

# Chapter Six

## Conclusions, Research Contributions and Further Studies

Based on the frameworks and model developed in Chapter Two, this research has demonstrated that Leviathan government behavior is the results of interactions among three different institutional settings, namely social, political and fiscal settings. As shown in Chapter Five, Leviathan government could arise as the fiscal institutional setting created flypaper effect or vertical fiscal imbalance and free-rider issues, personal rulership patrimonial value dominated the value structure in the social institutional setting and the political institution failed to produce accountable government. The implication is that addressing Leviathan government behavior required a holistic approach that covers all three institutional settings simultaneously.

Furthermore, regional proliferation has failed to discipline the government to demonstrate Leviathan government behavior. Since factors of production are not mobile, the proliferation fails to promote regional competitions and, hence, government efficiency. The absent of regional competitions combined with the institutional issues explained above lead to government inefficiency as demonstrated by increasing government size above the optimum level. Since part of the government spending comes from collecting taxes and/or charges and this research confirms that revenues collected from these sources tend to increase, Leviathan government behavior arises.

This research uses abductive ontological view where quantitative is the primary inquiry and a small part of qualitative research as the secondary inquiry. As such, it uses explanative inquiry by developing an econometric model to describe the interactions. A cross-sectional data on 243 local governments in 2007 were used to test the model. The contribution of this research is to propose an expanded analysis on the way Leviathan behavior should be understood. It is argued that the regional specific issues such as the absent of regional competition, the fiscal structure of the local governments, the social values and the political system can shed some light to understand the reasons fiscal federalism policy might fail to deliver expected results.

The contribution of this research is to propose an expanded analysis on the way Leviathan behavior should be understood. These regional specific issues include:

- the absence of regional competition that can be inferred by looking at the factors that might encourage regional proliferation. This factor is related to the design of the inter-regional fiscal transfer which provides fiscal incentive for regional proliferation. The incentive is attached to the hold-harmless provision and the transfer of funds to cover the salary of the local government employees.
- the regional proliferation that fails to promote regional competition due to the absent of mobility of factors of production. As a result, the proliferation cannot discipline regions to impose lower taxation

and/or charges but, at the same time, promote good quality public services provision.

- the fiscal structure of the local governments which is highly dependent on the inter-regional fiscal transfer from the central government. The non-formula component of the block grant or *DAU*, namely the hold-harmless provision and the funds transferred to cover the local government employees, encourages the local governments to be overstaffed and spending beyond their own fiscal capacity. This situation contributes to the increase in government size beyond the optimal level.
- the social values which are dominated by personal rulership patrimonialism also contribute to the increase in government size beyond the optimum level. In this research, the values are represented by the high transaction costs which tended to increase after 2007. At the local level, this value contributes to the practice of politico-bureaucrat-business symbiosis which remains post the New Order regime.
- the political system that fails to produce accountable government. This research confirms that direct voting mechanism is not sufficient to promote accountable government if the constituents do not demonstrate instrumental voting behavior or casting their votes based on the performance of the candidates during general election.

These institutional settings can shed some light to understand the reasons fiscal federalism policy might fail to deliver expected results.

## 6.1 LIMITATIONS OF THE RESEARCH

As explained in Chapter Three, aggregative data to measure the social and political institutional settings were not available at the time this research was conducted. As a result, this research used proxies to measure those variables based on the aggregative data available at the time the model was developed and estimated. This decision is not without any risk.

The selected proxies might not be suitable to measure those variables. When this situation arises, the estimated model might be biased. For these reasons, this research used multiple-research inquiries to minimize the risk. The descriptive inquiry presented in Chapter Four is used as a reference to cross-check the results obtained from the explanative inquiry in Chapter Five. While it is not possible to develop a model that can perfectly explain the phenomena under study, the risk will likely to be minimized when the results of analysis derived from both inquiries are not in contradictory and the model was developed on a solid theoretical frameworks.

Another risk is the used of econometrics in the analysis. As demonstrated in Chapter Five, econometrics requires aggregative data. As a result, the analysis derived from the estimated model does not explain individual regional behavior. The implication is that while designing a public policy usually based on aggregative data, some degree of customization is also necessary to increase the effectiveness of the policy. This situation indicates that the model should not be used as the only source of information in designing a public policy. Rather it also requires some micro-level data that explain individual region institutional settings that represented some degrees of customization in the design.

## 6.2 RESEARCH CONTRIBUTIONS TO PUBLIC POLICY PROPOSALS AND PUBLIC ECONOMICS LITERATURE

The model that has been developed in this research provides a basis for a government to develop a systemic approach for public policy intervention. The exogenous variables in the model (see Section 3.2) represent the channel for policy interventions for the purpose of promoting more efficient government. These variables spread across three institutions in the model. As a result, policy proposals by intervening these exogenous variables affect the performances of these institutions.

The first policy proposal is concerned with the fiscal institutional setting. The current structure has created flypaper effect and free-rider issues. The flypaper effect encouraged the local government to collect more revenues from local taxes and charges. Many of these new taxes and levies do not follow the guidelines on local taxes and levies provided by the central government. As a result, many of them have been cancelled by the central government.

Modifying the reward on local-own source revenues as described in Section 2.1.1 to also include the compliance of the new local taxes and levies on the guidelines is a proposal on reducing flypaper effect and free-rider behavior. While the new law has provided a form of penalty on this issue, providing additional support such as training programs to the local governments to understand the guidelines and to use them to design the correct local taxes and levies is necessary. However, tax compliance would not be sufficient to reduce flypaper effect and restrain free-rider behavior provided that the contribution of the Balance Funds arrangements to the total local government revenue remains dominant. This calls for a modification of

the transfer arrangements by returning larger portion of revenue sharing to the local government.

The second policy proposal is modifying the pool of the fiscal transfer to eliminate common pool problem. Currently, the fiscal common pool is the central government budget. This situation has created free-rider issue that encourage regional proliferation without considering fiscal capacity of the new regions. While there are other factors that encourage regional proliferation in Indonesia (see Section 4.1.1), modifying the fund pool so that proliferation will affect the allocation of the fund to the parent regions might contribute to a reduction in the problem.

The third policy proposal concerns with the standardization of public services provisions to encourage some degree of factors mobility across regions. The absence of mobile factors of production has made regional proliferation fails to discipline the local governments from demonstrating Leviathan government behavior. While encouraging perfect factors mobility is not possible due to some issues stated by respondents, some degree of mobility is necessary to constrain Leviathan government behavior. Encouraging the local governments to improve public service provisions based on the standard provided by the central government is necessary. While the Indonesian government through the Ministry of Home Affairs has clearly understood that to have standard public service provision is important, determining the standard is not an easy task. This issue is beyond the scope of this research.

The fourth policy proposal is political education for the constituents. This research also demonstrates that Leviathan government behavior

intensifies as the constituents fail to function as social and political control agents. The expressive voting behavior demonstrated by the constituents during election time and strong patrimonial rulership value in the society support the argument. These factors contribute to public accountability issue. Furthermore, this issue is partly contributed by the society.

This situation calls for the need to redefining the long-term political education to encourage the society to understand their responsibility as citizens and to take part as social and political control agents. The education should reach both the young Indonesians through the school system as well as adults. The changes in the curricula at all levels of education to address this issue are inevitable. In addition, creating social capital by encouraging the citizens to engage in civic organizations and/or community services is also necessary. The government can take part in creating the capital by providing the opportunity and spaces including neighborhood community centers and public libraries where people can exchange information and become aware of social issues around them.

The model has shown an expanded scope of fiscal federalism theory to include country specific issues. These issues apply to a situation where the assumptions of the theory are not fulfilled or the social and political institutional settings are different from those in the countries where the framework was originally introduced. In this research, the regionally specific issues include the absence of regional competition to attract factors of production, the social values dominated by patrimonial rulership values and the expressive voting behavior of the constituents. By understanding the

institutional setting in a particular country, this research confirms that fiscal federalism can give different results when it applies in different countries.

Another contribution to the fiscal federalism theory is to test Leviathan government behavior based on the Brennan-Buchanan hypothesis. This research confirms the hypothesis is based on the assumption that the government spending is fully financed by taxes. However, if the spending is also financed by other sources such as the inter-regional fiscal transfer, then the Brennan-Buchanan hypothesis testing for Leviathan government behavior cannot be applied. The alternative hypothesis uses in this research also accounts for the transfer received by the local government. By accounting for all revenues received by the local government, this research confirms Leviathan government behavior in Indonesia.

### 6.3 FURTHER STUDIES

As the scope of fiscal federalism literature has been expanded, the challenge is to identify how to incorporate the issues into the economic modelling. The mobility factors of production in jurisdictional competition, social values system that match the society where fiscal federalism was originally formulated and instrumental voting behavior in a democratic system cannot be assumed. These issues should be tested in the model. Since this requires a multidisciplinary approach, the challenge is to identify the proxies to measure aggregative social and political variables that traditionally external to economics.

This research confirms the importance of social capital as an instrument to influence the constituents' voting behavior to promote



accountable government during election time. However, further research is required to understand the way or the mechanism social capital affects voting behavior of the constituents in Indonesia. Furthermore, it also proposes the role of government leadership to create an environment where social capital can thrive. This environment represented by the public policy proposed and implemented by the government. However, similar to the above case, further research to understand the link between the government and the accumulation of social capital in Indonesia is required. This might shed some light to understand the link between welfare state and social capital in promoting democracy in Indonesia.

In addition, this research also establishes the role of values as one of the contributing factors in stimulating Leviathan government behavior in Indonesia. While the model uses in this research indicates that the values system, in this case the personal rulership patrimonialism, affects government size and this research argues that the system was inherited from the Dutch colonial time, it does not explain the reason that this system remains in practice long after the colonial time is over. This leaves room for further research to understand the reasons that this value continues in practice post-colonial time and to design a policy to constrain the practice.

This research also identifies other policies required to constrain Leviathan government behavior including proposing a standard public service provision and political education for the Indonesians to understand their political rights and obligations as citizens, particularly as social and political control agents. These open up some areas for further studies including setting-up the standard of public service quality, designing curricula for all

levels of education and designing public policies to encourage citizens to be engaged in civic organizations and community services.

A small group of people such as those members of the Chamber of Commerce and Industry in *Bandung* Province indicates their attempt to break from the value. While the number of participants is too small to represent the behavior of the Indonesia population, their efforts to exercise their voice rights by using their organization as the channel indicates the attempt. This is the form of strengthening social capital in a network. This also opens an area for further study to understand if there is a beginning of an institutional adjustment process toward progressive social change in Indonesia by looking at the way social capital grows in the society. It is also interesting to identify the voting behavior of these people, namely if they tend to vote instrumentally rather than expressively during the general election time. This voting behavior is also another factor that can promote progressive institutional change.

Finally, this research attempts to expand the scope of economics analysis to other areas such as political science and sociology. The basic methodology that used in this research was economics methodology which is different from both political science and sociology. As the research proceeds, the challenge is to identify common variables that served as the channel to link all these three disciplines together in developing the framework to highlight the overlap areas of three different institutional settings as demonstrated by the extent these settings simultaneously determine the efficiency level of government operation.

Another challenge is to identify the proxies to measure variables that are external to economics so that the impact of non-economic factors can be identified and analysed by using economics methodology. This research is a small contribution to understand the phenomenon of Leviathan government behavior in Indonesia by using three different perspectives. Nevertheless, it demonstrates that interdisciplinary approach to understand a phenomenon is possible.

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