



Development Progress



Indonesia's progress on governance:

State cohesion and strategic institutional reform

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For more information, contact Dan Harris (d.harris@odi.org.uk), Marta Foresti (m.foresti@odi.org.uk) or Liesbet Steer (l.steer.ra@odi.org.uk).

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List of abbreviations

ACBF	Africa Capacity Building Foundation
AusAID	Australian Agency for International Development
BPS	<i>Badan Pusat Statistik</i> (Statistics Indonesia)
DAU	<i>Dana Alokasi Umum</i> (General Allocation Grant)
DPD	<i>Dewan Perwakilan Daerah</i> (Regional Representative Council)
DPR	<i>Dewan Perwakilan Rakyat</i> (People's Representative Council)
DSF	Decentralisation Support Facility
GAM	<i>Gerakan Aceh Merdeka</i> (Free Aceh Movement)
GDP	Gross Domestic Product
IHPH	<i>Iuran Hak Pengusahaan Hutan</i> (Forest Concession License Fee)
IMF	International Monetary Fund
KKN	<i>Korupsi, Kolusi dan Nepotisme</i> (Corruption, Collusion and Nepotism)
LNG	Liquefied Natural Gas
MDG	Millennium Development Goal
MP	Member of Parliament
NGO	Non-Governmental Organisation
ODI	Overseas Development Institute
PSDH	<i>Pengelolaan Sumber Daya Hutan</i> (Forest Resource Royalty)
SBY	President Susilo Bambang Yudhoyono
WDI	World Development Indicators

1. Introduction

The world's fourth most populous state, rich in natural resources and biodiversity, the largest Muslim-majority nation and a significant player in one of the world's fastest growing regions, Indonesia has emerged from a decade of financial, political and environmental crises and is now recognised as an important partner in attempts to address global challenges.

Following the end of Suharto's 32-year reign as head of the New Order regime, and the economic turmoil of the East Asian financial crisis, Indonesia has undergone significant reform of its governance institutions. As might be expected following such an extended period of concentrated rule under a single leader, the initial period of release witnessed intense competition among a range of actors, all pressing for their demands to be met in whatever political settlement would replace the New Order system. This collection of interests, and the varying power of the actors involved, has produced a still-evolving set of institutions, with important consequences for the shape and stability of the future Indonesian state.

In the 12 years since the collapse of Suharto's regime, Indonesia has transformed from a highly militarised and centralised authoritarian state into what has been lauded as a story of democratic success. The country has pursued an aggressive programme of 'big bang decentralisation,' designed to devolve greater amounts of responsibility and decision-making authority to local levels. The aim is to enable citizens to better express their preferences, to increase the accountability of public officials and to improve the delivery of core governance functions, including provision of public goods. Yet decentralisation has been only the centrepiece of a broad-ranging programme of reform of formal government institutions, including the executive, the judiciary, local and national legislatures and the military.

This paper attempts to balance these elements of progress with a significant body of literature on the continued practical challenges of corruption, neo-patrimonial patron–client relations and 'money politics.' While some of the initial high hopes of reformers pushing democratisation and decentralisation have yet to be borne out universally in practice, so too have the worst fears of militarisation, national disintegration and radicalisation. Our attempt to reconcile some of the more optimistic and pessimistic analyses highlights the complex and diverse nature of the transition and reminds us that the story of governance in Indonesia is a story of progress rather than one of absolute success.

2. Context

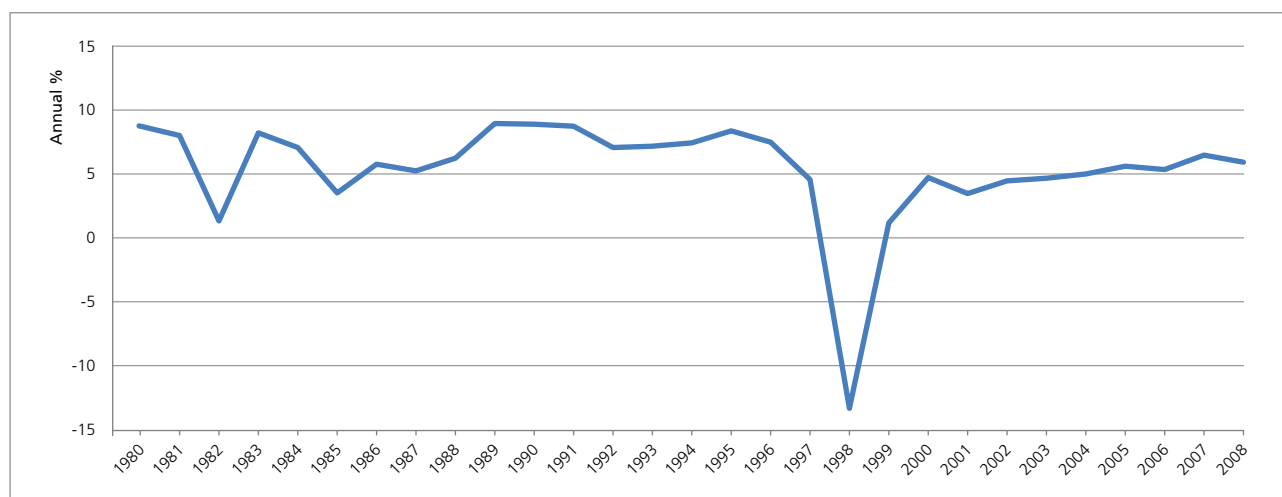
Any understanding of the achievements of Indonesians in building a more cohesive and stable nation state since 1998 should be grounded in an awareness of the key elements of the Indonesian context, including characteristics of the Indonesian state and of previous governance regimes as well as of the 1998 political transition.

2.1 Suharto and the New Order regime

For more than three decades preceding the 1998 governance transition, the centralised authoritarian New Order regime of Suharto ruled Indonesia. The complexity of Indonesia's governance transition arises in part from the fact that the New Order was not without its achievements. Key elements of the developmental state,¹ including a strong, often authoritarian, hand, resulted in strong macroeconomic performance, with natural resource revenues channelled relatively effectively towards 'developmental' (here taken to mean growth-enhancing) outcomes (Lewis, 2007; McCawley, 2005).

Although impressive rates of gross domestic product (GDP) growth during the 1980s were volatile, owing in part to fluctuations in world commodity prices, economic growth during the 1990s was high and sustained until the onset of the East Asian financial crisis in 1997. GDP growth rates peaked at 9.00% in 1990, but never fell below 7.22% (in 1992) (Figure 1).

Figure 1: GDP growth in Indonesia, 1980-2008



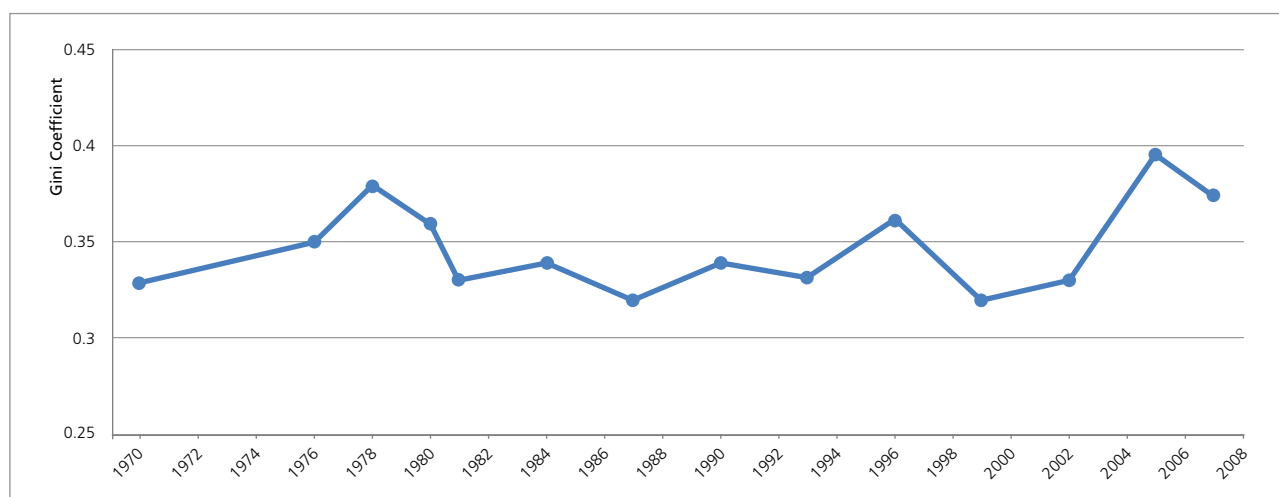
Source: WDI (<http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2>).

Despite international experience that suggests significant portions of government revenue coming from (non-tax) oil and gas sources leads to governance that ignores the needs of citizens, the New Order regime has been lauded for its ability to manage this wealth in unusually effective ways. This included significant investments in rural infrastructure, facilitating diversification away from overreliance on natural resources (Lewis, 2007; Rosser, 2007; Timmer, 2007). As Eifert et al. (2003: 8) describe:

'[...] the technocrats running the economy during the early part of Suharto's rule focused on food security, macroeconomic stabilization, and financial sector reform. Money was spent on improving economic infrastructure, and Indonesia's abundant gas reserves were harnessed to provide a supply of low-cost agricultural inputs to complement the introduction of high-yielding rice varieties.'

Income growth was shared relatively widely across the Indonesian income distribution, resulting in a remarkable level of stability in the Gini coefficient (Figure 2). Timmer (2007: 38) suggests that, given the types of investments described above, this stability 'should not be taken as the result of market-driven forces [...], but rather as a conscious government effort, led from the macroeconomic arena by the technocrats but blessed by the president, to stimulate what is now called pro-poor growth.'

Figure 2: Gini coefficient in Indonesia, 1970-2006



Source: Papanek (2004) from BPS data, in Timmer (2007).

Impressive levels of GDP growth and Gini stability under the New Order demonstrate the ability of the regime to avoid some of the pitfalls that can suppress aggregate economic growth in states that are more clientelistic or extract more rents. Nevertheless, the strong central control that facilitated the direction of neo-patrimonial practices towards growth-enhancing outcomes came at a price. Indonesia approached the late 1990s under the rule of a centralised regime, dominated by an alliance between an executive that had managed to hold power for more than three decades and a military establishment deeply involved in the day-to-day affairs of the nation. This ruling alliance, unencumbered by any effective system of checks and balances, served to protect the interests of a narrow subset of Indonesian society, with the Suharto family at its head. Political space, including that extended to individuals and the few permitted political parties, remained limited (Webber, 2006).

While the official position of the state was to promote 'Unity in Diversity' (Bünter and Ufen, 2009), such diversity often existed only superficially. The need to promote national unity resulted in policies of modernisation and homogenisation that challenged the survival of Indonesia's small-scale ethnic groups (Duncan, 2007). Other policies towards Indonesia's minority groups, including the state's official recognition of cultural status equality and symbolic promotion of ethnic or religious diversity, played an important role in diverting attention away from underlying socioeconomic and political inequalities (Langer and Brown, 2007). Despite the economic achievements of the New Order regime, this dynamic became increasingly significant, as expanding gaps between different socioeconomic, cultural and geographic subsets of the diverse Indonesian population became ever clearer. Lewis (2007) suggests three key sources of pressure facing the New Order government:

1. **Tensions over regional distributions of wealth and power.** Since the mid-1970s, natural resource revenues had accounted for a significant portion of the Indonesian economy. Although the percentage of total government revenue and total exports that the oil and gas sector contributed had decreased from its peak in the early 1980s, simmering centre–periphery tensions in regions including Aceh and Papua erupted over Jakarta's consolidation of key natural resource revenues. After two decades of Indonesian rule, East Timor too demonstrated significant separatist intentions.
2. **Growing resentment of the benefits accruing to the political elite and to well-connected military and Sino-Indonesian business interests.** While the majority of Chinese in Indonesia suffered from exclusionary practices (Box 1), a limited number of ethnic Chinese, such as the highly visible Bob Hasan, maintained control over vast business conglomerates. Along with senior military figures, these individuals, who benefited conspicuously from the economic policies and neo-patrimonial practices of the New Order regime, became the targets of growing resentment among indigenous business interests and an emergent middle class.
3. **Discontent among key representative organisations outside the control of the state.** In rural areas, Islamic organisations with close ties to broad swathes of the population, including a subset that advocated the creation of an Islamic state under Shari'a law, began to challenge the authority of the state. In urban areas, trade unions played a similar role. As grievances among these groups grew, so too did the occurrence of disturbances, such as the riots of July 1996 in Jakarta and attacks against ethnic Chinese (Lewis, 2007).

Box 1: The uneasy (and uneven) relationship between Suharto and the ethnic Chinese

Despite the inclusion of a small number of ethnic Chinese in Suharto's inner circle, the Sino-Indonesian community was subject to ethnic suppression that defied the national motto of 'Unity in Diversity.' Practices including the banning of Chinese names and Chinese characters contributed to an environment in which the state set aside the Chinese as a 'contaminating "other" that threatened the authenticity of the nationalist project' (Langer and Brown, 2007: 4; Muzzaki, 2010). Subject to such policies of assimilation, ethnic Chinese were 'thus denied the possibility of assimilating fully – for instance, alone amongst Indonesian citizens, they were obliged to have their ethnicity marked on their identity cards – and thus remained "second-class" citizens' (Langer and Brown, 2007: 4-5).

2.2 Economic and political crisis of 1997-1998

When financial crisis began to hit Indonesia in earnest in 1997, it revealed the underlying contradictions between the informal patchwork of practices that Suharto had managed to make work for three decades and the weakness of formal institutional practices dictated by globalisation. Indonesia suffered significantly as a result of the crisis: capital swept out of the country (including the large quantities of portfolio investment that had contributed to the burgeoning manufacturing sector), leading to a 13% decline in GDP, dramatic increases in poverty, unemployment and economic dislocation (Chaudhuri et al., 2009).

The crisis and the response to the crisis placed Suharto between the international community, including agencies such as the International Monetary Fund (IMF), which demanded the restructuring of the political economy, and his own cronies, members of the privileged elite seeking to preserve their authority.² The underlying cracks in the regime were ruthlessly exposed. In the face of growing popular discontent (reflected in unprecedented challenges of the regime and its leadership, including significant popular protests in the capital) and the loss of traditional sources of support, including the Indonesian armed forces, Suharto resigned on 21 May, only two months after his re-election for a seventh term by the People's Consultative Assembly. The regime's reliance on Suharto's personalised power meant that, without his personal authority, the institutions that had defined the New Order regime stood little chance of surviving and leading Indonesia formally into a period of transition (Lewis, 2007).

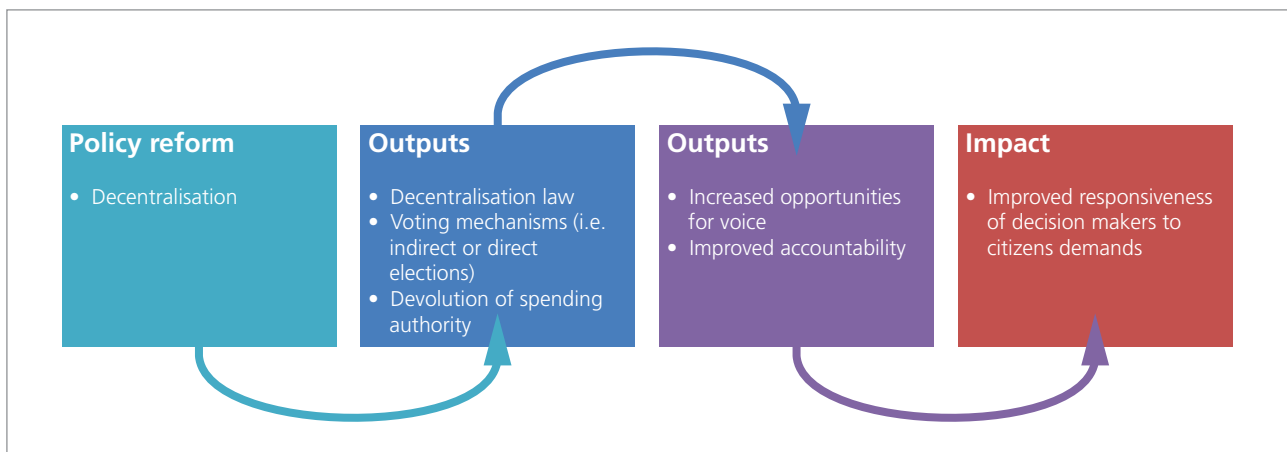
3. What has been achieved

The economic and political crisis that shook the foundations of the Indonesian state also precipitated a period of dramatic change. This was characterised by several governance reforms, particularly around the rules and institutions that shape the exercise of power and interactions between citizens and decision makers; and that govern behaviour in different arenas to pursue collective goals and interests.

3.1 Progress in governance in Indonesia: A nuanced approach

The value attributed to 'good governance' reforms is often predicated on assumptions about the expected outcomes and impacts of such reforms. The experiences of Indonesia since 1998 demonstrate that the linkages expected in much of the literature are far from automatic. This is particularly true where reforms in one area are expected to produce outcomes in another (Rocha Menocal and Sharma, 2008). For example, the implementation of a democratic decentralisation policy is often assumed to reduce the space between citizens and decision makers, improving the effectiveness of citizens' voice (i.e. more contact between non-governmental organisations (NGOs) and decision makers) and strengthening accountability relationships between the two groups of actors. In this way, it is thought to result in increased effectiveness and efficiency in the use of public funds, improved alignment with local development needs and, ultimately, improvement in core governance functions, including the delivery of public goods (Figure 3).

Figure 3: Theoretical flow of good governance reform



A number of recent accounts suggest these reforms led to encouraging progress in public goods provision in Indonesia (Chowdhury and Yamauchi, 2010). However, even the most optimistic analyses of governance acknowledge that, in practice, the impact of governance reforms on accountability, responsiveness, corruption and a number of other key governance concepts has been mixed. Despite reform, anticipated good governance benefits (interpreted as strengthened voice and increased accountability, reduced corruption, increased responsiveness and improved service provision) have yet to occur in many places. These benefits have been constrained by a number of highly political (rather than technical) factors, including: 'capture, clientelism, capacity constraints, competition over the balance of power between levels of governance, and weaknesses in the interregional information flows that are critical for effective competition' (Campos and Hellman, 2005: 238). Therefore, while local politics and governance practices have become far more vibrant following decentralisation reforms, local political processes have not yet necessarily become more genuinely participatory or responsive to citizens' interests (Choi, 2007).

Therefore, it seems important not to claim that decentralisation and democratisation in themselves constitute progress, but rather that characteristics of these processes have in practice contributed in some way to improved incentives for government (although these may not be the ones generally associated with such reforms). An analysis of Indonesia's experience with governance reform requires us not only to look at whether reforms to formal institutions have led to improvements, but also to examine more broadly whether institutional arrangements (formal or informal) have led the state to act in ways that have benefited the general population.³

This perspective can help us better understand how claims of 'progress in governance' can accommodate partial reform, geographic variation and a host of other challenges that Indonesia continues to face. The remainder of this section therefore first examines where significant political reforms have been made, and then suggests why such reforms, as partial as they have been in terms of true impact, are critical to Indonesia's progress in governance.

3.2 Widespread reform of formal government institutions

The period since 1998 has seen a number of significant reforms to the formal state institutions in place under the New Order regime. These reforms have fundamentally restructured the Indonesian state. They have changed the balance of power among the branches of government, introduced a system of checks and balances and brought an end to the executive dominance that defined the latter years of Suharto's reign (Chaudhuri et al., 2009). Here we present a brief survey of some of the most significant reforms.

3.2.1 Electoral reform

Among the most obvious changes in governance institutions that took place as a part of Indonesia's governance transition is the adoption of competitive, direct, 'free and fair' elections as the mechanism for choosing government leaders. Reforms in 2004 abolished the practice of guaranteed appointments to parliamentary seats for 38 members of the armed forces and police. Direct elections are now the preferred mechanism for the selection of both local government leaders (previously appointed by local councils) and, from 2005, national government leaders. This includes the election of the president and the vice-president under a single ticket (Stockmann, 2009), providing a strong public mandate for government leaders. Despite the fears of some electoral analysts prior to the first round of elections, that years of participation in the carefully managed New Order era electoral system would result in voter apathy and non-participation in democratic processes, voter turnout was high. A total of 93.3% of registered voters (85.69% of the voting-age population) voted in the 1999 parliamentary elections.⁴ Voter turnout has largely remained high in subsequent elections. Furthermore, Indonesians show a clear willingness to vote out incumbents, particularly where such candidates have been associated with corruption or other scandals.

Electoral laws and regulations have been assessed and, where necessary, modifications proposed, resulting in improvement not only relative to the New Order era but also from one election cycle to the next. Initial reforms enacted to govern the first round of elections in 1999 included the creation of a national election commission that guaranteed representation of each of the political parties participating, and thus comprised 43 members. While this structure appealed to Indonesian ideals of consensus building, partisan divides and large size hampered the commission. Further reforms, enacted prior to the second round of elections, replaced this ineffective body with a panel of five non-partisan commissioners. Such reforms are ongoing: currently, there is debate around the adoption of a German-style electoral threshold of 3.5-4% to reduce the number of parties, thus improving the stability of the party system while maintaining a degree of choice for voters.

3.2.2 Parliamentary reform

Under Suharto, parliament was marginalised as a largely rubber-stamp institution. It has since undergone extensive changes in composition and become a repository of significant power. The most dramatic alterations include the abolition of protected appointments in the DPR (*Dewan Perwakilan Rakyat*, People's Representative Council), mentioned above, and the introduction of a bicameral structure. Parliament now includes the DPR and the DPD (*Dewan Perwakilan Daerah*, Regional Representative Council). The latter is a newly created body, comprising 128 legislators, with four drawn from each of Indonesia's 32 districts.

³ This is reflected in the definition of progress in governance in the Progress Stories project: *Improvements in the sustained functioning of rule-governed arrangements which provide incentives for the state to act in ways that promote the wellbeing of the population.*

⁴ www.idea.int/vt/country_view.cfm?CountryCode=ID.

MPs have begun to act with significant independence from the executive and, as a result of the new powers accorded them in the post-Suharto era, are exploring their new role as a major component of Indonesia's developing system of checks and balances (Blöndal et al., 2009; Chaudhuri et al., 2009; Stockmann, 2009). Arguably the most significant new role for Parliament is its participation in a newly consultative budget process. Whereas under Suharto Parliament was called on only to formally approve the budget presented by the executive, parliamentary engagement now takes place at all stages of the budget process (Blöndal et al., 2009). While some capacity constraints do exist, analysis suggests that parliamentary scrutiny, particularly in the pre-budget phase, is increasingly effective.

3.2.3 Budget and financial reform

In addition to increased parliamentary scrutiny of the budget process, Indonesia has enacted a number of other noteworthy reforms. These have, for the first time since the formation of the Dutch colonial government, eroded a significant degree of the executive dominance that characterised the budget process. This new legal framework includes specific input controls and other fiscal rules designed to promote budget responsibility, reduce corruption and increase accountability (Blöndal et al., 2009). It has proven effective at improving both national- and sector-level governance (Box 2).

Box 2: Financial reform and Indonesia's Forest Reforestation Fund during the post-Suharto era

Changing practices in the governance of Indonesia's forestry sector Restoration Fund demonstrate how the potential benefits of Indonesia's institutional reforms may be felt at the sector level. Key reforms affecting the Restoration Fund include the passage of Law 1/2004 on State Treasury, which mandates the introduction of a Treasury Single Account, the strengthening of the Supreme Audit Board and the creation of effective and independent anti-corruption institutions. Restoration Fund receipts and expenditures are now included in the state budget, which increases transparency in the use of funds and the potential for scrutiny by a number of stakeholders. Improvements in audit capacity and the capacity of anti-corruption institutions have provided effective sanction mechanisms to deter and, where necessary, punish abuses.

Source: Barr et al. (2010).

3.2.4 Judicial reform and the rule of law

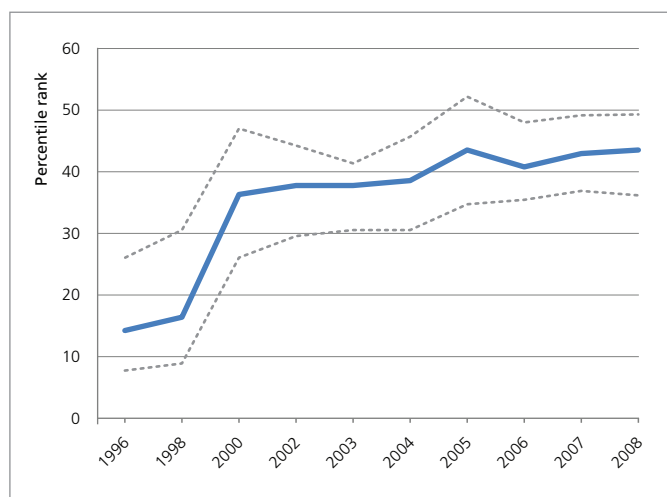
In contrast with the concentration of authority in the executive (and specifically in Suharto himself) during the New Order era, Indonesia has taken significant steps since 1998 towards the separation of powers and the establishment of a more independent judiciary. Critical reforms include the creation of the Constitutional Court (Stockmann, 2009) and shifting the responsibility for management of the court system from the executive to the Supreme Court (Chaudhuri et al., 2009).

3.2.5 Political space

Indonesia's drive to open up new space to include a diversity of political actors and opinions in the political process is one of the major achievements of post-New Order governance. A significant reduction in explicitly exclusionary policies, including the elimination of anti-Chinese legislation (Box 1, above) is an important component of this. Meanwhile, these repeals appear to be emblematic of a broader change in the relationship

between citizens and the state. This is reflected in a proliferation of civil society organisations and pressure groups, the development of new and active political parties and the increased ability of opposition parties to influence policy decisions. Such reforms have likely contributed to a significant improvement in the country's performance on leading indicators of public perceptions of voice and accountability (Figure 4).

Figure 4: Voice and accountability in Indonesia, 1996-2008



Source: Worldwide Governance Indicators (<http://info.worldbank.org/governance/wgi/index.asp>).

3.2.6 Military reform

While critics note that the military has retained the territorial structure that contributed to its strength, there is no doubt that significant reforms have been achieved, and the military has given up much of its political influence. In addition to loss of influence in the legislative assembly, as described above, chief among these is the end of *dwifungsi*, or the 'dual system' in which the armed forces not only played a military function but also retained significant involvement in economic activities. The police force has been separated from the armed forces and, although a number of ex-military officers, including President SBY, retain influential posts, serving military officers are no longer permitted to hold positions in the civilian bureaucracy (Aspinall, 2010).

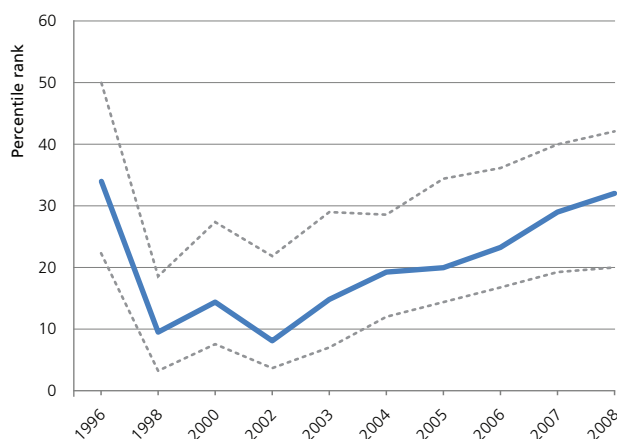
3.2.7 Independent oversight institutions

One of the key elements of the erosion of executive dominance since 1998 is the establishment or strengthening of independent agencies charged with the oversight of state institutions. These agencies include the Supreme Audit Agency (answerable to Parliament), the Judicial Commission, the Police Commission, the Office of the Ombudsman, the Corruption Eradication Commission, the Elections Commission, the Financial Transactions Task Force, the Anti-Corruption Court and the Commercial Court (Chaudhuri et al., 2009).

Box 3: Bottom-up and top-down anti-corruption movements in Indonesia – civil society and the Corruption Eradication Commission

The Corruption Eradication Commission is one of the clearest examples of how Indonesia's new independent oversight institutions are beginning to have an impact on governance. The commission, modelled on effective institutions in Hong Kong, Korea and South Africa, is recognised for its success in prosecuting a number of high-profile corruption cases. There are very real concerns that the corruption, collusion and nepotism (*korupsi, kolusi dan nepotisme*, or KKN) that were dominant under Suharto have merely been pushed to lower levels of government (Hadiz, 2010). However, together with some notable successes for civil society in pushing the investigation of corruption cases (see Rinaldi et al., 2007), public recognition of the effectiveness of the commission may be behind Indonesia's improving performance on corruption perception indices (Kaufmann et al., 2009).

Control of corruption in Indonesia, 1996-2008



Source: Worldwide Governance Indicators (<http://info.worldbank.org/governance/wgi/index.asp>).

3.3 Effects of reform on key state functions: the search for state cohesion

Much of the literature on Indonesian governance reform focuses on the extent to which reforms have resulted in improvements in voice, accountability, control of corruption and other governance indicators theoretically linked to new institutional arrangements. However, we also need to consider the possibility that those same reforms have served functions other than those that the development community that supported them intended. One key example of this type of effect is the impact of the democratic decentralisation reforms enacted in the post-Suharto period. While some of the expected dividends of democratic decentralisation, including improved accountability and service provision, have not been realised in full, we suggest these reforms have nevertheless served an important function in Indonesia.

The creation and maintenance of social and political order itself is an important goal of developing societies, 'independent of the question of whether that order was democratic, authoritarian, socialist, or free-market' (Huntington, in Fukuyama, 1997). Once Suharto's semi-coercive authoritarian regime collapsed, it became apparent that Indonesia needed to develop a new set of institutions in order to maintain the critical degree of state cohesion that is a prerequisite for a state to engage in more complex tasks, such as the organisation of coherent social policy and improvements in service delivery.

Democratic decentralisation can therefore be seen and judged not only as a set of technical reforms undertaken with the intent to improve 'governance,' but also as an intelligent political strategy intended to strengthen the basic but critical state function of state stability. In light of the significant rifts within Indonesian society that Section 2 describes, it is important not to underestimate the maintenance of a cohesive state as an accomplishment.

The need to maintain national unity and control in a post-authoritarian, post-crisis environment, including the prevention of eruptions of violence and continued violent resistance to the state over the long run, provided a strong incentive for Indonesian elites at various levels of government to embrace decentralisation reforms and to shape them in ways that would preserve their standing/status in Indonesian society.⁵

The decision of the Habibie government to decentralise, providing significant authority to the district level and bypassing the provincial level, at which separatism had found its clearest expression, has clearly been effective. Since decentralisation laws came into effect at the turn of the century, there has been a significant, if not complete, decline in regional separatism and regional conflict. Chaudhuri et al. (2009) cite the successful peace deal struck with the separatist Free Aceh Movement (*Gerakan Aceh Merdeka*, or GAM) in 2005, as well as 'reduced tensions in the Poso area of Central Sulawesi, in conflict-prone regions of Maluku and Flores, and

⁵ There is a strong theoretical tradition that argues for federalism as a means of alleviating regional conflict. See Shah and Thompson (2004) for this and a good summary of the motives for decentralisation.

in Papua' (Chaudhuri et al., 2009: 7) as key examples of this significant increase in state cohesion. Interviews suggested that the resentment towards Jakarta that was felt under the New Order has been tempered in districts across the country.

The lynchpin of this strategy to counter the fragmentation and possible balkanisation of Indonesia has been the institution of a complex, but largely effective, system of revenue redistribution. As part of the broader process of decentralisation, expenditure authority for all functions other than justice, defence, police, monetary policy, development planning and finance, was devolved to the local level (Shah and Thompson, 2004). However, the central government has largely retained its powers of revenue collection (taxation). Without significant fiscal resources of their own, local governments are dependent on transfers from the central government for the vast majority (90-93%) of local government revenue (Blöndal et al., 2009; Hofman et al., 2006). The resultant fiscal federal system is therefore vertically imbalanced,⁶ suggesting the structure of fiscal redistribution is critical to the provision of most public goods and providing an incentive for local-level leaders to maintain a good relationship with the central government. Fiscal redistribution in Indonesia relies on three key mechanisms: revenue sharing, general allocation grants and special allocation grants, which are detailed below.

3.3.1 Revenue sharing

Revenue sharing, in which central government shares varying proportions of tax revenues (including property and personal income taxes) and natural resource revenue (including oil, gas, mining, forestry and fisheries) with provincial and district governments, accounts for over one-fourth of all transfers from central to lower levels of government (Blöndal et al., 2009). In all cases, the district or municipality level of government receives a greater share than the provincial level, and producing districts or municipalities often receive a disproportionately higher rate of revenue sharing. Tables 1 and 2 present an overview of revenue-sharing arrangements before and after the implementation of the 1999 decentralisation laws. Resource-rich regions where demands for autonomy were greatest have received special autonomy arrangements. Under these arrangements, 'the provincial government of Aceh receives 55% of oil taxes and 40% of LNG [liquefied natural gas] taxes; the provincial government of Papua receives 70% of oil taxes and 70% of LNG taxes' (Barr et al., 2006).

Table 1: Revenue sharing prior to 1999 laws on decentralisation and fiscal balancing

Revenue source	Central government	Provincial government	District or municipality
Oil	100%	0%	0%
LNG	100%	0%	0%
Mining: Land Rent	20%	16%	64%
Mining: Royalty	20%	16%	64%
Forestry: IHPH	30%	56%	14%
Forestry: PSDH	55%	30%	15%
Fishery	100%	0%	0%
Land and Building Tax	19%	16.2%	64.8%
Land/Building Transfer Fee	20%	16%	64%
Personal Income Tax	100%	0%	0%

Note: IHPH = *Iuran Hak Pengusahaan Hutan* (Forest Concession License Fee); PSDH = *Pengelolaan Sumber Daya Hutan* (Forest Resource Royalty).
Source: World Bank (2003), in Barr et al. (2006: 67).

⁶ Note that, while this dynamic serves to strengthen the relationship between local and national governments, its full impact on the relationship between citizens and government is unclear. The separation of tax revenue collection and expenditure responsibilities may reduce some of the potentially positive impacts of a tax-based contract between citizens and the state. See Moore (2008) for more detail on the relationship between taxation and governance.

Table 2: Revenue sharing following 1999 laws on decentralisation and fiscal balancing and implementing regulations

Revenue source	Central government	Provincial government	Originating district or municipality	Other district or municipality in same province	All districts and municipalities in Indonesia
Oil	85%	3%	6%	6%	0%
LNG	70%	6%	12%	12%	0%
Mining: Land Rent	20%	16%	64%	0%	0%
Mining: Royalty	20%	16%	32%	32%	0%
Forestry: IHPH	20%	16%	64%	0%	0%
Forestry: PSDH	20%	16%	32%	32%	0%
Fishery	20%	0%	0%	0%	80%
Land and Building Tax	9%	16.2%	64.8%	0%	10%
Land/Building Transfer Fee	0%	16%	64%	0%	20%
Personal Income Tax	80%	8%	12%	0%	0%

Source: World Bank (2003), in Barr et al. (2006: 67).

3.3.2 General allocation grants

General allocation grants (*Dana Alokasi Umum*, or DAU) comprise two components, totalling 26% of total central government revenue after deductions for revenue sharing, and make up roughly two-thirds of all transfers from the national government (Blöndal et al., 2009). The first component distributes funds to cover the wages of the more than 2 million central government staff members, previously working in deconcentrated units, who were placed under the authority of local governments under Laws 22 and 25 of 1999 (ibid; Shah and Thompson, 2004). The second component is a formula-based allocation that incorporates assessment of both a region's fiscal needs and its fiscal capacity.⁷

The management of DAU by the Indonesian government has been an impressive demonstration of the capacity and willingness of the central government to ensure grants are delivered on time, according to formula and without corruption. A number of hold-harmless adjustments were used to smooth the transition to new formula-based DAU allocations, and the formula was adjusted over time where certain regions or districts faced a large reduction in year-on-year funds. The use of a clear formula for the allocation of these grants (like the revenue-sharing mechanisms) is a significant step towards overcoming the initial weight of the legacy allocations from the New Order era.

3.3.3 Specific allocation grants

Specific allocation grants to individual regions account for less than one-tenth of all transfers from the national government. Funds distributed through this mechanism include those for natural disasters response 'and other emergencies – and for financing central priorities at the regional level. Regions apply to the central government for the grant and must provide 10% matching funds from their own resources' (Blöndal et al., 2009).

3.4 Sustainability of progress

In laying the institutional foundations for a more cohesive and stable state, Indonesia's progress in governance appears sustainable. Despite existing questions about some aspects of the decentralisation process (including occasional episodes of low-level centre-periphery conflict), the programme of reforms enacted since the fall of the New Order does seem to have effectively addressed concerns about potential balkanisation. Power and stability are no longer concentrated within a single individual, and the chances of state collapse similar to that during the East Asian financial crisis appear to be relatively low. A number of new or newly reformed institutions appear increasingly consolidated.

⁷ For a more detailed description of DAU allocation, see Blöndal et al. (2009) and Hofman et al. (2006).

As elsewhere, it is clear much remains to be achieved in Indonesia. Future governments will face a variety of challenges, particularly if and when citizens' expectations change and demands for access to quality public services become more acute. Addressing the question of effective leadership and linkages between citizens and elites at the local level will be critical in ensuring continued progress in governance that improves the well-being of the population in general, including various minorities.

4. Drivers of progress

In Section 3, we demonstrated that the reform of major formal state institutions has been wide-ranging and has undoubtedly resulted in improvements in governance. We have also acknowledged that, while significant, these reforms have not necessarily led to the development of participatory, accountable, corruption-free governance, although they have led to important achievements, including the establishment of a basic level of state cohesion. Here, we suggest a number of factors that help explain the way Indonesia has pursued and achieved progress in governance. We then show why these factors have resulted in the type of mixed and partial outcome Section 3 described.

4.1 Framing governance transitions in terms of institutional change

Political scientists identify three strands within the body of thinking known as 'new institutionalism': historical institutionalism, rational choice institutionalism and cultural institutionalism (Hall and Taylor, 1996). Each of these three analytical approaches provides interesting insights into the ways in which Indonesia's governance institutions have changed over time and helped shape social, political and economic outcomes. For historical institutionalists, the form and function of governance institutions under the New Order regime undoubtedly influences Indonesia's new (decentralised democratic) governance regime. Rational choice institutionalists would recognise in the new governance arrangements how key actors, specifically local and national elites, sought to shape the post-New Order institutions in ways that would preserve or enhance their own power. Sociological institutionalists would note how perceptions of legitimacy that key actors and dominant institutions held helped shape the reform options available to the Indonesian state.

4.1.1 Historical determinants of future institutional outcomes

Historical factors help to explain some of the progress made in Indonesia, as well as some areas in which progress has stalled. Indeed, there is good reason to believe that much of the progress achieved has some of its roots in the historical legacies of New Order institutional arrangements. For example, Suharto's semi-coercive regime allowed for a range of social, political and economic actors to operate, as long as they could be incorporated into the system rather than challenging it (Aspinall, 2010). As a result, at the time of its collapse, already more than 11,000 civil society organisations were operating largely unregulated in Indonesia, including two of the largest mass-based Muslim organisations in the world, *Muhammadiyah* and *Nahdlatul Ulama*. The need for such organisations to continue to build capacity and explore the new boundaries of their role in the post-authoritarian world is evident, but they also provided something on which to fall back when the government collapsed. Furthermore, local NGOs have proven vital to attempts to address local government corruption (Davidsen et al., 2006; Rinaldi et al., 2007).

A second example of the potentially positive influence of previous institutional arrangements can be found in the approach to the exploitation and management of oil and gas resources under the New Order regime. Heavily centralised and unable to attract significant external investment, the Indonesian oil and gas sector failed to develop a dominant position during the New Order era. This failure, and the resultant lack of investment in petroleum-related infrastructure (relative to other similarly endowed countries), has resulted in the development of a broader-based Indonesian economy than might otherwise have been the case. This has both the direct benefit of developing a more inclusive growth process and the indirect benefit of making the government less reliant on non-tax natural resource revenues and therefore potentially more responsive (Moore, 2007).

However, at the same time, certain characteristics of New Order institutional arrangements have had important impacts on the institutional structures that have arisen during the post-authoritarian era which present challenges for progressive change. Indeed, for critics of the reform process, this is key to explaining the way in which processes of democratisation and decentralisation have played out in practice. As Chehabi and Linz (1998) argue with respect to the former (in Bünte and Ufen, 2009: 9), 'if the sultanistic regime is replaced by a democracy, chances are this new democracy will display strong clientelistic tendencies, with the democratically elected leaders using the resources of their office to build nationwide patron-client relationships.'

There have been similar critiques of the mixed outcome of decentralisation reforms, with reference to the presence of historically determined asymmetries of wealth, information and power, which are key features of this analytical approach. Rather than New Order-era oligarchic and special interest groups being swept away by *reformasi*, many reinvented themselves and found new and often powerful roles within Indonesia's new institutions (Hadiz, 2010). Elites were able to retain their privileged socioeconomic position and political influence under the new system in large part because of the authority they gained during the New Order era (Box 4).

Box 4: Decentralisation and the empowerment of local elites

The practical impacts of democratic decentralisation on the forestry sector in Malinau demonstrate the complexity of local politics and the mixed outcomes associated with reforms. Wollenberg et al. (2006) argue that, while decentralisation has changed the rules of the game, it has not necessarily benefited all groups equally. Instead, existing power asymmetries have resulted in a significant advantage to 'previous local elite and stronger ethnic groups who more easily developed alliances in both the social and state domains, as well as have more opportunities to use collusion' (ibid: 420). These local-level elites, as well as newly empowered private sector interests and local government officials, have been able to use both formal and informal channels to shape reforms processes to suit their interests.

4.1.2 Impacts of strategic choices on institutional change

The institutional structure of the New Order era and the historical distributions of power, wealth and knowledge that prevailed in that period were clearly influential in terms of shaping Indonesia's governance reforms. Meanwhile, another school of thought suggests there is also a need to examine the impact of stakeholders' responses to potential future outcomes. Rational choice institutionalism helps to identify the ways in which key actors can become agents of change (or stand in the way of change) by making strategic choices that actively shape the reform process.

For example, the withdrawal of the military from direct involvement in political affairs should be seen as a savvy response to the presence of a strong anti-military tone in many of the protests in the waning days of the New Order regime (Aspinall, 2010). By willingly consenting to the loss of parliamentary privileges and other reforms that reduced its visible influence in politics, the post-Suharto military was able to repair its reputation and preserve for itself a degree of influence in the new post-authoritarian institutional arrangements.

Perhaps the clearest example of the influence of rational choice on Indonesia's progress in governance is the strategy of decentralisation reforms. As Section 3 described, the Habibie government made the decision to devolve significant authority from the central to the district level and not the provincial level. In doing so, it responded to resentment about the centralisation of power and wealth in Jakarta by increasing regional autonomy, while creating a fiscal-federal system of redistribution that provides enormous incentives for local-level elites to remain part of a unified Indonesian state. There is little doubt these reforms should be seen as politically intelligent strategies, chosen by the Indonesian state to preserve the integrity of the nation state by shaping new institutional arrangements to meet the recognised challenges separatist elements presented.

4.1.3 Effects of social and cultural norms on institutional reform

A third analytical approach of institutional change helps explain the shape of Indonesia's post-1998 governance transition. Sociological institutionalism contends that not only do stakeholders operate in accordance with the historical determinants and rational incentives described above, but also they do so in the context of existing cultural norms that help determine the set of available options. This approach does not comment on the quality

of potential institutional arrangements, but merely describes the way in which actors' prevailing worldviews can make any given set of arrangements more or less (socially) legitimate. At times, actors may be aware of the influence of these norms. However, just as often, the extent to which existing norms influence the set of options at any given time remains hidden.

This dynamic can be seen clearly in the role both international and national norms play in the context of Indonesia's reforms. For example, the choice to enact the democratic decentralisation reforms that have played such a significant role in diffusing regional tensions since 1998 did not occur with reformers designing new institutional arrangements in a vacuum. Nor were they the only possible solution to the challenges of state cohesion facing the Indonesian state. As we noted above, key domestic actors clearly had incentives to support such reforms, yet it is also important not to ignore the strength of the international movement towards democratic decentralisation as a mechanism to achieve improved governance and development outcomes. In the economic and political crises of the late 1990s, and during the subsequent governance transition, policies endorsed by key international institutions including the World Bank and IMF carried significant weight. The institutions supported these reforms through softer mechanisms, such as the multi-donor Decentralisation Support Facility (DSF), and also through stronger mechanisms of conditionality.

At local level too, socio-cultural norms were influential in shaping the options available. Institutional reforms have resulted in a proliferation of different arrangements in districts and regions across the country. In some cases, local communities are pursuing institutional arrangements in line with alternative sources of legitimacy to formal secular law, which do not necessarily apply cross-nationally. This may be most apparent where new local autonomy has allowed for the implementation of new forms of governance based on traditional customs (*adat*) (Duncan, 2007). Similarly, the application of Shari'a law may also depend on local perceptions of legitimacy.

4.2 Accommodative reform

The three analytical approaches discussed above suggest a complex array of forces have guided the ongoing process of reforming Indonesia's governance institutions. However, the influence of these forces is no guarantee of progress: it merely helps explain the pattern of institutional reforms. What, then, accounts for the relative success of Indonesia's reform efforts to date?

One key factor is that governance reform has largely responded to expressed citizen expectations. In widespread survey work done in the late 1990s (at the height of the New Order era), provision of public goods, including health care, education and elements of the investment climate such as business licensing, was not among the key priorities of the general population (as one might expect). Rather, there was more concern about the reform of formal political institutions, the need to get rid of the rapacious Suharto regime and the need for macroeconomic stability. It is only as recently as the past three to five years that concerns about health and education have started to creep into public opinion surveys. Even now, survey work suggests that citizens report being largely satisfied with most public services (in large part because of low expectations). As a result, the types of reforms Section 3 detailed (e.g. strengthening the separation of powers, military reform, etc.) have received far more emphasis, whereas the capability, accountability and responsiveness of the government with respect to service delivery have been relatively neglected. That these preferences align with the practicalities of sequencing governance reforms has not necessarily occurred by design, but certainly has been fortuitous.

A second critical contributing factor is the willingness of the Indonesian state to pursue reforms that work, rather than designing reforms and measuring progress against some idealised form. That 'the art of the possible' has been realised in a way that accommodates some of the less savoury characters and practices of the old order is testament to the fact that institutional change needs to be grounded in the political structures (including power structures) of the state. The Indonesian post-authoritarian transition provides numerous examples of this accommodative style of reform (Aspinall, 2010):

- Extensive reform of the political party system provided new opportunities for the organisation of opposition, but it did not require the abolition of the ruling party under Suharto (*Golkar*).
- The military has ceded much of its formal political influence, including parliamentary seats, and made strides towards an increasingly transparent budget, but has maintained its territorial structure and much of its institutional capacity.
- Devolution has eased centre-periphery tensions but, in doing so, has created new opportunities for non-growth-enhancing rent-seeking behaviour, patronage and corruption at the local level.
- Pluralism has been maintained through the incorporation of Islamic and Islamist political forces into democratic institutions.

In each of these cases, it is precisely because change incorporated the interests of powerful, potentially disruptive, political forces that it was possible at all. These key actors 'were not starved out of Indonesia's new democracy. Instead they were all given a piece of the democracy pie, reducing their incentive to resist and challenge the system from the outside' (Aspinall, 2010: 32). As a result, Indonesia's willingness and ability to compromise some aspects of an 'ideal' set of institutional arrangements in the face of the practical realities of reform provides us with a good example of how to pursue institutional change without falling into the trap of wholesale transplantation of institutions and political settlements from one country to another. Reforms had to be suited to the Indonesian context or they would not have navigated the complex set of incentives facing both reformers and potential spoilers.

5. Conclusions

A number of authors caution against interpreting partial reform as a transitory point on the road to consolidated democracy (e.g. Carothers, 2002; Hadiz, 2010; Webber, 2006). We should also not assume the inevitability of continued reform or the irreversibility of reforms achieved to date. However, while heeding this warning, the story of Indonesia's progress in governance remains an impressive example of the coming together of a complex and diverse set of forces to solve significant challenges in governance. This section therefore concludes by presenting an overview of relevant lessons learnt, as well as a selection of remaining challenges, in an effort to emphasise the fact that governance in Indonesia, as in all countries, remains a work in progress.

5.1 Key lessons

- The adoption of varying analytical approaches reveals **a significant number of forces driving institutional change** processes. While the weight that can be attributed to a given driver will vary according to the issue at hand, the Indonesian case highlights the way in which these forces may apply differently to different actors. Where rational choice principles are influential in determining institutional outcomes, the degree of support different actors provide to specific reforms will reflect their own perceived incentives. National elites may have very different incentives and reasons for engaging in reforms than their development partners. It is unsurprising, then, that decentralisation has not necessarily played out in accordance with the expectations of the donor community (with respect to stronger voice and strengthened accountability relationships), given that national elites may have had different priorities (improving state cohesion).
- For many of Indonesia's governance institutions, current practices are the outcome of an **ongoing, iterative process of reform**, reflecting a significant degree of analysis and learning. Other examples include the initial round of Decentralisation Laws passed in May 1999, on regional autonomy and fiscal decentralisation, which necessitated further reforms to clarify responsibility and authority between levels of government. Subsequent reforms, including Laws 32/2004 and 33/2004 passed in 2004 and Law 12/2008 passed in 2008, increased effectiveness and efficiency in the use of public funds as well as their alignment with local development needs without changing the stated objectives of empowering local actors (Firman, 2009). While it is important not to assume Indonesia today is merely at an intermediate point on a linear route from a 'bad' form of governance (authoritarianism) to a 'good' form (consolidated democracy), these experiences should serve as a reminder of the partial nature of all governance reform processes.
- It is important not to measure progress merely in terms of changes in governance relative to the New Order era. Since the New Order regime collapsed, Indonesia has been engaged in **a process of learning and reform, taking place over time, with no discrete time-bound nature**. If Suharto had not resigned from office in 1998, he would eventually have left, and the chaos following the end of a regime so totally dependent on a single figure would always have led to a process of institutional transformation. This transformation has involved clear progress in establishing incentives for the government to provide socioeconomic benefits to the general population, incorporating, or at least accommodating, the interests of dissenters and minorities: this should be lauded as progress.
- As such, in the case of Indonesia, where governance reforms significantly redefine the relationship between citizens and the state, **flexible and longer-term support** are necessary to allow local processes to take their course and for institutional innovations to take root and show results.
- Where internal or external change in the governance context makes existing institutional arrangements untenable or socially illegitimate (as in the case of a highly consolidated authoritarian regime in Indonesia), **adaptive change in the institutions of governance which preserves beneficial characteristics of or outcomes for the state** can be interpreted as progress. This highlights the need to judge political institutions in light of their function in meeting the governance needs generated by dynamic contexts rather than according to absolute and static criteria of form.

- Indonesia's experiences with governance reform suggest that, while ideologically robust positions certainly serve a purpose in policy debates, the nature of political realities, particularly, but not limited to, existing distributions of power and the need to placate potential spoilers, often demands 'partial' or 'compromise' solutions. **Governance reform should therefore be understood as a process of accommodation and compromise** that seeks to create what Merilee Grindle has called 'good-enough governance' (Grindle, 2004). Maintaining the integrity of the state, addressing key bottlenecks to growth and responding to the demands of citizens should be prioritised over reforms that attempt to conform to some type of ideal governance.
- The **governance assets required during times of crisis** are often very different to those needed during stable times. As a result, moments of crisis can present serious challenges to existing institutions of governance and important opportunities for the promulgation or consolidation of governance reform. In the 1997 financial crisis, political and economic turmoil pushed existing centralised institutions of governance responsible for, among other things, controlling expenditure and monetary policy, past their breaking point. The 2004 tsunami in Aceh and the subsequent reconstruction effort pushed nascent institutions of local governance to develop new capacity and to reassess centre-periphery relations in order to access and distribute reconstruction funding. While these two crises clearly operated with different dynamics, in both cases crisis response required the use of specific governance assets that helped drive institutional change.

5.2 Challenges

In considering Indonesia's progress on governance, it is important to keep in mind earlier work that praised the political orders of the Soviet Union and other communist states as highly developed polities. Such work 'looks odd in retrospect, since their surface institutional calm masked a high degree of internal rot and illegitimacy' (Fukuyama, 1997). It is possible that formal democratic structures could similarly serve to mask 'internal rot and illegitimacy.' It is therefore critical to continue to recognise governance challenges, even where formal institutions are in line with international norms.

- **Weak instrumental links:** The limited nationwide data available on key indicators of socioeconomic development, and the number of other significant variables in play, particularly the East Asian financial crisis, which took place at the same time as the peak of regime change, make the attribution of progress in other dimensions of development difficult. However, the poor performance of Indonesia on numerous indicators of social development, including health and education Millennium Development Goals (MDGs), suggest the intrinsic value of progress in governance has not automatically and quickly translated into progress in other dimensions of development (Chaudhuri et al., 2009).
- Given the extent of decentralisation reforms, **variations in local-level political economies** will be critical in determining the extent of instrumental benefits in a number of sectors. For example, in the forestry sector, 'the plight of natural resources and environmental quality are now dependent on local leadership, local institutional capacity and willingness to conform to national standards and regulations. The current picture across Indonesia is mixed, with some regions demonstrating astuteness with regard to sustainability, while others are opting for exploitation with short-term gains' (World Bank, 2009: 1). This reflects a broader concern about the potential for increasing spatial disparities in the provision of public goods.
- New institutional arrangements require new capacities, and a number of key actors in Indonesian governance need to continue to engage in ongoing learning processes. For example, at central level, **capacity constraints** have hampered Parliament's effectiveness in carrying out its new responsibilities in the budget process (Blöndal et al., 2009). At the local level, many government offices are struggling to spend the available resources, with under-expenditure of allocated funding common, particularly at district level.
- Since the adoption of decentralisation reforms at the end of the 1990s, Indonesia has seen a significant **increase in the number of sub-national jurisdictional divisions**. Lax restrictions on the division of existing jurisdictions and the presence of strong financial incentives under decentralisation law have resulted in significant bureaucratic and political rent seeking (Fitriani et al., 2005, in Comola and de Mello, 2010). Seven additional provinces have been created, and local-level governments, which numbered 314 in 1998, totalled 510 in 2009 (Comola and de Mello, 2010; Firman, 2009). This local government proliferation (*Pemekaran Wilayah Kabupaten*) has led to concerns that Indonesia may face 'fragmentation of regional development, in which many local governments consider themselves of their own "kingdom of authority"' (Firman, 2009: 143).

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