ECONSTOR
Make Your Publications Visible.

A Service of
ZBW
Leibniz-Informationszentrum Wirtschaft
Leibniz Information Centre for Economics

Engelmann, Tobias et al.

Research Report

The devolution of the land and building tax in Indonesia

Studies, No. 89

Provided in Cooperation with:
German Institute of Development and Sustainability (IDOS), Bonn

Suggested Citation: Engelmann, Tobias et al. (2015) : The devolution of the land and building tax in Indonesia, Studies, No. 89, ISBN 978-3-88985-673-9, Deutsches Institut für Entwicklungspolitik (DIE), Bonn

This Version is available at:
https://hdl.handle.net/10419/199214

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

WWW.ECONSTOR.EU

Mitglied der Leibniz-Gemeinschaft

d·i·e

Deutsches Institut für Entwicklungspolitik

German Development Institute

Studies

The Devolution of the Land and Building Tax in Indonesia

Christian von Haldenwang
Alice Elfert
Tobias Engelmann
Samuel Germain
Gregor Sahler
Amelie Stanzel Ferreira

The devolution of the land and building tax in Indonesia

The German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE) is a multidisciplinary research, policy advice and training institute for Germany's bilateral and multilateral development cooperation. On the basis of independent research, it acts as consultant to public institutions in Germany and abroad on current issues of cooperation between developed and developing countries. Through its nine-month training course, the German Development Institute prepares German and European university graduates for careers in the field of development policy.

Dr Christian von Haldenwang
Department Governance, Statehood, Security
German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE)
E-Mail: christian.vonhaldenwang@die-gdie.de

Studies
Deutsches Institut für Entwicklungspolitik

89

The devolution of the land and building tax in Indonesia

Christian von Haldenwang
Alice Elfert
Tobias Engelmann
Samuel Germain
Gregor Sahler
Amelie Stanzel Ferreira

Bonn 2015

Studies / Deutsches Institut für Entwicklungspolitik
ISSN 1860-0468

Die deutsche Nationalbibliothek verzeichnet diese Publikation in der Deutschen Nationalbibliografie; detaillierte bibliografische Daten sind im Internet über http://dnb.d-nb.de abrufbar.

The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliografie; detailed bibliographic data is available in the Internet at http://dnb.d-nb.de.

ISBN 978-3-88985-673-9

© Deutsches Institut für Entwicklungspolitik gGmbH
Tulpenfeld 6, 53113 Bonn
☏ +49 (0)228 94927-0
🖷 +49 (0)228 94927-130
E-Mail: die@die-gdi.de
http://www.die-gdi.de

Acknowledgements

The present study is the outcome of research carried out by the authors in late 2013 and the first half of 2014. It has been made possible thanks to the collaboration of a large number of persons who contributed by sharing their knowledge with us and supporting us in the implementation of the project.

Above all, we would like to thank our Indonesian counterparts, Anwar Syahdat from the Indonesian Ministry of Finance and Niniek Gyat from Universitas Indonesia. Apart from providing guidance in the preparation phase of the project, both in Germany and in Indonesia, Pak Anwar and Ibu Niniek have consistently supported us during our field research. In this context we also gratefully acknowledge the generous support and interest taken in our project by the Ministry of Finance, and in particular the Directorate of Local Taxes and User Charges. We are further very grateful to the Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ) Indonesia, specifically Doris Becker, Budi Sitepu and Tim Auracher, who provided essential guidance and logistical assistance throughout the project.

We would also like to express our gratitude to all those who volunteered to be interviewed for this project and who shared their time and insights so generously with us. Very special thanks go to the local authorities and tax agencies in Banjarmasin, Denpasar, Depok, Lombok Barat, Rokan Hilir, Rokan Hulu and Tanjung Pinang, which received us with the warmest hospitality and dedicated so much of their valuable time to answering our many questions.

We received helpful and thought-provoking comments at different stages from several colleagues at the German Development Institute (DIE), namely Armin von Schiller, Jörg Faust, Stefan Leiderer, Peter Wolff, Julia Leininger and Charlotte Fiedler. As always, Gisela Kuhlmann provided excellent secretarial assistance.

Finally, we would like to thank the European Commission (Directorate-General for International Cooperation and Development), and specifically Ollivier Bodin, upon whose invitation we had the opportunity to present our findings at a workshop on tax and development issues in Brussels in May 2014.

Needless to say, all statements made and conclusions drawn in this study are our own. None of the aforementioned people should be held responsible for them.

Contents

Acknowledgements

Abbreviations

Executive Summary **1**

1 Introduction **11**

2 Decentralisation in Indonesia **14**
2.1 Democratisation and political decentralisation 15
2.2 Institutional setting at the local level 18
2.3 Fiscal decentralisation and the transfer system 20
2.3.1 Fiscal decentralisation 20
2.3.2 Transfer system 23
2.4 The land and building tax 28
2.4.1 New responsibilities for local governments 29
2.4.2 Disparities between local governments 30
2.5 The plantations sector: Next in property tax devolution? 31

3 Research design **33**
3.1 Research interest 33
3.2 Hypotheses 34
3.2.1 Macro dimension 35
3.2.2 Micro dimension 36
3.2.3 Devolution of the land and building tax in the plantations sector 38
3.3 Methodological issues 39
3.3.1 Tax potential 39
3.3.2 Local case selection 41
3.3.3 Measurement of political costs 45

4 Findings **50**
4.1 Macro dimension 50
4.1.1 Initial evidence suggests an increase in revenue 51

4.1.2 The transfer system creates disincentives for local tax collection 55
4.2 Findings from the case studies 58
4.2.1 Capacity restrictions do not sufficiently explain the underuse of tax potential 59
4.2.2 The reluctance to face political costs leads to an underuse of tax potential 68
4.2.3 Support from the central level follows a one-size-fits-all approach 82
4.2.4 The incentive scheme for local collection is ineffective 85
4.3 Plantations dimension 92
4.4 How do findings relate to previous research? 102

5 Conclusion 107

References 111

Figures

Figure 1: Indonesia's tax performance in comparison 12
Figure 2: Political hierarchy and subdivisions of the state 17
Figure 3: Local administration relating to tax policy 19
Figure 4: The Indonesian fiscal transfer system 23
Figure 5: Three dimensions of hypotheses 35
Figure 6: Annual percentage growth of land and building tax revenues, treatment group 54
Figure 7: Levels of local government structure 85
Figure 8: Distribution of revenues from the land and building tax in Rokan Hulu 91

Tables

Table 1: Start date for land and building tax collection of local governments (LGs) 2
Table 2: Percentage growth of land and building tax revenues 3
Table 3: Use of tax policy instruments related to observed political costs 6

Table 4: Overview: Provincial and local taxes in Indonesia 21
Table 5: Sub-national share of total national revenue and expenditure 22
Table 6: Overall revenue sources for all cities and districts combined (in IDR billions) 27
Table 7: Start date for land and building tax collection of local governments 29
Table 8: Hypothesis-testing with the most-similar method 42
Table 9: Sub-groups of case selection 44
Table 10: Values of selected cases 45
Table 11: Overview of tax policy instruments at the local level 48
Table 12: Percentage growth of land and building tax revenues 52
Table 13: Land and building tax revenues in the six case studies (IDR) 53
Table 14: Annual growth of land and building tax revenues (%) 55
Table 15: Transfers to sub-national governments 2006–2012 (in IDR billions) 57
Table 16: Types of revenues as share of the local budget in 2012 57
Table 17: Tax arrears 2012 and ratio of arrears to annual collection, 2008–2012 64
Table 18: Capacity constraints faced by each district of the sample 66
Table 19: Political cost-assessment per set of instruments 80
Table 20: Use of tax policy instruments related to observed political costs 81
Table 21: Local government clusters for land and building tax devolution 104

Annex

Annex 1: List of relevant legal acts (laws and regulations) 119
Annex 2: Fiscal needs and fiscal capacity weightings 2008–2013 120
Annex 3: Distribution of non-tax component of Shared Revenue Fund (DBH) 121
Annex 4: Distribution of tax component of Shared Revenue Fund (DBH) 121
Annex 5: Transfers to sub-national levels (in IDR billions) 122
Annex 6: Interview partners 123

Abbreviations

ADB	Asian Development Bank
APEKSI	Association of Indonesian Municipalities / Asosiasi Pemerintah Kota Seluruh Indonesia
DAK	Special Allocation Fund / Dana Alokasi Khusus
DAU	General Allocation Fund / Dana Alokasi Umum
DBH	Shared Revenue Fund / Dana Bagi Hasil
DISPENDA	Local Tax Administration / Dinas Pendapatan Daerah
DPPKAD	Office for Revenue, Financial Management and Regional Assets / Dinas Pendapatan, Pengelolaan Keuangan dan Aset Daerah
DPRD	Local People's Representative Council / Dewan Perwakilan Rakyat Daerah
FITRA	Indonesian Forum for Budget Transparency / Forum Indonesia Untuk Transparansi Anggaran
GAPKI	Indonesian Palm Oil Association / Gabungan Pengusaha Kelapa Sawit Indonesia
GDP	Gross Domestic Product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH
HDI	Human Development Index
ICT	Information and Communication Technology
IDR	Indonesian Rupiah
IMF	International Monetary Fund
KPP	Local Tax Agency of the Central Government / Kantor Pelayanan Pajak
LG	Local Government
MoF	Ministry of Finance
NJOP	Tax Object Sales Value / Nilai Jualan Objek Pajak
NOP	Tax Object Number / Nomor Objek Pajak

OECD	Organisation for Economic Co-operation and Development
PATTIRO	Center for Regional Information and Studies / Pusat Telaah Dan Informasi Regional
PBB-P2	Rural and Urban Land and Building Tax / Pajak Bumi dan Bangunan
RT/RW	Neighbourhood / Community Association – Rukun Tetangga / Rukun Warga
SISMIOP	Property Tax Information Management System / Sistem Informasi dan Manajemen Objek Pajak
SPPT	Tax Liability Notifications / Surat Pemberitahuan Pajak Terhutang
STAN	National College for Accountancy / Sekolah Tinggi Akuntansi Negara

Executive Summary

In order to stimulate revenue mobilisation and local autonomy, some governments decentralise property taxes to the municipal level. Indonesia has done so in a gradual process between 2010 and 2014, transferring responsibility for the rural and urban *land and building tax* to its nearly 500 cities and districts. But has this so-called devolution led to strengthening the property tax as a source of public revenue? The present study explores whether decentralisation leads to a better use of the land and building taxation potential in Indonesia.

The study holds that initial evidence at an aggregate level points to an increase in property tax collection after decentralisation. A more detailed look at individual cases reveals, however, that local governments shy away from making full use of the powers given to them by the new decentralisation law. The study analyses the implementation of the property tax reform at the local level and derives lessons from the initial outcomes of the current process. It combines a macro-level view with in-depth case studies in seven Indonesian cities and districts. Further, it discusses options for broadening local property tax collection in the future by extending it to the plantations sector.

The road to property tax decentralisation

After democratisation started in 1998/1999, Indonesia embarked on a significant decentralisation process, also referred to as "big bang decentralisation" due to the swiftness and boldness of reforms. By 2001 an extensive decentralisation of the political and administrative system in Indonesia was achieved, and would be continuously adapted in a process that is ongoing. In a move to discourage separatist movements and to keep a certain degree of central government control over sub-national units, many functions were transferred directly to the municipal level, partly bypassing the 34 provinces.

Even though own revenue collection at the local level was strengthened after 1999, it clearly failed to keep pace with the transfer of expenditure responsibilities. This led to a widening gap between local own revenue and local expenditure. As a result, local governments in Indonesia remained highly dependent on central and provincial government transfers. On

average, 90 per cent of local expenditure was financed through transfers in 2009. The central government therefore adopted Law No. 28/2009, which introduced several additional tax competences at the local level. Among the new local revenue sources, the tax on the *transfer* of land and buildings was devolved in 2011. In contrast, the rural and urban land and building tax was transferred in a gradual process that started in 2010 and ended on 1 January 2014. At the end of the transition period, all but 35 cities and districts had issued the required local regulation.

Table 1: Start date for land and building tax collection of local governments (LGs)

	01.01.2011	01.01.2012	01.01.2013	01.01.2014	No collection in 2014	Total
No. of LGs	1	17	104	334	35	491

Source: Ministry of Finance (MoF, 2013a) and interviews with MoF officials in February 2014

To increase autonomy, the central government not only transferred administrative competences, but also granted local governments certain policy-making powers. Local governments can freely set tax rates as long as they do not exceed 0.3 per cent of the assessed value of the property; the deduction threshold for this tax has to be at least 10 million Indonesian rupiah (IDR) (US$ 720) per property. Moreover, the law provides local governments with discretion to set differentiated tax rates and provide additional exemptions and tax relief.

More revenue collected at an aggregate level

On a macro level, there is initial evidence that cities and districts increased their revenue from the land and building tax compared to central tax collection. Table 2 shows the median growth of land and building tax revenues for different groups. Comparing the groups before and after devolution, we can see a higher annual percentage growth of land and building tax revenues for Surabaya (the first city to take over property tax collection in 2011) and for the 17 local governments that took over tax

collection in 2012. In the case of those following in 2013, revenue data is only available for the six cities and districts of the case studies.

Table 2: Percentage growth of land and building tax revenues

	Centralised tax collection			**Decentralised tax collection**		
	2008–2010	2008–2011	2008–2012	2011	2012	2013
2011 (1 LG)	11.42	→		14.51	14.54	
2012 (17 LGs)		12.55	→		15.01	
2013 (104 LGs)			8.12			
*2013 (6 LGs)**			*8.83*	→		*27.23*
2014 (334 LGs)			6.05			
No regulation (35 LGs)			-1.33			

* Data refers to Banjarmasin, Denpasar, Lombok Barat, Rokan Hilir, Rokan Hulu and Tanjung Pinang. Based on annual collection data (nominal figures) provided by the Ministry of Finance (MoF) and by local tax administrations of the case studies (for 2013).

As shown in Table 2, local governments that started tax collection in 2014, or did not start at all, performed worse than the early adopters. The group without local regulation at the beginning of 2014 even registers a negative average growth rate for the period 2008–2012. This suggests that local governments with high revenue potential started tax collection early in the transition period. Those starting late (or not collecting the tax at all) might have done so based on a perception of little revenue potential from this source.

Tax potential not fully used

In order to gather detailed information on local property tax collection, a pilot study was conducted in the city of Depok (Java). Subsequently, six cases were selected for in-depth studies: the cities of Banjarmasin

(Kalimantan), Denpasar (Bali), and Tanjung Pinang (Riau Islands, Sumatra), and the districts of Lombok Barat (Lombok), Rokan Hulu and Rokan Hilir (both Sumatra).

As a general finding, all but one case (the city of Denpasar) suffered the consequences of weak central tax collection prior to decentralisation: (i) low quality of tax registers (missing data, erroneous data, redundant data) and (ii) high amounts of uncollected tax liabilities of up to 8.9 times the average annual tax collection. At the same time, all cases without exception shied away from fully using the tax policy and administration instruments given to them by Law No. 28/2009. These instruments are:

- setting tax rates and exemptions within the legal limits sketched out above;
- updating the tax register through data cleaning, mass appraisals and individual (property-specific) value assessments;
- raising tax compliance through measures to promote voluntary compliance or by means of coercion;
- collection of arrears.

Of these instruments, local governments regularly engage in improving the quality of tax register data and in promoting voluntary compliance through some sort of public campaign. In addition, the provision of other local services (for instance, issuing construction permits) is often made conditional upon proof of property tax payment. To a lesser degree, property values are brought closer to real market values by means of mass appraisals (adjustment of base values for certain areas or zones) and individual assessments. Finally, only one local government has set itself budget goals with regard to the collection of arrears, and none of the cases visited has chosen to raise tax rates to the legal maximum (in fact, tax rates were only marginally raised in one district).

Why do local governments refrain from making full use of the tax powers given to them? As a first set of factors, the study discusses *capacity constraints*. Such restrictions are often mentioned as a main obstacle by central-level actors, and donor agencies in Indonesia have a strong focus on building or improving capacities in this field. Administrative training and infrastructure are seen as being fundamental in local tax collection.

This study finds, however, that capacity restrictions do not prevent local governments from increasing their use of tax potential. To be sure, certain capacity bottlenecks do exist in almost all cases visited. Key issues refer to lack of specific human resources (in particular, related to property valuation and operating ICT systems), data quality and ICT infrastructure. Still, in most cases, local governments do not consider these bottlenecks to be of critical relevance. Thanks to the current fiscal transfer scheme, all local governments – even very remote and marginalised ones – are equipped with a minimum level of qualified staff and technical infrastructure. This is openly acknowledged by local authorities. In addition, the interviews led at the local level did not produce any evidence according to which financial restrictions were an important bottleneck for effective tax collection. In fact, several local governments have contracted external consultancy services to cover lacking expertise in valuation and ICT management.

Key factor: Political costs

Rather than capacity restrictions, it appears that the *political costs* associated with different tax instruments play a decisive role in explaining the underuse of tax potential at the local level. In accordance with the political economy literature, the term "political cost" refers to an expected loss in votes in the following election. Based on a literature review and on information gathered at the local level, the study identifies four indicators that affect public opinion and the level of popular opposition to reform.

- Numbers: The larger the number of taxpayers (voters) affected by a specific policy, the larger the potential for increased opposition.
- Groups: Segments of the economic or political elite or groups with high levels of organisation are able to put up more resistance against measures than "average" citizens.
- Impact: The higher the impact of a tax measure on disposable income, the higher the level of expected opposition. Also, an immediate impact is supposed to generate higher (immediate) political costs compared to an indirect or incremental impact.
- Visibility: Individual political decisions or single administrative acts are usually less politically visible, and therefore less conflictive than, for instance, legislative processes involving a variety of stakeholders.

The combination of these four properties makes it possible to rank the political costs of individual measures as “low”, “medium” or “high”. To give an example, a municipal by-law setting higher tax rates carries a high political cost, because it affects a large number of taxpayers, including powerful groups, and the process is highly visible. In contrast, improving tax registers through data cleaning should have a low political cost, as the measure usually affects a limited number of individual taxpayers and elite members (some even benefitting from better data) and the overall visibility of the measure is low.

In general terms, the study finds that the instruments or approaches associated with low political costs – for example, low-profile administrative processes such as data cleaning – are used more, whereas those with high political costs are used very rarely (see Table 3). As the share of the land and building tax in the local budget is relatively small, the willingness to confront these political costs is – with the exception of some individual cases – quite low. Political costs, therefore, prevent local governments from fully using the instruments at their disposal to increase local revenue.

Table 3: Use of tax policy instruments related to observed political costs

	Approach	**Instruments**	**Political cost**	**Use of approach**
1	Setting tax rates	Local council regulation	High	Low
2a	Tax roll update: data cleaning	Complaints management; visits on site; improving ICT systems	Low	High
2b	Tax roll update: mass appraisal	Adjusting zone limits and/or zone values (zone-specific or across-the-board); adjusting construction values	Low – medium	Medium – high
2c	Tax roll update: individual assessments	Individual assessments	Medium	Low – medium

Table 3 cont.: Use of tax policy instruments related to observed political costs				
	Approach	**Instruments**	**Political cost**	**Use of approach**
3a	Tax compliance: promoting voluntary compliance	Awareness-raising and public education campaigns; benefits for timely payments; improving taxpayer services	Low	Medium
3b	Tax compliance: raising the stakes for non-compliance	Sending overdue payment letters; linking other services to tax payments; visits on site	Low – medium	Low – medium
4	Active arrears collection	Sending debt notifications; visits on site; linking other services to payments; improving ICT systems; amnesties for older debt against payment of newer debt; fines; seizure of property	Medium	Low
Source: Authors				

Property tax in the plantations sector: A case for deepened decentralisation?

As requested by the Indonesian Ministry of Finance, this study also explores options to further decentralise the property tax. Law No. 28/2009 barred local governments from collecting land and building tax originating from three major economic sectors – mining, forestry and plantations, which remained under central government tax administration. It should be noted that fiscal revenues generated through the land and building tax in these three sectors greatly exceed the revenues of the urban and rural land and building tax that was transferred to local authorities. Districts with significant economic activities in mining, forestry or plantations should therefore have a strong interest in deepening the decentralisation of the property tax to include these three sectors. However, mining and forestry in particular are politically highly sensitive sectors, which is one of the

main reasons why decentralising the property tax for plantations seems to be more viable in the near future than for mining and forestry.

By far the most important sub-sector in plantations in Indonesia is palm oil. The Indonesian government plans to drive production from 23.5 million tonnes of crude palm oil in 2011 to 40 million tonnes by 2020. Out of 7.8 million hectares of total plantations in 2011, around 75 per cent of the plantations are located on Sumatra and Kalimantan. The formula to calculate the land and building tax in this sector uses a hybrid approach containing three components – land surface, value of buildings and plants, and production value. This particular composition poses certain challenges to tax administrations, as it requires monitoring, controlling and assessment capacities that local tax authorities usually do not have.

The main argument for local governments in favour of the devolution of property taxes in the plantations sector is an increase in own revenues and autonomy. In addition, the devolution of the land and building tax in the plantations sector would be a significant move towards addressing the urban bias of property taxation in Indonesia. The devolution of the land and building tax in the plantations sector would clearly benefit less developed cities and districts. It would also increase revenue transparency: under the current scheme, the visibility of plantations and the corresponding revenue-sharing payments are disconnected. Therefore, local governments do not perceive that they benefit sufficiently from local economic activities.

Economically, the advantages and benefits from a devolution of the land and building tax in the plantations sector are still unclear. With such a tax, the local governments concerned may increase their tax revenue considerably, but may also have to face increased administrative costs to handle the new tasks. This depends on existing capacities and the form in which the reform is implemented – something that cannot be determined at this point. Challenges may further arise due to the complex formula chosen to calculate property taxes in the plantations sector and the dismantling of the current revenue-sharing system that provides at least some benefits to neighbouring cities and districts.

The districts concerned voiced their clear preference in favour of a local collection of the tax. Palm oil companies as well as the Indonesian Palm Oil Association (Gabungan Pengusaha Kelapa Sawit Indonesia) also

expressed a rather favourable opinion, finding more positive than negative aspects to such a process (closer exchange with decision-makers at local level, multiplicity of partners). In contrast, central government institutions such as the respective tax agencies, as well as other local governments, generally expressed their hesitance to devolve this specific responsibility, mostly due to equity and capacity concerns.

In general terms, one of the trickiest questions to tackle for Indonesian authorities is how to lower collection costs and increase benefits from land and building tax collection for the majority of municipalities characterised by rural settlement patterns and agricultural or forestry activities. In principle there seems to be space for a more active role of central government in accompanying local governments in this transition phase. In combination with the property transfer tax, the land and building tax could be a main pillar of fiscal empowerment and local autonomy. However, this would imply additional efforts with regard to addressing the challenges outlined above. Changing the prevalent property tax culture should be considered a joint task of central and local governments alike – not least because local governments still suffer the heritage of weak property tax collection under the previous central government administration. Although it may not be possible to convert all local governments into winners from land and building tax devolution, there are clearly policy options to enlarge the number of those benefitting from this reform.

1 Introduction

International development policy stresses the potential benefits of fiscal decentralisation in low- and middle-income countries. Positive effects associated with fiscal decentralisation include higher efficiency in the delivery of public services, the promotion of democratic accountability as well as increased local capacities. Not least, fiscal decentralisation can entail substantial gains in terms of public revenues (Bird, 2011; Faust & von Haldenwang, 2010; von Haldenwang, von Schiller, & Garcia, 2014).

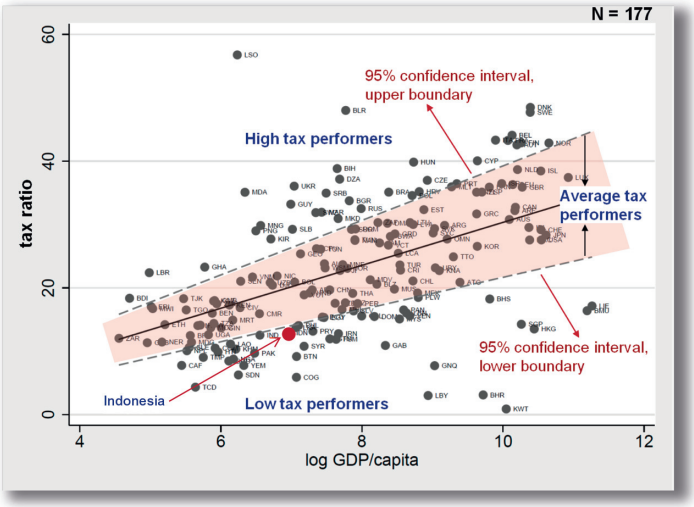
The link of fiscal decentralisation to growing public revenues has received more attention in recent years. Following the Monterrey Conference on Financing for Development in 2002, donors and international organisations have urged developing countries to increase domestic revenues, and sub-national levels have been identified as important areas of reform. In many countries, expenditure responsibilities assigned to sub-national governments clearly exceed their capacity to raise revenues from sources under their authority. This deepens their dependence on intergovernmental fiscal transfers and revenue-sharing arrangements (Bird, 2011). Assigning more important taxes to local governments, strengthening local capacity and autonomy, and reforming systems of intergovernmental transfers to incentivise local revenue collection are among the most frequent recommendations (Bird, 2011; von Haldenwang, 2010; Weingast, 2009). In this context, real estate taxes (or "property taxes", as they are often referred to) are widely recognised as a sustainable and economically efficient source of sub-national tax revenue (Bird & Slack, 2004; Sokoloff & Zolt, 2006).

However, it has also been observed that the effective collection of these taxes is often hampered by weak administrative capacities and political interventions at the local level (Fjeldstad & Heggstad, 2012). Local administrations do not always have the necessary capacity to regularly update tax registers, audit property tax declarations or enforce tax compliance. In addition, local politics or tax administrations are sometimes captured by powerful groups, and any decision to tax is taken while keeping the political costs it entails in mind (Slack, 2013).

As a "low tax performing" democracy (von Haldenwang & Ivanyna, 2012), Indonesia figures among those countries that are presumably in a good position to mobilise additional domestic revenue. According to estimates from the Organisation for Economic Co-operation and Development

(OECD), Indonesia's potential tax take under its current tax scheme is at about 21 per cent of gross domestic product (GDP) (Organisation for Economic Co-operation and Development [OECD], 2012, p. 5), as opposed to its current tax ratio of 12.6 per cent of GDP (see Figure 1). At the same time, Indonesian revenue collection is highly centralised: local revenues from tax collection and charges stood at only 0.8 per cent of GDP in 2011, the remaining revenues being collected by the central government (OECD, 2012, p. 49).[1] Whereas the decentralisation of expenditure responsibilities has progressed quite significantly over the last decade, the decentralisation of tax powers lags behind.

Figure 1: Indonesia's tax performance in comparison



Source: Adapted from von Haldenwang and Ivanyna (2012, p. 10). Tax ratio = tax collection in per cent of GDP.

1 Subnational governments are important tax collectors in some countries, especially in the higher-income groups, although in most of the low- or lower-middle-income countries they play only a minor role: in 2008, the mean difference between the central government and the general government (including subnational levels) tax revenue among lower-middle-income countries was 1.31 per cent of GDP (in those 19 countries that reported both data to the IMF), whereas in higher-income countries it was 5.76 per cent (27 countries). See von Haldenwang and Ivanyna (2012, p. 8).

The devolution[2] of the so-called land and building tax (*pajak bumi dan bangunan*)[3] to cities and districts, initiated by the Indonesian government in 2009, has been identified against this background as an approach to strengthen local revenues and narrow the expenditure–revenue gap at the local level (Kelly, Gyat, Nordiawan, & Harahap, 2011). Due to the recent character of reforms, however, little empirical evidence exists on the devolution of tax collection in general, and property tax in particular.

The present study contributes towards filling this gap. It analyses the implementation of property tax reform at the local level and derives lessons from the initial outcomes of the current process. The study combines a macro-level view with in-depth case studies in seven Indonesian cities and districts. Further, it discusses plans to broaden local property tax collection in the future by extending it to the plantations sector.[4]

- From a macro-economic view, our research explores whether revenues from the land and building tax increased after devolution. We discuss the concept of "tax potential" and analyse the incentive structure embodied in the Indonesian transfer regime.
- At the local level, the study focusses on the capacity restrictions that influence local tax collection, the political costs associated with land and building tax collection, and the influence of the incentive structure underlying local salary schemes for public officials.
- The third dimension of this research aims at deriving conclusions for a possible extension of the land and building tax devolution in Indonesia to the plantations sector.

---

2 Following Rondinelli (1989) and Schneider (2003), the term "decentralisation" refers to different states of decentralised decision-making, labelled de-concentration, delegation and devolution. De-concentration means a transfer of decision-making power to subordinate units of government. Delegation makes independent local units or agencies responsible for service delivery while remaining accountable to the central level. Devolution as the most extensive form refers to the transfer of powers to local governments with an independent source of legitimacy.

3 In this study the terms "land and building tax" and "property tax" are used interchangeably.

4 In the economic sectors mining, forestry and plantations, property taxes are still levied by the central government.

The report is structured as follows: the next chapter provides a brief sketch of the Indonesian decentralisation process. It argues that fiscal decentralisation cannot be understood without taking the current scheme of central government transfers into account. The chapter further discusses the main factors and characteristics of land and building tax collection and shows that this tax has not yet been decentralised completely. Chapter 3 introduces the research question and research design that guide the empirical analysis. We formulate hypotheses with regard to (i) the macro-level impact as well as (ii) the micro-level (case-specific) determinants of land and building tax devolution; (iii) further, the study explores conditions under which a devolution of this tax in the plantations sector might be beneficial. The section also introduces the methodology employed in the empirical analysis and the criteria used to select the seven cases. Chapter 4 reports the findings of the empirical analysis along the lines of the three research dimensions mentioned above. Chapter 5 summarises the findings and discusses policy options open to Indonesian authorities.

2 Decentralisation in Indonesia

After democratisation started in 1998/1999, Indonesia embarked on a significant decentralisation process, also referred to as "big bang decentralisation" due to the swiftness and boldness of reforms (for instance, see Hofman & Kaiser, 2004). The first part of this chapter gives an overview of Indonesia's recent history of democratisation and political decentralisation. The fiscal decentralisation and fiscal transfer system are introduced in the second section of this chapter, outlining the relevant legislation as well as the Indonesian approach to local taxation. The third section describes the characteristics of the land and building tax as well as the formal aspects of legislation and implementation at the local level. In light of the current discussion on a possible devolution of the land and building tax in other sectors, especially the plantations sector, the final part of this chapter gives an introduction to property taxation in the plantations sector.

2.1 Democratisation and political decentralisation

After its independence from Dutch colonial rule, Indonesia went through a short democratic period (1950–1957) followed by four decades of authoritarian regimes. The Indonesian state structure was highly centralised and autocratic. After independence, Indonesia was a centralised but multi-tier unitary state, with provinces as the second level, and local governments – called cities and districts (*kota* and *kabupaten*)[5] – as the third level of government (Shah, 2008) (see Figure 2).[6] In 1967, President Sukarno stepped down, and former military general Suharto took over. President Suharto ruled Indonesia until 1998 and further centralised power, with corruption, rent-seeking and patronage being inherent characteristics of his autocratic "New Order" regime. The first attempts to decentralise were made during the autocratic phase, but those initial attempts in 1957 and 1974 did not succeed due to regional unrest and lack of political will (Hofman & Kaiser, 2004). The petrified, centralised and autocratic state structure was one of the reasons that made Indonesia's decentralisation process very radical.

Decentralisation reforms were introduced during a political transition phase triggered by the Asian financial and economic crisis in 1997/1998. Indonesia was hit particularly hard by this crisis; from July 1997 onward, the rupiah dropped in what was almost a free fall, external debt grew and inflation was at a historic peak. To overcome the downward spiral and restore the confidence of financial markets, interim president Bacharuddin Jusuf Habibie followed the advice of international organisations such as the International Monetary Fund (IMF) and the World Bank and introduced decentralisation Laws No. 22/1999 and No. 25/1999. The transition period, called "*reformasi*", has been characterised by a crisis of

5 In the following, we use the terms "cities and districts", "*kota* and *kabupaten*" as well as "local level" interchangeably.

6 Both the second (*provinsi*) and third tier of government (*kota* and *kabupaten*) have formal taxation powers. Other sub-national levels such as sub-districts (*kecamatan*) as the fourth tier, or villages (*kelurahan* and *desa*) as the fifth tier do not have their own revenue sources.

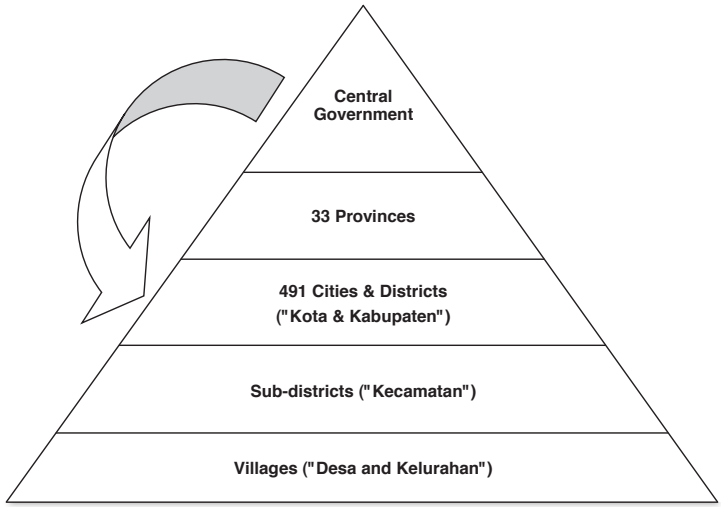
legitimacy, a weak central government and widespread distrust of public institutions.[7]

The influence of sub-national demands for autonomy on the Indonesian decentralisation process has been an important issue during the whole transition process. The secession of East Timor through a referendum in 1999 and aspirations for independence in the provinces Aceh, West Papua and Papua provided another important background for decentralisation. Local autonomy was seen as a means to hold the highly diverse nation-state together (Bunell, Miller, Phelps, & Taylor, 2013).

Secessionist aspirations not only provided a reason to decentralise but also influenced the design of the process. Law No. 22/1999 restricted central government functions and assigned a number of complex functions to local governments, largely bypassing the provincial level because local governments of cities and districts were considered to be too small and unattractive for separatist movements (Hofman & Kaiser, 2004). In addition, the central level had more influence over local governments than over the comparatively stronger provincial level (McCarthy, 2004). Moreover, the hierarchical relationship between provincial and local governments was partially dismantled in Article 4(2) of Law No. 22/1999. Instead of reporting to governors of provinces, heads of cities (*walikota*) and districts (*bupati*) started to report to locally elected parliaments (Dewan Perwakilan Rakyat Daerah (DPRD) – Local People's Representative Council) (Alm & Bahl, 1999).

7 For an overview of the main laws and regulations regarding decentralisation and land and building tax, please refer to Annex 1. For an excellent general account of Indonesia's democratisation and decentralisation process, see Horowitz (2013).

Figure 2: Political hierarchy and subdivisions of the state



Source: Authors

Laws No. 22/1999 on governance and No. 25/1999 on fiscal balance assigned important new functions to cities and districts. Law No. 22/1999 transferred most government expenditure functions, only excluding foreign affairs, defence, religion, natural resource utilisation and state administration,[8] whereas Law No. 25/1999 eliminated the earmarking of central government grants. In sum, the decentralisation process started in 1999 and took place within a very short time frame. Tight deadlines made this transfer of functions and resources even more radical, as by 2001 an

8 Article 7 (1) of Law No. 22/1999 defines central level functions as foreign policy; defence and security; justice; police; monetary and finance; religion; and other areas. "Other areas" are further specified in Article 7 (2) including *inter alia* macroeconomic planning and the exploitation of natural resources. Article 9 of Law No. 22/1999 describes provincial-level functions, including coordinating activities and assumption of tasks that cannot yet be performed by local governments. Article 11 (2) of Law No. 22/1999 defines public works; health; education and culture; agriculture; communications; industry and trade; investment; environment; land affairs; cooperatives; and manpower as obligatory governmental matters for districts and cities.

extensive decentralisation of the political and administrative system in Indonesia had been achieved and is still being adapted. Hence, the reference to a "big bang" decentralisation proves fitting (Hofman & Kaiser, 2004; Kis-Katos & Sjahrir, 2014).

2.2 Institutional setting at the local level

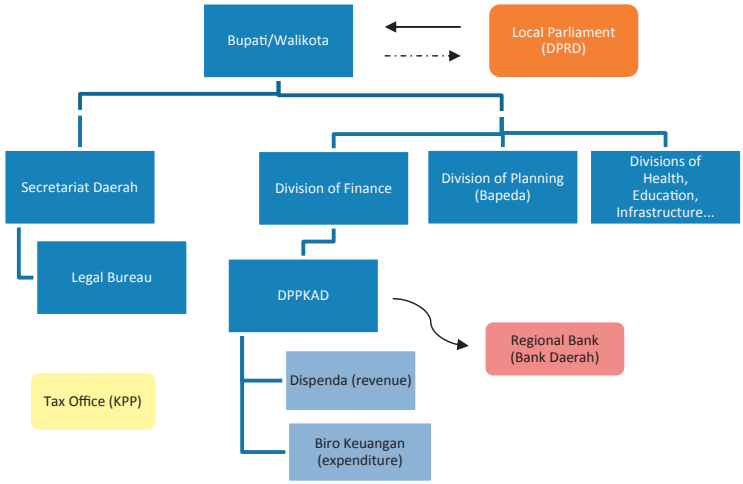
Each city and district is administered by its own local government and legislative body. In matters of local taxation, both enjoy certain decision-making powers.

Since 2005 district regents (*bupati*) and municipal mayors (*walikota*) have been directly elected and are accountable to the local parliament.[9] They propose local regulations (*peraturan daerah, perda*), sign them after approval by the local parliament and direct the activities of the local tax administrations. The technical process of local tax collection is regulated by local government decrees, issued by the head of the local government.

The DPRD can, in turn, dismiss the head of the region by rejecting the Annual Accountability Report (Laporan Pertanggung Jawaban). It approves the annual local budget as well as the local regulations (*perda*) that determine local tax rates and decide whether a tax is to be collected or not (Choi, 2007).

9 In an attempt to secure the power of the old party oligarchies, a law was passed in September 2014 by the outgoing parliament that dismantled the direct elections of *bupati* and *walikota*. Following public outcries, the new parliament reversed this ruling in January 2015, but the electoral regime is likely to suffer a series of revisions. See http://blogs.wsj.com/indonesiarealtime/2015/01/21/direct-local-elections-to-return-with-some-stipulations/ (accessed 02 Feb. 2015).

Figure 3: Local administration relating to tax policy



Source: Authors

Figure 3 shows the local administrative structure in districts and cities in Indonesia.

- The head of the local government directs, within the framework of national law, the activities of the local administration.
- The Secretariat *(secretariat daerah)* is led by the Regional Secretary, who responds to the head of the local government. It assists the mayor or district chief in formulating policies, coordinating the local executive and providing administrative services. The Legal Bureau, part of the Secretariat, makes sure that local regulations are in line with national laws and decrees.
- The divisions of local administration are organised along functions such as planning, finance, health, infrastructure and education. They implement local policies in those areas that have been devolved to the local level.
- The Division of Finance is in charge of local tax systems, including the land and building tax. Its office for revenue, financial management and regional assets (Dinas Pendapatan, Pengelolaan Keuangan Dan Aset

Daerah – DPPKAD) combines the responsibilities for revenue collection and expenditure, which are often taken care of by two separate sub-divisions. The devolution of the local land and building tax involved a great deal of change at this level. For instance, the Budget Bureau (*biro keuangan*) was formerly located under the auspices of the local Secretariat.

- Regional Bank *(bank daerah):* Revenues from tax collection at the local level are channelled through the (26) regional banks. These institutions are public banks that are usually owned by a group of municipalities or a province (or a combination of both).
- Tax Office (Kantor Pelayanan Pajak – KPP): Until 31 December, 2013 (or until the respective city or district took over the responsibility for the tax), the deconcentrated tax offices of the central government were in charge of managing the fiscal cadastre and the data about the financial value of buildings and property. Many local governments still use these data.

2.3 Fiscal decentralisation and the transfer system

2.3.1 Fiscal decentralisation

The second decentralisation law, Law No. 25/1999,[10] sought to empower sub-national governments to finance their new functions. Two new revenue-sharing arrangements allowed cities and districts to benefit from local economic activities through higher local revenues. Prior to decentralisation, revenue-sharing just comprised land and building tax and land and building transfer tax. It was now significantly expanded to include personal income tax and natural-resource revenue schemes (Brodjonegoro, 2001).

Obviously, the distributive impact of both transfers is highly unequal: with regard to income tax, the richest regions benefit most from revenue-sharing. With regard to natural resources, revenues are distributed according to the principle of origin. As a result, horizontal fiscal disparities between the metropolitan region of Jakarta and resource-rich

10 Replaced by Law No. 33/2004.

areas, on the one hand, and resource-poor or less-developed areas on the other hand increased (Firman, 2009).

A persistent fiscal gap provided the rationale to further decentralise tax instruments. The central government therefore adopted Law No. 28/2009, replacing Law No. 34/2000, and introducing several additional tax competences at the local level. A key feature of the new law consisted of replacing the former open-list approach to local taxation with a closed-list approach. The open-list approach, which was in place between 2000 and 2009, led to an uncontrolled mushrooming of local taxes, many of them with dubious legality. Article 2 of Law No. 28/2009, therefore, defined a new closed list of five provincial taxes and eleven local taxes (see Table 4).

Table 4: Overview: Provincial and local taxes in Indonesia

Provincial taxes	Local government taxes
1. Motor Vehicle Tax **2. Motor Vehicle Transfer Tax** **3. Motor Vehicle Fuel Tax** **4. Surface Water Tax** **5. Cigarette Tax** ***→ new provincial tax under Law No. 28/2009***	1. Rural and Urban Land and Building Tax (*Pajak Bumi dan Bangunan* – PBB-P2) *→ transferred from central government to local governments* 2. Property Transfer Tax *→ transferred from central government to local governments* 3. Hotel Tax 4. Restaurant Tax 5. Entertainment Tax 6. Advertisement Tax 7. Street Lighting Tax 8. Parking Tax 9. Non-Metal Mineral and Rocks Tax 10. Ground Water Tax *→ transferred from provincial governments to local governments* 11. Swallow Nest Tax *→ new local tax under Law No. 28/2009*

Source: Law No. 28/2009, Article 2, Sections 1–2

Among the new local taxes, the tax on the transfer of land and buildings was devolved by 1 January 2011. In contrast, the rural and urban land and building tax (PBB-P2) was transferred in a gradual process that started in

2010 and ended on 1 January 2014, when the central government ceased to have the legal competence to collect this tax (see Section 2.4). It is important to note that the Indonesian government not only transferred the responsibility for administering the land and building tax to local governments, but also, within certain limits, the authority over policy-making regarding this tax.

Despite the transfer of substantial financial resources, the fiscal gap between sub-national expenditure and revenue collection remains. Law No. 25/1999 and Law No. 34/2000 were not able to close this gap resulting from decentralising functions and increasing sub-national expenditures. Table 2 shows that both the share of sub-national own revenues in total national revenue and the share of sub-national expenditure in total national expenditure increased substantially. However, expenditure grew much more than local own revenue. In 2011, the share of local own-source revenue to total government revenue was 7.73 per cent, whereas the share of sub-national expenditure to total public expenditure amounted to 38.95 per cent. The difference is covered by central government transfers, which make local governments highly dependent on the central level. The median Indonesian municipality finances roughly 80 per cent of its budget through transfers.

Table 5: Sub-national share of total national revenue and expenditure

Year	Share of sub-national governments' own revenue in total national revenue (in per cent)	Share of sub-national governments' expenditure in total national expenditure (in per cent)
1989/1990	4.69	16.62
1998/1999	4.97	15.82
1999/2000	6.68	16.61
2000	4.55	16.19
2001	5.03	27.31
2002	7.52	36.28
2003	7.61	39.17
2004	7.86	35.19
2005	7.67	31.57

Table 5 cont.: Sub-national share of total national revenue and expenditure

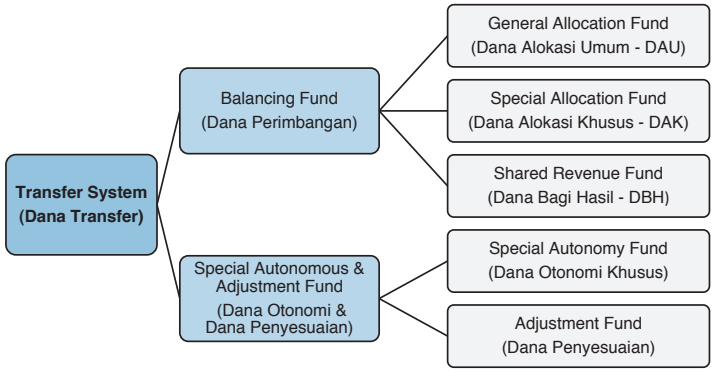
Year	Share of sub-national governments' own revenue in total national revenue (in per cent)	Share of sub-national governments' expenditure in total national expenditure (in per cent)
2006	6.04	32.97
2007	7.37	40.90
2008	6.59	36.19
2009	7.20	40.75
2010	7.24	39.37
2011	7.73	38.95

Source: Harjowiryono (2011), using World Bank and Ministry of Finance data

2.3.2 Transfer system

Fiscal decentralisation in Indonesia has been motivated by two potentially conflicting goals: to put available resources to their most productive use and, at the same time, to counter regional imbalances (Indonesian Forum for Budget Transparency, 2012; Widagdo et al., 2012). The two philosophies are reflected in the current transfer structure (see Figure 4).

Figure 4: The Indonesian fiscal transfer system



Source: Authors

The transfer system consists of three main mechanisms: the General Allocation Fund (Dana Alokasi Umum – DAU), the Special Allocation Fund (Dana Alokasi Khusus – DAK) and the Shared Revenue Fund (Dana Bagi Hasil – DBH).

The **General Allocation Fund** (DAU) makes up the largest proportion of transferred funds (MoF, 2012a, 2012c). Through the DAU, at least 26 per cent of the national budget is distributed annually to the *kota* and *kabupaten*. The distribution formula consists of two components, which together determine the share of each sub-national government.

- The first component, called *basic allocation*, covers the biggest part of the wage bill of each sub-national administration.[11]
- The second component, called *fiscal gap*, covers the gap between the fiscal capacity and the fiscal need of individual local governments. To assess the fiscal need, five proxy variables are used: population index, landmass, construction cost index, the inverse of the local Human Development Index and the local GDP per capita.

Based on Law No. 33/2004, the fiscal gap is computed using the following formula (Murniasih, 2007):[12]

DAU Distribution Formula

- DAU = Basic Allocation + Fiscal Gap
- Fiscal Gap = Fiscal Need – Fiscal Capacity
- Fiscal Need = Average total local budget expenditure (α_1 * population index + α_2 * surface area index + α_3 * inverse GDP per capita + α_4 * inverse of Human Development Index (HDI) + α_5 * construction cost index)
- Fiscal Capacity = β_1 * own source revenues + β_2 * revenue-sharing from taxes + β_3 * revenue-sharing from natural resources

11 According to Ministry of Finance officials interviewed in February 2014, the basic allocation covered 88 per cent of salaries for *kota* and *kabupaten* and 93 per cent of salaries for provinces in 2011.

12 For 2011, the total formula resulted as follows: DAU = Basic Allocation + Fiscal Gap; with Fiscal Gap = Fiscal Need - Fiscal Capacity; with Fiscal Capacity = 0.5 * locally generated revenues + revenues from the Shared Revenue Fund (Auracher & Bachmann, 2011).

Each year the MoF drafts three options for DAU transfers, with different weightings for each indicator (Auracher & Bachmann, 2011; Widagdo et al., 2012). Using the Williamson Index, a measure of spatial inequality, the three options are then ranked as first best, second best and third best option. The first best option with the smallest Williamson Index is the most equitable option and implies higher transfers to poorer sub-national governments. The options are then discussed in internal board meetings with directors of different directorate-generals within the MoF, before being sent to Parliament, which then decides on the distribution formula. If too many sub-national governments receive less DAU compared to the previous year, chances are high that the Parliament will press for adapting the weightings in the formula.[13] From a sub-national view, the changing weightings applied each year to the indicators clearly decrease the transparency of the transfer allocation (see Annex 2).

In contrast to the DAU, the **Special Allocation Fund** (DAK) does not automatically allocate funds to all sub-national governments. Instead, the fund is set up to support local governments with limited fiscal capacities to finance investments in specific sectors that have been defined as national priorities (Auracher & Bachmann, 2011; Widagdo et al., 2012).[14]

The **Shared Revenue Fund** (DBH) follows a different principle than the two allocation funds. It is comprised of a non-tax and a tax component (for further information, see Annexes 3 and 4). The revenues of both components are collected by the central government and then partly transferred to the sub-national levels.[15] The non-tax component entails revenues from natural resources such as forestry, fishery, oil and natural gas. The shared tax revenues derive from the income tax plus the land and building and land-transfer taxes before their devolution (Auracher & Bachmann, 2011; Widagdo et al., 2012).

13 This paragraph is based on information obtained from Ministry of Finance officials in February 2014.

14 Originally seven fields of activity in four sectors, namely education, health, local infrastructure and government office buildings, were defined as being eligible for financing from the Special Allocation Fund.

15 The exact distribution is laid out in Law 33/2004, Articles 8–26.

In addition to the three original funds, two more transfer mechanisms have been established in recent years: the Special Autonomy Fund (*Dana Otonomi Khusus*) and the Adjustment Fund (*Dana Penyesuaian*).[16]

- From a nation-wide perspective the **Special Autonomy Fund** plays a minor role because only the three regions with special autonomy status – Aceh, Papua and West Papua – are eligible to receive money from this fund. Nevertheless, for these three regions the transfers from the Special Autonomy Fund are substantial.
- The **Adjustment Fund**, on the other hand, is quite far-reaching in scope. Several sub-funds channel money in different sectors such as education or local infrastructure. In fact, the Adjustment Fund and the DAK pursue largely identical goals and are based on quite similar principles. The differences between the two mechanisms are that the Adjustment Fund is less formalised by law and that local governments – in contrast to the Special Allocation Fund – do not have to provide co-financing of 10 per cent (Widagdo et al., 2012).

The fiscal transfer system creates disincentives for the increase of own sub-national revenues. The current architecture of the system is mainly based on the fiscal gap of sub-national governments. Hence, entities with lower levels of own revenue collection receive higher allocations from the transfer system, whereas those that do a good job raising local resources are "punished", as the increase of revenues generated from local sources leads to lower transfer shares from the central government (Auracher & Bachmann, 2011). If a local government raises more revenues on its own, the fiscal gap of this entity will diminish, which, in turn, reduces its share of transfers from the DAU. The DAK and the Adjustment Fund are set up to support in particular those sub-national entities whose fiscal capacities are below the nation's average (see Law No. 55/2005, Articles 37–49). Hence, if these governments strengthen their fiscal capacities, they run the risk of receiving less money from these two funds as well.

Lastly, the fiscal transfer system lacks transparency due to the multitude of instruments and, thus, reduces accountability on both the provider and the recipient side. To give an example, the Adjustment Fund operates under central government regulations rather than legislation passed by the

16 For the exact distribution, please refer to Annex 5.

national parliament. These regulations do not specify conditions to be met in order to receive any funds nor provide an allocation formula. Further, the Adjustment Fund competes with, and undermines, the purpose of the DAK. There is a considerable overlap of activities funded by both the Adjustment Fund as well as the DAK (see Widagdo et al., 2012).

Besides other possible angles of reform, the reallocation of taxes on land and buildings and on the transfer of land and buildings from the DBH to the local governments constitutes a promising attempt to widen the income base, at least for some of the districts and cities, as these taxes supposedly have the highest potential to generate additional income for sub-national entities (Arnold, 2012; Widagdo et al., 2012). The general fiscal situations of local governments prior to the decentralisation of the land and building tax is shown in Table 3.

Table 6: Overall revenue sources for all cities and districts combined (in IDR billions)

	2008	2009	2010	2011	2012*	2013*
Total revenues	279,694	293,952	332,596	407,672	414,293	485,081
Local own source revenues	20,224	22,181	24,269	35,539	37,674	47,857
% of total revenues	7.23 %	7.55 %	7.30 %	8.72 %	9.09 %	9.87 %
thereof revenue from land and building tax	6.1	6.9	7.6	8.3	9.0	-
% of total revenues	2.18 %	2.35 %	2.28 %	2.03 %	2.18 %	-
Central Gov. transfers	240,551	249,336	282,187	340,761	348,635	404,533
thereof DAU	158,686	167,801	174,535	203,677	246,143	279,813

Table 6 cont.: Overall revenue sources for all cities and districts combined (in IDR billions)

	2008	2009	2010	2011	2012*	2013*
% of total revenues	86.01 %	84.82 %	84.84 %	83.59 %	84.15 %	83.40 %
Province transfers	13,212	15,011	15,524	19,978	25,105	29,794
% of total revenues	4.72 %	5.11 %	4.67 %	4.90 %	6.06 %	6.14 %
Other revenues	5,706	7,422	10,614	11,393	2,878	2,895
% of total revenues	2.04 %	2.53 %	3.19 %	2.79 %	0.69 %	0.60 %

* Planned according to national budget.
Source: Authors' calculations based on Ministry of Finance (2012b)

2.4 The land and building tax

With the introduction of Law No. 28/2009, the central government devolved the rural and urban land and building tax to the local governments. However, the land and building tax originating from the three sectors mining, forestry and plantations is still collected by the central government. The law stipulated a transition period of four years for the devolution of the rural and urban land and building tax, ending 31 December 2013 (MoF, 2013a). During the transition period, the land and building tax was managed either by the central or by local governments, depending on whether the local government already had implemented local collection or not. At the end of the transition period, all but 35 cities and districts had issued the required local regulation (*peraturan daerah*, *perda*; see Table 7). However, this does not necessarily mean that all these cities and districts have indeed started collecting the tax. With the end of the transition period, the collection by the central government came to an end, and those local governments that have not yet implemented the collection through local administration do not generate any of their own revenues from that source.

Table 7: Start date for land and building tax collection of local governments

	01.01.2011	01.01.2012	01.01.2013	01.01.2014	No collection in 2014	Total
No. of LG	1	17	104	334	35	491

Source: Ministry of Finance (2013a) and interviews with MoF officials in February 2014

2.4.1 New responsibilities for local governments

The overall objectives of the devolution of the land and building tax are to improve revenue autonomy of local governments, to increase sub-national revenues and to reduce local governments' dependence on fiscal transfers from the central government. In order to increase autonomy, the central government not only transferred responsibility for administering the land and building tax, but also granted local governments certain policy-making competences. With the transfer of responsibilities, local governments face new tasks with regard to administration; for instance, these include arrears management, tax collection, valuation, etc. These new administrative processes need to be integrated into local administration structures with the support of national institutions (Kelly et al., 2011).

Law No. 28/2009 grants local governments powers in policy-making but sets certain limits in order to keep a fairly homogenous system throughout the country. Within these limits, local governments are entitled to determine tax rates, exemptions, due date of payments and number of instalments. Furthermore, they are free to choose which tax administration system to apply. For the land and building tax, local governments can freely set a tax rate as long as it does not exceed 0.3 per cent of the assessed value of the property; the deduction threshold for this tax has to be at least IDR 10 million (US$ 720)[17] per property. Moreover, the law provides local governments with discretion to set differentiated tax rates and provide additional exemptions and tax relief (Kelly et al., 2011).

17 US$ figures are computed using the interbank rate of 31 August 2015.

Local governments need to adapt their administrations to cope with the requirements of the land and building tax. To handle these responsibilities, investments in public administration are fundamental. The central government published a template including all necessary investments to effectively administer the land and building tax, estimating the total investment need at IDR 2 billion (ca. US$ 144,000) per local government. According to information provided by the MoF, it is questionable whether all local governments are able and willing to invest such an amount, given the local incentive structures. However, our research shows that this estimation might exaggerate the average investment costs and may rather reflect the situation of large cities with many tax objects.[18]

2.4.2 Disparities between local governments

Benefits from the devolution of taxes are not equally distributed among local governments because of their high heterogeneity regarding resource potential and administrative capacity. Since land and building taxes in general have a strong urban bias, devolution of these taxes might further increase heterogeneity with regard to local revenues and financial capacity. Two main factors drive this urban bias: first, even though properties are located in both rural and urban areas, the revenue potential in urban areas remains higher due to higher property values in these areas. Second, administrative capacity is usually lower in rural areas. Both factors enable urban local governments to generate more revenues than those in rural areas (Kelly & Gyat, 2011).

Highly urbanised areas generally have a strong land and building tax revenue base and quite strong institutional human resources and systems capacities. Thus, these local governments need little technical assistance and support, since they have the strongest financial base and a greater ability to attract quality staff. In addition, these local governments typically have greater financial ability to finance capacity trainings and Information and Communication Technology (ICT) equipment. Furthermore, the central government tax agencies for the local level (KPP)

18 All seven cases visited reported far lower investment figures. To give an example, the head of the local tax administration in Depok stated that investment costs were only IDR 750 million (interview on 26 Feb. 2014).

are usually located in the urban areas, making it easier for them to provide technical and personal support to cities compared to rural municipalities (Kelly et al., 2011).

Rural governments, on the other hand, often have low land and building tax revenues and apparently less potential for revenue growth through property taxes. Before devolution, the 360 rural districts generated only 10 per cent of the total rural and urban land and building tax (Kelly et al., 2011). In fact, these areas face major challenges for substantially improving property revenue collection because of weak institutional and human resource capacities. Furthermore, these areas have difficulties in attracting qualified technical and administrative staff for tax management. Typically, these "low potential" local governments cover the more remote areas of Indonesia, where property values tend to be lower. Hence, the average unit cost of running a tax system increases due to lower average property values, lower tax assessments and larger geographical areas. As a result, these local governments find it difficult to effectively and efficiently generate revenues on their own and remain dependent on central government transfers.

2.5 The plantations sector: Next in property tax devolution?

The three sectors mining, forestry and plantations are exempted from the devolution of the land and building tax. However, at the central government level, a discussion is currently taking place on a possible future devolution of the land and building tax for these three sectors. It should be noted that fiscal revenues generated through the land and building tax in these three sectors greatly exceed the revenues of the urban and rural land and building tax.[19] Districts with significant economic activities in mining, forestry or plantations should therefore have a strong interest in deepening the decentralisation of the property tax to include these three sectors. However, mining and forestry in particular are politically highly sensitive sectors, which is one of the main reasons why

19 Of the three sectors, mining (which includes offshore drilling) is by far the strongest in terms of fiscal revenues.

decentralising the property tax for plantations seems to be more viable in the near future than for mining and forestry.

The most important sub-sector in plantations in Indonesia is palm oil. Together with Malaysia, Indonesia is one of the two main palm oil producers world-wide. In 2011 Indonesian palm oil producers harvested 23.5 million tonnes of crude palm oil, and the Indonesian government plans to drive production to 40 million tonnes by 2020. Out of 7.8 million hectares of total plantations, some 6.1 million hectares were productive in 2011. Sumatra and Kalimantan are historically the islands with the highest shares in palm oil production; around 75 per cent of the plantations are located on these islands. Palm oil production and its export are a key part of Indonesia's economy. First, the palm oil sector generates revenues for the central government through the taxation of exports. Second, palm oil production is labour-intensive: in 2011 around 3.2 million people were employed in this sector. Moreover, the further development of the palm oil sector is seen as an important step for poverty alleviation, as plantations are often located in rural and marginalised areas. Thirdly, the further development could also provide a chance to improve infrastructure in remote areas (Obidzinski, 2013).

These large production volumes in plantations make it an interesting sector for taxation. The intensive use of land for several years (an oil palm begins to produce only three to four years after planting) is especially convenient in the context of land taxation (Poku, 2002). Under the current regime, local governments with plantations benefit only partly from land tax revenues. Revenues are shared as follows: local governments receive 64.8 per cent and provinces 16.2 per cent. In addition, the central government levies a collection fee of 9 per cent and distributes the remaining 10 per cent of tax revenues to all *kota* and *kabupaten*. The formula to calculate the land and building tax uses a hybrid approach containing three components – land surface, value of buildings and plants, and production value. The first two components are characteristics of every property tax, whereas the last one is typically part of corporate income taxes or royalties. This particular composition, hence, poses a certain challenge for tax administrations in charge of assessing the tax value of plantations.

3 Research design

This chapter introduces the research interest that guides this study (Section 3.1) and the hypotheses underlying this research (Section 3.2). Hypotheses are discussed with reference to a macro and a micro dimension, as well as the above-mentioned plans to further deepen the decentralisation of the land and building tax. Lastly, this chapter provides a detailed description of the methodology used (Section 3.3). In particular, it explains how the cases were selected and discusses the operationalisation of two key concepts, "tax potential" and "political costs".

3.1 Research interest

The aim of the project is to contribute to the empirical research of fiscal decentralisation in developing countries and to support the ongoing decentralisation process in Indonesia. So far, empirical research on the devolution of land and building taxes in Indonesia has been limited. Against this background, the overarching research question posed in this study is: *Does decentralisation lead to a better use of the land and building taxation potential in Indonesia?* In exploring this question, the project aspires to identify achievements and shortcomings in the devolution process and in the local management of the tax. Are local governments better in collecting this tax than the central government? Are there cities and districts that have been more successful in managing the devolution process than others? If so, why? The analysis of the current process should also provide inputs to future fiscal decentralisation reforms.

The question of whether local governments do a better job in collecting the land and building tax than the central government in Indonesia is the starting point of our research. In this context, a first dimension of "better" refers to the amount of revenues collected: Do local governments obtain more revenues from the land and building tax than the central government did before? If so, do local tax administrations raise revenues in the first years after devolution because they reap "low-hanging fruits" such as unpaid tax bills from previous years? Is local tax collection perhaps affected by low levels of administrative capacity (staff, expertise, infrastructure)? Or do political considerations lead to lower (or higher)

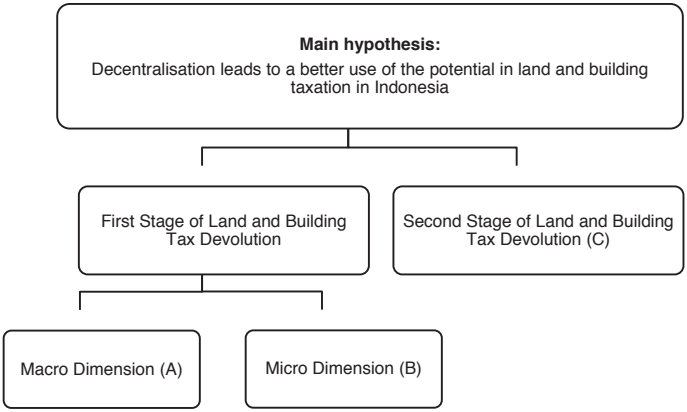
performance of local tax administrations? Not least, does central government support to local tax administrations influence local tax collection? In addressing these questions, the analysis of aggregate macro-level revenue data is combined with information gathered in seven case studies. By assessing the views of local actors, we want to shed light on the problems local governments face with regard to collecting the land and building tax.

A second dimension of "better" refers to the impact of decentralisation on ownership and accountability. The literature tells us that ownership and accountability can be improved by decentralising taxes to the local levels (Bräutigam, 2008; Martinez-Vazquez, 2011). In the Indonesian case, following the "big bang decentralisation", municipalities and districts are now responsible for a broad range of public services. To link the expenses for these services more closely to revenues should, in theory, increase the accountability of elected officials towards their constituency. Moreover, local officials may have a better knowledge of the local situation than bureaucrats in Jakarta and, thus, may use additional tax revenues more effectively. This research explores whether these theoretical effects really materialise in the case of the devolution of the land and building tax in Indonesia.

3.2 Hypotheses

Following the research interest outlined above, hypotheses were formulated with regard to different levels of analysis. In addition to the macro dimension and case-specific aspects of analysis, hypotheses refer to a possible decentralisation of the land and building tax in the plantations sector (see Figure 5).

Figure 5: Three dimensions of hypotheses



Source: Authors

3.2.1 Macro dimension

H.A.1: The kota and kabupaten that started collecting the land and building tax in 2011 and 2012 increased their revenues more than the others.

As local governments are usually considered to be more effective in collecting property taxes in general (Bird & Slack, 2004), we assume that local governments that already decentralised land and building tax collection increased their revenues from this tax more than the others.

To test this assumption, we compare land and building tax revenue under central tax collection (2008–2010) with data from decentralised tax collection (2011–2012).[20] Hence, the analysis focusses on the 18 cities and districts that started collecting the land and building tax at the beginning of 2011 or 2012. For these cities and districts, revenue data for at least one

20 Access to local tax revenue data for 2013 was restricted at the time of the empirical research, as local budget auditing by the National Audit Agency was still under way.

year after the devolution is available; therefore, they compose the treatment group. Revenue of the treatment group is compared with the revenue of several control groups that were built according to the initial year of local land and building tax collection. In addition, we use 2013 budget data from six out of seven *kota* and *kabupaten* we visited during our field research.[21]

H.A.2: The kota and kabupaten collecting land and building tax have little incentive to increase their own revenue collection due to perverse incentives built into the central-local transfer system.

This hypothesis follows the assumption that the extensive fiscal transfer system established in Indonesia over the last 15 years provides perverse incentives that may negatively affect efforts from local governments to increase their tax revenues and, thus, their use of tax potential. Being the largest component of the transfer system, the DAU could be especially problematic in this context.

3.2.2 Micro dimension

H.B.1: Local governments face capacity restrictions that prevent them from increasing their use of tax potential.

We expect that capacity restrictions may adversely affect the use of tax potential in many cities and districts. We assume that, apart from a few large cities such as Jakarta and Surabaya, many local tax administrations face some kind of capacity restrictions. Thus, possible bottlenecks for an efficient collection of the land and building tax may be human capacity, ICT infrastructure or the quality of registers. To explore this hypothesis, research will focus on the collection process (including arrears management) in order to assess which kinds of capacity restrictions local tax administrations face. This follows the assumption that collection and arrears management are crucial in terms of the use of tax potential.

21 The seventh case, Depok, is among the 17 local governments that took over property tax collection in 2012.

H.B.2: Local authorities perceive the political costs of local land and building tax collection as being higher than potential benefits.

Since local governments are free to choose whether they want to collect the land and building tax or not, we suppose that local authorities face certain political costs when they decide to collect the tax. Moreover, local authorities may consider potential benefits from additional revenue as being too small compared to a continued reliance on fiscal transfers. During our field research, legislative elections were held at the national and local levels in April 2014. This allowed us to examine the role of the land and building tax in election campaigns. In this context, we assume that land and building tax rates – or the collection of this tax in general – are an issue in local election campaigns. Furthermore, we analyse how local governments use the tax instruments available to them, such as setting the tax rate, updating data, granting exemptions, etc. Regarding this aspect, our research is guided by the assumption that instruments associated with higher political costs will not be used to their fullest potential.

H.B.3: Local governments perceive the support provided by central government as inadequate to increase their use of tax potential.

In a first step, we identify the types of support provided by the central government to local governments with regard to the land and building tax. In a second step, we explore whether local governments perceive the support from the central government as adequate and sufficient. Thus, the three questions discussed with regard to this hypothesis are: What kind of support did local governments receive? What kind of additional support do they require in order to improve the collection of the land and building tax? How do local governments cope with inadequate support from the central government? Our assumptions with regard to these questions are that local governments perceive support offered by the central government as being inadequate and insufficient to increase their use of tax potential.

H.B.4: The incentive scheme for the local level is not effective.

Local administrations can provide certain incentives (for instance, in the form of payments) in order to motivate local employees. We assume that the system of incentive payments is not effective for increasing local tax collection. In our field research, we analyse the current incentive system at

the local level and find out whether it contributes to an effective land and building tax collection.

3.2.3 Devolution of the land and building tax in the plantations sector

H.C.1: Local governments with palm oil activities would benefit from a devolution of the land and building tax for plantations.

This hypothesis is based on the assumption that, under the current regime, districts that depend to a large degree on palm oil plantations have fewer incentives to make better use of their tax potential than cities and districts that do not have large areas of palm oil plantations. Since the central government still collects the land and building tax from the plantations sector, only a limited part of the total land area is taxed by the local administration. In such cases, local administrations might be reluctant to invest large amounts in order to build up an effective land and building tax administration. Our assumption is that giving local governments the right to tax plantations would provide them with additional incentives to invest in a more efficient land and building tax administration, which, in return, would lead to an increase of the use of tax potential. Therefore, districts with a high level of dependence on palm oil production would benefit from a devolution of the land and building tax for the plantations sector.

Moreover, we assume that local governments that depend on palm oil plantations have already built up some capacities to collect the land and build tax from the urban and rural sectors. We therefore assume that these districts would be able to profit from learning effects and capacities built up during the first stage of decentralisation.

To test the hypothesis, we map the stakeholders involved at the local level and their positions regarding the devolution of the land and building tax for plantations. Furthermore, we identify perceptions at the local and central levels about the effectiveness of the current scheme of centralised taxation in the plantations sector.

3.3 Methodological issues

This section provides a description of the methodological approach. In general, descriptive statistics are used to compare decentralised and centralised tax collection at the macro level and a qualitative approach is chosen to gather information at central and local levels, based on semi-structured interviews with stakeholders in Jakarta and in the cities and districts selected for the case studies.

In the following, we elaborate on the measure of tax potential employed to assess the impact of certain policy choices on property taxation before and after the devolution (Section 3.3.1). Further, the selection of case studies is explained (Section 3.3.2). The third section introduces the concept of political costs associated with decisions and reforms in the context of decentralised property tax collection (Section 3.3.3).

3.3.1 Tax potential

To assess the success of local tax collection, solely relying on revenue growth figures would be misleading: even if a certain city or district was able to increase its revenue from the land and building tax, the question of whether these revenues are high compared to potential revenues would still remain unanswered. Hence, a more elaborated conceptual framework would be necessary to assess the utilisation of the land and building tax for a given city or district. Such an approach could draw on the basic revenue equation for property taxes widely used in the academic literature (for instance, see Kelly, 2013; Norregaard, 2013):

$$\text{Tax Revenue} = \text{Tax Base} \times \text{Tax Rate} \times \text{Coverage Ratio} \times \text{Valuation Ratio} \times \text{Collection Ratio}$$

The tax base and the tax rate(s) are subject to policy choice and can be taken as given. The coverage ratio specifies the percentage of tax objects listed in the fiscal cadastre compared to all tax objects. The valuation ratio determines the gap between the attributed values and the true market value of all available tax objects. The collection ratio states how much of the taxes owed are actually collected by the tax administration. In a perfect world (from a tax collector's perspective), these three variables would

each carry the value one to assess the maximum tax revenue and, thus, the theoretical tax potential under a given policy.

To assess the tax potential for the land and building tax in an individual city or district, the following formula is used by Indonesian tax administrations to estimate the land and building tax revenues for the upcoming year's budgets:

$$\text{Tax Potential} = \sum [(\text{NJOP of Tax Object}_i - \text{Exemption for Tax Object}_i) \times \text{Tax Rate}_i)]$$

Nilai jualan objek pajak (NJOP, which is the tax object sales value) stands for the assessed value of each tax object. For the urban and rural sectors, the NJOP is determined by the value of the plain land plus the value of any buildings. Generally, different approaches to assess the NJOP can be used, such as transaction values, construction costs or, in the case of commercial facilities, the income generated from the property. In reality, however, zoning[22] is often used in Indonesia to estimate property values. Many local governments set a collection target of 90 per cent of the tax potential.

Central government prior to devolution and local governments after devolution use an indicator of tax potential based on tax liability notifications (*surat pemberitahuan pajak terhutang* – SPPT) sent out to the taxpayer. This notification normally does not include tax arrears or fines but, in some cases, data on new buildings and updated values. Whereas in most *kota* and *kabupaten* the tax potential based on SPPT is used to define the tax target, other *kota* and *kabupaten* define their tax targets independently of their tax potentials. The *kota* Depok takes 85 per cent of the tax potential plus arrears to draft the tax target. Lombok Barat takes even 100 per cent of its tax potential as the basis for the tax target discussion with the local parliament. Rokan Hilir and Banjarmasin also use tax potential data to draft their tax targets. In Tanjung Pinang and Denpasar, it seems that the targets for land and building tax collection are defined independently of the tax potentials. Denpasar, for example, takes

22 Parcels of land are divided into different zones, with each zone reflecting different property values. Therefore, its main purpose is to simplify the valuation process. However, it can also be used as a policy tool to differentiate tax rates or exemption levels according to settlement patterns, land use or standards of living.

the target of the preceding year and adjusts it according to the central government's economic growth forecast, which was 6.5 per cent in 2014.

Contrary to these efforts, however, we find that, in its current form, "tax potential" cannot be used as a quantifiable indicator for both the macro and micro levels. At the macro level, the central government does not comprehensively keep track of this indicator. Hence, it is not possible to assess whether *kota* and *kabupaten* that started land and building tax collection in 2011 and 2012 actually increased their use of tax potentials or not.

At the micro level, the tax potential indicator employed by all *kota* and *kabupaten* of our sample is highly inaccurate. Firstly, tax liability notifications are often sent to buildings and properties exempted from paying the land and building tax (public property, buildings serving religious or social purposes). Another problem with this approach is incorrect data from the KPP, which leads to SPPT with incorrect property data or false addresses. In Rokan Hilir, for example, only about 25 per cent of all SPPT were paid in 2013. Finally, according to the information gathered from the local tax administrations, the NJOP values that form the basis of the liability notifications often diverge significantly from the market values of the properties. To sum up, not only is "tax potential" not a valid indicator for this research, but, perhaps even more importantly, it is currently not a useful indicator for local budget planning in Indonesia, leaving local governments with the conundrum of how to determine "good" targets for land and building tax collection.

As a result of these conceptual shortcomings, this study refers to "tax potential" as a qualitative measure of the degree to which local governments make use of the tax policy (such as setting tax rates) and tax administration (such as collecting arrears) instruments at their disposal. These instruments are introduced in further detail in Section 3.3.3.

3.3.2 Local case selection

In order to gather information on local property tax collection, we conducted one pilot study in the city of Depok (Java) and selected six cases for in-depth studies: the cities of Banjarmasin (Kalimantan), Denpasar (Bali), and Tanjung Pinang (Riau Islands, Sumatra), and the

districts of Lombok Barat (Lombok), Rokan Hulu and Rokan Hilir (both Sumatra). Cases were selected according to the most-similar method (Gerring, 2006). The criteria employed in the selection process include start date of tax collection, population density, local GDP per capita and share of area under palm oil crops on total surface. Additional aspects of consideration were accessibility, donor activity and security concerns.

Case study analysis aims to combine representativeness with variation along controlled dimensions of interest (Gerring, 2006, p. 88). Each technique has different features, and its use depends on the specific context, such as quantitative vs. qualitative approaches, hypothesis generating vs. hypothesis testing or availability of data. We chose the most-similar method for the selection of six case studies in order to explore variation along three lines of research that are introduced below. In the most-similar method, a researcher selects a minimum of two cases with different scores on the variable of theoretical interest (X_1) while at the same time trying to control possible causal factors (X_2) (Gerring, 2006, p. 131). As visualised in Table 8, the objective is to understand the relationship between the variable of theoretical interest (X_1) and the outcome of interest (Y) (Gerring, 2006, p. 132).

Table 8: Hypothesis-testing with the most-similar method

	X_1	X_2	Y
Case Type A	1	0	?
Case Type B	0	0	?

Source: Gerring (2006, p. 132)

In this study, the outcome of interest (Y) is the use of local land and building tax potential. Several control variables (X_2) were identified. One factor is the start date of tax collection: all selected cases started tax collection in 2013 or earlier (pilot case Depok), in order to make sure that local governments had acquired at least one year of experience in local tax collection at the time of the field research. A second control variable is population density, following the assumption that more densely populated areas generate higher levels of property tax revenue. We decided to not control for types of local government, which would mean choosing either only districts (*kabupaten*) or cities (*kota*), because there is no clear

definition for the types of local government. Population density appeared to be more suitable, because it also controls for cases that are just marginally above the threshold to become a city or *vice versa*.[23] The third factor controlled for in the selection process is local GDP per capita.

The most-similar method does not require measuring control variables with a very high degree of precision (Gerring, 2006, p. 133), allowing for the definition of minimum and maximum thresholds. Four sub-groups were created to better visualise the case selection (see Table 9).

First, a pilot study was conducted to test interview guidelines and access to interview partners. We chose Kota Depok, a city that started tax collection already in 2012. According to our Indonesian counterparts, this city serves as a good practice with a high degree of innovation when it comes to land and building tax collection. Its success is also reflected in the land and building tax revenue of 2012, which increased by almost 20 per cent in the first year after decentralisation (MoF, 2013b). Kota Depok is located in the suburbs of Jakarta.

We then selected a total of six cases comprising two cases (first group) to test our hypotheses on incentives and political costs, and four cases (second group) to test the hypothesis on capacity restrictions, of which two (third group) were also used to test the hypothesis with regard to plantations.

For the first group (B) the share of transfers in total local income was taken as the variable of interest. In one case, Banjarmasin, this share is comparatively high and close to the median of local government dependency on transfers in Indonesia. The second case, Denpasar, has a rather low share of transfers in the Indonesian context. We assume that the share of transfers in total local income is a rough proxy for incentives and political costs: the higher the share of transfers in total income, the lower the incentives for local tax collection; the higher the share of transfers in total local income, the higher the sensitivity to political costs.

For the second group, local GDP per capita is the variable of interest. Following the literature on tax effort and tax potential (for instance, see

23 Local governments with the designation "city" are usually more urbanised areas. The change from district to city depends on meeting thresholds for population density and local GDP per capita.

Fenochietto & Pessino, 2013), we assume that higher GDP per capita is associated with higher administrative capacity. Therefore, one case with high GDP per capita (Tanjung Pinang) is combined with another case with low GDP per capita (Lombok Barat) while controlling for possible factors of influence listed in the table below. For the third group, two cases with variation regarding GDP per capita and roughly similar patterns regarding areas under palm oil crops were selected.

Table 9: Sub-groups of case selection

Hypotheses	Variable of interest (X1)	Factors of control (X2)	Cases
(A) Pilot study	No variable of interest	Innovation, high performer	Kota Depok
(B) Incentives & political costs	Share of transfers in total income	Start date of tax collection: 2013 Local GDP per capita Population density	Kota Denpasar Kota Banjarmasin
(C) Capacity restrictions	Local GDP per capita	Start date of tax collection: 2013 Share of transfer in total income Population density	Kab. Lombok Barat Kota Tanjung Pinang
(D) Plantations		Additional factor of control: High share of palm oil activities	Kab. Rokan Hulu Kab. Rokan Hilir

Source: Authors

As shown in Table 10, the pairs of cities and districts chosen as case studies vary with regard to the variable of interest but are reasonably similar with regard to the other control variables. In addition, they are located on six different islands and, thus, cover various regions and ethnicities within Indonesia.

Table 10: Values of selected cases

	Start date of tax collection	Local GDP per capita (in mil. IDR)	Share of transfer in total income (in %)	Population density (inhabitants per km²)	Palm oil land area to total land mass (in %)
Kota Depok	2012	11.30	70.96	8,836	0
Kota Denpasar	2013	19.33	62.92	6,299	0
Kota Banjarmasin	2013	19.78	88.28	8,851	0
Kab. Lombok Barat	2013	8.06	88.53	676	0
Kota Tanjung Pinang	2013	32.11	89.62	1,362	0
Kab. Rokan Hulu	2013	33.14	95.05	65	49.7
Kab. Rokan Hilir	2013	78.40	95.44	65	25.8

Source: Authors

3.3.3 Measurement of political costs

Measuring the political cost of decisions and reforms to be implemented at the local level is a complex issue, as it is based on expectations of possible future impacts on voting and taxpaying behaviour.

Our definition of political costs is based on the political economy literature, in which decision-makers are assumed to be rational actors aiming to maximise their expected votes. A "political cost" is therefore represented by an expected loss in votes in the following election (Hettich & Winer, 1988). In that sense, politicians weigh the expected political benefits and costs before enacting public policy reforms, and their

perception of public opinion and possible opposition restricts their choices. Ashworth and Heyndels (1997) show that such vote-maximising political actors will choose reform paths that minimise political costs. The political instruments enacted are chosen so as to minimise the political costs and to reduce the opposition of the popular vote.

Bonfiglio and Gancia (2011) show that political reform is not necessarily punished by voters. However, as taxes tend to be unpopular, politicians shy away from using this instrument to its fullest potential in order to increase their chances of being re-elected. And indeed, the costs of tax reforms are usually highly visible and often more immediate than the benefits arising from increased revenue. Regarding taxation, the discontent of the voter can be triggered by the loss of disposable income, which stands against an indirect and less transparent provision of services by public expenditure (Kenny & Winer, 2006). The expected reaction of the voter – and consequently the choice of the politician – is therefore adversity to the costs of reform (Bonfiglio & Gancia, 2011).

Regarding the tax structure, Hettich and Winer argue that decision-makers choose their policy instruments according to the overall political costs. For instance, a group that is highly affected by property tax will oppose an increase in income taxes less than a further increase of the property tax. Consequently, politicians may have an interest in diversifying the tax base and using a variety of channels to increase or maintain revenue (Hettich & Winer, 1988). On the other hand, if a certain societal group dominates the discussion, one can expect a political support-maximising government to tailor its policy to the wishes of more influential groups (Ashworth & Heyndels, 1997).

In the case of Indonesia, we suppose that local authorities face political costs when they decide to collect the property tax. We therefore develop a simple analytical rooster using different indicators that presumably affect public opinion and the level of popular opposition to a reform, thereby influencing the expected loss in votes in the following election.

The indicators we identified for the assessment of political costs are:

- Numbers: The larger the number of taxpayers (voters) affected by a specific policy, the larger the potential for increased opposition.
- Groups: Resources controlled by affected taxpayers. Segments of the (economic or political) elite or groups with high levels of organisation are able to put up more resistance (both public and behind the scenes) against measures that affect them than "average" citizens.
- Impact: The higher the impact of a tax measure on, for example, disposable income or the level of tax enforcement, the higher the level of expected opposition. Also, an immediate impact is supposed to generate higher (immediate) political costs compared to an indirect or incremental impact.
- Visibility: Individual political decisions or single administrative acts are usually less politically visible, and therefore less conflictive, than, for instance, legislative processes involving a variety of stakeholders.

The combination of these four properties allows us to rank the political costs of individual measures as "low", "medium" or "high", as is shown in Chapter 4. It should be noted, however, that this ranking entails a certain degree of discretion, as the available data and information from the interviews do not allow for a completely formalised definition of the variables and their aggregation.

Regarding the Indonesian case, the transfer of the property tax has given local governments authority over the following tax instruments: (1) local tax authorities can set tax rates and grant exemptions from taxation, (2) they can adjust the assessed values through different mechanisms, (3) further, they can implement measures to increase tax compliance and (4) they can intensify active arrears collection. Table 11 summarises the instruments along with their advantages and disadvantages with respect to the political costs associated with them.

Table 11: Overview of tax policy instruments at the local level

	Approach	Instruments	Advantages	Disadvantages
1	Setting tax rates and exemptions	Local council regulation	Transparent; can be used flexibly to adjust the tax burden; direct impact on revenue	Highly visible; tedious process; highly political
2a	NJOP update: data cleaning	Complaints management; visits on site; improving ICT systems	Low-profile administrative process; linked to better taxpayer services	Investment not directly connected to higher revenue levels
2b	NJOP update: mass appraisal	Adjusting zone limits and/or zone values (zone-specific or across-the-board); adjusting construction values	Administrative process (but politically sensitive); important step in bringing NJOP closer to real market value; direct impact on revenue	May stir protests if NJOP is adjusted too quickly; across-the-board adjustments may lead to skewed tax burden
2c	NJOP update: individual assessments	Individual assessments	Administrative process (but politically sensitive); important step in bringing NJOP closer to real market value; direct and sizeable impact on revenue	Rather costly and demanding in terms of administrative capacity; likely to stir protest by powerful groups (wealthy people; main private-sector companies)

Table 11 cont.: Overview of tax policy instruments at the local level				
	Approach	**Instruments**	**Advantages**	**Disadvantages**
3a	Tax compliance: promoting voluntary compliance	Awareness-raising and public education campaigns; benefits for timely payments; improving taxpayer services	"Soft power" instrument; proven to be effective internationally; linked to better services	Draws public attention to the issue; immediate costs not directly linked to higher revenue levels
3b	Tax compliance: raising the stakes for non-compliance	Sending overdue payment letters; linking other services to tax payments; visits on site	Direct impact on revenue	May stir protests if robust tax collection is taken too far
4	Active arrears collection	Sending debt notifications; visits on site; linking other services to payments; improving ICT systems; amnesties for older debt against payment of newer debt; fines; seizure of property	High immediate revenue potential; linked to concepts of equity and fairness	Likely to stir protests due to low acceptance of the tax so far; may lead to excessive tax burden in individual cases; amnesties may undermine credibility of tax collection
Source: Authors				

4 Findings

In line with the research design introduced above, the chapter on findings is sub-divided into three sections: macro dimension (Section 4.1), micro dimension (Section 4.2) and plantations dimension (Section 4.3).

In Section 4.1 we present initial evidence suggesting that the decentralised collection of the land and building tax leads to a revenue increase from this source. However, evidence also suggests that marginalised cities and districts may not be able to take advantage of the decentralisation, and in some cases may even end up with less revenue than before.

Section 4.2 presents findings on the seven case studies. It shows that capacity restrictions may adversely affect the ability of some local governments to effectively collect the land and building tax. However, lacking capacities do not sufficiently explain the underuse of tax potential. Rather, accounting for political considerations that lead to less-effective collection provides a more conclusive picture.

Section 4.3 evaluates the opportunities and challenges of a possible devolution of the land and building tax for plantations. Including the plantations sector could make it more attractive for marginalised districts with large palm oil plantations to invest in local tax administrations and, thus, collect property taxes more effectively.

4.1 Macro dimension

In the following we present initial evidence for an increase in revenue from local land and building tax collection (Section 4.1.1). *Kota* and *kabupaten* that started collecting the land and building tax in 2011 and 2012 increased their revenues more than those with centralised collection. In principle, the same could be true for the 104 *kota* and *kabupaten* that decentralised in 2013. However, for 2013 revenue data was only available for the six *kota* and *kabupaten* of the case study sample. Based on this limited data set, it appears that those *kota* and *kabupaten* that decentralised early achieved higher growth rates than the rest of the local governments. Of the latter group, some *kota* and *kabupaten* might never be able to effectively raise revenue from this source, as is discussed in more detail below.

To be able to assess whether growth rates after decentralisation reflect a real advancement in collecting the tax, a quantifiable indicator that contrasts actual revenue with potential revenue would be useful. As mentioned above, most local governments in Indonesia estimate potential revenue from the land and building tax based on tax liability notifications (SPPT) sent out to the taxpayers. However, in all cases of our sample, deriving potential revenue from tax liability notifications has been shown to be highly inaccurate, which renders this indicator in its current form inadequate for local budget planning (Section 4.1.2).

As discussed above, the transfer system provides disincentives for local property tax collection (Section 4.1.3). Indeed, higher amounts of revenue from the land and building tax lower the allocation of the DAU for local governments in the following budget year. However, local authorities interviewed for this study are either not aware of this link between the transfer system and their local own source revenues, or they perceive this link as being too insignificant to impact on their revenue policy. Nevertheless, the study arrives at the conclusion that the existence of such an extensive transfer system might negatively affect the motivation of stakeholders to significantly raise local revenues. On average, roughly 90 per cent of local budgets are financed through central and provincial government transfers. Therefore, even high growth rates for locally generated revenue lead only to minor changes in most local governments' overall revenue.

4.1.1 Initial evidence suggests an increase in revenue

On a macro level, there is initial evidence that cities and districts increased their revenues from the land and building tax compared to central tax collection. Table 12 shows the median growth of land and building tax revenues for different groups of *kota* and *kabupaten*.[24] Comparing the groups before and after devolution, we can see higher annual percentage growth of land and building tax revenues for Surabaya (the first city to take over property tax collection in 2011) and "Group 2012" after

24 In this case the median is better than the mean to show the average increase or decrease of each group, as it better corrects for extreme values at both ends of the scale.

devolution. Surabaya increased its revenue growth rates by 3.12 per cent, whereas "Group 2012" shows an increase of 2.46 per cent.

For "Group 2013", revenue data for 2013 is only available for the six cities and districts of the case studies. Table 13 shows that five out of six local governments increased their land and building tax revenues from 2012 to 2013. Whereas the six local governments increased their revenues by 8.83 per cent on average from 2008 to 2012, the group shows a strong revenue increase of 27.23 per cent in 2013. We take this as additional evidence that points in the direction of increased land and building tax collection after devolution.

Table 12: Percentage growth of land and building tax revenues [25]

	Centralised tax collection			**Decentralised tax collection**		
	2008 – 2010	2008 – 2011	2008 – 2012	2011	2012	2013
2011 (1 LG)	11.42	→		14.51	14.54	
2012 (17 LG)		12.55	→		15.01	
2013 (104 LG)			8.12			
*2013 (6 LG)**			*8.83*	→		*27.23*
2014 (334 LG)			6.05			
No regulation (35 LG)			-1.33			

* Data refers to Banjarmasin, Denpasar, Lombok Barat, Rokan Hilir, Rokan Hulu and Tanjung Pinang. Based on annual collection data (nominal figures) provided by the Ministry of Finance and by local tax administrations of the case studies (for 2013).
Source: Authors

25 Due to missing data, the average percentage development from 2008 to 2010, 2008 to 2011 and 2008 to 2012 excludes 3 *kota* and *kabupaten* of "Group 2013", 28 *kota* and *kabupaten* of "Group 2014" and 8 *kota* and *kabupaten* of "Group No Local Regulation".

As shown in Table 12, "Group 2014" and "Group No Regulation" performed far worse than Surabaya and "Group 2012" between 2008 and 2012. The group without local regulation at the beginning of 2014 even registers a negative average growth rate for this period. We conclude that local governments with high revenue potential started land and building tax collection early in the transition period. This sheds some doubts on the question of whether "Group 2014", and especially "Group No Regulation", will be able to benefit at all from the devolution of the land and building tax.

Table 13: Land and building tax revenues in the six case studies (IDR)

Kota / kabupaten	**2012**	**2013**	**% growth**
Kota Denpasar	84,021,025,971	92,884,127,307	10.55
Kota Banjarmasin	12,911,917,453	18,964,163,545	46.87
Kabupaten Lombok Barat	5,170,341,792	6,521,858,715	26.14
Kota Tanjung Pinang	6,383,396,508	8,217,010,285	28.72
Kabupaten Rokan Hulu	4,916,146,500	4,800,000,000[a]	-2.36
Kabupaten Rokan Hilir	1,939,820,679	2,489,155,846	28.32
Mean			**23.04**
Median			**27.23**

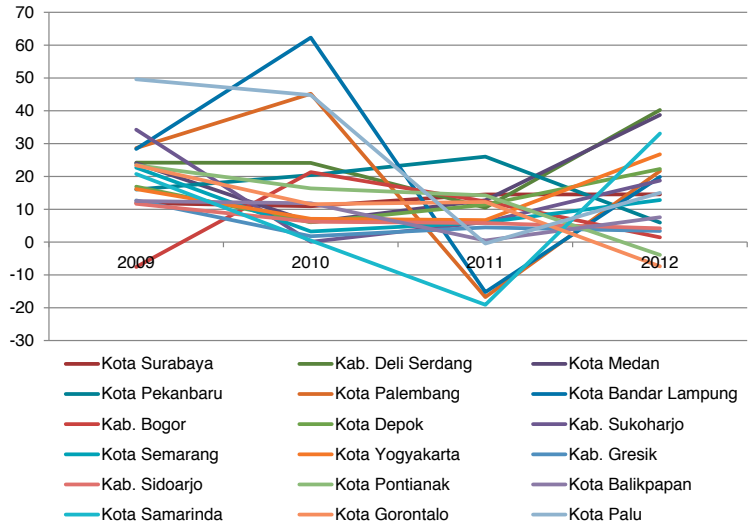
Source: 2012 data provided by the Ministry of Finance; 2013 data received by respective local tax administrations. [a] = Rounded figure obtained from the head of local tax administration, interview from 10 March 2014.

Taking a closer look at our treatment group, we see that two-thirds of the local governments in this group increased their revenues in 2012. Figure 6 shows that 12 out of 18 local governments increased their land and building tax revenues after devolution, whereas in six local governments revenues decreased. Some local governments, such as Kota Palembang, Kota Bandar Lampung and Kota Samarinda, increased their revenues

sharply in 2012 but showed high negative growth rates in the year before devolution, partly offsetting the increase after devolution.

In the years of central tax collection through the KPP, revenues from the land and building tax were characterised by surprisingly high degrees of volatility. An illustrative case is, again, Kota Bandar Lampung, where the accumulated absolute change in revenues from the land and building tax between 2009 and 2012 was 126 per cent.

Figure 6: Annual percentage growth of land and building tax revenues, treatment group



Source: Ministry of Finance (2013b)

We also observe that – in the year before devolving the land and building tax to *kota* and *kabupaten* – the growth rates of land and building tax revenues were comparatively low (Table 14). Whereas Group 2012 shows an average growth rate of 14.71 per cent between 2008 and 2010, there is only an increase of 6.11 per cent in 2011. The same applies to Group 2013, which shows an average growth rate of 9.01 per cent between 2008 and 2011. In 2012, the last year before devolution, the increase amounts to

only 4.38 per cent. This is an indicator for particularly weak central tax collection in the year before devolving the land and building tax.

Table 14: Annual growth of land and building tax revenues (%)

	2009	2010	2011	2012	2013
2011 (1 LG)	11.93	**10.92**	14.51	14.54	
2012 (17 LG)	22.70	11.56	**6.11**	15.01	
2013 (104 LG)	12.94	5.99	8.78	**4.38**	
*2013 (6 LG)**	*8.28*	*10.57*	*9.85*	***1.94***	*27.23*
2014 (334 LG)	13.29	3.85	5.55	2.89	
No local regulation (35 LG)	3.44	10.06	-5.42	-0.27	

* Data refers to Banjarmasin, Denpasar, Lombok Barat, Rokan Hilir, Rokan Hulu and Tanjung Pinang. Based on annual collection data (nominal figures) provided by the Ministry of Finance and by local tax administrations of the case studies (for 2013). Cells shaded grey = decentralised tax collection.
Source: Authors

4.1.2 The transfer system creates disincentives for local tax collection

In theory, the General Allocation Fund transfer system provides perverse incentives that may negatively affect efforts from local governments to increase their tax revenues and, thus, their use of tax potential. Following the DAU distribution formula illustrated in the box below, higher local tax revenues lead to higher levels of fiscal capacity and thus lower the fiscal gap that determines the allocation of central government transfers in the subsequent budget year. The exact effect is difficult to predict because the weightings are adjusted yearly. These adjustments are carried out by the MoF and have to be approved by the budget commission of the Parliament before entering the budget law.

DAU distribution formula for *kota* and *kabupaten* in 2013

- **DAU** = **Basic Allocation** + **Fiscal Need** [0.3 * population index + 0.13 * surface area index + 0.15 * inverse GDP per capita + 0.14 * inverse of HDI + 0.28 * construction cost index] – **Fiscal Capacity** [0.6 * own source revenues + 0.55 * revenue-sharing from taxes + 0.55 * revenue-sharing from natural resources]

However, local authorities interviewed for the case studies did not perceive DAU transfers to be a disincentive; instead, rather diffuse perceptions seem to exist at the local level about the effect of DAU transfers on local revenue mobilisation. This could be due to two characteristics of the fiscal regime: first, the total volume of DAU transfers to sub-national governments increased continuously from 2006 to 2012. Second, local own source revenues, and land and building tax revenues in particular, play only a minor role in the budgets of most *kota* and *kabupaten*.

The Parliament and MoF discuss the total amount of transfers to be given to sub-national levels each year. As a legal minimum, 26 per cent of the national budget has to be channelled to provinces and municipalities, but in recent years the amount has been higher. In 2013, transfers amounted to 30 per cent of the national budget. Table 15 shows that, against the background of continuous GDP growth in Indonesia over the last few years, the total amount of DAU transfers allocated to sub-national governments more than doubled between 2006 and 2013 in nominal terms. Most sub-national governments, therefore, received more transfers year by year. This leads to *kota* and *kabupaten* expecting that the transfer amounts will at least be equal to the amount they received the previous year.

Table 15: Transfers to sub-national governments 2006–2012 (in IDR billions)

Year	GDP growth (%)	General Allocation Fund (DAU)	Shared Revenue Fund (DBH)	Specific Allocation Fund (DAK)	Special Autonomy Fund	Adjustment Fund	Sum
2006	5.5	145,664	64,900	11,566	3,488	561	226,180
2007	6.3	164,787	62,942	16,238	4,046	5,250	253,263
2008	6.0	179,507	78,420	20,787	7,510	6,209	292,433
2009	4.6	186,414	76,130	24,707	9,527	11,807	308,585
2010	6.2	203,572	92,184	20,956	9,100	18,917	344,728
2011	6.5	225,534	96,772	25,233	10,421	54,548	412,508
2012	6.2	273,814	100,055	26,116	11,953	58,471	470,409

Source: World Bank (2014), Ministry of Finance (2012a)

The second characteristic mentioned above refers to the fact that for most *kota* and *kabupaten,* the share of own source revenue in the local budget is only a fraction of the share of central and provincial government transfers. The share of the land and building tax in the local budget is even smaller. With the exception of the larger cities, local own source revenues play only a minor role in local budgets. This means that for most *kota* and *kabupaten*, an increase in local own source revenues – for instance through a more effective collection of the land and building tax – does not significantly change the amount of transfers.

Table 16: Types of revenues as share of the local budget in 2012

Kota / Kabupaten	Own source revenues / local budget	Land and building tax / local budget	Transfers / local budget
Kota Denpasar	37.08 %	6.09 %	62.92 %
Kota Banjarmasin	11.52 %	1.08 %	88.28 %
Kabupaten Lombok Barat	11.08 %	0.61 %	88.53 %
Kota Tanjung Pinang	10.38 %	0.80 %	89.62 %

Table 16 cont.: Types of revenues as share of the local budget in 2012			
Kota / Kabupaten	**Own source revenues / local budget**	**Land and building tax / local budget**	**Transfers / local budget**
Kabupaten Rokan Hulu	4.39 %	0.40 %	95.05 %
Kabupaten Rokan Hilir	4.17 %	0.07 %	95.44 %
Mean of 491 kota and kabupaten	7.82 %		92.27 %
Source: Ministry of Finance (2012a), local tax and budget authorities			

On the positive side, none of the seven *kota* and *kabupaten* reported major problems with the transfer system. They perceive the transfer system as being transparent and predictable. Minor problems are the delays and oscillations of provincial transfers, difficulties with the Special Allocation Fund due to complex allocation procedures and a reduced predictability of revenue-sharing from natural resources (DBH). The general dependency on transfers is seen as being a further problem.

4.2 Findings from the case studies

Law No. 28/2009 gives local governments new powers in terms of decision-making and administration. However, the process of transferring – and at the same time modifying – an integrated property tax administration system from the central government to the local level is challenging. Shifting the administrative systems and procedures to local governments requires significant changes in management processes and strengthening local governments' institutional and system capacities (Kelly et al., 2011).

Currently, the most pressing challenges in the devolution of the land and building tax are valuation, tax collection and management of arrears. Regarding a possible devolution of the land and building tax in the plantations sector, the correct assessment of property value could also become more important. For a successful and effective devolution of the land and building tax following Law No. 28/2009, these challenges need to be addressed by the central government and local governments alike.

Based on the four hypotheses introduced above, this chapter arrives at the following conclusions: capacity restrictions prevent local governments from tapping the full potential of the land and building tax. However, lacking capacities do not sufficiently explain why local administrations shy away from making use of available instruments that would lead to an increase in revenue from this tax (Section 4.2.1). The reluctance of local public administrations to face the political costs associated with property tax collection provides an alternative explanation as to why these governments have so far not been able to fully exploit the potential of property taxation (Section 4.2.2). The support offered from the central government is relatively uniform and does not consider exceptional challenges such as high tax debt inherited from the central government, poor data quality and low acceptance of the tax by local taxpayers (Section 4.2.3). Lastly, the incentive system for the collection of the land and building tax is overly geared towards individual beneficiaries rather than institutional interests. Furthermore, the present scheme is ineffective, intransparent, complex and expensive (Section 4.2.4).

4.2.1 Capacity restrictions do not sufficiently explain the underuse of tax potential

In general terms, capacity restrictions do not prevent local governments from increasing their use of tax potential. Instead, political costs appear to play a more important role in shaping local tax collection. Whereas local governments usually refer to capacity restrictions in some way or another (infrastructure, qualification of local staff), they hardly ever mention them as key bottlenecks for the effective collection of the land and building tax.

This finding may be surprising at first glance. Capacity restrictions are often mentioned as a main obstacle by central-level actors, and donor agencies in Indonesia have a strong focus on building or improving capacities in this field. Why is it that capacity restrictions play a lesser role according to local actors? The answer to this question relates to fiscal transfers from central government. The basic allocation part of the DAU covers most expenses for public employees at the local level. Or, put in other words: basic allocation makes sure that even the poorest local governments have the necessary staff to provide, at least in theory, the public services they are supposed to provide. Moreover, in recent years,

most cities and districts have experienced sustained growth in transfers and own revenue, which leaves them with more resources to overcome possible capacity constraints.

Comparing the cases: Tanjung Pinang vs. Lombok Barat

To test our hypothesis on capacity restrictions, we chose GDP per capita as a proxy for administrative capacity. Following this line of thinking, we assume that local governments with a higher GDP per capita achieve higher revenue growth after decentralisation than those with a lower GDP per capita. Hence, Lombok Barat, with a GDP per capita of 8.06 million IDR (ca. US$ 580), should face more capacity restrictions than Tanjung Pinang, with a GDP per capita of 32.11 million IDR (ca. US$ 2,310). However, in the first year after decentralisation, Tanjung Pinang achieved only a slightly higher growth rate (ca. 29 per cent) than Lombok Barat (ca. 26 per cent – see Table 13). Of course, this only reflects the situation after the first year of local tax collection, so there could be larger differences in growth rates in the upcoming years.

In terms of number and qualification of staff – key determinants of administrative capacity – we observe similar levels in Tanjung Pinang and Lombok Barat. Nevertheless, Tanjung Pinang is clearly doing better in updating data and collecting arrears than Lombok Barat. In contrast to Lombok Barat, Tanjung Pinang contracted several private service providers for updating property values and ICT support. This allows Tanjung Pinang to better tackle capacity restrictions but creates additional expenditures. We observe similar policies in two other cities (Denpasar and Depok), indicating that the more advanced municipalities – and the cities in particular – are in a better position to address bottlenecks in tax administration. In the case of Tanjung Pinang, this policy may pay off in later years, so that it may be able to achieve considerably higher growth rates than Lombok Barat.

Although, as mentioned before, both cases are similar regarding human resources, they differ with regard to surface area and number of tax objects (*nomor objek pajak* – NOP). Lombok Barat claims that administrative costs exceed revenues from the land and building tax, as the revenue per tax object is relatively low. Therefore, we find that the significant difference in GDP per capita between Lombok Barat and Tanjung Pinang may in fact be a less decisive factor than the differences in settlement patterns, which exacerbate the urban bias of the property tax. For rural

municipalities with larger areas, more (small) tax objects and lower average property values, collecting the land and building tax requires higher inputs in terms of capacity and, ultimately, expenditure.

Another shortcoming of using GDP per capita as a proxy for capacity lies in the design of the transfer system. As explained before, local administrations highly depend on transfers from the national level. The transfer scheme compensates those cities and districts that raise less revenue than others with additional funds and, moreover, covers the paychecks of public employees. As a result, the transfer scheme largely offsets possible differences in capacity between local governments. This effect, however, is not reflected in the per capita GDP indicator.

Capacity constraints in detail

Although capacity constraints may not be the most decisive factor preventing local governments from increasing their use of tax potential, capacity-related bottlenecks still exist and may adversely affect the collection of the land and building tax. The following paragraphs summarise our findings on possible capacity constraints regarding human resources, data quality, ICT infrastructure, taxpayer services and financial resources.

Human resources

Whether human resource capacities at the local level are sufficient to effectively collect the land and building tax was a topic raised in many interviews.[26] The information gathered led to the conclusion that the amount of staff is a lesser issue in the context of administering the land and building tax, with the exception of Banjarmasin. Since the basic allocation of the DAU covers most of the costs for employing civil servants,

26 The topic has also been discussed in academic studies. For instance, Korte (2013, pp. 66–69) argues that the number of tax officials compared to total population has historically been low in Indonesia. Nevertheless, she doubts that the comparatively small number of tax officials is a real problem because, compared to registered tax payers, the number of tax officials is rather large. She also refers to interviews with several tax officials from the national level who state that the number of staff – at least at the tax department of the Ministry of Finance – is sufficient. Korte further argues that the actual problem in the context of human resources is that a large proportion of the staff is under-qualified to carry out complex tasks associated with a modern tax administration.

even remote cities and districts with otherwise low capacity levels can employ sufficient staff. In the case of Banjarmasin, however, the local administration voiced the need for more staff several times, even though 10 new employees had recently been added to the payroll.

Other than the number of employees, the qualification of staff plays a more prominent role in our case studies. The number of qualified personnel is limited, especially for the tasks of property valuation and operating the ICT systems. One-year training courses offered by the National College for Accountancy (Sekolah Tinggi Akuntansi Negara – STAN) seem to be the most adequate training facility offered to overcome qualification constraints for both tasks because STAN specifically targets these two areas. Though most cities and districts from our sample have so far sent one to three employees to these courses, this often proved to be insufficient to overcome capacity problems in terms of staff qualification. The fact that employees will be on leave for one year may hinder local governments from sending more staff to STAN courses, even more than financial constraints.

Some *kota* and *kabupaten* rely on external experts to deal with the lack of sufficiently qualified employees; in our sample, Tanjung Pinang and Denpasar run the most far-reaching schemes for contracting out specific tasks. Tanjung Pinang has contracted 10 consultants to operate the land and building tax ICT system. Denpasar relies on a total of 15 outsourced staff, who work mainly in the fields of property valuation and the operation of the ICT system. By relying on outsourced staff, the tax administration can expand or reduce its workforce more flexibly. Furthermore, it may be easier to get access to adequately qualified personnel if the selection is not limited to state employees. In addition, Denpasar relies on broad support from Universitas Gadjah Mada, one of Indonesia's best-known universities, to provide regular training to qualify staff for the needs of land and building tax collection.

Data quality

Data quality turned out to be one of the main capacity constraints that hinders cities and districts to increase their use of tax potential. All *kota* and *kabupaten* but Denpasar reported considerable problems with the data received from the respective KPPs during the devolution process. These problems mainly result from data inaccuracy in the form of *redundant*

data (more than one NOP for a single tax object, NOPs for non-existing objects); *missing data*, especially with regard to new buildings; and *erroneous data* due to wrong assessment or imputation (for instance, tax debt marked as overdue even though it had been paid). Of the six *kota* and *kabupaten* that face data problems, only Depok and Tanjung Pinang have followed a clear schedule to revise the data received from the KPP and, hence, have so far been able to correct considerable parts of it. Thus, there is significant variance in the extent *kota* and *kabupaten* are able or willing to revise the received data. This finding is of special importance since inaccurate data may further discourage people to pay land and building taxes.

Aside from the fact that inaccurate data renders collection more difficult, it also brings challenges in the context of tax debt from previous years. In all seven cases, the responsibility to collect the land and building tax came with significant amounts of accounts receivable from the time when the KPP was responsible for collecting the tax. The local tax administrations of Denpasar and Rokan Hilir initially even refused to take over the tax debt from the respective KPPs. They were reluctant to take the tax liabilities into their books because they feared a negative audit report from the National Audit Agency (Badan Pemeriksa Keuangan). At any rate, the vast amount of accounts receivable due to inaccurate data makes it difficult for local tax administrations to assess how much of the tax debt is actually collectable, which, in turn, hampers efforts to compute the real tax potential of the land and building tax.

Table 17: Tax arrears 2012 and ratio of arrears to annual collection, 2008–2012

Kota / kabupaten	Tax arrears end of 2012	Mean of collected property tax 2008–12	Ratio tax arrears / annual collection
Rokan Hilir	15 bn IDR	1.7 bn IDR	**8.90**
Rokan Hulu	27 bn IDR	4.2 bn IDR	**6.47**
Banjarmasin	65 bn IDR	10.7 bn IDR	**6.09**
Tanjung Pinang	32 bn IDR	5.7 bn IDR	**5.57**
Lombok Barat	26 bn IDR	5.0 bn IDR	**5.17**
Depok	196 bn IDR	79.0 bn IDR	**2.48**
Denpasar	143 bn IDR	69.0 bn IDR	**2.07**

Source: Local tax and budget authorities

ICT infrastructure

A deficient ICT infrastructure was frequently stated as being one factor that hinders local tax administrations from efficiently administering the land and building tax. However, this was voiced as a rather broad concern, and when we asked for a more detailed description of the problem, it turned out that the lack of ICT infrastructure can be mainly attributed to a shortage of qualified staff that is able to operate the ICT systems, and to low data quality. However, it is notable that Tanjung Pinang and Denpasar do not use the standard Property Tax Information Management System (Sistem Informasi dan Manajemen Objek Pajak – SISMIOP), which is provided by the central government, but took on significant additional investments to implement and run modified ICT programmes.

Taxpayer services

Local governments should provide convenient payment channels so that taxpayers do not have to face additional compliance costs (for instance, for transport). In Depok, Tanjung Pinang, Denpasar and Banjarmasin, this does not seem to be a problem when it comes to land and building tax collection. However, in more rural areas such as Rokan Hulu, Rokan Hilir and Lombok Barat, the availability of payment points is limited, which may prevent taxpayers from paying their taxes. To compensate for the

limited availability of payment points, local governments fall back on local tax collectors instead.

To collect the land and building tax, six out of seven *kota* and *kabupaten* have cooperation agreements with at least one bank, usually the respective regional bank (*bank daerah*). According to these agreements, taxpayers can pay the land and building tax at the branches of the banks, often without any cost for them. The only *kabupaten* not offering this service is Lombok Barat, where taxpayers either have to go to one of eleven *Kecamatan* (sub-district) offices or pay a tax collector. Even though the local governments of Rokan Hulu and Rokan Hilir cooperate with the local *bank daerah*, namely Bank Riau KepRi, they also rely on tax collectors. This is because both *kabupaten* stretch over a vast area of sparsely populated land, and the *bank daerah* only operates a few branches in the more urbanised areas of the district. Moreover, Lombok Barat and Rokan Hilir plan to introduce a so-called *mobil keliling*, a vehicle that visits far-off areas on a fixed schedule to offer basic banking services, including the possibility to pay the land and building tax; Banjarmasin has already introduced such a service.[27] Additionally, most of the districts and cities of our sample plan to cooperate with the post office or other banks in addition to their *bank daerah* to further increase the number of payment points.

Financial capacity

Financial constraints that prevent local tax authorities from investing in their land and building tax administration seem to be a minor concern in most *kota* and *kabupaten*. Some local governments such as Depok explicitly stated that the necessary investments in the infrastructure to administer the land and building tax are seen as being quite modest. In the case of Lombok Barat, however, the KPP is of the opinion that the costs to collect and administer the land and building tax are higher than the actual revenues that can be obtained from it. Even though this may not be the case in the long run, it appears obvious that the collection costs in poorer and rural *kota* and *kabupaten* can consume a considerable part of the revenue collected. In those cases, it will take a longer period for any

27 Banjarmasin operates the "*mobil keliling*" in cooperation with its "*bank daerah*". Rokan Hilir also plans to offer this service through the "*bank daerah*", whereas Lombok Barat wants to introduce a "*mobil keliling*" without cooperating with a bank.

investments to pay off; local governments may even decide to avoid investing in land and building tax collection altogether. However, we have not found evidence for such behaviour in the seven cases of our sample.

The following table summarises the capacity constraints faced by each district of the sample.

Table 18: Capacity constraints faced by each district of the sample

	Human resources	Data quality	ICT infrastructure	Taxpayer services	Financial capacity
Depok	Lack of staff (especially assessors) and need for additional training	Data received from KPP was inaccurate and has been updated in an incremental approach	Need for additional ICT support	Not mentioned as a major concern	Not mentioned as a major concern
Banjarmasin	Lack of staff in terms of number and need for additional training (especially in the field of valuation)	Data received from KPP is inaccurate; local government has not been able to update data yet	Lack of ICT infrastructure at *kelurahan* level	Limited access to payment points; limited reach of mobile banking but plan to increase coverage exists	Not mentioned as a major concern
Denpasar	Lack of staff in terms of number and need for additional training; contract external provider for individual assessments	Data itself very accurate; only some difficulties with transfer of data because of different ICT systems	No difficulties with running ICT system; contract external provider	Not mentioned as a major concern	Not mentioned as a major concern

Table 18 cont.: Capacity constraints faced by each district of the sample

	Human resources	Data quality	ICT infrastructure	Taxpayer services	Financial capacity
Tanjung Pinang	Need for additional training	Data received from KPP was inaccurate and is in the process of being updated	No major difficulties with running ICT system; contract external provider	Not mentioned as a major concern	Not mentioned as a major concern
Lombok Barat	Need for additional training	Incorrect data perceived as main challenge	Not mentioned as a major concern	Some difficulties in collecting tax in remote areas; rely on collectors; plan to introduce mobile banking	Costs to collect and administer the land and building tax could be higher than the actual revenues from it
Rokan Hulu	Need for assessors and additional training	Incorrect data perceived as main challenge	Not mentioned as a major concern	Major difficulties in collecting tax in remote areas; rely on collectors	Not mentioned as a major concern
Rokan Hilir	Need for additional training	Data received from KPP is inaccurate; difficulties in updating data	Some problems with the communication network	Major difficulties in collecting tax in remote areas; rely on collectors	Not mentioned as a major concern

Source: Local tax and budget authorities

4.2.2 The reluctance to face political costs leads to an underuse of tax potential

Local tax collection is clearly a politically sensitive issue, and politicians try to minimise the political costs associated with tax collection, for example by avoiding controversial measures and minimising publicity for political decisions that involve taxing their voters. Therefore, before issuing the local regulation on the collection of the land and building tax, most *kota* and *kabupaten* conducted a benchmark study to avoid the policies that met with resistance by taxpayers in other *kota* and *kabupaten*. Some *kota* and *kabupaten* held public hearings to get opinions on land and building tax collection at the local level from different groups of society, such as non-governmental organisations or private companies, but overall the new responsibility did not meet with resistance at the local level.

On 9 April 2014 legislative elections took place in all *kota* and *kabupaten*. During the electoral campaigns in the weeks before these elections, we expected to find property tax to be a topic of discussions and public discourse. However, in the seven case studies conducted, all stakeholders agreed that taxes in general were not an electoral topic. As taxes are an unpopular issue, political parties did not want to stir protests. It was argued that citizens would perceive paying taxes as a civil obligation, not as a political issue. Taxes, therefore, only play a role in so far as the revenue associated with taxes should be spent wisely and efficiently.

During their campaigns, parliamentarians usually focus more on the expenditure side; this is mainly due to the fact that citizens are more interested in public service delivery, such as for instance free health care and free education for the poorer segments of society and infrastructure improvements for the middle class.

Comparing the cases: Banjarmasin vs. Denpasar

As described in Section 3.3.1, local governments with high levels of central government transfers are assumed to be more sensitive to the political costs of tax collection in terms of protests and / or loss of votes. This is so because possible gains through additional local tax collection are comparatively small but associated with significant increases in the local tax burden. To give an example, if a local government with a transfer share of 90 per cent of

the local budget (an average value in Indonesia, and roughly the value of Banjarmasin) wanted to diminish its dependence by 10 per cent, it would have to double the local tax burden from 10 to 20 per cent of the budget. For a local government with a transfer share of 60 per cent (roughly the value of Denpasar), diminishing its dependence by 10 per cent would lead to an increase of just 25 per cent of the local tax burden.

Further, we expect a high level of dependence on central government transfers to be associated with low local revenue potential (and not just successful rent-seeking behaviour). Accordingly, local governments with high transfer shares should find it more difficult to significantly raise their own revenue collection than local governments with low transfer shares. At the same time, citizens are less accustomed to local revenue collection.

If these assumptions hold true, Banjarmasin should be considerably more reluctant than Denpasar with regard to strengthening local tax collection.

However, we did not find significant differences in tax policy and administration between both cases. Both local governments chose not to change the tax rate, which would be a transparent and broad-based measure to achieve revenue growth, but likely to be related to higher political costs. According to officials in Denpasar, the local government is quite satisfied with current levels of land and building tax collection – keeping in mind that it receives 100 per cent of the proceeds after devolution, compared to 64.8 per cent before. With regard to the gap between the assessed values (NJOP) and the market values of properties, Denpasar decided to raise the NJOP in an incremental and across-the-board approach – a measure that is less transparent and, therefore, less costly in political terms, but obviously also less effective in accounting for real market changes.

According to officials in Banjarmasin, the local government is working on an update of the NJOP. In addition, authorities are discussing a strict enforcement scheme by combining the water and the land and building tax bills. This approach could involve high political costs, as households with unpaid tax bills would risk being cut off from the water supply. As Banjarmasin is highly dependent on transfers, such a policy would run against the expectations spelt out above. In contrast, Denpasar proves to be rather weak on enforcement and even provides a discount scheme for certain taxpayers to lower their tax burdens.

Policy instruments

By taking over the responsibility for local land and building tax collection, local governments not only received the right to collect the tax but also the power over certain instruments related to the tax, such as setting tax rates or adjusting the NJOP.

Depending on how these instruments are used, they can lead to more progressive or regressive taxation, for instance by exempting certain groups from the tax burden. Officials at local levels often stated that they would use these instruments in such a way that "the society" would not be overburdened by the tax. In reality, this often boils down to maintaining tax rates and NJOP values roughly at the levels they had been before. There are, however, some examples of a more active use of the instruments, as is discussed below.

Setting tax rates and exemptions

Local governments have the authority to set the tariff freely up to the legal maximum rate of 0.3 per cent of the assessed value of the property. Further, they can choose as many different tariffs as they wish. Setting or changing the tax rates requires regulation by the local council. The instrument "setting tax rates" has some clear advantages, as it can be used flexibly to adjust the tax burden and has a direct impact on revenues. Moreover, it is a transparent measure. On the other hand, setting the tax rates is highly visible to the population and a very political issue, and the process *per se* is a tedious one. The political costs that come with this measure are high. It may come as no surprise, hence, that the usage of the instrument is low: in the seven case studies, all *kota* and *kabupaten* continued with the tax rate set by law before the devolution: 0.1 per cent < 1 billion IDR < 0.2 per cent, with only one slight change in the case of Rokan Hulu (0.11 per cent and 0.22 per cent).

Reasons for this policy vary, but most interviewees refer to the fear of protests against a higher tax burden – in particular because protests have already taken place in other municipalities. Another reason mentioned by local authorities is that they want to keep the tax burden low and, thus, leave the tariff at a rather low level. Especially in Lombok Barat this seems to be the case. Being a poor district (70 per cent of the population are small farmers), the local government believes that taxpayers do not

have the capacity to pay higher taxes and therefore decided against increasing the tariff. To raise own revenues, Lombok Barat rather focusses on other sources, such as the property transfer tax, which in their opinion shifts the tax burden to the wealthier groups of the population. Other local governments hope for more investments in their region, and therefore keep the tax rates for the land and building tax at low levels. However, the property transfer tax clearly has more impact on investments than the land and building tax. On the other hand, local governments are well-aware of the chance to generate own revenues through the land and building tax, and therefore do not want to lower the tariff either.

Outside our sample, however, there are *kota* and *kabupaten* that changed the tax rate. Some use different tariffs for different groups of taxpayers, for instance as a pro-poor policy. Jakarta offers one example of such a policy – in Jakarta five different tariffs are used. Medan, on the other hand, uses only one tax rate. The different tariffs sometimes lead to complaints by taxpayers (taxpayers complain directly to the local government). This is particularly the case if the rate increases substantially from one year to another.

In the case of setting exemption thresholds, Law No. 28/2009 determines a minimum value of 10 million IDR (ca. US$ 720) per tax object, but local governments can raise the threshold, thus favouring less wealthy sectors of society. Out of the seven *kota* and *kabupaten* included in our research, only Denpasar raised the threshold to 15 million IDR (ca. US$ 1,080). To further support specific parts of society, Denpasar developed a special subsidy scheme: there is a subsidy of 4 billion IDR (ca. US$ 288,000) per year for reduced land and building tax payments for farmers to keep agriculture in the area of Kota Denpasar. In a similar way, Depok supports agriculture in the city with exemptions from the land and building tax for farmers.

Most local authorities, however, do not use exemptions as an instrument for pro-poor policies, even though several governments state that they seek to minimise the tax burden for poorer parts of society.

Updating NJOP

Another instrument to influence the value of the land and building tax is the NJOP. It is determined by the value of the plain land plus the value of the buildings on that property. Generally, different approaches to assess

the NJOP can be used, such as transaction values, construction costs or, in the case of commercial facilities, the income generated from the property. In reality, however, zoning is often used in Indonesia to estimate property values. Land is divided into different zones, with each zone reflecting a different standard property value (expressed as an amount per square metre of land or constructed area).[28] Therefore, its main purpose is to simplify the valuation process. However, it can also be used as a policy tool to differentiate tax rates or exemption levels depending on the zone.

To update the NJOP, three measures come into play: data cleaning, mass appraisal and individual assessment.

- Data cleaning goes hand in hand with complaints management and often needs visits on site, as well as an improvement of the ICT systems. It is a rather low-profile administrative process that is linked to taxpayer services, but the investment is not always directly linked to revenue growth. With low political costs, it is a commonly used instrument in the cases of our sample.
- Mass appraisal means an adjustment of zone limits and/or zone values, either zone-specific or across-the-board, and the adjustment of construction values. Mass appraisal is a politically sensitive administrative process, but an important step in bringing the NJOP closer to the real market value. It has a direct impact on revenues. On the other hand, such a measure might stir protests if the adjustment happens too quickly. An across-the-board approach runs the risk of producing a skewed tax burden, as zone-specific developments are not taken into account. Political costs are low to medium, and the instrument is used almost regularly.
- Although individual assessment has the same advantages as mass appraisal – the impact on revenue can be sizeable – its disadvantages are different. Individual assessment is rather costly and demanding in terms of administrative capacity; moreover, individual assessment might lead to protests by powerful groups in society who own the high-

28 At the time of field research, most local governments still used the list of values provided by the central government (most recently updated in 2012). The list contains ca. 100 classes of property, ranging from an assessed value of zero to values of several billion IDR. Every class presents a certain range of values with a mean, which is taken as the base value for the property assessment.

price properties liable to this kind of assessment. Therefore, the political costs associated with this instrument are medium. In the cases visited for this study, it is clearly not being used to its full potential.

All local governments included in this study said they were planning to update the NJOP as well as the zones, but not all of them have embarked on that process yet. Tanjung Pinang is one example where the updating process has already started. The data Kota Tanjung Pinang received from the KPP does not reflect the real value of land and buildings and, on average, represents only around 40–50 per cent of the market value. The adjustment of values is managed in an incremental process in order to avoid protests from taxpayers. As a first step, values are incrementally raised to 70 per cent of the market value. Even though the head of the division in the local tax administration has the authority to update the NJOP, the updating process is considered politically sensitive and the final decision lies with the mayor (w*alikota*) himself.

As a contrasting case, in Rokan Hulu the fear of resistance to a higher tax burden is so high that there has been no updating of zones so far. The local government perceives the acceptance of the tax as being too low. Therefore, local authorities want to first solve administration problems, increase the acceptance of the tax and only then work on increasing revenues.

A third approach is taken by Denpasar. Here the local government opts for an across-the-board increase of all property values by one step per year. This means that starting in 2014 all zone values were raised to the next higher class in the 100-classes list mentioned above (footnote 28).

In general terms, mass appraisals apply to all buildings with an NJOP value under a certain threshold (usually 1 billion IDR). The owner of the property fills out a property tax form (*surat pemberitahuan objek pajak*), giving information on characteristics of the building (construction materials, number of floors, etc.). This information is used to compute the tax value.

Special buildings and those with a value of more than 1 billion IDR should be assessed individually, but few local governments apply this method to all potential objects. Individual assessments are conducted either by local government assessors or by external experts. In Tanjung Pinang, the cost of one individual assessment is estimated at 1.6 million IDR. In principle,

this method could be used to raise more revenue from the land and building tax without facing high political costs, as only small segments of the population are concerned, and most properties falling into this range belong to companies. As mentioned before, however, this approach concerns the wealthier parts of society that have more voice and better access to political decision-making. In addition, private companies are often powerful local stakeholders. Therefore, the political cost may be quite high, even though few actors are affected by the measure. At the same time, the reach of this instrument is limited in the poorer and rural municipalities; in Rokan Hulu, for instance, only one building (a palm oil factory) is assessed individually. In contrast, Tanjung Pinang conducts around 50 individual assessments every year.

Our findings suggest that local governments prefer to update the NJOP rather than change the tax rate, as updating the NJOP is not as universal and transparent as setting a higher tax rate by local council regulation. By doing this, local governments minimise the political costs they are facing due to the higher tax burden and still increase local revenues. At the same time, we observe that the instrument of individual assessment is not being used to its full potential in most of the *kota* and *kabupaten* we visited. As it appears, local governments shy away from taxing the private sector and the wealthier parts of local society.

Raising tax compliance

Local governments have two different sets of tools at their disposal to raise tax compliance among citizens: promoting voluntary compliance focusses on measures that make the payment of taxes easier or more convenient, whereas raising the stakes for non-compliance focusses on measures that make non-payment more risky and costly.

To promote voluntary compliance, local governments can use different instruments such as awareness-raising, public education campaigns (called *sosialisasi* in Indonesian), or offering benefits for timely payments and improving general taxpayer services. All those instruments are so-called soft power instruments (that is, not linked to enforcement powers on behalf of authorities), but they have proven to be effective internationally and are clearly linked to better services. However, *sosialisasi* draw public attention to the issue, and the immediate costs are not always directly

linked to revenue growth. Overall, the political costs of this instrument are low, but it is still not being used to its full potential.

Before devolution, the KPPs were responsible for collecting the land and building tax, but it appears that the agencies often experienced difficulties reaching the population. In some of our cases, local authorities stated that people neither understood why they should pay the tax at all, nor how the tax was determined, which led to strong resistance against the tax. Given the low levels of public acceptance, awareness-raising is important to make the new decentralised tax scheme work.

In general, local governments have a certain advantage, as they are closer to the citizens, know better about their needs and may be in a better position to link taxpaying to service delivery. In addition, they may point to the fact that, under the new scheme, 100 per cent of the revenue from the land and building tax accrues to local government, as opposed to 64.8 per cent before. The *kota* and *kabupaten* of our sample choose different paths to inform their citizens. Some local governments launch radio or TV spots or work together with village heads (*kepala desa*) to make special campaigns in villages showing high levels of resistance against the tax. Sometimes citizens are invited to public discussions on the topic; Rokan Hilir and Rokan Hulu implemented lotteries (promoted by Bank Riau KepRi) in which people who paid the tax on time could win motorcycles, TV sets and other rewards. However, not all local governments use public awareness-raising and education campaigns to their fullest potential. One factor to explain the reluctance of local governments to push this issue could be the low levels of public acceptance of the tax, inherited from the previous centralised regime. In general terms, the devolution of the tax was not used to promote a paradigmatic shift from a rather deficient tax collection process to a more effective one.

To ensure that people pay their taxes, it is important that governments provide the necessary services. Those services concern the collection process with payment channels, as well as the complaints management. Services provided by local governments vary significantly and are characterised, again, by an urban bias. For instance, Kota Depok offers a wide range of payment channels, including e-banking, phone banking, cash machines, payment at different banks (Bank Rakyat Indonesia, Bank Tabungan Negara), post offices, but no door-to-door collection. Before devolution, Banjarmasin had such collectors, but local tax authorities

decided against keeping this service because of widespread corruption. Instead, Banjarmasin introduced *mobil keliling*, an additional mobile payment point with officials from different institutions – to reduce corruption risks – that visits the different *kecamatan* on a fixed schedule and collects payments. In contrast, despite the risk of corruption, the rural districts of Rokan Hulu, Rokan Hilir and Lombok Barat rely on collectors to reach taxpayers in isolated and thinly populated areas. Both regions have few payment points, and the existing ones are only accessible for a small part of the population without exceedingly high travel expenses.

The services provided by local governments could still be improved, for instance by including supermarkets, kiosks, etc., in the payment process, but the smaller number of payment points and stakeholders in the process contributes to the transparency of the system. In this case, authorities need to find the right balance between taxpayer service quality and the necessary transparency of the system.

People have the right to complain to the local tax agency if they feel that something with the tax is not right. Local governments state different reasons why taxpayers complain. In some cases, taxpayers receive notifications or reminders for the first time due to new and stricter enforcement mechanisms (in the case of Banjarmasin). Most complaints, however, refer to errors in the valuation process or to unregistered payments in the past. In all cases visited, local governments solved the complaints through administrative processes, and so far no complaint has gone to court. But it appears that many taxpayers do not complain, although the data is wrong, because the amount is so small that actually travelling to the local tax administration facility would imply higher costs. It can be derived from this observation that there is room for improvement in the management of complaints and the provision of mechanisms for taxpayers to rectify their data. Easing the process could lead to more satisfaction of taxpayers, and a more efficient collection process.

Besides promoting voluntary compliance, local governments can raise the costs taxpayers have to face in the case of non-compliance. The rules for tax enforcement are set by the central government and have not substantially changed with the devolution of the tax. The general penalty to be paid by tax debtors is 2 per cent of the tax debt per month for a maximum of 24 months. As a last resort, the authorities can seize the

property. Auctions are only allowed after five years of unpaid liabilities. None of the municipalities in our sample has used this instrument yet.

However, local governments have additional options to enforce the payment of the tax: overdue payment letters and door-to-door collectors make people aware of their liabilities (and of the fact that authorities know that the tax is overdue). In addition, local governments link the provision of other services to tax payments. The clear advantage of those instruments is the direct impact on revenue. Then again, if "robust" or "coercive" tax collection is taken too far, it may stir protests. Hence, the political costs associated with these measures are at a low to medium level. The instruments are used, but still not to their full potential.

It appears to be a common practice that local governments deny public services – such as issuing business or construction permits, renewing ID cards and issuing birth certificates – if the applicant cannot provide proof of tax payments for the last two years. Moreover, in order to register a property sale, the property transfer tax as well as all outstanding amounts for the land and building tax for this property have to be paid. In order to get bank credit from the regional bank – often the only local source for financing services – proof of tax payments is also necessary. However, local governments have few options to enforce payment from property owners who do not live in the area where the property is located.

Nevertheless, there are also examples of local governments that decide not to enforce payments right away. In some cases, the tax administration can extend the payment deadline when a taxpayer demonstrates difficulties in paying the tax. In villages with low levels of collection, the village head can ask for an extension of payment time for the whole village at the *kecamatan* office.

The general penalty system for the delay of payments seems to be rather weak, and not one *kota* or *kabupaten* has fully used the legal instruments yet, but several local governments are working on enforcement mechanisms. For instance, Lombok Barat sent staff to Jakarta to receive training in this area. Moreover, there is at least one example of innovations in the area of enforcement: Kota Banjarmasin is working on a cooperation with the local water agency, which is owned by the local government. In the future, taxpayers will receive one bill for both water services as well as land and building tax liabilities. If property owners do not pay the

complete bill, they will run the risk of being cut off from the water supply. The approach is indicative of a local government that does not seem to shy away from the political costs it might face due to strict enforcement.

Pursuing active arrears collection

For active arrears management, local authorities have several instruments at their disposal. Some were discussed before in the context of enforcing timely tax payments, such as sending reminders, visits on site and the linking of services to payments. Other measures go beyond that: improving the ICT system, introducing amnesties for older debts against payment of newer debt, as well as fines for overdue payment and the seizure of property. The measures of arrears management have a high potential for collecting revenue immediately and are linked to the concepts of equity and fairness. All the same, they are likely to stir protests due to the low acceptance of the tax, they may lead to an excessive tax burden in individual cases and the amnesties could undermine the credibility of the tax collection process. Political costs associated with arrears management are at a medium level. So far the usage of the instruments seems to be low.

As mentioned above, local governments inherited huge amounts of debt from the KPPs and now have to find a strategy how to handle the arrears and the related data problems. Local governments rely on different approaches. As a first step, some local governments turned to the central government for help in asking for regulations on how to handle this debt. Rokan Hulu started to work closely together with the KPP in order to clear the data. Even before devolution, officers from the local tax administration and the KPP went to the 12 villages with the highest levels of unpaid tax and were able to detect 2.8 billion IDR of erroneous liabilities due to data problems.

Another problem regarding arrears occurs when it comes to the payment of current tax liabilities. If taxpayers are afraid of having to pay arrears for the last 10 years or more, they might not pay at all. In Lombok Barat local authorities are, therefore, using an amnesty approach – the clearing of debt older than five years. This approach is covered by central government regulation. This strategy was conducted in 2013 and has proven to be effective, as it motivates more people to actually pay their current taxes. At the same time, amnesties tend to undermine the credibility of tax

collection and may prove to be detrimental to local revenue mobilisation in the long run. Rokan Hilir also sent a proposal to the MoF to forgive debt that originated more than five years ago, but as the data is not cleared yet, the payment of the current tax bill is also possible without paying the older debt.

Overall, it appears that most local governments have no real strategy for how to collect the debt and focus instead on a rather passive form of collection along the lines sketched out above. This observation is reinforced by the fact that most local governments do not operate with budget targets for arrears collection. The collection of past debts can be a chance to access new revenues, but it may also alienate segments of the population. Further, some local governments seem to fear the audit commission and the consequences that those large amounts of arrears might have for them. Moreover, high levels of arrears hinder local governments from going forward with new efficient local collection methods. Handling the debt and the corresponding data problems seems to be one area where a clear strategy by the central government is needed.

Assessment of political costs for individual tax policy instruments

The detailed information on the use of instruments and the effects of the apprehension of authorities outlined above concerning the political costs makes it possible to assess the political costs for each set of instruments individually. For each approach used by Indonesian tax authorities, along with the indicators defined earlier (Section 3.3.2), we assess the number of taxpayers affected by the measure, the political influence of the groups affected, the size of the impact and the visibility of the measure, and attribute them a "+" in the case of high incidence and a "-" in the case of low incidence. The assessment is based on objective criteria (where available) in combination with information gathered from the interviews at the local level. Taken together, it provides us with an indication of the political costs of each approach.

Table 19: Political cost-assessment per set of instruments

	Approach	Instruments	Number	Groups	Impact	Visib.	Total pol. cost
1	Setting tax rates	Local council regulation	+	+	+/-	+	High
2a	NJOP update: data cleaning	Complaints management; visits on site; improving ICT systems	-	-	+/-	-	Low
2b	NJOP update: mass appraisal	Adjusting zone limits and/or zone values (zone-specific or across-the-board); adjusting construction values	+	-	+/-	-	Medium
2c	NJOP update: individual assessments	Individual assessments	-	+	+	-	Medium
3a	Tax compliance: promoting voluntary compliance	Awareness-raising and public education campaigns; benefits for timely payments; improving taxpayer services	-	-	-	+	Low
3b	Tax compliance: raising the stakes for non-compliance	Sending overdue payment letters; linking other services to tax payments; visits on site	-	-	+	+/-	Medium
4	Active arrears collection	Sending debt notifications; visits on site; linking other services to payments; improving ICT systems; amnesties for older debt against payment of newer debt; fines; seizure of property	-	+	+	-	Medium

Source: Aurthors

Table 20: Use of tax policy instruments related to observed political costs

	Approach	Instruments	Political cost	Use of approach
1	Setting tax rates	Local council regulation	High	Low
2a	NJOP update: data cleaning	Complaints management; visits on site; improving ICT systems	Low	High
2b	NJOP update: mass appraisal	Adjusting zone limits and/or zone values (zone-specific or across-the-board); adjusting construction values	Low – medium	Medium – high
2c	NJOP update: individual assessments	Individual assessments	Medium	Low – medium
3a	Tax compliance: promoting voluntary compliance	Awareness-raising and public education campaigns; benefits for timely payments; improving taxpayer services	Low	Medium
3b	Tax compliance: raising the stakes for non-compliance	Sending overdue payment letters; linking other services to tax payments; visits on site	Low – medium	Low – medium
4	Active arrears collection	Sending debt notifications; visits on site; linking other services to payments; improving ICT systems; amnesties for older debt against payment of newer debt; fines; seizure of property	Medium	Low

Source: Authors

Tables 19 and 20 demonstrate that only a small number of the instruments available to local decision-makers are used. The instruments or approaches associated with low political costs – for example low-profile administrative processes such as data cleaning – are used more, whereas those with high political costs are used very rarely. Political costs, therefore, seem to be an important obstacle for the effective use of instruments for increasing local tax collection. As the share of the land

and building tax in the local budget is relatively small, the willingness to confront these political costs is – with the exception of some individual cases – quite low. Political costs, therefore, prevent local governments from fully using the instruments at their disposal to increase local revenue.

4.2.3 Support from the central level follows a one-size-fits-all approach

According to the perceptions of several interviewees at the central and local levels, limited capacity prevents many local governments from collecting the land and building tax efficiently and effectively. To overcome this lack of capacity, some local governments voice their need for additional support from the central government. The Association of Indonesian Municipalities (Asosiasi Pemerintah Kota Seluruh Indonesia – APEKSI), the association of Kota, and donor organisations such as GIZ point out that local governments with low capacity levels are in particular need of additional financial and technical support from the central government. In a similar vein, several other donors (for instance, the United States Agency for International Development) and international organisations (for instance, the Asian Development Bank – ADB) engage in capacity-development activities with regard to local tax collection.

Modes of support offered by the central government

In the following, the different modes of support offered by the central government are described. Support is almost exclusively limited to providing training.

Training through the Ministry of Finance

Firstly, the MoF provides training courses of up to two weeks in different cities. Local governments can decide whether they want to send staff to these trainings. The costs for the courses themselves are usually covered by the central government, whereas local governments have to assume the costs for travel and accommodation.

Training courses at STAN and other MoF-affiliated training centres

Furthermore, local tax administrations can send staff to one-year training courses at the National College for Accountancy, which is affiliated with the MoF. In the context of local land and building tax administration, STAN centres are mostly used for qualifying ICT operators and assessors, though the costs for these courses have to be borne by the local governments. In addition, the MoF has recently established seven training facilities attached to universities in different cities. These training facilities were founded in cooperation with German technical cooperation to train staff from local administrations in financial management.

Support through the KPPs

Lastly, the KPPs offer support to the local tax administrations for a limited period of time. Usually this support commences before the land and building tax has been devolved to the local level, and it is supposed to carry on for up to two years after devolution. Before devolution, the KPPs provide training for local government employees for one to two weeks. In some cases these courses are followed by a secondment at the KPPs that may last up to three months. In contrast, the support offered by the KPPs after devolution seems to be only vaguely codified and, thus, depends largely on the relationship between the local tax administration and the corresponding KPP. In Tanjung Pinang, for example, the office of the KPP is located close to the office of the local tax administration, and assistance is carried out on a daily-needs basis. In the case of Banjarmasin, training provided by the KPP seems to be more codified. The KPP Banjarmasin, together with the province of Central Kalimantan, operates a training centre that is also used for the purpose of qualifying local tax officers for administering the land and building tax. At the other extreme, the tax administrations of Denpasar and Lombok Barat apparently did not receive any additional training from the KPPs after devolution.

Shortcomings of the support offered

The central government offers relatively uniform support with the aim of qualifying personnel at the local level for the additional tasks that come with collecting the land and building tax. This uniformity seems to be at odds with the fact that *kota* and *kabupaten* face quite different challenges in this context. For instance, remote *kabupaten* that stretch over a vast area

such as Rokan Hulu and Rokan Hilir face different challenges than the relatively condensed urban areas of cities such as Depok, Tanjung Pinang, Banjarmasin and Denpasar. However, this divergence is not reflected in the support offered by the central government.

Moreover, the support offered by the central government seems to be designed as if the tax system had performed reasonably well before devolution. For the exceptional challenges related to the poor quality of data, the huge amount of tax debt transferred to local governments and the low level of acceptance of the tax by local taxpayers, however, no specific support is offered by the central government. Thus, additional training for employees of local tax administrations as well as support with the data and ICT management are among the most frequently stated fields where local authorities would appreciate further support from the central government. Arrears management is another area where local tax administrations voice their need for more guidance from the central government, in particular with respect to debt accumulated under the jurisdiction of the central government, which was transferred to the local governments in the wake of the decentralisation.

Some *kota* and *kabupaten* use external consultancy services for certain tasks. These tasks include training provision, ICT support (up to running externally developed ICT systems), support for assessing and updating property values – especially for individual assessments – and updating the composition and value of property zones. Moreover, in all cases but Lombok Barat, there are cooperation agreements between the *bank daerah* and the local tax administration to provide taxpayers with additional payment channels.

Among the seven cases, the tax administration of Denpasar stands out as relying most heavily on external services, provided by consultants from Universitas Gadjah Mada (Yogyakarta). This support started with drafting the local regulation (*perda)* and encompasses extensive training courses, the provision of an externally developed ICT system – including support for its operation – and assistance in the property valuation process.

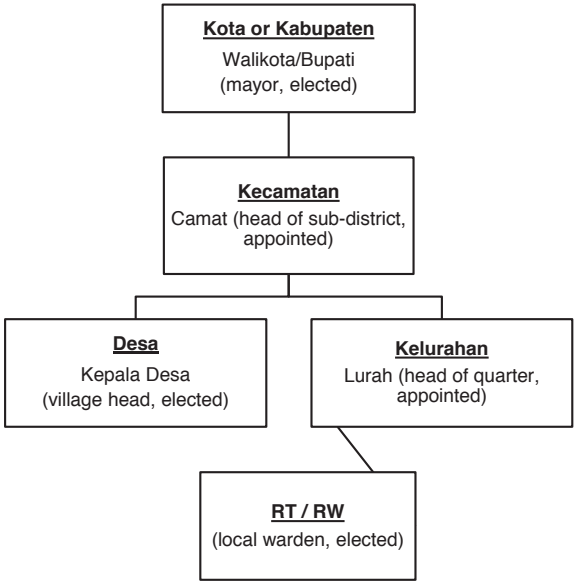
Some local governments perceive the support offered from the central government as being insufficient or inadequate. Reliance on external consultancies might be a result of this perception. We observed that those local governments with relatively high levels of capacity relied more heavily on external support than those with low capacity levels. It remains to be seen

whether this diverging reliance on external support constitutes an additional disadvantage for local governments with already low capacity levels.

4.2.4 The incentive scheme for local collection is ineffective

The administrative system for local tax collection and the remuneration and incentive scheme behind this administrative structure are quite complex. Some of the criteria for the incentive payments are based on total local own revenues, and some are based only on land and building tax revenues. This section identifies the main stakeholders involved in the administration and collection of the land and building tax and describes the local incentive scheme. Figure 7 shows the structure of the local government in Indonesia, including those administrative levels involved in the administration, collection and decision-making concerning the land and building tax.

Figure 7: Levels of local government structure



Source: Authors

The incentive scheme before devolution

Before the devolution of the land and building tax, actual tax collection was delegated to the local level. However, the management of the data on property objects remained in the hands of the KPPs. *Desa* (villages) are the lowest level in rural areas, whereas *kelurahan* (quarters) are the lowest level in urban settlements (neighbourhood / community association – *rukun tetangga / rukun warga* (RT/RW), which refer to the local wardens responsible for individual streets or settlements). In this sense, *desa* are more characteristic of *kabupaten* and *kelurahan* of *kota*, even though both structures can be found in both types of municipalities.

The actors responsible for the distribution of tax bills (SPPT) and the collection of the tax used to be the *kepala desa* and *lurah*. Furthermore, the *kepala desa* and *lurah* were involved in the monitoring of tax payments and encouraging taxpayers to fulfil their obligations. Therefore, these authorities were the link between taxpayers and the tax officials from the KPPs. In rural areas the local government also hired tax collectors who were in charge of distributing tax bills and collecting the tax. These tax collectors were often (but not always) the local RT/RW. Besides the collection by local government officials, taxpayers could pay their taxes at those banks and post offices where the KPPs had signed such cooperation contracts.

Since the *kepala desa* and *lurah* were operating within the structure of the local government, the remuneration for their services was decided by the head of the local government: the *walikota* (in *kota*) or the *bupati* (in *kabupaten*). In total 10 per cent of the total revenue from the land and building tax were channelled back to local governments. This share was not based on the achievement of specific targets, but rather a part of the revenue-sharing from the land and building tax.

According to information from the MoF, about 80 per cent of the local governments reached their targets in the last few years. The remuneration of the *kepala desa* and *lurah* was usually determined according to their achievements: if they reached their individual targets, they would receive a percentage of the collected tax. These so-called incentives could amount to up to 5 per cent of the tax revenue (usually 3.5 per cent). For the local officials, these amounts could total almost as much as their regular salaries.

During our field research, we were told several times that this incentive system had lent itself to manipulation by some officials involved in the tax collection. In order to reach the target, some officials paid the difference between the collected amount and the target. This was possible because local governments did not always have the correct data about actual tax payments. In some villages, the *kepala desa* paid the total amount for all taxpayers to the bank as a lump sum (collective payment), without giving the exact information on the taxpayers involved and the amounts paid by each individual taxpayer.

This phenomenon led – and still leads – to problems for taxpayers. In Indonesia the receipt of the payment of the land and building tax is also used as a proof of ownership. Thus, a taxpayer without a tax receipt might have difficulties proving ownership of property. Furthermore, local governments and other institutions (such as banks) require receipts on the payment of the land and building tax from previous years for certain services (such as renewal of ID cards or bank credit). Not least, failure to link actual payments to specific tax objects may lead to an unjustified accumulation of arrears and fines.

The incentive scheme after devolution

With devolution the incentive scheme for the local level has changed, and the decisions about the amounts distributed among those involved in the actual collection have also been transferred to the local governments. Nevertheless, the central government introduced certain limits to these amounts. The legal basis on which local governments can pay so-called incentives to officials involved in the collection of the land and building tax is Government Regulation No. 69/2010. This regulation, applying to all local taxes, provides that a maximum of 5 per cent of local own revenues can be spent for these purposes.

Incentive payments are based on the achievement of specific targets. The process starts with the local tax administration (Dinas Pendapatan Daerah – DISPENDA) proposing a target to the local parliament, set according to different methods and procedures used by each local government (see Chapter 2). The local parliament often tries to raise this target to encourage collection of local own revenues. The proposal agreed between DISPENDA and the local parliament is sent for approval to the *walikota* or

bupati and to the provincial government, before it is officially approved by the local parliament as part of the local budget.

Actors at the local level

Different local actors play a role in the administration of the land and building tax, the tax collection and the enforcement. In general, DISPENDA is responsible for the collection of the tax and the related administrative tasks. As before devolution, lower levels of local administration are involved in this process. Thus, the distribution of the tax bills is delegated to the *kepala desa* and *lurah*. Yet, these actors are not directly involved in the collection process. Being responsible for distributing the tax bill, they often shift tasks to lower administrative structures such as the RT/RW (lowest administrative units) or to tax collectors hired for this purpose (as before devolution).

In some municipalities, the RT/RW provide a report about the distribution of tax bills to their *lurah* or *kepala desa*. Still, we did not find proof of official data validation at this stage. In some cases, in September of each year, the *kepala desa* and *lurah* receive information from DISPENDA about open liabilities for the current year, which enables them to remind taxpayers to fulfil their obligations before the end of the year. In other cases, there is no bottom-up flow of information about changes in properties, for instance, and the information from the lowest level is not used very well. With regard to arrears, the *kepala desa* and *lurah* do not receive any information about older liabilities of taxpayers, apparently due to tax secrecy regulations.

As mentioned above, the *kepala desa* and *lurah* have almost the same function as before devolution, but in some cases they are less involved in tasks related to the actual collection. In urban areas, the *lurah* were formally tasked with monitoring the collection of the land and building tax by checking the lists submitted by tax collectors. They had a certain control over tax collection and the achievement of targets on which their incentive payments depended. Since devolution, the *lurah* do not seem to be involved in the monitoring anymore because, at least in urban areas, people have more payment points and mostly pay their taxes at banks. In some cities, such as for instance Tanjung Pinang, the *lurah* address taxpayers individually and encourage them to fulfil their obligations. In

other cases, the *lurah* and *kepala desa* are only responsible for distributing the tax bills and not involved in any monitoring.

The complex incentive scheme established after devolution covers all persons involved in the process. As stated before, 5 per cent of local own revenues can be used for payments of incentives. According to Government Regulation No. 60/2010, these are distributed among the following: *walikota*/*bupati*, vice *walikota*/vice *bupati*, *sekretariat daerah*, DISPENDA (management level), *camat, kepala desa* and *lurah*. Furthermore, the government regulation provides in Article 3 that other persons involved in the collection of local taxes can also receive incentive payments from the 5 per cent total. Usually the RT/RW do not receive any specific incentives apart from the regular allowances for their services. However, they – as well as the tax collectors – are sometimes paid a fixed amount (for instance, 1,500 or 2,000 IDR) per tax bill distributed. For the land and building tax in particular, Article 7 (2) provides that the *camat, lurah* and *kepala desa* can only receive a maximum of 5 per cent of the total amount available for incentive payments – hence, 5 per cent of total revenue from the tax. Furthermore, Article 7 (3) provides that other persons involved in the collection process can be remunerated with up to 10 per cent of the total amount available for incentive payments.

In the interviews carried out for this study, the remuneration of the *lurah* and *kepala desa* played a major role. The payment of incentives is based on the targets set by DISPENDA in accordance with the local parliament. This also applies to the *lurah* and *kepala desa*, even though the possibility of them influencing the actual collection are often limited, as shown above. In some cases, payments amount to about 1 million IDR per quarter, which is only slightly less than the ordinary salary. Hence, they are quite important for these officials.

As the distribution of so-called incentives is often disconnected from meeting collective and individual tax collection targets, it is questionable whether these payments represent actual incentives in a true sense of the word. In some local governments, the *kepala desa* receive, on top of these incentives, additional rewards based on their performance, such as motorcycles or computers. These kinds of payments correspond more closely to the general understanding of incentives.

As the *lurah* and *kepala desa* are quite close to the taxpayers, they act as formal and informal links between taxpayers and the tax administration. Thus, they could play an important role for the local government, if given the respective responsibilities and possibilities. This is not the case in all *kota* and *kabupaten* we visited, however, and with incentive payments being reduced, this may undermine tax collection efficiency.

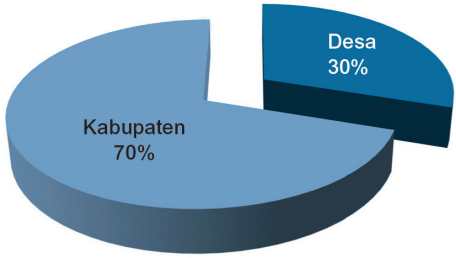
With regard to the perception of the new incentive scheme, we observe a mixed picture. In some *kota* and *kabupaten*, we were told that incentive payments decreased compared to the previous situation, especially with regard to the incentive payments to the *lurah* and *kepala desa*. Local government officials attribute these reductions to the above-mentioned restrictions outlined in Government Regulation No. 69/2010. The main problem in this context seems to be a lack of motivation of the *lurah* and *kepala desa* due to lower bonus payments on top of their regular salaries. However, not all local officials complained about this. In most cases, the *lurah* and *kepala desa* do not perceive their remuneration as being lower since devolution.

Besides the motivation of local officials, the financial aspects have frequently been addressed by the interviewees. Some local officials declared that the incentive scheme provided by Government Regulation No. 69/2010 is not adapted to local needs: they especially claimed that the incentives paid to the *desa* and *kelurahan* are insufficient to even cover the costs of sending out the tax bills. According to these actors, additional financial support should be given to the sub-districts in order to increase motivation. However, this does not apply to all the *kota* and *kabupaten* we visited.

To give an example, Rokan Hulu has introduced a separate incentive scheme for the villages (*desa*). Under Government Regulation No. 69/2010, local officials in *desa* receive about 300,000 to 1,000,000 IDR per year through individual incentive payments. In addition, however, Rokan Hulu introduced a scheme in which 30 per cent of local tax collection goes directly to the budgets of the villages. The remaining 70 per cent stays in the budget of the Kabupaten Rokan Hulu. By channelling funds through the villages' own budgets, Rokan Hulu wants to promote local development, achieve clearer benefits for the population and motivate village authorities to engage in tax collection. As the current scheme has proven efficient for the motivation of local officials, Rokan

Hulu plans to introduce a scheme in which as much as 70 per cent of the revenues from the land and building tax would go to the villages and only 30 per cent would remain at the level of the *kabupaten*.

Figure 8: Distribution of revenues from the land and building tax in Rokan Hulu



Source: Authors

Apart from the motivation of local officials, a general point should be considered with regard to remunerations in the public sector. Most public employees seem to be financially quite dependent on incentives and bonus payments, since these make up a sizeable part of their remuneration packages (sometimes even several times the regular salary). In addition to this, payments are based on criteria that the officials cannot always influence. This makes the entire system quite intransparent and expensive. In this context, tax-related incentives are just a small part of a public remuneration regime that seems to be outdated and inefficient. Our research showed that, due to political considerations, local governments are often not overly ambitious in their tax collection. Thus, the tax targets remain equally low. Furthermore, the expenses of this incentive scheme amount to 5 per cent of local own revenues without covering the regular salaries and infrastructure of the tax administration, and thus seem to be quite high in international comparison, even considering the relatively high costs of property tax collection in general (for instance, see von Haldenwang et al., 2014).

Beyond the scope of our study, our findings with regard to the complex incentive system at the local level indicate that the remuneration regime in the public sector in Indonesia might perhaps be in need of reform. A

regime where regular public salaries are small and topped up by high bonuses and incentive payments is not transparent and lends itself to all kinds of abuses.

4.3 Plantations dimension

Local governments with palm oil activities would benefit from a devolution of the land and building tax for plantations. Districts with large plantations are usually located in remote areas and are characterised by low property values. Accordingly, these districts belong to the group of *kota* and *kabupaten* less likely to profit from the current devolution of the rural and urban land and building tax. Collecting property taxes on plantations would make it more attractive for them to invest in an effective collection of both types of property tax.

Comparing the cases: Rokan Hulu vs. Rokan Hilir

Rokan Hulu and Rokan Hilir were chosen in order to discuss two hypotheses – first, the hypothesis on capacity restrictions; second, the hypothesis on the devolution of the land and building tax for the plantations sector.

In general, we found no major differences in capacity in the two districts, even though per capita GDP in Rokan Hilir almost doubles the one in Rokan Hulu. This could be due to the above-mentioned basic allocation of DAU transfers from the central government, but also because, until a few years ago, they have been one single *kabupaten* and, therefore, have a similar starting position. Concerning a future devolution of the land and building tax for the plantations sector, both local governments are clearly in favour of the idea and would expect such a reform to increase their own revenues. Further, both local governments agreed that a devolution of this tax would contribute to more transparency regarding the tax payments of this sector. All in all the devolution of the land and building tax in the plantations sector could provide an important motivation and new revenue source for rural *kabupaten* that have not benefitted much from the fiscal devolution process so far.

Opportunities and challenges of a devolved land and building tax collection for plantations

In many of the otherwise disadvantaged and isolated rural *kabupaten* of Sumatra and Kalimantan, the main economic activity is palm oil production. The plantations, and a whole set of services around them, make up most of the employment opportunities outside the public sector, and – since plantations involve activities with extensive land use – cover most of the land area in the corresponding regions. Hence, the local governments concerned see the devolution of the land and building tax in the plantations sector as a chance to increase their margin of action and local revenues.

Law No. 28/2009 devolved the rural and urban land and building tax, but maintained the handling of this tax in the plantations, forestry and mining sectors at the central level. However, as rural areas rarely benefit from the devolution of the tax to the same extent as urban areas, the devolution of the land and building tax from plantations can be seen as a chance for local governments to increase their benefits. In the final decision, technical and political challenges have to be taken into account, and potential benefits have to be contrasted with the additional efforts needed to make this tax work at the local level.

Unclear economic advantages

From an economic perspective, the advantages of a devolution of the land and building tax in the plantations sector are still unclear. With new responsibilities, the needs for local capacity development may increase, as may the administrative costs of managing the new tax. At the same time, devolution may create opportunities for economies of scale and scope that render the system more efficient. In our interviews with representatives from the central level and from local governments, we found contrasting opinions on the capacity of local governments to take on the local collection of this tax.

Administrative benefits

The rural and urban land and building tax as well as the land and building tax for plantations are both real estate taxes, and therefore bear similarities. Both involve tax objects to be assessed, notifications to be

sent out, registers to be kept up to date and tax payments to be collected. In this sense, the additional responsibility of managing the land and building tax for plantations may create certain economies of scale and scope. The initial devolution of property taxation led the local administrations to reallocate staff, build up organisational structures and create new capacities through trainings and infrastructure investments. Some of these new capabilities could be used for the management of the taxes from plantations. More specific knowledge on plantations is held locally by the local directorate for plantations and land-use planning (*dinas perkebunan*), which could provide specialised support where needed.

A frequently voiced position at the local level is that tax collection in the case of plantations may be even easier than in the case of rural and urban property taxes because of the extent and visibility of the respective properties and activities. Whereas the rural and urban land and building tax involves large numbers of tax objects – often amounting to hundreds of thousands – property taxation for plantations mainly involves a small number of medium and large companies (150 in the case of Rokan Hulu). The financial management is therefore comparatively simple, as the administration deals with a reduced number of taxpayers, larger amounts of taxes to be paid and payments transferred directly by the companies to the local government's bank account. The respective taxpayers tend to know their obligation to pay taxes, and collection and enforcement are less laborious than for the large number of tax objects with lower individual values in rural and urban property taxation. Following this argument, if local governments were successful in collecting the rural and urban land and building tax, they should also be able to manage this tax for plantations.

Another issue is the management of data, collection and arrears by the central government (through the KPPs). In the two cases of *kabupaten* with palm oil activities we visited, data was updated regularly, collection was quite effective and there were almost no arrears. This would further simplify the task of devolving the responsibility, but it could also raise questions about the sense in devolving a well-functioning system. However, the land data registered through official permits (*hak guna usaha*) does not always correspond to the actual size of plantations. Property taxes on plantations should be collected from plantations with more than two hectares (with smaller areas subject to the lower rates of the

regular land and building tax). But many smallholders avoid paying that tax, for instance by registering their land under the names of several family members. Private companies, on the other hand, receive permits for a certain land size for plantations, but often seem to expand beyond the official limits, which also creates conflicts of ownership with the local population. Therefore, the data on land cannot be based on permits alone, but will need to be matched with information gathered on site. The local DISPENDA, perhaps with support from *dinas perkebunan* and their in-depth knowledge of plantations, may know the area better than the central government, and would therefore be better suited to gather such information.

Administrative challenges

Our enquiry revealed a certain number of specific challenges in the collection of the land and building tax for plantations that do make it a more complex process than rural and urban property tax collection, thus calling for specific capacities. It may be difficult to overcome these challenges in *kota* and *kabupaten* that already struggle with collection of the current rural and urban land and building tax.

Mainly, assessment problems arise due to the hybrid calculation method in place for land taxes in plantations, which includes the value of the plants and the value of the production in addition to the value of buildings and land. The plant value varies with the age and the growth of the oil palms. The value of production requires information and means to monitor production and income of individual producers. Central-level actors such as the KPPs expressed doubts whether local governments would have sufficient capacities to manage this more complex calculation.

Another issue is the location and size of the tax objects, which can stretch over several districts, potentially with different tax rates. Currently, the revenue-sharing in the case of such plantations is negotiated between the *kota* and *kabupaten* that hold a share of this land. For dealing with the companies themselves, the competences for tax matters are mostly not located in the corresponding *kabupaten* but at the companies' headquarters in Jakarta, Pekanbaru or Medan. Therefore, with a devolution of the land and building tax in the plantations sector, an intensive exchange between the administrations of neighbouring districts would be needed to reduce tax evasion and avoid conflicts over the distribution of revenues.

Political considerations

The findings summarised above produce a mixed picture: although the land and building tax for plantations is more complex in assessment than the rural and urban land and building tax, the latter is more complex with regard to collection (due to the higher number of tax objects). These contrasting effects call for a weighing of potential economic benefits against potentially increased administrative costs. The lack of certainty in these regards explains the importance of political motivations in the choice of the right strategy. In our view, devolution of the land and building tax for plantations is essentially a political decision. This becomes even clearer when considering that local governments with large plantations express an interest in this particular devolution because, for them, property taxation on plantations poses a rather high revenue potential and, therefore, may result in increased financial resources for these local administrations. The same reason, however, may create resistance at certain levels of the central administration against giving up these responsibilities.

The local governments of Rokan Hulu and Rokan Hilir clearly voiced their interest in a devolved collection of the land and building tax for plantations and do not see any political challenges in passing such a law in their local context, notably because the issue had been broadly debated in their local parliaments at the time of the creation of the local regulations on rural and urban property taxation in 2010/2011. Some palm oil producing districts in Sumatra have even formed an association of palm oil producing *kabupaten* to defend their interests and to promote the devolution of land taxation for plantations. The companies we interviewed also argued in favour of devolving the tax, as they hope to get access to better services and infrastructure and to benefit from closer relations with local authorities.

On the national level, however, there appears to be pressure from different stakeholders, and the decision from 2009 to take three sectors (mining, forestry and plantations) out of the final draft for Law No. 28/2009 may be difficult to revoke. It would imply a strong mobilisation in favour of such a modification or in favour of a new set of tax laws, although it concerns only a few Parliament members directly, namely those from *kota* and *kabupaten* with large plantation activities. In previous discussions, the central administration opposed local collection of the land and building tax for plantations out of efficiency considerations, citing risks of double-accounting at the central and local levels in the plantations sector.

Originally, the initiative for the devolution of property taxation came from the national Parliament, which formed a Special Committee to pursue this issue. It initially included the devolution of the land and building tax of all five sectors (rural, urban, forestry, mining and plantations), and the main intention behind this initiative was a deepening of decentralisation. Due to resistance from the General Directorate of Taxes in the MoF and considerations about administrative capacity, the three sectors were taken out of the devolution plans in 2009; nevertheless, the arguments in favour of devolving property taxation for all sectors remain valid.

Revenue increase

The main argument for local governments in favour of the devolution of property taxes in the plantations sector is an increase in own revenues and autonomy. The issue of capacity remains, but in districts with plantations, the devolution of the tax would create greater incentives to collect property taxes in general. Hence, it is not surprising that *kabupaten* and local stakeholders with plantation activities strongly argue in favour of such a reform. Currently, 64.8 per cent of the collected revenue goes to the local level, although plantation activities are predominantly local and often make up a large part of the local economy. For the Kabupaten Rokan Hilir, for example, this share amounts to 51 billion IDR per year from the plantations sector alone. With 100 per cent of the collection going to the local government after decentralisation, the district would increase its revenue from this source (*ceteris paribus*) to 78 billion IDR.

In addition, the devolution of the land and building tax in the plantations sector would be a significant move towards addressing the urban bias of property taxation in Indonesia. Decentralised property taxation for plantations would allow for an increase in local tax revenues, and for greater incentives to collect land and building taxes in general. Local governments can be expected to put more efforts and political will into local tax collection if the potential increases. The devolution of the land and building tax in the plantations sector would therefore benefit the less developed cities and districts. Besides the idea to push decentralisation further – and to give the local governments more responsibility – these fiscal policy reforms are a way to even-out economic inequalities and contribute to local development.

Transparency

Another reason to support the devolution of land taxes in the plantations sector frequently mentioned by local stakeholders in Rokan Hulu and Rokan Hilir was the desire to increase transparency. With plantations being the most important economic activity (in Rokan Hilir together with mineral oil extraction), the real amount of revenues from this sector is unknown to the local administration, and the revenue-sharing mechanisms are perceived as being intransparent. As a matter of fact, the local administration does not get any information on the total amount of taxes specifically collected from the land and building tax in plantations by the central government. Instead, it receives combined revenue-sharing transfers that stem from different activities. The central government institutions are asked to increase transparency in this domain, to which the devolution could contribute greatly.

For taxpayers, the potential benefits of devolution are based on increased openness. Palm oil companies expressed their hopes for improved services and infrastructure based on closer relations and an exchange with local authorities. Dealing directly with local authorities would make it easier to file complaints and resolve local problems.

Lastly, regarding the potentials of a devolution of property tax in the plantations sector in Indonesia, the question of empowerment of the local governments is fundamental. The initial draft of the law on the decentralisation of land and building taxes included all five sectors (rural, urban, plantations, forestry and mining). The intention was to push for a deepened decentralisation and to hand over a maximum of competencies to the local level. Although the total revenue from the land and building tax on plantations is not very high and amounts to only about 1.2 trillion IDR annually (ca. US$ 86 million), the potential increase in revenue – and especially in decision-making power – is much higher for individual *kota* and *kabupaten*. This increase in transparency and own competencies is a major empowering factor for local governments.

Compensation perception

It is noteworthy, as a third point, that not only the actual increase of revenue or transparency motivates local governments to ask for a devolution of the land and building tax for plantations, but also the perception of

fairness and "rightness". As a matter of fact, the visibility of plantations and the corresponding revenue-sharing payments are disconnected. Therefore, the respective local governments do not perceive that they benefit sufficiently from local economic activities.

Plantation companies use the local infrastructure, especially roads, with their trucks causing substantial damage. Infrastructure investments are often financed directly by local or provincial governments. At the same time, the benefits from plantation activities take many detours before reaching the local governments. Other related taxes and user charges that local governments may levy are typically of minor fiscal importance: building permits, factory permits, the street-lighting tax, the non-metal mineral tax and the surface water tax. The larger ones are collected centrally, then divided into different transfer payments and shared among different entities at the central, provincial and local levels. Local actors often express the opinion that *kota* and *kabupaten* do not receive enough revenue from plantations to maintain the infrastructure. There is a certain disconnect between the costs created at the local level by plantation activities and the benefits channelled back to the local level through different transfers. It is therefore an issue of perception, aggravated by the fact that local governments know they receive 64 per cent of the revenue, and could receive more. Often, the palm oil companies have the feeling that they have already fulfilled their obligations *vis-à-vis* the community by paying their taxes and other charges, but local governments do not perceive that they received a fair share. Not least, large plantation companies have their headquarters in large cities and pay income taxes in these cities rather than where the economic activity takes place.

In some cases, local governments have issued local regulations aiming for compensation, for instance by making palm oil companies pay for damages caused to roads due to heavy-weight transport (e.g. Perda No. 43/2013 in Kalimantan Timur). In this sense, if local governments were better informed about the gains they receive from plantation activities (transparency), and/or received a higher share from the revenues, the problem of diverging perceptions and tensions at the local level could perhaps be resolved.

Need for technical revision

Several proceedings in the tax system are currently tailored to central-level collection. A reform of property taxation in the plantations sector would need to reconsider certain elements such as calculation methods and revenue-sharing.

Tax formula

The formula to calculate the land and building tax in this sector uses a hybrid approach containing three components – land surface, value of buildings and plants, and production value. This particular composition poses certain challenges to tax administrations, as it requires monitoring, controlling and assessment capacities that local tax authorities usually do not have. However, the formula could be revised to split responsibilities between the central and local levels in the case of a devolution of the tax.

More specifically, the value of plants needs to be assessed individually for each plantation, which requires the development of specific capacities for the taxation of plantations. Also, the tax formula contains an element based on the production value of the plantations, which in other contexts is instead associated with a corporate income tax or a royalty rather than property taxes. According to local authorities in the two palm oil districts visited for this study, these particularities would be manageable, but they could also be a point of negotiation in the devolution process, as many different constellations are possible in this area. First, the tax could be devolved to the local level as such, maintaining its three components. Second, the local governments could adapt the calculation methods by themselves, introducing simplified procedures. Third, the production value could be taken out of the tax formula and remain a central-level component of corporate income taxes or royalty schemes.

Distribution of benefits

Beyond the calculation method for the tax formula, the devolution would also have to take into account the distribution of benefits to the neighbouring districts, currently regulated by the revenue-sharing mechanism. Under a devolved regime, the *kota* and *kabupaten* without plantation activity would lose a share of their revenues, which they would need to compensate with a different income source. Not surprisingly,

central-level officials and stakeholders representing *kabupaten* without plantation activities argued that they would prefer the land and building tax for plantations to remain a central tax out of an equity perspective.

As a matter of fact, many *kota* and *kabupaten* without palm oil plantations suffer from the effects of transporting products or are otherwise affected by this activity (water use, haze/smog from burnings, etc.). These entities could legitimately make claims for compensation as well. It should be noted, however, that the current revenue-sharing regime is not an efficient way to address these claims, as revenues are shared without any regard to the actual burden each municipality has to confront.

For *kota* and *kabupaten* without plantation, forestry or mining activities, the amounts received from revenue-sharing of this tax are relatively small. The city of Denpasar on Bali, for example, receives about 5 billion IDR (ca. US$ 360,000) per year from this source, compared to ca. 93 billion IDR (ca. US$ 6.7 million) of land and building tax revenue in 2013. Even if the devolution of the land and building tax for plantations was a way to combat the urban bias in property taxation for the benefit of some *kabupaten*, other rural *kabupaten*, without any major plantation activity like in Lombok Barat, would hardly benefit from such a reform.

Perspectives for the devolution of the land and building tax for plantations

Economically, the advantages and benefits from a devolution of the land and building tax in the plantations sector are still unclear. With such a tax, the local governments concerned may increase their tax revenues considerably, but they may also have to face increased administrative costs to handle the new tasks. This may depend on existing capacities and the form in which the reform is implemented – something that cannot be determined at this point.

If economically manageable, the devolution of property taxation for plantations can be expected to be beneficial for the districts with palm oil plantations in terms of local empowerment and transparency gains. The devolution of the land and building tax in the plantations sector could provide an important motivation and new revenue source for the rural *kabupaten* that have not profited much from the fiscal devolution process so far. Additionally, as data on plantation land is not always accurate due

to false declarations, the proximity and local knowledge of the local administrations can be an asset in promoting collection efficiency.

Challenges may arise due to the complex formula chosen to calculate property taxes in the plantations sector and the dismantling of the current revenue-sharing system that provides at least some benefits to neighbouring *kota* and *kabupaten*.

The districts concerned voiced their clear preference in favour of a local collection of the tax. Palm oil companies as well as the Indonesian Palm Oil Association also expressed a rather favourable opinion, finding more positive than negative aspects to such a process (closer exchange with decision-makers at the local level, multiplicity of partners). In contrast, central government institutions such as the KPPs and other local governments generally expressed their hesitance to devolve this specific responsibility, mostly due to equity and/or capacity concerns.

4.4 How do findings relate to previous research?

Several studies have focussed on the implementation strategy and the necessary support before – and at a very early stages of – the land and building tax devolution in Indonesia. In contrast, research on later stages of the transition period and on the experiences of local tax collection is still limited. The ADB published a strategy and roadmap in 2009 for devolving the land and building tax and the property transfer tax (Asian Development Bank [ADB], 2009). In 2011, the ADB issued another report recommending asymmetric devolution approaches and support tailored to three clusters of local governments, grouped according to their revenue-raising capacities from this source (Kelly et al., 2011). In 2013, the Indonesian MoF published the proceedings of a seminar on property taxes in selected Asian countries. This includes a paper on land and building tax devolution in the city of Surabaya, which was the first local government to start land and building tax collection in 2011 (MoF, 2013a).

In general, previous research does focus on the preparation and the process of devolving the land and building tax to different groups of local governments, split according to their revenue-raising capacities. Capacity development is usually identified as the most relevant area of support. According to the information collected in this study, however, the

administrative costs of land and building tax collection are not the main constraint for local governments to use their tax potential more effectively. To take advantage of economies of scale and decrease collection costs, the studies mentioned above propose joint administration approaches that involve several local governments. However, this approach has not been put into practice so far. Other capacity restrictions with regard to human resources, data quality, ICT infrastructure and taxpayer services do exist, but these constraints are – in the majority of our case studies – not key factors with regard to effective tax administration. In the following sections, we contrast the observations and recommendations of previous research with our findings.

On the macro level, we find initial evidence that the 18 local governments, which started tax collection in 2011 and 2012, increased their land and building tax revenues. This is in line with findings on Surabaya. The city of Surabaya was able to sharply increase its land and building tax revenue after devolution in 2011 (MoF, 2013a, p. 139).[29]

Our second finding is that, at the case study level, local governments do not perceive the DAU distribution formula as a disincentive for their own revenue collection. This contrasts with the theoretical disincentive discussed in the literature (for instance, see ADB, 2009). The ADB recommends eliminating the disincentive by basing DAU calculation methods on property tax potential rather than actual property tax collections. The study proposes using statistical estimations in the short term and SISMIOP data on the tax base of each local government in the long term (ADB, 2009, p. 62). During our field research, we found that the tax potential indicator used at the local level is often based on tax liability notifications (SPPT) registered in the SISMIOP data base. As shown above, however, SPPT are currently not a valid indicator for local tax potential, as they most probably overstate legal liabilities while under-estimating property values.

At the micro level, the main interest of previous research focusses on asymmetric devolution strategies and the necessary support for different

29 Land and building tax revenues increased from IDR 341.7 billion in 2010 to IDR 540.4 billion in 2011.

types of local governments. The ADB identifies three local government clusters (see Table 21 and Kelly et al., 2011, pp. 71–72).

Table 21: Local government clusters for land and building tax devolution

Local government (LG) groupings	No. of LGs	% of LGs	% of PBB revenues
Cluster 1 – highly urbanised LGs These large LGs have strong PBB revenue bases and stronger institutional, human resources and systems capacities. They are expected to adopt the PBB from 2012 onwards.	30	6 %	70 %
Cluster 2 – medium urbanised LGs These LGs have a lower but still strong potential for further urban growth (secondary urban centres). These have tremendous potential for property tax revenue growth but experience wide variations in institutional, human resources and systems capacities. They are expected to adopt the PBB from 2012/2013 onwards.	100	20 %	20 %
Cluster 3 – less urbanised LGs These LGs have historically low PBB revenue collection levels and apparent less potential for PBB revenue growth. The PBB in these LGs is currently administered by the KPPs jointly with other surrounding LGs for reasons of economies of scale and LG capacity issues. They are expected to adopt the PBB (if they choose to) from 2014 onward.	360	74 %	10 %
Total	490	100 %	100 %

Source: Kelly et al. (2011, p. 26)

For local governments with high and medium revenue-raising capacities (Cluster 1 and parts of Cluster 2), the ADB study recommends a "local administration approach", with all administrative functions being transferred to the local level (Kelly et al., 2011, p. 63). Local governments with medium and lower revenue-raising capacities (parts of Clusters 2 and

3) are expected to follow the "joint administration approach" and outsource some administrative functions, such as data collection or valuation, to third parties. Possible third parties are the KPPs, joint ventures involving several local governments or private companies (Kelly et al., 2011, pp. 64–65).

Our cases are grouped as follows: Kota Depok and Kota Denpasar in Cluster 1, Kota Banjarmasin in Cluster 2, and Kota Tanjung Pinang, Kabupaten Rokan Hilir, Kabupaten Rokan Hulu, and Kabupaten Lombok Barat in Cluster 3 (Kelly et al., 2011, pp. 79–80). During our field research, we found that only Kota Depok, Kota Denpasar and Kota Tanjung Pinang rely on consultancy services from private companies or universities to provide functions such as valuation, ICT services or training. In some cases, specific aspects of administrative functions were outsourced, for example individual assessments or the creation of a website. In other cases, outsourcing covered entire administrative functions such as ICT management, including running the server and managing backups and maintenance.

No functions are outsourced to the KPPs or other sub-national governments. Although there is cooperation between the KPPs and local governments, in none of our cases did the KPPs carry out administrative functions on behalf of the local government. Also, the KPPs do not support local governments by providing equipment, as recommended by the Ministry of Finance (2013a, p. 145). We did not find any evidence of the "remote access" option, where local governments have remote access to the basic SISMIOP ICT systems still maintained by the KPPs (Kelly et al., 2011, pp. 30–31), nor did we observe any joint ventures with other local or provincial governments. Furthermore, we did not find cases in which the central government or provincial agencies handled the individual assessment of specific high-value properties on behalf of local governments, as recommended by previous studies (ADB, 2009, p. 67). In the rural cases, there are only a few buildings requiring individual assessment, whereas in urban areas, individual assessment is done with the help of private service providers. However, previous research shows that joint ventures in general might be a very effective instrument for increasing the effectiveness of land and building tax collection (Kelly et al., 2011, pp. 29–30). They allow for generating economies of scale and lower collection costs as a share of revenues (Kelly et al., 2011, pp. 61–62). During our field research, one local government of Cluster 3 stressed

that they were not able to collect sufficient land and building tax revenue to even cover administration costs.

In contrast to the recommendations of the ADB study, local governments in Cluster 1 follow the joint administration approach, whereas three out of four local governments in Cluster 3 follow the local administration approach. It seems that local governments with higher capacity levels and greater financial resources are more inclined or better positioned to contract third parties. Hence, it remains an open question whether outsourcing is an adequate strategy for local governments with low revenue potential.

The ADB approach to clustering *kota* and *kabupaten* according to their revenue-raising capacities may be suitable for some, but not all, local governments in Indonesia. As Kota Tanjung Pinang is part of Cluster 3, one would expect lower capacity levels and therefore a less effective land and building tax collection process after devolution. However, from our perspective, Tanjung Pinang is a high performer among the cases in our sample. To give an example, Tanjung Pinang is the only local government with a clear valuation strategy and an NJOP update process well underway. It already performed 50 individual assessments in 2013, with another 50 scheduled for 2014. The city increased the number of tax objects by almost 20 per cent between 2013 and 2014, it managed to collect IDR 3.4 billion (ca. US$ 245,000) in tax arrears in 2013 and it makes better use of the knowledge available at lower levels of local government than most other local governments.

Another finding of our study is that support should be tailored to the needs of the poorer and more rural local governments. So far, the central government has offered rather uniform support and does not sufficiently account for local heterogeneity. This is in line with the ADB identifying different support requirements for each of the three clusters (Kelly et al., 2011, pp. 27–31). In addition, we recommend specific support for local governments to better deal with the huge amounts of tax debt being transferred to the local levels and the poor quality of the data. These two challenges were already mentioned by the Ministry of Finance (2013a, p. 139), which identifies tax arrears of IDR 619 billion and the low quality of data as being the main challenges for the city of Surabaya.

5 Conclusion

Previous research on the decentralisation of the property tax in Indonesia was mainly focussed on the process of devolving the land and building tax. In contrast, this study explores first experiences with decentralised property tax collection. In this final chapter, we summarise the key findings of this study.

The study finds initial evidence for an overall increase in land and building tax revenue, but the picture remains unclear with regard to a better use of tax potential. This is so because the concept of tax potential employed by most local governments draws on highly inaccurate data that is based on tax liability notifications. Moreover, the majority of cities and districts started property tax collection in 2014 (or has not started property tax collection at all). For these local governments, no data on local collection were available at the time of the empirical research. From a case study perspective, we can confirm that capacity restrictions do prevent local governments from tapping the full potential of the tax. In contrast to other research, however, this study arrives at the conclusion that the consideration of political costs plays a more important role than capacity constraints.

In principle, the devolution of the land and building tax provides local governments with reliable revenues not attached to any expenditure restrictions. In this sense, it is a highly attractive source of income. True, the share of the land and building tax in total revenue remains small so far. However, if effectively used, decentralised property taxation may significantly increase the fiscal space for local governments. It provides benefits in terms of political empowerment and increased revenues. Yet, it also comprises unresolved challenges due to political costs, capacity restrictions and the unequal distribution of benefits arising from devolution. This is a topic Indonesian authorities might need to address in the future.

Absolute changes in revenue do not necessarily reflect improvements in tax collection. It is fair to assume that local governments with a higher potential to profit from decentralisation already took over the responsibility of collecting the land and building tax in previous years. Hence, it remains to be seen whether those local governments that started to collect the land and building tax in 2014 (or later) will also be able to increase their revenues. In the end, Indonesia could arrive at a situation in which total revenue from this

tax would actually be higher, but benefits from this increase would mainly accrue to a minority of local governments. One of the reasons for this finding is the urban bias of the land and building tax that we have identified in our study, as have others before.

The initial research question of this study referred to the use of tax potential. Indonesian authorities employ a concept of tax potential based on tax liability notifications. However, we find that this concept does not depict the "real" tax potential and its use. Often the assessed property values lie far below the actual market prices, which leads to an underestimation of the tax potential. On the other hand, factors such as redundant taxpayer data or notifications to exempted or non-existing tax objects artificially inflate the tax potential.

Due to these shortcomings, the approach to tax potential presently used by local governments is not a valid indicator – neither as a planning tool for local governments, nor as a performance indicator for research and monitoring. Though we cannot use tax potential in the sense of a quantifiable measure, we still use it as a qualitative framework to analyse whether certain procedures and policies have a positive or negative impact on the use of tax instruments. According to the findings presented in the previous chapters, none of the local governments in our sample uses its legal space to raise tax rates, adjust assessed property values to their true market value or aggressively collect tax debt from previous years. Hence, we find it safe to conclude that local governments are still far from fully using the revenue potential of this source.

The picture is more complicated, however, when comparing current local tax collection with previous central government collection. On the plus side, we observe rising revenues from this source in all seven municipalities we visited, and growth rates are higher than in previous years. Further, all local governments are engaged in activities to increase the assessed values of properties or to improve the data base – necessary prerequisites for any improved use of tax potential. On the negative side, local governments struggle with low levels of public acceptance of the tax and poor data quality inherited from the previous regime. Also, under the present fiscal decentralisation regime, the tax is of little relevance for local budgets, as openly acknowledged by some municipal council members. Finally, in rural areas the increased use of tax potential could be associated with significantly higher collection costs, which could cancel out potential benefits.

Using the broader approach, two main reasons appear to prevent local governments from effectively collecting the land and building tax and, thus, increasing their use of tax potential.

Firstly, many actors at the central as well as the local level see capacity restrictions as being a main reason for the ineffective collection of the land and building tax. Accordingly, most donor activities in this area address capacity restrictions. Administrative training and infrastructure are seen as being fundamental in local tax collection. However, we find that capacity restrictions are not the most decisive factor leading to an underuse of tax potential. Instead, political costs play a more important role. Thanks to the current fiscal transfer scheme, all local governments – even very remote and marginalised ones – are equipped with a minimum level of qualified staff and technical infrastructure. This is openly acknowledged by local authorities. In addition, the interviews led at the local level did not produce any evidence according to which financial restrictions were an important bottleneck for effective tax collection. Rather, high-ranking employees of the local tax administration as well as members of the legislature and executive in all cities and districts of our sample refrained from enacting measures associated with high political costs due to the fear of losing political support or stirring public protest. This under-use of policy instruments at their disposal prevents local governments from effectively using the local tax potential. Local governments would clearly benefit from drawing more on instruments such as property value adjustments and effective arrears collection.

Secondly, the fact that local governments have inherited a deficient collection system from the central government negatively impacts on the effectiveness of local tax collection. In order to build up a more effective system, local governments could benefit from support by the central government, provided that the support is better geared towards the actual needs of individual local tax administrations. So far, the central government has offered standardised forms of support focussed on staff training. However, most local governments face rather exceptional challenges in handling the huge amounts of tax debt inherited from the central government and facing the low public acceptance of the tax.

In principle there seems to be space for a more active role of the central government in accompanying local governments in this transition phase. In combination with the property transfer tax, the land and building tax could

be a main pillar of fiscal empowerment and local autonomy. However, this would imply additional efforts with regard to addressing the challenges outlined above, generating economies of scale and scope (for instance, through cooperation between municipalities) and reforming the current transfer system. Bringing the system of local collection incentives in line with actual responsibilities would be another task, even though this would probably imply reforming the public-sector remuneration system in general.

Lastly, we find that remote districts such as Rokan Hulu, Rokan Hilir and Lombok Barat have hardly benefitted from the decentralisation of the land and building tax so far because their scope to generate more revenue is limited due to the urban bias of the tax. Based on cost-benefit considerations, these local governments are reluctant to put much effort towards – and resources into – building up an effective property tax administration. In the case of the two palm-producing districts, their margin of action would be increased considerably by extending local property taxation to the plantations sector. This, in turn, could lead to greater incentives to collect land and building tax in general, and in the end result in increased revenues. The decentralisation of the land and building tax in the plantations sector would require an encompassing political reform to tackle the issues of revenue-sharing and the complex tax formula for property tax in plantations, but a modification of the current system would also provide opportunities for simplification. In general terms, one of the trickiest questions to tackle for Indonesian authorities is how to lower collection costs and increase benefits from land and building tax collection for the majority of municipalities characterised by rural settlement patterns and agricultural or forestry activities. Although it may not be possible to convert all local governments into winners from land and building tax devolution, there are clearly policy options to enlarge the number of those benefitting from this reform.

All in all, we conclude that the decentralisation of the land and building tax can be a beneficial approach to increase revenue and accountability in the Indonesian context. However, as of now, the potential of the decentralised property tax is not being sufficiently used.

References

Alm, J., & Bahl, R. (1999). *Decentralization in Indonesia: Prospects and problems*. Jakarta: United States Agency for International Development.

Arnold, J. (2012). *Improving the tax system in Indonesia* (OECD Economics Department Working Papers, No. 998). Paris: Organisation for Economic Co-operation and Development.

Ashworth, J., & Heyndels, B. (1997). Politician's preferences on local tax rates: An empirical analysis. *European Journal of Political Economy, 13*, 479-502.

Asian Development Bank. (2009). Strategy and roadmap for devolving the property tax in Indonesia. In *ADB – INO. TA 7010 – Preparing the second local government finance and governance reform program*. Jakarta: Author.

Auracher, T., & Bachmann, J. (2011). Fiscal decentralisation in Indonesia. In *Decentralisation as contribution to good governance (decgg) program*. Jakarta: Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH.

Bird, R. M. (2011). Subnational taxation in developing countries: A review of the literature. *Journal of International Commerce, Economics and Policy, 2*(1), 139-161.

Bird, R. M., & Slack, E. (2004). *International handbook of land and property taxation*. Cheltenham, UK and Northampton, MA: Edward Elgar Publishers.

Bonfiglio, A., & Gancia, G. (2011). *The political cost of reforms*. Barcelona: Institute for Economic Analysis-CSIC (mimeo).

Bräutigam, D. (2008). Introduction: Taxation and state-building in developing countries. In D. Bräutigam, O. H. Fjeldstad, & M. Moore (Eds.), *Capacity and consent: Taxation and state building in developing countries*. Cambridge: Cambridge University Press.

Brodjonegoro, B. (2001). *Fiscal decentralization in Indonesia*. Jakarta: The Institute of Economics and Social Research, University of Indonesia.

Bunell, T., Miller, M. A., Phelps, N. A., & Taylor, J. (2013). Urban development in a decentralized Indonesia: Two success stories? *Pacific Affairs 86*(4), 857-876.

Choi, N. (2007). *Indonesia's direct local elections: Background and institutional framework* (RSIS Working Paper No. 137). Singapore: Nanyang Technological University.

Faust, J., & von Haldenwang, C. (2010). *Integrated fiscal decentralisation: Taking new aid modalities to the local level* (DIE Briefing Paper 12/2010). Bonn: German Development Institute/Deutsches Institut für Entwicklungspolitik.

Fenochietto, R., & Pessino, C. (2013). *Understanding countries' tax effort* (IMF Working Paper 13/244). Washington, DC: International Monetary Fund.

Firman, T. (2009). Decentralization reform and local-government proliferation in Indonesia: Towards a fragmentation of regional development. *Review of Urban & Regional Development Studies, 21*(2-3), 143-157.

Fjeldstad, O.-H., & Heggstad, K. (2012). *Local government revenue mobilisation in Anglophone Africa* (CMI Working Paper 2012: 6). Bergen, Norway: Chr. Michelsen Institute / International Centre for Taxation and Development.

Gerring, J. (2006). Techniques for choosing cases. In J. Seawright (Ed.), *Case study research – principles and practices* (pp. 86-150). Cambridge: Cambridge University Press.

Harjowiryono, M. (2011). *Lessons learned from Indonesia's fiscal decentralization*. Paper presented at the International Conference "Fiscal Decentralization in Indonesia a Decade after Big Bang: Indonesian and International Perspectives on Best Practice for Fiscal Decentralization and Its Impact on Economic Development and Social Welfare", Jakarta.

Hettich, W., & Winer, S. L. (1988). Economic and political foundations of tax structure. *The American Economic Review, 78*(4), 701-712.

Hofman, B., & Kaiser, K. (2004). The making of the "Big Bang" and its aftermath: A political economy perspective. In J. Alm, J. Martinez-Vazquez, & S. M. Indrawati (Eds.), *Reforming intergovernmental fiscal relations and the rebuilding of Indonesia. The "Big Bang" program and its economic consequences*. Cheltenham: Edward Elgar.

Horowitz, D. L. (2013). *Constitutional change and democracy in Indonesia*. New York: Cambridge University Press.

Indonesian Forum for Budget Transparency. (2012). Report on analysis of regional budgets 2008–2011: Findings of a study of local budget management in 20 kabupatens and cities participating in the Kinerja program. Jakarta: National Secretariat, Author.

Kelly, R. (2013). *Making the property tax work* (International Center for Public Policy Working Paper 13-11). Atlanta, GA.: Andrew Young School of Policy Studies, Georgia State University.

Kelly, R., & Gyat, N. (2011). Sub-national tax classification options: Local government finance and governance reform. In ADB – INO: TA 7184. Jakarta: Asian Development Bank.

Kelly, R., Gyat, N., Nordiawan, D., & Harahap, R. (2011). *Indonesia: Local government finance and governance reform. Final report: Property tax devolution support*. Jakarta: Asian Development Bank.

Kenny, L. W., & Winer, S. L. (2006). Tax systems in the world: An empirical investigation into the importance of tax bases, administration costs, scale and political regime. *International Tax and Public Finance, 13*(2), 181-215.

Kis-Katos, K., & Sjahrir, B. S. (2014). *The impact of fiscal and political decentralization on local public investments in Indonesia* (IZA DP No. 7884). Bonn: Institute for the Study of Labor/Forschungsinstitut zur Zukunft der Arbeit GmbH.

Korte, N. (2013). *A comparative analysis of the tax administration in Indonesia and the Philippines*. Hamburg: University of Hamburg.

Martinez-Vazquez, J. (2011). *The impact of fiscal decentralization. Issues in theory and challenges in practice*. Manila, Philippines: Asian Development Bank.

McCarthy, J. F. (2004). Changing to gray: Decentralization and the emergence of volatile socio-legal configurations in central Kalimantan, Indonesia. *World Development, 32*(7), 1199-1223.

Ministry of Finance. (2012a). *Budget statistics 2006–2012*. Jakarta: Author.

Ministry of Finance. (2012b). *Consolidated APBN 2008–2013*. Jakarta: Author.

Ministry of Finance. (2012c). *Indonesia state budget 1980–2012*. Jakarta: Author.

Ministry of Finance. (2013a). *Property taxes in selected Asian countries: Seminar proceeding*s. Jakarta: Author, Directorate General of Fiscal Balance.

Ministry of Finance. (2013b). *Actual revenue of land and building tax of rural and urban sector (PBB-P2) year 2008–2012*. Jakarta: Author.

Murniasih, E. (2007). Is the new intergovernmental equalisation grant in Indonesia equalizing? *Public Finance Series of the Institute for Public Finance Reform, Moscow, 14*, 1-20.

Norregaard, J. (2013). *Taxing immovable property revenue potential and implementation challenges* (IMF Working Paper 13/129). Washington, DC: International Monetary Fund.

Obidzinski, K. (2013). Indonesia world leader in palm oil production. Bogor: Center for International Forestry Research. Retrieved from

http://www.blog.cifor.org/17798/fact-file-indonesia-world-leader-in-palm-oil-production/

Organisation for Economic Co-operation and Development. (2012). *OECD economic surveys: Indonesia 2012*. Paris: Author.

Poku, K. (2002). Small-scale palm oil processing in Africa. *FAO Agricultural Services Bulletin 148*. Rome: Food and Agriculture Organization of the United Nations.

Rondinelli, D. A. (1989). Decentralizing public services in developing countries: Issues and opportunities. *Journal of Social, Political and Economic Studies, 14*(1), 77-98.

Schneider, A. (2003). Decentralization: Conceptualization and measurement. *Studies in Comparative International Development, 38*(3), 32-56.

Shah, A. (2008). Indonesia and Pakistan: Fiscal decentralization – an elusive goal? In R. M. Bird & François Vaillancourt (Eds.), *Fiscal decentralization in developing countries* (pp. 115-151). Cambridge: Cambridge University Press.

Slack, E. (2013). The politics of the property tax. In W. J. McCluskey, G. C. Cornia, & L. C. Walters (Eds.), *A primer on property tax: Administration and policy* (pp. 69-88). Chichester: Wiley-Blackwell.

Sokoloff, K. L., & Zolt, E. M. (2006). Inequality and taxation: Evidence from the Americas on how inequality may influence tax institutions. *Tax Law Review, 59*(2), 201-276. Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=985831

Von Haldenwang, C. (2010). Taxation, fiscal decentralisation and legitimacy: The role of semi-autonomous tax agencies in Peru. *Development Policy Review, 28*(6), 643-667.

Von Haldenwang, C., & Ivanyna, M. (2012). A comparative view on the tax performance of developing countries: Regional patterns, non-tax revenue and governance. *Economics: The Open-Access, Open-Assessment E-Journal, 6*(32), 1-44.

Von Haldenwang, C., von Schiller, A., & Garcia, M. (2014). Tax collection in developing countries – new evidence on semi-autonomous revenue agencies (SARAs). *Journal of Development Studies, 50*(4), 541-555. doi: 10.1080/00220388.2013.875534

Weingast, B. R. (2009). Second generation fiscal federalism: The implications of fiscal incentives. *Journal of Urban Economics, 65*, 279-293.

World Bank. (2014). World Development Indicators. Retrieved from http://data.worldbank.org/data-catalog/world-development-indicators

Widagdo, S., et al. (2012). *Policy recommendations on revision of regional fiscal balance funding (Dana Perimbangan): Policy recommendations on the revision of Law No. 33/2004 concerning fiscal balance between the center and regions.* Budget brief. Jakarta: National Secretariat Indonesian Forum for Budget Transparency.

Annex

Annex 1: List of relevant legal acts (laws and regulations)

Law No. 22/1999 (replaced)	Decentralisation of functions
Law No. 25/1999 (replaced)	Financing of new sub-national functions (e.g. revenue-sharing)
Government Regulation (PP) No. 25/2000 (replaced)	Decentralisation of functions
Law No. 28/2009 (replacing Law No. 18/1997 and Law No. 34/2000)	Sub-national taxation
Joint Regulation to Law No. 28/2009 of the Minister of Finance and Minister of Home Affairs No. 213/PMK.07/2010 and No. 58 Year 2010 on the Preparation Phase Transfer of Land and Building Tax for Rural and Urban Local Taxes	Pajak Daerah dan Retribusi Daerah dan Peraturan Bersama Menteri Keuangan dan Menteri Dalam Negeri Nomor 213/PMK.07/2010 dan Nomor 58 Tahun 2010 tentang Tahapan Persiapan Pengalihan Pajak Bumi dan Bangunan Perdesaan dan Perkotaan Sebagai Pajak Daerah
Government Regulation (PP) No. 65/2001 (replaced)	Local Tax
Law No. 32/2004	Regional Government Administration
Law No. 33/2004	Fiscal Balance between Central Government and Regional Government (e.g. DAU formula)
Government Regulation (PP) No. 55/2005	Balancing Funds
Government Regulation (PP) No. 38/2007	Division of Authority between Central Level, Provincial Level and Local Government
Government Regulation (PP) No. 69/2010	Local Incentive Structure
Government Regulation (PP) No. 91/2010	Local Tax Collection System
MoF Regulation No. 148/2010	Exemptions
MoHA Regulation No. 56/2010	Institutional Structure of Local Governments
Source: Authors	

Annex 2: Fiscal needs and fiscal capacity weightings 2008–2013

	2008	2009	2010	2011	2012	2013
Fiscal needs weightings						
Population (α_1)	30 %	30 %	30 %	30 %	30 %	30 %
Surface (α_2)						
Provinces	15 %	15 %	15 %	15 %	15 %	13 %
kota and *kabupaten*			13.25 %	13.50 %	13 %	13 %
GDP per capita (α_3)	15 %	15 %				
Provinces			15 %	15 %	15 %	15 %
kota and *kabupaten*			15.75 %	16.5 %	15 %	15 %
HDI (α_4)	10 %	10 %				
Provinces			10 %	10 %	12 %	11 %
kota and *kabupaten*			11 %	10 %	11 %	14 %
Construction cost index (α_5)	30 %	30 %				
Provinces			30 %	30 %	30 %	28 %
kota and *kabupaten*			30 %	30 %	31 %	28 %
Fiscal capacity weightings						
PAD (β_1)						
Provinces	50 %	50 %	50 %	50 %	50 %	50 %
kota and *kabupaten*	75 %	75 %	93 %	93 %	60 %	60 %
Tax revenue-sharing (β_2)	75 %					
Provinces		95 %	73 %	80 %	75 %	70 %
kota and *kabupaten*		73.25 %	100 %	100 %	60 %	55 %
Natural resource revenue-sharing (β_3)						
Provinces	41.25 %	70 %	95 %	95 %	70 %	55 %
kota and *kabupaten*	50 %	100 %	100 %	63 %	52 %	55 %
Source: Data provided by the Ministry of Finance in February 2014						

Annex 3: Distribution of non-tax component of Shared Revenue Fund (DBH)

	Forestry	General mining (royalty)	Fishery	Oil	Gas	Geo-thermal energy
Central government	20 %	20 %	20 %	85 %	70 %	20 %
Producing province	16 %	16 %	0 %	3 %	6 %	16 %
Producing city or district	32 %	32 %	80 %	6 %	12 %	32 %
Other cities or districts within producing province	32 %	32 %	0 %	6 %	12 %	32 %
Source: Authors' compilation based on Law No. 33/2004, Articles 14–26						

Annex 4: Distribution of tax component of Shared Revenue Fund (DBH)

	Land and building tax	Land and building transfer tax	Personal income tax
Central government	10 %*	20 %*	80 %
Producing province	16.2 %	16 %	8 %
Producing city or district	64.8 %	64 %	12 %
Collection fee	9 %	0 %	0 %
* 10 per cent and 20 per cent respectively of the central government's share are distributed to all districts and municipalities Source: Authors' compilation based on data from the Ministry of Finance (2012b, 2012c)			

Annex 5: Transfers to sub-national levels (in IDR billions)

	2008	2009	2010	2011	2012
Total revenues and grants	981,609	848,763	995,272	1,210,600	1,338,110
Transfers to sub-national levels	292,433	308,585	344,728	411,325	480,645
% of total revenues	29.79 %	36.36 %	34.64 %	33.98 %	35.92 %
Thereof:					
General Allocation Fund	179,507	186,414	203,572	225,534	273,814
Special Allocation Fund	20,787	24,707	20,956	25,233	26,116
Shared Revenue Fund	78,420	76,130	92,184	96,772	100,055
Special Autonomy Fund	7,510	9,527	9,100	10,421	11,953
Adjustment Fund	6,209	11,807	18,917	54,548	58,471

Source: Authors' compilation based on data from the Ministry of Finance (2012b, 2012c)

Annex 6: Interview partners

National level:

- Ministries
  - Ministry of Finance (several divisions and units)
  - Ministry of Home Affairs
- National Parliament
- International donors
  - GIZ
  - ADB
- Associations
  - APEKSI
  - GAPKI
- Non-governmental organisations
  - FITRA
  - PATTIRO

Local level:

- Mayor: walikota / bupati
- Local tax administration: DISPENDA
- Local parliament: DPRD
- Local secretariat: secretariat daerah
- Kecamatan / Kelurahan
- Regional bank: bank daerah
- Central tax agencies: KPPs
- Local plantations administration: dinas perkebunan
- Palm oil producers

Publications of the German Development Institute/ Deutsches Institut für Entwicklungspolitik (DIE)

Studies

88 Abdel-Malek, Talaat. (2015) *The global partnership for effective development cooperation: origins, actions and future prospects* (409 pp.). ISBN 978-3-88985-668-5.

87 Ashoff, Guido. (2015). *Die Global Governance-Qualität der internationalen Aid Effectiveness Agenda: Eine theoretische Analyse und Bewertung der Systemreform der internationalen Entwicklungszusammenarbeit* (220 pp.) ISBN 978-3-88985-663-0.

86 Hampel-Milagrosa, Aimée. (2014). *Micro and small enterprise upgrading in the Philippines: The role of the entrepreneur, enterprise, networks and business environment* (169 pp.). ISBN 978-3-88985-640-1.

85 Zelli, Fariborz, Daniela Erler, Sina Frank, Jonas Hein, Hannes Hotz, & Anna-Maria Santa Cruz Melgarejo. (2014). *Reducing emissions from deforestation and forest degradation (REDD) in Peru: A challenge to social inclusion and multi-level governance* (178 pp.). ISBN 978-3-88985-651-7.

84 Fues, Thomas, & Jiang Ye (Eds.). (2014). *The United Nations Post-2015 Agenda for Global Development: Perspectives from China and Europe* (373 pp.). ISBN 978-3-88985-649-4.

83 Horstmann, Britta, & Günther Schulz-Heiss. (2014). *Providing international adaptation finance for vulnerable communities: A study on potentials and limits of social investment funds* (106 pp.). ISBN 978-3-88985-647-0.

82 Knörich, Jan, & Axel Berger. (2014). *Friends or foes? Interactions between Indonesia's international investment agreements and national investment law* (158 pp.). ISBN 978-3-88985-589-3.

81 Holzapfel, Sarah (2014). *The role of indicators in development cooperation: An overview study with a special focus on the use of key and standard indicators* (237 pp.). ISBN 978-3-88985-588-6.

80 Pietschmann, Elena. (2014). *Forgotten or unpromising? The elusive phenomenon of under-aided countries, sectors and sub-national regions* (147 pp.). ISBN 978-3-88985-587-9.

[Price: 10.00 Euro; books may be ordered from the Institute or through bookshops.]

Discussion Papers

8/2015 Mayer, Jörg. (2105) *How could the South respond to secular stagnation in the North?* (25 pp.) ISBN 978-3-88985-672-2.

7/2015 Loewe, Markus, & Nicole Rippin (Eds.). (2015) *Translating an ambitious vision into global transformation: The 2030 Agenda for Sustainable Development* (113 pp.) ISBN 978-3-88985-671-5.

6/2015 Fiedler, Charlotte. (2015). *Towers of strength in turbulent times? Assessing the effectiveness of international support to peace and democracy in Kenya and Kyrgyzstan in the aftermath of interethnic violence* (81 pp.). ISBN 978-3-88985-670-8.

5/2015 Tawfik, Rawia. (2015). *Revisiting hydro-hegemony from a benefit-sharing perspective: the case of the Grand Ethiopian Renaissance Dam* (54 pp.) ISBN 978-3-88985-669-2.

4/2015 Janus, Heiner, & Niels Keijzer. (2015). *Big results now? Emerging lessons from results-based aid in Tanzania* (31 pp.). ISBN 978-3-88985-667-8.

3/2015 Mroß, Karina. (2015). *The fragile road towards peace and democracy: insights on the effectiveness of international support to post-conflict Burundi* (74 pp.). ISBN 978-3-88985-666-1.

2/2015 Holzapfel, Sarah, & Heiner Janus. (2015). *Improving education outcomes by linking payments to results: An assessment of disbursement-linked indicators in five results-based approaches* (62 pp.). ISBN 978-3-88985-665-4.

1/2015 Bracho, Gerardo. (2015). *In search of a narrative for Southern providers: The challenge of the emerging economies to the development cooperation agenda* (52 pp.). ISBN 978-3-88985-664-7.

37/2014 Büge, Max. (2014). *Do preferential trade agreements increase their members' foreign direct investment?* (54 pp.). ISBN 978-3-88985-655-5.

36/2014 Meijer, Karen. (2014). *Can supply chain initiatives reduce deforestation? A comparative analysis of cases from Brazil and Indonesia* (38 pp.). ISBN 978-3-88985-662-3.

35/2014 Brandi, Clara, & Max Büge. (2014). *A cartography of the new middle classes in developing and emerging countries* (33 pp.). ISBN 978-3-88985-661-6.

[Price: EUR 6.00; publications may be ordered from the DIE or through bookshops.]

Analysen und Stellungnahmen (ISSN 1434-8934)

9/2015 Striebinger, Kai. (2015). *Vom Militärputsch zur Zivilregierung – Angemessene Antworten internationaler Akteure.*

8/2015 Berger, Axel. (2015). *Finanzierung globaler Entwicklung: Können Internationale Investitionsabkommen ausländische Direktinvestitionen erhöhen?*

7/2015 Brandi, Clara, Axel Berger & Dominique Bruhn. (2015). *Zwischen Minilateralismus und Multilateralismus: Chancen und Risiken von Vorreiterallianzen in der internationalen Handels- und Klimapolitik.*

6/2015 Klingebiel, Stephan, & Sebastian Paulo. (2015). *Orchestrierung: ein Instrument für die Umsetzung der Sustainable Development Goals.*

5/2015 Berensmann, Kathrin, Florence Dafe, Nannette Lindenberg, & Ulrich Volz. (2015). *Finanzierung globaler Entwicklung: Die Rolle der Märkte für Lokalwährungsanleihen in Subsahara-Afrika.*

[Analysen und Stellungnahmen free of charge available from the DIE.]

Briefing Papers (ISSN 1615-5483)

17/2015 Kreutz, Joakim. (2015). *Civil war outcomes and successful peace: setting the record straight.*

16/2015 Brandi, Clara, Axel Berger & Dominique Bruhn. (2015). *Between mini-lateralism and multilateralism: opportunities and risks of pioneer alliances in international trade and climate politics.*

15/2015 Berensmann, Kathrin, Axel Berger, & Clara Brandi. (2015) *Post 2015: The need for an enabling global economic governance framework.*

14/2015 Klingebiel, Stephan, & Sebastian Paulo. (2015). *Orchestration: An instrument for implementing the Sustainable Development Goals.*

13/2015 Griffith-Jones, Stephany. (2015) *Financing global development: The BRICS New Development Bank.*

12/2015 Garroway, Christopher, & Helmut Reisen. (2015). *Financing global development: Beware of 'end poverty' euphoria and trigger-happy reform of concessional finance.*

[Briefing Papers free of charge available from the DIE.]

For a complete list of DIE publications:
http://www.die-gdi.de