

**The Institutional Underpinnings of Fiscal Contracts in Indonesia:  
The Case of Surabaya**

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Decentralization, especially fiscal decentralization, in developing countries has highlighted the importance of understanding the political bases of taxation capacity. Of the major contending approaches, the assumption that successful revenue collection involves “quasi-voluntary compliance” by taxpayers, especially the private sector, seems the most useful. Yet, even this framework requires greater specification of the conditions under which taxpayers will give their “contingent consent”. This paper goes beyond the existing emphasis on legislative representation to explore the importance of private sector associations. It does so by presenting a case study of Surabaya, Indonesia, where the local government has significantly expanded its taxation capacity in recent years.

Why did Surabaya collect property taxes more successfully than many of its counterparts in Indonesia? I argue that a strong business association—Real Estate Indonesia (REI), which represents property developers—enabled the city to increase revenues in the service of an

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<sup>2</sup> Comments enthusiastically welcomed, but please do not cite or circulate without permission.

enormous push to expand infrastructure in the city, especially for road transportation. Local businesses drive increases in property taxation to enable cities to spend on infrastructure, but only if they can resolve two political problems that commonly bedevil taxation. Businesses must reach a distributional consensus, and they must forestall local officials from diverting new revenues away from business-friendly projects. It takes strong and influential business associations to resolve these problems.

I present the argument in three steps. First, I briefly detail Surabaya's recent fiscal achievements. Second, I argue that alternative hypotheses, derived from the literature on the political economy of taxation in democracies, cannot explain these changes. Third, I detail the public role of local businesses—especially property developers—in Surabaya to show that the strength and cohesiveness of a local business association explains tax policy better than the alternative explanations.

An explanation for the source of Surabaya's tax capacity will have implications that extend beyond the city and inform larger debates about the effects of decentralization on local development. Indonesia's decentralization program is well-designed and thorough-going, making it one of the most fiscally decentralized countries in the developing world (World Bank 2005). It is one of only two stable democracies in Southeast Asia (with the Philippines), and its current arrangements build on historical traditions of decentralized, consultative decision-making naturally suited to archipelagic societies. Yet despite these apparent advantages, the efficiency of taxation varies widely from town to town, demonstrating the limits of scholarly understanding of the effects of decentralization. My argument—that variation in the strength of local business associations explain why similar local governments enact different tax policies—not only accounts for this variation, but it also poses a partial explanation for geographically uneven

development. Local governments that increase property taxes at the expense of other sources of revenue will achieve faster economic growth through more efficient economies, less economic inequality and better capacity to finance public goods.

### **THE ARGUMENT IN CONTEXT**

Cities in the developing world must overcome obstacles to taxation in order to cultivate stable, efficient sources of revenue that can finance much-needed infrastructure and other public goods. The property tax is the most economically efficient local tax according to literature on public finance, yet many local governments neglect it because it is politically unpopular and administratively challenging (Bird 2010, Rosengard 1998). While the public finance literature recognizes such political challenges, it does not explain why some city governments have the “political will” to overcome them, but most do not.

There are three broad approaches to this puzzle in the literature on the political economy of taxation in democracies. The first views tax policy as the outcome of class conflict (Meltzer and Richard 1981). Elections empower the poor to demand higher taxes and redistribution, while the rich resist through capital flight (Bates and Lien 1985), repression (Boix 2003), or lobbying (Frieden 1991). Scholars working in this tradition have suggested that competitive elections (Careaga and Weingast 2003) and politically weak business sectors (Fairfield 2015) are keys to collection of efficient, progressive taxes such as the property tax.

However, the class conflict framework fits poorly in the context of local electoral politics in the Indonesia. First, local governments typically do not redistribute directly. They provide services that benefit both rich and poor, such as policing, roads, sanitation, education and health, so local elections should be less class-based than national ones. Second, Indonesian elections are often characterized by “political market imperfections” (Keefer and Khemani 2005). Voters are

not sure what incumbents achieved in office, and do not believe candidates' promises, so elections do not aggregate broad demand for policy. Instead, elections are contested on the basis of patronage and handouts, thereby empowering elites who have resources to influence the outcome of elections (Aspinall and Mada 2016).

The second approach, which views tax policy as a source of patronage, is more in keeping with the Indonesia's well-established reputation for distributive politics. For example, Scott (1972) hypothesized that competitive national elections would reduce tax revenues, because officials would overlook tax obligations in exchange for political support. This effect is likely to be exaggerated at the local level because local officials can substitute central transfers and presidential patronage for locally generated revenue, thus freeing themselves from the yoke of balanced budgets (Rodden 2002). By the same token, uncompetitive elections should allow powerful incumbents to extract higher taxes without jeopardizing their positions, a proposition for which Rogers (2014) finds evidence among Argentine provinces.

While the patronage approach recognizes Indonesia's many "political market imperfections", it has difficulty explaining cases of successful tax reform. Scott shows how officials exploit the state's fiscal power as a political weapon, but does not explain why they might attempt to increase taxes broadly and equitably. Furthermore, the very incentives that tempt officials to politicize tax policy undermine the state's capacity to administer taxes by sowing suspicion and provoking resistance. As a result, easy taxes, like user fees, are probably more susceptible to patronage manipulation than property taxes, which are more politically controversial and administratively demanding.

The third approach, finally, assumes that citizens' willingness to pay taxes depends on the terms of a "fiscal contract" under which taxpayers agree to taxes in exchange for useful

public services (Lieberman 2002, Timmons 2005). For example, studies on national political economies of taxation have proposed that economic elites submit to taxation in exchange for political representation (Ross 2004), security (Slater 2010), or racial privilege (Lieberman 2003). At the local level, fiscal capacity in America's colonies coalesced where participatory democracy compelled "officials to negotiate with their constituents about the details of sophisticated policy regimes" (Einhorn 2009: 171). This approach is especially useful in the context of Indonesia, because many local governments cannot even assess tax obligations accurately, much less compel citizens to pay. Under these conditions, the "quasi-voluntary compliance" of wealthy citizens is a necessary condition to enable local governments to emphasize efficient, progressive sources of revenue like the property tax (Levi 1981).

Yet, this literature is vague with respect to the political institutions that underpin fiscal contracts. Studies that focus on distributional conflict explain taxpayer consent by pointing to the power of "social solidarity" (Feldman and Slemrod 2009), the extent of "moral obligation" (Lieberman 2009), and public standards of "tax fairness" (Scheve and Stasavage 2016). Meanwhile, studies that focus on the threat of opportunistic behavior by public officials submit that parliaments (North and Weingast 1989), independent bureaucracies (Weingast 1990), political parties and labor unions (Timmons 2010) generate credibility by protecting their constituents from predatory states. However, these arguments fail to specify how variation in the character of an institution modifies its effect on fiscal capacity, partly because they consider distributional conflict and the threat of opportunism separately. As a result, they struggle to explain subnational variation.

I address this gap by contending that strong, encompassing business associations provide the institutional underpinnings for successful fiscal contracts. Businesses are a key group of

taxpayers, and their associations, as economic institutions, shape their incentives to pay taxes.

Incorporating the effects of variation among business associations within a fiscal contracts framework generates more nuanced hypotheses about the conditions under which businesses are willing to pay taxes.

Specifically, business associations vary along three key dimensions, according to Schneider (2004). In contrast to narrowly organized sectoral organizations, *encompassing associations* represent a broad variety of firms across multiple industries. *Cohesive associations* have sufficient organizational strength, deriving from “material resources and internal intermediation”, to mediate among competing interests and influence member firms’ behavior. Finally, *connected associations* have privileged access to policy-makers through regular, but not necessarily formal, consultation mechanisms.

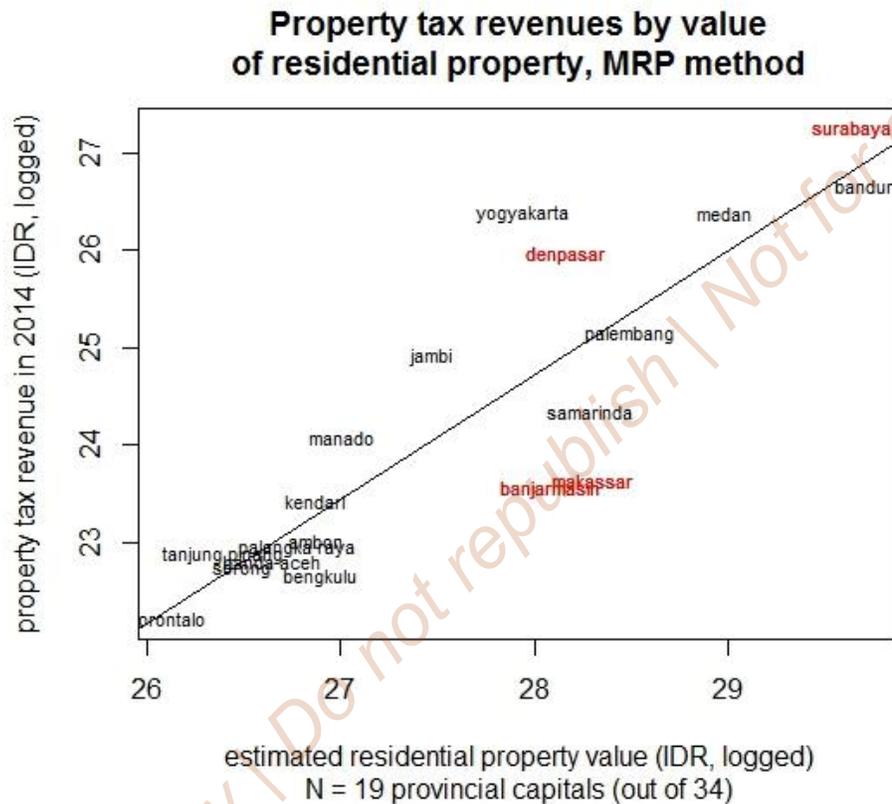
Business associations that are encompassing, cohesive, and connected can be well-suited to resolve two key political problems that hinder taxation. First, they provide a forum in which businesses can mitigate distributional conflict by negotiating trade-offs, and second, they create mechanisms to monitor public spending through consultation with officials. When local business associations organize consensus and restrain opportunism, they encourage tax compliance by lending credibility to official promises about the benefits of taxation.

## **BACKGROUND**

In 2009, the Indonesian government decentralized authority over property taxes to cities and districts, significantly expanding the fiscal powers of local governments. The property tax, according to public finance experts, constitutes a substantial source of untapped revenue in the developing world, especially in urban areas. Thus, the legislation had the potential to endow local governments, especially cities, with greater fiscal autonomy and to equip them to invest

more aggressively in infrastructure and development. Yet, not all local governments embraced their new powers. While some cities aggressively raised rates and enforced compliance, others hesitated, seemingly indifferent to the opportunity to increase revenue.

**Figure 1**



Source: Tax revenue from DJPK, Ministry of Finance; property values estimated by author.

Figure 1 illustrates this variation with data from 19 provincial capital cities. Provincial capitals, out of all local governments, are best positioned to benefit from the decentralization of the property tax. Property in capital cities is more valuable and easier to assess than in smaller cities and outlying districts, so it can yield higher revenues at lower costs. Yet, even these major cities vary, as the figure shows. The y-axis shows property tax revenues for the year 2014, as reported by the Directorate General for Fiscal Balance, Ministry of Finance. (Fifteen provincial capitals are missing from the figure because they were not included in the Ministry's data.) The

x-axis presents my estimates of the total value of residential property in each city, which I calculated by combining data from the 2010 census and online property classifieds.<sup>3</sup> The best-fit line represents expected tax revenues for a given value of residential property. In the figure, six cities, including Surabaya and Denpasar, have revenues significantly higher than expected, while four cities, including Banjarmasin and Makassar, have seemingly neglected the revenue potential of the tax.

## **SURABAYA**

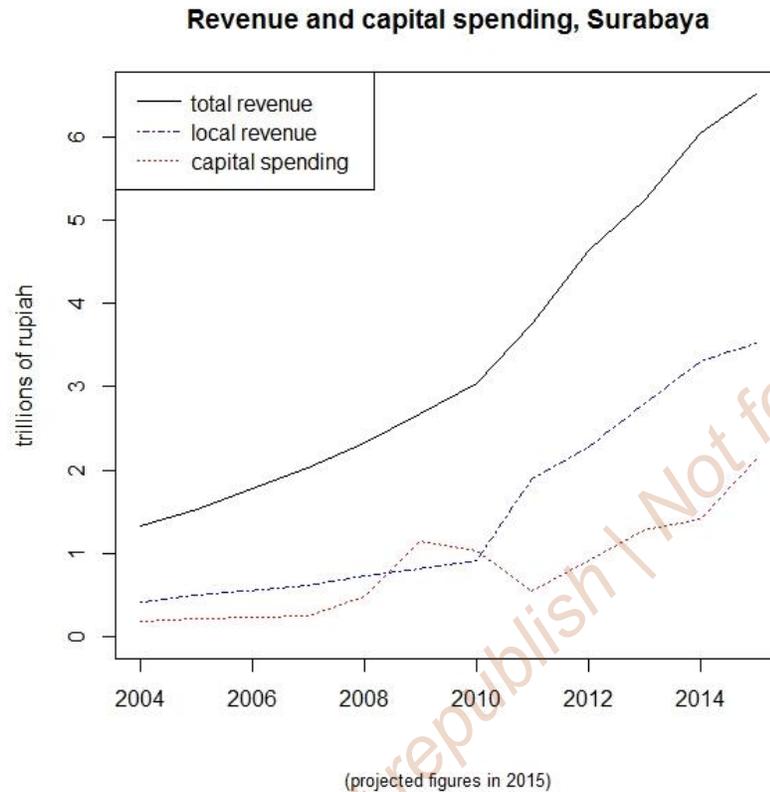
Perhaps no city has benefited from the decentralization of the property tax more than Surabaya, Indonesia's second largest city. The city budget quickly doubled after the change, from 3 trillion rupiah in 2010 to 6 trillion rupiah (USD 500 million) in 2014 (Figure 2). Locally generated revenues accounted for the entire difference, while central government transfers remained constant. The most important new sources of revenue were the property tax and the property transactions tax, which contributed a combined 1.5 trillion rupiah, or half of the total increase.

More tellingly, property tax revenue increased significantly after Surabaya took over administration of the tax from the Ministry of Finance. In 2011, Surabaya relied on property valuations and tax records that it inherited from the central government to collect just under 500 billion rupiah (USD 60 million). By 2015, Surabaya had increased property tax revenue to 830 billion rupiah. In so doing, Surabaya exemplified a best-case scenario for public finance experts as a local government that outperformed the central government in administering the property tax because the revenue potential is much higher as a share of the local budget.

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<sup>3</sup> However, note that these estimates do not include commercial property, the value of which varies across cities.

Figure 2



Source: DJPK, Ministry of Finance

Surabaya's revenue growth was accompanied by an increase in capital spending that was nearly as dramatic. Spending on capital investments, such as land acquisition, machinery procurement, and construction projects, doubled to 2.1 trillion rupiah (USD 160 million) between 2010 and 2015 (Figure 2). In particular, the city began to execute major infrastructure projects that had been years, even decades, in planning. The largest projects were the Kenjeran Bridge, the expansion of Ahmad Yani Street, the construction of western and eastern bypass roads<sup>4</sup>, the diversion underground of the Banyu Urip irrigation channel, and the redesign of the Satellite Highway Interchange. The primary effect of these projects was to improve traffic flow

<sup>4</sup> In Indonesian, Jalan Lingkar Luar Barat and Timur, or JLLB and JLLT.

on the western, southern and eastern margins of Surabaya—where multi-million dollar mixed-use developments are reshaping the city.

Mayor Tri Rismaharini, or Bu Risma as she is popularly known, oversaw all of these changes, and has become one of the most popular mayors in Indonesia. In 2015, she was reelected to her second five year term with 86% of the vote.

In sum, Surabaya approximates the ideal success story for fiscal decentralization, as depicted in the public finance literature. The city embraced its new fiscal authority and dramatically increased revenues by focusing on the most efficient taxes, especially the property tax. Those revenues were directly translated into investment in much-needed transportation and water infrastructure, much to the delight of local voters, who subsequently rewarded the mayor for her performance by reelecting her in a landslide. Yet, Surabaya's success should not be taken for granted. Viewed in the context of other Indonesian cities, as well as Surabaya's own recent past, the city's ongoing development boom is striking.

How did Surabaya generate political support for increasing taxes and building new infrastructure? While something like a development consensus exists in which the mayor's office works closely with developers to plan and execute infrastructure projects, it has been tested repeatedly. As recently as 2011, the Surabaya city council voted to impeach Risma over changes to the billboard tax ordinance, and in 2010, Risma generated intense controversy when she refused to approve a central government plan to construct a new toll highway through the city.

In this chapter, I show evidence that fiscal policy in Surabaya was neither an effort to “soak-the-rich” and redistribute to the poor, nor was it a scheme to distribute patronage to Risma's electoral base. Rather, the overall effect of Surabaya's fiscal policy is to shift resources from the commercial city center to the fast growing margins of the city, where major new

property developments are rising. Real Estate Indonesia, and the major property developers, worked closely with City Hall to develop these planning priorities and to execute key projects. In exchange for the infrastructure that would make their investments viable, REI encouraged its members to pay property taxes. The association accomplished these goals by providing a forum for businesses to negotiate distributional trade-offs and a means to monitor public spending.

## **RIVAL EXPLANATIONS**

According to the class conflict approach to taxation, elections prompt tax increases by channeling popular demand for redistribution. Furthermore, the more competitive elections are, the more the pressure to “soak-the-rich” intensifies. Superficially, Surabaya fits this pattern. Risma steadily increased taxes during her first term as mayor after winning a close election in 2010 with 41% of the vote. As a first-term mayor facing a hostile city council, Risma might have been tempted to cater to Surabaya’s poor voters as allies against the city establishment.

Yet, close examination of changes to the property tax during Risma’s first term show that her administration carefully preserved the vertical incidence of the tax that it inherited from the Ministry of Finance. In other words, the property tax maintained a similar level of progressivity because the city uniformly increased property valuations across the economic spectrum.

Surabaya achieved a 66% increase in property tax revenues over four years primarily by revising the property valuations that it inherited from the Ministry of Finance.<sup>5</sup> A comparison of the 2011 and 2015 schedule of land valuations reveals across-the-board increases in land valuations of 50 to 100%.<sup>6</sup> For example, the median increase in the lowest valuation in each of

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<sup>5</sup> In general, Indonesian cities have preferred this method of increasing revenues because it is easier than conducting field surveys to revise property data and it is shielded from politics because new valuations do not require the approval of the city council. Furthermore, rate adjustments are legally constrained because the law that decentralized the property tax also limited property tax rates to no more than 0.3 percent (?).

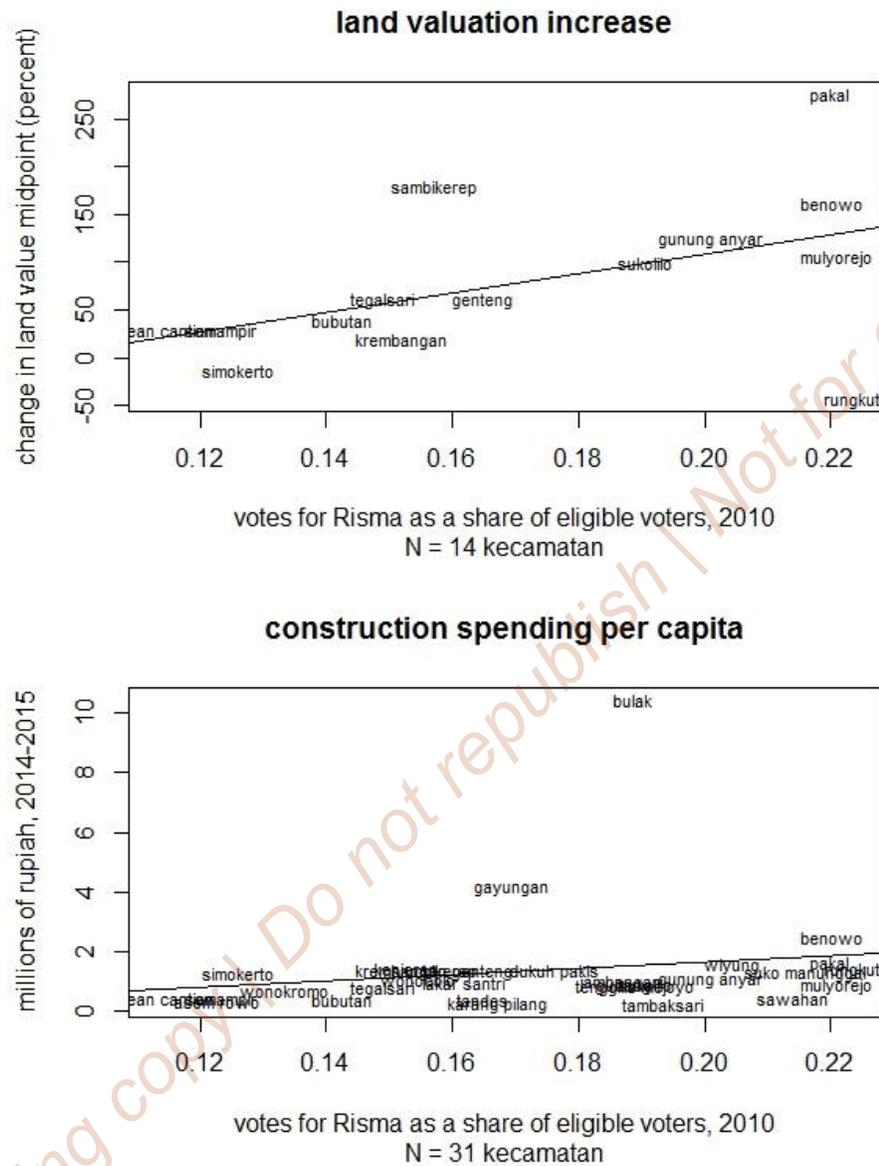
<sup>6</sup> I obtained hard copies of the 2011 schedules of property valuations for 14 out of 31 city sub-districts (*kecamatan*) from the City Legal Office (*Bagian Hukum*), as well as a complete 2015 schedule in PDF from the official city website.

75 neighborhoods (*kelurahan*) was 49%, while the median increase in the highest valuation in those neighborhoods was 68%. (Note how closely these changes track the increase in revenue.) As a result, the ratio of the highest to lowest valuation changed very little within neighborhoods. Land valuation grew more progressive in forty five neighborhoods (that is, the ratio of highest to lowest increased), but less progressive in 30 neighborhoods (that is, the ratio decreased). In the median neighborhood, the ratio increased by 0.49, but the average change across all neighborhoods was a decrease of 0.1. The pattern across neighborhoods was similar, in that rich neighborhoods were no more likely to become more progressive than poor neighborhoods.

If property tax policy in Surabaya has not targeted the poor, then perhaps it has favored Risma's supporters. The patronage approach to taxation expects that local officials will reduce taxes on their supporters, while expropriating as much as possible from their opponents. Therefore, revenues should fall when elections are competitive and elected politicians need to reward their supporters. Recent tax history in Surabaya, however, belies these expectations. Tax revenues rose, not fell, after Surabaya's competitive election in 2010.

Variation in land valuation across city sub-districts deepens the impression conveyed by the overall revenue figures: Risma did not single out supportive sub-districts for favorable treatment. Figure 3 shows that land valuations actually increased more in districts where a greater share of eligible voters supported Risma. Nor did construction spending make up for the tax increases—per capita spending on construction is relatively constant regardless of a sub-district's previous support for Risma. While it is likely that the tax office still cut deals with individual taxpayers, Surabaya's fiscal policy did not systematically favor sub-districts that supported Risma.

Figure 3



Overall, the changes in valuation resemble neither a concerted effort to increase taxes on the rich, nor an attempt to favor Risma's supporters. Rather, the changes seem to have brought official valuations more in line with fair market values. The 2015 valuations predict 2016 baseline neighborhood land values twice as accurately as the 2011 valuations (though neither fit

the baseline land values well).<sup>7</sup> The model results are merely suggestive because of a dearth of data on property transactions in Indonesia, but they suggest that the changes to property valuation under Surabaya's administration have been motivated by technical as much as political concerns.

## **FISCAL CONTRACT**

While Surabaya's fiscal policy has not favored the poor or Risma's voting base, it nevertheless has had redistributive implications. In this case, Surabaya redistributed public resources from the commercial center of the city to the developing margins of the city. By two different measures, land was taxed most heavily in the center of the city, while construction spending per capita was highest at the northwest, northeast, and southern city limits.

I argue that this spatial redistribution across neighborhoods reflects a bargain between City Hall and major property developers in which property developers endorse high taxes on completed developments in exchange for infrastructure spending that complements new developments. This bargain is upheld by Real Estate Indonesia, which works with the city to develop city planning priorities and pressures its members to pay taxes. The association's close relationship to City Hall provides both the means to monitor public spending and the leverage to discipline its members.

### *Tax incidence across neighborhoods*

Four city sub-districts, Genteng, Tegalsari, Mulyorejo and Dukuh Pakis, stand out as the most heavily taxed relative to 2011 tax obligations and to present land values. Surabaya's residents will recognize these sub-districts as some of the most desirable neighborhoods in the city. Genteng and Tegalsari comprised the heart of the late colonial city, while Dukuh Pakis and

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<sup>7</sup> The 2015 valuations predict 2016 baseline neighborhood land values with an  $r^2$  of 0.08, while the 2011 valuations predict the same values with an  $r^2$  of 0.04. Complete results available upon request.

Mulyorejo hosted the first exclusive housing developments in the post-war era. Overall, these sub-districts encompass most of the commercial heart of the city and many of its most well-established residential neighborhoods.

**Figure 4**

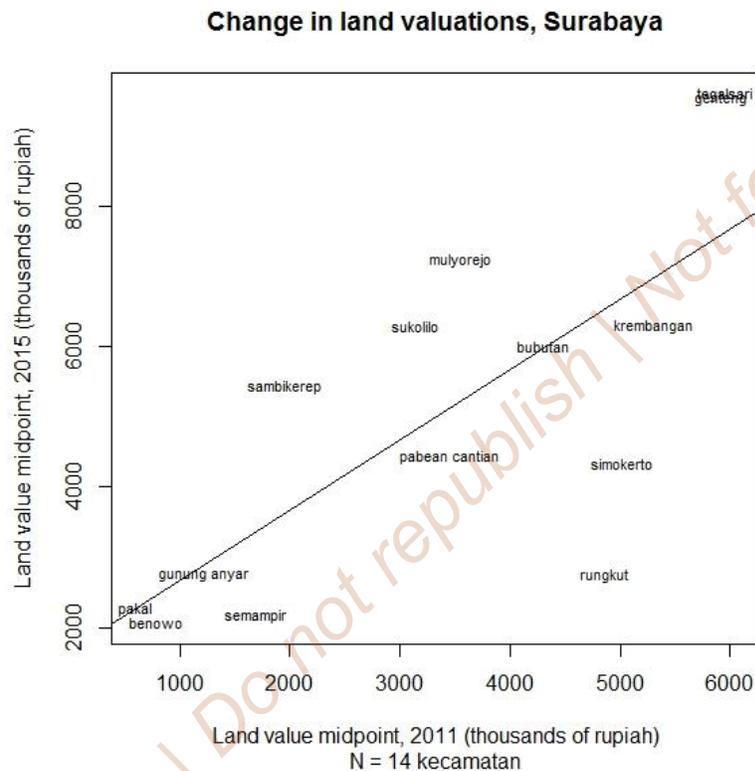
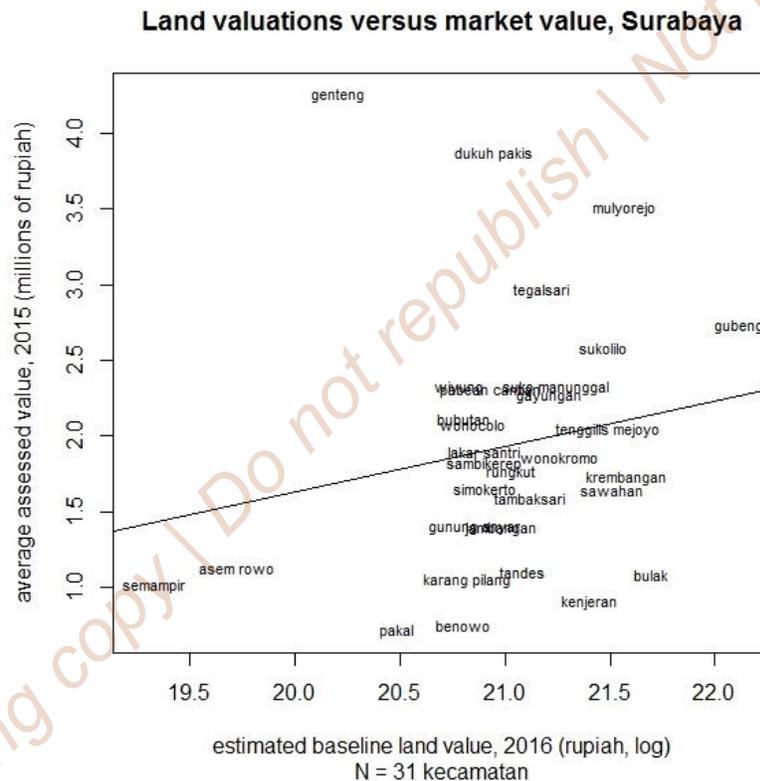


Figure 4 compares land valuation by sub-district in 2015 and 2011. I summarize the land valuation for a given sub-district simply by taking the midpoint between the minimum and maximum valuations.<sup>8</sup> Recall that Surabaya's 2011 property valuations were inherited from the Ministry of Finance, while the 2015 valuations reflect four years of gradual revision by the city tax office. The best-fit line shows the expected 2015 valuation, for a given level of valuation in 2011. In sub-districts above the best-fit line, land valuations increased disproportionately to other

<sup>8</sup> I received the 2011 schedules, numbering hundreds of pages, in hard copy, so calculating an average valuation will be impossible until I can manually transcribe the schedules into Excel.

sub-districts. Land valuations increased most in Tegalsari, Genteng, and Mulyorejo, and they also increased in Sukolilo and Sambikerep. (I do not have 2011 data for Dukuh Pakis.) By contrast, land valuations increased more slowly in sub-districts below the line, such as Simokerto and Rungkut. The key observation is that the Surabaya tax office chose to increase valuations in Tegalsari, Genteng and Mulyorejo much more rapidly than their counterparts with similar valuations in 2011.

**Figure 5**



Whereas Figure 4 depicts neighborhood tax burdens relative to 2011, Figure 5 depicts tax burdens relative to fair market values for land. The y-axis presents the average official land valuation by sub-district in 2015, while the x-axis presents baseline neighborhood land values in 2016. I estimated baseline land values using data from 1,530 property advertisements that I

collected from the website OLX Indonesia in 2016. I was able to match 60% of these data, or 911 advertisements, to specific sub-districts. With these data, I estimated an OLS model using lot size, building size, property type (residential, commercial, undeveloped), land tenure (outright ownership, building rights, informal ownership), and sub-district dummy variables to predict asking price. I combined the model intercept and sub-district dummy variables to produce baseline land values for each sub-district.

The figure reinforces the implications of the previous figure. It shows that no sub-districts are taxed as highly as Genteng, Dukuh Pakis, Mulyorejo, and Tegalsari, even after accounting for the fair market value of land. The specific estimates of baseline land value are imprecise, and should be interpreted cautiously. I have only eight observations from Dukuh Pakis, 15 from Genteng, 19 from Tegalsari, and 84 from Mulyorejo. In particular, the baseline land values for Genteng would seem to be too low for the central business district. Yet, ordinary folks live in urban kampongs behind Genteng's commercial establishments, and derelict buildings blight even the prestigious Tunjungan Street. In addition, my estimates do not capture buildings and other improvements, which constitute much of the value of property in Genteng. In sum, Figure 5 should not be accepted as the final word on tax incidence in Surabaya, but rather as additional supporting evidence that the commercial heart of the city is taxed more heavily than similarly endowed neighborhoods elsewhere.

#### *Construction spending across neighborhoods*

While the commercial center of the city pays disproportionately more in taxes, neighborhoods on the edges of the city have been benefitting the most from city spending on infrastructure. Surabaya's exploding revenues enabled Mayor Risma's administration to double spending on capital investments in just five years. The majority of the expenditures funded

improvements to Surabaya's roads and drainage system, including projects to construct bridges, widen roads, introduce sidewalks, enlarge canals and purchase flood control pumps.

During 2014 and 2015, the city spread its construction expenditures more or less evenly across the city, with the exception of Bulak, Gayungan and Benowo sub-districts (Figure 6).<sup>9</sup> These sub-districts benefited from major infrastructure projects that drove per capita spending much higher than might be expected given their relatively light tax obligations. In contrast, spending in the commercial heart of the city was in line with other sub-districts despite its greater tax burden.

Bulak extends along Surabaya's northeastern coastline from the Suramadu Bridge to Kenjeran beach, where several drainage projects, two major road projects, including the eastern bypass road, and Kenjeran Bridge were intended to generate tourism in what had been a poor fishing community. Gayungan is the southern gateway to Surabaya, where an ambitious project to widen Ahmad Yani Boulevard was intended to improve communication between the city and its southern suburbs. And Benowo sits on Lamong Bay at the northwestern boundary of Surabaya, where bus terminal improvements and two road projects, including the western bypass road, were intended to reduce traffic congestion and improve access to the Lamong Bay Container Terminal.

Projects currently in progress continue the pattern of investment on the city's margins. The diversion underground of the Banyu Urip irrigation channel poured billions more rupiah into Benowo in 2016 and 2017. The western and eastern bypass roads, still in the beginning stages of construction, will eventually provide north-south arteries on the western and eastern margins of

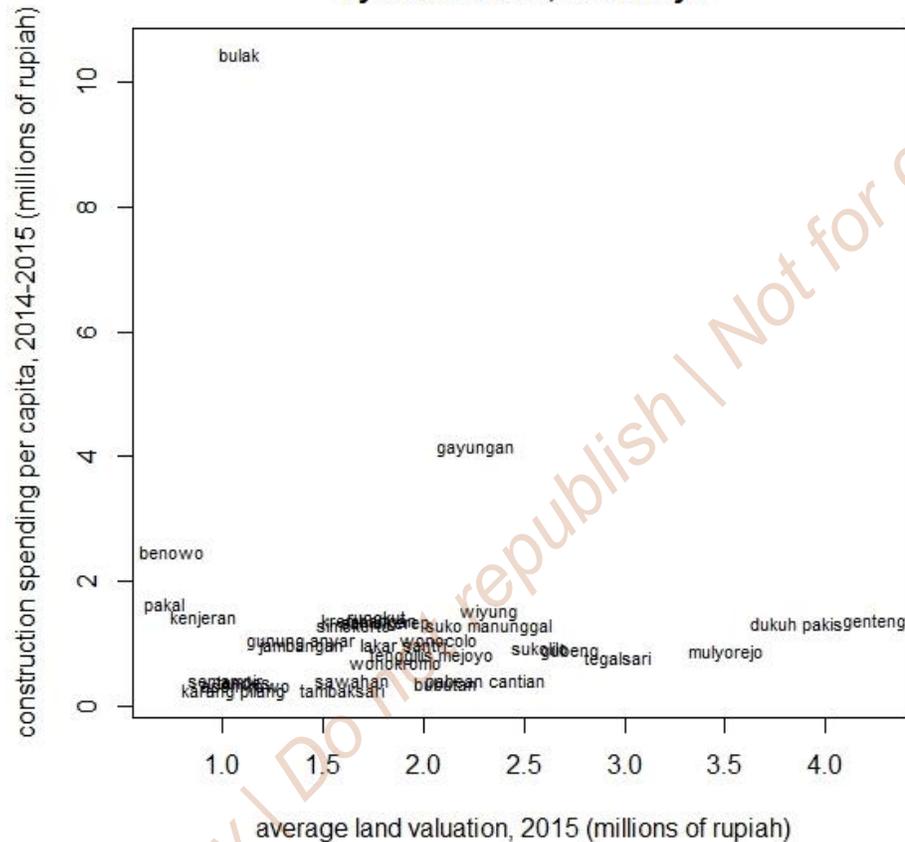
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<sup>9</sup> The data on construction projects comes from the Indonesian government's Public Procurement Plan Information System ([sirup.lkpp.go.id](http://sirup.lkpp.go.id)). I was able to match 2,202 projects to a specific sub-district, accounting for 67% of construction projects and 80% of construction spending in 2014 and 2015.

the city. And a developing transit project will lay track for an electric tram along Ahmad Yani Boulevard, further improving transportation through Gayungan.

**Figure 6**

**Construction spending and property tax assessments  
by kecamatan, Surabaya**



## INSTITUTIONAL UNDERPINNINGS

How has Surabaya generated political support for a fiscal policy of spatial redistribution?

I contend that Surabaya's property developers drive spatial redistribution, endorsing both higher taxes in the commercial city center and lobbying for infrastructure development on the city margins. Their influence has increased during Risma's administration, when Surabaya's rapidly expanding budget enabled the emergence of a "growth regime" encompassing developers, City

Hall, and middle- and working-class voters (Stone 1989). At the same time, the growth regime excluded elements of Surabaya's political and industrial elite.

The coalition grew out of a strong working relationship between Risma and Surabaya's major developers that developed during Risma's time as a city planner in the city bureaucracy. However, REI, as the corporate representative of hundreds of local and national developers, was essential to sustaining the coalition. The association addressed distributional conflict by extending benefits to smaller developers, and it overcame mistrust between developers and the government by enforcing agreements between Risma and association members. As a part of this arrangement, REI encourages members to report sales data accurately to the city tax office.

#### *Background to the coalition*

Before her election as mayor, Risma had already been collaborating with property developers for the better part of a decade in her job as a city planner in the Surabaya city bureaucracy. As early as 2002, Risma was involved in a project to develop a new business district along Menganti Road in western Surabaya (*Kompas*, November 29, 2002). The city signed an MOU with a group called Cakra Nusaraya Consortium, led by Nugroho Suksmanto, the developer of the exclusive Mega Kuningan district in downtown Jakarta. The project, which never came to fruition, would have developed a "Mega Kuningan" for Surabaya comprising commercial, office, and residential properties on approximately 150 hectares of land. Notably, it was understood that Cakra Nusaraya, not the city, would install public infrastructure, including a main road, drainage system, green space, and sidewalks. Meanwhile, existing residents were to be relocated further west on land owned by Citraland, a project of property giant Ciputra.

As director of the city's development oversight office (Bagian Bina Pembangunan), Risma was responsible to oversee the Cakra Nusaraya project. The initial MOU was valid for six

months and renewable conditional on satisfactory progress by the developers. Risma told *Kompas* newspaper that the city would “constantly monitor their monthly reports” (November 29, 2002). Years later, Nugroho recalled that Risma was initially “very supportive” of the project, but that as time passed her interest waned (*Properti Indonesia*, April 1, 2014).

The Cakra Nusaraya project anticipated later projects executed under Risma’s administration. As mayor, Risma would continue to pressure private developers to build public infrastructure, and to employ MOUs to coordinate among multiple property developers. However, Risma also learned from her experience with the failed Cakra Nusaraya project. Whereas Cakra Nusaraya attempted to conjure up a new central business district *in toto*, later projects would build on existing developments. In addition, the Cakra Nusaraya MOU required developers to acquire land for the project, but under Risma’s administration the city would shoulder that responsibility.

Risma refined her approach to working with property developers as she ascended the city bureaucracy. From 2005 to 2008, Risma directed the parks and sanitation department (Dinas Kebersihan dan Pertamanan); then she directed the city development planning board (Badan Perencanaan Pembangunan Kota, or Bappeko) until she resigned to run for mayor in 2010. During this time, Risma’s demanded much from developers, but she also viewed them as engines of urban development. On the one hand, she demanded private assistance for public projects, proclaiming on one occasion that “there must be consideration from third parties, specifically private enterprises” to expand public spaces in Surabaya (*Kompas*, June 19, 2006). On the other hand, she viewed private projects as an essential component of development. On the 715<sup>th</sup> anniversary of the founding of Surabaya, for example, she highlighted new housing complexes

and malls on the edges of the city as evidence of “relatively even” urban development (*Kompas*, May 23, 2008).

Many businesses willingly engaged Risma’s call for collaboration. For example, Telkom Indonesia volunteered funding in 2006 that the parks department used to revitalize Bungkul Park, remaking it into one of Surabaya’s most popular and recognizable public spaces. However, Risma was also willing to apply the city’s regulatory powers to demand cooperation, if necessary. In 2006, Risma unilaterally seized thirteen petrol stations whose business permits had lapsed, and converted the properties into parks (*Tempo Magazine*, January 5, 2015).

Risma’s most important regulatory tool was the “public facilities” (*fasilitas umum*, or *fasum*) regulation. According to a 2010 city ordinance,<sup>10</sup> developers are required to reserve forty percent of each property development for public facilities such as roads and parks, but in practice the use of such facilities is often restricted to residents only (Arai 2015).<sup>11</sup> At Risma’s urging, developers gradually began placing public facilities within their concession areas under city management.<sup>12</sup> The results were impressive. By 2009, Surabaya had increased the land area of public green spaces by 40 square kilometers, with 83 developers contributing public facilities (*Kompas*, February 15, 2007; September 10, 2009). As a result, Surabaya became the only Indonesian city in which the share of green space met the twenty percent threshold established in the 2007 law on spatial planning (*Tempo Magazine*, January 5, 2015).<sup>13</sup>

Perhaps no statement exemplifies Risma’s view of urban development as strikingly as her call, just one month after being inaugurated as mayor, for new private investment on Surabaya’s

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<sup>10</sup> Peraturan Daerah No. 7/2010 tentang Penyerahan Prasarana, Sarana, dan Utilitas Pada Kawasan Industri, Perdagangan, Perumahan dan Pemukiman.

<sup>11</sup> Strictly speaking, the regulation distinguishes between “public facilities”, such as roads, drainage, and lighting, and “social facilities”, such as parks and athletic fields.

<sup>12</sup> For example, the city acquired two hectares of green space from developers in 2007, and fourteen hectares of roads, drainage and green space in 2009.

<sup>13</sup> UU No. 26/2007 tentang Penataan Ruang

East coast. She said, “By all means, build anything at all in East Surabaya, I turn it over completely to the developers. And we will do everything in our power to facilitate any project that conforms to regulations” (*Surabaya Pagi*, October 25, 2010).<sup>14</sup> In particular, she challenged by name Pakuwon Group to develop a recreation area. On this occasion, she articulated a model of development in which the city facilitates the business of private developers in return for their investment in public parks and infrastructure—a model which would guide her throughout her administration.

For their part, Surabaya’s property developers expressed dissatisfaction with city government in the years preceding Risma’s administration. The largest concern of the big developers was transportation infrastructure, especially in West Surabaya. REI repeatedly complained about the lack of access to the new developments west of the Surabaya toll road, which included projects by Ciputra, Pakuwon, and others. When traffic backed up on Mayjen Sungkono/HR Muhammad, there was no alternative access route to that part of the city (*Kompas*, June 30, 2003; March 22, 2005). In addition, REI objected that tax obligations “strangled the necks” of property developers, estimating that the combined total of taxes on a new property amounted to twenty percent of the sale price (*Kompas*, May 29, 2003). Finally, REI lamented the cost of obtaining permits for new projects, complaining that they paid more in Surabaya than elsewhere and implying that costs were inflated by officials who demanded bribes (*Kompas*, June 30, 2003).

Smaller developers, represented by the All-Indonesia Community and Housing Developers Association (Asosiasi Pengembang Perumahan dan Pemukiman Seluruh Indonesia, or Apersi), echoed REI’s concerns about taxes and infrastructure. They depended on the city to

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<sup>14</sup> “Silahkan bangun apa saja di Surabaya Timur, saya kembalikan dan saya serahkan sepenuhnya kepada pengembang. Dan kami akan berupaya memberikan kemudahan asal semua sesuai aturan.”

connect their housing projects to roads, water and electricity, especially because their projects tended to be located on less desirable land far from the city center (*Surabaya Pagi*, November 13, 2008). Their most pressing concern, however, was the unpredictable regulatory environment and the high costs of obtaining permits (*Kompas*, October 7, 2010; *Surabaya Post*, April 16 2010; *Surya*, February 5, 2010).

From the perspective of the developers, the issue of infrastructure was no idle concern. In the 1970s, Darmo Grande pioneered the first exclusive housing development in western Surabaya, and it sat empty for years until the Surabaya toll highway opened up access to the west in 1987 (Dick 1992). More recently, developers have been expanding further west, but if transportation access does not keep pace, their investments risk similar fates.

#### *Rise of the coalition*

By 2010, Risma had won local and national acclaim for transforming Surabaya into a greener city, making her one of the most popular public figures in Surabaya (Affan 2011). At the same time, the outgoing mayor, Bambang Dwi Hartono (Bambang DH) was prevented by term limits from running for re-election. Thus, Risma's name quickly emerged as a potential mayoral candidate.

By one newspaper account, a group of 35 property developers, including Ciputra and Pakuwon, were some of Risma's earliest champions. This group agreed at a meeting in December 2009 that they preferred Risma to other potential nominees because of her impressive record as a city planner, according to an anonymous source who purportedly attended the meeting. While the director of Ciputra's subsidiary Citraland Group declined to confirm that a meeting was held, he did offer a veiled endorsement of Risma, saying that mayoral candidates

“need not be politicians, when there are also accomplished bureaucrats”.<sup>15</sup> He also reiterated developers’ hopes that the new mayor would invest in new infrastructure: “As a developer in Surabaya Barat, I hope that infrastructure will be upgraded, because road construction there is still proceeding slowly despite rapid population growth” (Abdiono-Fatoni 2009).<sup>16</sup>

Soon after, Risma was nominated as a mayoral candidate by Partai Demokrasi Indonesia – Perjuangan (Indonesian Democratic Party of Struggle, or PDI-P). A group of young party activists advocated on her behalf, eventually winning the approval of party chairwoman Megawati Sukarnoputri even though Risma was not a member of the party. Dahlan Iskan, chairman of Jawa Pos Group, completed the electoral coalition, lending the voice of Surabaya’s biggest and most influential newspaper to Risma’s campaign (Supriyanto, et al 2014).

However, the true contours of Risma’s supporting coalition were only brought into relief after the election in the controversy over the “central city expressway” (*tol tengah kota*). In this episode, PDI-P abandoned Risma, siding instead with the industrial enterprises and construction contractors who would have benefited most from the proposed project. Property developers, on the other hand, continued their quiet support for Risma, who refused to approve the project—defying the Public Works Ministry in the process—and earned the gratitude of thousands of working-class residents who would otherwise have been displaced.

The proposed expressway would have cut through the center of Surabaya from Wonokromo to the port at Tanjung Perak, following either the Kalimas River or the Surabaya-Malang railroad bed (*Kompas*, June 28, 2004). From its inception the project was controversial in Surabaya, and its critics suspected that it would displace residents, exacerbate flooding, and worsen traffic (Davidson 2015; Mada 2010). However, the expressway would have significantly

<sup>15</sup> “Tidak harus orang parpol, orang birokrat yang berhasil kan juga ada.”

<sup>16</sup> “Sebagai pengembang Surabaya Barat, saya berharap infrastruktur ditingkatkan, sebab pembangunan jalanjalandi sana masih pelan. Padahal pertumbuhan penduduknya paling cepat.”

reduced logistical costs for companies with factories located at the Surabaya Industrial Estate Rungkut (SIER) or in neighboring Sidoarjo, by providing a direct link to the port at Tanjung Perak. In contrast, the existing toll road offers a circuitous route to the west of the city, and forces trucks to exit the highway before entering the port (Setyarso, et al 2014).

Thus, the central expressway pitted the interests of residents and businesses in the center of the city against the interests of industrial enterprises in Rungkut and Sidoarjo to the south. At times, the participants in the debate explicitly referred to the conflict in these terms. For example, provincial council member Bambang Suhartono, of PDI-P, asked in 2011, “Now is the time, will the city government make Surabaya a city for housing or business?” (*Surabaya Pagi*, August 13, 2011).<sup>17</sup> Three years later, Wisnu Sakti Buana, a leading PDI-P figure in Jawa Timur, sometime rival of Risma, and Risma’s deputy mayor, echoed that analysis, “It doesn’t matter whether the road is buried underground so no one sees it or elevated as high as the sky. What matters is that there must be a toll road. If not, well, modify Surabaya from a city of commerce into a city of mere tourism” (Setyarso, et al 2014).<sup>18</sup> More often, however, the project’s proponents justified the highway in terms of traffic relief, while critics countered that it would only worsen traffic by concentrating vehicles downtown.

Just before Risma took office, the concession holder Margarya Jawa Tol (MJT) tried to revive the central expressway project, which had been dormant since 2007, setting up a showdown between Risma and the city council (Dewan Perwakilan Rakyat Daerah, DPRD). Risma flatly refused to issue a construction permit, so the company appealed directly to the city council, which approved the project by a vote of 32 to 6 on December 16, 2010 (Harsaputra 2010). At the same time, the council was debating whether to impeach Risma for increasing the

<sup>17</sup> “Sekarang sayat (sic), Pemkot Surabaya itu mau menjadikan Surabaya sebagai kota hunian atau bisnis?”

<sup>18</sup> “Terserah, mau dibuat di bawah tanah biar tidak kelihatan atau ditinggikan setinggi langit. Yang penting, tol harus ada. Kalau enggak, ya, ubah Surabaya dari kota niaga menjadi kota wisata saja.”

tax rate on large billboards. While PDI-P initially opposed impeachment, the party decided to clear the way for the central expressway project by betraying Risma, and on January 31, 2011 she was impeached. Risma remained in office, however, after the press and the public responded with outrage and national party leaders of PDI-P and Democrat Party were obliged to intervene on Risma's behalf (Setyarso, et al 2014).

In this conflict, the city council was representing what might be considered Surabaya's traditional political and industrial elite. The central expressway's three most prominent advocates were Wisnu Sakti Buana; Soekarwo, Governor of East Java; and Jamhadi, chair of the local chapter of the Indonesian Chamber of Commerce and Industry (Kamar Dagang dan Industri Indonesia, or KADIN). Wisnu Sakti was the youngest son of the late Sutjipto Soedjono, one of PDI-P's most senior politicians. Soekarwo was financed and advised by Alim Markus, the founder and CEO of Maspion Group, a local political heavyweight with extensive production facilities in Sidoarjo (Chong 2015). And Jamhadi was the CEO of Tata Bumi Raya, a construction contractor founded by Sutjipto and linked to the project (Davidson 2015). Thus, these three spokesmen personified the alliance among Surabaya's historically dominant party, local manufacturers, and politically connected construction contractors—an alliance which would have benefitted immensely from the central expressway project.

In contrast, press coverage portrays Risma as a lone defender of the people, heroically refusing compromise, supported only by chairwoman Megawati. But while it is undeniable that Risma had considerable popular support stoked by the friendly coverage of Jawa Pos, I suspect that she had property developers in her corner, as well.<sup>19</sup> While Surabaya's developers did not publicly state a position about the central expressway, they met with Risma on friendly terms

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<sup>19</sup> Indeed, I cannot help but speculate—without evidence, unfortunately—that titans of property development in Jakarta may have encouraged Megawati and even President SBY to intervene in the impeachment proceedings.

even as the controversy roiled (Budi Said 2013).<sup>20</sup> Risma solicited their input to develop her transportation plan, and they responded by doing everything in their power to advance the agenda, which substituted western and eastern bypass roads and a mass transit network in place of the central expressway. As I discuss in the next section, they donated land and money to these transportation projects in order to get shovels into the ground as soon as possible.

*Institutionalizing the coalition*

The coalition between City Hall and property developers offers material benefits to large and small developers, their middle-class clientele, downtown businesses, and the working-class residents of Surabaya's urban kampongs. Large developers have finally received their long-awaited roads and small developers their streamlined permitting process. Projects are well underway to construct a new road network that will open up access to the margins of the city where luxury housing developments are expanding rapidly. Meanwhile, the city has partnered with REI to cut red tape for development projects. Not only the developers, but also their middle-class clientele benefit from these programs, because they enjoy shorter commutes and a wider variety of housing choices. Furthermore, progress on the bypass roads undercuts support for the central expressway, offering downtown businesses their best hope for avoiding the disruption threatened by the project. Finally, the city has made significant progress on its goal of laying paving stones in every urban kampong, increasing the prestige of those working-class neighborhoods.

I argue that REI held these disparate groups together in two ways. First, it spread benefits across its membership in order to sustain a distributional consensus among large and small developers. Second, it facilitated tax increases by assuring its members that the city government

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<sup>20</sup> I'm still trying to locate the October 29, 2011 issue of Jawa Pos which supposedly corroborates this blog post.

was committed to projects that would benefit them. REI drew on significant organizational capacity to achieve these objectives.

REI's East Java chapter has demonstrated considerable organizational capacity independent of its involvement in the growth coalition, not unlike the national organization and Jakarta chapter, as documented by Arai (2015). REI has a wide membership in the East Java, with an average of 402 members per year between 2010 and 2016 (REI 2016).<sup>21</sup> Membership in REI confers legitimacy to developers, and in return, REI expects its members to meet official regulatory standards. They must obtain clear ownership over land, pay taxes, integrate green space and public facilities into new developments, respect government requirements for mixed-income housing, and most elementally, build all of the units that they sell. While not all REI members meet all of these requirements all of the time, they respect them enough to resent the competitive advantage that “amateur” developers gain by ignoring them (Pandia 2005).

REI applies both sticks and carrots to enforce membership standards. For starters, it screens new members by requiring them to present a business “masterplan” and to obtain a recommendation from a current member. It also offers selective incentives to members in good standing, such as access to credit and training in project planning. Finally, REI seeks to punish non-members. In 2014, for example, REI had active agreements in place with six local governments<sup>22</sup> and several banks that only REI members would receive construction loans and permits (*Kabar Bisnis*, November 14, 2014).

REI also possesses the trappings of a professional organization, including a beautiful two-story office building in Surabaya, administrative staff, glossy business cards, and weekly lunch meetings. Under the leadership of Paulus Totok Lusida (2013? – 2016), the organization

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<sup>21</sup> These figures include members from throughout the province and not just Surabaya.

<sup>22</sup> The local governments were Banyuwangi, Jember, Batu, Malang, Sidoarjo, and Surabaya.

had 60 officers, in addition to administrative staff, responsible for various portfolios like subsidized landed housing (*bidang rumah sejahtera tapak*).

Finally, REI has enjoyed privileged access to Surabaya City Hall, especially during Risma's administration. Most importantly, Risma spent years in talks with REI before enacting city's new land use master plan (Rencana Tata Ruang Wilayah, atau RTRW) in 2014 (Muiz 2013; Budi Said, October 29, 2011; *Jawa Pos*, February 3, 2015).<sup>23</sup> REI also consulted with the city when it was considering revising its method of property valuation—a process from which KADIN was excluded, much to its chagrin (*Jawa Pos*, February 6, 2015). The city council listens to REI, as well. For example, the development committee (Komisi C) invited REI to testify at a committee hearing, and the committee chair immediately embraced REI's position that privately constructed apartment towers offered a solution to Surabaya's shortage of low-income housing (*Sorot News*, July 19, 2013).

In sum, REI had sufficient influence over its own members and within City Hall to solve the political problems that might otherwise have derailed the growth coalition. First, REI spread benefits across its membership, both geographically and by size. Surabaya's major developers wanted nothing as much as they wanted better road access to their exclusive developments in western Surabaya, including Citraland, Pakuwon Trade Center, and the Darmo Octagon.<sup>24</sup> Yet, that is not where the city focused its spending in 2014 and 2015. Instead, REI's membership absorbed much of the cost of the new infrastructure in the west, allowing the city to reallocate resources to the northwest, northeast, and south (and also guaranteeing progress on the projects dearest to REI).

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<sup>23</sup> Peraturan Daerah No. 12/2014 tentang Rencana Tata Ruang Wilayah Kota Surabaya Tahun 2014-2034

<sup>24</sup> These projects, and others like them, are spread across Sukomanunggal, Dukuh Pakis, Wiyung, Lakar Santri and Sambikerep sub-districts.

Specifically, eight developers agreed to build sections of the western bypass road where the route passed through their concession areas.<sup>25</sup> When finished, the road would be handed over to the city as “public facilities”. The developers’ work would account for approximately eighty percent of the length of the twenty kilometer road, while the city would complete the remaining twenty percent of construction, primarily located in the northwest (*Kompas*, September 23, 2015). In addition, REI agreed to fund and build a 600 meter underpass at the Satelit expressway interchange, a crucial intersection linking western Surabaya to the rest of the city.<sup>26</sup> Thirty-eight developers, including Citraland and Pakuwon, contributed a total of 75 billion rupiah (USD 5.6 million) to the project (*Jawa Pos*, May 1, 2017; *Surya*, June 4, 2015).<sup>27</sup>

In addition to spreading infrastructure projects geographically, REI spread benefits across developers of different sizes by championing two issues of particular importance to smaller developers. First, REI joined Apersi in demands for a more streamlined regulatory environment (Muiz 2013).<sup>28</sup> Indeed, Paulus Totok Lusida at times spoke as if REI’s cooperation on infrastructure projects was contingent on changes to the project permitting process (*Kompas*, September 23, 2015). In 2013, the city moved to an online system for permit applications, and in 2015, REI signed an MOU to process permit applications jointly with the city (*Kompas*, March 18, 2013; *Surya*, March 26, 2015). These changes reduced processing times from up to two years to forty-four days (Jajeli 2017). Second, REI began to lobby in 2015 for the establishment of a public “land bank” to enable small developers to acquire land for low-income housing in the city

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<sup>25</sup> The developers are Mitrakarya Multiguna, Bumi Serpong Damai, Galaxy Citraperdana, Citra Bahagia Elok, Tamancitra Suryahijau, Suburhijau Jayamakmur, Ciputra Surya, and Ciputra Surya Padang Golf.

<sup>26</sup> Specifically, the Satelite interchange is where Mayjend Sungkono/HR Muhammad intersects with the Surabaya toll expressway.

<sup>27</sup> PDI-P, still excluded from the growth coalition, criticized REI’s management of the project and called on the city to nullify the agreement (PDI-P 2016).

<sup>28</sup> Clearly, faster processing benefits both large and small developers, but the issue is especially important to smaller developers because they are less capable of absorbing the costs introduced by capricious decision-making and long processing times (Rahayu 2012).

center (*Jawa Pos*, July 6, 2015). Apersi had long complained that high land prices in the city center made such projects financially unviable (*Surya*, February 5, 2010).

REI not only mitigated distributional conflict among its members, but it also obtained assurance that the city government would follow through on its promises without opportunistically taking advantage of REI's members. The most direct means by which REI bound the city to developer priorities was through joint management of its members' highest-priority projects. Thus, REI's members undertook jointly to construct the western bypass road, REI procured an MOU jointly to administer construction permits, and REI launched construction of the Satellite underpass (through which the city plans eventually to run a monorail train [Surabaya 2015]). These were formal, public agreements from which neither side could easily withdraw.

For the time being, however, the interests of both sides may be sufficiently aligned to mitigate fears of betrayal regardless of formal agreements. The central expressway controversy still simmers, and Governor Soekarwo and deputy mayor Wisnu Sakti Buana are poised to revive the project at the first opportunity. Thus, REI has a window of opportunity to upgrade infrastructure on the margins of the city that may only last as long as Risma remains in office. Consequently, both sides felt so much pressure to demonstrate progress before the 2015 mayoral election that they rushed to launch three different road projects before the beginning of the campaign period (*Surabaya Pagi*, September 26, 2015).<sup>29</sup>

Finally, I contend that REI's ability to forestall distributional conflict and to commit the city government to infrastructure projects lent it sufficient credibility to persuade its members to accept property tax increases, especially in the city center. Publicly, REI has considerably moderated its stance on taxation. Whereas in 2003 REI officials protested that property taxes

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<sup>29</sup> The projects were the western bypass road, the Satellite interchange, and the Teluk Lamong Port access road.

“strangled the necks” of property developers, in 2015 they refrained from criticizing a roughly twenty percent hike in valuations, preferring instead to focus on technical details of administering the tax (*Jawa Pos*, February 6, 2015).

Internally, REI exhorted members to pay taxes. According to an interview with REI chairman Paulus Totok Lusida, REI had an informal agreement with the city tax office that, for purposes of tax assessment, members would under-report the value of all property sales by exactly thirty-five percent.<sup>30</sup> He claimed furthermore that he threatened to help the city prosecute members who did not comply with the agreement. If REI’s members complied with the agreement, and Surabaya’s rising revenues imply that they may have, it would have benefitted the city in two ways despite the under-reporting. First, under-reporting by only 35% was probably significantly more than what developers reported previously, because it was not uncommon to report property transactions according to official assessed value, which is usually one-third or less of the market value depending on the location (Agustia, et al 2013; *Jawa Pos*, February 6, 2015; February 7, 2015). Second, for the first time, the city would have had reliable sales data, allowing it to value property much more accurately and easily in the future.

Many of the new revenues returned to REI’s members in the form of infrastructure upgrades, but not all of them. For REI’s members, the cost of participating in the growth coalition was to subsidize spending in Surabaya’s urban kampongs. Early in her administration, Risma announced a goal of laying paving stones on every street in every urban kampong, and she has worked hard to fulfill that promise (Pandia 2011). Between 2013 and 2015, the city budgeted 240 billion rupiah (USD 20 million) to lay paving stones on perhaps 1,000 side streets and back alleys, many of which would have been wide enough only for motorcycles and

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<sup>30</sup> Personal interview, March 18, 2016. I was not able to corroborate the thirty-five percent agreement with other sources.

pedestrians (Antara, January 23, 2013). In 2015, the paving stones project accounted for seven percent of all construction spending; in 2014, eight percent.

## CONCLUSION

This chapter presents a case study of Surabaya, a city that enthusiastically embraced administration of the property tax and quickly increased revenues compared to levels under management of the Ministry of Finance. The chapter shows that a policy-making coalition comprising property developers, the mayor, and middle- and working-class voters endorsed tax increases in exchange for better infrastructure. Specifically, the coalition redistributed resources from the commercial city center to the margins of the city where developers have been rapidly expanding with new projects. REI, a strong business association, was the institutional lynchpin of this coalition because it organized a distributional consensus among developers and negotiated with the city government to guarantee progress on its highest-priority projects.

The case study reveals stark disagreements within Surabaya's oligarchic elite. While fiscal policy is closely aligned with the interests of giant property developers, it excludes certain elements of the traditional industrial and political elite entirely. Furthermore, the governing coalition was responsive to elections, in that the city sought support from working-class residents in urban kampongs with the paving stones campaign and rushed to launch new road projects before the beginning of the campaign period. The "city of work" (Dick 2002) would seem to be opening a new chapter as a city of housing, or *kota hunian*.

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