

What determines the quality of local economic governance?

Comparing Vietnam and Indonesia

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Overview

- Context and key questions
- Drivers of reform in Vietnam
- Drivers of reform in Indonesia
- Explaining the different incentives
- Implications for policy in Indonesia

Context

- Large literature suggesting a strong link between the quality of economic governance/economic institutions and economic performance (since North 1981, 1989, 1990)
 - And a large literature arguing about causality (e.g. Acemoglu et al (2001), Glaeser et al (2004), Kaufman and Kraay (2002))
- Wave of decentralisation across many countries
 - Indonesia in 2001 – now over 500 districts
 - Vietnam in 2004 – now 63 provinces

Interest in local economic governance

- IFC Doing Business at the city level
- Provincial Competitiveness Index in Vietnam
- Local Economic Governance Index in Indonesia

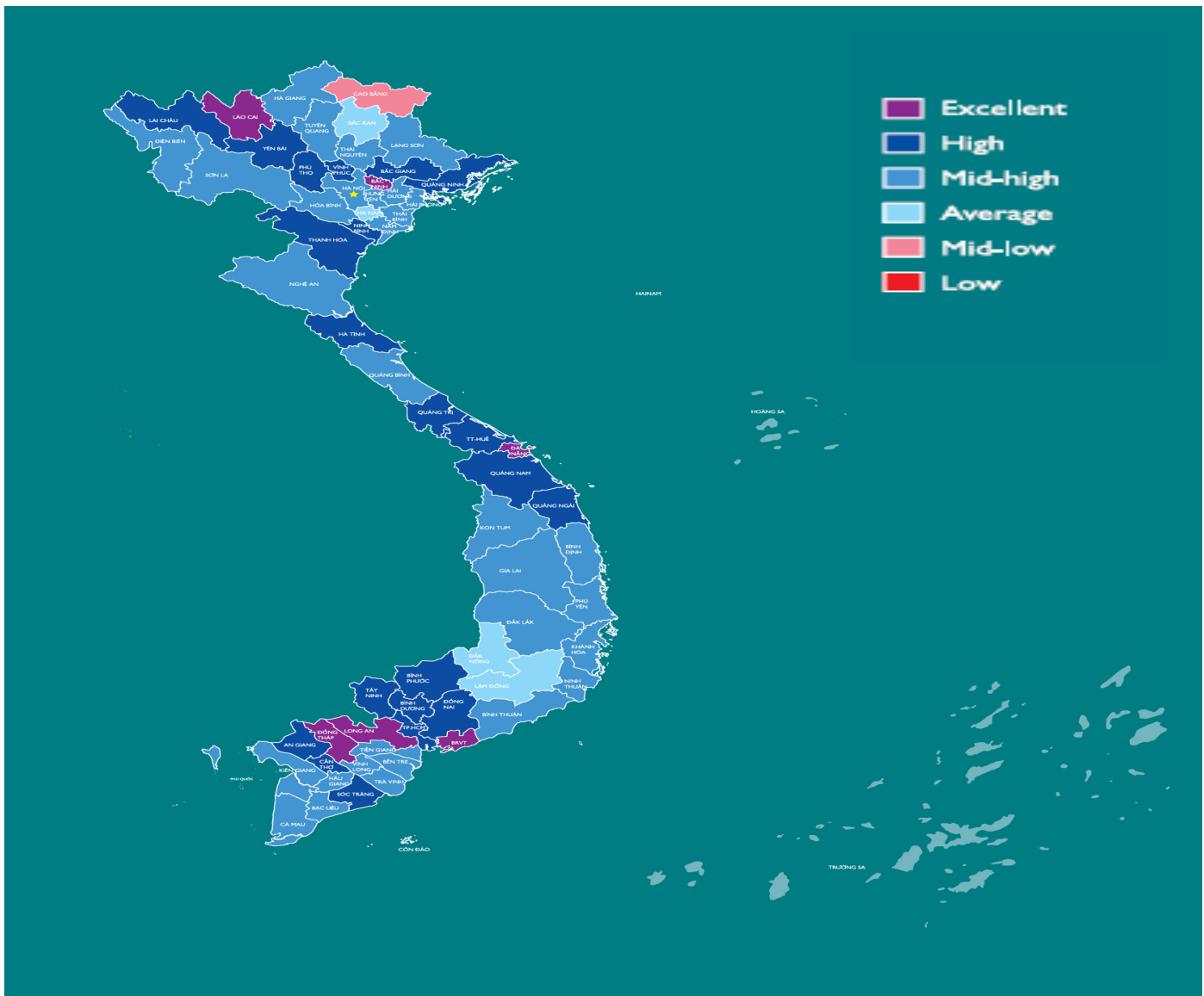


...underlying assumption is that improving the quality of local economic governance will boost local economic performance.

Key questions

- What determines the large variation in the quality of local governance we observe across regions in Vietnam and Indonesia?
- What drives local level economic reform?
 - Who are the key actors? What motivates them to reform? What constraints do they face?

The 2011 PCI map



Structural Drivers of Reform in Vietnam

1. Current level of PCI Yes - ive
2. Leadership changes Yes +ive
3. VCCI diagnostic workshops Yes +ive
4. Being one of the major five cities Yes - ive
5. Having greater revenue autonomy Yes +ive

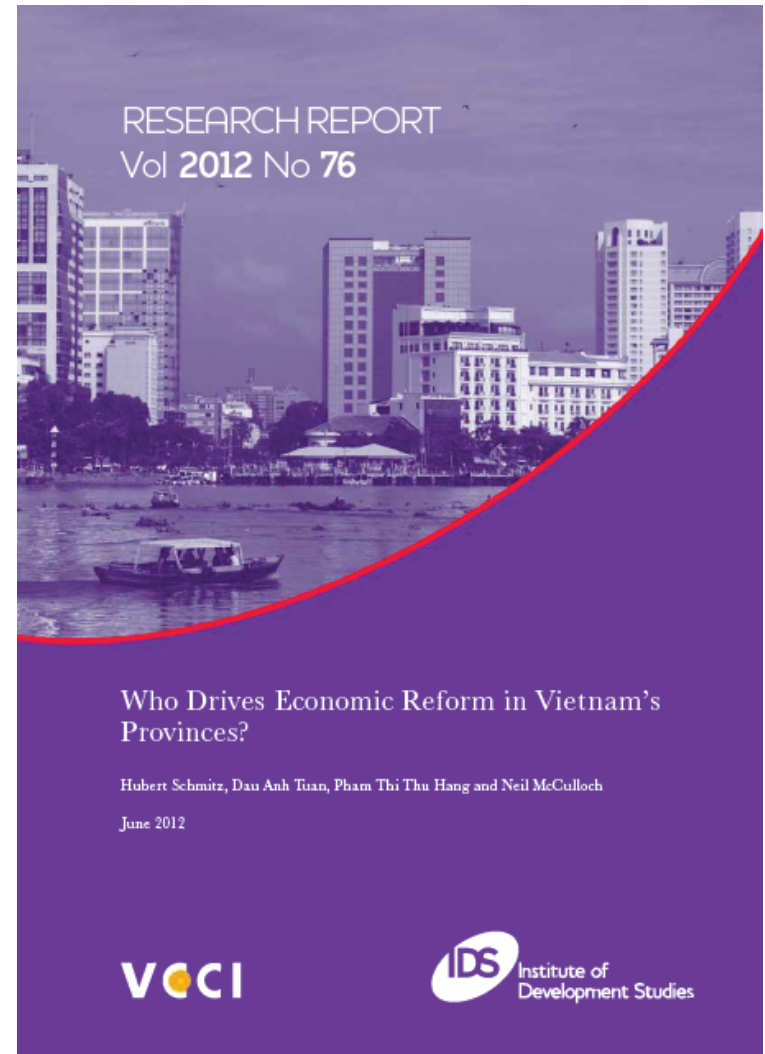
And factors that don't affect reform

1. Having a higher education level No
2. Size of the economy No
3. Previous private investment No
4. Distance from Hanoi or HCMC No

What drives provincial economic reform in Vietnam?

Qualitative Research

- 4 provinces
- 121 interviews
 - government, business, donors, national experts, media
- Questions
 - Who were the key drivers (government, party, private sector) and why/how did they achieve reform?



Vietnam Qualitative Results

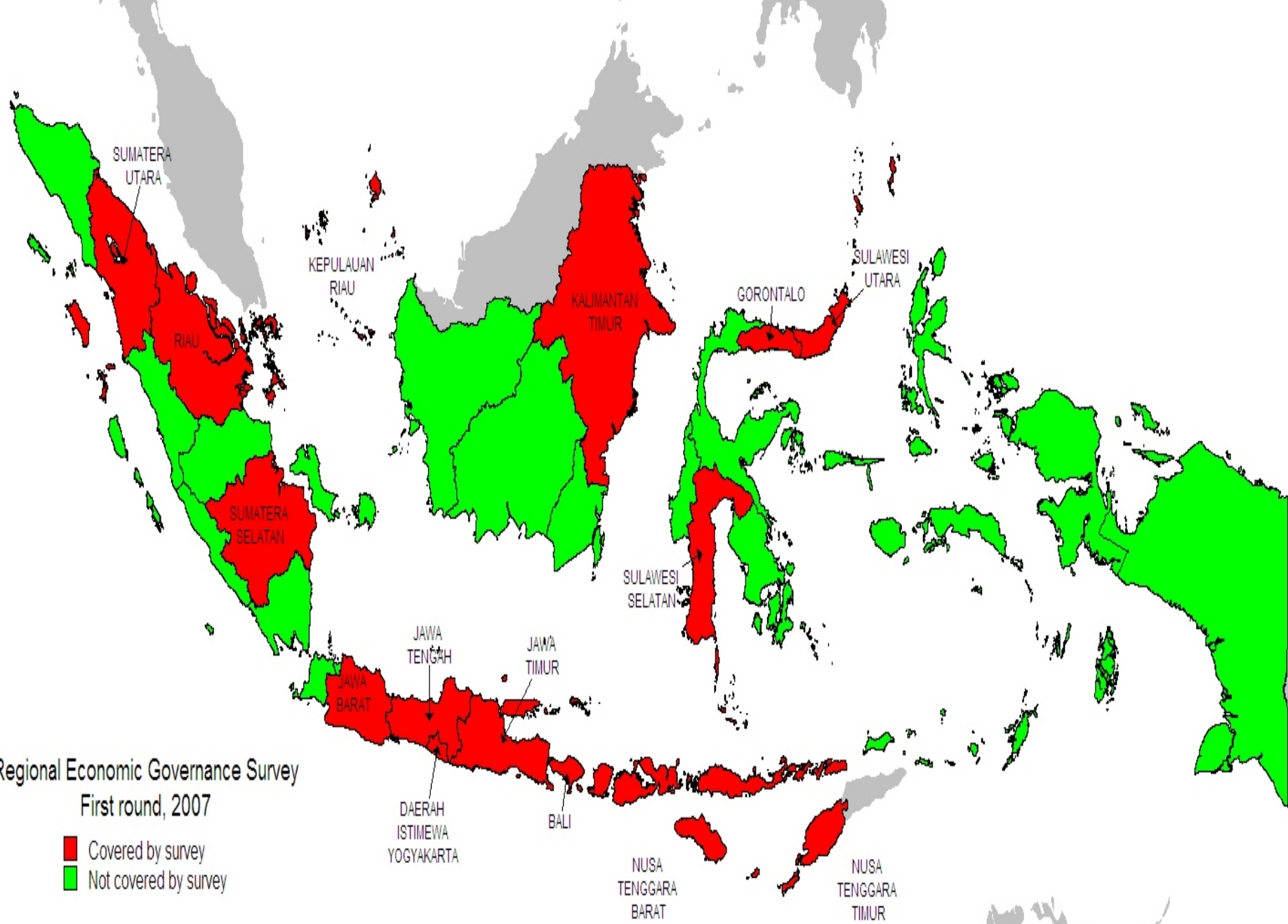
Key driver of local reforms was NOT central government mandated investment climate reforms. Rather ...

- Decentralisation of investment approval provided an opportunity for local governments to drive their province's growth
- Informal, local coalitions of party, government and business tackled problems together
- Need capacity on both sides
- Strong upwards accountability meant that the PCI *did* act as an incentive for reform for local provincial chairmen

What drives reform in Indonesia?

Lots of scholarship on Indonesian decentralisation

- Leadership (von Luebke, 2009)
- Elections and campaign finance (Aspinall and Fealy 2010, Mietzner 2013)
- Investment climate (Patunru et al, 2012)
- Drivers of growth (Suharnoko, 2009)
- Impact of decentralisation (Widharja and Pepinsky, 2011)



Regional Economic Governance Survey
First round, 2007

- Covered by survey
- Not covered by survey

Components of Local Economic Governance

1. Access to Land and Security of Tenure

2. Business Licensing

3. Local Government and Business Interaction

4. Business Development Programs

5. Capacity and Integrity of the Mayor/Regent

6. Local Taxes, User Charges and other Transaction Costs

7. Local Infrastructure

8. Security and Conflict Resolution

9. Local Regulations

What determines the quality of local governance?

Structural Factors	What we expect
Size of economy	...might induce more rent-seeking
Natural resources	...might induce rent-seeking
Population	...makes governance more complex
City	...makes governance more complex
Remoteness	...out of sight, out of mind
Education	...might improve the quality of administration
Ethnic or religious fragmentation	...makes governance more complex

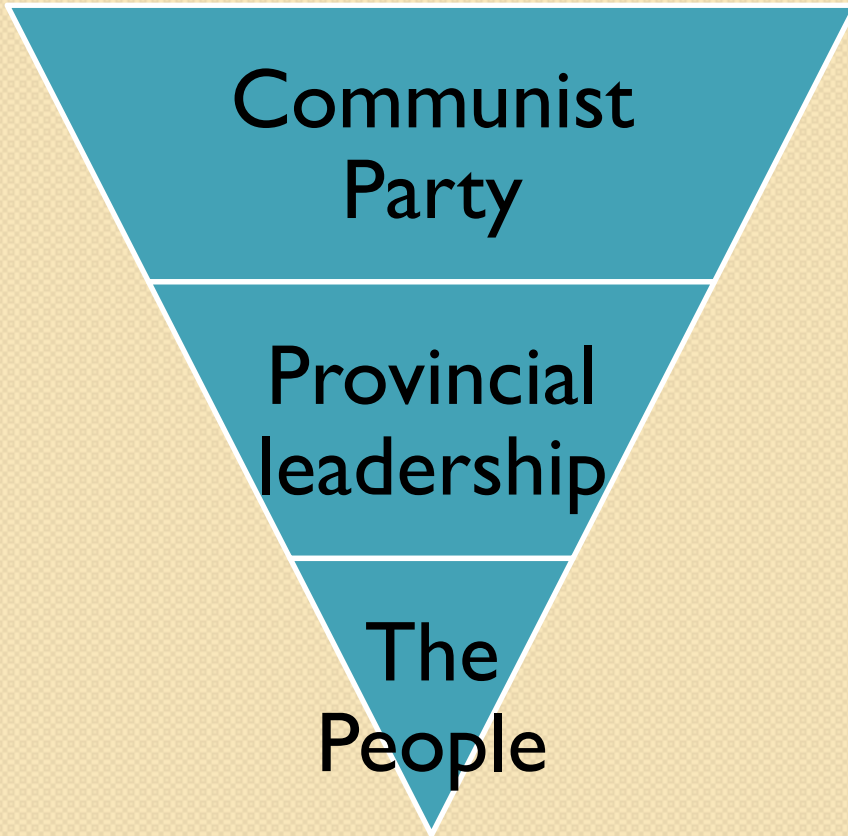
Results - what determines the quality of local governance

Structural Factors	What we find
Size of economy	Strong negative effect on governance
Natural resources	Negative but not significant
Population	Strong negative effect
City	Negative but not significant
Remoteness	Strong negative effect
Education	Greater SMP Net Enrolment positive but not significant
Ethnic or religious fragmentation	Negative but not significant

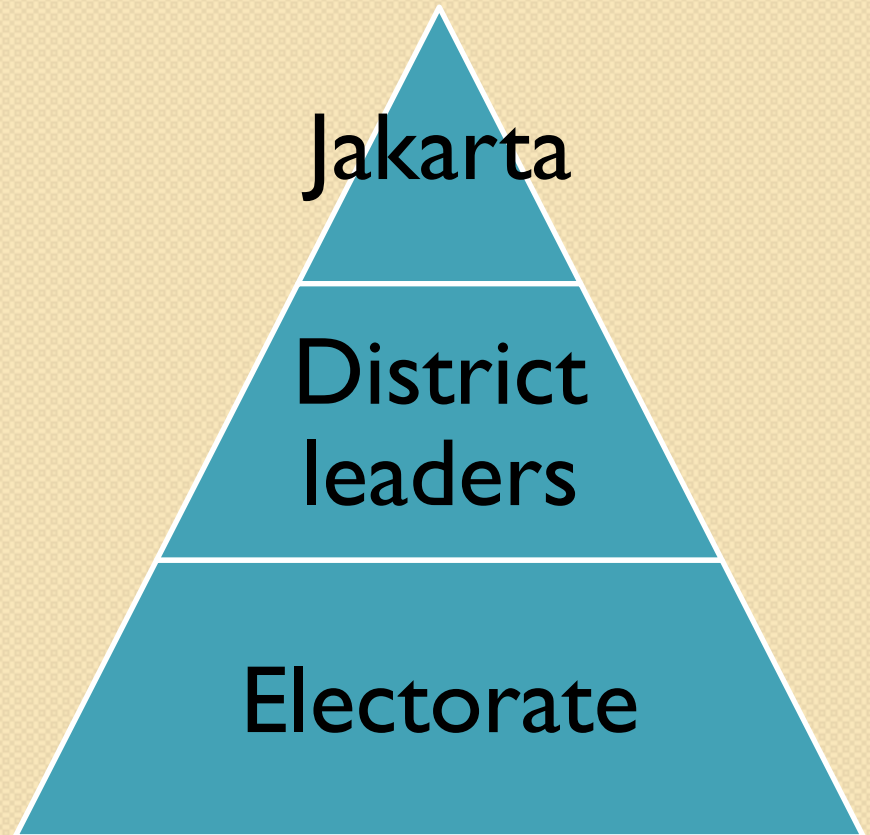
- Structural factors matter and in precisely the way we expect
- But they only explain 10% of overall variation - there is much still to play for

Log non-oil RGDP	-1.763 (1.66)*
Share of mining in GDP (2002)	-0.108 (0.03)
Log population (2002)	-2.426 (3.71)***
City	-1.288 (0.90)
Log distance from Jakarta	-1.221 (1.60)
Net enrolment middle school (2002)	1.745 (0.50)
Ethnolinguistic Fragmentation	-1.354 (0.59)
Religious Fragmentation	-0.448 (0.13)
Constant	124.927 (6.19)***
R^2	0.10
N	195

Vietnam



Indonesia



Upwards vs Downwards Accountability

Provincial Party Chairman, Vietnam

Incentives/Rules of the Game

- Political promotion depends on economic performance
- Political promotion depends on compliance with central initiatives
- Central oversight is strong and accountability is upwards.

Possible Strategies

- Steal the state budget
- Elite state-business alliances
- Improve the investment climate

Likely outcome

- Local elite state-business alliances and associated performance (and corruption)
- Lots of efforts to comply with PCI

Bupati, Indonesia

Incentives/Rules of the Game

- Political promotion depends very little on economic performance and not at all on compliance with central initiatives
- Central oversight is weak or non-existent. Accountability is to electorates, and to funders/local elites.
- Political campaigns require large financial resources and promotion depends on being able to contribute in a substantial way to the party

Possible Strategies

- Steal the state budget
- Elite state-business alliances
- Improve the investment climate

Likely outcome

- Lots of corruption of state budget
- Local elite state-business alliances but focussed on rent-seeking not performance
- Minimal efforts to boost the local investment climate

Compare their incentives

Policy Suggestions

- I. Strengthen central/provincial monitoring and incentives
 - Revamp the decentralisation law to provide stronger oversight at Province and Centre (already happening)
 - Tighten central/provincial monitoring of licensing/concessions
 - Construct a credible tool for central/provincial monitoring of performance
 - Help the province and centre use the tool; potentially link to rewards or punishments



Policy Suggestions

2. Strengthen accountability to citizens



- Socialise the results of performance to district and provincial electorates and parties

Educating Brazilian voters about the results of independent audits put pressure on politicians to perform

Policy Suggestions

3. Reduce reliance of local leaders on oligarchs

- Change the campaign finance laws to provide public funding for parties
- Put strict limits on campaign expenditure

