HETERODOX REFORM SYMBIOSES

THE POLITICAL ECONOMY OF INVESTMENT CLIMATE REFORMS IN SOLO, INDONESIA *

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Abstract

Many countries are embracing investment climate reforms in order to facilitate higher investment and economic growth. Interestingly, these policy efforts – although based on similar institutional recommendations – give rise to distinctly different results across and within countries. Much of the existing investment climate literature favors a rule-based ‘good governance’ approach, in which less advanced economies are advised to boost investment and growth by adopting well-established OECD-type institutions and practices. While there is little doubt that the protection of property rights, low corruption, and effective public services are desirable long-term objectives, it remains questionable whether orthodox institutional prescriptions are the most promising pathway to get there. By taking a deeper look into the political economy of the city of Solo, we find that relationship- (rather than rule-) based cooperation can be a key factor for policy reform. In this paper we demonstrate that informal deliberations between government leaders and local firms can provide an effective mechanism to improve local investment climates. In the case of Solo, a ‘heterodox symbiosis’ between public and private actors – involving the mayor and a broad spectrum of multi-sectoral/scale/ethnic firms – has brought about important regulatory and administrative reforms and contributed to a rise in private investment.

Keywords: Regional development, investment, informal institutions, transition countries

JEL: H7, O17, O20, P25, P26, R11

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1. INTRODUCTION

Investment climate reforms are at the center of recent policy debates. They have become a key focus area of the World Bank and other donor’s global development program.¹ The exact definition of the “investment climate”, however, remains rather unclear. Some use the term to cover regulatory reform – for example, the World Bank’s Doing Business surveys focus on issues such as starting a business, dealing with licenses, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business (World Bank 2006b). Other definitions have incorporated issues of public sector engagement (notably the quality of physical infrastructure),² whilst others again extend the scope to aspects of political stability and macroeconomic policy³.

However defined, the underlying hypothesis of the last decade’s explosion of work on the investment climate is clear: measures that reduce time/cost barriers and the uncertainty of doing business will lead to more business activity, private investment, economic growth and, ultimately, less poverty. Moreover, there is now considerable evidence, primarily from the major international institutions, indicating the negative growth impact of poor investment climates.⁴ But there is also a remarkable diversity in the choices and outcomes of policy measures. While some governments have gained additional growth and investment by applying orthodox policies – introducing formal rules that secure property rights, liberalize trade flows, and wind back the reach of government – others have experienced notable economic progress by pursuing decidedly heterodox policy measures that are more informal and discretionary in nature – including regional and sectoral subsidies, special economic zones, and the protection of infant industries.

The reason for this phenomenon, according to Dani Rodik (2006), is that standardized prescriptions are often too inflexible to be successful. As Rodrik convincingly points out, countries and regions are successful in stimulating their economies, not because they ‘take a laundry-list approach a la Washington Consensus’, but because they maintain a certain policy flexibility to address critical ‘binding constraints’ as they arise (2006:976-7). Thus while existing economic literature teaches us much about long-term national growth determinants – such as the impact of geography, factor endowments, history, and the presence of well-established property rights⁵ – mid-term growth explanations demand a deeper look into the political economy of economic reform. In other words, whether a polity successfully responds
to emerging ‘binding constraints’ will depend, to a large extent, on the constellation of policy actors, powers, and interests. Much of the existing investment climate seems to ignore these political economy considerations and advocates a standardized ‘good governance’ paradigm, in which less advanced economies are advised to boost investment and growth by adopting well-known OECD-type rules and practices. While there is little doubt that the protection of property rights, low corruption, and effective public services are desirable long-term objectives, it remains doubtful whether formalized prescriptions are the best path to get there.

In a similar vein, Moore and Schmitz (2008) argue that the advocacy of orthodox governance principles is misleading without the recognition of historical and socio-economic contexts. In the developing world, public-private relationships are distinctly different from OECD-type ideals: “exchanges between investors and politicians are likely to be hand-in-hand, informal, shaped by personal or small-group relationships rather than general rules or principles, and to involve relatively direct bartering of one favour for another” (2008:40). According to the authors, the informal – and sometimes particularistic – nature of public-private cooperation can be explained in three ways. First, the introduction of liberal democracy and market capitalism in developing countries was often based on exogenous blueprints, rather than endogenous class struggles and political conflicts and, therefore, provides a weaker foundation for the emergence of universalistic norms. Second, in view of colonial and authoritarian legacies, executive and political elites often remain powerful and unconstrained by societal checks; this can give rise to more particularistic action and – especially in countries with high aid and resource incomes – to a proliferation of rent-seeking activities (Bates 2008; Brautigam et al. 2008). Third, poor governance and violent conflicts in many developing nations diminishes the credibility in formal norms and interaction and, thereby, motivates politicians and business people to prioritize informal, hand-in-hand agreements that serve their common interest best (Haber et al. 2003).

East Asia provides a good example for the heterodox governance model. Regardless of sustained periods of (semi)authoritarian rule, countries like Singapore, Korea, Indonesia, Malaysia, Vietnam and China display an impressive record of economic reform and progress. Arguably these heterodox success stories question the applicability of orthodox ideals in early transition periods: while impartial rules and transparent governance structures are undoubtedly desirable long-term goals, they may not be a feasible option during regime transformations. Indeed, following the propositions of Rodrik (2006) and Moore and Schmitz
growth-inducing policies (such as investment climate reforms) in post-authoritarian transitions can initially be based on markedly informal – or even particularistic – dynamics.

This paper seeks to shed new empirical light on this heterodox reform hypothesis. While the debates in the 1990s (Grindle and Thomas 1991; Krueger 1993; Rodrik 1996; Williamson 1994) were primarily concerned with policy dynamics on national levels, the continuous rise of decentralization and local democracy around the world has opened up a new angle of inquiry: the political economy of local policy reform. The analysis of decentralized decision making is a timely topic. With increasing devolution of administrative and political powers to lower levels of government, the ‘local dimension’ has gained increasing attention in recent academic debates. This paper seeks to contribute to this emerging research area by focusing on a local economy in a country that has experienced presumably the most far-reaching decentralization experience in modern history: The Republic of Indonesia.

Indonesia, the fourth most populous nation on earth, has undergone a remarkably dynamic transition over the last 10 years. After the Asian crisis and General Suharto’s resignation in 1998, Indonesia’s government put an end to thirty years of authoritarian rule and implemented far-reaching political and administrative reforms. In 1999, Indonesian citizens were called upon to elect their national and regional representatives in a truly democratic way. At the same time, the national government enacted decentralization laws that fully devolved local tax and service authorities to more than 400 district governments. This positioned Indonesia – at least in administrative terms – as one of the most decentralized countries in the world.

It is important to note, however, that these formal reforms did not take place in a historical vacuum, but against the backdrop of several centuries of authoritarian (colonial and post-colonial) regimes. As discussed above, the introduction of formal rules – such as the decentralization and election laws in 1999 – needs to be seen in the context of long-standing informal norms – such as patrimonialism and clientelism. Suharto’s New Order regime, for instance, was clearly sustained by a pyramid-like patronage structure, in which national, provincial, district and village elites were coordinated along hierarchical lines and received rewards for being loyal to superiors (Von Luebke 2007). This ensured coherence and certainty, but also suppressed participation and innovation from societal actors in local polities. After the introduction of decentralization, many of these former elites (in or close to
local government positions) managed to stay in power; whereas society at large has only slowly embraced its newly-attained political rights (Hidayat 2000). Thus, while the implementation of decentralization and local democracy in Indonesia suggests, at first sight, a clear move towards more formal and universalistic modes of governance, the reality in local policy areas is still dominated by informal and particularistic relationships (Choi 2005; Hadiz 2005; Vel 2005).

But this persistence of informal relationships, we argue in this paper, does not preclude effective policy reforms, investment climate improvements, and economic progress. By taking a deeper look into the political economy of Solo City, a municipality that stands out for its strong public-private relationships, we find that informal cooperation between local officials and business people can be a driving force for policy innovations and improvements. In many cases, these non-formalized alignments provide political support and direction for government leaders to indentify necessary reform initiatives and, in a subsequent step, ensure a consistent implementation by local bureaucracies. As we will outline in this paper, Solo’s heterodox public-private symbiosis – between a reformist mayor and a group of multi-sectoral/scale/ethnic firms – has effectively improved the local investment climate and – in conjunction with other external factors\(^1\) – contributed to the recent rise in private investment.

2. POLITICAL ECONOMY OF POLICY REFORM – A BRIEF REVIEW

Unconstrained public administrations tend to obstruct private economic activity by enacting distortionary regulations, inflicting superfluous administrative requirements, and capturing illegitimate rents (Batra \textit{et al.} 2002; Djankov \textit{et al.} 2002:35; World Bank 2006b). This view, which marks the starting point of our analysis, finds support in three different currents of thought: public-choice literatures suggesting that bureaucrats pursue private rather than the public interests (Breton and Wintrobe 1975; Downs 1967; Niskanen 1971; Tullock 1965), state-failure literatures demonstrating how state regulations such as trade quotas, permits and taxes, are misused for rent-seeking purposes (Krueger 1974; 1990; Srinivasan 1985) and corruption literatures showing that unrestrained bureaucracies are more susceptible to gross misconduct (Klitgaard 1998; Shleifer and Vishny 1998). A common conclusion that emerges from these schools of thought is that public administrations need to be kept in check in order to provide efficient, responsive and non-corrupt public services. Political and
economic scholars have proposed three performance-enhancing checks in particular: (1) subnational competition, (2) interest group pressure, (3) and government leadership.

The argument that subnational competition enhances government performance finds its roots in Tiebout’s (1956) prominent work on asset and taxpayer mobility. The basic proposition is that decentralization makes differences in service-tax packages more visible and, thereby, motivates citizens to move to local governments that serve their preferences best. Over time, this ‘exit option’ induces local governments to compete for mobile asset holders by means effective service provision and efficient revenue management.12 Besley and Case (1995) extend the idea of subnational competition towards local politics, arguing that decentralization enables rational citizens to compare the economic performance of local incumbents with that of their counterparts in other districts. Because local politicians know that they risk being ousted from office, once they fall distinctly below these comparative ‘yardsticks’, they will naturally adjust their policies accordingly.

While subnational competition results in the ‘exit’ of taxpayers or politicians, interest group pressure is based on citizens’ ‘voice’. As Hirschman (1970) notes, voicing one’s concerns is an important alternative to exiting from an unsatisfactory situation. Citizens who are unwilling (or unable) to bear migration costs can choose to express their dissatisfaction in the policy arena. However, whether societal voices help to promote economic reforms depends, amongst other things, on social-historical contexts and the interest group constellations. According to Putnam’s (1993; 1995) studies, societies with strong horizontal ‘civic engagement’ – cutting across social, ethnic, and religious divides – display higher collective action and better economic performance than those who are characterized by hierarchical and clientelistic structures.

Moreover, regarding interest group constellations, Olson (1965) reminds us that collective action is often constrained by group-size related incentive problems. In general, large, encompassing groups are less successful in coordinating their interests than small, particularistic ones. Since coordination costs rise with group size – including efforts to monitor members and penalize non-compliance – large societal groups are prone to common free-rider problems and, therefore, less effective in voicing their interests towards the government. This group-size dilemma, which tends to favor particularistic interests over common goals, raises a cautionary note about public-private action. As some scholars have suggested, a hasty devolution of powers to local levels of government, without the
establishment of functional checks and balances, is likely to induce undesirable elite capture (Prud'homme 1995). This caveat is also reflected in the seminal papers by Grossman and Helpman (1994) and Bardhan and Mookherjee (2000) indicating that highly concentrated interests – i.e. the absence of interest group competition – tend to result in less favorable policy outcomes. Thus, in view of all these arguments, interest group pressures are more likely to stimulate broad-based government reforms, (1) the more they rest on horizontal, non-clientelistic society structures, (2) and the more they encompass a wide spectrum of business sectors and actors.

While sub-national competition and interest group pressures approach public reform from the ‘demand-side’, the third dimension, government leadership, provides a supply side perspective. It focuses on ‘public entrepreneurship’, and the extent to which government leaders can be a key driving force for policy change. Existing public-reform studies from Latin America (Diamond et al. 1990; Grindle and Thomas 1989; Harberger 1993), Africa (Gray and McPherson 2001; Grindle 1996), and Asia (Ahrens 2002; Haggard et al. 1993; Rodrik 1996) confirm that the quality of government leadership matters a great deal. While the Asian experience – the first (Singapore, Taiwan, Korea), and second generation (Thailand, Malaysia, Indonesia) of tiger economies – suggests that government leadership were instrumental for socio-economic progress, the accounts from Africa and Latin America point in somewhat opposite directions. In the case of Africa, a long legacy of corrupt and non-visionary leaders has proven to be ‘a serious impediment to policy reform’ that has left African populations ‘tyrannized, and impoverished …over the past four decades’ (Gray and McPherson 2001: 728). The common theme that runs through all these country experiences is that government leadership – be it for good or bad – makes ‘a critical difference in the introduction, scope and pursuit of policy reform’ (Grindle and Thomas 1991).

3. CONCEPTUAL FRAMEWORK AND METHODOLOGY

The conceptual framework that guides this study is straightforward. The discussion encompasses three stages: it starts by deciphering the political economy that underpins the public-private sphere, proceeds to outline the characteristics and indicators of Solo’s investment climate and, in a final step, explores changes in recent economic performance.

< Figure 1 around here >
Figure 1 summarizes the flow of discussion. Section 4 maps Solo’s political economy, guided by three salient concepts in the policy reform literature: namely, interest group constellations, mayoral leadership, and economic/political yardsticks. Against this contextual background, Section 5 then explores the nature of public-private cooperation and the resulting investment climate in Solo. In particular, we explore the degree of inclusiveness (by focusing on the scope of policy actors) and reform orientation (by looking at current practices and future planning). The empirical findings in this section rest on in-depth interviews and a local business survey with randomly chosen firms. Section 6 explores recent changes in Solo’s economic growth and private investment and, cognizant of common attribution problems, proposes tentative links between Solo’s public-private alignments and its rising economic performance.

Overall, the following discussion is guided by two overarching questions. The first one, which guides the analyses in Section 5, asks whether heterodox public-private reform alignments (based on relationship- rather than rule-based cooperation) result in a better investment climate. The second question, which is addressed in Section 6, goes one step further and inquires whether these heterodox reform alignments also have observable effects on local investment and economic growth. Due to the multiplicity of investment decision factors, the lag of ‘policy change’ and ‘observable reaction’, and the limited availability of robust data, we do not offer conclusive propositions, but rather seek to outline tentative causal links, which need to be explored further in quantitative cross-district analyses.

In order to answer these two questions, we draw together empirical evidence by making use of three different methods: (1) in-depth interviews, (2) a local business survey, (3) and a desk review of secondary data.

In-depth Interviews: To gain important contextual information, we conducted 25 in-depth interviews with local stakeholders. Interviews were semi-structured and covered salient issues of public-private relations, government performance (efficiency, services, corruption), and economic growth and investment. Key informants included public officials (finance, planning, small-industry, economic planning), business people (retail, manufacturing, public construction, service), NGO members, media representatives, and academics. In addition, local opinions were complemented by national perspectives. With the objective to add some additional crosschecks, we consulted a number of policy experts (World Bank, The Asia
Foundation, UN-CAPSA, and KPPOD), and academics (University of Indonesia, CSIS) in Jakarta.

Local Business Survey: During our fieldwork in February 2008 we conducted business surveys with 64 local business respondents. The applied sampling frame was guided by practical considerations. Due to the limited availability of reliable business data, respondents were randomly chosen by local ‘yellow pages’ and evenly stratified across retail, manufacturing and service sectors. Consistent with employment structures in rural Indonesia, the vast majority of the surveyed respondents were owners of small firms with less than 20 employees.

Secondary Data: As a third and final step, we collected a range of secondary data sources. Official reports from government departments, business associations and local media offices were useful to triangulate interview information and further enlarge our technical understanding of district tax regulations, license requirements and business services. Moreover, local news clippings proved a rich source of information on local business, corruption, and politics.

4. MAPPING SOLO’S POLITICAL ECONOMY

The Research Site

Before turning to the political economy, it is useful to briefly sketch the geographical, historical, and economical context of our research site. The city of Solo is the second largest municipality in Central Java. Located in the eastern lowlands between two volcanic mountains, the city extends over an area of 44 km². While official statistics report a population of 550,000, daytime numbers can rise up to 1.5 million, owing to the large inflow of commuters from surrounding districts. Similar to the city of Yogyakarta, the city of Solo developed around an ancient Javanese kingdom – the Keraton Kasunanan. This historical heritage features prominently in today’s sultanate palace (Sangga Buana), which continues to host traditional ceremonies – such as court dances, gamelan concerts and Batik demonstrations – and has become one of Solo’s main tourist attractions. While agricultural production is virtually absent, the economy of Solo primarily rests on secondary and tertiary sectors.
local GDP. In 2007, for instance, accrued mostly from trade, hotel and restaurant services (24.2 %), local manufacturing (24.1 %), and physical construction projects (13.44%).\textsuperscript{16}

Informed by this contextual setting and the literature discussion above, the following sections explore three important pillars of Solo’s political economy: namely, (1) the constellation of local business groups, (2) the significance of government leadership, (3) and the presence of subnational checks and balances.

*Constellation of Local Business Interests*

Reform pressures from Solo’s private sector are more likely to emerge from informal than formal channels. Formalized business associations, for example, are largely unable to represent local firm interests in the decision making process. A case in point is the local chamber of commerce (*KADINDA*). Stripped from its former New Order privileges\textsuperscript{17}, Solo’s local chamber has lost much of its functionality since decentralization. According to the interviews with Solo’s business people, there is little benefit of becoming a KADINDA member. For one thing, KADINDA does not act as an obligatory umbrella organization for public contracts. For another, it has failed to build a functional organizational structure and provide members with adequate business services. Most interviewees concur that the chamber provides neither a meaningful service portfolio nor an effective platform for business advocacy. In view of these structural problems, which can be observed in many other districts across Rural Indonesia (von Luebke 2007: 202-7), Solo’s business chamber is facing declining support and membership.

Apart from the chamber of commerce, Solo’s private sector exhibits a large array of sectoral business associations, such as furniture (*ASMINDO*), tourism (*PHRI*), real estate (*REI*), construction (*GAPENSI*), and batik (*Laweyan*) groups. These sectoral associations seem to have found a more flexible and effective way to voice policy concerns. Instead of attending official business-government forums – which are often fraught with ceremonial and inefficient procedures – local firms prefer to address policy issues in private audiences with Solo’s mayor. According to one senior businessman, “the mayor schedules informal meetings with private-sector representatives every evening … He does not discriminate against anyone. He has an open ear for all private sector concerns.” This informal exchange has clear advantages: it provides sectoral associations with a platform to criticize inadequate
government practices and, at the same time, provides Solo’s mayor with additional performance measures of the local bureaucracy.

The reasons why sectoral associations are more involved in informal public-private dialogs than the business chamber KADINDA relate to issues of organization and leadership. Apart from its organizational problems (manifested in inadequate services and poor membership outreach since the introduction of decentralization), KADINDA is also constrained by personal factors. As the director of KADINDA is one of the defeated candidates in the 2006 mayor elections, he continues to avoid dialogs with Solo’s incumbent. Sectoral business associations, on the other hand, exhibit more adaptive leadership. As their organizational structures were less formalized during the New Order era, sectoral groups find it less difficult to adjust their operation and communication structures to the Post-Suharto context. Moreover, interviews with local informants suggest that sectoral business leaders were more strategic in establishing their support networks. The directors of the Chinese business group PMS, for instance, have continuously strengthened their relations with government (through formal and informal dialogs with Solo’s mayor and other senior officials) and civil society (through extensive funding for community centers, ambulances, and other public services). This strategic combination of government and societal linkages, which Abdel-Latif (2008) refers to as ‘organizational capacity’, helps sectoral groups to gain policy influence. The rising influence in the policy arena, in turn, allows to reinforce associational membership and compliance and, therefore, helps to reduce collective action problems (Olson 1965)\textsuperscript{18}.

Thus, the dysfunctionality of formal business-government structures – such as the chamber of commerce – should not lead to the conclusion that private-sector actors have little influence in Solo’s policy arena. While they remain relatively mute in official spheres, the voices of Solo’s business people emerge strongly in informal public-private discussions. As we will outline in greater detail below, these informal consultations with the mayor allow the private sector to criticize imprudent public policies and practices and, in doing so, provide effective checks for the performance of Solo’s government.

*Government Leadership*

As foreshadowed in the discussion above, government leadership emerges as another key factor in the political economy of Solo. Surprisingly a large number of interviewees, both
in the private and public sector, stress that Solo’s first directly-elected mayor is an important driving force for Solo’s economic development. According to these narratives, Mayor ‘Jokowi’, as he is commonly referred to, has initiated policy reforms that make Solo’s neighborhood more safe\(^1\) and its bureaucracy more efficient. As one academic pointed out, Jokowi has strongly improved the safety of this municipality by his communicative approach. Since his election in June 2005, the amount of illegal extractions by local hoodlums and the frequency of violent demonstrations in Solo have notably decreased. The reason for this improvement is the mayor’s continuous efforts to tackle problems in Solo’s suburbs by directly approaching people and their problems. Moreover, several business respondents emphasize that Jokowi’s extensive business experience has been a valuable asset in his attempts to increase the performance of Solo’s bureaucracy.

The fact that Jokowi established a successful business, before taking office as Solo’s head of government, makes him a well-positioned candidate for public sector reforms. For one thing, his strong financial background arguably reduces the susceptibility to corruption activities. According to several private sector observers, his motivation for taking office was not monetary gain but rather the prospect of achieving government reforms and attaining local prestige. The interview with the mayor himself confirmed a sincere concern for public reforms and economic development. After outlining the key stones of his economic agenda – such as the integration of Solo’s peddlers into the formal sector by providing government facilities and credits, the rehabilitation of Solo’s traditional markets, and the encouragement of private investment in real estate and technology incubators – Jokowi also acknowledged that many of his visions are compromised by the bureaucratic inefficiency of his staff. “Solo’s technical departments adhere to lengthy administrative procedures. Bureaucrats do not operate like business people. Many public officials do not implement my ideas or instructions because they are either not willing, or not able, to do so … Much needs to be improved in Solo’s current government.”

The willingness to create a more business-friendly government is also illustrated in the mayor’s efforts to supervise his staff and reduce administrative corruption and inefficiency. The performance of Solo’s public servants is arguably enhanced by Jokowi’s routine of random visits to administrative units. “We are never quite sure”, the head of Solo’s industry and commerce department notes, “whether the mayor drops into our office. It is his habit to conduct unannounced inspections and see if everyone is doing his job properly”. Apart from these monitoring efforts, Jokowi has set performance-enhancing incentives by signaling that
he is prepared to penalize administrative misbehavior. According to the interviews, he has so far demoted two senior bureaucrats (kepala dinas) for their involvement in corrupt administrative practices. Moreover, the mayor’s initiative to hold monthly evaluation meetings and to disclose his mobile number for 24-hour public complaints has further induced performance pressure among high-ranking officials. The potential embarrassment of being exposed for low performance, keeps department heads ‘on their toes’. As one senior government respondent recalls, “in a recent meeting, Jokowi embarrassed the head of urban management (dinas tata kota) in front of his colleagues. He presented pictures of himself rehabilitating Solo’s public gardens, which demonstrated the incompetence of the responsible officials.” Overall, Jokowi’s supervisory and coercive measures set new incentive structures that stimulate higher performance standards. Overall, in light of his reform efforts, financial independence, and extensive business experience, Solo’s current mayor emerges as a likely promoter of investment climate improvements.

Subnational Competition - Economic and Political Checks

The strong role of Solo’s mayor suggests, at least at first sight, that policy reforms are primarily a matter of government leadership. Looking at the bigger picture, this leadership-centric setting may remind readers of other ‘guided democracies’ that have emerged in East Asia’s economic transition. Japan’s postwar recovery, Singapore and Korea’s rise in the 1970s/80s, Indonesia and Malaysia’s miracle growth in the 1980/90s, and China and Vietnam’s success story over the last decade, bear witness of such government-led policy reforms (Ahrens 2002; Chu et al. 2004; Haggard 1990). At the same time, leadership-based explanations tend to prompt suspicion among critical observers. Lessons from other parts of the world, suggest that, in the absence of accountability checks, benign authoritarianism regimes can easily turn into predatory dictatorships (Huntington 1996; O’Donnell and Schmitter 1986). This naturally raises the question to what extent Indonesia’s local government leaders, such as Solo’s mayor, are exposed to accountability checks in the newly decentralized political framework.

Recalling the literature discussion above, two counterbalancing forces come to mind: economic checks in terms of interjurisdictional asset mobility, and political checks in terms of electoral pressure. Economic accountability checks, as outlined in the Tiebout (1956) model above, are yet to evolve. The assumption that Solo’s mayor and his staff refrain from predatory practices because they fear out-migration of mobile taxpayers would be misleading.
at this stage. Based on our field observations, local firms are unlikely to leave the city because of bad government policies. In view of economic and social investments, many of Solo’s business people are tied to their current location. For one thing, moving into another district entails notable sunk costs, especially for firms with immobile assets and established customer networks. For another, Chinese business people, who constitute a large economic force in the region, refrain from moving out of their familiar environment, as this may expose them to more ethnic or religious frictions. Solo, in particular, is renowned for its inter-ethnic conflicts. According to our interviews, a series of clashes between indigenous (pribumi) and non-indigenous groups in 1965, 1980 and 1998, resulted in severe casualties and property losses in the Chinese Indonesian community. In order to prevent future hostilities, Chinese firms have used the umbrella organization PMS to finance a wide range community facilities, including a professional sport center, a stand-by ambulance, and mobile fire-fighting appliances. Moving into a new district would render these precautionary investments ineffective. Thus, in light of location-specific assets of both Javanese and Chinese firms, interjurisdictional competition à la Tiebout does not play a significant role at this point of time.

A more effective check on government leadership, however, is given by electoral pressures. The official introduction of direct (‘first past the post’) elections in 2004 provides local government heads with strong incentives to attend to the voices of their constituencies. In the case of Solo, a re-election in 2010 hinges upon the performance of the current government. As a senior public official summarized it, “Jokowi should bear in mind that he only received 40 percent of the popular vote … Notwithstanding his victory at the 2006 mayoral elections, he nonetheless needs to make great efforts to gain public support.” If Jokowi wants to stay in office, he will require additional campaign funding and political support – both of which are found in the private sector. In this sense the public-private consultations, between Jokowi and a broad range of multi-sectoral business associations, serves as an important political check on government leadership. This accountability link is further enlarged by the emergence of yardstick competition. Consistent with Basely and Case’s (1995) argument above, local electorates in Solo are gradually comparing the performance of their mayor with that of other government heads in the region. Supported by rising access to media information, several interview respondents were fully aware of the policy differences between Jokowi and his colleagues in other jurisdictions. The district head in Sragen, for instance, is often quoted as a reformist leader that sets comparable benchmarks of government reform. Thus, akin to Basely and Case’s proposition, Jokowi political success
also depends on the degree to which he keeps his performance in line with regional yardsticks.

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Surprisingly, compared to the rising electoral accountability of the mayor, local parliamentarians (DPRD) remain relatively detached from their constituency. The weak representation of local councilors arguably rests on misspecified electoral rules. Under the current legal setting, nearly all parliamentary seats go to candidates that are placed at the top of party list. As list positions are ultimately decided in a rather intransparent manner at provincial or national levels (Ufen 2006), Solo’s politicians are more concerned to sustain close ties with political headquarters than with local constituents. The dysfunctional accountability link between DPRD representatives and their electorates is also reflected in our business survey in Solo. As illustrated in Table 1, over 90 percent of the business respondents state that they ‘rarely’ or ‘very rarely’ interact with local DPRD members.

In summary, government leadership is an important driving force of policy reforms in Solo. Mayor Jokowi, whose leadership qualities benefit from his long-term business experience and financial independence, has pushed for a more efficient and business-friendly administration. His efforts to supervise public officials and penalize gross misconduct pave the ground for better government performance. Less visible but equally important, however, are the forces that keep the mayor at check. Sectoral business associations, which maintain a close informal dialog with the mayor, have considerable influence on current and future policy decisions. Since 2006 Solo’s mayors are elected by direct popular vote. In order to take or remain in office, leaders require the assistance of private sector actors. Especially sectoral business groups that have the organizational capacity to mobilize political support – both in terms of campaign donations and advocacy – are therefore attractive allies for the incumbent mayor. The informal meetings between sectoral groups and the mayor thus serve as an important platform to identify common policy interests and reform priorities. These priorities are increasingly informed by yardsticks set by other government leaders in the region. Thus, in view of this public-private interest symbiosis, it becomes obvious that policy reforms are not the result of single-handed leadership decisions, but the result of an interest alignment between Mayor Jokowi and a number of sectoral interest groups.
5. PUBLIC-PRIVATE ACTION: CHARACTERISTICS AND INDICATORS

After mapping the general political economy, we now take a closer look at the public-private policy sphere in Solo. In order to do so, we focus in particular on the characteristics and indicators of the local investment climate. As outlined in Figure 1, the following discussion will explore Solo’s policy arena in terms of its (1) inclusiveness (2) and reform orientation. Wherever possible, the analysis of these two dimensions will be complemented with investment climate indicators from our local business survey.

5.1 Inclusiveness

An important aspect in the analysis of Solo’s investment climate is the constellation of policy actors. Is the public-private sphere ‘inclusive’, in a sense that it encompasses a large array of private sector actors, or ‘exclusive’, in a sense that it centers around a handful of powerful business elites. Recent experiences from other post-authoritarian transitions (Hellman et al. 2000; O’Donnell and Schmitter 1986; Shleifer and Vishny 1998), show that polities with narrow, mono-sectoral interests are more prone to predatory extraction or rent-seeking activities. In a similar vein, Grossman and Helpman (1994) and Bardhan and Mookherjee (2000) remind us that a diversity of interest groups stimulates more competition in policy arenas and, therefore, reduces the likelihood of government capture.

Solo’s policy arena exhibits a notable diversity of business interests. The findings from our business survey indicate the presence of a wide and evenly spread range of business associations – comprising multi-sectoral/scale/ethnic interests. As outlined in Table 2, nine organizations are recognized as ‘key business associations’ by at least a quarter of the survey respondents. The composition of these business associations reveals a wealth of sectoral interests – including public construction, furniture, real estate, hotels and restaurants, land transportation and handicraft. The results also signal a spread of ethnic influence. According to our observations, ASMINDO, ORGANDA and ASEPHI display a high membership of Javanese firms, whereas REI, PHRI and PMS are strongly influenced by Chinese business interests. Moreover, while some organizations are dominated by concerns of large firms (GAPENSI, REI, PHRI, and PMS), others also exhibit a strong link to small-scale business interests (ORGANDA, ASMINDO and ASEPHI).
The balanced diversity of interest groups can be visualized in a public-private relationship chart (see Figure 2). Based on focus group discussions with local firms – where participants were asked to position six familiar business associations in relation (a) to the mayor and (b) each other – it became obvious that Solo’s business associations are not concentrated, but remain in notable distance to each other. Although some groups are somewhat closer to the mayor (e.g. ASMINDO and PMS) than others (e.g. KADINDA and HIPMI), the discussions with local firms confirmed that there is considerable competition between sectoral associations. Overall, the multi-sectoral character of Solo’s economy and the balanced influence from Chinese and Javanese firms render the emergence of narrowly-defined collusion arrangements improbable. As soon as one group receives illegitimate benefits from the government, another equally influential group is likely to intervene.

The inclusiveness of Solo’s policy sphere has also benefited from the leadership of Mayor Jokowi. Business respondents unanimously agree that, compared to his predecessor, Solo’s current mayor has created a valuable communication platform for a wide spectrum of private sector interests. As a Chinese businessman notes, “Jokowi never discriminates in favor of businesspeople from certain groups.” In a similar vein, a senior journalist emphasized “the mayor stands out for his welcoming attitude … he accommodates local businesspeople regardless of their ethnicity, religion, and status.” The overarching tone is that the mayor’s open-house policy has widely benefited Solo’s private sector. Although these face-to-face consultations in the mayoral residence are mostly informal, they are not skewed towards any particular interest groups. From time to time, these informal channels are complemented with official forums, such as Solo’s ‘coffee mornings’, a bi-monthly event that brings together public and private actors to exchange their thoughts.

Overall, it seems that Solo’s mayor has been successful in striking the right balance between diverging religious and ethnic fractions. On the one hand, he maintains close ties to Javanese Muslim communities. As one business respondent commented, “Jokowi regularly joins local Koran studies (Pengajian Islam) and uses the opportunity to discuss policy issues with Islamic scholars and students”. He also reaches out to the wider Javanese society by attending local ‘mutual help’ associations (Arisan) in Solo’s suburbs. The business voices that emerge in these meetings, the mayor explained, are primarily those of small traditional
firms which are concerned about licensing services and micro credits. On the other hand, there are equally strong links between the government leadership and the Chinese community. The large number of joint activities of Solo’s government and PMS (a social association of Chinese entrepreneurs) provides a clear indication of this point. A look into the PMS Bulletin (2007), for instance, reveals that Mayor Jokowi formally launched a Christmas Bazaar, a Chinese Cultural Festival, and several sport events in 2006. Moreover, during our fieldwork in April 2008, Javanese and Chinese people jointly celebrated Chinese New Year (*Imlek*) and commemorated a local Chinese hero on the government compound. Thus, contrary to the Suharto era, where government-business interaction were often biased and remained behind closed doors (Root 1996), today’s informal relationships in Solo are more balanced and transparent.26

The effort for more transparent public-private action is also reflected in the mayor’s response to individual business requests. “My house is open to everyone”, he emphasizes in our interview, “I discuss with business people every day … and if they can convince me that their company will stimulate employment and development, I will give them a government permit right away”. Jokowi’s impartial treatment is confirmed by the majority of business respondents. Although the mayor cannot fully monitor administrative procedures, due to typical principal-agent constraints27, his decisiveness to penalize misconduct (see Section 4) appears to translate into better bureaucratic performance. According to the results of our business survey (see Table 3), roughly 6 in 10 firms are satisfied with the access to licensing information (59.4 percent) and the ease of administrative licensing procedures (60.9 percent).

Apart from these licensing indicators, the Jokowi administration also demonstrates inclusiveness in terms of its support towards different business sectors. The government’s assistance to two sectoral groups – street vendors and real estate developers – provides an illustrative example in this context. Considering the former, Solo’s far-reaching informal sector program has been widely reported throughout Indonesia (Kompas 2006; Sinombor 2008). Since 2006, Solo’s government is gradually providing sheltered market spaces and micro credits to over 5000 roving street vendors (*PKL*). According to our informants, this relocation program mainly rests on the initiative of Mayor Jokowi, who has been negotiating with *PKL* associations over the last two years. As one businessman recalls, “The mayor listened to the people with impressive endurance ... He attended over 70 discussion rounds
with informal traders, seeking consensus for compensation and relocation modalities.” While some PKL were initially reluctant to leave their familiar trading areas, most observers concur that the relocation program has brought several benefits for Solo’s economy. First, a large majority of relocated salesmen enjoy a higher economic security; most notably because peddlers now have access to credit and safe facilities. Second, the formalization of thousands of new businesses has generated additional income for Solo’s official budget ($PAD$). And third, the relocation has made the inner city more accessible for urban restoration and property development.

As foreshadowed in the last point, the support for street vendors and traditional businesses has opened the door for new real estate investments. As one entrepreneur summarizes it, “Jokowi’s policy sequencing was smart. He deliberately dealt with PKL and local markets first – providing informal and small firms with notable benefits. Later, when he gave his permission to real estate development, resistance was low … mostly because the support for PKL and traditional markets was still fresh in the memory of the people.” The notion that Solo’s government purposely pursued a balanced support strategy – which initially attended to small firms, before assisting property developers – is confirmed in the interview with the mayor: “my objective is to create a modern city that maintains its heritage … it is important to strengthen traditional businesses and markets … but, at the same time, Solo is changing. It needs to accommodate new investments and urban development.” Indeed, over the last two years, three large real estate projects have sprung up in Solo.

In view of all this, we can conclude that Solo’s policy sphere is fairly inclusive. On the one hand, business associations are evenly spread across sectors and ethnic affiliation and, therefore, compete for, rather than capture, local government support. On the other hand, the government leadership is also urged to treat business interests impartially; above all, because its political future may well depend on the support of several, rather than single, business groups. As we have seen, this mutual interdependence creates a high level of inclusiveness in Solo’s policy arena. This is readily observable in the even-handed provision of business licenses and in the balanced public support of different business sectors.

5.2 Investment Orientation

The second analytic dimension of Solo’s public-private action is its investment focus. The underlying question in this section is whether key policy actors – both from the public
and the private sector – are chiefly concerned with stimulating productive investment (by pressing for conducive regulations and scrutinizing bureaucratic practices) or with consumptive extraction (by enacting captive regulations and seeking illegitimate rents)? To assess the strength the prevailing investment focus, we divide the discussion in two parts. First, we explore the degree to which current practices (regulations and licensing) promote private investment. Second, we investigate the extent to which Solo’s future planning indicates a strong investment orientation.

Current Realities

In order to estimate the investment focus of current policies and practices, it is helpful to first explore Solo’s regulatory environment and licensing practices. By and large, the city’s regulatory environment appears unproblematic. In the context of its nation-wide assessment of local regulations in 2004, the Regional Autonomy Watch (KPPOD 2004) evaluates Solo’s local bills as ‘fairly conducive’ for investment (grade 3 out of 4). According to the assessment, the city’s regulatory framework does not exhibit any serious obstructions for local trade or investment activities. Contrary to other jurisdictions – which have constrained markets by taxing regional commodity flows or prohibiting certain goods – Solo’s mayor has inherited a good set formal rules, which he has – according to our interviews – maintained and implemented well over the last years.

According to the interviews with local firms, the Jokowi administration has made efforts to reduce rather than increase regulatory constraints on Solo’s economy. A good example in this context is the current attempt to revise the regulation on ‘urban construction’. Guided by traditional principles, the existing construction bill (Perda 06/1991) stipulates that new buildings should not exceed the highest point of the sultanate palace (Sangga Buana). In order to support hotel and real estate investments, the government is now in the process of abolishing this bill. As one real estate developer recalls, “When Jokowi took office, he opposed this Perda and strongly pushed for its revision in 2007. Encouraged by his efforts, three property developments are underway which will, eventually, be higher than the Sangga Buana palace … while the revision was initially opposed by local preservationists, Jokowi and the real estate association managed to advance the revision in the city council.”

A look into Solo’s recent media reports reveals that the introduction of a new market bill, which stipulates the relocation, formalization and taxation of informal peddlers, has raised criticism in some parts of society. Especially smaller traders, who are still reluctant to formalize their business, openly complain about these government interventions. Notwithstanding individual hardships that arise with these relocation and formalization process, Solo’s market bill does not distort the local economy. The discussions with the mayor and local firms suggest that market fees clearly benefit the development of Solo’s
traditional trade sector. Budget incomes from trade levies are earmarked for providing micro-
credits to small traders and for reconstructing traditional market facilities.

Another business-enhancing regulatory reform is the ongoing revision of licensing requirements. Most respondents concur that license administration has become more business-
friendly over the last two years. Responding to complaints of the business community, which repeatedly criticized the myriad of administrative desks and paperwork, Mayor Jokowi has
advocated the streamlining of existing licensing procedures. As the head of Solo’s ‘One-Stop
License Shop’ (OSS) explains, the reform initiative was mainly inspired by Mayor Jokowi’s
prior business experience. “Remembering the excessive red tape during his furniture business,
the mayor was determined to simplify licensing procedures. He first gathered support in the
local parliament and then approached technical departments … Some department heads
rejected the reform initiative. But Jokowi either convinced or replaced them over the last
years.” Since regulatory processes in the parliament take time, the mayor issued a preliminary
executive decree to authorize the establishment of the OSS (SK Walikota 13/2005).

The main advantage of this ‘integrated service unit’ is that local firms do no longer
need to grapple with a long line of desks but simply complete all bureaucratic formalities with
‘one stop’. As the mayor stressed in our interview: “prior to the establishment of the OSS,
business people here were often required to wait for several weeks, which gave ample leeway
for corruption … Now they can obtain almost all licenses in 6 days or less”. Another
business-friendly feature of the new OSS is that small and micro firms – such as street
vendors (PKL) that are in the process of formalizing their business – receive basic licenses
(TDP, SIUP) within two days, free of charge. “Due to these new services and the streamlined
procedures”, the head of the OSS emphasizes, “the amount of administered licenses per year
has notably increased. In 1998 the technical departments processed roughly 7000, in 2005 the
OSS issued more than 10.000 licenses.” This optimistic tone of the government leadership is
shared by several large firms who benefit from the increased efficiency. As one hotel manager
notes: “Under Jokowi licensing is much more efficient. Under the former government we
were still using informal brokers to obtain our licenses, but these days are gone.”

Among bureaucrats, Jokowi’s OSS initiative evoked divided reactions. While some
seem to support the idea of public service reforms, others seem to be less in favor of
far-reaching changes. The officials at the department for urban planning (Tata Ruang), for
instance, proudly announced that, due to the new OSS, they were able to cut down waiting
times for land permits (IMB) from one month to one week. The senior officials at the
department for industry and commerce (Perindag), on the other hand, were less enthusiastic.
After declaring their support for government reforms in general, some officials at Perindag
criticized that departmental licensing powers were transferred to the OSS on the basis of a
mayoral decree, not a parliamentary regulation. Some of this criticism may rest on the fact the
OSS has stripped technical departments from valuable income sources, both formal and informal. According to most business people, corruption still persists in some parts of Solo’s bureaucracy. “Although illegitimate extraction has gone down significantly,” a Chinese businessman comments, “local government officials are still far from clean”.

Indeed, there is reason to believe that public servants remain prone to corruption activities. An indicator for this corruption susceptibility is given by the prevalence of substantial recruitment bribes. The phenomenon of illegitimate entrance fees, which seem to arise in several Indonesian districts, is confirmed in our interviews. A retired senior official, for instance, admits that some of the incoming public servants paid up to Rps 75 million (US 7500) in order to attain their position. Although the details of these internal bribes flows remains unknown, it is clear that these ‘up-front investments’, which can occur at recruitment and promotion stages, have a bearing on administrative practices. Given that initial monthly salaries of incoming public servants are roughly Rps 1 million (Rachmadi 2005) investments of this kind are equivalent to several years of income. Naturally, the step to attain a ‘return on investment’ by seeking additional, illegitimate incomes for administrative services is a small one. This dysfunctionality of internal incentive structures may also explain why Solo’s firms continue to be exposed to licensing corruption during license procedures. As illustrated in Table 4, roughly 6 in 10 respondents report that they have experienced substantial irregularities while obtaining standard business permits. Interestingly, firms reporting higher corruption problems were also those with less access to licensing information (see Table 5). Since the OSS provides firms with ample information, this tendency signals that irregularities may be particularly high once firms deal with departmental agents (brokerage) instead of going to the one-stop service.

Future Planning

Apart from current administrative practices, additional insights also arise from future development planning. Due to the high level of inclusiveness in Solo’s policy sphere development priorities are largely the result of an interactive process. As outlined in Section
5.1, business (and other societal) actors can transmit their interests and concerns by consulting with the mayor and, to a limited extent, by participating in council hearings. The combination of the reformist orientation of the mayor and the even spread of private sector interests provides a fertile ground for investment-oriented planning.

In general, Solo’s development plan follows the maxim ‘tradition meets modernity’. As outlined above, the balanced government treatment of traditional and modern businesses (street vendors and real estate developers) also extends to its upcoming development priorities. A clear example in this context is the plan to strengthen small-scale business and tourism by revitalizing three of Solo’s historical city areas. The first one is the traditional market area ‘Pasar Klewer’. According to several interviewees, the upcoming city budget includes several measures to reconstruct the former market hall, which constituted a key trading point in the colonial era. The second one is the old batik quarter ‘Laweyan’. Prioritized activities, include infrastructural programs (re-asphalting roads, repairing traditional street lights, and restoring colonial workshops) as well as capacity programs (batik painting and marketing assistance). The third one is the sultanate palace (Sangga Buana). But as the interview with the mayor indicates, the restoration measures of the sultanate quarter are currently on hold. Although the Sangga Buana is a key priority for Solo’s tourism industry, a conflict in the sultanate family makes it impossible, for the time being, to proceed with the planning.

At the same time, Solo’s urban planning places great weight on modernization. For one thing, the government has advanced a plan to establish an innovative technology center. According to the economic head of Solo’s development planning board (Bappenas), the foundation stone of the center, commonly known as ‘Solo Techno Park’, was laid in 2007. Now the next steps will be to establish vocational training facilities, in cooperation with the Technical Academy of Manufacturing Engineering (ATMI), and a business incubator with the co-funding of a European investor (reportedly AUD 20 million). Although its completion may require several years, Solo’s technology park is likely to raise local labor and technology standards and, in doing so, make the greater Solo region more attractive for prospective domestic and foreign companies.

Moreover, as the interview with Mayor Jokowi reveals, several other government programs are likely to make Solo a more modern and appealing location for future investment. Probably the most important stimulus will be the construction of two inter-provincial highways (‘Trans-Java’) which, very much to Solo’s advantage, will intersect at the city’s northern boundaries. Although these toll roads projects are managed in Jakarta, the narrative of the mayor indicated that his visits to Jakarta may have helped to speed up the process. Another infrastructural enhancement is given by the planned extension of Solo’s regional airport. By enlarging runways and passenger terminals, the new airport will attract
larger carriers and therefore help to stimulate tourism flows. Moreover, the government is planning – according to Jokowi’s descriptions – to sign an agreement with the ‘Cambridge School’ in Singapore to further enhance secondary and tertiary education in Solo. Further Additional investment stimulations are likely to arise with a series of (inter)national events that are scheduled over the next year: including a UN Habitat event, a national food fair, and the annual meeting of Indonesian municipalities (APEKSI). As Jokowi summarizes it “if the image is good, investment will surely follow’.

All in all, current practices and future plans in Solo project a fairly positive image. Juxtaposing the evidence from regulatory conditions, licensing procedures, and forthcoming development agendas, the empirical evidence suggests that the public-private alignments between Mayor Jokowi and private sector groups help to stimulate, rather than to constrain, Solo’s investment climate. Overall, interviewees agree that administrative practices have become more efficient and less uncertain. The absence of market-distorting regulations and the introduction of efficient one-stop services underline this point. Admittedly, our survey results also indicate that license corruption remains an issue. A possible explanation for the persistence of administrative irregularities is that current reform initiatives have yet to reach all officials and firms. Presumably, a number of businesses are largely unaware of OSS facilities and have dealt primarily with departmental officials so far. Because sectoral officials are difficult to monitor and, at the same time, remain susceptible to internal recruitment corruption, the tenacity of administrative misconduct is not surprising.

The reasonably good outlook for private investment is furthermore supported by Solo’s well balanced development agenda. Based on the continuous interaction with private sector groups, Mayor Jokowi and his administration have formulated a stimulation package that benefits small firms in traditional sectors and, at the same time, paves the ground for investment in modern retail and property. According to current development plans, traditional traders and craftsmen will be supported by physical restoration programs and designated development zones (preventing an immediate entry of large supermarkets in traditional market areas). Meanwhile, the planned enlargement of Solo’s airport, the intended technology center, the construction of the Trans-Java highways, and a series of upcoming national events, will certainly attract the attention of potential investors. These findings are confirmed by the perceptions emerging from Solo’s business survey (see Table 6). Current practices of the government receive a mixed reaction, with roughly half of the respondents (47.6 percent)
confirming a strong investment orientation, and half (52.4 percent) suspecting a predominance of government-internal interests. The response towards Solo’s future development agenda is clearly an optimistic one. Here, almost 7 in 10 of the surveyed businesses feel that forthcoming government activities are well planned.

Solo’s overall good performance is also confirmed in Indonesia’s latest subnational business survey (KPPOD 2008). In comparison with other Indonesian municipalities (see Table 7), Solo stands out for the high anti-corruption efforts of its mayor (column 1) and the high presence of business associations (column 2) and public-private forums (column 3). Licensing procedures in Solo are slightly less corrupt (column 5), and markedly more time-efficient (column 4) than the municipal average. Overall, 70 percent of Solo’s business respondents feel that recent government policies have had a positive effect on their business, one of the highest approval rates within the 10-city comparison.38

6. RECENT CHANGES IN ECONOMIC PERFORMANCE

Against the background of the outlined public-private interest alignment, this section explores to what extent investment climate reforms have already translated into observable changes in Solo’s economic performance. Undoubtedly, attributing economic progress to the specific characteristics of Solo’s public-private interaction is a difficult endeavor. Two attribution problems in particular deserve attention. First, improved local economic policies are by no means the only factor that drives growth and investment. There is a rich empirical literature that demonstrates that (especially long-term) economic progress is explained by differences in geography, factor endowments, historical heritage and institutional architectures.39 These exogenous factors and other nation-wide determinants (such as changes in consumption patterns, credit lines, or macro-economic policies) can not be controlled for in a single case-study.40 Second, improved investment conditions and observable investment realization are likely to be separated by certain time lags. This renders the attribution less certain: as most of Solo’s economic indicators are available up to the year 2006, roughly one year after the Jokowi-administration took office, causal links need to be made with caution. Cognizant of these limitations, the remaining discussion will outline recent developments in Solo’s private investment and growth.
A first proxy for business and investment activity is given by the number of registered firms. Considering the period between 2003 and 2006, we find that a continuous rise in local trade licenses (SIUP). As outlined in Table 8, a particularly high increase occurred during the first year of Major Jokowi’s office term: between 2004 and 2005 the number of registered trade businesses rose from 749 to 1039, which implies a growth rate of roughly 40 percent.

Investment flows in Solo have also notably increased over the last years (see Table 9). The local department of industry and trade (Dinas Perindag) reports that private investments have more than doubled from 188 billion Rupiah in 2003 (approx. US$ 20 million) to 417 billion Rupiah in 2006 (approx. US$ 45 million). These official figures, which have to be treated with a certain amount of caution, suggest that Solo’s asset inflows have grown, on average, at a rate of 30 percent.

This increasing investment trend is also reflected in data of Indonesia’s Central Bank. According to the estimates of ‘Bank Indonesia’, outstanding investment loans to MSMEs (micro to medium-sized firms) amount to Rps 183 billion in 2006 and have increased by 9.5 percent since 2003 (see Table 10); while loans to large firms add up to Rps 157 billion and display a growth rate of 32.8 percent during the same period. Once these figures are compared to the wider developments in Central Java, it becomes obvious that Solo’s MSME loans expanded half as fast, whereas Non-MSME credits grew more than 40-times faster than the provincial average.

The fast growth of Non-MSME loans is well in line with our observation of the vast expansion of real estate and retail investments over the last years. The ongoing constructions of three large apartment buildings – the ‘Solo Paragon’, ‘Solo Center Point’, and ‘Kusuma Tower’ – and the establishment of numerous shopping malls – including the ‘Grand Mall’
‘Solo Square’ and ‘Ciputra Sun Mall’ – bear ample witness of these investment activities. Since Solo has insufficient access to land, private investments expand vertically, in real estate and modern retail, rather than horizontally in manufacturing industries. Moreover, high minimum-wages and rising labor standards have made Solo’s manufacturing sectors less attractive. As one businessman in the construction industry explains it, “investors will stay away from labor-intensive sectors, as long as national labor laws and minimum-wage policies remain prohibitive … That is why current investments focus primarily on construction and retail”.

As mentioned, the expansion of Solo’s private investment is not only determined by the improved investment climate. According to local business people, a set of external factors – such as the emergence of the TransJava highways that intersect in Solo – have a strong bearing on private sector decisions. Given the in-depth case-study approach, we cannot control for these exogenous economic and political factors. It is clear, however, that the close public-private alignment between Mayor Jokowi and local firms have created a momentum of optimism and attracted both local and national investors. There is broad agreement among local interviewees that the reduction of economic uncertainty – both in terms of improved security and reduced administrative preferentialism – has been a salient driver for more business commitments. Thus, while the effect of improved policy conditions on rising investment flows cannot be quantified, its existence is widely confirmed.

Turning from investment activity to economic income, the statistical data shows moderate growth rates. As illustrated in Table 11, official figures indicate that Solo’s gross domestic product, measured at constant prices of 2000, has increased between 5 and 6 percent over the last five years. While these estimates are slightly higher than the average growth rates in Central Java during this period, they nonetheless remain relatively low in light of the indicated investment flows. An explanation for this moderate GDP growth may be found in the fact that financial assets have so far been mainly directed into retail and property sectors, which have lower income effects than investments in labor-intensive industries. While productive investments in Solo’s cottage industries – including batik, textile, and food processing sectors – are likely to rise over the next years, stimulated by rising tourist flows and government support, they are yet to translate into higher GDP figures.
7. CONCLUSION

The key objective of this paper was to characterize the dynamics of informal business-government relationships and analyse their effects on investment climate reforms. Indonesia’s recent transition, from a centralized authoritarian to a decentralized democratic regime, provides a rare opportunity to explore the political economy of policy reform on a subnational level. The city of Solo offers valuable insights for the ongoing investment climate debate, particularly for decentralized transition countries. Overall, the presented evidence challenges the conventional wisdom which holds that rule-based governance is a sine-quaque-non condition for effective investment climate reforms. Our study highlights that improved formal institutions can be the result, rather than the cause, of constructive public-private cooperation. In Solo, an informal relationship-based deliberation process – between a progressive mayor and a diverse multi-sectoral group of business actors – has provided a constructive basis for the advocacy of regulations (such as one-stop services, licence simplifications, and business promotion schemes) that improve the local investment climate.

The strength of this heterodox reform symbiosis, in which institutional reforms develop out of a specific constellation of personal relationships, rests on two basic ingredients. The first ingredient is a ‘reform facilitator’ who manages the public-private cooperation process; who solves collective action problems by providing space for deliberation, information, and incentives; and who is powerful enough to induce regulatory/administrative changes and, at the same time, politically-constrained enough to not misuse his powers for excessive private gain. In the case of Solo, Mayor Jokowi acts as the reform facilitator. Benefiting from his former business experience and financial independence, the mayor displays a high level of interpersonal management skills and reform-oriented leadership. According to our observations, he combines strategic skills (e.g. encouraging and maintaining public-private cooperation) with operational expertise (e.g. installing reform incentives in local bureaucracies) and communication abilities (e.g. containing societal frictions and mediating across ethnic divides). Moreover, in view of the upcoming elections in 2010, Solo’s mayor has a clear incentive to closely attend to the voices emerging in informal discussions with business (and other societal) actors.

The second ingredient is the constellation of ‘reform group’. Our empirical findings suggest that an even spread (in terms of sector, size, and ethnicity) of well-organized business
interests raises the likelihood of effective investment climate reforms. The political economy in Solo provides a good example. Although formal representation in business chambers and parliaments is weak, local businesses seem to have found an effective way to influence future policy decisions – through regular, informal deliberations with the mayor. Solo’s sectoral associations strike a right balance between organizational strength within (due to adaptive leadership and strong government/society linkages) and organizational competition between interest groups (due to their multi-sectoral/scale/ethnic composition). Due to this balance private-public alignments do not result in particularistic deals with the government but rather in broad-based reform agendas. The diversity of business actors that have access to the mayor’s attention – encompassing small traders from traditional markets as well as large real estate constructors – has stimulated an open competition of ideas. At the same time, these sectoral groups are powerful enough to mobilize political support and/or campaign funds for the reform agenda. Due to its symbiotic character, the informal public-private dialogs in Solo provide an important platform for the deliberation, direction, and implementation of policy reforms. They place the mayor in a stronger position to identify and reduce shortcomings of local bureaucracies.

Solo’s public-private reform symbiosis has led to clear improvements in the local investment climate. Four aspects stand out in particular. First, Solo has become a safer and less uncertain environment for business activities over the last two years. Our interviews clearly suggest that Mayor Jokowi’s efforts to mediate between small and large, traditional and modern, Javanese and Chinese firms, has reduced the degree of hostility and violence in the city. Second, Solo has refrained from enacting market-distorting regulations. In contrast to several other districts in Indonesia, the government has not issued any bills that obstruct trade or investment activities. Third, Solo has improved licensing services for local firms. The establishment of a one-stop shop, with transparent fees and procedures, has notably reduced waiting times and uncertainties for license applicants. And fourth, the city has put forward a well-balanced development plan. Informed by continuous private sector discussions, the mayor and his administration have drawn up a support package which fosters both small-scale investment in traditional markets (e.g. reconstruction of Pasar Klewer and Laweyan) and large-scale investment in modern retail and real estate (infrastructural enhancements, technology transfer, and location marketing). In light of this evidence, the answer to the first question of this study – namely, whether heterodox reform alignments can lead to improved investment climates – is in the affirmative.
The answer to the second overarching question – the observable impact on economic progress – is less clear cut. Given the early stage of Solo’s public-private reform initiatives, it is difficult to link improved ‘conditions for investment’ to directly observable ‘realization of investment’. This is particularly true in light of the outlined attribution problems. Keeping these qualifications in mind, we can nonetheless identify a tentative positive link between Solo’s public-private reform alignment and recent economic progress. During the first years of the Jokowi administration (2005-2007), Solo’s economy has seen a rise in business licenses, outstanding investment loans, and real investment. The rise in local investment features in the emergence of large retail and property projects (‘Solo Paragon’, ‘Solo Center Point’ and ‘Kusuma Tower’), but also in the expansion of local markets and traditional handicraft centers. So far these investments have not translated into substantial growth rates, but considering Solo’s developing plans – the construction of a business incubator (‘Solo Techno-Park’), the restoration of local traditional markets, the expansion of Solo’s airport, and the hosting of numerous national events – and considering the mentioned ‘time lag’, it is likely that local GDP rates will rise significantly in the years to come.

Of course the presented public-private alignments and investment climate reforms reflect but a snapshot of Solo’s current political economy. Whether the outlined public-private symbiosis has sustainable effects over time will depend on the degree to which the current reform momentum (which is mostly personal and temporary in nature) can be institutionalized in formal norms. Given Jokowi’s key facilitation role, there is a wide-spread concern about the continuation of reforms after his resignation. As a senior official summarizes it, “if the mayor is not re-elected or steps down, the reform momentum is bound to decline.” Mayor Jokowi seems aware of this caveat and has started to expand the deliberation process to other like-minded officials (the vice mayor and selected department heads). Furthermore, he has increasingly pushed local councilors to turn recent mayoral reform decrees (e.g. the ‘One-Stop Licence Shop’) into formal district bills (Perda). Thus, the durability of Solo’s current reform symbioses would benefit from the inclusion of additional senior government officials and the continued formalization of improved regulatory practices.
References


Source: Authors’ focus group discussion with 20 business representatives in Solo. Note: ‘M’ signifies the position of the mayor. Focus group participants were asked to position six familiar associations (see Table 2) in the policy arena, according to their relationships towards the mayor (visualized by concentric circles) and towards each other (visualized by respective group distances).
Table 1: Perception of Parliamentary Representation (in Percent)

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<th>Interaction with Parliamentarians</th>
<th>Very Often</th>
<th>Often</th>
<th>Rarely</th>
<th>Very Rarely</th>
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<td></td>
<td>0.0</td>
<td>6.3</td>
<td>19.1</td>
<td>74.6</td>
</tr>
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</table>

Source: Authors’ business survey with 64 randomly selected small- and medium-sized firms in Solo.
Note: Survey question E2: ‘Please evaluate how often local parliamentarians ask for your opinion’.

Table 2: Recognition of Business Associations

<table>
<thead>
<tr>
<th>Business Organization</th>
<th>Explanation</th>
<th>Recall Rate (percent)</th>
</tr>
</thead>
<tbody>
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<td>GAPENSI</td>
<td>Public Construction</td>
<td>64.1</td>
</tr>
<tr>
<td>KADINDA</td>
<td>Industry and Commerce</td>
<td>59.4</td>
</tr>
<tr>
<td>ASMINDO</td>
<td>Furniture Export</td>
<td>54.7</td>
</tr>
<tr>
<td>REI</td>
<td>Real Estate</td>
<td>40.6</td>
</tr>
<tr>
<td>PHRI</td>
<td>Hotel and Restaurants</td>
<td>34.4</td>
</tr>
<tr>
<td>HIPMI</td>
<td>Young Entrepreneurs</td>
<td>32.8</td>
</tr>
<tr>
<td>ORGANDA</td>
<td>Land Transportation</td>
<td>28.1</td>
</tr>
<tr>
<td>ASEPHI</td>
<td>Handicraft</td>
<td>26.6</td>
</tr>
<tr>
<td>PMS</td>
<td>Chinese Entrepreneurs</td>
<td>26.6</td>
</tr>
</tbody>
</table>

Source: Authors’ business survey with 64 randomly selected small- and medium-sized firms in Solo.
Note: Survey question G6: ‘Please identify key business associations in the economy of Solo’. ‘Recall Rate’ reflects the share of respondents explicitly mentioning a specific business association.

Table 3: Access to Business Licensing - Information and Administrative Ease (in Percent)

<table>
<thead>
<tr>
<th>Access to Information</th>
<th>Administrative Ease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Easy</td>
<td>15.6</td>
</tr>
<tr>
<td>Easy</td>
<td>43.8</td>
</tr>
<tr>
<td>Hard</td>
<td>26.6</td>
</tr>
<tr>
<td>Very hard</td>
<td>14.0</td>
</tr>
</tbody>
</table>

Source: Authors’ business survey with 64 randomly selected small- and medium-sized firms in Solo.
Note: Survey question C1: ‘Please evaluate the access to licensing information’; and C2: ‘Please evaluate the administrative ease to obtain business licenses’.
### Table 4: Level of Corruption during Licensing Procedures (in Percent)

<table>
<thead>
<tr>
<th>License Procedures</th>
<th>6.3</th>
<th>31.3</th>
<th>51.5</th>
<th>10.9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Low</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very High</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Authors’ business survey with 64 randomly selected small- and medium-sized firms in Solo.
Note: Survey question C3: ‘Please evaluate the level of corruption fees during licensing procedures’.

### Table 5: License Corruption in Relation to Information Access (In Percent)

<table>
<thead>
<tr>
<th>Access to License Information</th>
<th>Very High</th>
<th>High</th>
<th>Low</th>
<th>Very Low</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Low</td>
<td>4</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>Low</td>
<td>3</td>
<td>13</td>
<td>2</td>
<td>2</td>
<td>20</td>
</tr>
<tr>
<td>High</td>
<td>3</td>
<td>15</td>
<td>11</td>
<td>4</td>
<td>33</td>
</tr>
<tr>
<td>Very High</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>10</td>
<td>28</td>
<td>17</td>
<td>9</td>
<td>64</td>
</tr>
</tbody>
</table>

Source: Authors’ business survey with 64 randomly selected small- and medium-sized firms in Solo.
Note: Survey question C1: ‘Please evaluate the access to licensing information’; and survey question C3: ‘Please evaluate the level of corruption fees during licensing procedures’.

### Table 6: Evaluation of Current Practices and Future Urban Planning (in Percent)

**Current government practices focus primarily on ...**

| Private Investment Promotion | 47.6 % |
| Government-internal Interests | 52.4 % |

**Future government activities are...**

| Well Planned | 68.8 % |
| Poorly Planned | 31.2 % |

Source: Authors’ business survey with 64 randomly selected small- and medium-sized firms in Solo.
Note: Survey question G1: ‘Please evaluate the focus of Solo’s current administration’; and question G4: ‘Please evaluate Solo’s future city planning’.
Table 7: Solo’s Performance in Comparison

<table>
<thead>
<tr>
<th>City</th>
<th>(1) Strong Anti-Corruption Efforts of the Mayor</th>
<th>(2) Presence of Business Associations</th>
<th>(3) Presence of a Public-Private Forum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Solo</td>
<td>72.6</td>
<td>35.3</td>
<td>35.3</td>
</tr>
<tr>
<td>Denpasar</td>
<td>66.0</td>
<td>28.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Depok, Jakarta</td>
<td>26.0</td>
<td>20.0</td>
<td>24.0</td>
</tr>
<tr>
<td>Malang</td>
<td>37.3</td>
<td>21.6</td>
<td>5.9</td>
</tr>
<tr>
<td>Kupang</td>
<td>54.0</td>
<td>18.0</td>
<td>14.0</td>
</tr>
<tr>
<td>Makasar</td>
<td>62.0</td>
<td>20.0</td>
<td>36.0</td>
</tr>
<tr>
<td>Manado</td>
<td>37.3</td>
<td>11.8</td>
<td>29.4</td>
</tr>
<tr>
<td>Medan</td>
<td>30.0</td>
<td>10.0</td>
<td>16.0</td>
</tr>
<tr>
<td>Surabaya</td>
<td>22.2</td>
<td>31.5</td>
<td>16.7</td>
</tr>
<tr>
<td>Yogyakarta</td>
<td>64.0</td>
<td>38.0</td>
<td>40.0</td>
</tr>
<tr>
<td>Average</td>
<td>47.1</td>
<td>23.5</td>
<td>22.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>City</th>
<th>(4) Processing Days for Trade Licenses</th>
<th>(5) Indication of Illegal Processing Fees</th>
<th>(6) Business-Friendliness of Government Policies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Solo</td>
<td>13</td>
<td>47.1</td>
<td>70.6</td>
</tr>
<tr>
<td>Denpasar</td>
<td>26</td>
<td>28.0</td>
<td>40.0</td>
</tr>
<tr>
<td>Depok, Jakarta</td>
<td>19</td>
<td>46.0</td>
<td>58.0</td>
</tr>
<tr>
<td>Malang</td>
<td>27</td>
<td>58.8</td>
<td>60.8</td>
</tr>
<tr>
<td>Kupang</td>
<td>14</td>
<td>44.0</td>
<td>70.0</td>
</tr>
<tr>
<td>Makasar</td>
<td>18</td>
<td>50.0</td>
<td>64.0</td>
</tr>
<tr>
<td>Manado</td>
<td>11</td>
<td>56.9</td>
<td>82.4</td>
</tr>
<tr>
<td>Medan</td>
<td>12</td>
<td>86.0</td>
<td>58.0</td>
</tr>
<tr>
<td>Surabaya</td>
<td>34</td>
<td>64.8</td>
<td>59.3</td>
</tr>
<tr>
<td>Yogyakarta</td>
<td>15</td>
<td>26.0</td>
<td>68.0</td>
</tr>
<tr>
<td>Average</td>
<td>18.9</td>
<td>50.8</td>
<td>63.1</td>
</tr>
</tbody>
</table>

Source: Authors’ estimates based on raw survey data from the Regional Autonomy Watch (KPPOD 2008).

Note: Figures denote the share of 50 business respondents in each of the ten cities that (1) confirm the presence of strong anti-corruption efforts, (2) belong to a business association, (3) confirm the existence of an active public-private forum, (5) indicate illegal licensing fees, (6) and perceive current government policies to have positive business effects; column (4) denotes average waiting times to obtain standard trade licenses (SIUP).

Table 8: Number of Local Business Licenses

<table>
<thead>
<tr>
<th>Year</th>
<th>Local Trade Licenses SIUP (units)</th>
<th>Growth Rate (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>719</td>
<td>4.17 %</td>
</tr>
<tr>
<td>2004</td>
<td>749</td>
<td>38.72 %</td>
</tr>
<tr>
<td>2005</td>
<td>1039</td>
<td>10.01 %</td>
</tr>
<tr>
<td>2006</td>
<td>1143</td>
<td></td>
</tr>
</tbody>
</table>

Source: Department of Industry of Trade, City of Solo, 2008.
Table 9: Private Investment in Solo

<table>
<thead>
<tr>
<th>Year</th>
<th>Local Investment (mill. Rps)</th>
<th>Growth Rate (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>187,546</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>273,314</td>
<td>45.73 %</td>
</tr>
<tr>
<td>2005</td>
<td>335,460</td>
<td>22.74 %</td>
</tr>
<tr>
<td>2006</td>
<td>416,634</td>
<td>24.20 %</td>
</tr>
<tr>
<td>Average</td>
<td>303,238</td>
<td>30.48 %</td>
</tr>
</tbody>
</table>

Source: Department of Industry of Trade, City of Solo, 2008.

Table 10: Outstanding Investment Loans in Central Java and Solo by Firm Size

<table>
<thead>
<tr>
<th></th>
<th>Outstanding Investment Loans (million Rps)</th>
<th>Annual Average Growth (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>End 2006</td>
<td>2003-2006</td>
</tr>
<tr>
<td>Central Java</td>
<td>5,883,869</td>
<td>7.7</td>
</tr>
<tr>
<td>MSME</td>
<td>2,791,908</td>
<td>18.1</td>
</tr>
<tr>
<td>Non-MSME</td>
<td>3,091,961</td>
<td>0.8</td>
</tr>
<tr>
<td>Solo</td>
<td>340,106</td>
<td>18.1</td>
</tr>
<tr>
<td>MSME</td>
<td>183,098</td>
<td>9.5</td>
</tr>
<tr>
<td>Non-MSME</td>
<td>157,008</td>
<td>32.8</td>
</tr>
</tbody>
</table>

Source: Bank Indonesia, 2008.
Note: the term ‘MSME’ refers to micro/small/medium enterprises; whereas ‘Non-MSME’ refers to large firms.

Table 11: GDP Growth in Solo and Central Java

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Solo (mill. Rps)</th>
<th>Growth Solo (percent)</th>
<th>Growth Central Java (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>3,468,276.94</td>
<td>6.11</td>
<td>4.98</td>
</tr>
<tr>
<td>2004</td>
<td>3,669,373.45</td>
<td>5.80</td>
<td>5.13</td>
</tr>
<tr>
<td>2005</td>
<td>3,858,169.65</td>
<td>5.15</td>
<td>5.35</td>
</tr>
<tr>
<td>2006</td>
<td>4,067,529.94</td>
<td>5.43</td>
<td>5.33</td>
</tr>
<tr>
<td>2007</td>
<td>4,308,617.53</td>
<td>5.93</td>
<td>n/a</td>
</tr>
</tbody>
</table>

Note: figures are based on constant prices of the year 2000.
Dutch established the first rural administrations by placing regional aristocrats in leading positions, holding a

Zhuravskaya (2000) and China (Jin) still considers public-service positions as the most prestigious, secure employment. Arguably, ever since the

because of functional disincentives: as defection can hardly be monitored, individuals in large groups tend to

In this paper, however, the term ‘Solo’ is used to indicate the city area, not the wider economic region (as it is

which includes six adjacent districts – namely, Klaten, Boyolali, Sragen, Karanganyar, Wonogiri, and Sukoharjo.

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

The largest city of Central Java is the provincial capital Semarang. In administrative terms, the city of Solo is often referred to as ‘Surakarta’, in order to distinguish it from the ‘Greater Solo Region’ (Treisman 2000:4), has also been adapted in analyses of recent transformation countries such as Russia (Zhuravskaya 2000) and China (Jin et al.; Weingast 1995). In this paper, however, the term ‘Solo’ is used to indicate the city area, not the wider economic region (as it is sometimes done by locals).

In 2005, for example, secondary and tertiary sectors contributed 42 and 57 percent to Solo’s annual GDP, respectively. Further information is accessible at Central Java’s statistic bureau: see http://jateng.bps.go.id.

The 2007 GDP data was obtained at the Central Bank of Indonesia, Solo office.

With the enactment of Kepres 18/2003 and 80/2003, KADINDA has lost its former key position: firms involved in public tender projects no longer require KADINDA membership or authorization. Today, a myriad of new construction associations have been set up. According to one government respondent, this has brought about an unhealthy competition of reducing implementation prices which, given the lack of monitoring and enforcement, results in fraudulent input management and unprecedented low project qualities.

As Olson (1965) has cogently argued, individual compliance to collective initiatives in large groups often fails because of functional disincentives: as defection can hardly be monitored, individuals in large groups tend to free-ride on other members’ efforts and, thereby, reduce the likelihood that overall objectives are achieved. To overcome this problem, Olson argues, individuals require ‘selective incentives’ from the group leadership that coerce or convince them to comply with collective goals. As other scholars have shown, these collective action problems are particularly eminent in rural economies with a large geographic and sectoral dispersion of group members (Bates 1981; Ostrom 1990; Ramsay 1987). Over the last decades, Solo frequently appeared in the news for its violent ethnic conflicts. According to our interviews, a series of clashes between indigenous (pribumi) and non-indigenous groups in 1965, 1980 and 1998, resulted in severe casualties and property losses in the Chinese Indonesian community.

After a brief assignment as forestry official in Sumatra, Jokowi started an export business with Javanese furniture, which he sells primarily to Singapore and Eastern Europe. He was also the head of ASMINDO, the association for furniture producers in the Solo region.

According to the reports of the national election commission (KPU), Major Jokowi contributed Rps 600 million (roughly US$ 65,000) his electoral campaign in 2004.

The reform orientation of the mayor is observable, for instance, in his willingness to accept temporary business losses for the chance to engage in public sector reforms. In a personal interview, he emphasized that “being the mayor of Solo entails more [monetary] costs than benefits for me. There is hardly any time for continuing the operations of my firm or maintaining business contacts. My government work is too demanding”.

It is a common phenomenon that government officials enjoy a high social status in Indonesia. Society at large still considers public-service positions as the most prestigious, secure employment. Arguably, ever since the Dutch established the first rural administrations by placing regional aristocrats in leading positions, holding a

Endnotes

2 See for example the World Bank’s (2006b) Rural Investment Climate Assessments.
4 See for instance Stern (2002:19), Batra et al. (2002), and Dollar et al. (2003).
6 This argument connects to the wider evolutionary-institutionalist debate. Scholars like North (1990) and Hayek (1971) have pointed out that institutions evolve in the course of iterative steps, in which new and old norms stand in continuous competition to each other. For a summary of this debate see Roland (2000).
7 Since the mid 1990s more than 80 percent of all developing countries (with populations of more than five million) have decentralized administrative/political powers to local levels (Dillinger 1994:1). Moreover, between 1974 and 1997, the number of countries with democratically elected governments tripled from 39 to 117: a rise from 20 to 60 percent (Jaggers and Gurr 1995; World Bank 1997:111).
10 See also MacIntyre (2001) and McLeod (2003).
11 A discussion of the ‘attribution problem’ is presented in the conclusion of this paper.
12 Tiebout’s subnational competition theory, which “remains a towering shadow” in the policy reform literature (Treisman 2000:4), has also been adapted in analyses of recent transformation countries such as Russia (Zhuravskaya 2000) and China (Jin et al.; Weingast 1995).
13 In-depth interviews took place at private residences or offices and lasted between 30 to 90 minutes.
14 The largest city of Central Java is the provincial capital Semarang. In administrative terms, the city of Solo is often referred to as ‘Surakarta’, in order to distinguish it from the ‘Greater Solo Region’ (Keresidenan Solo) which includes six adjacent districts – namely, Klaten, Boyolali, Sragen, Karanganyar, Wonogiri, and Sukoharjo.
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16 The 2007 GDP data was obtained at the Central Bank of Indonesia, Solo office.
17 With the enactment of Kepres 18/2003 and 80/2003, KADINDA has lost its former key position: firms involved in public tender projects no longer require KADINDA membership or authorization. Today, a myriad of new construction associations have been set up. According to one government respondent, this has brought about an unhealthy competition of reducing implementation prices which, given the lack of monitoring and enforcement, results in fraudulent input management and unprecedented low project qualities.
18 As Olson (1965) has cogently argued, individual compliance to collective initiatives in large groups often fails because of functional disincentives: as defection can hardly be monitored, individuals in large groups tend to free-ride on other members’ efforts and, thereby, reduce the likelihood that overall objectives are achieved. To overcome this problem, Olson argues, individuals require ‘selective incentives’ from the group leadership that coerce or convince them to comply with collective goals. As other scholars have shown, these collective action problems are particularly eminent in rural economies with a large geographic and sectoral dispersion of group members (Bates 1981; Ostrom 1990; Ramsay 1987).
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21 According to the reports of the national election commission (KPU), Major Jokowi contributed Rps 600 million (roughly US$ 65,000) his electoral campaign in 2004.
22 The reform orientation of the mayor is observable, for instance, in his willingness to accept temporary business losses for the chance to engage in public sector reforms. In a personal interview, he emphasized that “being the mayor of Solo entails more [monetary] costs than benefits for me. There is hardly any time for continuing the operations of my firm or maintaining business contacts. My government work is too demanding”.
23 It is a common phenomenon that government officials enjoy a high social status in Indonesia. Society at large still considers public-service positions as the most prestigious, secure employment. Arguably, ever since the Dutch established the first rural administrations by placing regional aristocrats in leading positions, holding a
government rank has been widely recognized as a privilege; for a more detailed discussion on public sector prestige see von Luebke (2007:115). Considering that Jokowi grew up in a modest setting near Solo, as the son of a local security guard, his decision to run for mayor is likely to be influenced by prestige considerations.

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

25 For a detailed discussion of the Arisan phenomena in rural Indonesia see Geertz (1962).

26 The general increase in transparency is also observable in Solo’s main newspaper. Every day on its front page, the SoloPos prints selected citizens’ complaints and comments, which are sent in via SMS messages. Since the newspaper reaches roughly 30,000 readers every day, these SMS feedbacks constitute a valuable means to monitor the policy sphere. A similar ‘24/7’ complaint platform is provided by Mayor Jokowi, who publically announced his mobile number and encouraged residents to report any misconduct or injustice they encounter.

27 Principal-agent theories predict administrative misconduct as a result of asymmetric information structures between service providers (‘agents’) and service requestors (‘principals’). The classical problem proceeds as follows: societal or government principals authorize bureaucratic agents to provide public goods on their behalf; but because the former have insufficient technical expertise (‘hidden information’) and insufficient overview of the latter (‘hidden action’), outcomes tend to be suboptimal unless adequate incentive structures are introduced (Arrow 1985: 37). For seminal contributions in the principal-agent debate see Rose-Ackerman (1975), Tirole (1986; 1992), Pratt and Zeckhauser (1985) Moorkerjee and Png (1992) Holstrom and Milgrom (1991; 1994), and Sappington (1991). For an excellent overview on this debate see Furubotn and Richter (2005); Harriss (1986; 1992), Pratt and Zeckhauser (1985) Mookherjee and Png (1992) Holstrom and Milgrom (1991; 1994), and Sappington (1991). For a detailed discussion on the discussion on agency problems to developing countries.

28 The national newspaper Kompas (Sinombor 2008) reports that the PKL formalization has raised the official income from traditional markets from 5 to 12 billion Rupiah (700,000 to 1,200,000 US).

29 The first property is the ‘Solo Paragon’ developed by the Gapura Prima Group and Sunindo Prima; the second is the ‘Solo Center Point’ constructed by PT Duta Mitra Propertindo; and the third is the ‘Kusuma Tower’ built by PT Kusuma Mulia.

30 The only regulatory issue in Solo, according to KPPOD’s(2004) assessment, is the unclear wording of the city’s ‘street lightening’ bill (Perda .07/2003).

31 Obstructive trade taxes are apparent in the districts of Bima, Lombok Barat, Lombok Timur, and Mataram.

32 Alcoholic prohibition bills have been enacted, for example, in Kebumen, Manado, Lotim, Bima and Bandung.

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

34 Bribe payments from incoming public servants (CPNS) are reported in several Indonesian districts. The national newspaper Kompas for instance, features a story of a CPNS candidate complaining to President S. B. Yudhoyono for being asked to pay Rps 40 million to enter the public service in Bekasi, West Java. (Kompas 2004); other examples include: (1) ‘Penerimaan CPNS dinilai KKN’ (Acceptance of Public Servants Evaluated as Corrupt), Waspada, 24 March 2006, page 12; (2) ‘Penerimaan Karyawan Perusahaan Syarat KKN’ (Approval of Regional State-Owned Enterprise Staff depends on Corruption Fees), Bernas, 10 February 2004, page 3; (3) ‘Pengakuan Seorang Mantan CPNS: Bayar 50 Juta, Saya Diterima jadi Pegawai’ (Confession of a former local CPNS Candidate: Once I Pay 50 Million, I am accepted as a Public Servant), Pedoman Rakyat, 9 December 2003, page 1; (4) ‘Perlu Pelicin Rp. 40-75 Juta Untuk Jadi PNS Di Sum-Ut’ (In North Sumatra, You Need to Pay 40-75 Million to Become a PNS), Republika, 3 December 2001, page 11; (5) ‘PNS Keluhkan pungli ambil SK naik pangkat’ (Public Servant complains promotion requires Bribes), Surya, 23 April 1998, page 8; (6) ‘PNS: Antara Idealisme dan Realitas’ (Public Servants: Between Idealism and Reality), Kompas, 6 July 2003, page 30.

35 A more detailed discussion on recruitment/promotion corruption is found in von Luebke (2006; 2007).

36 Some of these activities are co-funded by provincial and national departments.

37 The 10,000 businesses that currently served in the OSS are presumably only a fraction of Solo’s entire business community. Although official numbers are not available, the fact that roughly 1.5 million people
commute to Solo each day indicates a much larger number of businesses. Moreover, over 5000 street vendors have just joined the formal economy and will be obtaining business licenses.

38 Similar results emerge from a regional business climate survey in Central Java, funded by the German Development Agency GTZ. It shows that Solo has markedly improved its public policies and practices between 2005 and 2007 and receives the highest score (8 out of 10) within a 7-district comparison (average score is 5.8). According to the report, the City of Solo ‘seems to offer the most conducive business climate in the region. Here, enterprises [perceive] today’s and tomorrow’s business conditions as excellent, are less bothered by [labor] problems… and like to join together in associations’. (GTZ 2008:94).

39 For a detailed discussion on the multitude of factors linked to economic growth and investment see for instance Barro and Sala-i-Martin (1994), Barro (1997), Acemoglu et al. (2004), and MacIntyre (2003). In the existing literature growth is commonly linked to four types of independent variables: (1) geography – including location and natural resource endowments, (2) factor endowments – including population, human resources, availability of capital and land, (3) history – related to colonial occupations, international and civil wars, or preexisting trading routes, (4) and institutions – such as legal norms (property rights, enforcement structures) and political architectures (constitution, electoral rules, party system).

40 An interesting avenue for future research is therefore the construction of intra-country datasets (for Indonesia and other transition countries), which allow to explore the effects of regulatory reforms on investment and economic growth in a more robust fashion.

41 According to our interviews and observations, local government departments due not display a high rigor in the way they collect and verify investment data. Moreover, as several critical observers pointed out, much of Solo’s current investment is not reported to government offices. We will discuss this point in further detail below.

42 The inclusion of more and more government actors may also help to reduce the outlined public sector dysfunctions – namely, corrupt public recruitment or promotion practices, which can undermine, or even stall, reform initiatives. In this early transition period, the motivation of public officials to join reform initiatives depends not only on mayoral leadership but also on the political will of the central government to implement anti-corruption measures and set/monitor public performance standards. Against this background, it becomes obvious that heterodox reform momentums, which often emerge without formalized rules at the outset of the process, can be formalized more easily if they are accompanied by a set of compatible national institutions.