

# What explains innovative city governments? A transaction cost approach

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## ABSTRACT

For the past two decades, since the Philippines and Indonesia started engaging in large-scale decentralization, various awards have been given to innovative city governments. A review of award recipients allowed a glance at some of the most innovative cities in the region over a period of 10 years or more. However, we still have very little clue as to why a few city governments have been consistently more innovative than the rest.

This paper presents the preliminary results of a comparative study between “innovative” and “typical” city governments in Indonesia and the Philippines to explain why some city governments have been more innovative than others. The research uses a transaction cost framework to complement traditional explanations of local developmental progress, namely leadership and deep-rooted institutions in the society.

I conducted fieldwork in eight Philippine and Indonesian cities to explore the costs of obtaining information about innovations, the costs of bargaining for public resources, and the costs of monitoring and enforcing an innovative program. The hypothesis was that city governments which face smaller transaction costs would be the more innovative. I also investigated aspects related to the city’s leadership and society.

The research refutes simplistic claims on the primacy of leadership or institutions alone and finds that the two cannot answer why some city governments have become more innovative than others. Similarly, the hypothesized transaction cost aspects – alone – cannot answer the question. Only cities which combine leadership, institutions, and transaction costs can create positive feedback loops that enable public innovations over time. In the quest to explain policy change, this highlights the importance of a mezzo-level, urban governance variable beyond the Policy Network which could bridge two seemingly random variables: leadership that is short-term and personality driven, and society which is long-term and path-dependent.

This paper contributes to the literature on public innovation by introducing the use of transaction cost approach and institutional analysis to explain local, urban, public innovation in the developing world.

## 1. Introduction

### Research question

This paper presents an inquiry into the factors that contribute to some city governments being more innovative than others. The inquiry introduces a “transaction cost approach” to complement mainstream approaches that have tried to explain public innovativeness, namely leadership (individual/personality factors) and society (deep rooted institutional factors). To narrow down the context, the research specifically explores public innovation conducted by governments of middle-sized cities in the Philippines and Indonesia.

Before proceeding with the methodology and findings of this inquiry, the following background provides a rationale to explain why the topic was chosen.

## Motivation

### *Middle-sized cities*

Fast rate of urbanization have generated increasing interest on issues related to the city. More recent research identified a trend of high growth in secondary cities. Markusen, Lee, and DiGiovanna (1999) explores how smaller cities in the U.S., Brazil, Japan and Korea have grown much faster than the primate or major cities in their respective countries. UN-HABITAT (2009) argued that population growth in the future will take place in smaller and middle-sized cities, as opposed to the largest megacities. Similarly, “middleweight cities” of the world are poised to deliver 40% of the global growth by 2025 (Dobbs et al. 2011).

However, fast rate of urbanization in the developing world presents major challenges (Devas and Rakodi 1993). The shift from rural communities to urban society happens in accelerated manner and demands from city governments the capacity to plan, finance, and manage this change. City leaders are increasingly expected to deliver not just performance, but also innovations to deal with new problems and/or old problems of unprecedented scale.

### *Local public innovation*

While the U.S. has acknowledged local government innovations since the late 20<sup>th</sup> century,<sup>1</sup> in other parts of the world this interest has been growing largely since the beginning of the 21<sup>st</sup>. The World Mayor Prize has been given since 2004 to mayors that “have the vision, passion and skills to make their cities amazing places to live in, to work in and to visit”. Similarly, the Globe Sustainable City Award, the Lee Kuan Yew World City Prize, and Citibank’s City of the Year Award are just some of the notable appreciations given to cities worldwide for their performance and public sector innovations.

In the developing world, especially Asia, we also find awards such as the Chinese Local Governance Innovation Award conducted by Peking University since 2000, the Urban Management Innovation (*Inovasi Manajemen Perkotaan* or IMP) Award in Indonesia which started in 2008, and the *Galing Pook* (GP) Award in the Philippines which started much earlier in 1994, to coincide with the country’s expansive effort of decentralization.

### *Decentralization in the Philippines and Indonesia*

The Philippines and Indonesia both experienced a “people power revolution” in 1986 and 1998, respectively. Having toppled long-standing authoritarian regimes, both countries embarked on a new era of democracy and decentralization that limits the power of the executive, strengthens the legislative, and enables a larger governing role for local governments.

Due to fast pace and wide extent, decentralization in the Philippines and Indonesia were labeled as “big-bang” (World Bank 2005). Before decentralization (1985-1991) the average yearly expenditure of Philippines’ local government units (LGUs) was about 11 per cent of the country’s total public expenditure (Manasan 2008). After decentralization (1992-2003), it increased to about 23 per cent

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<sup>1</sup> For example, Harvard Kennedy School’s “Innovations in American Government” Award has been conducted since 1986, and the National League of Cities has been conducting the City Showcase program since 1989.

per annum and by 2009 it has reached 25 per cent (Martinez-Vasquez 2011). Similarly in Indonesia: the average annual proportion of central government transfers to regional governments was 19.6% for the period of 1990-2000, but increased to 30.9% for the period of 2000-2010.<sup>2</sup>

### *The need for a framework*

Despite increasing attention on local public innovations and the role of city governments in tackling growing urban problems, an important question remain under-studied: why do some local governments conduct more innovative programs than others? Frameworks that attempt to explain public innovation remain limited in number and scope.

Common explanations about innovativeness have traditionally relied on leadership variables, suggesting that much of innovation occur because of a leader's will and skills (For example, Kingdon 1984, Doig and Hargrove 1990, Kuczumski 1996, Adair 2007, Gaspersz 2012, Ostrom 1965). Let's call this the "agency" argument. This seems to explain the case of some local governments which were innovative under the leadership of one mayor, while not so innovative under the leadership of the subsequent mayor. However, it does not explain why some cities remain consistently innovative over the years, mayor after mayor.

Another common explanation is the deep-rooted societal variables related to the city, such as history, norms, and presence of long-standing local organizations (For example, Touffut 2004, Greif, Kiesling, and Nye 2014, Vázquez Barquero 2002, Acemoglu, Johnson, and Robinson 2002, Granovetter 1985). Let's call this the "structure" argument. This implies that a society's progress depends on variables that are difficult to change in the short run. However, it does not explain the phenomenon of some cities with unfavorable structural variables which have transformed themselves for the better, despite the odds.

This research proposes an alternative framework to explain local public innovation through a mezzo-level structure that links leadership (agency) with society (structure) by examining local urban governance. The proposed framework is one based on the notion of transaction cost, commonly considered as part of the New Institutional Economics field. By offering to view public innovation as a risky transaction, I attempt to provide a third, and arguably less explored explanation as to why certain organizations have been more innovative than others.

## **2. Literature Review**

### **Public innovation**

Innovation can be described by two main characters: newness and implementation (Altshuler and Behn 1997). According to Mulgan (2007, 6), "Public sector innovation is about new ideas that work at creating public value. The ideas have to be at least in part new (rather than improvements); they have to be taken up (rather than just being good ideas); and they have to be useful".

Since innovation is the implementation of an unproven initiative, its success is not guaranteed – there is a persistent element of risk. For the private sector, risk is acknowledged as part of day-to-day reality, and typically has been factored in the business plan (Bhatta 2003). For the public sector, however, risk is typically seen as an unwelcome aspect. Mulgan (2007) argues that people can be

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<sup>2</sup> Data from analysis of Indonesia's national budget (APBN)

skeptical of public innovation especially on issues where lives and livelihoods are at stake. Thus the easiest way to deal with risks in the public sector is often to avoid them altogether.

Innovation, which requires multiple actors to work together, is different from invention or creativity, which could be about just one person having great ideas. The proponent of an innovative program needs to convince a group of people to approve a new idea and to implement it collectively. In a sense, she needs to conduct agreements or “transactions” with a number of parties for whom taking control of public resources for a risky endeavor could be rewarded by collective political capital if successful, or slammed with downfall if otherwise.

### Transaction costs

Transaction cost economics (TCE) argues that economic activities take different forms based on the goal of minimizing transaction costs (Williamson 2010, 1981, 1991). Where transaction costs are low, economic actors would tend to use the market system: they would buy products and services as opposed to making them. On the other hand, where transaction costs are high, economic actors would tend to make use of a firm to make products and services, as opposed to buying them on the market.

Dahlman (1979) identified three types of transaction costs: 1) search and information costs, 2) bargaining or negotiation costs, and 3) policing and enforcement costs. First, *information costs* include the costs of finding out what to buy, who to buy from, how to buy it, and at what price. These costs stem from the presence of information asymmetries (where not everyone has the same access to information), as well as bounded rationality (where some information is simply too complex for humans to process and understand).

In the context of public innovation, information costs include the effort needed to find out about innovative ideas, projects and programs. There are multiple ways in which knowledge can be accessed. One is through access to information and communication technology (ICT), including the media. Knowledge also comes from trusted personal connections (Marsden et al. 2011, Campbell 2012). Public innovators’ participation in networks and communities of practice possibly cultivates knowledge about innovative programs that have been conducted. Familiarity with other cities and understanding of how such programs work in real terms also breaks down information and knowledge gaps, and provide motivation for public innovators to replicate the same in her own city (Marsden et al. 2011).

Second, *negotiation costs* are the costs of coming to an agreement. These include the time and resources spent on negotiating, convincing, and agreeing to the content and conditions of the contract. Issues related to social capital, such as trust, commitment, expectation, credibility and reputation plays an important role here.

In the context of public innovation, the public innovator has to convince a number of actors to gain approval and support for using public resources to implement a new idea. Formally, the city council needs to be convinced to approve the budget. However, Stone (1993), Molotch (1976), DiGaetano and Klemanski (1993) and others have argued that urban development is often driven by informal networks of business interests, land-owners, and local politicians (“urban regime”). Local political rivalries may also be present at the city, where a current leader may be made ineffective due to constant challenges from a political rival.

Third, *monitoring and enforcement costs* include the costs of knowing whether the “contract” (an agreement) is being carried out the way it is supposed to. Enforcement costs specifically include the costs of monitoring, rewarding and punishing those who do or do not conduct the agreement.

In the context of public innovation, monitoring and enforcement take into effect after the proposed innovation has been approved. To ensure that her staff can reliably conduct the job, the innovator needs to have performance requirements in place, including incentives and disincentives. But even more basic than performance is the capacity of the staff. The public innovator needs to make sure that her staff is equipped with the skills and expertise needed to conduct the innovation. Otherwise, monitoring and enforcement would be a costly deed to conduct.

### **Leadership and society**

As explained in the beginning, traditional explanations of development, progress, and innovation are dominated by variables related to leadership and society. These will be also explored in this research, along with the transaction cost framework.

Leadership variables related to the progress of a society are the personal traits that make someone a “good” or effective leader. These can be broken down into a leader’s credible commitment (the will to do something even if it means tying one’s own hands or being unpopular), effectiveness (ability to make others do what one wants, usually through charisma - be it strong or persuasive), and past experiences in sectors other than the local government (that would provide one with the inspiration to set new standards, different or higher from that typically adopted by local governments).

Society variables are deep-rooted institutional variables that have been embedded so long in a society, such that they are considered as heavy structures. These include a society’s history (the notion of “path-dependency”), the presence of local organizations that has had strong influence on the society for many years, and the overwhelming presence of good local norms that encourage meritocracy, transparency, and hard work. In contrast to leadership, which may seem random, these are considered deeply engrained variables that have been present in the society for a long time.

## **3. Methodology**

### **Case Study**

The research is conducted through a study of multiple cases, where four “innovative” city governments (two from the Philippines and two from Indonesia) were compared and contrasted with four “typical” city governments (again, two from each country). I explored each of the eight cities in terms of the transaction costs faced by city leaders since decentralization started, as well as the kind of leadership and society that the city has had over the years.

Data was gathered through a combination of semi-structured interviews, direct observation of programs and activities, and collection of formal documents and news articles. Interviews were conducted in each of the eight cities with current and former city mayors, city councilors, city government employees, NGO activists, academics, and business people. A total of 74 respondents were interviewed at the local level (average of 9.25 per city), generating more than 60 hours of interview recording. In addition, there were there were six respondents from national-level agencies (award-giving agencies and relevant ministries from both countries).

## Case selection

Innovative city governments were identified through a review of public innovation award winners. Since decentralization started, the Philippine government has been conducting a prestigious, national-level award to “recognize innovation and excellence in local governance”. The *Galing Pook* (GP) Award began in 1994 and has been given annually to programs conducted by LGUs (provinces, cities, municipalities, and barangays). Now in its 20<sup>th</sup> year, it holds a wealth of data on local public innovations: 328 awarded programs spread over multiple sectors such as economic development, environmental protection, and public management.

As many as 58 out of 144 cities in the Philippines (40.3%) have won at least one GP award over the years. Out of the 58 cities award winners, 14 have won at least three awards (see Table 2). We shall consider these as the Philippines’ “innovative” city governments. The first two cities, Naga City in Camarines Sur and Marikina City in the National Capital Region (NCR), were chosen as cases for this research due to the fact that they have collected the most number of GP awards, and also because they both fit the criteria of middle-sized cities.<sup>3</sup>

**Table 1: Philippine cities with 3 or more GP Awards**

No.	City, Province	Awards
1	Naga, Camarines Sur	10
2	Marikina, NCR	8
3	Quezon City, NCR	7
4	Cebu City, Cebu	6
5	San Carlos, Negros Occidental	6
6	Puerto Princesa, Palawan	5
7	Mandaluyong, NCR	4
8	Muntinlupa, NCR	4
9	Iloilo City, Iloilo	3
10	Legazpi, Albay	3
11	Munoz, Nueva Ecija	3
12	San Fernando, Pampanga	3
13	Surigao, Surigao del Norte	3
14	Tagum, Davao del Norte	3

The innovative cases were compared with “typical” city governments in the Philippines, as control mechanism. Two typical cases, namely Malabon City in the NCR and Dagupan City in Pangasinan, were selected as control for Marikina and Naga, respectively, based on the following criteria: 1) has not won a GP award or other significant awards related to innovation, 2) has a population within a range of  $\pm 25\%$  from the population of the case cities, 3) preferably located within similar geographic and demographic context as the case cities.

In Indonesia, three awards in particular have recognized public innovation at the local level: the Urban Management Innovation (IMP) Award, the Innovative Government (IG) Awards, and the Public Service Innovation (Sinovik) Award. The IMP Award is chosen as the main source of

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<sup>3</sup> As of the 2010 Census, Marikina had a population of 424,150 while Naga had 174,931.

identification for Indonesia’s “innovative” city governments due to the fact that it has been conducted the longest (since 2008),<sup>4</sup> and that it deals more specifically with urban issues. Out of Indonesia’s 93 autonomous cities, seven have won at least two IMP awards (see Table 3). Balikpapan City in East Kalimantan and Pekalongan City in Central Java were chosen as each has collected the most number of IMP awards, and because they are both middle-sized cities.<sup>5</sup>

**Table 2: Indonesian cities with two or more IMP awards**

No.	City, Province	IMP awards
1	Balikpapan, East Kalimantan	3
2	Pekalongan, Central Java	3
3	Cimahi, West Java	2
4	Payakumbuh, West Sumatra	2
5	Pontianak, West Kalimantan	2
6	Probolinggo, Central Java	2
7	Surakarta, Central Java	2

Two typical cases, namely Samarinda City in East Kalimantan and Tanjungpinang City in Riau Islands, were selected as controls for Balikpapan and Pekalongan, respectively. They were selected based on the following criteria: 1) has not won any of the three awards related to public innovation, 2) has population within the same size-classification as the case cities (between 500,000 and 1,000,000 for Balikpapan’s control, and between 100,000 and 500,000 for Pekalongan’s control), 3) preferably located within similar geographic and demographic context as the case cities, and 4) for logistical reasons, not very costly or time consuming to reach.

#### 4. Findings

The following are abbreviated findings from the analysis, in which societal, leadership, and transaction cost aspects are dissected for the both innovative and typical city governments. The explanations are simplified in Table 3, in which each city has either presence or absence of each variable (“Yes”, “No” or “Not always”).

##### Innovative city governments

###### *Society*

Three innovative city governments, namely Naga in the Philippines and Pekalongan and Balikpapan in Indonesia started with already having progressive societies. Naga and Pekalongan have had a long history of being an “opposition base” and “activist city”. Religious organizations play a big role in both cities, not just in religious matters but also in education, community development, and social services. NGOs, people’s organizations, and higher education thrive in Naga while Pekalongan is home to Indonesia’s largest savings and loans cooperative, revealing egalitarian and entrepreneurial values. Balikpapan also has had a progressive society, but its modern history is shorter compared to Naga and Pekalongan. Since the discovery of oil in 1897, the city has developed oil refineries and attracted related manufacturing and service workers. The city’s residents are multi-ethnic,

<sup>4</sup> Note how Indonesia is 14 years behind the Philippines in terms of recognizing local public innovations

<sup>5</sup> As of the 2010 Census, Balikpapan had a population of 557,579 while Pekalongan had 281,434.

disciplined, relatively more educated and skilled, and primarily composed of migrants who have stayed for two to three generations and adopted Balikpapan as their new hometown.

In contrast to the three, Marikina in the Philippines did not start by having a progressive society. For the most part before 1992, Marikina was mostly regarded as a dirty and unsafe area of Metro Manila where crime rate was high, the streets and sidewalks were unruly, and the river was polluted and lined with squatter settlements. The city government was subject to patronage politics, public services were unsatisfactory, and there is a sense of indifference among the citizens.

### *Leadership*

All four innovative city governments have had committed and effective leadership. Three cities in particular had a period of leadership transformation that was started by Jesse M. Robredo in Naga (1989), Bayani Fernando in Marikina (1992), and Basyir Ahmad in Pekalongan (2005). All were strong leaders who worked hard, proved their words, lived humbly in both personal and public spheres, and expected the same from their staff.

Robredo was working for San Miguel Corporation in Manila when the People Power revolution broke off. Motivated to serve, he returned to Naga, quickly gained popularity, and was elected as mayor in 1989. He was mayor of Naga for a total of six terms (1989-1998 and 2001-2010) and was succeeded by John G. Bongat, a similarly popular and committed leader from the same political slate. Basyir is as medical doctor from a family of immigrant entrepreneurs who entered politics in 1999 as city councilor and was elected as mayor in 2005. Nearing the completion of his second term, Basyir will step down by the end of 2015. Bayani Fernando (BF) was already an established engineer who owned an AAA-rated general contractor when he became mayor. During his three terms (1992-2001), BF was known for his disciplined and iron-handed personal character. He was succeeded by his wife, Marides Carlos Fernando (MCF), who also led the city for three terms (2001-2010), and subsequently Del De Guzman (2010-2016), who was part of the Fernandos' political slate between 1992 and 2010.

Balikpapan was different in the sense that it has had effective leadership for a much longer period. Due to Balikpapan's strategic value, the New Order Regime had planted capable mayors with military-background, such as Syarifuddin Yoes (1981-1989) and Tjutjup Suparna (1991-2001). However, since the city already had disciplined and skilled residents, the mayors did not act so much in authoritarian ways, but in worked in partnership with community groups to create a livable city with much emphasis on the natural environment. After decentralization, Balikpapan's mayors were no longer from the military, but Imdaad Hamid (2001-2011) and Rizal Effendi (2011-2016) have continued the good leadership tradition of their predecessors.

### *Transaction Cost*

All four innovative city governments have faced either low transaction costs or have managed such costs to be efficient enough to introduce a public innovation and implement it successfully. In terms of information costs, they were familiar with various innovative programs that have been conducted in other cities. Pekalongan encouraged heads of departments to observe, replicate, and modify best practices of other cities. Marikina leaders, especially BF, deliberately explored various cities that they visited, took photos, measured objects and distances, and conducted brainstorming sessions with his staff upon return to discuss how the same could be replicated. The four innovative cases

also made use of their networks, for example by participating actively in national and international city associations, and building their own networks based on specific issues. For example, Pekalongan developed multi-stakeholder networks for issues such as ICT, public markets, healthcare, etc. ICT was also deliberately and specifically utilized and developed to explore further innovations.

In terms of negotiation costs, all four city governments built the trust of citizens and managed good working relationship with citizens groups. This was done, for example, by having weekly or monthly lunch or dinner meetings, frequent visits to communities, and establishing open but structured communication mechanism with constituents. The city's leaders also managed to contain possible disruptions from political rivals by winning landslide elections (thus preventing the rise of meaningful rivalry), or by making political negotiations such that they could govern effectively.

Not all cities, however, had the full and constant support of city council. In Robredo and Fernando's first term, most city councilors were affiliated with old established political elites who opposed most of the mayors' initiatives. Seeing difficulty in introducing innovations, Robredo launched a campaign slogan during re-elections where he called for people who trusted him to also vote for his political affiliates to sit in the city council (*Ubos kung ubos, gabos kung gabos*). Following a successful first term, citizens have granted Robredo and Fernando's slates landslide victories and a city council that is mostly composed of their political affiliates. The same, however, could not be done in Balikpapan, where the mayor was not supported by political parties which had majority seats in the parliament.

In terms of enforcement costs, all four innovative cases have built capable civil servants and conduct extensive trainings for their staff. The most impactful capacity building, however, as noted by various civil servants, are occasions where the mayor interacts with his or her staff on a day-to-day basis, and leads by setting a personal example. Pekalongan and Marikina, for example, did not start by having a motivated civil service, but over time, the habits change and government staffs now have pride in their achievements. Three of the four cities provide monetary incentives and disincentives to government staff. Pekalongan's incentives, however, were more in the form of appreciations, motivation, and pride rather than salary top-ups or bonuses.

## Typical city governments

### *Society*

Three of the typical city governments, namely Samarinda and Tanjungpinang in Indonesia and Malabon in the Philippines had little indication of having a progressive society. Samarinda and Tanjungpinang have been the trade and administrative centers of their respective areas for several centuries. However, such roles were enabled by a feudal and rent-seeking system which was maintained by the local kingdoms, continued by the Dutch, and remained in character in modern-day Indonesia. Rent-seeking activities (i.e., rampant issuance of coal mining concessions in Samarinda) and lenient use of public funds (i.e., construction of lavish government offices in Tanjungpinang) were generally accepted as long as the money trickles down to the local economy. Critical awareness is rising in Samarinda, where civil society groups have won a citizen's law suit in 2014 against the mayor for neglecting the natural environment. However, just like in Tanjungpinang, for the most part the citizens have been permissive.

Table 3: Comparison of variables across eight city governments

Framework	Variables	Innovative city governments				Innov. Case Count	Typical city governments				Typ. Case Count
		Naga, PH	Marikina, PH	Pekalongan, ID	Balikpapan, ID		Dagupan, PH	Malabon, PH	Samarinda, ID	Tanjungpinang, ID	
Transaction Cost	<b>Low information cost</b>										
	Familiarity w/ other cities	Yes*	Yes	Yes	Yes	4/4	Yes	Not always	Yes	No	2/4
	Networking opportunities	Yes	Yes	Yes	Yes	4/4	Yes	Yes	Not always	No	2/4
	Access to ICT	Yes	Yes	Yes	Yes	4/4	Yes	Yes	Yes	No	3/4
	<i>Variable count</i>	3/3	3/3	3/3	3/3		3/3	2/3	2/3	0/0	
	<b>Low negotiation cost</b>										
	Relationship w/ city council	Yes*	Yes*	Yes	Not always	3/4	Not always	Yes	Yes	Yes	3/4
	Relationship w/ citizens	Yes	Yes*	Yes	Yes	4/4	Not always	Not always	No	Not always	0/4
	Healthy political rivalry	Yes	Yes	Yes	Yes	4/4	No	No	Yes	Yes	2/4
	<i>Variable count</i>	3/3	3/3	3/3	2/3		0/3	1/3	2/3	2/3	
	<b>Low enforcement cost</b>										
	Capable civil servants	Yes	Yes*	Yes*	Yes	4/4	No	No	Yes	No	1/4
	Capacity building activities	Yes	Yes	Yes	Yes	4/4	Yes	Not always	Yes	Yes	3/4
Incentives & disincentives	Yes	Yes	No	Yes	3/4	Not always	No	Yes	Yes	2/4	
<i>Variable count</i>	3/3	3/3	2/3	3/3		1/3	0/3	3/3	2/3		
<b>Variable count</b>		<b>9/9</b>	<b>9/9</b>	<b>8/9</b>	<b>8/9</b>		<b>4/9</b>	<b>3/9</b>	<b>7/9</b>	<b>4/9</b>	
Leadership	Leaders' commitment	Yes	Yes	Yes	Yes	4/4	Yes	Not always	No	No	1/4
	Leaders' effectiveness	Yes	Yes	Yes	Yes	4/4	Not always	No	No	No	0/4
	Leaders' experience	Yes	Yes	Yes	Yes	4/4	Yes	Not always	Yes	No	1/4
<b>Variable count</b>		<b>3/3</b>	<b>3/3</b>	<b>3/3</b>	<b>3/3</b>		<b>2/3</b>	<b>0/3</b>	<b>1/3</b>	<b>0/3</b>	
Society	Favorable history	Yes	No	Yes	Yes	3/4	Yes	Not always	No	No	1/4
	Progressive local orgs.	Yes	Yes*	Yes	Yes	4/4	Yes	No	Not always	No	1/4
	Good local norms	Yes	Yes*	Yes	Yes	4/4	Not always	No	No	No	0/4
<b>Variable count</b>		<b>3/3</b>	<b>2/3</b>	<b>3/3</b>	<b>3/3</b>		<b>2/3</b>	<b>0/3</b>	<b>0/3</b>	<b>0/3</b>	
<b>Total variable count</b>		<b>15/15</b>	<b>14/15</b>	<b>14/15</b>	<b>14/15</b>		<b>7/15</b>	<b>3/15</b>	<b>8/15</b>	<b>4/9</b>	

\*Previously not so

Malabon has had a mixed history. In the 19<sup>th</sup> century it was a busy processing and trading hub for grains and other produce coming from the farmlands of Pampanga and Bulacan. The city's recent history, however, saw the area turn into an informal "first landing point" for various migrants from all over Philippines looking for a better life in the NCR. Located near the Manila Port, local syndicates made good business by building shanty towns to accommodate the transient population who had little affiliation or attachment with Malabon. For many years the condition has been neglected.

Dagupan is different from the other three cities. It has been, for several centuries, the commercial, religious, education, and healthcare center for Ilocos region, another area aside from Manila that connects the rice-producing regions of Central Luzon with the South China Sea. Dagupan is also a media hub for the region, where political conversations take place openly and citizens participate actively in government activities. Economic activities are vibrant with the city being acknowledged as the most competitive among Philippines' "emergent cities" in 2009.

### *Leadership*

Three of the four typical cases, namely Samarinda, Tanjungpinang, and Malabon, have not had a consistent presence of committed and effective leadership with experience other than the public sector. In Malabon, until the election of Antolin A. Oreta, III as mayor in 2013, the city had been led mostly by established elites who preferred a lenient and compromising approach to governing. The same goes for Tanjungpinang, which had been led by a local, established figure who focused more on construction projects and ensured that civil servants did not stress too much about development targets. In Samarinda, the leadership position has been held by local politicians who benefited from rent-seeking activities, and regeneration of such leaders had been sustained by a robust system of local patronage politics.

In the three cities, there had been cases where the past mayor or high ranking officials were investigated for a corruption case. For example, Samarinda's 2010 land price mark-up case involved seven heads of departments and the previous mayor's assistant. In Tanjungpinang, the previous mayor and vice mayor were investigated for personal use of public funds in 2013. In Malabon, an active mayor was suspended in 2003 after being found "guilty of abuse of authority".

Dagupan, in contrast with the three cities, generally have had committed leaders with big ambitions for improving the city. Alipio F. Fernandez, Jr. (mayor 1992-2001, 2007-2010) was a traditional politician who was good at wooing people's support and focused on providing basic services. Benjamin S. Lim (mayor 2001-2007, 2010-2013) was known for his innovations and marketing skills. He is a retail businessman that owns supermarkets throughout the region and started the city's signature Bangus Festival in 2002. Belen Fernandez (mayor 2013-2016) is also a retail businesswoman who owns successful outlets in the region, making her the top realty tax payer in Dagupan. She is known for being hard-working and fearless in tackling corruption. However, as the next section will explain, Fernandez and Lim do not go well with each other.

### *Transaction Cost*

Despite having favorable society and leadership, Dagupan's leaders did not have favorable transaction costs, especially in terms of negotiation cost. Due to bitter leadership rivalry among Fernandez and Lim, the city's leadership is typically split among the two political rivals. This resulted

in the mayor facing oppositions when introducing signature programs, and the nullification of existing program when the rival takes control of city hall at the next election. Malabon also experienced bitter political rivalry but not so much to the damaging extent as Dagupan. However, neither of the two Indonesian cities experienced bitter political rivalry (it typically only takes place during elections).

In Malabon, Samarinda, and Tanjungpinang, regardless of the political composition of the city council, getting approval and support from the legislative was not so much of an issue as “quid pro quo” negotiations were typically welcomed. All four city governments, however, had issues with keeping a close and mutual relationship with citizens groups in a consistent manner. Sometimes, as in the case of Dagupan, a leader may have good ideas but did not manage to build complete trust from some interest groups. Other times, as in Malabon, rivalry between citizen groups prevented the leader from getting the full support.

In terms of information cost, three of the four cities typically had familiarity with innovative programs conducted in other places, built extensive networks, and had good access and utilization of ICT. Tanjungpinang was an exception as for the most part until 2014, it was rather inward-looking.

In terms of enforcement cost, again, there was wide difference between the four cities as Samarinda had good capacity of civil servants, constantly conducted trainings, and had the resources to implement a sizeable incentive system for civil servants. Tanjungpinang also heavily conducted trainings and implemented an incentive system, but admitted to having staff which are under capacity. Malabon and Dagupan has had issues with capacity of civil servants, but only sporadically conducted trainings and kept an incentive system, typically due to budget limitations.

## 5. Comparisons and Analysis

The findings as explained in Table 3 are further simplified as a Venn diagram in Figure 1. If a city government has more than half of the indicators related to leadership (3 variables), society (3 variables), or transaction costs (9 variables), it is considered to be in possession such aspect.

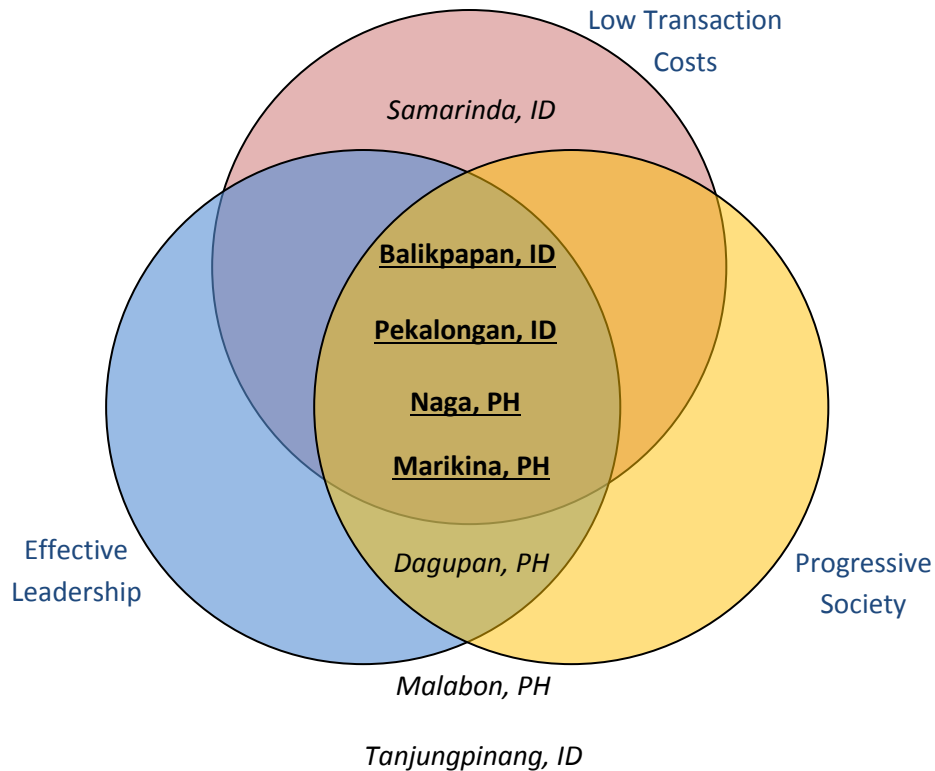
Figure 1 shows that innovative city governments, in this case, Naga and Marikina in the Philippines, and Balikpapan and Pekalongan in Indonesia, have all three sets of variables: effective leadership, progressive society, and low transaction costs. Meanwhile, typical city governments such as Dagupan and Malabon in the Philippines, and Samarinda and Tanjungpinang in Indonesia, do not have all of the three.

The four typical cases show differences in the presence (or absence) of these variables. Malabon and Tanjungpinang are lacking in leadership, society, and transaction cost variables. Dagupan, however, shows presence of effective leadership and progressive society (though not to a full extent), but lack having favorable transaction costs. Samarinda, interestingly, have built efficient transaction costs, but lack having an effective leadership and progressive society.

Referring to Table 3, the experience of Naga, Pekalongan, and Balikpapan highlights how effective leaders (3/3 variables) were able to emerge from a progressive society (3/3) and faced low transaction costs (9/9, 8/9, and 8/9 respectively), or were able to alter the transaction costs in their favor, such that they could implement new, innovative programs that transformed the city. Thus

Naga, Pekalongan, and Balikpapan are cities where effective leadership, progressive society, and low transaction costs work together to make the LGU an innovative one.

**Figure 1: Innovativeness in relation to Leadership, Society, and Transaction Costs**



Legend:

**Bold Underline**: Innovative city governments

*Italics*: Typical city governments

Marikina highlights how effective leaders (3/3) were able to emerge even from an initially not-so-progressive society (initially 0/3, but then 3/3). Such leaders had especially strong political will, character, and charisma, such that they could alter transaction costs which were initially against their favor (negotiation costs were initially 1/3, but then 3/3), and implement the needed transformative programs. Over time (23 years of consistent implementation of such programs), Marikina was able to change the values, norms, and habits of their population such that it has now become a progressive society.

In Malabon and Tanjungpinang, a less-than-progressive society (0/3) coupled with inconsistency in having effective leaders (0/3) have prevented the city from introducing innovative programs. Even if sometimes promising leaders with commitment and favorable experience were given a chance to lead, they were prevented from being effective. Malabon’s and Tanjungpinang’s transaction costs were low (3/9 and 4/9, respectively). However, permissive attitude and low capacity of civil servants in both cities, inward-looking orientation in Tanjungpinang, and predatory interest groups in Malabon, consistently presented challenges to the mayors.

While the six cases above show that leadership and society variables were all-present in the innovative cases and all-absent in the typical cases, two remaining cases (Dagupan and Samarinda) show otherwise. Dagupan shows that leadership and society, alone or together, are not enough (necessary but insufficient) to explain innovation. Dagupan is a case where even relatively effective leaders (2/3) and relatively progressive society (2/3) were not able to join forces to implement innovative programs consistently over time. A large part of the explanation may be that Dagupan had relatively unfavorable transaction costs (4/9), especially in terms of having bitter political rivalry which resulted in nullification of existing programs, not to mention lack of consistent support from city council and citizens groups.

Similar to Dagupan, Samarinda showed that transaction costs alone were also not enough (necessary but insufficient) to explain public innovation. Samarinda had relatively favorable transaction costs (7/9), which show that the leaders have consistently been able to generate a favorable political and administrative setting for whatever program they would propose. However, issues with committed leadership (1/3) and absence of progressive norms in the society (0/3) prevented the city from coming up with innovations that generate meaningful public value.

## **6. Conclusion and Limitations**

This research refutes traditional claims of the primacy of leadership (agency) alone or deep-rooted societal institutions (structure) alone. A mezzo structure that links leaders and their social setting is present in the form of transaction costs, and it seems to matter in providing or completing a framework to explain a city government's innovativeness.

In terms of external validity, eight cities may not be enough to make a strong conclusion. Just as this research identified one city (Dagupan) to claim the insufficiency of traditional leadership and society explanations, other research only needs to find one other city to argue that even a combination of leadership, society and transaction costs may not be enough.

However, this research has identified a missing gap in the literature and contributed a framework in attempt to fill that gap. Further testing of this framework and more exploration into other possible factors are welcome.

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