

CHAPTER 11

**DEVELOPING STATE CAPACITY IN INDONESIA:
LESSONS FROM TECHNICAL ASSISTANCE
PROGRAM IN THE MINISTRY OF FINANCE**

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INTRODUCTION

The notion of (good) governance in Indonesia cannot be separated from the nation's development agenda since late 1990's. Searching for effective governance within a democratic framework has been put into action through various reforms initiatives, at both national and subnational level. In the viewpoint of practitioners and scholars, the idea of governance itself has been translated into the new way of thinking about state capabilities and state-society relationship; thus, the international organizations (IMF, World Bank and UN) intensively promoted "good governance" as the new reform objective (Pierre and Peters, 2000: 50; Leftwich, 1994).

Governance, with regards to extensive researches on the role of society and private sector, will continuously put the state at the center of analysis due to its key role in creating the structure of state-society-private sector relationships. However, giving the fact that governance addressed the crucial role of the state in steering economy and society to reach collective goals,¹ it is necessary to discuss in more details about the state efforts to upgrade its capacity in the first place. Various studies in multifaceted aspects regarding the importance of enhancing state capacity has been done,² nevertheless, in many developing countries, including Indonesia, capacity of the

¹ Point of views of thinking about governance and role of the state; see Pierre and Peters (2000) and Peters (2001).

² For example Rondinelli *et al.* (2003) provided several case studies on state capacity enhancement.

state remains questionable and in some cases even it impedes the development and reforms process. Therefore, international organizations and donor countries also had proposed holistic approach of capacity development in their agenda.

This chapter objective is to overview the state initiatives to enhance its capacity through technical assistance with capacity development approach. A case study of the Ministry of Finance (MOF) efforts with donor approaches to develop its capacity during the last three decades is summarized to develop better understanding on the capacity development issues. Interchangeably, discussion regarding individual, organization and system level within the ministry, particularly in its revenue raising arm (Directorate General of Taxation/DGT) will be a major case, since it is the largest unit within the ministry consists of a half of the total staff (31,000 out of 62,000 total MOF staff in 2009) and spreading in operational units (329 tax offices in 2009) all over the country. Similar to other public institutions in Indonesia, the ministry's poor performance was also combined with people's perception as one of the most corrupt institutions, especially in tax and custom units. Good governance is the ultimate objective of enhancing the ministry's capacity, yet several corruption cases still occurred even during the reform process. This study attempts to explore the pattern of reform initiatives and the ministry's efforts to develop its capacity and performance, as well as improving integrity and curbing corruption, in recent years. Then, discussion will also look at attitude change, from leadership and organizational culture point of view. This study argues that capacity development largely has been the main theme of technical assistance in Indonesia for many years; however, to enhance good governance practice, change in public officials' attitude is crucial to support any reform program. There is still a gap between capacity development policies/efforts and improvement in public officials' attitude which was "unconsciously" neglected in practice by government and donors, hence this study tries to shed light on this issue.

This qualitative study combines capacity development literature and interviews based on fieldwork conducted in 2007, 2010 and 2011. The author realizes that it is almost impossible to encompass all aspects of the capacity development and choosing this case study would not be sufficient enough to represent overall view on technical assistance. Nevertheless, by analyzing different approaches of capacity development initiatives by donors might be significant to grasp ideas, means and lessons on enhancing state capacity matters.

1. THE CONCEPT OF CAPACITY DEVELOPMENT

1.1 Some Definitions

There are many concepts and definitions regarding “capacity” but somehow similar to each other and depends on the scope of issues being addressed. Capacity usually refers to the abilities of individuals (technical competence) or organizations to perform functions and to achieve stated objectives. ADB (2007: 1) explains capacity as widely understood as “the ability of people, organizations and society as a whole to manage their affairs successfully” and is a key to overall development performance. CIDA (2000: 2) defines capacity as abilities, skills, understandings, attitudes, values, relationships, behaviours, motivations, resources and conditions that enable individuals, organizations, networks/sectors and broader social systems to carry out functions and achieve their development objectives over time.

In a more comprehensive definition, capacity is the ability of an individual, an organization or a system to perform functions and to meet objectives effectively and efficiently, which should be based on a continuing review of the framework, conditions and on a dynamic adjustment of functions and objectives (Millen, 2001 in GTZ-SfDM, 2005: 11). This study will limit the definition of capacity as the ability at three levels: individual, organization and system within the public institution (MOF) reform case.

1.2 Historical Context of Capacity Building/Development

Some development specialists and international organizations prefer the terms “capacity development” or “capacity strengthening” instead of “capacity building,” to signal that the task is one of strengthening existing capacity rather than constructing capacity that does not yet exist. However, both of the terms, capacity development and capacity building have dominated the development interventions since 1960s and to some extent share the same framework as development concept.

Many scholars used capacity building term in short as a training to improve individual’s ability but others argued that it is much broader than that. A different set of capacity development understandings could be traced along with historical evolution of the concept itself. This section summarizes briefly on how capacity development has been approached for the past forty years and so (DFID, 2002). Capacity development initiatives in the 1960s

and 1970s were focused on human development or individual level by providing training and skills, tools and equipment for individuals in key positions. Many developing countries received Official Development Assis- tances (ODA) in forms of accepting international experts and officers to fill capacity gap, awarding scholarships, taking “manpower” audits and pro- viding on-the job training. By the late 1970s it was recognized that this single approach had not brought improvements that much.

Capacity building began to shift the focus to the role of the organi- zation in the early 1980s. Understanding capacity building process moved from a focus on individual skills and competencies to focus on getting organizations re-structured or re-designed. Organizational changes were made to systems for policy making, systems for human resources and financial management, and changes the way services were delivered. Other crucial organization changes may involve the redesign of structures, chang- ing job responsibilities and management structures. Nevertheless, many developing countries’ organizations, in reality, remained unreformed, thus pursuing organizational changes were not sufficient enough to achieve im- proved capacity. By the late 1980s, it was realized that while a focus on individual and organization was still necessary, by themselves they were not sufficient. As a technical assistance concept, capacity development also requires institutional/environment changes and reforms as well to support organizational changes in a wider framework.

The role of institutions (system) in capacity development approach began to be acknowledged in the early 1990s. These institutions are both formal and informal. Formal institutions consist of legal systems, property rights, the relationship of the executive to the legislative, etc. While the norms and values that influence individual and collective behaviours are informal institutions. The key point here is to turn individual competence into organizational capacity requires institutional changes. Overall summary of capacity development evolution as technical assistance is in the following table.

Table 11.1. History of Technical Assistance for Capacity Development

| <i>Period</i> | <i>Focus</i> | <i>Mode of Capacity Development</i> | <i>Motives (Dominant Ideas)</i> | <i>Technical Assistance Paradigm</i> |
|-----------------|-------------------------------|--|--|--|
| 1960s-1970s | The Individual | <ul style="list-style-type: none"> - Degree level training - Skills acquisition - Tools and equipment | <ul style="list-style-type: none"> - Counterparts - Gap-filling | <ul style="list-style-type: none"> - Scholarship (abroad) - Manpower reviews - On the job training |
| 1980s-mid 1990s | The Organization | <ul style="list-style-type: none"> - Reconfiguring organizational structures - Reforming/ strengthening: <ul style="list-style-type: none"> a. Systems for policy making and analysis b. Systems for managing people, information, cash and asset c. Service delivery processes | <ul style="list-style-type: none"> - Business management - Business process re-engineering | <ul style="list-style-type: none"> - Organizational audits - Restructuring - Counter parting - Job evaluation and grading - Job descriptions - Technical advisers/ consultants |
| Late 1990s | The Institutional Environment | <p>Incentive structures within formal organizations:</p> <ul style="list-style-type: none"> - Human Resources Management (Pay, discipline, performance management) <p>Wider institutional environment:</p> <ul style="list-style-type: none"> - The accountability of the executive to the legislature and to citizen - Responsive government - Legal and judicial framework | <ul style="list-style-type: none"> - New institutional economics - The rules of the game | <ul style="list-style-type: none"> - Sector or “whole” budget support - Public expenditure management - Performance management - Pooled Technical Assistance |

Source: DFID (2002: 12) and modified by the author.

1.3 Capacity Development as a Holistic Process

The capacity development concept later became understood as a set of interventions in addressing multi level of objects and regarded as a holistic process of development. This section will review some capacity development frameworks being used by international organizations and scholars in determining the key issues of development initiatives.

As the pioneer of introducing the concept, UNDP (1998: 20) used capacity development that has to consider three levels:

- a. The system level, i.e. policies, regulatory framework, and frame conditions that support or hamper the achievement of certain policy objectives;
- b. The entity level, i.e. the structure of organizations, the decision-making processes within organizations, procedures and working mechanisms, management instruments, the relationships and network between organization;
- c. The individual level, i.e. individual skills and qualifications, knowledge, attitudes, work ethics and motivations of the people in organization.

Capacity development (CIDA 2000: 8) also refers to the approaches, strategies and methodologies used by developing country and/or external stakeholders to improve performance at four levels: the individual, organizational, network/sector, and the enabling environment. Meanwhile, DFID (2002: 3) proposes best practice for capacity development which is likely to require a mix of interventions at these three levels: the individual (tools and training), the organization (restructuring, the reform or strengthening of business management systems) and the institutional (pay, promotion, and possibly culture change). Bringing about individual and organisational change is easier than institutional change. Similar concept of capacity development was offered by JICA (2004: 16) in its programs/projects, featuring 3 levels of capacity actors: Individuals, Organizations and Society.³

In the view of scholars of public sector context, Grindle (1997: 8) determines the term capacity building as intended to encompass a variety of strategies that have to do with increasing the efficiency, effectiveness and responsiveness of government performance. Moreover, she pointed out that good government has much to do with the quality of human resources, organizations and institutions in the public sector. At the local government sphere, Kimura (2002: 258-262) argues that the capacity building process

³ Following UNDP's capacity building framework in 1998, almost all international and donor organizations agree on the holistic approach of capacity development, consisting of system, organization and individual level (at least).

should address some crucial issues at individual level (on the job and off the job training), institutional level (horizontal local government coordination, clear target, concrete function/roles and bottom-up/participatory planning model), and system level (priority of policies, build decentralization system to support policies, participatory model of NGOs and role of leadership).⁴ Capacity building is decisively necessary process to cope with revolutionary change at the local government, with donors' assistance.

Capacity building in Indonesian language context which means "pembangunan kapasitas" and has been adopted by government institutions, development agencies, major companies and NGOs largely in their planning and policy document (Fanany *et al.*, 2009: 3), and also in particular public organization structure.⁵ Overall, the term capacity building (pembangunan kapasitas) itself in Indonesian language is mostly related to the individual competency enhancement process, or in a rather narrow sense compared to the multilevel capacity approach proposed by international and donors organizations. Capacity building is also well written in government planning documents, NGOs mission statements and served as "catchy words" in official speeches or public communication but very rarely implemented as development concepts without any international/donors organization involvements. Therefore, to observe and analyze the concept of capacity development in Indonesia will necessarily have to narrow down on the approaches by looking at the partnership programs or technical assistance projects conducted by government and international organizations.

The term capacity development,⁶ being used in this study (as international organizations and scholars argued), will be related to performance improvement initiatives at individual, organization and system level. Furthermore, this study limits the capacity development within the technical assistance framework at individual level focusing on human resource development efforts particularly overseas training programs. Organization level will cover the issues of organizational restructuring and incentives structure improvement. Thus, capacity development at system level attempts to review some regulations/policy reforms and the state working mechanisms of development.

⁴ This study by Kimura (2002) was based on fieldwork in Indonesia, the Philippines, and Japan's experience.

⁵ This is typically applied in the human resource division/department in government organization structure.

⁶ This study prefers to use the term "capacity development" to distinguish it from the narrow perception of "capacity building" which largely has been understood in Indonesian language as individual competency enhancement efforts.

1.4 Capacity Building as Technical Assistance Framework

Technical assistance is known as “a form of aid given to less-developed countries by international organizations such as the United Nations (UN) and its agencies, individual governments, foundations, and philanthropic institutions. Its object is to provide those countries with the expertise needed to promote development.”⁷ Technical assistance may involve sending experts into the field to teach skills and to help solving problems in their areas of specialization, or vice versa, by providing scholarships, seminars, study tours in developed countries to give an opportunity to individuals in less developed countries in order to learn special skills that can be applied when they returned home. Technical assistance is basically a project based approach on development in which the period of implementation might vary in each country’s development program cases.

Since the 1960s, Indonesia has been a major aid recipient. As a leading donor, World Bank has financed projects totaling to US\$25 billion since 1967 (Fanany, 2009: 6). Other aid donors to Indonesia include USAID, AusAid, GTZ, the Inter-Government Group on Indonesia (IGGI) which later changed into Consultative Groups on Indonesia (CGI),⁸ the Asian Development Bank (ADB), and other governments, most notably that of Japan. Some of those aids are within long term assistance covering multi sectoral development projects. In terms of technical assistance, recently National Development Planning Board (Bappenas) in 2009 clarifies that there are 228 technical assistance activities in the amount US \$ 1.71 billion implemented during the period of 2006-2009.⁹ Technical assistance remains one of the main sources for development efforts; yet, in recent years the government tries to reduce its debt-development financing dependence.¹⁰

⁷ Definition from Encyclopedia Britannica.

⁸ Forum that gathers international donors set up by the government and World Bank from 1992 until 2007.

⁹ Bappenas and related ministries have role to evaluate each project/technical assistance proposal granted by Government Regulation No. 2/2006. The number of technical assistance mentioned above is separated from project assistance which is comprised of 194 project assistance in the amount of US \$ 11.48 billion (Ministry of National Development Planning/Bappenas 2009).

¹⁰ High evaluation and monitor have been conducted in order to reduce government debt to GDP as stated in Mid-term National Development Plan 2004-2009. According to Bappenas, the external financial sources are still needed to accelerate our development efforts; however its risks, especially loan, should be managed properly.

It was mentioned in previous section that capacity building being perceived as holistic framework of development is consists of system level, organization level and individual level. Giving the fact that capacity building is a broad concept that can be applied in many aspects of development, the technical assistance under the name of “capacity building” has been provided in wide range of sectors and levels. World Bank, for example, offers seven broad themes which cut across sectors and regions: climate change, fragile and conflict-affected state, governance, growth and crisis, health systems, public-private partnership and urban governance.¹¹ Assessing the key issues of capacity in developing countries often requires coordination of multi donors’ assistance and largely being implemented in long term programs or projects.¹² The outcomes of the initiatives are varying from failure to successful cases. However, the need for addressing development problems through technical assistance and the search for sudden improvement through various resources (e.g. experts, technology) adopted in capacity building project, has shifted to certain level (system, organization or individual) issues within the context of technical assistance rather than considering the written concept of long term holistic approach towards sustainability.

Typical argument being raised recently is that at the stage of implementation (capacity building project), the project is short term and very targeted results in comparison with broad capacity building concept meaning itself. Donors also want to tell their stakeholders that they are providing good value for the money they are providing. They need to do this in predictable planning and reporting format, and result based approaches (of project) provide clear and linear logic. Unfortunately, capacity building/development results are not easily identified and reportable in short term. This leads to a paradox (Lusthaus *et al.*, 1999: 13).¹³ This study will not investigate further about the paradox but notice that there is a tendency that capacity development in recent years implemented in shorter period of time and more towards the project goal oriented in public sector reforms rather than long term technical assistance.

¹¹ Capacity Development Resources Centre, Word Bank website (January 2011).

¹² The Paris declaration on aid effectiveness in 2005 was one of international donors’ efforts to continue to increase efforts in harmonization, alignment and managing aid for results with a set of monitorable actions and indicators.

¹³ On the one hand, donors want to use Capacity Development as long term investment, but, on the other, they also want to use a project (expertise and technology based) which plans and reports in the short term.

Since the capacity of Indonesian public institution, as many of other developing countries have been regarded as low and most significant problem that requires donor organizations intervention,¹⁴ it is important to investigate further different approaches of technical assistance related to the state capacity building. This study employs holistic concepts of capacity development to be applied in Indonesian public institution as a case study and then analyzes the pattern and lessons from the long years of technical assistance experience. The next section deals with the history of long term technical assistance implemented from 1960s to 2000s in order to enhance state capacity within the Ministry of Finance (MOF).

2. TECHNICAL ASSISTANCES FOR DEVELOPING CAPACITY OF THE MINISTRY OF FINANCE

2.1 Background

Unlike other sector reforms (e.g., decentralization¹⁵) in which these clearly used the formal term “Capacity Building”, there is less evidence on the development effort involving the MOF that directly labeled as “Capacity Development” or “Capacity Building,”¹⁶ but rather uses more specific terms such as “Economic Policy Reform” or “Reform of Public Finance Management.” Nevertheless, characteristics of those reforms mean much more than just narrowly policy oriented reforms when they come to the implementation stage. Some scholars even regarded the patterns of reforms where the MOF lead the initiatives as “Institution Building” (Roemer and Stern 1997: 76), or “Bolstering Capacity” (Lippincott, 1997: 97), or “Institutional

¹⁴ For example, Turner and Hulme (1997: 105) argued the public organizations that had been encouraged to expand and multiply in early years were now perceived as obstacles to development.

¹⁵ Donor community, including the ADB (2005) and GTZ (Rohdewold, 2004), explicitly used the term “capacity building” on its assistance and projects in supporting decentralization reform from 1999 to 2001.

¹⁶ This study only noted that there is a single-short term technical assistance provided by ADB (from 1998 to 2002) named “Capacity Building for Financial Governance” as part of IMF programs, which largely implemented in capital market and financial institutions that covered not only the MOF but also other financial institutions stakeholders outside the MOF such as Bank Indonesia, Finance and Development Supervisory Board/BPKP and National Civil Service Agency/BKN (ADB 2006). Due to its short term and multi sectoral technical assistance framework, this study will not address the initiative.

Development (Stern, 2000: 123). The government and donors realized that putting development initiatives requires multilevel intervention, and reforms are seen as continuing form of development facing dynamic changes at national environment context.

To understand the details of wide range of donor's effort in Indonesian economic development, it is necessary to summarize the history of major technical assistance.¹⁷ This part will divide the technical assistance into four periods and briefly examines the process with regards to the main theme of technical assistance provided.

2.2 Prior to 1980: Economic Stabilization Programs

In 1966, after the fall of President Soekarno era which led to hyperinflation, the government set up the main economic targets first, to stabilize price and strengthen the rupiahs at the international market. Within a decade, the country had achieved significant improvements where hyperinflation was overcome, stabilized the rupiahs, turning capital flights in capital inflows and annual real growth around 7 percent (Glassburner, 1978: 137-138).

Those attempts by economist were largely to move from "guided economy" (term used in previous government) into more "laissez-faire" or allowing market to work greater than in the past was conducted, although it is also noted that in important arena remains subject to government intervention at macro level. The national development plan (REPELITA) was the guideline of pursuing economic development and translated into various program activities.¹⁸ The era also was noted as the era involving fundamental macro level reform policies such as exchange rates interest rates, domestic oil prices and price of agriculture/rice (Gillis, 1989: 79). Much of appreciation in literatures were given to the dedicated senior economists (mostly workers of the ministry of finance and national development planning agency) who were trained abroad with Ford Foundation assistance¹⁹ and had established the foundation of Indonesian economic development (Nelson, 1987; Shiraishi, 2006). However, behind those economic policy

¹⁷ There are large numbers of technical assistance provided which are related to various sectors and aspects of development. This study only gives brief review on particular issues related to the economic development.

¹⁸ For more details, please see Glassburner (1978) pp. 143-153.

¹⁹ A technocrats group sometimes known affectionately as the "Berkeley Mafia" because they gained PhD degrees from the University of California.

reforms provided, there was also assistance from development agency- the so called Development Advisory Service (DAS),²⁰ which was established in 1963, and later on continued to work with the senior economist policy maker in 1968 with the full-scale advisory project related to the economic stabilization program (Roemer and Stern, 1997: 59).

In the aspect of human resource capacity development, as a continuation of previous Ford Foundation funded scholars, the General Participation Training (GPT) Project funded by USAID started to provide routine short courses and degree courses to contribute to the country's development after returned.²¹ This program, which was conducted from 1967 to 1981, had sent 1429 participants to overseas study to the United States (Nelson, 1987). Later, it was noticed that around 20 percent of minister in 1994 cabinet had received training under GPT (Buchori *et al.*, 1994: 17)

There is no doubt, from the capacity development point of view, that development assistance during 1960s to end of 1970s was largely assisting the government in formulating policies to enable the state to conduct its economic stabilization programs and later, converting oil boom wealth into sustainable development policies. Initial program to develop human resource capacity was established; nevertheless, the system levels of macro economic structure were where mainly the intervention of development assistance played the major role.

2.3 1980s-Mid 1990s: The Need for Economic Policy Reforms

The beginning of 1980s is the era when technocrats (Ministry of Finance) began to believe that the rise of the oil price would be ended and might potentially lead to budget deficit since three quarter of its tax and export came from oil (Stern, 2000: 116). Together with Harvard Institute of International Development (HIID) assistance,²² the government launched the

²⁰ DAS was Harvard University based experts and later changed its name into HIID (Harvard Institute for International Development).

²¹ This project was provided largely to government officials and others from the private sector. Contrary to the successor project, Professional Human Resource Development (PHRD) is only applied to the government officials with a majority in the MOF and Bappenas

²² The members of the HIID technical team included 19 economists, six lawyers, and two accountants/computer specialists, organized by Malcolm Gillis (Heij 2001: 235).

Fiscal Reform Project (FRP) in 1981 and the tax reform was the central issue to focus on along with other projects²³ (Roemer and Stern, 1997: 61).

Gillis (1989: 80) underlines that the tax system relatively untouched by significant reform initiatives before had been the object due to its defect in tax structure and tax administration, and then seen as complex, unenforceable and ineffective system which might hinder the national budget. The tax reform was intended to simplify the tax laws and regulations, diversify the tax base, increase fiscal equities and bring the tax structure into international best practice. The three laws on general tax provisions and procedures simplified tax income and newly introduced value added taxes, stipulated in 1984 and began its implementation in January 1985, and later also renewed the property tax law and stamp duty law in 1985. MOF recognized the successful reforms and also required basic changes in taxation procedures, administrative machinery and the tax information (Roemer and Stern, 1997: 63). Highly regarded in terms of preparation, as Harberger, (1989: 32) explained that tax reforms in Indonesia was under careful preparation analysis beforehand and working under three levels: professional-technical, political and administrative.

However, the first reaction towards the tax administration reform proposals from Directorate General of Taxation members was generally rather hostile, partly because the simplification of tax system might reduce tax collectors' illegal additional income. Furthermore, Gillis and HIID team had difficulties to introduce the proposed reform because of the tax office resistance with all the vested interests. Some tax officials felt that they were out of the reform process consultation and the approach had been top-down" (Heij, 2001: 243-244). Given the fact that during this era corruption was common in the public sector especially in taxation units, the new tax administration system had little affect on fighting corruption or implementing good governance practice and the main purpose was to overhaul the system in order to increase tax revenue.

A decade later, the government and parliament amended the set of tax laws and yet enjoying much more of fiscal stability from tax revenue. The economic performance history was seen as magnificent to reflect Indonesia's

²³ The Fiscal Reform Project (FRP) later shifted to trade and industrial policy and macro economic management (Custom and Economic Management Project/CEM) which is not covered in this study.

steady development,²⁴ until the financial crisis which led to economic crisis hit in 1997, and the fall of new order regime in 1998. Nevertheless, the change of tax administrators' attitude was not so significant and it was continued to be a common practice for companies to make additional payments to tax officials to reduce the tax payable until late 1990s (Heij, 2001: 250). This study argues that two decades after the comprehensive tax reform being implemented, the tax administrators remained to keep the "traditional business" and only adapted into the new form of tax structure.

Meanwhile, the MOF with HIID assistance also began to develop its young employees' capacity to become young professionals who can perform necessary analysis to make rational and well informed policy decisions through intensive training program (Lipincott, 1997: 102; Stern, 2000: 121). Since the establishment of FRP in 1981, it was confirmed that a massive overseas training would be needed to prepare the tax and other MOF officials to manage the new system and to provide the core senior staff of the MOF the necessary expertise over the next two decades (Roemer and Stern, 1997: 76). HIID also provides trainings in terms of courses and seminars on fiscal and monetary policy. Realizing that the individual's capacity might hinder the development policy formulation and implementation in the future, the comprehensive training programs (degree/non degree, overseas/domestic) was conducted in long term projects²⁵ in order to improve the analytical capabilities in the ministry.

The key capacity development intervention in this era was still largely in the form of system level where tax reforms together with other economic policy reforms took place. However, there was significant effort to shift the attention towards individual levels and it was necessary to do so since the young staff will be important to support further reforms in coming years. Eventually MOF gained large benefit of high number of qualified employees with analytical skills compared to other Indonesian public institutions.

²⁴ The World Bank considered Indonesia as one of the "east Asian miracle country" (Word Bank 1993).

²⁵ The so-called Overseas Training Offices (OTO) in collaboration with the National Development Planning Agency/Bappenas and later on was changed into Professional Human Resources Development Project (PHRDP) that will last until the 3rd Phase in 2013.

2.4 Beginning 2000s: The Need for Overcoming Financial Crisis Impact

The new era began with the economic crisis occurring in the end of 1990s which led to political instability and forced the country into the economic management under the International Monetary Fund (IMF) policies and conditionality. The close monitoring of post-crisis economic recovery policies by IMF was put in wide-range of fiscal and monetary structural adjustment program, which had been signed in the Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) in 2000.²⁶ To improve the economic performance at system level,²⁷ MOF and related ministries proposed State Finance Law “package” consisted of the State Finance Law (Law No. 17/ 2003) in March 2003, the State Treasury Law (Law No. 1/2004) and the State Audit Law (Law No. 15/2004). The State Finance Law package not only contributed to define role and interrelationship of MOF, Supreme Audit Board (BPK), technical ministries and head of regional government, but also clarified MOF’s role as fiscal policy maker, treasurer, revenue collection and asset manager.

The restructuring policies advised by IMF brought impacts on organizational level of public institutions in wide range of areas,²⁸ including organizational structure within the MOF. Organizational restructuring that has been pursued by the ministry was “reorganization,” covering almost all echelon 1 units at central level or non-operational office (back office).

Furthermore, one of the aspects of the IMF memorandum was “the tax system needs to be reformed to ensure that it is broad-based, non distor-

²⁶ LOI and MEFP with IMF January 20, 2000; available online at <http://www.imf.org/external/np/loi/2000/idn/01/index.htm>.

²⁷ Also as an impact of the 1945 Constitution of Indonesian Republic (UUD 1945) Chapter VIII Article 23 of the constitution regarding state finance which had been expanded up to 8 (eight) articles. Those articles provide guidelines regarding state budget process, taxes, currency, central bank regulation, and Supreme Audit Board as state finance control function that have never been clearly regulated in the constitution before. The constitution mandate has put MOF as central role in state economic and finance management/fiscal regulator and executor, while Central Bank (Bank of Indonesia) acts as monetary regulator and the Supreme Audit Board takes responsibility to control the whole state financial matters.

²⁸ Initially, the IMF targeted wide range of institutions: the public sector (fiscal management and civil service reform), financial sector (IBRA, the state-owned banks, and the regulatory and supervisory institutions), the judiciary, and the institutions responsible for corporate governance. This study only highlights fiscal management issues which have main related issues on improving organizational capacity of the MOF.

tionary, equitable, and transparent. Tax administration has to be overhauled to ensure that regulations are implemented faithfully and in an even-handed manner.”²⁹ In spite of minor revision on tax laws package in 2000, the government together with IMF assistance put more emphasis on the effectiveness of tax administration at organizational aspects and improving check and balance on organizational mechanism at the ministry of finance structure. Brondolo *et al.* (2008:15) argued that the Directorate General of Taxation (DGT) organizational structure had some weakness that might hinder tax administrative performance. In the headquarters, it was not organized in a manner that would support effectively the ongoing operations and to develop new tax administration programs. While the field offices, on the other hand, had separate units for administering different types of taxes along with a parallel network of audit offices and property tax offices, all of which operated largely independent from each other. This organizational set up led to a fragmentation of tax administration programs, both at headquarters and the field offices, resulting in a lack of accountability for results. This called for an intention to implement “Tax Administration Reform” which was called as “Modernization.” The reform in MOF began with the Directorate General of Taxes by establishing 2 units of Large Taxpayer Offices (LTOs) in Jakarta-also known as “modern tax offices” in June 2002 as pilot project, administering 200 companies as largest taxpayers which cover 25% of the total national tax revenues.³⁰ Although the initiative to improve tax administration by targeting large taxpayer already mentioned in LOI 2000, yet the schedule of LTOs implementation occurred in LOI 2002³¹ after intensive consideration and preparation. The LTOs were a revolutionary change by adopting new organizational structures based on functions, not on tax types as common tax offices. The new administration had urged a tax office to combine all the tax types (e.g., income tax, value added tax, withholding tax, and land and building tax) and managed them into one service section where previously each of them was administered in different section. Moreover, the modern tax office is a merger of formerly three separate tax offices: Tax Service Office (KPP), Tax Audit and Investigation

²⁹ MEFP with IMF January 20, 2000, point no. 12.

³⁰ Later in 2007, State-owned Enterprise Tax Office became Large Tax Office, and in 2009 the Large Individual Taxpayer (High Wealth Individual) Tax Office was established. By 2010, there are 4 Large Tax Offices which handle around 39.4 % of the total national tax revenues.

³¹ LOI with IMF April 9, 2002, available online at <http://www.imf.org/External/NP/LOI/2002/idn/01/index.htm>.

Office (Karikpa), and Land and Building Tax Office (KPPBB). The two main agenda for modernization process are creating a customer oriented public services and minimizing corrupt behaviors. To conduct the last agendum is the hardest part due to the fact Directorate General of Taxes for long years hold a status as one of the most corrupt institution.

2.5 Late 2000s: The Need for Sustainable Tax Reform

In 2008, the end of process of the Modernization, the government (MOF/Directorate General of Taxes) began to formulate the second phase of “Tax Administration Reform”. In January 2009, the World Bank agreed to provide assistance with a loan amount of US\$ 110 million in the project so called “Project for Indonesia Tax Administration Reform” (PINTAR) for 6 six years implementation until December 2015.

The Project for Tax Administration Reform (PINTAR) for Indonesia has two main objectives to: 1) increase taxpayer compliance by increasing the efficiency and effectiveness of the Directorate General of Tax (DGT); and 2) improve good governance in tax administration by strengthening transparency and accountability mechanisms. According to World Bank (2008), there were four components to the project. The first component of the project was increasing the efficiency of taxpayer data collection and management. This component aimed at improving taxpayer registration, returns processing, taxpayer accounts management, documents management, and Information and Communications Technology (ICT) infrastructure. The second component of the project was human resource management and development. This component would support and strengthen ongoing reforms in DGT by addressing basic capacity building needs related to the main functions and improving training capacity. It would also support the improvement of human resource policies and strengthen anti-corruption policies and mechanisms. The third component of the project was strengthening compliance management operations. This component would increase the efficiency of selected core operational functions of tax administration. It would concentrate on: a) tax audit, introducing risk-based audit selection, reforming business processes for desk and field audit, computerizing processes supporting the tax audit function, and improving the audit planning and monitoring process; and b) arrears collection, in particular enhancing the arrears monitoring system, reforming business processes for arrears collection, and enhancing the collection enforcement ICT system. The fourth and final component of the project was project and

change management. This component would support the management of the project, through technical assistance, in particular a change in management program including the improvement of internal and external communications and feedback surveys, familiarization and specific transition training. The PINTAR project was the main pillar of second phase of tax administration modernization in 2009.

Table 11.2. Summary of Major reform programs involving the Ministry of Finance Capacity Development Framework

| Period | Technical Assistance Program | Source | Development Focus |
|-----------------|--|-----------|-----------------------|
| Prior to 1980s | Economic Stabilization Program | DAS | System at Macro Level |
| | General Participant Training (GPT) | USAID | Individual Level |
| 1980s-mid 1990s | Fiscal Reform Project* | HIID | System at Macro Level |
| | Overseas Training Office/Professional Human Resource Development Project (PHRDP) | HIID/WB | Individual Level |
| Beginning 2000s | Structural Adjustment Program/Memorandum of Economic and Financial Policies (MEFP) | IMF | System at Macro Level |
| | Tax Administration Reform/Modernization | IMF | Organization Level |
| | PHRDP phase II | JBIC | Individual Level |
| Late 2000s | Program for Indonesia Tax Administration Reform (PINTAR) | WB | System at Micro Level |
| | PHRDP phase III | JBIC/JICA | Individual Level |

Notes:

This summary does not necessary cover all the reforms that were implemented by MOF in the past. For the purpose of this study, only major related programs are highlighted.

*) The program was fully financed by the Government of Indonesia, HIID only provide technical assistance.

3. LESSONS LEARNED IN CAPACITY DEVELOPMENT PERSPECTIVES

This section will investigate further on the MOF reform initiatives that can be translated into the framework of capacity development and will explain in more details on how the process evolved. It will define some

lesson and implication that are might relevant to the state capacity enhancement and governance issues in particular.

3.1 Individual Level

“People are the lifeblood of any organization and the agents of reform and renewal in public administration.” The knowledge, skills, values and attitudes of public servants are at the heart of state performance (UN Economic and Social Council, 2004:1). Therefore, human resources are the key elements of organizational performance particularly during the reform process. Capacity development initiatives at individual level will be observed from two perspectives: long term human resources development intervention and redesigning training method.

3.1.1 Long Term Human Resources Development Intervention

Technical assistance to support human resource development by providing opportunities for formal education abroad have been initiated over a long term period of intervention. To ensure the availability of educated people with analytical capability in the government might be the crucial point to support Indonesian development efforts. Prior to 1980s, the Ford Foundation and USAID through its General Participant Training (GPT) had initiated the overseas training programs to enhance the knowledge and skills required for young public officials which later on were noticed by the emergence of technocrats. However, it was not in the form of a deliberate effort by the government to address the specific areas of government officials but rather the effort by the donors to provide training opportunities. Until the beginning of 1980s, the demand for qualified officials to support the upcoming economic policy reforms (including major tax reform), the government worked closely with the HIID to formulate massive training programs for the MOF and other related ministries’ officials.

Realizing that the Ministry of Finance is known for superb quality at top levels (the first generation of technocrats) but had little analytical capacity at the intermediate and junior levels in the 1980s (Roemer and Stern, 1997: 77), the government with HIID assistance started the Overseas Training Office and the Professional Human Resources Development Project (PHRDP). With HIID help, hundreds of MOF staffs were sent abroad (United States) to pursue master’s and doctorate degree. In return for the human resource investment, the quality of the Ministry of Finance staff was

markedly strengthened, undoubtedly reducing the need for foreign technical assistance.

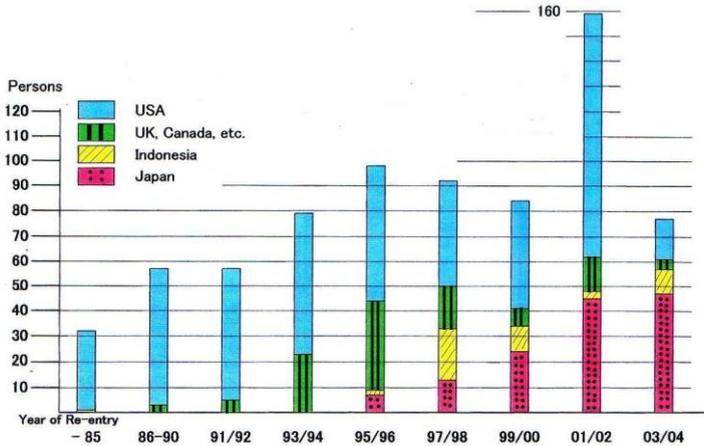
From 1989, the World Bank acted as a major funding source and created new project the so-called Professional Human Resource Development Project (PHRDP). The first phase of PHRDP implemented from 1991 to 1998 to send abroad (majority to United States) hundreds of officials from the Agency for the Assessment and Application of Technology (BPPT), National Development Planning Agency (BAPPENAS) and MOF. The program had strengthened MOF human capital base due to high retention rate of graduates and offered greater analytical capability (Lippincott, 1997: 118-19). In 2000, HIID assistance project was ended.

The feature of individual capacity development within the ministry during 1980s and 1990s had been widely discussed in Lippincott (1997) and Stern (2000). This study will provide further analysis on the individual level capacity development since the end of 1990s to middle of 2000s when the second phase of PHRDP ended and started the third phase of PHRDP.

The second phase (PHRDP-II) started from 1996 to 2004 with Japan Bank for International Cooperation (JBIC) loan agreement and introduced Japanese universities as main destination. To send officials to Non-Japan countries might be approved by JBIC only when the specific educational need would not be fulfilled in Japan. This phase embarked the increasing number of Japanese universities graduate\officials and replaced the United States (and UK, Canada etc) universities graduates that previously dominating, as can be seen in figure 11.1.

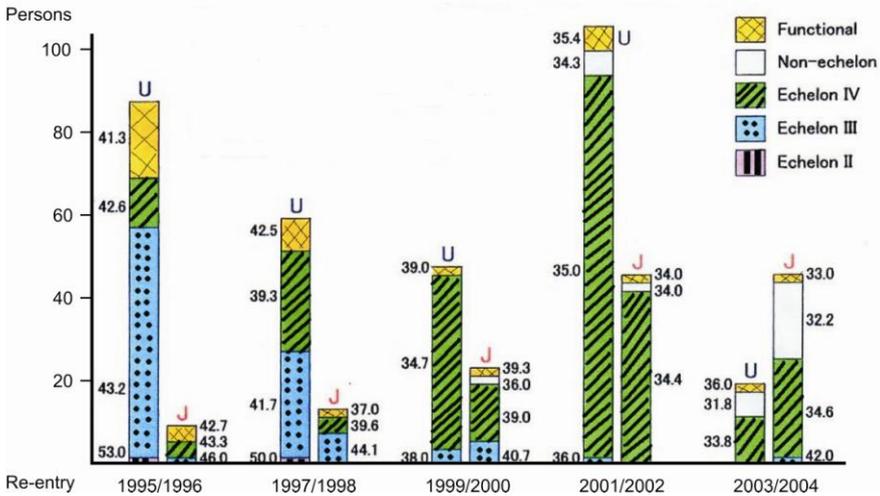
The Indonesian government agencies, including MOF, are public sector which set a great value on the academic career of an individual. Therefore, the alumni of PHRDP also enjoyed status at number of positions and occupied an essential part in the professional human resources of the ministry, particularly returnees from Japanese universities in late years. The picture of the MOF officials' status after returning back from PHRDP overseas trainings are described in figure 11.2 below.

Figure 11.1. The Number of Returnee by Country PHRDP I and II, The Ministry of Finance



Notes: - Total 725 officials (resigned/transfer officials are excluded), as of June 2004.
Source: OFUTET (PHRDP-JBIC) Report, 2004 (unpublished).

Figure 11.2. MOF Returnees' Status by Re-entry after PHRDP Overseas Training



Notes:
 U = USA, Canada, Australia and European Universities Graduates
 J = Japanese Universities Graduates
 Numeral = Average of ages, as of June 2004
Source: OFUTET (PHRDP-JBIC) Report, 2004 (unpublished)

Since end of PHRDP-II programs in 2004, the Ministry was forced to change strategy. However, the ministry's efforts to continue in upgrading its human resources remained strong. MOF allocated sources of fund from non-tax revenue budget and other alternative to provide master's degree scholarships for domestic universities. The demand from officials to apply for the opportunity is always high, around 1,900 applicants every year. MOF wisely believes that providing higher degree scholarship, particularly overseas training and even the source of fund comes from loan, will benefit the Indonesian human resource as a whole regardless the graduates will stay in the ministry or leave for other government office or private sector.³²

The new scheme PHDRP-III (JBIC loan) finally started in 2006 for 7 years duration (until 2013). The objective of the project is to strengthen the institutional administration capacity of the central and local government in order to facilitate the decentralization process. BAPPENAS, especially regional development planners and MOF officials, are the target of the project. Summary of PHRDP-III fellowships plan is as follows:

Table 11.3. PHRDP-III Fellowships Plan (2006-2013)

| No. | PROGRAM | TARGET (Number of Officials) | | |
|------------------|--------------------------------|------------------------------|-----|--------|
| | | BAPPENAS | MOF | TOTAL |
| Overseas Program | | | | |
| 1 | PhD Linkage | 30 | 20 | 50 |
| 2 | MA Linkage | 459 | 125 | 584 |
| 3 | Non-Degree Linkage | 175 | 0 | 175 |
| 4 | MA Regular | 0 | 154 | 154 |
| 5 | Non-Degree Program | 0 | 140 | 140 |
| 6 | OJT in Japan | 86 | 0 | 86 |
| Sub Total | | 750 | 439 | 1.189 |
| Domestic Program | | | | |
| 1 | Master Program | 2.291 | 300 | 2.591 |
| 2 | Non-Degree Program | 5.050 | 0 | 5.050 |
| 3 | Pre-Departure Language Program | 2.000 | 0 | 2.000 |
| Sub Total | | 9.341 | 300 | 9.641 |
| Grand Total | | 10.091 | 739 | 10.830 |

Source: Loan Agreement JBIC IP-535 (2006)

The positive aspects of PHRDP-III in comparison with previous project are the huge number of candidates (nearly 11,000) and focused on

³² Interview with Zulkarnain H., the Head of Post Graduate Education Division FETA (PPSDM-MOF), August 2007.

developing officials at regional/local levels. The program also will monitor closely the impact of the program and its effectiveness to build the organizations' capacity. Another feature is introducing "Linkage Program" or sandwich/double degree program (1 year at domestic university and another year in Japan) which idea was initiated by BAPPENAS.³³ Although many observers doubt regarding the linkage program's quality, the main reason of this scheme is to reduce cost of overseas program. It was calculated that the cost of one overseas degree program is more or less equivalent to seven domestic degree programs.

Apart from PHRDP Program, in recent years there is also other overseas study opportunities provided by other international agency, such as AusAID (Australian Government) which has allocated some students (around 10-20 person each year) from the Ministry to pursue academic degree in Australia.³⁴ Yet, the PHRDP still remained to be the largest project in terms of numbers of scholarships awarded.

To sum up, the long years of MOF's vigorous human resources development effort through PHRDP programs have been successful for establishing qualified managerial skills within the ministry (see details on the changes of MOF officials' education background in 1996, 2001 and 2006 as appendix-1). Nevertheless, this study notes that the overseas training initiatives are still lacking of creating specialty in more specific area of study. The main reason is less attention from MOF units toward overseas training need analysis that leads to give candidates big space to choose the program regardless of organization's necessities. Another reason is that there are limited programs offered by Japanese universities in terms of international class. Since majority of specific area of studies are conducted in Japanese language, probably it will be useful for the future to set up better pre-departure Japanese language program or increase the language requirement for candidates. Furthermore, this study also underlines that MOF should support grant (not loan) scholarship awardees because in many cases those officials faced difficulties once they had opportunities to enhance their capacities due to several strict personnel regulations.

³³ Interview with Dr. Eiji Oyamada, team leader of the PHRDP-III consultant, August 2007.

³⁴ The AusAID provides scholarship for several government officials the so called "targeted scholarship" based on the agency's evaluation in the public sector in Indonesia.

3.1.2 Redesigning Training Method

Apart from providing formal education opportunity for MOF officials, other important issue is how to upgrade the individual skills and capabilities from a regular training that can improve their daily job performance. The Finance Education Training Agency (FETA) is an MOF unit that performs in-service training function. In order to perform this function, the organizational structure of FETA is consist of Training and Education Center Units (Personnel, Budget, Taxation, Customs and Excise, and General Finance Affairs), College of State Accountancy, and Regional Training Centers. However, rigidity with the national training system regulations has hindered FETA's creativity and innovation in maintaining the quality of training programs, albeit there some efforts in recent years. Classic problem of lack of linkage between training and personnel planning (analysis of individual/institutional training need) still exists. Staffan Synnerstrom, ADB Governance Advisor for Indonesia, insisted that there are two things need to be introduced in reforming the training system.³⁵ One is that training should be demand-driven and related to the needs of the position. The other is that the market for training of civil servants needs to be opened up to allow for private training providers, leading to a situation where the state training centers (Pusdiklats), would have to compete with each other as well as with institutions outside the civil service.

In addition, FETA also encountered difficulties in supporting the ministry's on-going reform programs. In the case of modernization in DG of Taxes, where there were requirements of "Modern Tax System" trainings, in 2006, around 4.000 officials were placed in modern tax offices. Within next two years around 24.000 officials will be needing to be trained on modern tax systems, thus, FETA can not accommodate the scheme (Modernization Team, 2006). Therefore, DGT was forced to conduct in-house training in Directorate General of Taxes Headquarters and look for alternative solutions. With assistance from AusAID (Indonesia-Australia Specialized Training Project/IASSTP), one initiative had been taken by DGT through implementing Training of Trainer (TOT) approach in particular subjects: service delivery, code of conduct and law enforcement. Moreover, the method being used was Adult Learning Principles where the training requires more involvement from participants so that the training becomes more fun and interesting. Unlike previous training method, the modern tax

³⁵ The Jakarta Post, April 26, 2005.

system training included 50% hard skill and 50% soft skill learning material in order to upgrade officials' capacity. The new method of TOT further had been implemented vertically to tax regional offices and tax offices nationwide. Some feedbacks from the participants show that the new training method had brought positive impacts on the perception towards the importance of training and their daily job. In short, redesigning training method had solved the problem of inadequate trainer staffs in FETA and gap between the rigid national training regulation/method and institutional training needs.

Another training improvement initiative is through e-learning activities. This method can save training cost by using online learning modules and available at anytime without gathering the participants into class. The leaning materials such as Standards Operating Procedures (SOP) were developed by DGT with the assistance from Technical Assistance Management Facilities (TAMF-Australia). JICA later on also assisted the DGT in building Taxation e-learning module.

In broader perspective, after a long period of capacity development at individual level being implemented, the government can manage to upgrade its human resource capacity to handle the development and reforms program. However, this study argues that the capacity building initiatives are so much dependent upon the availability of donors' assistance. It might be understood that human resource development requires large amount of investment and will take along period to gain the result. The government (including MOF) still hesitates to prioritize their policies on human resource investment due to the limited budget and relies on donor assistance. Meanwhile, other government agencies (e.g., Bank Indonesia) or state owned enterprises (BUMN such as Pertamina, etc.) can manage their own human resource development with their own budget and enjoy more flexibility to set up their programs in line with their own strategic human resource plan and organization's needs. The situation of the ministry in managing human resource development leads to the donors' supply-dependence and lack of human resources planning flexibility. The challenges ahead for the ministry are to put individual capacity development align with the human resource strategic plan and search for alternatives to gain ability to invest on human resource that might lead to a more effective management of human resource development.

3.2 Organization Level: International Best Practices

The second level of capacity development is related to the organization level of the MOF which had begun to be addressed intensively at the beginning of 2000s. This initiative attempts to support the impact of State Finance Laws Package and tax administration reform under IMF programs. Among many aspects of organizational reforms during this period, this study would like to focus on three major issues: organization restructuring (reorganization and modernization), improvement of MOF official incentives (remuneration system) and code of conduct/control mechanism.

3.2.1 Organization Restructuring

Basically from organization theory, the rationale of restructuring is that the structure of organizations can be designed to improve organizational effectiveness and efficiency. Turner and Hulme (1997: 107) explain that many of the strategies and techniques that comprise administrative reform can be classified as restructuring. Eliminating red tape, downsizing, decentralizing authority, and improving organizational responsiveness to clients are some of these restructuring devices. Thus, some scholars had offered organization restructuring models to identify differences and similarities of structural dimensions. For example, Hage and Finsterbusch (1987: 59-80) identify at least four basic organizational models in their work on improving bureaucratic performance in developing countries. The main point is they adopt a contingency perspective which argues that different organizational structures are required for different organizational contexts. Their arguments and findings have inspired this study to try to identify organization restructuring models within the Ministry of Finance which concludes generally these two models of organization restructuring being adopted by the ministry under reform label: “reorganization” and “modernization.”

The first ideas of reorganization are to re-define MOF tasks and functions to improve inter-units check and balance and to create more effective coordination among echelon 1 units and in line with “international fiscal management best practices.” Reorganization has intended to clarify the tasks and functions, improve check and balance (establishment of Directorate General of Budget and Treasury), separate policy regulator and operator (establishment of Fiscal Policy Agency) and task further specialization (establishment of Directorate General of Debt Management, Directorate General of State Assets and Directorate General of Fiscal Balance). This

study indicates that reorganization model has similarity to reform in the sense Max Weber's ideal type of bureaucracy in which to focus on separation of functions and tasks specialization to achieve effectiveness in public administration. This study also underlines reorganization within the ministry brought inevitably the impact on enlargement of MOF structure.³⁶ However, it is too early to determine whether the "larger structure" can be counter-productive as many New Public Management supporters had argued, or vice versa. However, the reorganization is an inevitable effort in every organization to adapt with the changing tasks and environment.

The second model of organization restructuring is modernization, which first was implemented in Directorate General of Taxation, started by establishing 2 pilot project units of Large Taxpayers Office (LTOs).

The concept of LTO (or in many literatures named as Large Taxpayer Unit/LTU) itself widely known as IMF endorsed program, initially began in Latin America 1970s (Argentina, Peru and Ecuador) spread to Africa (Kenya, Tanzania), Eastern Europe (Hungary, Latvia, Poland, Bulgaria and Russia) in 1990s and in South Asia (Sri Lanka, Pakistan). These countries had piloted administrative reforms in auditing, self-assessment, the functional organization of work, and taxpayer services. Some governments have directed their tax administrations to adopt a taxpayer service ethos, whilst insisting on innovative enforcement measures to boost compliance. Some developed countries in 1990s, such as Netherlands, Australia, New Zealand and USA also began to have reorganized administration around different size segments of taxpayers. Nevertheless, such initiative to comprehensively modernize tax administration remains an unfinished agenda in many developing countries with various outcomes and results, both positive and negative, and have been generated along with the implementation process (Gill, 2003: 11; McCarten, 2004: 28-29).

LTOs within the MOF were described as a total overhaul of organization by adopting new organization structures based on functions, not tax types, and combine all the tax types (e.g., income tax, value added tax, withholding tax, and land and building tax) and managed them into one service section where previously each of them was administered in different section. Then the LTO itself was built by combining three previously

³⁶ Interview with Ragil Kuncoro, MSc, Fiscal Policy Agency, July 2007. According to him, "The demand for creating special DG/ agency to conduct specific task in public financial management (e.g., state and debt management) is very strong, particularly from donors. Although it is against public sector reform theories (small government and lean structures), this condition seems unavoidable at the moment."

separated tax office functions (administrative, audit and land/building tax). All these combinations intended to simplify tax handling and bureaucracy. Taxpayers only need to pass one door in dealing with their taxation matters. On the other hand, the number of employment in modern tax office became smaller than total previous three tax offices. This means employment efficiency had occurred in the process of implementing the new structure.

Well-trained officials (through selection process), who act as account representatives, have been established within the Tax Office to provide one-stop tax service (e.g., information, tax related consultation, tax account and payment monitoring) for each taxpayer. In addition, office automation and e-government, such as e-registration, e-filing and e-tax return, also have been introduced. All these ideas are part of endeavors to achieve and increase customer (taxpayers) satisfaction. Overall structural and management reforms mentioned above had brought positive impact in organization performance. The ministry claimed that this new concept of “modern tax office” had increased 30-40% of tax revenue in each tax office.³⁷ In terms of taxpayers’ satisfaction, there is significant improvement showed by the result of independent surveys.³⁸ Following this success, Directorate General of Taxation had expanded the concept of modernization to be applied in all tax offices, which was done in 2008.

In the beginning of July 2007, the other revenue arms of the MOF, Directorate General of Customs and Excise launched the pilot of “Major Customs Office” in Tanjung Priok port in Jakarta, which processed around 70% of Indonesia’s exports and imports. These offices are similar in concept to the LTOs. They have more modern organizational structures and officials stationed at them will receive significantly higher salaries but be subject to much stronger discipline. The Director General has targeted to increase customs revenue around 200 billion Rupiah per month and to reduce “unofficial/informal payment” up to 25% every year in addition to offer more transparent and faster import/export handling process. Meanwhile, Directorate General of Treasury, which has 178 vertical offices called State Treasury Office (KPPN), also initiates to implement the modernization concept recently. The 18 offices of Modernized KPPN Pilot Project have been launched on September 4, 2007.³⁹ These offices claimed that better and

³⁷ Media Indonesia, January 29, 2006.

³⁸ For example, a survey by AC Nielsen in 2005 had shown that the quality of service and integrity were significantly increased.

³⁹ Kompas newspaper, September 4, 2007.

faster services to the government treasurers and government's project partners, and prohibit any kinds of bribes involved in the process. Again, efficiency becomes a priority. While previous offices consisted of 1.413 officials, the new structure only requires 591 officials to perform their tasks.

Modernization, as the second model of MOF organizational restructuring, has been the major program to reform bureaucratic structure and improve organizational capacity. It was believed that the modernization process brought more transparent structure, customer service-orientation, effective in terms of functions and efficient in terms of number of officials employed. Modernization becomes a main instrument for the ministry to give strong signal to the public about fundamental reform and later on considered as a pioneer for overall public sector (bureaucratic) reform in Indonesia.

3.2.2 Remuneration System

In many case studies about public administration reform, there are significant positive correlations between public sector remuneration systems and its performance as well as its integrity. Important lesson from successful countries in reforming bureaucracy is organization restructuring and working mechanism changes were not enough. They should be complemented with reforming remuneration system to formulate adequate income to ensure civil servants well-being and accelerate their productivity. It is not a secret that Indonesian civil service for many years has been claimed as underpaid due to low salary level compare to other developing countries and private sector counterparts. Quah (2006: 176) describes the monthly salaries of Indonesian civil servants usually last for only 10-12 days. Even though there are some studies that had argued about low salary issues as a root cause of civil servants' poor performance and corrupt practices (Filmer and Lindauer, 2001: 201), the government still considers remuneration system as one of the main factors of public sector reform agenda. However, limited national budget became a main constraint to implement remuneration system throughout public sectors at once.

Modernization process that started through the creation of LTOs as pilot project was not only an attempt to improve organization structure and public services, but also as first initiative to improve MOF remuneration system. It was described earlier that to improve Directorate General of Taxation's—a notably corrupt institution—performance and in combating fraud/corrupt practice, the ministry had to employ more vigorous “reward

and punishment” approach to ensure integrity improvement. Thus, the new allowance along with new code of conduct became important instrument to create a totally new generation tax officers within selected areas (modernized tax office).

The new remuneration in terms of new allowance, the so called “extra activity allowance” (*tunjangan kegiatan tambahan/TKT*), was introduced in first modernization pilot project of LTOs in 2002. The structure of the new allowance still adopts a mixed of ranks and positions as basis. The officers in lowest rank (IIa) received 2.6 million Rupiah per month or about US \$ 289 (1 US \$=Rp9.000) and the highest position (head of regional tax office/echelon II) received 16.6 million Rupiah or equivalent to US \$ 1,844. In 2007, the Director General of Taxes allowance was set to 20 millions Rupiah or about US \$ 2,222 (Minister of Finance Decree No. 164/KMK.03/2007). In sum, the increase range of those allowances varies from 300% to 500%. Later, similar new allowance approach was implemented in Customs Offices and State Treasury Offices Pilot Project.

Reform in remuneration system had brought significant improvement in officials’ motivation and integrity, although it is too early to generalize without any deep studies about the impact. But the results of independent surveys have shown positive results. As the massive modernization and reorganization process continue, the ministry began to shift its remuneration system concept: from corrupt practice prevention to performance-based approach. In 2007, the new allowance had been established in the form of “newly TKPKN”. The structure of new TKPKN was established based on Job grades (27 grades) and replacing other specific job allowances and previous “extra activity allowance” in selected modernization areas. Moreover, the range among each structural position depends on job grade, which is based on the new constructed job descriptions. It helps to reduce sense of uniform remuneration level based only on rank and seniority regardless of the job and responsibility of each official holds. The newly TKPKN also had correlation with official’s attendance and discipline (e.g., disciplinary sanction will affect in reduced allowance). In general, the new structure had introduced a closer meaning on performance based remuneration, although it remains quite simple.

However, after the modernization process being implemented to all tax offices in 2008, the positive link between remuneration improvement and performance becomes doubtful. Successful case in LTOs cannot be generalized into overall tax offices since the later offices do not strictly adopt staff selection process and close monitoring as the pilot project. Remu-

neration system needs to be analyzed more to provide incentives towards performance improvement, instead of based on equal treatment regardless of officer's tasks and responsibilities. The further efforts to match the remuneration with the real performance and to provide incentives towards best performer in the ministry are essential to improve the capacity of organization.

3.2.3 Code of Conduct and Control Mechanism

The overall punishment system in Indonesian bureaucracy is based on Government Regulation No. 30/1980 (PP 30/1980) on Civil Service Disciplinary Regulation. However, it is widely known that the ideal implementation of this regulation has been very difficult due to many reasons such as few standards on interpreting details of the PP 30/1980 misconducts in each organization, hesitancy culture of upper level officials and high degree of collusion inside organization to avoid strict punishment system implementation.

MOF had introduced Code of Conduct (COC)⁴⁰ approach to deal with those kinds of difficulties and tried to implement ideal punishment system within the ministry units. Furthermore, the COC establishment is intended to set a behavioral standard for each echelon 1 unit of MOF, and to clarify as well as simplify the punishment implementation process. COC contains official's obligations and prohibitions. There are COC committee (inside) and National Ombudsman Commission (outside) that monitor the COC implementation and also act as complain centre.

The first attempt to implement COC was in DG of Taxes modernization: Large Taxpayer Office (LTO) in 2002 then followed by other modern offices. It becomes such as "ritual" for selected officials to sign COC agreement before they can get the new allowances. Later, it was considered as successful then it became overall DG of Taxes COC. Some other echelon 1 (Directorate Generals) units within MOF also followed similar COC enactment. Based on interview,⁴¹ this study concludes that the successful factors of COC implementation are high integrity of those selected officials, office member's high commitment, shared common "feeling" that nobody wants to

⁴⁰ The term being used in Indonesian language is "Kode Etik" (Code of Ethics). However, due to its characteristic of having sanctions for punishing violation of the code, Kode Etik can be categorized as code of conduct (not ethics).

⁴¹ Interview with a small group of modern tax offices members in Jakarta, July 2007.

be the first victim or bad example of COC misconduct, and close monitoring from IMF. However, when the modernization program finally was implemented in all tax offices, the effectiveness of COC became doubtful because there were no further tight selections in official recruitment process and the DGT found it difficult to guide the enactment of COC in all tax offices.⁴²

Another MOF effort in increasing control mechanism was through reform within internal control unit or Inspectorate General (IG). IG is a common unit in overall Indonesian ministry/department that has main function to control all units within the ministry in performing their tasks and functions, while Supreme Audit Board (BPK) is the external control body.

History of IG as control mechanism has not been remarkable, especially during new order period where mostly IG within ministries was underperforming and overlooked while conducting its main duties. Worst, the audit units which suppose to find problems are a part of problem itself. The routine duty for auditing other units' performance has been a tool to gain personal income through selling audit findings. It is widely known that performance audit result or audit report draft can be negotiated and became a commodity for bribery. The phenomenon also has been happening in MOF. OECD had concluded that IG's regular audits have not managed to drive corruption down, especially corruption in tax, customs and budgeting agencies (ADB/OECD 2002: 1).

MOF started to improve IG performance by establishing a new division within IG named Investigation Unit (IU) or Inspektorat Bidang Investigasi (IBI). The basic idea was to create a new "respectable and clean internal control" unit. With assistance from IMF and World Bank, the ministry began to build this new unit through highly selective recruitment from existing officials. The examination process included background, audit skill, motivation (psycho test) and the most important point is integrity by using a lie detector during interviews. Those who selected as members of IBI have been also given new allowance to ensure they maintain integrity in performing their tasks.⁴³

The ambitious program to curb corruption within MOF also has core function as a complaint centre (through hotline/toll-free number and mail/email). Then, investigates any officials' misbehavior and misconduct reports and recommends disciplinary sanctions. Moreover, in February 2005 IBI had

⁴² Interview with staffs at Directorate of Internal Compliance and State Apparatus Transformation (KITSDA), DGT, October 2010.

⁴³ Interview with IG internal unit division members, August 2007.

organized agreement with Corruption Eradication Commission to create smooth coordination between institutions and cooperate in corruption case handling management. Within one year since its establishment, IBI had earned reputation as respectable investigation unit - even some regarded it as “frightening”- among officials within MOF.⁴⁴ In addition, the ratio of *proven cases* of misconduct per total cases being investigated were also categorized as very high, around 87% in 2005 and 91% in 2006. Based on these performance outcomes, the new role of IG Investigation Unit (IBI) has been offering more quality and effectiveness in audit process as well as overall control mechanism practices toward curbing corruptions within MOF.

In the internal echelon 1 unit, for example the Directorate General of Taxation (DGT) had established special unit of misconduct investigation under Directorate of Internal Compliance and State Apparatus Transformation (KITSDA). This unit investigates public complaints reported directly to the DGT and suggests proper sanction if there were proven. Furthermore, according to the new Law on General Tax Provisions and Procedures No. 28/2007 article 37C, the Ministry established Tax Supervisory Committee to supervise DGT duties.

Multilayered control mechanism had been implemented and contributed to lowering down official misconducts. However, several big corruption cases involving tax officials in 2008 and 2009 brought question towards the effectiveness of these control mechanisms in recent years. It takes more than incentives, strict regulations and control mechanism to curb corruption in the ministry because it was deeply rooted in the organization for many years. It also needs a strong leadership to change the old culture of unproductive, low-performance and low-integrity public official in Indonesia, and to be against to the politically corrupt environment.⁴⁵

Nevertheless, from these three aspects: organization restructuring, remuneration system improvement and code of conduct/control mechanism, the MOF had increased its organization capacity towards international best practice and then generated better performance and integrity, despite several corruption cases involving tax officials. In general, the government with donors support had been implementing continuously from the pilot project up to spreading to other areas of reforms. Later, the case of MOF organizational reform became the pioneer of overall Indonesian public administration

⁴⁴ Interview with one of DG Taxes staffs who used to be an object of IBI investigation in 2005, August 2007.

⁴⁵ Interview with Mr. Anwar Supriadi, Head of Tax Supervisory Committee, April 2011.

reforms that are still ongoing this time. One thing also must be underlined that even after the government decided to exit from IMF program in 2006, the MOF still pursues the reform processes and manages to introduce the second phase of modernization in tax administration in 2009.

3.3 System Level: From Economic Development to Good Governance Efforts

Donors intervention at the system level, unlike in other developing countries, perhaps largely can be regarded as successful in the history of Indonesian economic development. Prior to the 1980s, the government with the technical assistance support could build the foundation of economic development and turned unstable economic condition into steady economic growth. The donors worked closely with the senior economists within the ministry of finance in wide areas of economic policy formulation. Development Planning (REPELITA) for every 5 years, balance budget and fundamental macro level reform policies such as exchange rates, interest rates, domestic oil prices and price of agriculture/rice were introduced as guidance for Indonesian development agendas.

During 1980s, the system level intervention began to focus more on specific fiscal sector: the tax reform as a central issue. The overhaul of tax system in Indonesia was started in 1980, under the pressure of declining revenue from oil; the Minister of Finance initiated the comprehensive tax reform with technical assistance team (HIID) who formulated the tax laws draft in extreme confidential way to avoid adverse reaction (Asher, 1997: 137). However, it was noted also that at the beginning there is no significant support from senior tax officials (tax administrator) because they had little reason to produce changes since they already enjoyed financial prosperity compare to other civil servant (Gillis, 1989: 92). Within 3 years, the set of tax laws draft of General Tax Provisions and Procedures (Law No. 6/1983), Income Tax (Law No. 7/1983), and Value Added Tax on Goods and Services and Sales Tax on Luxury Goods (Law No 8/1983). Later, Land and Building Tax (Law No. 12/1985) and Stamp Duty (Law No. 13/1985) were enacted in 1985. Combining those simplified tax laws, the reform also addressed the new computerized system and reform of tax procedures. The Indonesian tax reform was widely considered as a successful case and the reform process continued for a decade (Jenkins *et al.*, 1997: 158).

In 2000s, under the IMF monitoring, the system level development began with the stipulation of state finance law package, the State Finance

Law (Law No. 17/ 2003) in March 2003, the State Treasury Law (Law No. 1/2004) and the State Audit Law (Law No. 15/2004). The Ministry of Finance clarified its role as fiscal policy maker, treasurer, revenue collection and asset manager and also the interrelationship with Supreme Audit Board (BPK), technical ministries and head of regional government (see appendix-2). Those laws started the era of state financial governance where check and balance mechanism had been built between state financial institutions to achieve good governance. Meanwhile, the masterpiece of Tax Laws 1983 and 1985 had been amended for the third time to adjust some tax bases and procedures, but the core of those laws remained as the foundation of tax regulations and tax administration up to date. Needless to say that the recent more democratic era has given more space of transparent policy formulations and vice versa; the people's demand for good governance has forced changes in the state capacity at system level.

Indonesia managed to come out of IMF programs in 2006; however, the demand for good governance remains high and the government faces serious challenges to implement further the reform particularly in the revenue raising arms,⁴⁶ the Ministry of Finance (Directorate General of Taxation/DGT). Following the first phase of tax administration reform which largely involved in organizational level as discussed before, the DGT launches the second phase of tax administration reform with the assistance of World Bank under the Project for Indonesian Tax Administration Reform (PINTAR) in 2009. In contrast with the tax reform in 1980s with secret preparation and low support from senior tax officials, the second phase of tax administration relatively can be seen as DGT decision makers' intention to signal the public that DGT will continue the previous tax administration reform and improve the governance system.

The purposes of six years PINTAR program are: a) to increase taxpayer compliance by increasing the administration effectiveness and efficiency, and b) to improve good governance in tax administration by strengthening transparency and accountability mechanisms. The project consists of four components: 1) increasing the efficiency of taxpayer data collection and management, 2) human resource management and development, 3) strengthening compliance management operations, and 4) change management. The main feature is also introducing information and communication technology infrastructure to support DGT administrative operations.

⁴⁶ For example, the national headline cases of corruption involving middle and high ranking tax officials have prevailed in 2008 and 2009.

Good governance and capacity building are also labeled in the project to mark the government's high intention to improve the tax administration by adopting information and communication technology systems.

This study indicates that the state capacity at the system level has been developed and evolved during long period of technical assistance. Comparing to previous years of assistance, the Ministry of Finance along with related ministry nowadays can build their capacity to formulate macro economic policies. Thus, recently, technical assistance has moved towards more specific areas of intervention at specific sector or micro level of institution, and shifted towards the used of information and communication technology infrastructure.

Despite the achievements of MOF in developing capacity at system, organization, and human resource, this study argues that the ultimate goal of good governance practice in this public institution is still far from satisfaction as indicated by big cases of corruption within the ministry in recent years and low public opinion on the institution's integrity. Fundamental change in MOF requires a changing attitude of overall leaders and staffs which cannot only rely on technical assistance but rather should be started from internal initiatives. The next section will propose alternative perspectives on how the capacity development efforts should be complemented by the role of leadership and organizational culture change aspects towards good governance practice.

4. BEYOND CAPACITY DEVELOPMENT INITIATIVES: THE NEED FOR ATTITUDE-CENTERED REFORM

4.1 The Role of Leadership

In recent years, some scholars began to integrate leadership with the reform in developing countries. Wallis *et al.* (2007) argued the failure of the New Public Management and other model of public administration reforms in the world, to some extent, due to neglecting the importance of leadership in the process. Furthermore, Wallis *et al.* (2007: 4) defines the leadership theory as the "missing link" of the public sector reform theory. Andrews *et al.* (2010), in the World Bank recent study on "Development as Leadership-led change", released the new approach to address development and found out the importance of "change space" provided by leadership to enhance public sector reform effectiveness. Given the various definitions on leader-

ship theory, this study will highlight one term of leadership as “the process of influencing others to understand and agree about what needs to be done and how to do it, and the process of facilitating individual and collective efforts to accomplished shared objectives” (Yukl, 2010: 8).⁴⁷ Leadership is the important factor to ensure the successful capacity development initiatives, and this factor is mostly out of range of the donors’ technical assistance. Lopes and Theisohn (2003: 1) argued that capacity development is grounded in ownership, guided by leadership, and informed by confidence and self-esteem. Ownership of the reform is another factor that can build the sustainable capacity development process.

Given the fact described in the previous sections, capacity development in MOF under technical assistance had been introducing reforms in three levels: individual, organization, and system. There are significant improvements in terms of achieving economic stability, revenue targets or other organization performance indicators, but in achieving good governance practice, MOF is still far from people’s expectation under the current bureaucratic reform process. This study observes more on MOF leaders’ attitude towards the reform process in terms of leadership and ownership, especially in DGT.

Prior to the 1980s, the leadership in tax agency was believed to be very weak and combined with “tax compromise” where tax officials and taxpayers were both engaged in win-win solution in tax matters at the cost of the state. “The superior and no less than the subordinate generally are reluctant to enter possible conflict situations. He gives his orders and rarely attempts to intervene or to closely supervise their implementation. This pattern of behavior reciprocally gives subordinates their own measure of freedom from possible overt conflict” (Smith in Lerche, 1980: 48). Avoiding conflict culture and choosing large discretions were the source of pervasive bribery and extortion in the era of complicated and unenforceable Dutch tax statute-based laws.

⁴⁷ Sociologists rather look at the linkage between leadership and its functions to define it, for example: the unique and essential function of leadership is the manipulation of (organizational) culture (Schein, 1985: 317) and the task of building special values and a distinctive competence into the organization is a prime function of leadership (Selznick, 1983: 27). Other scholars made clear distinction between manager and leadership (Kotter, 1990, 1996 in Nahavandi, 2007: 10; Yukl, 2010: 7), manager’s role is to bring order, predictability and consistency through planning, budgeting and controlling while leadership, on the other hand, is aimed at producing organization change.

A comprehensive tax law reform in 1983 was initiated by the Minister of Finance and HIID team. The tax administrator leaders were not properly consulted and being left out in the process of the tax reform. Furthermore, Heij (2001: 243) described that the tax officials fought the proposed law since the approach was rather top-down from the MOF. Only after the fact that after the government financial collapse in 1983, the HIID team can get some acceptance. From this point of view, this study argues that the ownership of the tax reform was not on the tax administrators' hand. Gillis (1985: 9) later argued that "the reform was well prepared and prospect of the reform much depends upon the readiness of middle level tax official to break with well embedded traditions, such as liabilities assessment by tax officials (rather than taxpayers) and allowing to exercise official discretion in tax administration." Then, if the reform is foundered, it will be largely because of the failure to reduce the scope of rent seeking in the tax administration itself (Ibid: 10). Unfortunately, leadership, especially at the middle level, to accommodate fundamental changes towards good governance practice was not fully available at that time. Various kinds of bribery and extortion still existed in the tax administration even after two decades since the comprehensive reform began in early 1980s. There was hope in mid of 1990s when Mr. Mar'ie Muhammad acted as Director General of Taxation. However, the man who was widely known as "Mr. Clean" eventually could not cope with the rampant corruption in his office and outside corrupted political environment. Not much change happened in the traditional practice of tax officials as it was more than ten years ago. Scattered reforms were introduced to enhance the officials' integrity but the tax official themselves did not feel the ownership of the reform programs and only became slogans.

In the early 2000s, comprehensive tax administration reform was implemented with the IMF assistance and introduced good governance as the main theme. However, the DGT leaders at that time were like having two agendas in their hand. They supported the pilot project of modern tax office because it was a top-down decision from IMF and government. Meanwhile, they also maintained the old practice and corrupted rule of the game. The only difference was that the practice was not openly discussed, but everyone inside the organization knew that. Therefore, the tax office modernization was also called "silent revolution," because the top leader never clearly stated the reform programs in public sphere and there was a high possibility that the reform might not succeed and overcome the high pressure of well-established corrupt behavior between tax official and taxpayers. Siregar (2005) argued that bribery and extortion were noted still existing and more

structural basis, involving each level of officials in tax office. The LTO pilot project was regarded as successful in improving integrity but outside the pilot project, “the business still as usual” (Rizal, 2006).

Later, the minister of Finance, Mrs. Sri Mulyani, sent a stronger signal to fight against corruption in the ministry. She replaced the DGT top leader and the new appointed Director General, Dr. Darmin Nasution who was coming from outside DGT, carefully continue the modernization program and tried to impose integrity in the way DGT business process. The tax administration reform gained momentum with the support from its leaders and the sense of ownership of the reform began to spread in almost all officers in DGT. In early 2009, the Director General himself announced the second phase of Modernization with assistance from World Bank under PINTAR project.

However, several cases of corruption involving low and middle tax officials in 2010 (Gayus Tambunan and Bahasyim cases) appeared in headline news.⁴⁸ This has brought public attention on the effectiveness of the reform program. The DGT leaders reacted fast to overcome these issues, punished all the related officials and, at the same time, showed to other officials that corrupted practice will not be tolerated nowadays. Even though the public opinion was built upon those corruption cases but the reform must go on for the sake of overall public service in Indonesia. This study argues the effectiveness of the reform depends upon the commitment and ownership of the reform program that can determine the sustainable of capacity development and create fundamental changes. Moreover, this study also supports Gillis (1985) argument that the success in tax administration reform lies on the readiness of middle level officials to change their ways towards good governance practice. However, the leaders who really can lead to change the DGT are scarce and most of the top level officials perceived as having “dark side” of corrupt behaviours in the past. Former Custom Director General and currently the Head of Taxation Supervisory Committee, Mr. Anwar Supriadi, argued that DGT is lacking of leadership figure, which can guide the reform process into fundamental changes. Since the reform process was implemented in many areas but the attitude of tax officials has not changed much, he believed that the key element is leadership. Leadership can be enhanced through training, but if it is not working then the higher authority should immediately find the replacement.⁴⁹ The

⁴⁸ The Jakarta Post, March 31 2010.

⁴⁹ Interview with Mr. Anwar Supriadi, Head of Tax Supervisory Committee, April 2011.

leaders' selection criteria are also another thing need to be considered since the promotion in DGT and MOF still bound with the overall civil service regulation which still emphasizes on rank and seniority rather than capability and integrity. Leaders have the obligation to change subordinate's attitudes and create changing space for organizational culture based on performance and integrity. Therefore, it is crucial for capacity development initiative to take leadership as the key ingredient to determine good governance practice in the MOF reform process.

4.2 Managing Organizational Culture Changes

Bureaucracy in Indonesia is characterized by the culture of poor performance and corruption. Nowadays, democratic reforms have made those characteristics no longer acceptable and have increased the demands for transparency, accountability, better performance and professionalism in public sector. Fundamental reforms in public administration are urgently needed as a prerequisite to achieve good governance practices. MOF has been starting to implement extensive reforms that cover three levels as previously mentioned.

MOF was known as one of the most corrupt institution, therefore it became a starting point of bureaucratic reform, especially in tax and custom agency. As explained in the previous section, the extensive reform in tax agency has started since 1980s and, yet, the reform depended critically upon the readiness of tax officials to change their ways. Within 5 years after the reform began, there was little evidence of any significant change for better tax administration (Bird, 1991: 41; Gillis, 1989, 1990; Jenkins, 1989). Even in the late 1990s, it was still a common practice to make additional payment to tax officials to reduce the tax payable (Heij, 2001: 250). This concludes that almost two decades after the tax reform implemented, the tax administrators remain to keep the "traditional business" and only adapt into the new form of tax structure. Many scholars noticed about this and concluded that the problem of corruption was deeply rooted and suggested the low level of wages was the source of problem (Quah, 2006).

Tax office modernization program implemented in 2002 was a starting point to overhaul old organizational culture of bribery and extortion, as well as poor performance of tax officials. However, this study argues that the increase in remuneration has not been directly correlated with improvement of performance, especially after the modernization being up scaled into all tax office in Indonesia. The pilot project of LTO can be seen as successful

case but in other offices outside the pilot project, the better performance and integrity remained questionable (Siregar, 2005; Rizal, 2006). The DGT headquarters also find it difficult to monitor the code of conduct (COC) implementation in 331 tax office in all over Indonesia. Of course the spirit of reform had been introduced to all tax officials, and the misconduct behaviours will not be tolerated anymore. More than just close monitoring, creating new organizational culture as pattern of beliefs, values or social guidance can be effective for fostering integrity among tax officials. Therefore, the DGT initiated to instill the new organizational culture in the form of new organization value.

Organizational culture definitions from scholars' point of view are various. Schein (1985) defines it as "a pattern of basic assumptions — invented, discovered, or developed by a given group as it learns to cope with its problems of external adaptation an internal integration— that has worked well enough to be considered valid and, therefore, to be taught to the new members as the correct way to perceive, think and feel in relation to those problems". Rohdewold (1995: 111) argued the set of values, attitudes, norms, shared beliefs and mental orientations that shape and determine the behaviours and expectations of the members of that organization. Organizational culture is abstract form of rule of the game inside organization that determines successful overall performance and distinguishes it from other organizations. Hence, organization culture is more important than structures for remuneration and control as a determinant of organization performance (Grindle, 1997: 33).

In 2009, DGT had declared the new organizational value which can be described into 4 values: "Professionalism" , "Integrity" , "Teamwork" and "Innovation". This is the first attempt of public institution in Indonesia to introduce a set of organizational values to employees and external stakeholders. In 2010, internalization processes of new organization values to all tax officials were conducted massively with the help from a management consultant.⁵⁰ When there were several news-headlined of corruption cases, introducing the new values had also became tools to give signal to public that DGT still maintains the reform momentum and raises the low-motivated official caused by the public negative judgments. However, organizational values theoretically should be the basic assumption and beliefs of organi-

⁵⁰ Interview with staffs at Directorate of Internal Compliance and State Apparatus Transformation (KITSDA), DGT, October 2010.

zation members, so far just became public image enhancing and ceremonial or ritual tools.⁵¹

Setting up new organizational culture was largely successful in private sectors and state-owned enterprises in Indonesia (e.g., Panasonic Indonesia Mfg., Garuda Indonesia). Based on interview among staffs of those companies,⁵² the leaders (founders or CEO) had significant role of translating corporate values from their philosophical view into their strategic plan and business activities. To set the corporate value as whole organization member beliefs, continuous training programs are essential to gain officer awareness. More than ritual base, organizational value should be the anchor to direction of organization in performing its duties. The DGT should analyze deeper about organization culture changes, particularly in accordance with the good governance practice. Another point of view is that an organization like DGT must review its organization culture as a business process where tax law enforcement and service are DGT core business. Quality assurance of core business should be relied on organization values as the centre of evaluation.⁵³ Good governance will be only normative word unless both leaders and officials realized and changed their mindset that the new organization culture should be managed properly in their daily activities instead of rituals or image enhancing agendas. Ideal organizational culture and value will induce motivation and pride among organization members. A sad fact is the reform in DGT somehow has lowering down the motivation among some officials. The previous (corrupt) culture could motivate officials to perform harder and, eventually, get acknowledgement (pride) from their supervisor as well as additional (illegal) income. In reform era, when incentive and working standard have been well established, officials tend to perform merely to meet standard and try not to involve corrupt activity, without any harder efforts or initiatives. Less motivation has been observed and need to be addressed immediately.⁵⁴ Yet, there are still possibilities if the new culture based on performance and integrity might be overcome by those who are against and resist the changes.

⁵¹ Interview with tax officials in Jakarta, West Java and Bali, April 2011.

⁵² Interview with Mr. Norman Parmanto, Human Resources Manager, Panasonic Manufacturing Indonesia, October 2010 and Ms. Diah, Public Relation Officer, Garuda Indonesia, April 2011.

⁵³ Interview with Mr. Wahyu Tumakaka, Directorate of Internal Compliance and State Apparatus Transformation (KITSDA), DGT, April 2011.

⁵⁴ Interview with Mr. Ferliandi, Human Resource Division, DGT, April 2011.

This study argues that along with the capacity development initiatives, MOF should put more effort to manage new organizational culture and implement it as the basic value in organization business process. MOF leaders are the prime actors to guide the new culture into practice by acting as leading example. Experience shows that it might take years to fundamentally change the organizational culture especially in public sector; however it would be better if MOF start to enter the learning process earlier with all the support MOF has currently.

5. CONCLUDING REMARKS

A vigorous overseas training through PHRDP programs continue to ensure qualified MOF managerial skills supply. The rise of Japanese universities graduates has been a phenomenon in recent years. Nevertheless, this study concludes that the absence of organizational training need analysis has minimized specialty establishment in more specific area. Language barrier might be another problem for candidates to select specific area of study in Japan. In broader view, the government still need to put individual capacity development align with the human resource strategic plan and search for alternatives to gain ability to invest on human resource that might lead to a more effective management of human resource development.

The organization level capacity development featuring organization restructuring model in terms of reorganization and modernization has brought significant impact in organization performance. However, the organization restructuring will still be a part of on-going reform process and the ministry needs to adapt to the changing environment/system level. Improvement of officials' remuneration system largely can increase the integrity especially in pilot project offices, but still doubtful to increase the overall officials performance. The further initiative is needed to match between remuneration and performance, and also provides incentives to best performer in organization.

From the system level, the capacity development has evolved as a response of national development agendas over a period of time. Long history of technical assistance provides some lessons to improve the capacity to analyze the needs of system reforms, from the basic economic development to the good governance initiatives.

In general, within the capacity development framework, this study concludes that initiative to enhance state capacities with donors' technical

assistance in the Ministry of Finance case has been involving in all three dimensions: system, organization and individual level, as a holistic approach. The key point of human resource development can manage to reduce the donors' dependency on formulating development policies in recent years. Developing organization level capacity which has been intensively pursued since 2000s to support policy changes has shown positive signal and became the lesson to improve other public sectors in Indonesia. At the system level, comparing to previously long term wide areas of macro economic policies intervention, the development system capacity has shifting to more short term and specific area/micro level of intervention (tax administration) including advanced information communication technology (ICT) technical assistance.

This study argues that the capacity development process has not put enough effort in changing the attitude of MOF officials; therefore, examining leadership and organizational culture change are important to ensure reform process towards good governance practice. There are significant changes in leadership commitment and ownership of the MOF reform in recent years. However, further initiatives to develop leadership in the organization are still urgently needed. Similar case on organizational culture has been changed gradually, but the reform still requires serious effort to change the attitude and mindset towards good governance practice. Good governance is still far from ideal form, but the MOF should put more efforts with all the support and resources it has. After a long period of various technical assistance, the state capacity is largely developed; however, the final objective of good governance practice remains as the main objective and an unfinished business in the current ongoing capacity development.

There is a need for further study to confirm the findings of the study and to provide a more comprehensive analysis on the capacity development matter.

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APPENDIX-1

Size and structure of MOF human resources (1996, 2001, 2006)

| | 1996 | | 2001 | | 2006 | |
|--------------------|--------|-------|--------|-------|--------|-------|
| | Number | % | Number | % | Number | % |
| Total number | 45.564 | 100 | 54.794 | 100 | 62.738 | 100 |
| Gender | | | | | | |
| a. Male | 35.699 | 78.35 | 42.918 | 78.33 | 49.458 | 78.83 |
| b. Female | 9.865 | 21.65 | 11.876 | 21.67 | 13.280 | 21.17 |
| Kind of Position | | | | | | |
| - Structural | 43.582 | 95.65 | 52.296 | 95.44 | 59.316 | 94.55 |
| - Functional | 1.344 | 2.95 | 2.475 | 4.52 | 3.409 | 5.43 |
| Education | | | | | | |
| - Primary School | 1.583 | 3.47 | 1.326 | 2.42 | 1.118 | 1.78 |
| - Secondary School | 2.627 | 5.77 | 2.384 | 4.35 | 2.009 | 3.20 |
| - High School | 24.473 | 53.71 | 25.655 | 46.82 | 27.327 | 43.56 |
| - Bachelor (D3) | 7.418 | 16.28 | 10.021 | 18.29 | 10.402 | 16.58 |
| - Diploma (S1) | 8.719 | 19.14 | 13.737 | 25.07 | 17.581 | 28.02 |
| - Master (S2) | 592 | 1.30 | 1.607 | 2.93 | 4.184 | 6.67 |
| - PhD (S3) | 34 | 0.07 | 43 | 0.08 | 59 | 0.09 |

Source: Source: Human Resource Bureau Secretariat General MOF, personal request

APPENDIX-2

State Finance Law package and Principles

| Laws | Major Principles |
|--------------------|--|
| State Finance Law | <ul style="list-style-type: none"> - Distribution of power between the executive and legislative branches and among levels of Government on State Finances - The financial relations between the government and the central bank - The financial relations between the government and state owned enterprises - The limitation of activities funded through extra-budgetary funds - The planning and budgeting process - The role of the Parliament in the budget process - The authorization for urgent and unforeseen expenditures - The budget structure and expenditures classifications - The role of MOF and line ministers in public expenditure management - The government accountability on state financial management |
| State Treasury Law | <ul style="list-style-type: none"> - Replace the Dutch Law “ICW” (Indische Comptabiliteitswet) enacted in 1925 and other President Decrees - Clearly puts MOF in charge of managing the budget - Clearly states the principle of single consolidated fund, thereby eliminating extra budgetary fund - Budget allocation and allotment process - Payment and accounting system - Cash management and financial planning - Debt management - Government procurement and property management - internal control system, penalty and sanction and settlement of government financial loses |
| State Audit Law | <ul style="list-style-type: none"> - Replace Dutch regulation “IAR” (Instructie en verdere bepalingen voor de Algemeene Rekenkamer) - Task and Scope of audit conducted by BPK - Audit procedures as adapted from US Government Accountability Office (GAO) standards |

Source: Financial Management Reform Committee Ministry of Finance, 2001.