

# Decentralization And Rent Seeking In Indonesia

Akhmad Rizal Shidiq

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## Abstrak

Tulisan ini menemukan bahwa implementasi dari program desentralisasi di Indonesia selama 1999-2002 tidak selalu mencerminkan akuntabilitas yang lebih baik dan mampu membawa keuntungan sosial berdasarkan rent based on transfer arrangement ketimbang sistim sentralisasi dari rejim Orde Baru. Terlihat bagaimana rents based on transfers secara massive di zaman Orde Baru diatur berdasarkan aliansi dari militer, birokrasi, dan kapitalis, yang dengan aturan dan institusinya menangani masalah koordinasi dan meminimasi ongkos politik (political cost). Sebagai hasilnya, pembangunan kapitalis masih nangkap. Di lain pihak, desentralisasi sejak 1999, meskipun secara signifikan telah memindahkan rents based on transfer kepada tingkat lokal (kabupaten), belumlah memperlihatkan tipe baru dari kapitalis yang lebih produktif. Selain itu, desentralisasi, hingga data 2002, meningkatkan biaya dalam mengorganisasikan rents based on transfer yang baru.

*Kata Kunci: Desentralisasi – Pencarian rente - Indonesia*

*Key Word: Decentralization – Rent seeking - Indonesia*

## 1. INTRODUCTION

There is a common optimism in Indonesia that transferring authorities from central to local government under decentralization would bring better accountability of economic. Strengthened by the *reformasi*<sup>1</sup> following the Soeharto resignation, this ideal is supported across the country and is popularly accepted as an integral part of necessary reform to be made

The decentralization itself, also popularly known as the regional autonomy, refers to the issuance of Law 22, 1999 on Regional Governance and Law 25, 1999 on Fiscal Balance between the Central Government and the Regions. The law requires that by January 2001 all administrative and institutional arrangement should have been completed. Surely things are not as smooth and simple as previously expected. While both sides of decentralization pros-cons have pointed to governance and local accountability as the basis of their arguments, so far the analysis misses the biggest part of the problem: rent seeking.

Rent seeking is defined broadly as the activities that seek to create, maintain, or change the rights and institutions on which the particular rents are based (Khan, 2000). Indeed the mainstream methodology for rent seeking analysis itself suffers from incompleteness, especially the need to incorporate the real political and institutional problem in developing countries. Some of the shortcomings are the failure to differentiate types of rents that demand specific treatment; and overemphasizing the costs of rent seeking but disregarding its potential benefits

The notion of rents in public discourse for the topic of decentralization and accountability in Indonesia particularly refers to rents based on transfers<sup>2</sup>. These are rents organized through the political mechanism and in developing countries and are often the basis for asset accumulation, the emergence of new capitalists and middle class (Khan, 2000). The KKN issues and discontent to the previous centralized regime

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<sup>1</sup> Reformasi, literally translation for "reform", is an Indonesian term to describe the popular political changes after the political and economic crises in 1998.

<sup>2</sup> Khan (2000) describes various type of rent: monopoly rents, natural resources rents, rent based on transfers, Schumpeterian rents, rents for learning, and monitoring and management rents.

revealed the dissatisfaction with central government management of transfers; not only natural resource outcomes to mainly resource rich regions, but also on how the central government distribute rents to local capitalists.

Since Indonesia is in early stage of capitalist development -and now starting from scratch again after the economic and political crisis-, the state is deeply involved in the process of private property rights creation. The relevant benchmark for accountability is not the condition of relatively rent-based transfer free as in many developed countries; but rather whether decentralization will lead to socially more beneficial rent-based transfers process in Indonesia compared to the previous centralized regime.

To answer this research question, this paper draws on an historical account of rents based on transfers' arrangement in the previous New Order<sup>3</sup> regime and the change after the 1998 economic and political crisis. Subsequently, this paper also analyses the three conditions that determine the cost of new rents based transfers arrangements: the size of transfers passed to local governments; the character of capitalists involved in the new rent seeking process, and the costs of organizing the new rents based on transfers.

The paper finds that strong centralized Soeharto's regime -built from the alliances amongst the military, bureaucrats, and Chinese capitalists- had the effective mechanisms to rents based on transfer's coordination as well as to minimize the political conflicts. As a result, despite enormous rents based on transfers, capitalist developments could take place at both central and local levels. On the other hand, since it started in 1999 until 2002, the decentralization has increased new rents based on transfers at the local levels sharply. Yet, new capitalists have not yet emerged in these new processes. The costs of organizing the new rents based transfers are also much larger than of the previous regime's due to weak coordination mechanisms and emergences of more clientelist patron-client relationships<sup>4</sup>.

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<sup>3</sup> New Order is the popular name for Indonesia Suharto's administration in the period of 1965-1998

<sup>4</sup> Patron-client relationships are repeated relationships between specific patrons and their clients. These relationships are usually personalized and the exchange are between two types of agents distinguished by status, power or other characteristics (Khan and Jomo,

Moreover, as the decentralization has just started in 1999, in this first three years transitional period, the stability of new rents seeking arrangement is not yet known. Therefore, the analysis of new rents based transfers in here should be treated as preliminary findings for the period of 1999-2002.

## 2. ARGUMENTS FOR AND AGAINST DECENTRALIZATION

The main arguments for decentralization are mainly based on the ideas of efficiency and accountability. On efficiency grounds, the local governments provide the better mechanisms to reveal public preferences than centralized ones. Accordingly, local governments can design better public charges –through taxation policy- over this preferred public service provision (Tiebout, 1956). Furthermore, productive efficiency can also be improved since decentralized governments can tailor service provision to revealed preference due to local government's information advantage (Oates, 1999).

The second argument for decentralization is on the accountability side. By bringing the government closer to the people decentralization brings the popular voice into policymaking (World Bank, 1997; Paterson: 1997; World Bank, 2000). The logic of this idea is that greater participation will lead to the greater government accountability and responsiveness. Weingast (1995) argues that federalism can augment the market to work by limiting the ability of state to confiscate the wealth of people while at the same time state could secure property rights.

On the other hand, there are at least three arguments against decentralization (Prud'homme, 1995). *First*, on macroeconomic management, decentralization can hamper the stabilization process -due to the limited resources of central government to coordinate the counter-cyclical state intervention- (also argued by Treisman (1999); missing of economies of scale opportunities; and decreasing flexibility to correct the erroneous economic policies. *Secondly*, decentralization may lead to bigger inter-regional disparities. And last, the mechanism of vote by feet

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2000). Clientelists patron clients relationships are defined as the state as patrons within the networks lack the power to enforce rights (Khan, 1996)

(Tiebout, 1956) to maintain local government accountability does not likely exist, particularly in developing countries<sup>5</sup>.

### 3. RENTS BASED ON TRANSFERS AND DECENTRALIZATION

Among the several types of rents<sup>6</sup>, this research will focus on the analysis of rents based on transfer: transfers organized by political mechanism - but excluding the welfare purpose transfer such as subsidies- which is very relevant to developing countries and the formation of productive capitalist class that can boost economic growth as well as maintain political stability for development.

This paper adopts the extensive framework built by Khan (2000) that accommodates the institutions and political settings within the analysis. The scheme of decentralization always involves the change - sometime abrupt- of institutional and political settings within the country. It shifts administrative authority (decentralization) and political institutions (devolution) to lower level of government<sup>7</sup>.

As decentralization brings the change on institutional and political structure, it will also have the different impact on the rents based transfer. To know whether such change brings the socially beneficial outcome, it is important to address the two costs; the cost of transferring the rents to local level and the cost of organizing that rent seeking process.

The former cost consists of two analyses. First analysis is the size of transfer received by sub-national level. Secondly, it is also important to

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<sup>5</sup> Furthermore according to Brueckner (2000), the Tiebout's benefit of decentralization may also be offset by local corruption and tax evasion efforts.

<sup>6</sup> The other types of rents are monopoly rents, natural resources rents, rent based on transfers, Schumpeterian rents, rents for learning, and monitoring and management rents (Khan, 2000)

<sup>7</sup> According to Khan (2002, forthcoming), the improvement of local accountability and governance under this new game can only be realized if three conditions fulfilled: effective general election to represent general preferences, ability of politician to control bureaucrats- not directing and colluding to benefit particular interests-, and availability of reliable public indicators over government performance. Arguably, those three requirements are hardly found in many developing countries.

know whether the rents go to the more productive proto-capitalists in the new decentralized settings.

The second cost is the cost of organizing the rent seeking process. This consists of political transaction costs for negotiating the size and allocation of the rents: which is determined by the degree of social fragmentation and the strength of redistributive pressure. Such analysis is the extension of institutional structure of agencies in Vishny and Shleifer (1993) with additional assessment of power distribution among the players in rent seeking process in Khan (1996)<sup>8</sup>.

## 4. HISTORICAL ACCOUNTS

### 4.1. The Ups and Downs of Decentralization in Indonesia

The local politics dynamic in Sukarno's era, including the separatism and local rebellion, shows three important messages. First, the problem of local resentment for political and economic imbalance between Java and Outer Java had already occurred during in Old Order. Second the changing roles and alliances between bureaucracy, military, and politicians had been shaped both in central and local level and the issue of decentralization could not be separated from the conflict among those three elements to gain control over the development process. Third, the change toward decentralization, and vice versa, was determined by the economic and political crises.

Subsequently in the New Order regime, as argued by Robison (1990), the political configuration of Soeharto's administration can be interpreted in terms of the state's involvement in class formation and conflict and capitalist class formation. In this case, the structure was built on interplay among state as the coalition of (previously weak) national bourgeoisie –both Chinese and Indigenous–; the military; and the economic technocrats<sup>9</sup>.

<sup>8</sup> Both Vishny & Shleifer (1993) and Khan (1996) papers specifically deals with corruption. Yet their framework may be extended to rent seeking process. Indeed corruption itself is a part of rents seeking activities.

<sup>9</sup> The coalition depended on military dominance government because, as a matter of fact, they provided the economic prosperity built on the technocrat's policies. The military, due to its ideological stand as counter revolutionary force against PKI (Communist

According to Chalmers (1997) the new order can be divided into three periods. The 1966-1974 was the period of economic reconstruction when the policies are considered market-oriented. In this period, the regional economy was not yet the issue since the main issue is to integrate the local economy to the world economy and to stimulate the capital investment. In the second period of the oil boom, 1974-80s, the focus shifted to distribution of wealth and how to create a self-reliant economy. Along with increasing wealth, the alliance of the military, politicians, and capitalists had been formed –with the former more and more dominant-. Economic policies emphasized on the national strengths and corporatist state mobilization of the forces for development. The need for mobilization of resources brought the importance of centralized type of development management to the fore. In the third period from 1980s, the oil price decreased. As the consequence the capacity to finance regional development also decreased. This period had been marked by the series of deregulation measures and more liberal development approach. The need of more decentralized type of development had begun to be addressed (Hill, 2000).

In sum, from descriptions above, both before and after New Order, the ups and downs of decentralization were determined by the degree of political conflict between local and central, the strategies on each stages of development, and the availability of financial resources.

#### 4.2. Rent Seeking Operations under New Order

The Actors, Modus Operandi and Flows of Rents. In the New Order, the main actors of rent seeking were the military, business class –mainly Chinese ethnic-, and the bureaucrats. Yet unlike to the old 1950s military-business relationship, the New Order regime bypassed the role of pribumi-indigenous non-Chinese people-brokers (Ross, 2001). The result was the lower transaction cost at the expense of the indigenous people. Meanwhile Golkar was used by the regime as the political vehicle to

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Party of Indonesia), had no choice but to pursue economic reconstruction that brought about social order. It did not implement redistributive policies but capital investment and accumulation (Robison, 1990)

exploit the powerful local aristocrats. The regime benefited from the patronage network of the former PNI<sup>10</sup> to control the local bureaucracy.

The mechanism also became more centralized as Soeharto used the rotation of military officers and bureaucrats to prevent them to build strong regional basis. Perhaps the most important change was that the role of parties in the alliance had been cut back severely after the reduction of the number parties into only three in the 1973 general election. In practice the party system became monolithic with Golkar as the single government supported party. This party was the sole channel for people to join into bureaucracy and more indirectly to take part in the rent seeking process.

According to Ross (2001), the Soeharto's patronage and military-business alliance had succeeded in coping with the typical problems of such patronage, namely, discrimination against more efficient capitalists; political attacks from against of public wealth abuse; and the problem of cheating within the arrangement.

To overcome those problems, Soeharto took three measures. First, he encouraged the military to cooperate through joint ventures with the better-capitalized and more experienced businessmen –that is foreign and ethnic Chinese enterprises-<sup>11</sup>. Secondly, to avoid the public accusation, Soeharto built the *yayasan* –charitable institution- as the vehicle to disburse and allocate rents with minimum political risk. Thirdly, the to keep the loyalty of military, the post retirement scheme was prepared in the form of preferential access to credit; appointment as foreign investors domestic partners; or strategic positions in Soeharto's firms or *yayasan*.

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<sup>10</sup> Partai Nasional Indonesia (Nationalist Party of Indonesia), the Soekarno's party and the biggest party during the Soekarno era

<sup>11</sup> Yet, Ascher (1999), in his research on Indonesian forestry, pointed out that this simple terms of trade is not sufficient to explain why Chinese partners has been chosen. He argues that because of its politically weak position, these businessmen were willing to sacrifice profit maximization and support the development project in other sectors led by the President as well as his efforts to prevent disunity in the state apparatus.



## 5. OFF BUDGET

For above political structure to work, rent allocation has to be directed through the use of off budget funds. The budget, especially development expenditure both at the central level and inter-government transfers, was the crucial device to channel funds from resource extraction and foreign aid to support centralized type of economic development. The off budget fund was also significant in the process of capital accumulation and cementing the military-capitalist-bureaucracy alliance.

The precise magnitude, in monetary term, off budget was hard to measure. Yet from the scattered information available, especially after the scandal finding leaked to public, it was hardly doubtful to assert that indeed the size is significant. The strong involvement of state apparatus in creating new means of business, through credit facilities, preferred business privilege, permits, and even political security- support the prediction for undoubtedly huge amounts of off budget funds.

### 5.1. Fiscal Expenditure

The performance intergovernmental transfer is crucial since local fiscal expenditure determined the flows of rents based transfer as the latter were often derived from the development project financed by the former. State, both in central and local, allocate these projects to certain capitalists at the exchange of rents such as commission, kickbacks, or side payment.

As shown from the average ratio of revenue sharing to total expenditure in Table 1, the district's depended considerably high, with increasing trend, on revenue sharing.

**Table 1**  
**Indonesia: Average Revenue Sharing Received by Districts and Average Ratio**  
**of Revenue Sharing Received to Total Expenditure of Districts**

Period	Nun. of districts	Average Revenue Sharing Received by Districts		Average Ratio of Sharing to Tot Expenditure	
		Bn Rp	Coeff. Variance	%	Coeff. Variance
1989/90	289	1.85	1.59	22.14	1.12
1990/91	288	2.43	1.88	20.06	0.87
1991/92	294	2.86	1.45	20.86	0.71
1992/93	295	3.79	1.54	25.28	0.71
1993/94	297	4.85	1.33	32.35	0.82
1994/95	297	5.74	1.34	33.05	0.52
1995/96	299	7.25	1.20	36.98	0.46
1996/97	289	7.99	1.01	33.77	0.46
1998/99	286	9.17	1.26	41.85	0.72
1999/00	298	11.15	1.22	43.92	0.68
2001	231	27.53	2.53	41.45	4.23

source: LPEM-FEUI data base (processed)

note: - coefficient variation is average figure divided by standard deviation  
 - using the more extensive data from Khoirunurrofik (2002), the average revenue sharing received by districts (361 districts) in 2001 is Rp 38.65bn with coefficient variation of 2.50

In sum, intergovernmental transfer of fiscal expenditures was crucial for the local levels. In fact, according to Hill and Weidemann (1991) economies in the regions were driven by rapidly expanding expenditures by, and grants from, the central government.

## 5.2. What Happened in Local Level?

So far the rent seeking analysis has focused on the structure and mechanism developed in central level. Indeed the process of rent seeking at the local level were connected to, and worked under, the rules imposed by the centralized regime. This doesn't mean that there was no dynamic local specific rent seeking process.

Local mechanism of rent seeking related to the spending policy of allocated funds. The *Proyek Pemerintah* –government projects- of Inpres program has been the main object of corruption, “kickbacks” and side

payment. And as bluntly expressed by Sidel (2002), not all the proceeds were simply kicked upstairs to higher officials; the local elites benefited as well.

Similar to the center, the main structure of military-bureaucrats-business alliance has also developed at local level as part of centralized structure. In this central-local relationship, to borrow trade distribution chains metaphor, the local state apparatus operated as the 'retailer for distribution' and 'collectors' of the rents. These apparatus were responsible to 'wholesale' in central with reward mechanism related to franchise 'renewal fee' given to the center (Sidel (2002), quoting Malley<sup>12</sup>). The terms of this political trade can be in monetary term of bribes – setoran- to the political brokers entrenched in Golkar and military that act as single entity of state under Soeharto and the political term of the Golkar winning.

The central-local military-bureaucracy-business relationships were by no means static. Across the regions, apart from undoubtedly coercive mechanisms, to form the solid alliances, there were different adjustments introduced in the regions to deal with the sensitive issues of ethnicity, religion, and the civilian-military dichotomy. This is particularly true in the early days of the institutionalization of regime political structure. Over the time, there was also some development of the strengthening local alliance vis-à-vis central authority.

## 6. THE 1998 CRISIS, DECENTRALIZATION, AND RENTS BASED ON TRANSFERS

### 6.1. Why Endorsing Decentralization: It's politics!

In fact New Order local development gave several evidences. *First*, despite growing resentment from the mainly natural resource rich regions, the centralized regime succeeded to cope with the problem of interregional inequality. *Secondly*, the political power settings assigned and enabled central government to deliver public services and economic development. *Thirdly*, despite leakages and corruption, the mechanism

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<sup>12</sup> Michael S. Malley, "Resource Distribution, State Coherence, and Political Centralization in Indonesia", PhD. Dissertation, University of Wisconsin, Madison, 1999

of intergovernmental transfer, INPRES, worked well in driving the economy across regions as well as to improve physical and social infrastructure. Therefore it hints that the decentralization in Indonesia is more a political problem, rather than the economic development predicament.

Furthermore the severe 1998 economic crisis led to mounting political pressures for Soeharto administration. Following the student demonstrations and various social resentments across the countries, Soeharto resigned and Habibie was appointed as President. This moment marked the end of previous political power configuration and military-bureaucracy control described in the earlier section. Golkar and the military were discredited severely during this reformasi period.

Habibie, determined not only to fill the gap until the next election but also to run as the effective President in subsequent period, faced the similar problem that had faced Soeharto 32 years before. The fall of the regime was associated with the winning of democratic movement supported by students, NGOs, and the middle classes in Indonesia. In the 1990s these groups had been the critics of the regime and local government's lack of popular control (Booth, 2002). Additionally, it also brought the issue of separatism reappeared such as Aceh, Papua, and East Timor (Bourchier, 2000). Habibie's problems were to consolidate the scattered nation, to restore economy and to manage the administration; and equally important to mobilize his constituents to run for next presidential election.

Habibie himself was also a component amongst others –the military, Chinese businessmen, technocrats, and etc- of Soeharto's structure. Despite working under one structure, these elements were highly depended on Soeharto as the central figure to manage and mediate powers and conflicts amongst them. They did not develop their own communication mechanisms. When the President had gone and picked Habibie as his successor, all of these elements could not reconsolidate the power and were very anxious amidst severe pressures from reform movement especially in Jakarta.

As an element of New Order regime, Habibie was not military man, not ethnic Javanese, in different camp from Chinese businessmen- for his strategic industry concept- and his main constituents were in Golkar and especially were from the outer Java factions within the party.

Practically when he came to power, he lacked of control to the other elements of the New Order patronage or to the new popular reformist power in central level.

The Golkar, associated with the former government's political party, was survived as seen from the surprisingly general election result. The Golkar win the second largest position in national level and showed consistent strong positions across the country. In outer Java regions, political structures of Golkar remained powerful. Aside from PDI-P<sup>13</sup>, there were no big parties that could maintain the political basis as widespread as Golkar<sup>14</sup>. At central level politics, however, Golkar was not as strong as in the regions since pressures from reformasi movement against them were greater in Jakarta's political sphere.

By that, it was reasonable for Habibie to mobilize his political power from Golkar by shifting the game to the regions. It was expected that local patronages of Golkar and local politicians would back Habibie against pressures from the Jakarta's politicians. Against this backdrop, endorsing decentralization law was a politically explicable decision for Habibie to shift the game to regions and gain political supports. Thus, decentralization was a political decision rather than of economics<sup>15</sup>.

Unfortunately as a political decision, the big bang approach (Hofman and Kaiser, 2002) –short and quick implementation– for decentralization to cut any political opposition did not worked as intended. The delay of the implementation can be seen as the reflection of the political resistance and the Habibie's lacks of power to control the elite. Indeed, although Habibie failed to win the presidential election in 1999, the political conflict over decentralization remains<sup>16</sup>.

<sup>13</sup> PDI-P (Indonesia Democratic Party-Struggle, lit.) is the Megawati's party and the winner of 1999 general election.

<sup>14</sup> PKB (National Awakening Party) of Abdurrahman Wahid, for example, had only strong constituents in East and Central Java. PAN (National Mandate Party) of Amien Rais had only small supports from urban class and West Sumatra's Muhammadiyah basis

<sup>15</sup> This was in contrast with the argument in favour decentralization that arose before the crises –1990s– that stated the high dependency of local government to central government financing and the inadequacy of central financing due to declining windfall profit from oil as the source of demand for decentralization

<sup>16</sup> It confirms that simultaneous political, administration, and fiscal decentralization – especially in the new democracy– as the political process determines the pace and

## 6.2. Rents Based Transfer After 1999 Decentralization

For that purpose of knowing whether the decentralization brings a more socially beneficial rent seeking process, at least three questions should be addressed. First, whether the rent to local actors has increased or not. Secondly, whether the new, if any, capitalists involved in the new rent seeking arrangement are more productive than the previous ones. And third, whether the costs of setting the new rent seeking process, rent seeking cost, has decreased or not.

## 6.3. Increasing Rents Based on Transfers to Local Level

To estimate the change in rents that may flow differently after the decentralization, can be seen from the formal transfer of intergovernmental fund. These funds are relevant as the previous rent seeking activities in local level is highly related to the development projects financed by development budget –INPRES- from central government. The size of rents, therefore, was determined by the size of this transfer. As rent size related to the “location” of political power of government functions and authority, the shift of such power can be used as the proxy.

Most of the disputes between local government and central government were about how to allocate the DAU –General Allocation Fund- and Revenue Sharing; the new devices to assign governments fund. Before decentralization, funds were transferred to local levels under the routine expenditure of subsidy to local government, *Subsidi Daerah Otonom* mainly for civil servant salaries, and the development expenditure for regional development. The regions also received the revenue sharing over tax and non-tax revenues. After decentralization, such transfers have been replaced by block grant of DAU (*Dana Alokasi Umum*) -General Allocation Funds-, DAK (*Dana Alokasi Khusus*)- Specific Allocation Funds- and Revenue Sharing.

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manner of devolution - possibly at the expense of macroeconomic imbalance and disruption in local public service- (World Bank's PREM notes, September 2000, "Indonesia's decentralization after crisis")

DAU is the special purpose grants –the use of these funds are under regions authorities- originating from central government budget to overcome the disparities of inter-regions financial ability to finance their need of expenditure for development.

The Law 22/1999 on Fiscal Balance between the Central Government and the Regions requires the central government to transfer at least 25 percent of domestic revenue –after revenue sharing- to local government. Out of that number, 90 percent goes to district levels. Additionally, this transfer can be seen as government response to the regions' popular demand to obtain larger shares and controls of state funds (Simanjuntak, 2002, forthcoming). The DAK-specific allocation fund- is the fund to assist in financing certain requirements –unpredicted needs or national commitments- and depending on the available budget from the central state budget.

As shown in Table 2, the previous figures during 1990's of local transfers had never reached 25 percent of total domestic revenue. Thus the law effectively increases the local government revenue.

Table 2  
*Indonesia: Ratio Transfer-to-Local Regions to Total Domestic Revenue*

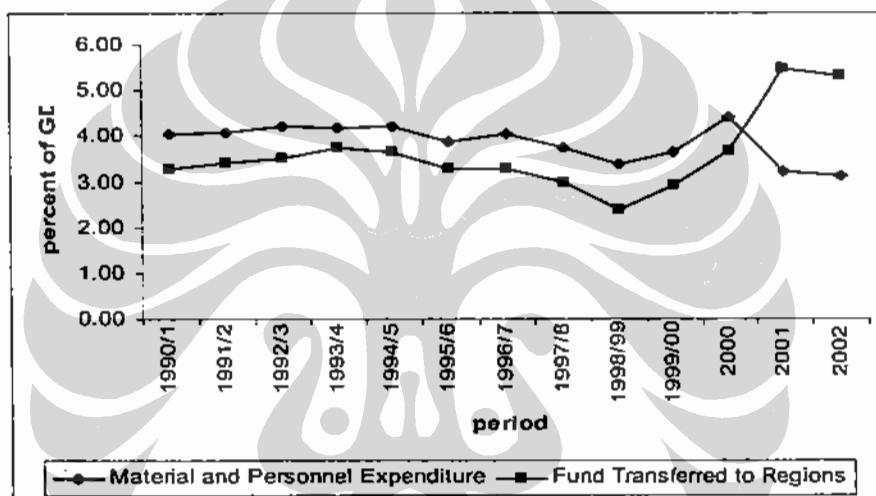
PERIOD	PERCENT
1989/90	16.95
1990/91	16.30
1991/92	19.94
1992/93	21.32
1993/94	22.14
1994/95	22.02
1995/96	21.15
1996/97	20.80
1997/98	18.64
1998/99	15.75
1999/00	15.88

source: Bank Indonesia, Statistik Ekonomi Keuangan Indonesia

note: Transfer-to-Local Regions are the Routine Expenditure of Subsidy to Local Government –SDO, mainly for local personnel expenditure; and Development Expenditure of Regional Development.

Furthermore, in percentage of GDP, the size has been increased from 3.68 percent in 2000 to 5.46 percent and 5.30 percent for the year of 2001 and 2001 respectively (see Graph 1). Even if all the decrease of central government personnel and material expenditure were assumed to be the central government apparatus transfer to local, still that there are the increase of 0.98 and 0.65 percent for 2001 and 2002, as compared to the year of 2000 figure.

**Graph 1**  
*Indonesia: State Budget for Material and Personnel Expenditure and Transfer to Region (as percentage of GDP)*



Source: Bank Indonesia, Statistik Ekonomi Keuangan Indonesia and Jakarta Post

Note: the figures of 1990/91 to 1999/2000 are the budget after-audited-figures and nominal GDP; the else are the budgeted figures and its GDP target

From the central government budget, the DAU constitutes 74.28% and 73.46% of total fund transferred to local levels. The average of fund transferred to each districts jumped from Rp 8.59-bn in 1999 to Rp 183.99bn in 2001 (see Table 3). Furthermore, the Revenue Sharing component has also increased for district as can be seen from the new allocation rule.



The dependency of local government, by the way, is still high (Table 4). On average, the portion of transfer (revenue sharing and grants) to total expenditure in district budget, in fact has increased slightly from 91.53% in 1999 before decentralization to 91.56% in 2001. But compared to the 1990s figures of about 88-89%, the dependency increased quite remarkably.

Table 3

*Indonesia: Average Routine Expenditure, Average Development Expenditure, and Average Transfer Received by District's Level*

	Numobs	Average Routine Exp.		Average Development Exp.		Average Transfer	
		Bn Rps	Coeff. Variance	Bn Rps	Coeff. Variance	Bn Rps	Coeff. Variance
1989/90	289	3.637	0.724	7.599	0.675	12.24	0.55
1990/91	288	8.190	0.790	9.991	0.892	15.59	0.73
1991/92	294	9.953	0.720	11.767	0.657	18.97	0.55
1992/93	295	13.480	0.741	13.422	0.641	23.82	0.60
1993/94	297	15.890	0.738	14.780	0.670	26.56	0.59
1994/95	297	19.549	0.778	16.705	0.750	30.84	0.64
1995/96	299	22.867	0.788	19.011	0.726	35.80	0.64
1996/97	289	30.157	0.730	23.658	0.669	45.30	0.58
1998/99	286	81.292	0.642	23.957	0.878	59.12	0.57
1999/00	298	62.647	0.625	27.456	0.754	80.59	0.55
2001	231	140.902	0.570	67.906	1.013	183.99	0.61

source: LPEM Data Base (processed)

note: - coefficient variation is average figure divided by standard deviation  
 - from the more extensive data of DAU allocation from Khoirunirofik (2002), the average transfer to districts (361 districts) was Rp 204.956-bn with coefficient variation of 0.641

**Table 4**  
*Indonesia Average Ratio of Transfer-Received-by-District to Total Budget Expenditure*

Period	Num of districts	Average Transfe to District Total Expenditure Ratio (%)	Coefficient Variation
1998/90	289	88.03	0.148
1990/91	288	88.21	0.139
1991/92	294	89.39	0.133
1992/91	295	88.98	0.128
1994/91	297	88.49	0.133
1995/92	296	87.31	0.38
1996/91	299	88.12	0.151
1997/92	291	88.08	0.213
1998/91	292	58.79	0.200
1999/92	298	91.53	0.132
2001	231	91.56	0.342

source: LPEM data base (processed)

note: - coefficient variation is average figure divided by standard deviation

By now, it is clear that district's funds increased sharply. But would it be sufficient to cover expenditures including additional expenditure from transferred personnel and offices? Despite many complaints raised by local government, the answer is yes. Part of the complaint is from the misunderstanding that the transfer is merely DAU without assuming the other elements of revenue sharing. Secondly, in particular to the 2002 DAU, the formula for DAU distribution guaranteed the minimum amount that local can obtain are a minimum are related to the actual wage bill (Simanjuntak, 2002, forthcoming).

Furthermore, Hofman and Kaiser (2002) also argued that on aggregate, more than enough revenues seem to have been devolved to match the transferred revenue responsibilities. Regions have Rp 2.1 trillions surplus in 2001 -1.5% of GDP-; and the districts received most of the surplus.

The size of budgetary fund is only one dimension of the rent magnitude. The other dimension is the authorities of government to disburse that transferred fund. In this respect, the Law 22/1999 assumes

the significant shift of authority and responsibilities from central to local government. The hierarchical relationship between centre, provincial and district government was abolished and the head of region, *bupati/walikota*, is to be elected by, and accountable to, the local council –DPRD– and no longer part of the central apparatus. The function of government is devolved to Indonesian's region and mainly districts level except the national defence, international relations, justice, police, monetary, development planning, religion and finance. The districts have responsibility to perform functions of health, education, culture, agriculture, communications, industry and trade, investment, environmental and land use affairs, cooperatives and labour (Hofman and Kaiser and Booth, 2002). This arrangement implies the enormous shift of state political power to regions and as the location of rent seeking process are determined by the location of state political power, it can be assumed that the size of rent in districts level increases as well.

On the other hand, whether the centralized off budget arrangements under New Order regime persists or not remains unclear. On one side there was a heavy pressure from international agencies to eliminate the off budget fund under the economic stabilization scheme as well as the popular demand following the 'reformasi'. Yet on the other side, it seems that the similar off budget mechanism, particularly related to the political party finance, still exists in different manner. Wahid's resignation and many public scandals of the government agency such as Indonesia Banking Restructuring Agency, *Bulog*, or the political brokerage in the state owned enterprise management positions; indicate the persistence of this mechanism in central level. Whether off budget mechanism similar to the former regime's started to emerge in local level along with the power devolution also remains hazy.

In sum, the rent transferred to district undoubtedly increase significantly as seen from the size of fund transferred and the government function devolution.

#### 6.4. New Capitalist?

Ideally, this section should address two issues. First, have any new capitalist joined the new more localized rent seeking process? Second, are

these new capitalist more productive than the previous capitalists under the more centralized regime?

Given that the decentralization program was only recently implemented, those questions could not be answered yet. The new rent seeking process itself is in formation as there are still disputes in particular devolution and distribution government functions. Arguably, as the districts political structures differ considerably as well as their economic structure; the decentralized rent-seeking pattern may have various forms across district.

Still the preliminary findings from newspaper<sup>17</sup> and forestry sector researches<sup>18</sup> show that at least three general patterns of the relationship between new decentralized districts government and capitalists have emerged.

First, there are tendencies that districts government try to exercise its new political powers to seize large capitalists that previously set agreements with central government. This can be shown from the popular demand for the revenue sharing of State Owned Enterprises – SOE- located in the district; the takeover of formerly centrally managed scheme of revenue sharing from tax and local development programme as well as the permit license (Casson, 2002-b; Barr et.al: 2002); or demand for stock share in large private or state enterprises.

Despite its variability of devices, it is clear that the old capitalists are still in the game, as the local state seems to have no intention to totally exclude them.

The balance of power between the old capitalists and the district governments depends on the industry specification and concentration level as well as the political impact that the old capitalist can exert on local government. If the industry requires the large capital, technology intensive and large initial investment, such as oil palm plantation, the old capitalist still retains the considerable influence because there are not many players in the industry, such as in timber logging. Similarly, if the

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<sup>17</sup> Based from local and national newspapers -between mid 1999 to 2001- and clippings provided by *Unit Pemantau Desentralisasi*, Institute for Economic and Social Research, Faculty of Economics, University of Indonesia

<sup>18</sup> Various publications of Case studies on Decentralization and Forests in Indonesia project by Center for International Forestry Research (CIFOR)

industry affects large numbers of local process, such as large employers, the closure can inflict the large political costs on the local government. On the other hand, if the old capitalists industries excluded the local communities, the local government, supported by the local communities, gains stronger political pressure.

The other way to seize the old capitalists is to issue districts laws for additional levies and taxes for the existing companies or raising tariffs and intensification of the old taxes and charges (SMERU Field Reports in West Java (2002), North Sumatra, and North Sulawesi (2001)). The LPEM FEUI study (2002) finds that businessmen assumed that this policy has increased the business uncertainty. Moreover, the study also revealed that the regions with lower regional autonomy index—or to have problem with decentralization- have higher additional business costs.

Secondly, there are tendency that districts government started to include the formerly excluded capitalists into the game. Sometimes this includes the illegal activities such as gambling fee or illegal logging levies (Casson: 2001b). Yet the more common method is the issuance of permits to certain new capitalists mainly under the scheme of increasing the local communities participation in the business. This effort is understandably relevant as local communities that often had been neglected now have the stronger political power after the reform. Yet in many places old capitalists have captured such initiatives. In addition, it also seems that such schemes are to formalise the rent seeking from activities formerly restricted by old regime.

The strong cases are the districts head issuing of small-scale forestry use permit HPHH (*Hak Penungutan Hasil Hutan*) to enable local communities to benefit from the forestry and timber business. However, since those local communities entrepreneurs usually lack of capital and distribution network, those local communities have to form the partnership with capital owner *cukong* or HPH holders.

Last, some districts also starts to get into business by developing the new BUMD (*Badan Usaha Milik Daerah*), -districts state owned enterprise-. The BUMD might be generated to occupy the existing business of central state owned enterprise, BUMN, located in the district or the new one into the existing business to compete with the old state and private companies.

In sum, the preliminary findings show that most of the new capitalist are not new ones. While the old players seem to adjust to the new arrangement of stronger districts government, the number of players increased by the addition from the formerly excluded actors. However whether the capitalists involved in present rent seeking process are more productive than in previous process remains unclear.

## 7. COST OF ORGANISING THE NEW RENT SEEKING PROCESS

The 1998 economic and political crises, denounced as the peak of failure of the circulation and accumulation mechanisms of Soehartos' regime, effectively destroyed the political configuration of the regime. The alliance between the military and bureaucrats were broken and as a consequence of the reintroduction multiparty of general elections in 1999, the new powerful political class are emerged: the politicians or political parties elites<sup>19</sup>.

According to Sidel (2002), the power arrangement shifted from the narrow circle of the bureaucracy, university belts, and military to the broader pool of powerbrokers whose importance is related to the ability to mobilize voters. The lobbies are now conducted in DPR –People Representative Council (legislatives)- and based on the political party affiliations, rather than to previous narrow circle based on the loyalty to the Golkar-military alliance under full command of President. Those new powerbrokers consist of machine politicians, businessmen, and gangster-like figure. In addition, the local party machineries are now relatively more powerful as they can bloc the votes.

Following the abrupton of the central power arrangement, local power relations have broken as well. According to Widodo (2002) in his particular research in Blora district, the local state has been paralysed by two things: the movement of youths, students, and middle classes over

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<sup>19</sup> In the central level this phenomenon can be observed from the result of 1999 general election when Golkar was no longer the single majority winner; the rise of "central axes" –coalitional arrangements of mainly Islamic parties and Golkar in the 1999 presidential election- politicians that defeated the presidential candidate from the general election winner of PDI-P; and the composition of coalition type of Presidential cabinet.

the issues of land disputes, access to basic needs and local KKN, -stimulated by mass media that spread the reformasi in Jakarta across the country effectively-, and the inability of bureaucracy and military to cope with the certain security threats.

At the local level, the legislatives, elected from the multiparty general election in 1999, are now more powerful (CSIS, 2001; Usman, 2002). Those legislative members gain the seats from their affiliation to the political parties. In turn, these political parties are controlled by the local elites of religious leaders, businessmen, gangsters, and village headmen (Sidel, 2002) and their influence are, similar to the case on central level, anchored in their ability to mobilize vote.

These altered power settlements force the rents based transfers to serve the political stability rather than capitalist development purpose. In fact this is enhanced by the change of the rule of the game from development, as one source of government legitimacy and survival, to elections. Or using Olson's (1993) terminology, it shifts the condition of the state as 'stationary bandits' that have longer time horizon -therefore have the intention to economic development as the state knows that the higher development will lead to greater rents-, to the 'roving bandits' who have shorter time horizon -such as elections- due to its politically weaknesses. The stationary authoritarian Soeharto regime established its legitimacy on economic development, and disregarding the elections or popular votes mechanisms, as well as built the institutions for that purpose. This is in contrast with the present condition in which the elections becomes more important and democratic, yet the capitalist economic development has not shown any clear policy direction since the political elites are competing each other for next elections or short term political arrangements.

Against that backdrop, it can be seen that the number of rents suppliers are increasing from two sources: the legislatives that now play crucial role in rents allocation, and the more independent local governments -that previously worked as subordinate of centralized rent seeking process-. According to Vishny and Shleifer (1993) such increasing number of suppliers might be desirable if it leads to the very fragmented institutional structure, in which rents based transfers suppliers compete with each other to provide similar rights so that the cost of rents seeking is minimal. However, the recent power structures

are rather moving toward the intermediate fragmented structure of agencies in which the competing agencies supplying the complementary rights that are most harmful to the economy.

Central to these structures are the complementarities of rents based on transfer and the problem of coordination that hampers the rents based on transfer suppliers to act as monopolist. Those two problems can be drawn from the new relationship between central and local level of political structure –vertically-; as well as the relationship between legislative (politicians) and executives (bureaucracy) both in local and central level –horizontally-.

To obtain the rents based transfer, now the capitalists have to deal with two tiers of government –local and central- and two sides of state of executive (bureaucracy) and legislative (politicians). The latter separation happens in both local level –Pemda (local executives) versus DPRD (local legislatives)- and central level–ministries and DPR-. In the recent period, competing factions involved can cancel out each other's rents allocation. The central government can stop the rents allocated by local government as well as the latter may also bypass the central regulations. Not only through formal bureaucracy regulations, the central still also retains considerable control through the party mechanism. Similarly, rents issued by the bureaucracy can be contested by the legislative while the former may also challenge the latter through their formal authorities. These structures show the complementarities aspects of recent rents based transfer structure, as capitalists have to obtain rents from all of those conflicting parties before starting to produce.

The problem of coordination can be seen by the absence of a strong mechanism to regulate rents seeking process. There are no longer credible mechanisms such as assignment and rotation of bureaucracy and military officers to maintain centralized or monopolized rents based transfers supply. Yet it should be noted that it does not mean that there are no controls of central government over local government. As mentioned above, such control can be exercise through the political party mechanisms in which the contestant of certain local positions should obtain the *restu*, approval, from Dewan Pengurus Pusat, Party Central



Committee<sup>20</sup>. However the effectiveness of these mechanisms have been offset by the absence of a single majority party from the 1999 general election at both the central and local level.

The above complexities imply that the problem of complementarities and coordination is not merely a number of rents suppliers and competitors, but also the distribution of power amongst those agencies as well as rents seekers under the patron-client relationship (Khan, 1996). According to this framework, the decentralization, and formerly the political crisis, has shifted the previously patrimonial to clientelist patron-client relationship. In the latter, the state as the patron is less strong as it could not secure its ability to allocate and protect the rents based transfers. The state also has to consider the political power of the competing clientelist organizations of the state officials, bureaucracy and legislative and private sectors alliances. Consequently the rents based transfers will be granted to the more politically powerful clientelist groups that may not necessarily be the most productive.

This is the very case of Indonesia after decentralization. The clientelists organizations emerges everywhere after the fracture of old regime. These organizations consist of the new arrangements under new powerbrokers and political machinations described by Sidel above.

Conflicts occur vertically and horizontally following the decentralization. Vertically, the implementations of decentralization are accompanied by growing resentments from both the central and local government. The local governments often cite that central government is not fully committed to the decentralization as seen from the slowness of the supporting regulations for Law 22 and 25/1999; the inconsistency of law implementation; and reactive manner in ratifying regulations (Usman, 2002). The local government also point out the reluctance of central line ministries to transfer their authorities to local government as allowed by the law. On the other hand, the central government also reveals the incidence of local incapability to manage the transferred function and to deliver public service (Alm, Aten, and Bahl, 2001) and the unwillingness of local government to coordinate their policies.

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<sup>20</sup> The recent case is Jakarta governor election that was intervened by DPP PDI-P as well as several incident of conflict over *restu* pusat in several districts in Java.

Regardless of their validities, such tension sometimes leads to the overlapping regulations between the two levels of government.

Additionally, in a broader sense than just administration issues, the clientelist groups of state officials, politicians and businessmen at the central and local level also start to compete over economic resources. Central clientelists groups are now in defensive position against the growing power of local clientelist groups, empowered by decentralization issues, whereas the role of the state to solve disputes with low cost seems less effective than previous regime<sup>21</sup>. Yet it is also evident that the central clientelists groups starts to consolidate their power, and somehow toward new patrimonial patron-client relationships, after the new administration of Megawati, that in favor of a strong central state supported by her alliances of Jakarta bureaucrats, the military and business (Sidel, 2002).

At the local level, such process of weakening state and the increasing power of clientelists organization can be seen from the massive incidence of money politics, the mass demonstrations against the state policies, and the bigger role of interest groups such as Non Governmental Organizations. These movements are related to the formation of new local clientelists groups that fight over rents allocation and inflict the horizontal conflicts. The bases of those groups lie on the abilities to mobilize local public for election and access to local communities that are now politically more important. The structure of those groups are now more competitive since the local communities itself are fragmented and the votes can be channeled to various parties or flexible political arrangement.

The other source of local horizontal conflict is the transfer of central bureaucracies to local government. The transfer of 2.1 millions personnel, 239 provincial-level offices of central government (kanwil), 3,933 district-level offices of central government (kandep), and 16,180 technical units (UPT) (Usman 2002, quoting Koran Tempo, July 14, 2001 and GTZ Decentralization News March 2001) is not only creating logistical problem and formal local organizational settings, but also power arrangement problems. It is because the bureaucratic positions imply a certain power and access to the rents based transfers process.

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<sup>21</sup> See the case of PT Kaltim Prima Coal and PT Semen Padang for example

Indeed such transfer already causes several horizontal conflicts amongst local bureaucrats and between local bureaucrats and local political elites. To avoid such conflict, there is the tendency for local government to maintain an unnecessary large administrative structure (Usman, 2002)

In sum, the cost of organizing new rents based transfers are now much larger than that of previous centralized regime. This is because of the increasing suppliers of rents without any reliable coordination mechanism and the shift toward more clientelist patron-client relationship that impose higher political cost as the consequence of the rising vertical and horizontal conflicts.

## 8. CONCLUSION

As seen from its historical accounts, the issues of decentralization and rents based on transfers in Indonesia are the problem of conflicts among elites elements that supports certain regime's political structure. The degree of centralization depends on the political power of local levels, abilities of the regime to set power structures with inherent reward and control mechanisms, and the availability of rents based transfers and its circulations. Whether these rents based on transfers could support capitalist development, as well as political stability, depends on the availability of well-built mechanisms for coordination and minimizing political conflicts. The choice of actors within these political alliances is crucial as well.

The strong centralized Soeharto regime was able to generate the above mechanisms. Consisting of alliances amongst the military, bureaucracy, and Chinese businessmen, with minimum participation of political parties, the rents based transfers were managed through orderly political structures, networks, agencies, and institutions entrenched to the centre. The regime was supported financially by the natural resources boom and foreign investments and aids. For controlling elements of rents seeking process and maintaining the close ties to local levels, the regime employed the military and bureaucrat assignments and rotation mechanisms. In turn, despite massive rents based on transfers, the state could still deliver capitalist development at both national and local levels.

Furthermore, rather than the problems of regional economic development, the disrupting political structures of the New Order after the 1998 crisis and the swing of political balance to local regions caused the shift to decentralization. Up to 2002 the new rents based on transfers at the local level increased sharply, as can be seen from the formal regulations for greater intergovernmental funds and local level authorities. However, there was only weak evidence that the new capitalists have emerged in these new rent seeking processes and structures. The costs of organizing the new rents based transfers are also much larger than that of the previous regime's due to weak coordination mechanisms and tendencies in power structures for more clientelist patron-client relationships. Without overcoming these problems, the Indonesia's decentralization program may lead to economic disaster.

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