no special award or certification awarded at the end for participating in the TMN program, cooperation has enlarged the window of opportunity to cooperate with other institutions abroad. Wakatobi’s selection as one of the pilot cities is a solid achievement for the city. Meeting the requirements to become a pilot city develops the city’s human resources and prepares the city for dealing

[4]DELGOSEA has four thematic areas which are: Peoples’ Participation in Planning and Decision Making, Institutional Governance, Inclusive Urban Public Services, and Fiscal Management and Investment Planning. Wakatobi is working under the third thematic area of the TMN with the project of Low Carbon City (DELGOSEA 2011a, b).

with TMNs from abroad. After the program had finished, Wakatobi developed a strategy to continue to use their new capabilities to further environmental policy.

3.2.3 The External Governance of the TMNs in Wakatobi

In terms of the external governance of the DELGOSEA network, the context and conditions in Southeast Asia are quite different from those in Europe. The first variable within external governance depicted in the literature is the influence of the network on governmental organizations in Europe. In this empirical research, the cities are in countries with a different relation to the regional actor, ASEAN. Thus, even though the governments of Indonesia (Wakatobi) and Thailand (Muangklang) are part of ASEAN, this regional organization is a looser form of cooperation between sovereign states. Currently, there is a discussion between DELGOSEA and ASEAN to find links of interests and activities to bolster an environmental sustainability cities program. However, during the recent DELGOSEA and Wakatobi programs, there was no involvement from ASEAN.

The second variable under external governance, "interdependence", is related to competition or cooperation between TMNs or TMNs with other NGOs. This research has found no other network that competes with DELGOSEA in the region. In the Wakatobi case, DELGOSEA and the local government of Wakatobi are cooperating with the local community and are working towards raising environmental awareness in the society. This cooperation went well, because both the network and the local community complemented each other in pursuing the same goal. The local community helped the network to better understand the local area and how to approach the society to implement the program. The advantages of this cooperation are tangible in terms of a number of concrete programs, the new regulations related to waste management, and the establishment of a new local community group to be engaged in a compost forum (Community Waste Management Partners) at the village level.

The third variable for external governance depicted in the literature is "intermediation" and it focuses on the important position of the city within the network, especially on the role of key intermediary actors that lay between the network and the city. Even though Wakatobi is a relatively a new member of UCLG-ASPAC and the DELGOSEA project, they have been successful in comprehensively implementing the entire DELGOSEA program. The position of the intermediary actor is likely playing an important role here. The project coordinator of the program Abdul Manan also serves as the head of the regional planning agency in the Wakatobi local government. This benefits both parties. As depicted in the literature, the more influential the intermediary actor, the more likely that the city will implement the network program. This is also a benefit for the city itself as they can implement their environmental program better by providing funding assistance and local expertise and technology.

3.3 The Yogyakarta Experience Under the ICLEI Program

Yogyakarta, the capital city of the Yogyakarta Special Region, has developed rapidly in all sectors. As a city of education, culture, and tourism, the population of Yogyakarta continues to increase. This increase has resulted in a significant rise in energy demand. One of the local government strategies is to find a solution to this problem by joining a leading TMN for environmental protection, the ICLEI.

3.3.1 TMNs and Decentralized Governance in Yogyakarta

ICLEI is a well-known TMN that is focused on the environment and sustainable development, which has an active network of various sizes of cities in 84 countries. ICLEI provides training, shares knowledge, and exchanges information for capacity building to support local initiatives in achieving sustainability objectives. Similar to the UCLG previously discussed, ICLEI has divided its organization into particular regions and themes. The ICLEI's Southeast Asia Secretariat (ICLEI SEAS) serves 37 ICLEI members in the region, including Indonesia, the Philippines, and Thailand. ICLEI SEAS is involved in empowering local governments to reduce greenhouse gas emissions, make climate change adaptations, integrate sustainability principles into local government management, and create low-carbon and resource-efficient communities. ICLEI SEAS with the support of the Renewable Energy and Energy Efficiency Partnership (REEEP) introduced a project on carbon emission reduction through local action plans by integrating renewable energy and energy efficiency measures into city activities (ICLEI 2011). The project is entitled: 'Local Renewables: South–South cooperation between cities in India, Indonesia, and South Africa.' The REEEP project provides knowledge and experience on best practices and learning processes from a previous Local Renewables Initiatives (LRI) successfully implemented in Asia (ICLEI and REEEP 2013).

In an interview, city official and project officer of the program Cesaria Eka Yulianti Sri Hastuti,[5] stated that Yogyakarta previously worked with ICLEI in 2000 on a program designed to reduce CO_2 emissions as part of a global climate change program. In this program, assessments were made on what was the most appropriate method for reducing CO_2 emissions in Yogyakarta. In 2010, cooperation further expanded, when ICLEI approached Yogyakarta to collaborate again in a new program concerning renewable energy and energy efficiency called Local Renewable Initiatives: South–South Cooperation Program.

[5]Cesaria Eka Yulianti Sri Hastuti is the project officer for the Local Renewable Initiatives: South-South Cooperation Program for Yogyakarta. She reports the progress of this program to a project coordinator located in the Philippines, who in turn reports to the general secretary for the region located in India. She is also serves as head of the subdirectorate in Regional Development Planning Agency of Yogyakarta City. She has provided most of the information and data concerning Yogyakarta in this chapter during an interview completed on 26 November 2014.

Referring to the first characteristic of the TMNs related to membership, Yogyakarta is autonomous and may decide whether or not they want to join the program. Even though ICLEI SEAS offered the project to Yogyakarta without demanding prior special requirements, if Yogyakarta finds an obstacle to their participation, they may decline to participate in the program. Yogyakarta was also one of the CCP of ICLEI, and work on the program related to the first international initiative that aims to facilitate emission reductions by local government. Therefore, it is almost certain that the previous cooperation with ICLEI has given benefit to Yogyakarta as they have agreed to join ICLEI's other project-based programs. Subsequently, Yogyakarta join the Local renewables South–South cooperation program, which was followed by the signing of a Memo of Understanding (MoU) by the mayor of Yogyakarta, Haryadi Suyuti, and ICLEI in 2012 (ICLEI et al. 2012). After the MoU was signed by both parties, it was agreed that all the rules designed by the network for the program would be implemented using the mechanisms of the network. Therefore, it is clear that Yogyakarta is eager to be an active member of the network and be involved in its numerous programs.

Having discussed the membership characteristics within ICLEI SEAS for Yogyakarta, this part of the discussion will address the second characteristic of TMNs, the polycentric and non-hierarchical organization system. The polycentric system of the TMNs allows their members to not only work with their national government but also with other institutions. In the case of Yogyakarta, this condition is inseparable from the benefits of decentralization in Indonesia. During the interview with Hastuti, she mentioned, "the involvement of Yogyakarta in TMNs such as ICLEI is one of the perceived benefits of decentralization. Yogyakarta could attain tangible benefits and collaborate in their programs through the cooperation offered from abroad, without having to consult with the Central Government or the Government of the provincial-level regions" (Hastuti 2014). In addition, the position of the network and city remain equal, even though the funding fully comes from ICLEI. The execution of the program still has to go through the bureaucratic process within the Yogyakarta city government, which has their system and particular working groups designed to implement the program of cooperation.

The third characteristics of TMNs are the "direct implementation" of the decision making within the networks. At times, the Yogyakarta government faced difficulties in implementing their environmental program. During the interview, Hastuti emphasized that "even though we have detailed planning in our environmental program, we cannot just implement it because of the funding consequences which come with it" (Hastuti 2014). In other words, not the entire program of the environmental sector and mitigation to climate change was passed when submitted to the regional expenditure agency. The facts indicate that the presence of ICLEI is beneficial for the government in terms of funding, knowledge, and technology (Hastuti 2014). The local budget agency argues that there are several other crucial programs that need to be addressed and implemented. Therefore, it is clear that both Yogyakarta and ICLEI are sharing similar environmental goals, and that is why the ICLEI program may be directly implemented. ICLEI supports Yogyakarta in working towards creating a sustainable eco-city. This objective is in line with the goals of the national government in reducing energy consumption and reducing the production of greenhouse gases.

It is clear that TMNs in Southeast Asia and Indonesia do not work in the particular context of the EU, the site of the previous research about TMNs. This current empirical research has found some new evidence about the functioning of TMNs in the context of decision making in Indonesia. Nevertheless, TMNs have some similar characteristics across the globe and work in a similar fashion. Having a relatively universal system that works globally may be one of the reasons for the success of the network approach in any situation. The program in Yogyakarta was executed after having looked at the experience of other pilot cities, Coimbatore in India and Ekurhuleni in South Africa, which have similarities with Yogyakarta, as a medium cities with certain advantages. The city of Coimbatore has been declared an advanced local renewable city through its participation in the Local Renewables project from 2008 to 2010. By the end of the program, the two cities came to Yogyakarta to give a presentation on the evaluation of the strengths and weaknesses, the problems encountered during the operation of the program in Yogyakarta, and its final outcomes. The renewable energy program is part of the South–South exchange of ideas, which is a learning program for relevant developing countries with similar contexts such as the scope for local action in climate change mitigation program in national policies.

3.3.2 The Internal Governance of the TMNs in Yogyakarta

As mentioned in the theoretical section, the first indicator within internal governance is “information and communication” strategies. In Southeast Asia, ICLEI SEAS directly approaches cities to participate in its pilot cities program the ‘Local Renewables: South–South Cooperation,’ whereas in the European context, the TMNs wait for cities to apply to become a pilot city. Thus, in the case of Yogyakarta, there was no prior selection to join the program; instead, direct communication came from ICLEI SEAS nominating Yogyakarta to be one the pilot cities to represent Indonesia in the program. A possible explanation for this may be that the solid achievement of Yogyakarta in implementing the previous program helps the TMN to avoid risk and thus seek a city which is stable and reliable. This city is considered to have excellent educational achievements and able human resources. In addition to being a special district, Yogyakarta is often used as a benchmark as a successful city by other local governments in Indonesia.

The second indicator within internal governance, “funding and cooperation”, supports the idea that the TMNs offer crucial contributions in terms of financial resources. In this case, there was no joint funding with a regional organization like in the EU. Because TMNs often work to avoid failure and want the project to run smoothly, ICLEI funded all the expenses during the program and had a direct role in monitoring and providing technical guidance. The monitoring of the program also involved the procurement of goods for energy efficiency using a competitive auction system to avoid monopoly pricing. At the beginning, ICLEI established a timetable with several workshops planned to address issues of renewable energy and energy efficiency. For example, an ICLEI project officer was responsible for data collection and dissemination of the detailed requirements for calculating energy efficiency. After all the data was collected, the ICLEI team analyzed it and created a workshop about the pilot project, which lead to the implementation of several new programs after the workshop finished.

It is also important to examine the third variable within internal governance which is "recognition, benchmarking and certification". Even though there are no particular formal rewards for performance in terms of recognition, the fact that ICLEI returned to Yogyakarta and encouraged a new project without going through any selection process certainly did not happen without a reason. In other words, ICLEI recognized and considered Yogyakarta to be one of the successful cities based on its previous collaboration.

In terms of benchmarking, we can see this in the contribution of the TMN in assisting other cities to learn from successful programs in, for example, Coimbatore, India. By establishing a process for other cities to learn from Coimbatore, ICLEI is able to have a decisive influence on policy changes across the region. ICLEI and Yogyakarta have long-term goals together to change the mindset and the awareness of society related to the use of electricity and other energy sources. ICLEI also created a model for a local renewables initiative. The model design emerged after ICLEI held a benchmarking program for the representatives of the cities of Yogyakarta, Ekurhuleni, and Coimbatore. This benchmarking program enriched Yogyakarta with certain knowledge and helped it create its own Renewable Energy Information Center (Hastuti 2014). The learning process also included policy development related to waste management. Yogyakarta learned from Coimbatore, which does not employ a waste separation system but instead processes its waste in landfills to create gas and electricity.

With regard to certification, ICLEI has appointed Yogyakarta as a pilot city for monitoring greenhouse gases for the countries in Southeast Asia. Yogyakarta has become a pilot city because it has a liveable environment, although the city has a high level of economic activity. ICLEI has observed Yogyakarta since 1999 and considered Yogyakarta as the most prepared city for responding to the impact of climate change due to greenhouse gases. This finding confirms the association between recognition and compliance. It is almost certain that Yogyakarta itself is also very pleased to work with ICLEI again, and even expects a continuation after the current renewable energy program ends.

3.3.3 The External Governance of the TMNs in Yogyakarta

As described in the theoretical framework, the present study was designed to determine the three indicators within external governance of TMNs, which are influence, interdependence, and intermediation. First, with regard to influence, the previous research emphasized the engagement of the TMNs in Europe in lobbying the EU. In the case of ICLEI SEAS, we find less engagement with the regional actor, the Association of Southeast Asian Nations (ASEAN). ICLEI's emphasis on South-South cooperation also helps attract other cities in the south to join the network and participate in its programs.

A further indicator within the external governance system of the TMNs that we need to address is "interdependence." The main idea of interdependence is the cooperation and competition between transnational networks. In terms of ICLEI SEAS, they for example cooperate with REEEP, a global partnership which provides policy initiatives and financial resources for sustainable energy projects. ICLEI SEAS works closely with REEEP to scale up clean energy business models. The ICLEI programs will be well implemented if there is comprehensive support for cities in terms of technology and expertise.

We now turn to the final variable within external governance, which is "intermediation". Yogyakarta is one of the members of ICLEI that is considered highly active locally and transnationally. Previously, Yogyakarta participated in the CCP project in Indonesia. The network provided an opportunity for Yogyakarta to interact extensively as they hired a representative/project officer to run the program directly; Hastuti, the project officer, also served as an internal staff member in the Yogyakarta city government. It is very beneficial for this person to know the city and its strengths and weaknesses. The implementation of the pilot project involves several government agencies, in particular the utilization of regional assets to provide certain facilities and infrastructures. Hastuti (2014) also emphasized that during the local procurement for the energy efficiency program, the Yogyakarta government allowed eligible companies to submit a bid after a tender was issued to avoid monopoly pricing and preserve transparency. In addition, since Hastuti is not only the project officer of the program, but also serves in the local government office, she holds positions that possibly influence the decision maker within Yogyakarta government to implement the program. This finding confirms the association between the intermediary actor and the influential local policy network. Therefore, the successful direct implementation of the ICLEI program in this case is viewed as likely due to the intermediary actor, as her main responsibility is for the sake of the city itself, therefore she can carefully guide the network's program in the city.

3.4 Comparative Analysis

Environmental governance is a matter of international negotiation that does not only take place in the global arena, but also occurs at the local level. As mentioned in the theoretical framework, previous empirical research on the functioning of TMNs took place within the context of the EU. According to the current analysis, the TMNs function in Southeast Asia and Indonesia somewhat differently than depicted in the literature review. The comparisons we are drawing here are between the two TMNs operating in Southeast Asia, and a comparison between these TMNs and those operating in Europe subject to the previous research.

In terms of the first variable of the internal governance system, "information and communication," both DELGOSEA and ICLEI are using the same strategy which is using pilot cities as an information disseminator of best practices. However, DELGOSEA has designed several requirements for the cities before they apply and join the program as pilot cities. In contrast, ICLEI SEAS directly offers their cooperation to a particular city, as long as the background of the city and their suitability for the program assures them. In fact, ICLEI SEA tends to work repeatedly with the same governments when the impressions and results from the previous cooperation are positive.

Both TMNs also work differently regarding the second variable of the governance system, which is "funding." Both DELGOSEA and ICLEI SEAS provide financial means to run the program. However, DELGOSEA defines one of the requirements to join the pilot cities program as the city must be willing to share some of the financial burden to implement the program, while ICLEI runs their program without direct city funding. This difference may be related to DELGOSEA's internal system of organization, which attempts to encourage cities and stakeholders to contribute to the implementation of the program. Nevertheless, both networks are able to find pilot cities to join their programs and can implement their program successfully.

The third variable in internal governance is "recognition, benchmarking, and certification". Compared to the previous empirical research that took place in European cities, there is no overall performance-based award in the programs. The only award within these two projects is the best practice award, given to one of the pilot cities when they have implemented particular programs successfully and with a higher level of achievement compared to the other pilot cities. However, being selected to be one of the pilot cities in the network is already an achievement for a city. The literature suggests that this award could be a motivation for cities to join the network.

There are also some differences in terms of external governance, especially with regards to the first variable related to "influence," focused on lobbying and participation in consultation processes with the EU. The TMNs in Southeast Asia and Indonesia are not engaged in the lobbying process with regional organizations such as ASEAN. Although there may be some informal discussions occurring, the link between the existing regional intergovernmental organizations work on environmental issues (ASEAN environmental body) with the TMN (DELGOSEA) is rather weak. A possible explanation for this may be that the existence of these two TMNs is relatively new in Southeast Asia. In addition, before several countries in Southeast Asia experienced decentralization, they had not been exposed to much cooperation from institutions abroad. This was particularly a limitation of the local government, as the national government tended to work with intergovernmental organizations.

As far as the second variable "interdependence" is concerned, which depicts the cooperation or the competition between TMNs, or between TMNs and NGOs, competition among TMNs was not observed in the analysis of the two cities, and only a little evidence of cooperation between the TMNs was seen. However, both of the case studies describe the cooperation between TMNs and other NGOs. The cooperation has gone very smoothly and supports the implementation of the program. In the Wakatobi case, DELGOSEA even cooperates with a small local community group at the village level, which in turn created new jobs related to the use of waste in the handicrafts industry and a new local community group in Wakatobi.

The last variable of external governance is the “intermediation” function that depicts the position of the city within the network and role of a key intermediary actor who lies between the TMN and the city. In this case, both TMNs successfully engaged with the intermediary actor. The intermediary actors in both case studies had a dual role. They both not only served as a project coordinator of the program, and reporting directly to the regional manager, but also served as a local government officer in their city. They also held important positions in their agency. Therefore, the TMNs have no reason to be concerned whether or not their program will be implemented.

Regarding the empirical studies in the two cities in Indonesia, this research has found important similarities and differences. Both networks have their particular policy domains. The central network may have several related policy domains on a certain theme but the city remains the object of focus. The precise policy domains emerge in each of the regional section of the networks, with a particular project. The UCLG has its UCLG ASPAC and DELGOSEA program; the ICLEI has its ICLEI SEAS and South-South Cooperation Local Renewables Program. The two networks involve members from a varied region, as the DELGOSEA selects the specific geographic area and reviews applications from cities in that area wishing to participate, whereas ICLEI directly chooses particular cities that are suitable for its program.

These findings enhance our understanding of the complexity of the environmental governance as depicted by Kern and Bulkeley (2009), Keiner and Kim (2007), Betsill and Bulkeley (2006). There is a relation of power and influence between the local governments, national governments, and the TMNs. The networks have stimulated local governments to be more active in environmental policy-making. The case studies have shown how the TMNs work at times differently in Southeast Asia, compared to the original theory developed from TMNs operating in Europe. Both Wakatobi and Yogyakarta are making a solid contribution to the national and international environmental and climate change commitments, as well as contributing in improving the environment for their local society.

4 Conclusion

The present study was designed to determine the role of TMNs in assisting cities to improve their environmental performance and support the nation states in meeting their (inter)national environmental agreements. Theoretically, as argued by Bulkeley et al. (2003), TMNs are engaged in the policy process through carefully designed internal governance processes to tie the network closely together, and through a set of external governance processes designed to influence other actors. The dissemination of information about best practices is the most important role of TMNs in achieving their goals.

In terms of conceptualizing transnational networks, the TMNs model should be expanded beyond the original context of Europe to include those in Southeast Asia and other regions, and to add contemporary details concerning the role of TMNs in environmental policy. A close analysis of the networks in Southeast Asia, and the involvement of countries and the cities in the region, is necessary to comprehend the application of the TMNs model more generally. The transnational networks involving local authorities are indeed one of the substantial features of environmental governance, which is not only developing in Europe, but also extends now across Southeast Asia, albeit unevenly across the region.

It is also beneficial for further academic development to employ comparative case studies involving cities and TMNs. This focus on research of networks of cities across a given region is a new development in IR. The existing IR literature is often state centric. Here we pay attention to the types of multi-level state structures and networks involving subnational level actors. A better comprehension of the emerging patterns of governance will strengthen our understanding of the interactions between levels of government and global environmental governance.

Beyond improving the conceptualization of transnational networks for environmental governance, this research has contributed to an empirical examination of two TMNs in Southeast Asia. Returning to the second research question posed at the beginning of this study, it is now possible to state that the two cities in Indonesia are experiencing the perceived benefits of decentralization. Decentralization gave the cities the authority and the ability to cooperate more closely with TMNs and cities abroad. The most significant function of the TMNs is their role as an information disseminator for local authorities. In both cities, TMNs have assisted the cities in meeting their environmental goals through the pilot cities project. The pilot cities project consisted of a funding system, as well as the transfer of knowledge, technology, and expertise.

The cases of Wakatobi and Yogyakarta show that the TMNs have also assisted cities in improving their local environment. We assume that, if the local government maximizes the role of TMNs in environmental policy, then they can contribute more to the state meeting its international environmental commitments. However, this conclusion needs to be placed within the wider context of how much a tangible implementation of the local policy will contribute to the state commitment, when so few cities are participating in these TMN programs. TMNs should thus also encourage smaller cities to take part in their initiatives.

Overall, this study strengthens the idea that TMNs are a newly emerging form of global environmental governance, also in Southeast Asia. This new pattern has helped the cities of Wakatobi and Yogyakarta in Indonesia to gradually achieve their long-term goals of becoming a sustainable city. Like many cities in the world, these two cities have faced difficulties in achieving their sustainable city goals. However, having looked at several variables within the governance system of the TMNs, we suggest that further studies need to be carried out in order to further explore the governance system of TMNs in contexts beyond Europe. We conclude that TMNs have a significant role in helping not only cities to achieve local sustainability goals, but also to contribute to the international environmental commitments, which nations have made to the international community.

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Part IV
Governance to Limit Opportunities for Corruption in a Decentralized Environment

Chapter 9
Institutional Change and Corruption of Public Leaders: A Social Capital Perspective on Indonesia

Mala Sondang Silitonga, Gabriel Anthonio, Liesbet Heyse and Rafael Wittek

Abstract Incidents of corruption by local public leaders have increased in Indonesia in the era of a decentralized democratic regime, in which regional governments enjoy greater power and autonomy to manage regional resources. Previous research suggests that the shift of formal power from the central government to regional governments resulted in new actors at the local level becoming involved in corruption. Building on ideas from social capital theory, the current study attempts to complement previous work by analyzing the shifts of public leaders' corruption behavior under the decentralized democratic government. We suggest that besides formal power relations, informal relations are important for initiating and sustaining corruptive transactions, and corruption requires a different social capital base in different institutional settings. The objectives of this paper are (1) to organize current knowledge on institutional change and corruption, (2) to extend current thinking on public leaders' corruption in Indonesia and beyond, and (3) to suggest a framework for future empirical study. We present an empirical

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study on the link between institutional change and corruption, based on a unique data set of real corruption cases as they were reported in Indonesian public newspapers. Based on this first exploration—which indicates that indeed the nature of corruption networks in Indonesia has altered since decentralization—the proposed theoretical framework is deemed of value for further empirical investigation.

Keywords Corruption · Institutional change · Social capital · Public leaders · Indonesia

1 Introduction

Broadly defined, corruption is "the abuse of public power for private gain" (The World Bank 1997: 8). In the public sector, this relates to efforts of public leaders in executive, legislative, or judicative branches of government to gain improper personal benefits for themselves or for their associates, by misuse of entrusted public power through illegal means (Fijnaut and Huberts 2002; Shleifers and Vishny 1993). An example is bribery or extortion by public officials, where they use their power in illegitimate ways to obtain a payment from individuals in exchange for a government service or permission (Nielsen 2003; Jain 2001).

Corruption is regarded as one of the most destructive, yet unresolved problems in society, especially in developing countries (Jain 2001; Chang and Chu 2006; Klitgaard 1998). In most centralized developing countries, one of the strategies to address the harmful problem of corruption is by exploring ways to implement decentralization policies (Litvack, et al. 1998; Crook and Manor 2000; De Asis 2000). The World Bank defines decentralization as "the transfer of authority and responsibility for public functions from the central government to intermediate and local governments or quasi-independent government organizations and/or the private sector" (Litvack and Seddon 1999: 2).

A review of previous studies has shown contradictory arguments. On the one hand, several studies suggest that (fiscal) decentralization reduces the level of corruption because it increases the level of accountability at the local level by reducing the power of the national level. It thus brings the government closer to the people by empowering local governments and organizing public scrutiny at the local level. On the other hand, decentralization may enhance corrupt behavior for several reasons. First, decentralization is often associated with less control, monitoring, and evaluation from the central government, which leaves room for local officials to engage in corruption. Second, decentralized systems give greater power to local officials and this discretion may lead to closer relationships with citizens, which in turn may contribute to favoritism of public officials toward particular citizens or groups. This can lead to public service inequality and corruption (Gurgur and Shah 2014; Shah 2006; Shah et al. 2004).

In Indonesia, as is evident from reports, media coverage, and previous studies (see for example Renoe 2002; McLeod 2000; Budiman et al. 2013), corruption was a rampant phenomenon during the centralized autocratic regimes of the Soeharto

Presidency (1966–1998). In 2001, the regime changed with the initiation of decentralization policies, where heads of regions were selected by the local council (i.e., local representative democracy model) and the introduction of direct elections of the heads of regions in 2005 (i.e., local direct democracy model). However, corruption also still exists in the decentralized system at the national and subnational level (Mietzner 2010). Data from the World Bank (2013) pinpoint that the trend from 2001 to 2013 country's percentile rank in controlling corruption ranged from 9 to 33 out of 100, with 0 indicating that the country is perceived to be highly corrupt. This percentile rank shows that even after the decentralization, Indonesia does not perform well in its attempts to control corruption. Some scholars, therefore, argue that decentralization has not reduced corruption but shifted it from the central government to the lower tiers of government (Hadiz 2004; Kristiansen et al. 2008), involving public leaders from legislative, executive, and judiciary branches of government, as well as civil servants.

2 Research Question

In this chapter, we focus on the persistent problem of corruption in Indonesia and investigate whether and how corruptive behaviors of local public leaders have changed after the implementation of a decentralized democratic system in Indonesia. We particularly focus on the manner in which institutional changes resulting from the decentralization effort in Indonesian society have enabled or constrained opportunities for corruption of public leaders. We argue that, whereas decentralization and democratization may increase accountability and transparency of the local government (Crook and Manor 2000; Huther and Shah 1998; Fisman and Gatti 2002), the institutional change from a centralized autocratic regime to a decentralized democratic regime may also have had unintended side effects through which other players and forms of corruption became more likely.

One of the few attempts to investigate the relationship between decentralization and corruption in Indonesia was the Local Government Corruption Study (2007). Based on a qualitative comparison of ten corruption cases, it documents how the shift of formal power from the central government to regional governments resulted in new actors at the local level becoming involved in corruption (Rinaldi et al. 2007). Our study aims to complement this previous work. We suggest that the presence of formal power is a necessary but not a sufficient condition for initiating and sustaining corruptive transactions. A shared characteristic in many corruption cases is that they reflect attempts of individuals or groups to realize personal benefits by utilizing their social networks (Vardi and Weitz 2004). We, therefore, complement existing research with a relational perspective, focusing on the (informal) social capital base of corruption.

By examining the structures of corruption networks in Indonesia, and the actors and set of relations linking these actors (Wasserman and Faust 1994), we elaborate on the argument that corruption requires a different social capital base in different institutional settings. The actors' relations in themselves are legal activities. However, if, for example, the work relation between a head of region and a local council is followed by illicit transactions to gain personal profits, the ties will turn into illegal activities (Warburton 1998; Granovetter 2004; Andvig 2005). Therefore, we suggest those actors' relations as part of leaders' social capital play a salient role in reinforcing or breaking a corrupt transaction.

3 Scientific and Societal Relevance

Our study makes three distinct contributions to the knowledge on corruption of public leaders, in general, and the Indonesian case in particular. First, we develop a general theoretical framework specifying how institutional change affects the structure and nature of public leaders' social networks and corruption-related behaviors. Second, we present a descriptive analysis of the link between institutional change and corruption, based on a unique data set of real corruption cases as reported in Indonesian public newspapers. Third, in relation to the increasing numbers of incidents of corruption in Indonesia, this study contributes to current thinking on public leaders' corruption in Indonesia, especially from a social capital perspective.

In the remainder of this chapter, we describe the research design. In the next section, we introduce our theoretical background. This will be followed by the data and results. The last section will include the discussion and the conclusion.

4 Research Design

This study consists of a content analysis and a historical/comparative analysis. These methods include an investigation into government reports and the reports of international institutions (e.g., The World Bank), as well as previous research articles on decentralization and corruption in Indonesia, next to an analysis of newspaper articles.

In order to understand the structure of corruption networks in different institutional settings, we collected data on public leaders' corruption cases in Indonesia by means of reported news from newspapers. The motivation to use newspaper data for this study is that it can provide information when alternative data (e.g., statistical data) are unavailable or difficult to obtain (McCarthy et al. 1996; Franzosi 1987), which is very much the case for corruption research. Moreover, newspaper reports represent information that has become available to the public. They, therefore, constitute an important source of public opinion that shapes public perceptions of corruption (Andvig et al. 2000), which makes newspaper reports relevant to study in themselves. Furthermore, journalists' records, often based on court files, provide valuable information that can be used not so much to produce a representative picture of corruption in Indonesia, but to gain more insight into the variability in the social structural foundations of corruption, which is the aim for this chapter. We further elaborate on the specifics of the data collection and analysis process prior to presenting the results of our analysis (see the results section).

5 Theoretical Background

The general definition of corruption implies some form of exchange of valued items between at least two parties (individual, groups, organizations) operating outside the law (Warburton 1998; Andvig 2005; della Porta and Vannucci 2012). The social capital theory suggests that individuals invest in social relations with others if the resulting obligations are likely to yield some benefit—such as benefits resulting from corruption—in the future (Flap and Völker 2013). The return from a social relationship depends on the institutional arrangement in which it is embedded. In particular, election mechanisms and other social political conditions of government are determinant factors in the institutional arrangement (Andvig 2005; Yilmaz et al. 2008). Corruption and the social structures in which it occurs can thus be better understood by exploring the structural and functional characteristics of the institutions that govern the relations between different groups of interests (Economakis et al. 2010). Such an analysis helps explain why, for example, specific types of social relationships that are valuable in some settings—like "weak ties" in Western industrialized countries—may be of less value or even problematic in other settings. This institutional hypothesis about the "returns to social capital" has been investigated in depth for the transition from a socialist to a capitalist regime in Eastern Germany (see, e.g., Völker and Flap 1995).

We develop on the above ideas to study how the change from a centralized autocratic regime to a decentralized democratic regime affected leaders' relational structures (social capital) in Indonesia, and the resulting opportunities and constraints for corruptive behavior (see Fig. 1). Below, we first distinguish between types of corruption and two types of institutional settings, before we continue to reason how these regime types generally affect the opportunities for corruption. We then continue to elaborate on the specific social structure of corruption in terms of the number and type of actors as well as the type and nature of relations involved, as proposed by proponents of the social capital perspective.

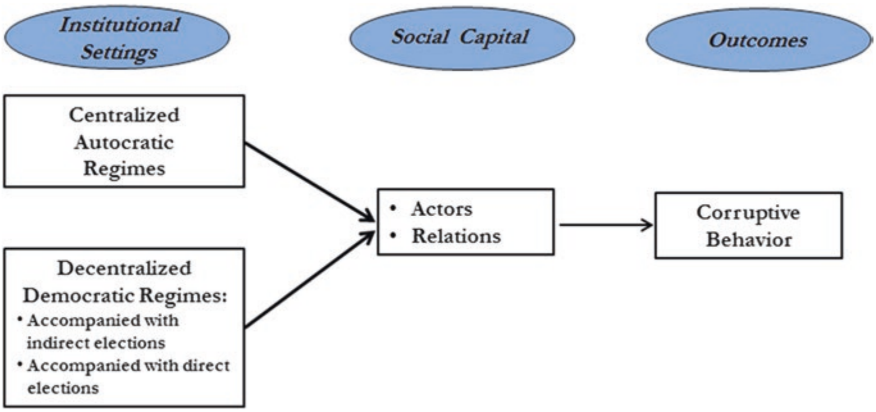

Fig. 1 Conceptual model

6 Types of Corruption

Corruption in the public sector can be classified in various types, ranging from petty corruption, which involves low-level officials who receive a bribe for the provision of basic government services, to grand corruption, where kickbacks are provided to political elites and high-ranking officials to secure government procurement (bid rigging) through political decision-making processes (Rose-Ackerman 2008).

Based on the nature of corruptive transactions, corruption can be distinguished into more specific forms. In this study, we classify the types of corruption as follows:

1. Bid rigging or misprocurement is favoring a certain bidder in the government procurement process by tailoring the specification and the budget of the tender to particular bidders, thereby ignoring other bidders' existence (The World Bank n.d).
2. Bribery /kickback/payoffs refer to illicit payments to public officials (including cash, gifts, charities, and other types of contributions) to obtain government contracts, a license, or other improper business advantages (The World Bank 2008; Amundsen 1999).
3. Embezzlement is when public officials steal money from government budgets or misspend funds (Fan et al. 2010); usually, there is no private agent or civilian directly involved (Amundsen 1999; Andvig et al. 2000).
4. Favoritism, which also includes nepotism (Andvig et al. 2000), is the practice among those with power or authority of favoring family members, relatives, friends, and anybody close and trusted to gain a government project or contract or any other benefit (Amundsen 1999).
5. Fraud is a manipulation of information, facts, and expertise in illegal transaction networks by public officials and individuals from the private sector, who seek to gain a private profit (Amundsen 1999; Andvig et al. 2000).
6. Money laundering or reinvestment of illicit money is the process of concealing illicit gains generated from criminal activity in order to obscure its origins (Schoot 2006).

7 Centralized Autocratic Regimes and Decentralized Democratic Regimes

In the period before 2001, Indonesia can be characterized as a centralized autocratic political regime. Centralized autocratic political regimes are characterized by extractive political and economic institutions (Acemoglu and Robinson 2012). Power is concentrated in the hands of a few political elites, and these elites manipulate economic institutions to extract resources from wider society. In centralized autocratic regimes, all access to resources, such as orders, are dominated by the central government, at the expense of the power base at the local level (Acemoglu and Robinson 2012). For example, when electing the heads of regions during the centralized autocratic regime in Indonesia (1966–1998), the local council had a right to propose nominees to the central government through the Ministry of Home Affairs. However, the central government takes the final decision about the appointment. Hence, in this phase, the Indonesian central government had the authority to ignore local aspirations (Mietzner 2010).

Since 2001, after more than 32 years of being a highly centralized government, Indonesia has become one of the most decentralized countries (Hofman and Kaiser 2002). Decentralized democratic regimes reflect an ideal type of inclusive political and economic institutions (Acemoglu and Robinson 2012). In decentralized democratic regimes, substantial power and resources are shifted from central to lower level authorities. In Indonesia, these powers are transferred to the head of region and the local council. According to Law No. 22/1999, local governments, especially district and municipality levels, have an authority over all fields of governance, except in the fields of foreign policy, national defense, justice, monetary and fiscal policies, and religious affairs. With the distribution of functions among central and local governments, lower level authorities are thus more independent to make decisions in particular policy areas, including the budgetary aspect, and do not need to seek approval from the central government at all times.

Decentralization policies can, however, be implemented in various ways (Yilmaz et al. 2008). In Indonesia, local governments experienced two phases of decentralization with distinctive characteristics (Mietzner 2010). The first model is local representative democracy (2001–2004), and the second model is local direct democracy (2005–2014). The two models are different with regard to the general local election mechanisms (i.e., indirect election mechanism and direct election mechanism) and the power position between the local executive and legislative.

The local representative democracy model was implemented in the first phase of decentralization in Indonesia (2001–2004). The main characteristic of the representative democracy model is that the local council holds significant power as representatives of the people to select heads of regions (i.e., governors, mayors, regents, and their deputies) through indirect local elections. Therefore, the local council has a right to impeach and remove the head of the region. Furthermore, in the representative democracy, according to the Law No. 22/1999 on regional government, the local council in Indonesia has a wide scope of functions, namely a legislative function, a representative function, and a control function over the local executive body.

The local direct democracy model was introduced as part of Indonesia's democratic reform programs. Based on Law No. 32/2004 in the second phase of decentralization in Indonesia, the direct democracy model assures the election of local executives through a one-man-one-vote mechanism, with the aim at representing the real interest of the local communities and strengthening accountability to citizens (Labolo and Hamka 2012). In terms of formal power position, according to

Law No. 32/2004, in the second phase of decentralization, the relation between local council and the head of region is characterized by check and balance mechanisms. Moreover, the executive body has more power and autonomy to manage local resources and local allocation budget, implement local government policies, involve in the provision of infrastructures and other responsibilities assigned to local government compared to the first phase of decentralization.

8 Institutional Change and Its General Implications for Corruption

We suggest that different institutional settings create various opportunities and constraints for corruptive behavior of local public leaders. Below, we first briefly outline the assumed consequences of different institutional settings for opportunities for corruption in general, before we further specify our theoretical expectations by distinguishing key elements of a social capital (i.e., actors and types of relations), in the next section.

In *centralized autocratic regimes*, due to their strong economic and political power, members of the elite have the interest and the means to maintain the conditions for their favorable position. This can be achieved by directly investing in those actors who play a major role in maintaining the system (Kaufman 1974), such as high-ranking bureaucrats and judges. This results in patronage or patron–client networks (Scott 1972; Khan 1998; Renoe 2002). The patron provides his/her clients benefits and protection, and the client reciprocates with loyalty and support, usually in activities that are functional to maintain the patron's illegitimate sources of income and influence (Scott 1972; Lomnitz 1988; Granovetter 2004). In a centralized autocratic system, local public leaders only have access to these networks by means of a patron higher in the hierarchy (McLeod 2000, 2005). In Indonesia, the position of head of region and other high-ranking positions were thus most likely given to subordinates with a connection to the top leader at the central level (Robertson-Snape 1999; Renoe 2002). These appointed heads of regions had privileges to replicate the structure of patron–client corruption at the central government in the form of corruption at the local level under a tight control from central government. Heads of region could thus exploit the resources and maneuver the system as long as their loyalty to those higher up in the hierarchy remained (see: Robertson-Snape 1999; Renoe 2002; McLeod 2000; Liddle 1985).

Despite the fact that *democratic decentralized regimes* may increase accountability and transparency of the local government (Crook and Manor 2000; Huther and Shah 1998; Fisman and Gatti 2002), such a setting also results in increased discretion at the local level which may create opportunities for local officials to engage in corruption (Prud'homme 1995). Moreover, different types of decentralized systems may lead to specific opportunity structures for corruptive transactions. Decentralization with a representative election system, as was the case in the first phase of decentralization in Indonesia, can be expected to resemble the corruption structures of centralized autocratic regimes to a large extent (Mietzner 2010). Political patronage in this system is still assumed to be present, particularly in Indonesia, where the local council has the power to impeach and remove the head of region in this phase (Mietzner 2010; McLeod 2005). The heads of regions (particularly governors), therefore, frequently bought votes to secure their appointment, thereby creating classic patron–client relations (Hofman and Kaiser 2002; USAID 2009; Mietzner 2010).

However, if decentralization is accompanied with direct local elections, political power will be much more dispersed and, due to periodic elections, potentially unstable. A politician who is unimportant today may be elected and become highly influential tomorrow or current local public leaders might lose their position with the next election. These conditions influence social relations of both local public leaders and those who might potentially benefit from them. For public leaders, for example, it then seems opportune to invest in relationships with those who have the power to reelect them (Choi 2009; Buehler 2007).

9 Institutional Change and Social Capital Traits of Corruption Structures

We have argued how variations in institutional settings may create different opportunities for corruption. In this section, we specify this argument in various theoretical expectations by building on the social capital perspective.

The building blocks of social capital are good social relationships between at least two actors (Coleman 1988). A good social relation implies that mutual reciprocity obligations and interpersonal trust have been developed through previous interactions (Coleman 1988; Putnam 1995). This perspective is helpful in the study of corruption, since corruption also implies some form of exchange of valued items between at least two parties (individual, groups, organizations) operating outside the law (Lambsdorff 2002; Andvig 2005; della Porta and Vannucci 2012). Since actors and types of relations are key in understanding social relationships and networks (Wasserman and Faust 1994), we propose to focus on these basic elements of social capital to formulate specific theoretical expectations about the nature of corruption before and after decentralization in Indonesia.

9.1 Corruption Actors

We define actors as individuals or groups of individuals who are involved directly and indirectly in a corrupt transaction. In specific terms, Rose-Ackerman (2008) acknowledges that the most common corrupt transaction occurs between government officials (usually as bribe takers) and private actors (as bribe givers), and it involves power and resource exchanges. Similarly, Warburton (1998, 2013) points out that at least one of the actors who is involved in corruption must necessarily be in a position of power (power holder). However, we also acknowledge that in embezzlement cases, corruption networks might occur among public officials who have personal benefits without direct involvement of private actors.

We suggest that the institutional setting influences the number and nature of actors present in networks of corruption. As stated previously, in centralized autocratic regimes, all access to resources are dominated by the central government, with less power and resources at the local level (Acemoglu and Robinson 2012). Corruption networks are, therefore, highly centralized and dominated by patronage relations (della Porta and Vannucci 2012). The relationships are usually personalized, and the actors with access to the elite do not have an interest to share this access. They keep it exclusive and tend to maximize the benefits for themselves or their in-group members (Khan 1998). In this condition, lower level staff will face difficulties to gain direct access to top-level elite members, unless they have a patron themselves (Kettering 1988; Scott 1972). Therefore, the number of local actors involved in corruption will be likely limited to those who have access to the top leaders in central government.

Decentralized democratic regimes, in contrast, create a larger number of administrative or governmental tiers. More tiers will be associated with more local officials involved in corruption. As argued by Manor (1999: 101), decentralization "is always attended by an increase in the number of persons who are involved in corrupt acts." This is also due to the fact that decentralization results in higher decision-making and resource-allocation discretion at the local level (Acemoglu and Robinson 2012), since in some domains the position of local public leaders is stronger compared to national decision-makers (Prud'homme 1995; Choi 2009). Compared to the centralized regime, in a decentralized regime the newly acquired power and legal authority allow local public leaders to build internal and external organizational networks. They have more capacity to decide with whom to engage, whom to trust, and whom to turn to for information (Warburton 1998; Granovetter 2004). There are thus more opportunities for local public leaders to become involved in networks of corruption, because they have more discretion to control these networks (Lambsdorff 2002) and to impose power over their subordinates to become an aide in corrupt transactions (Tanzi 1998). Based on the above, we expect that given the institutional change from a centralized autocratic regime to a decentralized democratic regime with direct elections in Indonesia, in the latter regime more actors, and specifically more local public leaders, will be involved in networks of corruption.

9.2 Types of Relation

Corrupt actions are driven by the interaction between or a relation of at least two actors to gain personal benefits (Warburton 1998; Andvig 2005; della Porta and Vannucci 2012). Actors' relations can be based on formal relations or informal relations (Bag 1997; Hutchcroft 1997; Vannucci 2011). Formal relations, such as the work hierarchy between upper and lower level officials (Hiller 2010; Bag 1997) contribute to conditions facilitating corruption when leaders exploit these hierarchical relations in combination with patron–client networks (Granovetter 2004). Informal ties between actors involved may lead to the occurrence of corrupt behavior (Warburton 1998). In particular, strong ties, such as kinship and friendship, can be used to enforce corrupt transactions (Kingston 2007; Rose-Ackerman 2008). The characteristics of informal ties are, when compared to formal ties, more symmetrical (Lomnitz 1988), horizontal, and personal (Warburton 1998), and demand long-lasting reciprocity (Andvig 2005).

Differences in institutional settings are expected to facilitate certain types of corruptive relations in terms of their structure (dyadic or triadic) and their quality (formal or informal). Due to the specifics of centralized autocratic regimes, with strong patron–client relationships, we expect corruption in these regimes to be predominantly characterized by dyadic exchanges (Kaufman 1974) with strong unilateral dependence relations between a powerful patron and a low status client, resulting in a highly centralized structure. Such patron–client relationships are expected to be particularly based on a combination of formal and informal relationships, such as kinship or friendship (Nielsen 2003; for the case of Indonesia, see McLeod 2000; Renoe 2002). In particular, actors who both informally and formally have strong relationships, which are also called multiplex relations, will be able to reap benefits from the patron–client system.

In decentralized democratic regimes with direct elections however, local public leaders can exert higher discretionary power, which gives them opportunities to manipulate the system for corrupt purposes (Jain 2001). Whereas we do not estimate the dyadic patron–client system to disappear completely in this phase, we do expect a diversification of types of relations in various ways. First, we predict more triadic relationships to developed, because central control will diminish and this will allow for more and a higher diversity of actors to be involved in corruption (see previous section). In such a context, strong, multiplex patron–client relationships will no longer be the sole manner to engage in corruption. Decentralization thus is expected to create opportunities for larger and more diverse networks of corruptive actors to develop, which can also be based on unidimensional relations (i.e., not necessarily a combination of both informal and formal relationships).

Based on the above, we thus expect that both formal and informal ties play a prominent role in networks of corruption in both centralized and decentralized regimes. However, in centralized autocratic regimes, we expect corruption networks to be predominantly characterized by dyadic and multiplex relations, whereas in decentralized regimes (and especially in the setting of direct elections), we also predict triadic and unidimensional relations to be present, and thus overall we expect to observe a trend toward the diversification of types of relations.

10 Data and Results

10.1 Data Collection and Analysis Process

We explore the value of our theoretical expectations on the basis of 200 corruption cases, derived from newspaper articles reported by "The Jakarta Post" (http://www.thejakartapost.com), a leading daily online English Language newspaper in Indonesia. This high-quality newspaper has won several awards in national journalism and has a high reputation for following the ethics and standards of journalism (Putra, n.d). As one of the national newspapers, the coverage of the Jakarta Post includes recent corruption phenomena of the regional level. In order to minimize data bias (Franzosi 1987), the reported cases in the Jakarta Post were cross-checked with the information from other reliable national and local newspapers (e.g., digital editions of Kompas, Tempo, Media Indonesia, Jawa Pos, and Pikiran Rakyat), as well as government reports.

The newspaper data collection was completed in three stages: We first identified and collected those articles related to public leaders' corruption reported in the newspapers. The unit of analysis is thus the group of public leaders who hold power in public decision-making and implementation processes. This can be individuals (e.g., a mayor or minister) or groups of individuals (e.g., the local council). The key terms that were included in the search were corruption, bribery, embezzlement, bid rigging, fraud, misprocurement, kickback, graft, favoritism, and nepotism. In a second step, we reviewed the content of the articles, removed the articles with repetitive news, and made a list of articles ordered per corruption case, so we could calculate the total number of corruption cases covered in the newspapers in the selected years. In total, the search yielded 947 articles, covering a total of 200 corruption cases. In a third step, for all cases, we systematically coded the following information based on our theoretical expectations:

1. The type of corruption per case: bribery (kickbacks), embezzlement, fraud, favoritism (which include nepotism), bid rigging (misprocurement), and money laundering. One case can pertain to various types of corruption.
2. The type of actors involved from both public and private sectors: individual, a group of individuals, and a corporate group.
3. The total number of actors per case: an individual (e.g., a governor) or a group of individuals (e.g., local council).
4. The number of public leaders involved per case (depending on the decision-making power): an individual (e.g., a mayor) or a group of individuals (e.g., local council).
5. Types of relations:

    (a) Dyadic versus triadic ties: whether the ties consisted of two central actors (or actor groups) or of three or more.

    (b) Formal versus informal ties: whether the ties consisted of formal (i.e., work hierarchy) or informal (i.e., kinship, friendship, and horizontal work relation). Unlike work hierarchy, a work relation reflects an informal tie between actors based on interpersonal reciprocity and transactions (Andvig 2005).

(c) Multiplex versus unidimensional ties: whether the ties consisted of multiplex (i.e., formal and informal ties co-occur), or unidimensional (i.e., the ties are either formal or informal in nature).

We chose three time points for comparison in our Indonesian newspaper data. For the corruption cases before the decentralization effort, we collected data from the years before 2001. Due to a limitation of our data in pre-decentralization years, we also refer to previous studies for additional data and information (Robertson-Snape 1999; Renoe 2002; McLeod 2000; King 2000; Liddle 1985, 2013; Aspinall and Fealy 2010; Blunt et al. 2012). For the corruption cases after decentralization, we distinguish the data based on the first decentralization phase (2001–2004, i.e., decentralization accompanied with indirect local elections) from the second phase (2005–2013, i.e., decentralization accompanied with direct local elections). In order to reduce potential selection bias, we included all reported corruption cases in both time points. Based on these data, we can provide a descriptive, preliminary exploration of our theoretical expectations.

11 Results

Up to now, local governments in Indonesia have experienced two phases of decentralization: the first phase characterized by indirect elections and the second phase characterized by direct elections. In our analysis, we distinguish and compare the corruption cases for the centralized era and the two phases of decentralization to study if and how this process of institutional change had an influence on local elites' corruptive behavior in both executive and legislative bodies, and the resulting networks of corruption.

From the total 200 cases, 10 cases reported occurred before year 2001 (pre-decentralization), 96 cases occurred between year 2001 and 2004 (first phase of the decentralization, a three-year time span), and 94 cases occurred between year 2005 and 2013 (second phase of the decentralization, an eight-year time span). The average cases per year in the first phase are 24 cases, while in the second phase of the decentralization are 10 cases. Since data on the centralized era are limited, we complement the analysis of this era with secondary sources.

Below, we present descriptive data to explore the value of our theoretical expectations. For each of the three phases, we compare the frequency and nature of (a) corruption, (b) the actors involved, and (c) the types of relations of the corruption networks. We consider the first decentralization phase (with indirect elections) as a transition phase from full centralization to full decentralization (when direct local elections were introduced). Hence, we expect to find a longitudinal trend in the composition and nature of corruption networks in terms of actors and types of relations.

11.1 Types of Corruption

For the cases analyzed, we identified a variety of corruption types at various levels. Table 1 shows the number of corruption cases that were identified at the provincial or district/municipality level. This table shows that most cases in all three phases pertained to the lowest local level (district/municipality), indicating that local-level corruption is a phenomenon that can be observed throughout time. However, we also see an increase in the proportion of cases at this lowest level from 77 % in the first decentralization phase, to 90 % in the second phase of decentralization.

Table 2 gives an overview of the types of corruption present in the sample and the extent to which types of corruption co-occurred in one case. Given the fact that two or more types of corruption can be present at the same time, the total number of types of corruption identified exceeds the number of cases (i.e., 200 cases versus 296 counts of types of corruption).

Before decentralization, five out of the ten collected cases are about the embezzlement of government funds. Similar to the pre-decentralization phase, in the first phase and second phase of decentralization, embezzlement of government funds is the most frequently reported type of corruption, 42 and 38 %, respectively. This finding is in line with previous work by Valsecchi (2013), who shows that embezzlement is the most common type of corruption in local government after the transition to decentralization in Indonesia.

Table 1 The number of corruption cases at local governments

Corruption cases at local governments	Pre-decentralization (Before 2001)	1st phase of decentralization (2001–2004)	2nd phase of decentralization (2005–2013)	Total
Province	3	22 (23 %)	9 (10 %)	34
District/ municipality	7	74 (77 %)	85 (90 %)	166
Total	10	96	94	200

Table 2 Types of corruption

Types of corruption	Pre-decentralization (Before 2001)	1st phase of decentralization (2001–2004)	2nd phase of decentralization (2005–2013)	Total
Bribery	0	20 (13 %)	30 (23 %)	50
Bid rigging	2	29 (19 %)	18 (14 %)	49
Embezzlement	5	64 (42 %)	50 (38 %)	119
Favoritism	2	26 (17 %)	11 (8 %)	39
Fraud	4	12 (8 %)	16 (12 %)	32
Money laundering	0	2 (1 %)	5 (4 %)	7
Total	13	153	130	296

In the first phase of decentralization (characterized by indirect elections), the second most often-encountered type of corruption is bid rigging or misprocurement. In this period, there are 29 out of 96 cases relating to a covert agreement where authorities favor a certain bidder in the government procurement process by tailoring the tender's specification and budget to manipulate the bidding process. The third most common corruption case in this phase is favoritism, including nepotism. We identified 26 cases out of 96 cases related to favoritism, which is the practice that those with power or authority favor family members, relatives, friends, or anybody close and trusted to receive a government project or contract or any other benefit.

In the second phase of decentralization (characterized by direct elections), bribery is the second most common corruption type (30 out of 94 cases), followed by bid rigging (18 cases) and fraud (16 cases). These bribery cases are not only about private actors bribing public officials, for example, to secure a project or contract ($N = 20$), but also about public officials from different institutions bribing each other ($N = 10$). For example, several cases pertain to local public leaders who bribe parliament members to gain approval for a local budget or who bribe a judge to buy judicial decisions. When we compare the two phases of decentralization (see Table 2), we notice a prominent increase in bribery cases (from 13 % in the first phase to 23 % in the second phase), as well as a decrease in the percentage of embezzlement cases (from 42 to 38 %), bid-rigging cases (from 19 to 14 %), and favoritism cases (from 17 to 8 %).

Furthermore, we conclude that corruption types sometimes overlap (see Table 3), meaning that two or more types of corruption could be identified per case, except for the centralized regime. In our sample, 39 % of the cases in the first phase of decentralization consist of more than one type of corruption, whereas in the second decentralization approximately 33 % of the cases consist of two or more types of corruption. For example, there were networks of corruption consisting of actions to secure favorable contracts and to offer projects to a certain private company as part of a bid-rigging attempt, which was then followed by bribery (19 cases).

Table 3 Overlap corruption cases

Types of corruption	Pre-decentralization (Before 2001)	1st phase of decentralization (2001–2004)	2nd phase of decentralization (2005–2013)	Total
Case consisted of one type of corruption	10	59 (61 %)	63 (67 %)	132
Case consisted of two types of corruption	0	20 (21 %)	26 (28 %)	46
Case consisted of more than two types of corruption	0	17 (18 %)	5 (5 %)	22
Total	10	96	94	200

11.2 Number and Types of Corruption Actors

In order to explore whether the number of actors involved in corruption cases has increased in the transition process from complete centralization to full decentralization, as we expected, we identified the total number of actors involved per corruption case identified. Per phase, we calculated the total number of identified actors and divided this by the number of cases per phase, in order to generate the average number of actors per phase per case. We did this in two ways. First, we calculated this average of the number of individual actors involved (see Table 4). This calculation shows that in the pre-decentralization case, an average of 3.6 actors per case were involved, although we have to be careful to draw strong conclusions due to the low number of cases. In the first decentralization phase, this was an average of 14.1 actors per case, while in the second phase the averaged dropped to 6 actors per case. This exploratory descriptive analysis does not confirm our expectation that the number of actors per case on average will increase with the progression of decentralization.

Second, we made a similar calculation based on the degree to which an individual actor is part of a collective decision-making authority or not (see Table 4). This is important because collective decision-making bodies may differ in size (i.e., number of members per decision-making body), and this might distort our data somewhat. For example, a corruption case that involves a local council with a large number of members is more likely to lead to a large proportion of local councilors involved in the case. This leads us to consider council members as a group of actors that have collective decision-making. By considering councils as single actors, the average number of actors per case involved per phase change. In the pre-decentralization case, on average 2.3 actors per case were involved. In the first phase of decentralization, these were 2.7 actors per case, and in the second phase of decentralization, these were 3 actors per case. This exploratory descriptive analysis points to a preliminary confirmation of our expectation that the number of actors per case on average has indeed increased with the progression of decentralization, if we consider local councils as single actors.

We also expected that the proportion of local public leaders involved in corruption increases with the progression of decentralization. Our first observation is that in all 200 cases, various types of local public leaders were involved, including governors, mayors, regents, local council members, and senior civil servants (see Table 4). Once again, we first analyzed the average number of individual local actors involved. In the pre-decentralization phase, 31 out of 36 corruption actors identified in the cases are from the local level (see Table 4). In the first period of decentralization, 92 % of the corruption actors are local-level leaders or local-level staff, with local council members being involved in a total of 78 % of the cases in this phase. In the second phase of decentralization, this slightly decreased to 80 % of the total cases in which local actors are involved. The percentage of local council members interestingly, however, dropped in this phase to 33 %. This analysis does not confirm our expectation that more local actors will be involved throughout time. If we consider

Table 4 Corruption actors

Corruption actors	Pre-decentralization (Before 2001)		1st phase of decentralization (2001–2004)		2nd phase of decentralization (2005–2013)		Total	
	Individual actor	Group actor	Individual actor	Group actor	Individual actor	Group actor	Individual actor	Group actor
Local government								
Governor/deputy	2	2	19 (1 %)	19 (7 %)	5 (1 %)	5 (2 %)	26	26
Regent/mayor/ deputy	7	7	77 (5 %)	57 (22 %)	76 (13 %)	71 (25 %)	160	135
Senior Civil Servants and Supervisor	7	4	98 (7 %)	68 (26 %)	137 (24 %)	86 (30 %)	242	158
Administration staff	1	1	10 (1 %)	5 (2 %)	52 (9 %)	27 (10 %)	63	33
Local council	14	4	1087 (78 %)	49 (19 %)	188 (33 %)	22 (8 %)	1289	75
Central government								
Parliament member	0	0	0	0	13 (2 %)	5 (2 %)	13	5
Minister	0	0	10 (1 %)	10 (4 %)	0	0	10	10
Judge	0	0	0	0	18 (3 %)	6 (2 %)	18	6
Senior civil servant	1	1	11 (1 %)	11 (4 %)	3 (1 %)	3 (1 %)	15	15
Private sector								
Private company CEO, Director/ state- and regional-owned company director/ individuals	4	4	78 (6 %)	41 (16 %)	78 (14 %)	57 (20 %)	160	102
Total	36	23	1390	260	570	282	1996	565

local councils as one actor, this does not alter the overall picture. In the centralized regime, 14 out of 36 actors were from the local level. In the first phase of decentralization, local council members were involved in 78 % of the cases, whereas in the second phase of decentralization local council members were involved in 33 %, also indicating a decreasing involvement of local actors in corruption cases. Local councils were an actor in the collected corruption cases in 19 % of the case in the first decentralization phase; this reduced to 8 % in the second phase of decentralization.

We do see, however, that next to local councils, other types of local actors become more prominent corruption actors throughout the decentralization process. For example, the percentage of regents, mayors, and deputies increases from 5 % in the first phase to 13 % in the second phase, and a similar pattern can be observed with regard to civil servants (senior civil servants, supervisors, and administrative staff). In the first phase, they were identified as corruption actors in 8 % of the cases, whereas in the second phase this increased to almost 33 % (see Table 4). In the post-decentralization phase, subordinates in charge of local budgetary legislation and public procurement units were apparently often forced to become involved in corruption by their public leaders or higher level managers. From a total of 60 cases involving low-level officials and administration staffs, 33 cases involved those who are in charge of local budgetary legislation and public procurement units (e.g., subdivision chief in finance and regional plan units, project manager, and treasurer). In several cases, as reported during the court trial, the reason low-level officials engaged in corruption was not to gain money, but because of an order and pressure from higher level actors (7 cases).

A final interesting observation is that at the central level, while judges and parliament members were not identified as corruption actors in the sample of cases in the first phase of decentralization, they were identified as corruption actors in the second phase of decentralization. Ministers, on the contrary, were no longer identified as corruption actors in our sample of the second phase.

11.3 Type and Nature of Relations

With regard to the diversity and nature of relations in the identified corruption cases, we expect that in the centralized era, corruption networks were predominantly characterized by dyadic and multiplex relations that have an overlap in formal and informal relations, whereas throughout the decentralization process, also triadic and unidimensional relations would develop.

11.3.1 Dyadic and Triadic Relations

Among the ten cases identified in the centralized era, there were only two cases that involved three groups of actors, indicating that indeed most relationships were dyadic in nature (see Table 5). Based on the construction of each network

Table 5 Types of relations

Types of relations	Pre decentralization (Before 2001)	1st phase of decentralization (2001–2004)	2nd phase of decentralization (2005–2013)	Total
Dyadic relations, between				
a. Individuals	5	39 (41 %)	34 (36 %)	78
b. Group/organization	3	35 (36 %)	29 (31 %)	67
Triadic relations, among				
a. Individuals	0	4 (4 %)	15 (16 %)	19
b. Group/organization	2	14 (15 %)	11 (12 %)	27
Relations with more than three nodes (individuals and groups)	0	4 (4 %)	5 (5 %)	9
Total	10	96	94	200
Types of relation				
Formal relations work hierarchy	8	76 (45 %)	70 (42 %)	154
Informal relations				
a. Horizontal work relation	7	80 (47 %)	71 (43 %)	158
b. Kinship	0	3 (2 %)	13 (8 %)	16
c. Friendship	0	11 (6 %)	12 (7 %)	23
Total	15	170	166	351
Multiplex relations				
a. Work hierarchy–kinship ties	0	0	1	1
b. Work hierarchy–friendship ties	0	0	1	1
b. Work relation–kinship ties	0	3	8	11
c. Work relation–friendship ties	0	11	11	22
Total	0	14	21	35

of corruption in the pre-decentralization period, we identified that the basic relation between actors involved reflect the patron–client ties, either between head of region with the subordinate or between head of region with member of local council. This finding is confirmed in previous studies stating that during the centralized government in Indonesia, local public leaders relied on their informal networks to obtain local power and in turn used their position and access to resources to maintain their informal networks (Choi 2009).

However, contrary to our expectations, dyadic relations remain a prominent trait of the corruption networks in our sample, also during and after the decentralization process (see Table 5). In the first phase of decentralization, 77 % of all corruption cases in our sample are characterized by dyadic relations, whereas the remaining cases (23 %) pertain to triadic relations, or relations between four actors or more. In the second decentralization phase, 67 % of the cases is dyadic in nature, and 33 % is triadic in nature or involves more than three actors. Based on this, we could conclude that non-dyadic relations might be slowly becoming more prominent in Indonesia's corruption networks through time.

11.3.2 Formal and Informal Relations

We expected that both formal and informal relations are important in the occurrence of corrupt transactions in all phases, both centralized and decentralized. Table 5 shows that this is indeed the case. In general, we can observe a slow trend in which formal relations become a bit less prominent than informal relations: 45 % of the relation was formal versus 55 % being informal in the first phase, whereas in the second phase 42 % pertained to formal relations versus 58 % to informal relations. With regard to informal relations, especially work relations are often mentioned in our sample of corruption cases: 47 % of the cases in the first phase involved work relations, and in 43 % of the cases in the second phase, work relations were a trait of the network. It is striking that kinship and friendship relations are not often reported on in our data. This could be related to the type of data we collected. We return to this issue in the conclusion and discussion.

In the centralized regime, we expected to find a combination of formal and informal relationships to exist, especially due to the patronage system, but this cannot be observed from the ten cases we collected in this phase. Therefore, we refer to the previous studies, which revealed that during the pre-decentralization the overlap between formal and informal relations of actors involved were obvious. Top leaders chose subordinates based on the level of closeness in the kinship or friendship, where loyalty is strong (see: Liddle 1985; Renoe 2002; Robertson-Snape 1999).

11.3.3 Multiplex Relations

From the data, we identified that there were not many multiplex relations in the post-decentralization era (see Table 5). Most of the overlapping relations are between work relation and kinship or friendship relations between public officials and private actors. In the first phase of the decentralization, 14 out 96 cases were multiplex relations, with 11 of those cases related to work relation and friendship ties (11 %), and the rest of the cases were related to work relation and kinship ties. In the second phase of decentralization, there were 21 out of 94 cases (22 %) with multiplex relations. Among those cases, we discovered one case combining a formal relation (work hierarchy) with kinship ties and one case combining a formal relation with friendship ties. Furthermore, 11 cases combined a work relation with friendship ties and 8 cases had overlaps with a work relation and kinship ties between local public officials and private actors. Overall, we could conclude that the percentage of multiplex relations had increased from the first to the second phase of decentralization, contrary to what we expected.

12 Discussion and Conclusion

Many studies have already addressed the relationship between decentralization policies and corruption, also in Indonesia. However, these studies show mixed results. Using an exploratory analysis of a set of 200 corruption cases obtained from newspaper articles, we studied the characteristics of corruption networks in different institutional settings in Indonesia based on a social capital perspective. We explored to what extent the institutional changes in Indonesia from a centralized autocratic regime to a decentralized democratic regimes influenced the structure of corruption networks at the local level. To our knowledge, this is the first time that corruption networks in Indonesia have been studied in this manner.

Given that our analysis is based on a particular sample of corruption cases (i.e., those revealed and discussed in Indonesian newspapers), we do not claim that these findings represent all corruption cases in Indonesia, nor that we have presented a representative picture of corruption in Indonesia. Nonetheless, this sample allowed us to explore the variability of social–structural characteristics of corruption. However, as with any type of data used, our data have its limitations, because it is journalists who decide on which corruption cases to report and how to report on these cases. The lack of press freedom in the centralized authoritarian regime probably influenced the extent to which reporters could freely report about these cases, leading to less information quality of this sample of 10 cases, compared to the samples during the two phases of decentralization. Second, the role of the anti-corruption body (i.e., the Corruption Eradication Commission) established in 2003 during the post-decentralization to fight against corruption in Indonesia has contributed to the high number of cases made public and published in newspapers. Third, there is limited mentioning of kinship and friendship relations in our data, whereas other sources pinpoint at the importance of these types of relations in corruptive actions (Scott 1972). This potential underreporting could be a trait of the type of data we collected: It might be that in newspaper articles, these types of informal relations are not as much a focus compared to the relations in a work hierarchy.

Despite the limitations of our data, the evidence presented in this chapter suggests that corrupt transactions exist at the local level in both pre- and post-decentralization regimes in Indonesia, even though decentralization is seen as a promising strategy to control corruption. This finding is in agreement with previous studies on local government corruption in Indonesia (see Rinaldi et al. 2007). Compared to the pre-decentralization years, this chapter also shows that the decentralization policies have to some extent changed the nature of corruption networks at the local level, particularly in terms of the types of corruption, the actors, and the types of relations. First, whereas embezzlement remains the most prominent type of corruption in all three phases studied, we do see an increase in the bribery cases reported but a decrease in the number of bid rigging and favoritism cases published. Second, although it has been argued that the scale of corruption may be smaller after decentralization (in terms of resources, actors' position, and size of the case) compared to the grand corruption cases during the Soeharto era (Renoe 2002; Blunt et al. 2012), we conclude that in total more local actors are involved per corruption case. Third, while local councilors were prominent corruption actors in the first phase of decentralization, their role seems to have substantially decreased in the second decentralization phase. We argue that this phenomenon relates to the power position of local councils as regulated by Law No. 22/1999. According to the law, local councils have extensive functions, namely a legislative function, a representative function, and a control function over local executive bodies. With members of local council having extensive powers and functions, opportunities for political corruption were aggravated in the first decentralization phase. However, in the second phase of decentralization, the relations between local council and head of region are more restricted to work relations. Under Law No. 32/2004, the local council's function is more characterized as check and balance mechanisms. We argue that because of these factors corruption implicating members of local council decreased after the decentralized democratic regime, as we see in the second phase. Fourth, we also see the increased prominence of civil servants' involvement in corruption at the local level. This result is in line with previous studies that stated that after the decentralization policies in Indonesia, corruption also escalated among lower level officials (Rinaldi et al. 2007; Kristiansen et al. 2008).

However, not all has changed. First, the overall participation of local actors in corruption does not seem to have changed significantly. This leads us to conclude that the decentralization policy also seems to create privileges and benefits to local leaders to establish extensive informal networks with various different actors from central and local governments as well as with private actors. This argument is consistent with Buehler's finding (2007), which demonstrates that strong personal networks of local politicians after the decentralization in Indonesia are even more beneficial in securing personal interest. A second aspect that changed minimally is related to the dyadic relationships in corruption networks. Patron–client networks, which we argued to be the main characteristic in centralized autocratic regimes, remain to exist even after the decentralization process was initiated in Indonesia. This is in line with Robinson and Hadiz's argument in Liddle (2013) that even after the authoritarian regime was replaced with decentralized democratic institutions, Indonesia is still a system in which a few powerful elites shape and control public policy. However, we must note that we do observe a slow trend in which other types of relations (with three or more actors involved) gain prominence in our data. Finally, the application of a social capital perspective shows that informal relations play an important role in the emergence of public leaders' corruption in all three phases studied. As argued by Rose-Ackerman (2001), together with formal regulation, informal relations may represent the key elements for fighting corruption.

In closing, we suggest that decentralization should not be viewed as the only solution for governance challenges in terms of controlling corruption. Democracy at the local level can have a positive impact on reducing corruption in the long run (Lambsdorff 2006). However, without government transparency and comprehensive reforms, which include conducting fair and transparent local elections, enhancing professionalism, integrity, and commitment of bureaucracy to fight against corruption, improving the credibility of the anti-corruption agencies, strengthening justice system in the prosecution of corruption cases, and allowing greater level of control by the public on corruption issues, it will very difficult to control the occurrence of corruption, also in decentralized democratic regimes.

We hope that this study will complement previous research and at the same time provide some useful points for further research. As mentioned above, the findings of this study are related to several previous works on decentralization and corruption. However, the exploratory approach of this study would be more convincing if it was supported by empirical hypothesis testing. Therefore, in order to overcome the limitations and bias of our present study, in future research we will systematically analyze the social network of corruption by means of statistical methods and relational algebra and apply it to our sample of newspaper reports on corruption in Indonesia's decentralized democratic system.

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Chapter 10
Corporate Governance and Corruption: A Comparative Study of Southeast Asia

Nureni Wijayati, Niels Hermes and Ronald Holzhacker

Abstract The weak corporate governance framework in Indonesia, as in other countries in Southeast Asia, was deemed a crucial factor in deepening the financial and economic crisis in the late 1990s. Over a decade after the 1997 Asian financial crisis, Indonesia and other Southeast Asian countries have made substantial governance reforms. The reform measures of the institutional framework, both in the public and corporate sectors, were intended to transform Indonesia into a clean, transparent, and accountable country. While the reforms have resulted in increased political stability, improved government effectiveness, and a more conducive investment climate, corruption remains a major concern in Indonesia. This study aims to evaluate how corporate governance mechanisms can reduce the opportunities for corruption. By utilizing agency theory, we argue that a strong corporate governance institutional framework helps to reduce a country's level of corruption. We focus attention on three components of corporate governance mechanisms, i.e., shareholder rights, the quality of the board of directors (BoD), and appropriate accounting and auditing standards, including transparency standards. In an attempt to strengthen corporate governance standards and practices in Indonesia, we conducted a comparative study among Southeast Asian middle-income countries, i.e., Indonesia, Malaysia, and Thailand. We rely on accessible secondary data such as corporate governance codes, laws, and regulations. Our study concludes that the Indonesian corporate governance institutional framework is less stringent compared to Malaysia and Thailand.

The first author is the original researcher and serves as the author for correspondence, the remaining authors are promoters and supervisors listed in alphabetical order who also have contributed to this chapter.

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This condition provides a favorable environment for corruption to persist because the standards and practices are less demanding and the companies do not necessarily have to comply with the existing regulatory framework.

Keywords Corporate governance · Corruption · Institutional framework · Southeast Asia · Indonesia

1 Introduction

1.1 Background

After being hit hard by the 1997 Asian financial crisis, Indonesia embarked on a series of governmental reforms and began to revise standards for corporate governance. Weak governance practices have had a significant detrimental effect on Indonesia's economy and society. Many scholars have in particular stressed that sound corporate governance is important in protecting a country's vulnerability to financial crisis (Mitton 2002; Johnson et al. 2000; Baek et al. 2004; Kirkpatrick 2009). The reform initiatives have resulted in increased political stability, improved government effectiveness, a more conducive investment climate, and improved corporate governance. Substantial efforts, not only in the public sector but also in the corporate sector, have been designed to transform Indonesia into a clean, transparent, and accountable country.[1] In the private sector, there was an effort to promote good governance practices by establishing a new institution, the National Committee on Corporate Governance (NCCG).[2] Over the decade following the 1997 crisis, corporate governance practices in Indonesia have improved through a better legal framework particularly in the area of financial and capital markets. However, although Indonesia has enhanced its corporate governance practices and has attempted to combat corruption practices,[3] this has not a significant impact on reducing the level of corruption.

[1]Several laws have been introduced to tackle corruption such as Law No. 31 of 1999 on Eradicating Criminal Acts of Corruption as amended by Law No. 20 of 2001, Law No. 28 of 1999 on State Officials who are Clean and Free of Corruption, Collusion, and Nepotism, and Law No. 15 of 2002 on Criminal Acts of Money Laundering.

[2]NCCG was established under a Ministerial Decree from the Coordinating Minister for the Economy, Finance and Industry No. KEP-31/M.EKUIN/06/2000. Then, in 2004 the NCCG was transformed into the National Committee on Governance (or KNKG), composed of the Public Governance Sub-Committee and the Corporate Governance Sub-Committee under a Ministerial Decree No. KEP-49/M.EKON/11/2004.

[3]In an attempt to enhance the enforcement of law process, at the end of 2003 the government established the Indonesian Corruption Eradication Commission (or "KPK"), an independent body which has special authorities to prevent, combat, and prosecute acts of corruption. The KPK has made significant performance since its establishment. Between 2004 and 2012, the KPK handled 283 corruption cases involving a total of 337 politicians, government officials, local leaders, and private sector executives (KPK 2012 Annual Report).

Table 1 Corruption rank in Southeast Asian countries, 2002–2012

Country	2002	2004	2006	2008	2010	2012
Singapore	98.5	98.5	97.6	98.1	98.6	97.1
Brunei	65.4	69.8	63.4	72.8	79.5	72.2
Malaysia	62.4	70.2	64.9	59.2	62.9	65.6
Thailand	47.8	51.7	44.4	42.2	48.1	46.9
Vietnam	34.6	24.4	24.9	25.7	31.4	35.4
Philippines	39.0	30.2	22.0	25.2	22.4	33.5
Indonesia	**8.3**	**17.1**	**21.5**	**34.0**	**25.2**	**28.7**
Cambodia	15.1	14.1	8.3	6.8	6.7	14.4

Source The Worldwide Governance Indicator—The World Bank (2013)
The score ranges from 0 (lowest rank) to 100 (highest rank)
Note Indonesia has made progress in the World Bank's good governance indicators for corruption, gaining rather steadily in the past decade from 8 % to almost 29 % in the worldwide rankings, but this remains well below the median for all countries. This ranking is also well below the position of other middle-income peers in the region, for example, Malaysia at almost 66 % and Thailand at almost 47 % are ranked considerably higher in the control of corruption

Compared to its neighboring countries, Indonesia has indeed a chronic problem with corruption. Table 1 shows the comparison of corruption perception ranks among the Southeast Asian countries. The figures provided by the Worldwide Governance Indicators reveal that Indonesia has experienced a positive trend in controlling corruption. It implies that the level of corruption has decreased over time. However, if we compare Indonesia with other countries in Southeast Asia, Indonesia's ranking remains much lower than the others. It ranks second lowest in the region. One important ingredient of corruption is bribery, which always involves payers and receivers. This paper focuses on the bribe payers, in particular firms or corporations as a basis for our analysis. Referring to agency theory, we argue that bribery is part of opportunistic behavior by individuals and corporations, which can be reduced by implementing sound corporate governance.

Corporate governance consists of a series of control mechanisms that govern the relationships among various stakeholders including the shareholders, board of directors (BoD), management, employees, suppliers and community. We assess the quality of corporate governance by focusing on each country's institutional framework. This is motivated by the argument that institutions play a crucial role in determining how economic resources are efficiently allocated. Countries with sound rules of law including property rights protection tend to be wealthier and generate better economic performance (Acemoglu et al. 2005). More specifically in terms of corporations, variation in a country's legal framework and investor protection has many consequences. For example, the quality of investor protection can affect stock market size, ownership concentration, corporate governance, and firm performance (La Porta et al. 1998; Djankov et al. 2008; Doidge et al. 2007). In addition, the role of institutional mechanisms is more substantial, particularly in the phase of a decentralized economy when regional development needs more local entrepreneurs to be involved. Therefore, improved corporate governance frameworks are required to provide a clearer guidance in managing business based on integrity and professionalism. This paper examines the country's corporate governance institutional framework that may influence the level of corruption. We focus on how laws and regulations stipulate shareholder rights, the BoD, accounting and auditing, and transparency. The analysis in this paper is based on the content of the latest version of corporate governance codes, laws, and regulations in the three countries, i.e., Indonesia, Malaysia, and Thailand.[4]

The study of corporate governance and corruption is highly relevant in the context of middle-income countries, and especially for Indonesia, for at least three reasons. First, before the 1997 crisis, Indonesia had long employed a centralized government model and relied heavily on the executive power (Brodjonegoro 2009). In 1999, there was a dramatic change in the political system, when the government introduced a decentralization law. It has turned Indonesia into a more democratic regime, by granting more authority and autonomy to local governments. Deregulation became a priority to stimulate competition that is hoped will lead to faster economic development (Weingast 1995). However, decentralization itself does not necessarily improve the quantity of investment if there is a perceived lack of governance (Kessing et al. 2007). Furthermore, an open market economy implies that the supply of corporate finance comes not only from domestic investors, but also from overseas investors. It is important to stress that many foreign investors demand high standards of disclosure and transparency from the firms in which they invest. Thus, the existence of sound corporate governance in the decentralization era is essential to attract (foreign) investors.

Second, the decentralization process involves power sharing between central and local governments, including the creation of market arrangements (Weingast 1995). This means that economic activities are no longer limited to specific economic centers, but these activities are diffused more across different regions. As markets develop, the power of a state in controlling economic resources will decline, which may create more business opportunities and new entrepreneurs (Cao and Nee 2000). The larger role of the private sectors may contribute to enhancing societal welfare. To ensure that all economic actors can fairly access economic resources, specific institutional arrangements are required. In particular, there must be institutional mechanisms to promote accountability, regulate economic activities, and impose rules for the benefit of public interests. Firms may deliver benefits for society through value creation, not only for shareholders, but also for other stakeholders. This sustainability can be achieved, among other factors, by implementing good corporate governance. A great deal of research has documented that there is a positive link between good corporate governance and corporate sustainability[5] (see, e.g., Aras and Crowther 2008; Jamali et al. 2008).

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[4]In this paper, we do not consider the enforcement of law. It might be possible that strong regulations do not necessarily imply a good implementation in practice.

[5]Corporate sustainability is a concept which integrates the role of corporations not only in terms of corporate economic activities but also in the environmental and societal goals (van Marrewijk 2003; Berger et al. 2007). In other words, corporations have a responsibility to create financial profits for the shareholders on the one hand, and on the other hand, they contribute to the well-being of stakeholders, including society and the environment. It is also known as the triple-bottom-line notion (Hubbard 2009; Painter-Morland 2006).

Third, good corporate governance can stimulate economic growth because it provides a control mechanism to ensure that economic resources are efficiently allocated. Firms may enhance their governance by appointing competent and independent directors, controlling management misconduct, and applying a high standard of financial reporting. In addition, companies are encouraged to generate timely, accurate, and transparent information. Reliable information is essential for investors in allocating their funds to the most productive use. More disclosure leads to increased investor confidence and therefore results in a greater opportunity for firms to further expand. Thus, it may boost economic development (Morck et al. 2005; Tiwari 2010). Recent studies also suggest that transparency is an important ingredient to restrict corruption (Lindstedt and Naurin 2010; Peisakhin and Pinto 2010). It facilitates shareholders and the public to access company information, making it easier to detect corrupt behavior by the company. A higher degree of transparency may reduce corruption and make markets more efficient, which facilitates growth in the economy.

1.2 Research Questions

As the nature of corrupt transactions is secretive, parties who are involved tend to hide these illicit transactions. It leads companies to be relatively opaque, with low levels of transparency and disclosure. Corporate governance provides instruments to discipline such behavior, but how the corporate governance framework can reduce the level of corruption is still unclear. To address the issue, this paper focuses on two questions: first "How can an improved institutional framework for corporate governance decrease the level of corruption?", and second "How does the corporate governance institutional framework of Indonesia compare to that of Malaysia and Thailand?" Three aspects of corporate governance are examined, namely two internal control mechanisms (shareholder rights and BOD), and one external control mechanism (accounting and auditing standards). We also discuss the importance of transparency and disclosure as a key factor in mitigating corruption.

1.3 Scientific and Social Significance

Previous research on corruption has mainly focused on analyzing its causes (Glaeser and Shleifer 2002; Bohara et al. 2004; La Porta et al. 1999; Treisman 2000; Schulze and Frank 2003) and the negative effects of corruption, including lowering investment (Gyimah-Brempong 2002; Wei 2000) and impeding economic growth (Drury et al. 2006). However, little attention has been given to research on the relationship between corporate governance and corruption. Wu (2005) asserts that the quality of corporate governance has a significant impact on lowering the country's level of corruption. To measure the quality of corporate governance, Wu (2005) only employs the role of the BoD and the quality of accounting standards. This study complements the previous literature by adding other variables which we consider as key elements of corporate governance, i.e., shareholder rights and transparency.

In addition, this study aims to compare the Indonesian corporate governance code,[6] laws, rules, and regulations with those of Malaysia and Thailand. Our study may contribute to strengthen the Indonesian corporate governance regulatory framework through policy recommendations that enhance transparency. The public trust can be encouraged through higher standards of integrity and transparency in the private sector. More importantly, the improvement of corporate governance practices may attract investors, enhance productivity, and contribute to sustainable economic development. This, in turn, will contribute to increasing Indonesia's income per capita.

1.4 Methodology

In order to better understand how corporate governance practices in Indonesia can be improved, we conducted a comparative study with two additional Southeast Asian middle-income countries, Malaysia and Thailand. We examined each country's institutional framework, which consists of its corporate governance code, company law, rules and regulations, and related institutions that support corporate governance practices.[7] Malaysia and Thailand were chosen to be relevant counterparts for three reasons. Firstly, they both suffered with Indonesia from the aftermath of the 1997 Southeast Asian crisis. Besides macroeconomic factors, which are considered to be leading causes of the crisis (Corsetti et al. 1998; Kumar and Debroy 1999), weak governance practice is also acknowledged as a main factor that deepened and prolonged the crisis in all three countries (Lee 1999; Johnson et al. 2000, Haggard 2002). Since then, emerging Southeast Asian countries have taken measures with regard to the improvement of corporate governance. Recently, Malaysia and Thailand have shown their commitment to maintain a higher standard of corporate governance institutional framework, making them regional leaders in this respect (ROSC 2012b, c).

Secondly, in the last decade, Indonesia, Malaysia, and Thailand have been regarded as the top three Gross domestic product (GDP) contributors among

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[6]Corporate governance code generally consists of principles and standards which are voluntary with regard to its implementation; it defines the structure and mechanism how corporations are governed. According to the Financial Reporting Council (2012), the code is not a rigid set of rules, and corporations are not necessarily strictly bound by the code. Thus, it is contrary to laws and regulations which impose mandatory rules including enforcement.

[7]The legal framework here refers to those issued until December 31, 2013.

ASEAN member states, leading them to be promising investment destinations. In 2010, their combined GDP represented approximately 68 % of total ASEAN GDP (ACIF 2011), classifying them as middle-income economies.[8] Although Indonesia, Malaysia, and Thailand have similar economic system, their legal system is different. Unlike the Indonesian system, which relies predominantly on civil law, Malaysia as a former British colony adopted the common law system. Thailand mainly applies a civil legal system, combined with some common law elements (Kanchanapoomi 2005). These unique characteristics of legal systems may be helpful in explaining why there are differences between these countries in corporate governance frameworks and in the performance of companies in meeting these standards.

The paper is organized as follows. Section 2 reviews the previous literature on corporate governance and bribery, and a theoretical framework linking the two. Section 3 provides an overview of the business landscape in Southeast Asian countries and their current corporate governance performance. Section 4 presents a comparative analysis of the corporate governance institutional framework of the three countries. Finally, Sect. 5 concludes our study.

2 Literature Review

2.1 Corporate Governance

Corporate governance is characterized by the structure and process of how a corporation is directed and controlled. It governs the relationships between the shareholders, BoD, management, and other stakeholders to ensure that a corporation achieves its objectives. More importantly, corporate governance is characterized by a system that provides a mechanism of control among these various bodies and participants. However, corporate governance does not stand alone; it is part of the political and economic system where laws, rules, and regulations apply. The Organisation for Economic Co-operation and Development (OECD) declares in its corporate governance framework that the "corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities" (OECD Principle I 2004).

Corporate disciplinary mechanisms have become a central issue for discussions among scholars as these mechanisms may mitigate the divergence of interests

[8]The World Bank classifies the low-/middle-/high-income economies based on their Gross National Income (GNI) per capita. For the year 2013, low-income economies are defined as countries with GNI per capita ≤US$1045; middle-income economies between US$1046 and US$12,745; and high-income economies ≥US$12,746 (http://data.worldbank.org/about/country-classifications/a-short-history).

between shareholders and managers. Research on corporate governance has extensively utilized traditional agency theory since Jensen and Meckling (1976) constructed a fundamental argument of the separation of ownership and control. Managers (agents) who run a day-to-day business operation have relatively better information than shareholders (principals). This asymmetric information enables the managers to engage in unfavorable behavior, which may hurt shareholder value. Their opportunistic behavior is intended to obtain personal benefit at the expense of the shareholders, such as receiving higher bonuses and compensation (Bebchuk and Fried 2003). The managers may conceal relevant information in order to mask their actions, which may include fraud and financial manipulation (Albrecht et al. 2004). The principal-agent conflict model is prevalent among the Anglo-American companies in which ownership structure is widely dispersed. However, when the pattern of shareholdings is concentrated, agency problems turn into conflicts between controlling shareholders and minority shareholders or principal–principal conflicts (Young et al. 2008). In this case, management tends to act in the best interest of the controlling shareholders which can potentially expropriate the minority investors (Claessens et al. 2002; Lemmon and Lins 2003).

Nevertheless, whatever the type of the agency conflict, the essence lies in how to minimize these conflicts. Any incongruent interests between shareholders and managers or between majority and minority shareholders may be aligned through a monitoring system. Stemming from this concept, corporate governance mechanisms aim at ensuring that managers (inside shareholders) will behave in the best interest of all shareholders. The literature on corporate governance suggests that there are two sets of mechanisms that play a substantial role in governing corporations (Weir et al. 2002; Daily et al. 2003). We utilize a framework from the World Bank as presented in Fig. 1. The first set of governance mechanisms consists of internal control mechanisms, which mainly focus on the internal governance of a company. It arranges the distribution of authority within a corporation, among the shareholders, BoD, and management. The description of shareholder rights, the roles, and responsibilities of boards of directors and management should be clearly addressed. All shareholders should be treated equally and their rights should be well protected. On behalf of the shareholders, the BoD serves as corporate supervisors and monitors. The effectiveness of the BoD in serving their duties is essential to ensure that the company maximizes value for all stakeholders.

The second set of control mechanisms of corporate governance consists of external mechanisms. Business is embedded in society which has a specific culture, legal framework, and political and economic system. Globalization and competitive markets have forced domestic companies to be more concerned about their governance. A more open economy is likely to lead to a higher level of competition, and lower barriers to entry, which encourage companies to be more professional in managing their business. In addition, an open economy attracts foreign investors to bring in capital and the presence of foreign shareholders in domestic companies can change governance standard of domestic companies. Foreign shareholders require a higher level of corporate governance standard to ensure their interests are taken care of within the corporate structure.

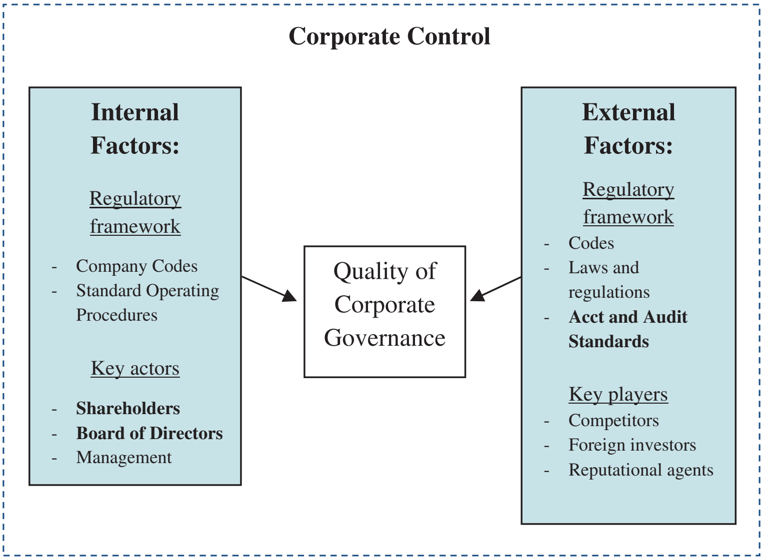

Fig. 1 A theoretical framework. *Source* Adapted from Corporate Governance: a framework for implementation (The World Bank Group 2000)

The country's legal origin also influences the institutional framework of corporate governance. Countries may adopt a common law or civil law system. Previous research has documented that countries with common law provide a better legal system in terms of investor protection and law enforcement (La Porta et al. 2000). It is difficult or even impossible for countries to amend their legal origins as it is considered too costly. However, new laws can be mandated without changing the legal origins of a country. For the purpose of improving corporate governance standards, rules and regulations that induce accountability and transparency may be introduced. For instance, the mandatory requirement to disclose the profile of the BoD in the annual report will enable shareholders and the public to obtain better information regarding the capabilities of the BoD.

Besides the rules and regulations, another tool to monitor firms is accounting and auditing standards. The quality of accounting standards is related positively to the level of corporate governance, since strong accounting standards enforce companies to disclose information in manners that generate transparent, accurate, and comparable financial information. Here, the role of regulatory agencies is essential to provide regulatory frameworks that protect the public interest. It is believed that strong regulatory frameworks can stimulate markets through the functions of regulating, stabilizing, and enforcing contracts.

There are also other elements that potentially improve the corporate governance practices. They usually represent a pressure group of stakeholders such as employees, customers, nongovernmental organizations, and professional organizations. Most of these stakeholders are independent groups which may be vocal since they represent the public interest instead of their own interest. For example, a nongovernmental organization with a focus on environmental issues can challenge the company if there is misconduct in managing industrial waste. A credit rating agency as a reputable agent will demonstrate its expertise to assess the company risks. A company that has a higher quality of governance will be awarded a better rating than a company that is deemed more risky. The reliable rating then can help the public and investors to make a better investment decision. Even though this paper does not take into account these factors to be part of the analysis, the role of these external stakeholders as company watchdogs is considered to be growing in practice.

All instruments discussed above determine the quality of corporate governance. The quality of corporate governance can be enhanced if all components in the corporate control mechanism work effectively. In other words, shareholders should be more active to ensure that the BoD and management do their duties properly; the BoD should strengthen their monitoring role without neglecting their advisory roles. Policy makers should enact adequate regulations that promote a better investor protection and an efficient market. To be an efficient market, companies are required to share their information to the public. In this sense, transparency is a key point that enables investors and the public (outsiders) to assess the company's performance. The public's interest is better protected when corporate transparency is improved. When the private sector has a strong commitment to properly managing business activities through sound corporate governance, it can improve efficiency and productivity. Furthermore, it leads to promoting national economic development by generating a higher income per capita, ultimately creating a prosperous society.

2.2 Agency Problem and Bribery

Corruption is a big concern in Southeast Asia. While Singapore and Malaysia are perceived to be relatively "clean" countries, other emerging countries such as Indonesia, Vietnam, the Philippines, and Thailand have been struggling to combat corruption. Two key elements of corruption are bribery and fraud. Generally, bribery is a corrupt act which involves payers and receivers. Rose-Ackerman (1999) specifically defines that bribery is a payment, in money or in kind that imposes a reciprocal obligation between the two parties involved. The major areas in which companies could bribe are when they are dealing with licensing, procurement processes, and institutions where they have insiders' information. In contrast, fraud and embezzlement are corrupt acts that involve company's insiders such as management and employees. Nevertheless, no matter the type of corruption, its presence reflects how well the company governs its business.

It has long been documented that agency conflicts arise due to information asymmetry and moral hazard. Managers (insiders) have better access to company information than shareholders (outsiders). A large body of literature has shown that management, in pursuing their own personal interests, tends to hide relevant information to shareholders (Arnold and de Lange 2004). For example, management can inflate the reported earnings in order to obtain a greater bonus (Healy 1985; Balsam 1998; Shuto 2007). It seems to be favorable for the shareholders when the firm's income is increasing. However, what the management is displaying is a distorted financial statement that incorporates manipulative actions. A similar analogy can also be applied with respect to bribery.

In order to win a procurement contract and/or receive a lucrative license, management and insiders may be tempted to pay bribes as a shortcut of doing business. The asymmetric information problem makes it challenging for outside shareholders to access the true information. As the nature of bribery is secretive, managers can conceal such transactions by deceiving the (outside) shareholders. A recent bribery case involving the company Sentul City provides a good case in point. Sentul City is an Indonesian publicly listed firm, engaged in real estate development. In relation to obtaining a land conversion permit to be utilized for a luxury housing project (nearly 3000 ha), one of its subsidiaries is accused of giving a bribe to the local regent (The Jakarta Post, June 2014). The case allegedly involves the CEO and is currently under the investigation by the Corruption Eradication Commission.

In the short run, both managers and shareholders of a corporation may gain benefits from bribery. Since the company sales are boosting, the managers will be awarded with higher compensation. However, this may not hold for over the long term. Wu (2005) contends that bribery bears some hidden costs, which can potentially turn into future risks such as legal suits, fines, and impairment to reputation. Bribery allows managers to exploit the company resources for their own personal benefits at the expense of the outside shareholders. Furthermore, bribery may harm firm performance because it impedes sales growth (Kochanova 2012; Seker and Yang 2012) and reduces productivity (De Rosa et al. 2010). Moreover, bribery at the country level will cause economic inefficiency and distort economic growth (Drury et al. 2006; Meon and Sekkat 2005). In this context, bribery not only expropriates the shareholders' rights, but may also hurt the public interest.

2.3 Corporate Governance and Bribery

Good governance is about principles of integrity, accountability, and responsibility. As discussed, corporate governance provides mechanisms of checks and balances which may assist companies in not becoming involved in illegal behaviors, including bribery. How the corporate governance framework can reduce, though not eliminate, the level of corruption will be addressed in this section. Specifically, we focus on four elements of corporate governance that can potentially reduce the opportunities for corruption, namely shareholders rights, BoD, accounting and auditing standards, and transparency.

2.4 Shareholder Rights

Unlike the typical agency problem between principal and agent (Jensen and Meckling 1976) in Anglo-American countries, the conflict in Asian firms is best described as majority versus minority shareholders (Shleifer and Vishny 1997) or principal–principal conflicts (Jiang and Peng 2011; Young et al. 2008). The majority shareholders in most cases are family owners who exercise their control through pyramidal structure and cross-holdings. Using their control rights, inside shareholders may more easily utilize firm resources for bribery activities. To mask those illegal activities, the inside shareholders may then redistribute the costs and benefits of the bribery to other companies in the same group (Wu 2005). Such behavior is mostly not known by the outside shareholders, since they do not have access to all the relevant information. Even if they do know about the bribery, they do not have enough control rights to challenge these practices. The minority shareholders will always be the losers when shareholder voting takes place. Their opportunity to participate in key decision-making process is limited. For instance, in the case of the appointment of directors, the minority and outside shareholders are rarely involved in the process, because the controlling shareholders can appoint persons to sit on the board based on their own interests. Consequently, when the participation of outside shareholders is weak, their role in corporate monitoring will be limited. In case of inadequate regulations, the shareholder rights to actively participate and monitor the management and inside shareholders are restricted. The incidence of bribery is greatest when the regulations do not facilitate the active participation of shareholders. Therefore, improved shareholder activism can create a better accountability system to prevent bribery. In other words, a country's corporate governance institutional framework concerning the shareholder rights is crucial in determining the level of bribery. Thus, we suggest that when shareholder rights are better protected, the level of corruption tends to be lower.

2.5 Board of Directors

The BoD of a corporation have a mandate from the shareholders to direct, supervise, and monitor the management, as well as assure that all corporate activities comply with legal requirements. They should ensure that the interests between shareholders and management and also the interests between majority and minority shareholders are aligned. Many studies have addressed how corporate control through boards can be exercised more effectively. For example, the presence of independent or outside directors is essential in providing objective opinions to ensure that the decisions made are in the best interest of all shareholders (Anderson and Reeb 2004). Furthermore, in order to attract competent persons, the selection process and remuneration package of the BoD should be clearly formulated. Previous empirical research has found that firms which commit fraud tend to have a lower percentage of outside directors, a fewer number of audit committee meetings, and a higher percentage of dual-role CEOs (Farber 2005; Uzun et al. 2004; Sharma 2004). In brief, a strong BoD structure should enable the detection of any opportunistic behavior by the management and inside shareholders, including bribery.

While management or inside shareholders may obtain instant benefit from bribery (with regard to securing the orders or boost the sales), such opportunistic behavior may lead to potential risks which are incongruent with the shareholders' interests such as lowering the firm's growth (Seker and Young 2012; Kochanova 2012; Svenson and Fisman 2007), and impairing firm reputation (Serafeim 2013; Karpoff et al. 2013). The existence of corporate governance frameworks that clearly formulate, regulate, and enforce the board function is fundamental in determining the quality of the boards. Thus, strengthening the competency, roles, and responsibilities of the BoD will lower the incidence of bribery because it provides a reliable control mechanism in preventing and detecting bribery. It implies that the boards of directors should prioritize a commitment to conducting effective oversight in such way that it may lead not only to short-term performance but also long-term performance. Based on the above discussion, we suggest that the quality of the BoD has a positive impact on reducing the level of corruption.

2.6 Accounting and Auditing Practices

Accounting and auditing standards are well recognized as a means to account for company's activities. These standards and regulations are regarded as external devices to discipline firms. On the one hand, accounting standards give guidance for companies on how to report their economic transactions in figures. On the other hand, auditing provides assurance that company's financial reporting has complied with the accounting standards. Previous research has documented that the quality of accounting information is negatively related to the country level of corruption (Kimbro 2002; Picur 2004; Riahi-Belkaoui and AlNajjar 2006). When clear accounting standards exist, organizations are required to disclose information in ways that generate transparent, accurate, and comparable financial information. Malagueno (2010) argues that higher accounting and auditing standards impose management to be more transparent with respect to the use of the organization's assets, making corrupt practices difficult to undertake and conceal. However, the interesting issue is not the existence of those standards per se, but to what extent the external disciplinary mechanisms are exercised.

The appointment of independent auditors, including their fees, and the requirement of audit quality assessment are examples of how the practice of auditing can improve the quality of corporate governance. A higher standard of accounting and auditing is needed to generate qualified financial statements, which encourage investor confidence and public trust. Therefore, the adoption of qualified accounting and auditing standards supplies a complementary means in the process of combating corruption. It is suggested that when the quality of the accounting and auditing practices is high, the level of corruption tends to be low (Kimbro 2002). A lower level of corruption may lead to enhance efficiency and economic growth, because more resources can be directed to support productive activities instead of paying bribes.

2.7 Transparency

According to the OECD, disclosure and transparency is one of the corporate governance principles. It states that “corporate governance framework should ensure timely and accurate disclosure on all material matters, including financial situation, performance, ownership and governance of the company” (OECD Principle IV 2004). Transparency refers to the openness of information, its truthfulness, and no concealment of relevant information. It means that transparency does not only relate to the availability of the truthful information but also the publicity of all material information in such a way that the public can access the information. A simple example of this is board remuneration. The salaries and bonus packages of a board should be properly documented and available not only in a company’s files, but should also to the public. Information that is not disclosed either in the annual report or in the company’s Web site is not useful from a corporate governance perspective since it cannot be easily accessed by the investors and the public. Generally speaking, good corporate governance mechanisms are a necessary condition, but it is not sufficient for protecting the public interest. It should be accompanied by transparency.

Transparency is critical from the perspective of agency theory. Scholars have confirmed that transparency mitigates asymmetric information which leads to lower conflict of interests (Brennan and Solomon 2008; Frankel and Li 2004). The basic premise of transparency is that more disclosure of material information reduces the probability of a company to misbehave. This concept can be simply applied in the context of reducing bribery or corruption. A strong disclosure requirement enables shareholders and the public to better monitor and scrutinize company behaviors including potential illegal actions. Disclosures of executive remuneration package, the selection process of the BoD, any conflict of interests, etc., reduce the opportunity for corruption. Transparency can be improved if there is a strong regulatory framework for firms to publish any information that not only influences economic decisions, but also protects the public interest. Hence, the level of corruption can be reduced if there are strong disclosure requirements. A higher level of transparency and disclosure provides a mechanism to create an accountable business environment that ensures public trust. It may lead to increased economic growth because investors and society at large are confident that companies run their business with integrity and accountability.

Before continuing this analysis and discussion, Sect. 3 below will describe the general business landscape in Southeast Asia, followed by current developments on corporate governance in Indonesia, Malaysia, and Thailand.

3 Institutional Setting

Business in Southeast Asia is heavily based on a relation-based model. Unlike a market-based system, which substantially relies on arm's-length transactions, the relation-based system is more informal and unobservable (Li 2003) and is based on personal relations between business representatives. Furthermore, Li (2003) explains that parties who are involved in a relation-based transaction tend to have a longer commitment. This long commitment is intended to ease coordination and reduce transaction costs. Internal control mechanisms among inside players to monitor their commitment are more prominent than external ones. Consequently, conglomerates or business groups are regarded as an efficient strategy to control economic activities, to enforce agreements outside the court system, and to maintain long-term relations among insiders. Recent data of 2008 reveals that more than 46 % of top publicly traded firms in East Asia are family-dominated (Carney and Child 2013). According to this study, the Philippines hold the largest portion of family ownership, followed by Hong Kong and Singapore. Indonesia and Malaysia exhibit more or less the same share of family firms (see Table 2).

Another characteristic of the Asian business is the close ties between the government and corporate sectors. It is rational for companies to build a relationship with government officials, as resources are mostly under government control. The government has the authority to issue licenses and permits, and it is manifested by several government policies directed to support certain business groups based on the political favoritism. For instance, Johnson and Mitton (2003) found for Malaysia that politically connected firms obtain preferential access to loans from state-owned banks. Also in Indonesia, the government has often awarded business licenses and preferential treatment to crony companies, such as the Salim Group and the Barito Group (Luez and Oberholzer-Gee 2006).

The corporate governance problem becomes more serious, when government officials or politicians become involved in business. The power and authority they possess might be misused for their own interests, either for their political career or for their own business. For example, former Thai Prime Minister Thaksin Shinawatra was a billionaire who owned the largest telecommunications company in Thailand, Shin Corp. In 2011, the Supreme Court of Thailand seized his assets of USD1.4 billion that were accrued through corruption and conflict of interest during his administration (BBC News 2011).

Over a decade following the 1997 crisis, Malaysia, Indonesia, and Thailand have been working on improving corporate governance practices. They have made significant progress in strengthening the legal framework. In 2000, Malaysia amended its Company Act 1965, while in 2007 Indonesia introduced a new Company Law,

Table 2 The percentage of family-controlled firms in 2008

Country	No. of firms	% of family ownership[a]
Hong Kong	158	60.6
Indonesia	132	57.3
Japan	136	9.6
Korea	159	54.5
Malaysia	154	51.5
Philippines	114	78.5
Singapore	131	60.2
Taiwan	163	13.8
Thailand	149	37.8
East Asia nine	1296	46.1

Source Carney and Child (2013, p. 505)
Note Carney and Child (2013) investigated the changes of ownership concentration among East Asia's largest companies in 1996 and 2008. They found that compared to 1996, the number of family-concentrated firms have declined in 2008 particularly in Southeast Asia countries including Indonesia, Malaysia, and Thailand. It results from major political changes with respect to democratization that occurred following the 1997 crisis
[a]Based on the 10 % cutoff level of ultimate control

including the revision of the corporate governance code. Thailand revised its Public Limited Companies Act 1992 and Securities and Exchange Act 1992 in 2008. All those efforts have resulted in a more comprehensive regulatory framework, which guides corporate governance practices in those countries. However, the performance of each country in achieving a high corporate governance score varies. Table 3 displays a comparison of Corporate Governance scores assessed by the Asian Corporate Governance Association (ACGA) (2012) and the Asian Development Bank (ADB) (2013). Both surveys unveil similar results, showing that Thailand consistently ranks in a higher position than Malaysia and Indonesia.

The Asian Corporate Governance Association (ACGA) has undertaken a biannual survey in collaboration with CLSA Asia-Pacific Markets (a leading investment group) since 2000. The survey assesses the quality of corporate governance of 864 listed companies across Asia-Pacific markets in six areas, i.e., CG rules and practices, enforcement, political and regulatory environment, accounting and auditing, and CG culture. The score ranges from 0 (lowest rank) to 100 (highest rank). Similar to the ACGA, which selects the country's largest companies based on their market capitalization, the ADB in cooperation with the ASEAN Capital Markets Forum (ACFM) rank the corporate governance performance of top ASEAN publicly listed companies. The ASEAN CG Scorecard is developed to cover the OECD CG principles, specifically the rights of shareholders (26 indicators), equitable treatment of shareholders (17), role of stakeholders (21), disclosure and transparency (42), and responsibilities of the board (79). Moreover, the scoring is balanced with the bonus and penalty mechanism. Companies demonstrating an exemplary practice beyond the minimum standards will be rewarded a bonus, whereas companies with poor practices will be penalized.

Table 3 Corporate governance score

Country	ACGA, 2012	ADB, 2013
Indonesia	37	43.4
Malaysia	55	62.3
Philippines	41	48.9
Singapore	69	56.1
Thailand	58	67.7
Vietnam	n/a	33.1
Mean total score	46	53.7

Source The Asian Corporate Governance Association (2012), The Asian Development Bank (2013)
Note Both surveys use different methodologies in assessing the quality of corporate governance that cause a different result. While ACGA takes a survey based upon a mixed assessment between company's self-assessment and analyst's perception, ADB scores the CG performance which is assessed by each country's independent body. The scores achieved by Indonesia are quite unsatisfactory because they are still below the mean total score of the region

4 Discussion and Analysis

4.1 Comparative Corporate Governance Institutional Framework

This section will present a comparison of corporate governance institutional frameworks in Indonesia, Malaysia, and Thailand. We specifically focus on the issues of shareholders, BoD, accounting and auditing, and transparency. In running the analysis, it is important to stress that we assume that the enforcement of law is a given factor. Table 4 illustrates the comparison of corporate governance institutional frameworks for Indonesia, Malaysia, and Thailand. The legal frameworks that we refer to consist of the companies acts, the securities and exchange acts, the stock exchange rules, and corporate governance codes. The most recent laws governing limited-liability companies in Indonesia, Malaysia, and Thailand are the Company Law No. 40/2007, the Companies Act 2007, and the Public Limited Companies Act No. 3/2008, respectively. Every country has a capital market regulator, which is responsible for governing, supervising, and enforcing the securities regulations, i.e., Bapepam-LK[9] for Indonesia, the Securities Commission for Malaysia, and the Securities and Exchange Commission for Thailand. In addition, these three agencies also have a responsibility to oversee the operation of the country's stock exchange. All publicly listed companies must

[9]Badan Pengawas Pasar Modal dan Lembaga Keuangan (Bapepam-LK). http://www.bapepam.go.id/pasar_modal/index.htm. Since January 1, 2013, the role of Bapepam-LK has been replaced by the Indonesia Financial Services Authority or Otoritas Jasa Keuangan (OJK) - http://www.ojk.go.id/en/. The process of transition from Bapepam-LK to OJK, however, takes about one year. All capital market regulations in this article are based on those set by Bapepam-LK.

Table 4 Key corporate governance institutional frameworks

	Indonesia	Malaysia	Thailand
1. *Legal and regulatory*			
Companies act	The Company Law No. 40/2007 (CL 2007)	The Companies Act 2007 (CA 2007)	The Public Limited Companies Act No. 3/2008 (PLCA 2008)
Securities and exchange act/ regulations	The Capital Market Law No. 8/1995 The Bapepam-LK Regulations until Dec 2013	The Capital Markets and Services Act 2007	The Securities and Exchange Act 2008
Stock exchange rules	The Indonesian Stock Exchange Rules[a] (IDX Rules) until Dec 2013	The Bursa Malaysia Listing Requirements (BMLR) until Dec 2013	The Stock Exchange of Thailand's Listing and Disclosure Rules (SET Rules) until Dec 2013
Corporate governance code	Indonesia's Code of Good Corporate Governance 2006 (hereafter CG Code 2006)	Malaysian Code on Corporate Governance 2012 (hereafterCG Code 2012)	The Principles of Good Corporate Governance for Listed Companies 2012 (hereafter CG Principles 2012)
2. *Shareholder rights*			
a. Shareholders' meeting procedures:			
– Advance notice prior the date of general meeting	28 days for announcement and 14 days for invitation	21 days	7 days
– Proxy voting	Yes	Yes	Yes
– One-share, one-vote	Yes	Yes	Yes
– Proposal of additional agenda items	10 % of voting rights (CL 2007)	5 % of total voting rights; or 100 shareholders who each holding shares not less than RM500 (CA 2007)	1/3 of issued shares (PLCA 2008)
b. Minority and institutional share-holders participation	Indonesian Society of Securities Investors (relatively passive)	Minority Shareholders Watchdog Group (very active)	– Association of Investment Management Companies – Thai Investor Association (very active)

(continued)

Table 4 (continued)

	Indonesia	Malaysia	Thailand
c. Related party transactions:			
– Thresholds	More than 0.5 % of paid-in capital (Bapepam- LK Regulations No. IX.E.1, 2008)	More than 5 % of net tangible assets (BMLR Chapter 10, 2013)	More than 3 % of net tangible assets (SET 22-01, 2003)
– First approval	By non-interested shareholders (Bapepam-LK Regulations No. IX.E.1, 2008)	By non-interested shareholders (BMLR Chapter 10, 2013)	By non-interested shareholders (SET 22-01, 2003)
– Procedure	Any interested party having conflict of interest is prohibited to involved in discussions and decision making process (CG Code 2006)	Any interested party should withdraw their rights in decision making and voting session (BMLR Chapter 10, 2013)	Any interested party should abstain in decision making and voting session (SET 22-01, 2003)
– Independent appraisal	Only if it is deemed necessary by the Bapepam-LK (Bapepam-LK Regulations No. IX.E.1, 2008)	Yes, any related party transactions exceed the thresholds should be appraised by an independent appraiser (BMLR Chapter 10, 2013)	Specific transactions should be appraised by an independent appraiser (SET 22-01, 2003)
3. *Board of directors*			
a. Roles and responsibilities	Clearly stated in the Company Law and CG Code	Clearly stated in the Companies Act and CG Code	Clearly stated in the Public Limited Companies Act and CG Principles
b. Component	– Sufficient size (CG Code 2006)	– A balance of executives and non-executives (CG Code 2012)	– A balance of executives and non-executives (CG Principles 2012, SET Code of best practice, 1999)
	– Min. 30 % of Board of Commissioners must be independent (IDX Rule No. I-A, 2004)	– At least 2 or 1/3 of BoD must be independent (BMLR Chapter 15, 2013)	– Al least 3 or 1/3 of BoD must be independent (SET, 2008)
c. Term limit of independence directors	No provision	No more than a cumulative period of 9 years (CG Code 2012)	Encouraged to be limited in respective company's policies (CG Principles 2012)

(continued)

Table 4 (continued)

	Indonesia	Malaysia	Thailand
d. Directorship	Only for banking and financial institutions, max 2.	No more than 5 directorships in other listed companies (BMLR Chapter 15, 2013)	Encouraged to be limited, no more than 5 board of listed companies (CG Principles 2012)
e. Separation of chairman and CEO	Yes, the nature of two-tier system (CG Code 2006)	Yes, should be different persons (CG Code 2012)	Strongly encouraged to be different persons (SET Code of best practice, 1999; CG Principles 2012)
f. Position of chairman	No provision	Must be independent (CG Code 2012)	Strongly encouraged to be independent (SET Code of best practice, 1999; CG Principles 2012)
g. Education programs	Not clearly regulated	Mandatory training and continuing education programs (BMLR Chapter 15, 2013)	Strongly encouraged but not mandatory (CG Principles 2012)
h. Nomination and selection	Nomination Committee (CG Code 2006)	Nomination Committee	Nomination Committee
– Establishment of policies and procedures	Not clearly regulated	Should be formalized, as part of BoD duties (CG Code 2012, BMLR Chapter 15, 2013)	Should be transparent (CG Principles 2012)
i. Remuneration			
– Establishment of policies and procedures	Yes, proposed by the Remuneration Committee (CG Code 2006)	Yes, proposed by the Remuneration Committee (CG Code 2012)	Yes, proposed by the Remuneration Committee (CG Principles 2012)
j. Conflicts of interest (CoI)	A board member having CoI is not allowed to participate in discussions and decision making process (CG Code 2006)	A board member having CoI (directly or indirectly) should not participate in voting and discussion (BMLR Chapter 10, 2013)	A board member having vested interests should not participate in decision making process (CG Principles 2012)
4. *Accounting and auditing*			
a. Full convergence to IFRS	1 Jan 2012	1 Jan 2012	2013

(continued)

Table 4 (continued)

	Indonesia	Malaysia	Thailand
b. Term limit of independent auditors	Max. 3 years for public accountant partners, and 6 years for public accounting firms (Ministry of Finance Decree No:17/PMK.01/2008; ROSC 2011)	No provision (ROSC 2012a)	Only requires a rotation of public accountant partners for every 5 years (not for accounting firms) (SEC News Release No. 25/2005; ROSC 2008)
c. Requirement of audit quality assurance	Yes (ROSC 2011)	Yes (ROSC 2012a)	Yes (ROSC 2008)
d. Existence of auditor watchdog	Auditor Oversight Committee (ROSC 2011)	Audit Oversight Board (ROSC 2012a)	Auditor Disciplinary Steering Group (ROSC 2008)
5. *Transparency and disclosures*			
a. CG code and principle compliance	No specific provision for listed companies to report their compliance with CG Code (ROSC 2010)	Listed companies should disclose their compliance or explain any non-compliance items (BMLR)	Listed companies should disclose their compliance or explain any non-compliance items (SET Rule)
b. Ownership structure	Mandatory (Bapepam-LK No. VIII. G7, 2012)	Mandatory (BMLR)	Mandatory (SET Rule)
c. BoD profile	Mandatory (Bapepam-LK No. VIII. G7, 2012)	Mandatory (BMLR)	Mandatory (SET Rule)
d. BoD nomination and selection	Not clearly regulated	Mandatory (BMLR)	Voluntary (CG Code, 2012)
e. Remuneration:			
Policies and procedures	Voluntary (CG Code 2006)	Mandatory (BMLR)	Voluntary (CG Code, 2012)
Values	Voluntary (CG Code 2006)	Mandatory (BMLR)	Mandatory (SET Rule)
f. Audit and non-audit service fees	No provision (CG Code, 2006)	Mandatory (BMLR)	Mandatory (SET Rule)

(continued)

Table 4 (continued)

	Indonesia	Malaysia	Thailand
g. Conflicts of interest	BoD member shall make an annual statement that he/she has no CoI in any decisions he/she made, but not necessary to disclose in the annual report (CG Code, 2006)	BoD members should disclose any conflict of interest in the annual report (BMLR)	BoD should avoid any CoI positions (SET Rule)
h. Code of conduct	Stated in CG Code, but no mandatory provision for companies to establish an ethical business conduct (CG Code, 2006)	Clearly stated in CG Code as part of BoD responsibility to formulize a company's code of ethics (CG Code, 2012)	Clearly stated in CG Code as part of BoD responsibility to formulize a corporate's code of conduct and code of ethics (CG Principles, 2012)
i. Whistleblowing	Companies must develop a mechanism to accommodate whistleblower complaints (CG Code, 2006)	As part of the code of conduct (CG Code, 2012)	As part of the code of conduct (CG Principles, 2012)

[a]Indonesia Stock Exchange. http://www.idx.co.id/index-En.html

Notes to maintain a consistency in addressing specific issue, we utilize the following terms

No provision = there is no clause either under the CG code or laws and regulations explaining such issue

Not clearly regulated = only stated under the CG code but not governed by the laws and regulations comply with the regulations and listing requirements stipulated by the respective capital market regulator and the stock exchange agency.

While the structure of legal and regulatory framework pertaining to the securities regulations among the three countries is similar, there is a difference with respect to the establishment of the corporate governance code. The Malaysian Code on Corporate Governance is set by the Securities Commission, while the Corporate Governance Principles for Listed Companies in Thailand is stipulated by the Stock Exchange of Thailand (SET)[10]. In Indonesia, however, the National Committee on Governance[11] is responsible for establishing and updating the Code of Good Corporate Governance. Even though the Code is regarded as voluntary for companies, there is a gap with respect to the compliance particularly for publicly listed companies. In Malaysia and Thailand, under the stock exchange agency's rules, listed companies are required to explain the extent of their compliance with the code. Any non-compliance items should be clearly explained by the company. Unfortunately, this practice has not yet been applied in Indonesia. This means that listed companies are not required to report their compliance with any provisions of corporate governance.

4.2 Shareholder Rights

One pivotal agency problem in Southeast Asian companies is that key decision making is mostly held by the single-majority power of family shareholders. Minority or outside shareholders have limited opportunities to participate in the decision-making process or to request an additional explanation from the management. Accordingly, the main concern is how to encourage the monitoring role of outside shareholders including the channels, which enable them to voice more strongly. All three countries have provided mechanisms to conduct shareholders' meeting. Companies should announce and send a meeting notice to all shareholders within a reasonable period prior to the date of the meeting. This will allow shareholders to schedule and attend the meeting with ease. However, prior notice in itself does not guarantee that the shareholders' rights can be easily exercised. Even though proxy voting is allowed in the three countries, the possibility of proposing an additional agenda item varies among them. For shareholders in Malaysia, it is much easier to place items on the shareholders' meeting agenda, because it only requires a minimum threshold of 5 % of all voting rights. Indonesia shareholders only require 10 % of total voting rights; the Company Act of Thailand, on the contrary, requires one-third of total shares issued. To cope with this issue, in 2006 the Thai Stock Exchange launched a best practice guideline for companies to establish a written mechanism that enables minority shareholders to propose agenda items in advance prior to the meeting.

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[10]Stock Exchange of Thailand. http://www.set.or.th/en/.

[11]Komite Nasional Kebijakan Governance (KNKG). http://knkg-indonesia.com/home/.

Another crucial issue with regard to investor protection is regulations focused on related party transactions (RPT). Many studies have documented that the typical concentrated ownership in Asian markets provides greater opportunities for controlling shareholders (insiders) to expropriate minority shareholders (outsiders) (Claessens et al. 2002; Villalonga and Amit 2006; Juliarto et al. 2013). Abusive RPT, among others, is one way of expropriation of outsiders that insiders can take, including the sales of the insiders' assets to another firm in the same group at below market prices and intra-loans without sufficient guarantees. To curb the pervasiveness of RPT, several regulations are needed to ensure that shareholder rights are protected from such transactions. We can see from Table 4 section 2c, that according to the Corporate Governance Codes in the three countries, any interested parties who have conflicts of interest should abstain from decision making and voting on the RPT. In addition, the country's securities regulator (the Security Commission and the Stock Exchange) requires a threshold for RPT which should be approved by independent shareholders and/or BoD. For example, in Indonesia any RPT that is deemed to have a conflict of interest and that has a value of more than 0.5 % of paid-in capital must be first approved by non-interested shareholders. Malaysia and Thailand apply a threshold of 5 % of net tangible assets and 3 % of net tangible assets, respectively. However, Indonesia has no provision requiring that RPT should be assessed by an independent appraiser or even a statement from the BoD or the Audit Committee concerning the reasons to take such transactions. This makes it much more difficult for investors in Indonesia to judge whether the transactions are objective and beneficial or not. Hence, the likelihood of engaging in abusive practices may be easier in Indonesia than in Malaysia and Thailand.

Lastly, the shareholder rights can be improved by the establishment of organizations that facilitate investors to be more active. The presence of these investor organizations can reduce the free-rider problem, particularly among outside shareholders. It is more efficient if shareholders unite as one group in order to promote shareholders' activism. However, to become an effective organization it should be supported by an appropriate legal and institutional framework. One of the most active organizations is the Minority Shareholders Watchdog Group (MSWG)[12] which is established by major Malaysian institutional investor groups in 2000. The MSWG has conducted various activities such as Annual General Meetings (AGM) and Extraordinary General Meetings (EGM) monitoring, the Directors' Remuneration Survey, Corporate Governance Survey, and the Dividend Survey (MSWG's Web site). In Thailand, a similar organization is the Thai Investor Association, which has actively conducted an assessment of the AGM in collaboration with the Stock Exchange of Thailand (SET's Web site). In contrast, even though Indonesia has the Indonesian Society of Securities Investors (ISSI), it is quite a passive organization.[13] Indeed, shareholder activism in Indonesia is not

[12]Minority Shareholders Watchdog Group. http://www.mswg.org.my/.

[13]We had tried to search any information regarding the ISSI; however, we did not obtain the ISSI's web site and news about its activities.

common. One reason may be that the cost of court actions in Indonesia is higher than in other Asia-Pacific countries (ROSC 2010), which may lead shareholders to be reluctant to file a suit against a company. Recent empirical research also shows that the level of shareholder protection in Indonesia is lower than in Malaysia. Djankov et al. (2008) reveal that Indonesia's and Thailand's shareholder protection index is 4, while for Malaysia it is 5 (out of 6).[14]

Even though Indonesia has made some improvements in empowering shareholders, the effectiveness of protecting outside shareholders remains a concern. The controlling shareholders often take a decisive position. In general, once the management and inside shareholders have made decisions, the outside shareholders will follow without opposing them. Since shareholder rights in Indonesia tend to be overlooked, their participation in monitoring the company is a challenging issue. This situation will generate greater room for management to behave opportunistically, facilitating them in taking abusive actions, including bribery beyond the outsiders' control.

4.3 Board of Directors

The structure and competency of BoD have been a growing issue in corporate governance debates, focusing on their ability and effectiveness in carrying out their duties. In Southeast Asia, it is widely known that controlling shareholders tend to appoint insiders to become a CEO and a board member. The executives and board members are typically trusted people elected from other companies in the same group. They can be family members, relatives, or bureaucrats. When those persons are less competent and have conflicts of interests, their capability to monitor thoroughly is questionable. Therefore, the selection and remuneration process including the composition of the BoD becomes essential to be considered as part of corporate control mechanisms.

Since Indonesia applies a two-tier board system, there is a separation between the supervisory board (board of commissioners) and the executives. On the other hand, Malaysia and Thailand have a one-tier board system following the Anglo-American model, where a CEO is part of the board. In the one-tier system, the CEO is usually appointed as the chair. In this case, there is a lack of an effective monitoring mechanism, which may lead to abuse of power. To counter this, it is important to clearly separate the position of the chair and CEO. Malaysia and Thailand have stipulated this issue through their respective stock exchange regulations. In Malaysia, it is even required that the chair should be an independent

[14]Djankov et al. (2008) have revised the previous measure of shareholder protection (formerly known as the anti-director rights index) which was first introduced by La Porta et al. (1998), after receiving a constructive critique from a legal scholar (Spamann 2009).

person. This provision is not present in Indonesia nor Thailand (see Table 4 section 3d). Given that ownership structure is mostly family-dominated, when a chairman position is not independent, it is prone to be chaired by controlling shareholder family members. This phenomenon is quite common in Indonesian companies.

Another concern of board independence relates to the termination of board membership. A policy to limit the tenure of a person sitting as an independent director is open to debate. It is a common governance practice to limit top public positions like presidential terms or parliamentary tenures. With respect to independent directors, there is no consensus to what extent it is necessary to regulate term limits. However, currently many countries have either recommended or introduced term limits for directors. The rationale behind this regulation is that their independence will be impaired with the passage of time. They tend to become more cooperative with other board members and management, which in turn leads to less effective control. In 2012, the Malaysian Code on CG started to stipulate that a person can serve as an independent director for a maximum cumulative period of nine years. Other countries which also have set such regulations are the UK, Singapore, Hong Kong, and France. In addition, other jurisdictions simply recommend or encourage this, such as Thailand, Spain, and the Netherlands. For Indonesia, up until now there have been no guidelines for director tenures or for the maximum age of directors, making it possible for firms to install directors for life.

Another challenging issue is multiple directorships, such as a director who sits on multiple boards. A growing literature shows that the monitoring role of boards is relatively less effective if board members hold many directorships (Fich and Shivdasani 2006; Core et al. 1999). Directors, who are too busy, may harm firm value as they do not have enough time to effectively monitor management (Ferris et al. 2003). Table 4 section 3d shows that in this context again Malaysia leads by introducing a regulation that limits the number of directorships to five. This brings Malaysia up to a set of best practices for corporate governance, comparable to other countries such as Singapore, the Netherlands, and the UK. The Bursa Malaysia[15] (Malay Stock Exchange) also requires a mandatory training and continuing education program for the BoD; Thailand only strongly encourages this and Indonesia has no clear provision on it. In sum, Malaysia supplies a stronger regulatory framework with respect to the effectiveness of board monitoring roles, compared to Thailand and Indonesia.

We conclude that on average the quality of the Indonesian BoD is weaker than the boards among its regional peers, which likely has a detrimental effect on the effectiveness of these boards in terms of their role in controlling and monitoring management. Since BoD members are mostly linked to inside shareholders, their independent and critical opinions are questionable. The loose monitoring system may increase the management's opportunity to take action that is not in line with the interests of the minority shareholders. Thus, it is easier for management to act

[15]Bursa Malaysia. http://www.bursamalaysia.com/market/listed-companies/.

and conceal illicit transactions for their own benefits. Hence, we can say that a stronger corporate governance framework with regard to the quality of the BoD will limit the likelihood of corrupt activities.

4.4 Accounting and Auditing

Both Indonesia and Malaysia have fully adopted the International Financial Reporting Standards (IFRS) since January 1, 2012. Thailand followed to converge with the IFRS in 2013. Most countries in the world have fully adopted the international accounting standards, i.e., the IFRS as well as the International Auditing Standards (IAS). The introduction of those standards in the three countries is still in the early stage. This does not mean that there are no variations in practice, but it is beyond our analysis to investigate the gap between the accounting standards and its actual implementation.

An important issue relates to the independence of the auditor. Similar to the case of independent directors, external auditors and auditing firms should have a tenure restriction when serving their clients. Referring to Table 4 section 4b, Indonesia has stipulated a maximum period of six years for a public accounting firm to be able to audit the same company, and three years for its partner auditors. Thailand imposes this rule only for auditors (not for audit firms), while Malaysia until currently does not have any provisions. The independence of external auditors can also be measured by their audit fees. There is a considerable body of literature which suggests that high audit fees paid by a company can intensify the economic bond between the auditor and the client, leading to impair the auditor's independence (Frankel et al. 2002; Lin and Hwang 2010). When their independence is impaired, it may lead to a higher possibility for the occurrence of earnings management, thus lowering the quality of financial statements (Cahan et al. 2008; Larcker and Richardson 2004). Disclosure of auditor's fees in Indonesia does not take place, however, since there are no rules to impose companies to do so.

Furthermore, the quality of accounting and auditing in Indonesia is increasingly questionable pertaining to the low number of chartered accountants (CAs). Compared to Malaysia and Thailand, the ratio of the Indonesian CAs to the population is very low. For every 1 million inhabitants, Indonesia only has 71 CAs while Malaysia and Thailand has 1270 and 867, respectively (Asean Federation of Accountants, 2013). Kimbro (2002) found that the number of accountants in a country has a positive significant influence in reducing corruption level. Hence, Indonesia has several challenges to improve its audit quality in the fight against corruption. Insufficient number of qualified registered accountants, lack of resources in building a professional accounting body, and inadequate capacity to ensure the quality of accounting and auditing are some obstacles that lead to weakening the monitoring role. In conclusion, Indonesia's institutional framework in accounting and auditing is less strong than Malaysia and Thailand, providing more room for corruption to exist.

4.5 Transparency

Finally, transparency is a very essential tool to enhance corporate discipline. A strong legal framework itself does not guarantee that companies follow the rules. It should be enforced by mandatory disclosures, in which shareholders and the public can scrutinize the company based on the information that the company declares. Transparency and disclosure are considered as efficient and effective tools to enforce law. International corporate governance codes and best practice recommendations have guided what items need to be disclosed, such as ownership structure, BoD profiles, and any other material information including the board selection process and remuneration policies.

In terms of corporate code compliance, it should be noted that Indonesia does not require listed companies to report their corporate governance practices. It means that there is inadequate enforcement of law, since listed companies only adopt the code on a voluntary basis without explaining any discrepancies. Crucial issues such as conflict of interest, the composition of boards and executive remuneration, and auditor fees may thus not be reported in the annual report. On the other hand, Malaysia and Thailand require mandatory disclosure to what extent the companies comply with the corporate governance codes and principles. If the company does not comply with any item of the codes, it should explain the reason for the respective non-compliance item. Table 4 section 5 provides a detailed comparison of the three countries related to the disclosure requirements.

While listed companies in the three countries are required to disclose audited financial statements in the annual report, there is a variation regarding the regulations to disclose non-financial information. As stipulated by the Malaysian securities commission regulations, the members of the BoD should disclose any conflicts of interest they have. For example, when they engage in RPT, either directly or indirectly (through their family members or relatives), and/or when they hold other positions deemed to bear conflict of interest such as a position in the government and political party, this should be reported. Such regulations are absent, both in Indonesia and Thailand. However, in many areas Thailand has the same mandatory regulations as Malaysia to impose companies to declare information in the annual report, including information about board remuneration, audit fees, and company code of conduct. In addition, listed companies in Indonesia are not required to disclose the board nomination and selection process, the policy to manage RPT, and the code of conduct.

On the basis of the aforementioned discussion, we can draw the conclusion that on average, Malaysia has proven to be a leader of the three countries in the area of transparency and disclosure, followed by Thailand. Indonesia mostly relies on the voluntary-based approach with respect to transparency and disclosure. This decreases the companies' awareness of the importance of transparency. Lower levels of transparency make it easier for companies to hide any material information that may involve abusive or non-arm's-length transactions. This supports our conjecture that improved transparency will reduce the probability of corruption.

5 Conclusion

As the economies in Southeast Asia are expanding, the role of the corporate sector is increasingly important for the livelihoods and well-being of citizens. This in turn may enhance the demand for countries to improve their framework for corporate governance. Competition and globalization may further increase the importance of corporate governance, as good corporate governance is demanded by foreign and institutional investors. Companies with better corporate governance perform better and have a more positive market valuation (Klapper and Love 2004; Bhagat and Bolton 2008), allowing them to grow sustainably. The need for sound corporate governance is essential to encourage a better investment climate, to provide a reliable monitoring mechanism to check corruption, and to improve the efficient allocation of economic resources for economic growth and the creation of a sustainable society. This is consistent with the widely held belief that corporate governance is directed not only to enhance shareholder value, but also to foster economic growth (Mayer 2012; Tiwari 2010). Furthermore, the implementation of sound corporate governance is especially important in countries perceived as highly corrupt, like Indonesia. Although Indonesia's level of corruption has been reduced in the last decade, its achievement is still below the ranking of other middle-income countries in Southeast Asia (The World Bank 2013, the Worldwide Governance Indicators). A similar pattern applies to the performance of corporate governance in which Indonesia's score is not satisfactory enough compared to that of Malaysia and Thailand (ACGA 2012, ADB 2013).

We focused on the institutional framework to provide evidence that a stronger institutional framework of corporate governance helps to decrease the likelihood of corruption. Specifically, we utilized agency theory to shed light on the link between corporate governance and corruption. This stems from the asymmetric information problem, which stresses the view that it is difficult for shareholders and the public to access the company's information. Managers and insiders are able to mask their bribery activities by reporting false information to the public. The opportunistic behavior of bribery can be reduced by establishing corporate governance best practices that aim at reducing such behavior. These best practices focus on monitoring decision making by managers and ensuring that business operations are operated with a high standard of integrity.

In this study, we compared the corporate governance institutional framework of three Southeast Asia countries Indonesia, Malaysia, and Thailand. We found that Malaysia has the strongest institutional framework with respect to shareholder rights, the quality of the BoD, accounting auditing, and transparency standards, which in turn leads to a tightened monitoring system. When monitoring is well developed, the opportunity for bribery and corruption can be curbed. It may explain why Malaysia has a relatively low level of corruption. On the other hand, Indonesia's institutional framework is less stringent compared to Malaysia and Thailand. Some crucial issues that should be highlighted here include RPT, shareholder activism, and the quality of the BoD. The Indonesian corporate governance framework is mostly voluntary based. This approach may not provide sufficient conditions for companies to adopt corporate governance best practices. Moreover, transparency is another challenging issue in Indonesia. Hence, the probability of corruption is larger because companies can easily conceal the illicit transactions without having to be worried. Our results suggest that Indonesia needs to improve its institutional framework of corporate governance to be in line with international best practices.

Lastly, it should be noted that this study does not incorporate the enforcement of law as part of the comparative analysis. A strong legal framework does not necessarily imply a commitment to fully apply and enforce it by state actors and regulatory bodies. Future research should focus on establishing whether there is a gap between the existing regulations and actual implementation by companies and enforcement by regulatory authorities and states.

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