



**DECENTRALISATION AND DEVELOPMENT COOPERATION:
ISSUES FOR DONORS**

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EXECUTIVE SUMMARY

Decentralisation is a politically constrained necessity in the course of development. It takes many forms, from those involving minimal and partial devolvement of political authority (such as administrative decentralisation, privatisation and establishment of parastatal agencies) to a more comprehensive transfer of powers and resources (political devolution, autonomy). While there have been instances when accumulated pressure has made some devolution of power imperative (as in Indonesia), it is seldom perceived to be in the best interests of the centre to strengthen the periphery. As such, decentralisation typically takes place during periods of political and economic upheavals. This has on occasion led to bad design and/or problematic implementation of decentralisation programs.

Theoretically speaking, centralisation and decentralisation are not “either-or” conditions. Effective and efficient functioning of government requires an appropriate balance of the two, which varies across countries and over time. Nevertheless, central governments are usually wary of the political impact of decentralisation on its authority and have sought to minimize it regardless of the potential benefits. There are indeed potential advantages (e.g. greater efficiency and participation) and disadvantages (such as a loss of economies of scale and more difficult policy coordination) that have been identified with decentralisation processes worldwide. However, it is a country’s particular political setting and its design of change that ultimately determine the extent of the benefit or cost of a decentralisation program.

The second part of the paper discusses the developments leading up to the introduction of the decentralisation laws in Indonesia, analyses issues and problems of implementation thus far, and maps out the prospects. Whereas the country previously lagged behind its neighbours in its decentralisation agenda, its current program is one of the most comprehensive and drastically implemented known cases. Under Law 22/1999, district-level governments enjoy control over functions that most directly affect the people, including urban services, primary and secondary education, public and basic health services, environmental management, planning and local economic development. However, regional inequality has subsequently become a major concern as Law 25/1999 assigns some 15 percent of oil, 30 percent of natural gas and 80 percent of mining, fishing, forestry revenues, as well as the bulk of centrally collected property taxes to the producing regions. Even as the law also stipulates that a minimum of 25 percent of total domestic revenue be transferred to local governments via the General Allocation Fund (DAU), the adopted formula is perceived to be biased toward more populous and richer regions.

Unless for governments and residents in resource-rich provinces, decentralisation has been generally viewed with caution and often implemented with reluctance. Central government staffs (including those in sectoral departments) that stand to lose the most as authority and associated perks are transferred to their regional colleagues, could be tempted to drag their feet. Using the schemes allowed for them (i.e. deconcentration and co-governance, with which they are to set standards, give directions and provide training and supervision), they may exploit inherent conflicts within the legislation to resist actual delegation of authority. Such a stance has been boosted by the recent rise of President Megawati Sukarnoputri, who has been known for her strong nationalist fervour. On the other hand, the clear winners of decentralisation (i.e. district and city governments) have been currently in a state of “culture shock”. Many, especially those in financially weak regions, could subsequently discover that decentralisation does not offer the olive branch they have hoped for. For example, there have been ongoing funding problems. The DAU block grants allocated for fiscal 2001 have been reportedly inadequate to pay for the salaries of reallocated staff and meet the running costs for the devolved government functions.

Other stakeholders of decentralisation have been less clear winners and losers in the process. Provincial governments are losers as 90 percent of the DAU grants and 80 percent of natural-resource funds will go directly to the districts/cities level. However, provisions in Law 22/1999 regarding deconcentration stipulate that the central government can delegate supervisory and other powers to the provincial governments, which potentially also strengthen their bargaining position. Meanwhile, sub-district and village governments may not see substantial changes, except, perhaps the possibility of greater grassroots pressure for accountability. Two other major players – civil society institutions and foreign aid donors –

could see decentralisation as an avenue for greater prominence, though they will not benefit directly from the process. Finally, the business community is trying to digest the evolving impact of decentralisation on the business climate. The signals received thus far have been mixed.

The short-term prognosis for Indonesia's decentralisation program is not encouraging. An orderly process is simply not possible at this stage due to Indonesia's adverse economic and political circumstances and the magnitude of the change to which it has committed itself. A great deal of confusion is evident throughout the country in the rush to implement the complex administrative and institutional changes related to the decentralisation program. This disorganised nature of the implementation process leaves it vulnerable to inefficiency and abuse. While decentralisation appears to be an inevitable process (even if a roll-back is implemented soon), widening regional inequality (at least temporarily) seems to have also become a forgone conclusion. Nevertheless, the overall outcomes of decentralisation will yet evolve and it may take a decade or so before any appropriate assessment of the program can be made.

Very little research has been done in Indonesia on the impact of decentralisation from a local perspective. Most reports on decentralisation reflect the views of the centre. As most governance activities currently focus on the national level, the decentralisation process in Indonesia will require from most donors a change in mindset, moving from a centric approach to a more regional approach. Donor coordination will be of utmost importance as a growing number of donors support decentralisation activities, yet there is limited absorptive capacity at the regional level.

Part III suggests a regional targeting approach, supplemented with assistance to the centre to develop the 'enabling environment' for effective decentralisation. The entry points for possible project intervention are location, sector and focus. Given the goals of poverty alleviation, there is a range of options for sectoral approaches. As the decentralisation process is quite complex and evolving, the focus entry points directly target local government and governance issues.

As in other countries, some local governments in Indonesia will respond to the decentralisation efforts relatively more positively than others. The factors that influence success – administrative and fiscal capacity, local leadership and the strength of civil society - vary dramatically between different parts of Indonesia and this needs to be reflected in potential aid projects. In other words, an overall 'blanket' program is inappropriate. However, a core program implemented with flexibility in different local outlets could prove helpful. Given their potential (and enthusiasm) as a tool for social control, university students could be valuable allies in various aid endeavours, alongside traditional non-governmental organizations.

While decentralisation has raised hopes for better poverty alleviation ventures, no *a priori* relationship can be ascertained. In the Indonesian context, there is little in the decentralisation policy that addresses how regions are to tackle poverty and empowerment of marginalised groups. Nevertheless pro-poor considerations are being pushed as part of the allocation to the regions of the central government's revenue. In fact, most income inequalities are due more to differences among individuals within provinces or even regions rather than to differences between provinces or regions, hence rich regions may still have a high incidence of poverty. Drastic redistribution across regions will only be successful if targeting is improved within each region. This largely depends on the abilities and political will of local governments to engage in genuine redistribution. In addition, there are the issues of local capacities, adequate funding and, to prevent poverty alleviation effort from turning into short-term consumption support, the wider economic prospects.

Due to its early stages, major lessons should not be drawn from the Indonesian decentralisation process thus far. Beyond the grand design (the macro aspect of decentralisation), we believe that micro lessons of decentralisation processes are best shared within a country, where regions and subregions can learn from other regions, and provinces from other provinces. Only in limited cases, mainly (though not exclusively) for the central government, is it effective to study processes of other countries.

ABBREVIATIONS

ABS	Australian Bureau of Statistics
ADB	Asian Development Bank
AusAID	Australian Agency for International Development
BAPEDAL	Badan Pengendalian Dampak Lingkungan (Indonesia Environment Protection Agency)
BAPPENAS	Badan Perencanaan Pengembangan Nasional (National Development Planning Agency)
BPS	Biro Pusat Statistik (Central Bureau of Statistics)
Bupati	Regent or head of government of a Kabupaten
CGI	Consultative Group for Indonesia
CIDA	Canadian International Development Agency
CSIS	Centre for Strategic and International Studies
CSO	Civil Society Organisation
DAU	Dana Alokasi Umum (General Allocation Fund)
Dinas	Regional government operational division
DPR	Dewan Perwakilan Rakyat (House of the People's Representatives)
GOA	Government of Australia
GOI	Government of Indonesia
GTZ	Gesellschaft fur Technische Zusammenarbeit (German Technical Cooperation Agency)
IASTP	Indonesia-Australia Specialised Training Program
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
JICA	Japan International Cooperation Agency
Kabupaten	Rural District or regency (several districts in each of Indonesia's provinces)
KKN	Korupsi, Kolusi, Nepotisme (Corruption, Collusion, Nepotism)
Komnas HAM	Komisi Nasional Hak Asasi Manusia (National Commission on Human Rights)
Kota	Municipal District (or town if the context does not imply an autonomous region)
LSID	Longitudinal Survey of Indonesian Decentralisation
MPR	Majelis Permusyawaratan Rakyat (People's Consultative Assembly)
MoHARA	Ministry of Home Affairs and Regional Autonomy
NGO	Non-Government Organisation
NTB	Nusa Tenggara Barat
NTT	Nusa Tenggara Timur
SMERU	Social Monitoring and Early Response Unit
TA	Technical assistance
TAMF	Technical Assistance Management Facility
USAID	United States Agency for International Development
Walikota	Mayor, or head of government of a Kota
WB	World Bank

GLOSSARY

TERM	EXPLANATION
STATE	Country, but also often referred to as a state within a federalist country
<i>Associations</i>	Professional (standards) or interest-based groupings
<i>Civil society</i>	Independent forces, associations, and interest groups that commonly proliferate within a democratic system
<i>Governance</i>	Governance is the exercise of economic, political and administrative authority to manage a country's affairs at all levels
GOVERNMENT	
<i>The centre</i>	The central government, the national government
<i>The periphery</i>	The regions, the states, the provincial governments and all their jurisdictions (e.g. regencies, municipalities, townships)
<i>Subnational government</i>	Governments under the national government; the periphery
<i>Regional government, Local government</i>	Same as subnational government. Regional government is often referred to as provincial government or state, while local government is often (but not always) considered lower-level government
<i>Two-tier system/two-tier state</i>	Unitary state, comprising the central government and provinces, and so on
TERMINOLOGY OF DECENTRALISATION	
<i>Decentralisation</i>	Decentralisation in general sense. Also used to refer to devolution, especially in Indonesia, where the term for devolution is <i>desentralisasi</i>
<i>Deconcentration Administrative decentralisation,</i>	Often called structural reform or administrative reform; decentralisation without devolving political powers
<i>Devolution¹, devolvement of powers</i>	The original sense of decentralisation: transfer of powers from the centre to the regions
<i>Localisation</i>	Same meaning as decentralisation, as used by the World Bank in World Development Report 1999/2000
<i>Regional autonomy</i>	Electoral autonomy in the regions, i.e. the ability of local people to elect their own leaders and hold these leaders accountable. In Law 22/99, defined as the right of regions to regulate and manage their own affairs
INDONESIAN DECENTRALISATION	
<i>Law No. 22/1999</i>	Assigns to central government only key national functions such as foreign relations, defence, justice, the monetary and fiscal system and religion (by article 7 (1)) and national policy and planning functions (by article 7 (2)), devolves to provincial government only trans-regional affairs, while devolving all other authorities directly to local governments (city and district)
<i>Law No. 25/1999</i>	Provides the fiscal framework for local government, emphasising local financial decision-making. The law mandates that a minimum of 25 percent of domestic revenues be transferred to local governments, together with specified percentages of the property tax and increased retention of natural resource revenue by regions in which the revenue originated. It mandates a sizable increase in block grants, with local government in full control over use of the fund.
<i>Region</i>	Region (<i>daerah</i>) is a generic term for an area provided with autonomy by law (by having its own government and legislature), and may be province, Kabupaten or Kota. It is contrasted with territory (<i>wilayah</i>) for an area of deconcentrated government.

See also Attachment D: Regional and Local Administration

¹ Problems may arise in the Indonesian context as delegation is translated as *pelimpahan*, which means deconcentration. And devolution is translated as *penyerahan* which means decentralisation.

CHAPTER 1: DECENTRALISING STATES: AN OVERVIEW OF THEORIES AND PRACTICES

Decentralisation is a long-standing phenomenon arising from the need to address increasing administrative, financial and democratic complexities within a particular political jurisdiction. The imperative for some decentralisation rises as development progresses. However, distinct national political and economic interplays allow different countries to face different urgencies and/or come up with different, or differing degrees, of devolvement measures. The World Bank (1999, p.122) notes that decentralisation (or “localization” as it sees it) typically takes place during periods of political and economic upheaval, such as euphoria at the fall of an authoritarian regime, an economic crisis that precipitates a regime’s collapse, and the jockeying for power of new interest groups. Other specific national features are also factors in a decentralisation program. For example, in countries with small land areas, such as Hong Kong and Singapore, there may seem little apparent point in decentralisation if it simply creates more expensive layers of government while reducing the benefits of economies of scale. In the case of Singapore, the necessity for a strong centralised state is augmented by the perception of long-term threat either from external aggression or because of economic vulnerability (Chan, 1993). In command economies or those caught up in the process of rapid industrialisation, moves to divert resources to regional or local governments are likely to be countered by central politicians and officials who do not wish to see the national effort dissipated (Scott, 1996, p.5).

Mark Turner & David Hulme (1997, pp.151-2) maintain that “the needs of the modern state to provide some services to at least part of its citizenry, to exercise political control over its territory and to bolster its legitimacy require that a degree of authority is delegated and some decisions are made outside of the political and administrative centre.” In consequence, all systems of government involve a combination of central control and local autonomy. While potential advantages (e.g. greater efficiency and participation) and disadvantages (such as a loss of economies of scale and more difficult policy coordination) have been identified with decentralisation processes worldwide, it is a country’s particular political setting and its design of change that ultimately determine the extent of the benefit or cost of a decentralisation program.

Ian Scott (1996, p.4) observes that, in the original sense of power transfer from the centre to the regions, governments have been generally cautious in committing themselves to decentralisation. In fact, few governments have ventured beyond limited devolution and most have retained effective control of key ministries and resources at the centre. Varying degrees of decentralisation have occurred, but political calculations remain an overriding motive. Whilst accumulated pressure has occasionally made some devolution of power imperative – as in the current Indonesian situation – a trigger of some sort is required to shock the centre into giving regional concessions. This has, on many occasions, led to hasty designs and/or problematic implementations of decentralisation programs.

Approaches to Decentralisation

Turner & Hulme (1997, p.155) identify six different forms of decentralisation within three different levels of delegation of authority. These are succinctly summarized in the following table:

Forms of Decentralisation

Nature of Delegation	Basis for Delegation	
	Territorial	Functional
Within formal political structure	Devolution (political decentralisation, local government, democratic decentralisation)	Interest group representation
Within public administrative or parastatal structure	Deconcentration (administrative decentralisation, field administration)	Establishment of parastatals and quangos
From state sector to private sector	Privatisation of devolved functions (deregulation, contracting out, voucher schemes)	Privatisation of national functions (divestiture, deregulation, economic liberalization)

The above forms of decentralisation are all-inclusive and a wide range of reforms, in that sense, can be categorised into some kind of decentralisation. The least extent of decentralisation is arguably that of privatisation, with virtually all or most countries in the world having embraced it to some degree. Nonetheless, Turner & Hulme (ibid, p.154) also point out that to decentralisation “purists” only devolution – the transfer of authority to sub-national governments electorally accountable to sub-national populations – is deemed an authentic form of decentralisation. Meanwhile, the World Bank identifies political, administrative, fiscal and market decentralisation as types of such efforts. Arguably, these relate to similar forms of decentralisation: devolution for political decentralisation, deconcentration for administrative decentralisation, privatisation for market decentralisation, and fiscal decentralisation representing a cross-section of devolution, deconcentration and privatisation. Indeed, fiscal decentralisation manifests the financing aspect of decentralisation. As will be discussed later, without properly having this as a complement, decentralisation efforts could result in lower standards of services (in the case of function ahead of finance) or inefficiency and corruption (finance ahead of function).

Highlighting the post-colonial evolution of developing countries’ politics (particularly in Asia), Scott (1996) identifies four different approaches to decentralisation. This indirectly verifies the forms of decentralisation that have been implemented within their real and historical contexts. These include:

1. Institutional indigenisation
2. Structural reform and deconcentration
3. Democratic decentralisation
4. Functional decentralisation

Generally speaking, these approaches carry with them a mixture of decentralisation forms, with, for example, structural reform and deconcentration accompanied by a degree of fiscal autonomy (e.g. discretion in the use or collection of certain financial resources) and perhaps also a small amount of political devolvement (e.g. some freedom to establish policies and/or manage a program). A rough pattern can be identified along this line, with structural reform focusing more on administrative decentralisation and democratic decentralisation focusing more (however limited) on political devolvement, but neither can exclude each other. On the other hand, indigenisation is merely a superimposition of previously held administrative structures where a dualistic or quasi-decentralised system existed during the colonial era. Functional decentralisation arguably represents innovative decentralisation thinking, perhaps more applicable in developed economies with established administrative efficiency. However, in some respects, reform of state-owned enterprises in many Asian countries may also be categorized into this kind of decentralisation. To simplify matters, the term “decentralisation” subsequently used here generally refers to political devolution (i.e. decentralisation in the “purist” fashion). In any case, decentralisation to such an extent

(involving devolvement of political authority) is nearly always accompanied by fiscal decentralisation (though the timing and degrees involved may not commensurate) and this usually succeeds earlier administrative decentralisation advances.

1. Institutional Indigenisation

Under the legacy of centralised colonial control, Asia's political and organisational institutions resisted any attempted decentralising reforms in the 1950s and 1960s, leading to a conspicuous lack of comprehensive decentralisation. This is because colonial governments were typically centralised (with limited degree of delegated authority) and hierarchical (the chain of command was a focal point of the administration) (Hanaoka, 1984). More importantly, colonial administrators generally worked with traditional rulers and elites. A bureaucratic system of this kind is difficult to reform because it incorporates two kinds of authority and entrenches administrative elites who have much to lose if the level of popular participation is increased.

In the immediate post-colonial period, government reform efforts were partly an attempt to indigenise institutions inherited from the colonising power. Sovereign central governments formed subsidiary councils as part of their administrative structures and incorporated village headmen and local notables into such councils, often by giving them a disproportionate say in their affairs. In this way the centre secured positive local support for central directives and enhanced its own legitimacy, without significantly devolving power. This indigenisation arguably represents the early form of administrative decentralisation or deconcentration.

2. Structural reforms and deconcentration

Increases in government functions and activities exacerbated the gap between the centre and periphery, as the public need to interact more often with the bureaucracy. One common recipe to deal with this (a vogue in the 1970s) is to increase the number of local councils and government offices outside the capital. This measure of deconcentration was a relatively effective solution to the imperatives of administrative decentralisation. Since many Asian governments had only limited functions and did not require the profusion of administrative agencies generated by welfare states, local government could be seen as a simple extension of the central ministries. Government departments were often present in the provinces and regions but their officials were expected to respond to central instructions not local demands; policy implementation was "top-down" rather than "bottom-up".

Examples from several countries illustrate some key variations in this process (Scott, 1996, pp.9-10). In Thailand, a local government system prevails where the most important officials, the provincial governors, are appointed from the career staff of the Department of Local Administration of the Ministry of the Interior as deputies (Raksasataya, 1993). Further down the structure are the tambol councils composed of all village headmen, departmental officials at that level and local notables; these serve a symbolic status but little effective power. The Sri Lankan case offers an example of strengthening central political control at the local level. In 1973, a District Political Authority was introduced whereby groups of government party members of parliament were given responsibility for administrative functions relating to development at the district level (Navaratne, 1985). This actually resulted in the alienation of a considerable segment of the people from the development activities that were being undertaken. In Korea, Zambia and China before the "open door" policy, the politicisation of regional and district administration has also been used as a means to try to facilitate the implementation of national policies, sometimes to the detriment of local priorities (De Valk & Wekwete, 1990).

In Indonesia itself – a sprawling archipelago with diverse ethnicity – deconcentration (through Law No.5/1974, which allowed for the dispersal of central government funds and functions through branch offices of central agencies) occurred alongside a comprehensive correspondence of civil and military structures (Forrester, 2001). Each level of the civil service structure, from the centre down to the village, was practically mirrored with a corresponding level of the Army territorial structure. To bolster this strategic correspondence, many army personnel who had served in the territorial structure were subsequently appointed to the civil service positions they had mirrored. In this respect, the central government actually strengthened its grip on the regions.

3. *Democratic decentralisation*

Rising political pluralism, the growth of civil society and greater public pressure for democratisation increased the pressure for political devolution starting from the 1980s (Scott, 1996, p.11). The new wave of decentralisation was partly inspired by the overthrow of the Marcos regime in the Philippines in 1986, the emergence of democratic movements in Taiwan and South Korea, and the collapse of the Soviet Union. Governments in some countries, such as Indonesia, Malaysia and Thailand, have continued to follow the path of structural reform and limited administrative decentralisation, but simultaneous political pressures for more participation inevitably generated significant repercussions for the structures and politics of local administrations.

Three major aspects of the new wave distinguish the process from earlier structural reforms:

- Increased public demand for the creation of elected local bodies instead of consultative forums (as generated through earlier modes of decentralisation). Popularly elected local representatives were sometimes opposed to the central government and might consequently push for greater political decentralisation. In Taiwan, for example, the Democratic Progressive Party captured 41 percent of the vote in the mayoral and county magistrate elections of 1993 (Wong, 1994). Six years earlier the country had been under martial law and the control of a single party.
- Linked to this increased political pluralism is the proliferation of civil society in Asian countries. As Scott (1996, p.12) puts it: “If vigorous independent local organisations do develop, they are likely to serve as a spur for a real transfer of power if only because these organisations need to interact with local authorities who are competent to make decisions within their own jurisdictions.” Two examples – the importance of local NGOs in the Philippines (Brillantes, 1993) and the privatisation of the Saemul community development movement in South Korea (Kim, 1993) – provide illustrations of how previously controlled central organisations can ‘go local’, with important consequences for the balance of power. In the case of the Saemul movement, what was initially seen as “induced participation” (Whang, 1985, p.106) has now become an independent institution capable of affecting political stability (Lee, 1993, p.38).
- Finally, democratisation processes have also strengthened the basis of administrative decentralisation (Scott, 1996, p.12), pushing for greater responsiveness of the central government along the way. Padilla (1993), for example, notes that the 1992 Local Government Code in the Philippines, which provides for an extensive devolution of powers, would have been unlikely under

the Marcos regime, due to its democratisation objectives.² In Korea, Jong (1991, p.151) reports that there has been considerable deconcentration of central government officials although not much decentralisation. Other democratisation-related measures seek to boost responsiveness in largely centralised systems. The Hong Kong government has adopted a scheme similar to that of the citizens' charters in Britain (Cooray, 1993) and Singapore has sought to improve its complaint-handling procedures (Quah, 1993). In Indonesia, the theme *keterbukaan* (i.e. openness) and the creation of *Kotak Pos 5000* (a supposedly anonymous facility where citizens can lodge complaints against government officials on any aspects of administration) in the early 1990s can be seen as an effort to respond to similar pressures.

4. *Functional decentralisation*

The next wave of decentralisation reform (which still needs to run its course in much of Asia) closely relates to function and is more attuned to cost-benefit calculations by the centre. The scheme -- which is in line with some of the precepts of the new public management, rather than the old public administration doctrines -- offers the maintenance of ultimate central control while devolving responsibility. In it, decentralisation is deemed favourable if it is at least resource-neutral, and not something that ought to be pursued at any cost (Scott, 1996, p.13). The British 'Next Steps' agencies, for example, are decentralised in both a territorial and functional sense. "If their chief executive officers meet the targets set in the framework documents agreed with the central ministries, then they can continue to operate as de facto decentralised units. Residual control may still rest with the centre but the effect of decentralisation of this kind is to shift cost concerns to the agency and to deflect consumer demands and complaints away from the central government departments".

This "functional decentralisation" differs from deconcentration in that powers are devolved rather than delegated. However, this is theoretically achieved without unleashing the usual political, economic and organisational constraints on decentralisation. While the cost-effectiveness argument may not have been explicitly incorporated in many decentralisation programs in Asia, the ideas have certainly begun to be considered. In the area of public enterprise, reforms supported or mandated by the World Bank and the International Monetary Fund (IMF) have emphasised the accountability and independence of state managers; a process that has gained further currency since the Asian crisis struck in 1997.

Assessing the Costs and Benefits of Decentralisation

The above illustrations show that central governments are usually wary of the political impact of decentralisation on their authority and have sought to minimise it regardless of the potential benefits. The literature notes the range of political, economic and administrative benefits a decentralisation program can generate. For example, "decentralisation has been recommended *inter alia* as a cure for cumbersome decision-making at the centre; as a means of achieving greater popular participation and of empowering local communities; as an aid to planning, improved policy implementation and more effective delivery of services; as a way of generating additional resources; and, at its widest, as a necessary pre-condition for small-

² As described by Alex Brillantes (1998): The Philippines' Local Government Code "radically transformed the nature of the Philippine politico-administrative system by shifting significant powers and functions to the thousands of local governments throughout the country through a comprehensive process of devolution. Responsibilities formerly belonging to the national government were devolved to local governments. These included the delivery of basic services such as health, agriculture, social services, and aspects of environmental management and infrastructure. It likewise increased the financial resources to local governments by increasing their share from the internal revenue allotment."

scale, ecologically sustainable, development” (Conyers, 1990; De Valk, 1990; Premdas and Steeves, 1992; Saxena, 1980 -- quoted in Scott, 1996).

The World Bank has dedicated substantial attention to the discussion of decentralisation, including through its “Decentralisation Online” website. Interestingly, the bank notes that centralization and decentralisation are not “either-or” conditions, and that “in most countries an appropriate balance between the two is essential to the effective and efficient functioning of government”. The Bank asserts that “decentralisation under appropriate conditions” can:

- play an important role in broadening participation in political, economic and social activities in developing countries;
- help alleviate the bottlenecks in decision making that are often caused by central government planning and control of important economic and social activities;
- help national government ministries reach larger numbers of local areas with services;
- allow greater political representation for diverse political, ethnic, religious and cultural groups in decision-making;
- relieve top managers in central ministries of “routine” tasks to concentrate on policy;
- create a geographical focus at the local level for coordinating national, state, provincial, district and local programs more effectively and provide better opportunities for participation by local residents in decision-making;
- lead to more creative, innovative and responsive programs by allowing local “experimentation.” It can also increase political stability and national unity by allowing citizens to better control public programs at the local level.

On the negative side, adds the Bank, decentralisation does have potential disadvantages:

- It may not always be efficient, especially for standardised, routine, network-based services. It can result in the loss of economies of scale and control over scarce financial resources by the central government;
- Weak administrative or technical capacity at local levels may result in services being delivered less efficiently and effectively in some areas of the country;
- Administrative responsibilities may be transferred to local levels without adequate financial resources and make equitable distribution or provision of services more difficult;
- It can sometimes make coordination of national policies more complex and may allow functions to be captured by local elites;
- Distrust between public and private sectors may undermine cooperation at the local level.

The above positives and negatives of decentralisation are useful theoretical extrapolates, but obviously what counts is the presence or absence of the “appropriate conditions” mentioned above. Generally speaking, a country with a cohesive political structure stands a good chance to decentralise smoothly and so is a respectable level of administrative competency and honesty, especially in the regions. A robust civil society will also help focus on the

attainment of decentralisation benefits by bridging gaps and serving as a deterrent to abuse. As most developing countries usually face funding shortfalls, aid activities often bridge financial gaps. The irony is that many countries with the least possession of such “appropriate conditions” are usually those who need decentralisation the most.

Lessons from Worldwide Experiences

Despite the reluctance of central governments to decentralise, the World Bank (1999, p.107) notes that some 95 percent of the world’s democracies now have elected subnational governments, and countries everywhere – large and small, rich and poor – are devolving political, fiscal and administrative powers to subnational tiers of government. In many cases, with policymakers unable to gain a full control of the pace or genesis of the decentralisation process, it has been implemented haphazardly. Moreover, successful decentralisation policies cannot simply be replicated elsewhere, given vastly different institutions (i.e. political institutions and traditions, regulatory frameworks, property rights, nature of business-state relationships, social/cultural norms, and others), as well as the specific circumstances (e.g. macroeconomic conditions, budgetary situation, civil war, or even relevant externalities) prevailing in the individual countries at particular times. As such, there is no prescribed set of decentralisation policies that can be considered superior to others.

Hal Hill (2000) asserts that there is no clear cross-country relationship between national economic performance and the extent of decentralisation. “Good and poor (economic) outcomes can be found alongside centralised and decentralised structures.” Whether decentralisation takes place within a two-tier system (i.e. unitary state) or a three-tier system (federal state) also appears to exert no direct influence on economic performance, or indeed, the success or failure of the decentralisation programs itself. The World Bank’s Decentralisation Website notes that despite the implicit constitutional guarantee for independent decision-making by subnational governments in the federal state, the extent and nature of powers devolved to the lower tiers actually vary widely from country to country in both federal and unitary states and also may change from time to time.

Latin American nations, which decentralised in the 1980s through the mid-1990s, are examples where the unitary-versus-federal state variation was not really a relevant determinant of the macroeconomic outcomes of decentralisation. Argentina and Brazil present cases where the post-military regime reverted in 1983 and 1988, respectively, to the old federal structure (Burki, Perry & Dillinger, 1999, p.11). Colombia, Venezuela and Mexico, on the other hand, decentralised (especially with authorising direct election of governors and more liberal municipal legislation) formally as federal states, but with the characteristics of centralised politics. In Colombia (beginning in 1983) and Venezuela (beginning in 1989), decentralisation meant the replacement of appointed governors by elected ones, while in Mexico decentralisation (starting in 1977) allowed for the emergence of genuine political competition at the subnational level. Meanwhile, Chile, Bolivia and Guatemala are examples of two-tier states that went ahead with electoral autonomy, beginning in 1990, 1987 (formalized with legislation in 1994) and 1985, respectively, following the transition from military to civilian rule. Table 1 shows a broad spectrum of economic growth rates in decentralising Latin American economies, making a case that numerous other factors must be incorporated to account for the variation. The economic environment in the 1990s was simply better than the 1980s (which saw two oil shocks), and consequently economic growth was stronger. In Asia, the Philippines, which underwent significant decentralisation in 1991/92, gradually recorded improvements in its economic performance (with growth rates of 0.03 percent in 1992, 2.1 percent in 1993 and 4.4 percent in 1994). However, its rates of economic growth remained well below that of Indonesia, which hardly decentralised at all.

Table 1 : Indicators of Decentralisation and Economic Performance

	Electoral Autonomy	Independence of Subnational party organisation	The year decentralisation began	Subnational share of total spending (%)	Average annual GDP growth	
					1980-199	1990-1998
Brazil	Both levels elected	Strong	1988	37	2.7	3.3
Argentina	Both levels elected	Weak	1983	45	-0.4	5.3
Colombia	Both levels elected	Strong	1983	47	3.6	4.2
Venezuela	Both levels elected	Weak	1989	19	1.1	2.0
Mexico	Both levels elected	Weak	1977	30	0.7	2.5
Chile	Local level elected	Strong	1990	15	4.2	7.9
Bolivia	Local level elected	n.a.	1987	10	-0.2	4.2
Guatemala	Local level elected	n.a.	1985	11	0.8	4.2

Source: *Shahid Javed Burki, Guillermo E. Perry & William R. Dillinger (1999, p.15, Table 1.2) and the World Bank (1999, Table 11).*

Furthermore, well-established institutions could be crucial to the successful operation of a decentralised system. While federalism in some developed economies, such as Germany, Switzerland and the United States, has been thought to contribute to macroeconomic stability, decentralisation in Brazil, Argentina and Colombia has been perceived as having produced undesirable macroeconomic consequences (Burki, Perry & Dillinger, 1999, p.35).

Nonetheless, worldwide there have been scores of decentralisation projects from which lessons can be drawn. The World Bank (1999) has usefully catalogued such experiences in the past 15 years and examined their impacts against four major yardsticks – political stability, public service performance, equity and macroeconomic stability. Some of these experiences are summarised below. The pattern that emerges, however, is again inconclusive. Some decentralisation programs can be seen to have contributed to political stability, but had little or no positive impact on equity (e.g. the decentralised federal system of the former Soviet Union and, to a certain extent, South Africa). Others have improved the provision of social services but caused a drain of fiscal resources and contributed to central government deficits (e.g. some examples from Latin America, and also India with its consolidated public sector deficit). In fact, for countries with large and economically diverse regions, more relevant lessons may be found at home. Officials from less progressive regions can learn from the programs of more developed provinces within the country. The potential benefits, in this respect, are more readily replicable given the largely similar regulatory frameworks and institutions the officials are dealing with.

Political Stability

Because decentralisation is actually a product of political bargaining, political stability has been generally a natural outcome of the process. In South Africa and Uganda, decentralisation served as a path to national unity (World Bank, 1999). In the early 1990s, South Africa reformed the dual structure of its race-based apartheid by subdividing the country into 9 provinces, 5 metropolitan areas and 850 municipalities, all racially mixed and with democratically elected governments. While there remain some difficulties, such as how to divide responsibility for health and education between the central government and the provinces, decentralisation has become the country's main instrument of unification. In Uganda, after years of civil war until 1985, decentralisation helped reunite hostile factions. A broad-based politics of "resistance councils" and "committees" bestowed power to the people of a village (the council) to freely choose their leaders (committees), forming the basis for local government policy as enshrined in the 1995 constitution. While various problems have lingered, such as stagnation in the quality of local services and revenue shortfalls,

decentralisation has more successfully maintained national unity than the previous policies of centrally imposed controls.

In war-ravaged Bosnia and Herzegovina, decentralisation is seen to have deflated secessionist tendencies. Under the Dayton Peace Agreements, the national government's authority has been limited to international relations (including customs, trade policies, and debt management), central banking (through a currency board), telecommunications and national infrastructure. However, the state has little direct revenue (from passport fees), few spending powers and no redistributive functions. Because it relies heavily on transfers from two entity governments (i.e. the Federation and the Republika Srpska), it faces challenges in carrying out even its minimal responsibilities. Large inequalities are also present and could further develop among and within the entities. Meanwhile, Russia's transformation into a decentralised federal system can be seen as a means of conceding enough power to regional interests to forestall their departure from the republic. In Sri Lanka, and Indonesia, decentralisation may offer a political solution to the civil war, or secessionist struggles. However, whether this can be achieved is yet to be discovered.

Public Service Performance

Decentralisation, in theory, can create avenues for improving the provision of public services. Local leaders know their constituents better and can be made more accountable for their performance. Citizens can also "vote with their feet", hence punishing less responsive regions with brain and capital drains. More innovative solutions, better targeted programs, more accurate identification of problems may result when local people are allowed to manage their own affairs. However, the reality has been far from convincing. A quote from the World Bank (1999, p.109) makes the point:

"... evidence supporting these arguments is scanty – not because there is evidence to the contrary, but rather because the causal relationships are difficult to prove. Governments perform a variety of functions under vastly different circumstances, which complicates comparisons of performance in a country before and after decentralisation, or across countries between centralised and decentralised systems. Moreover, efficiency and responsiveness can be hard to measure, and indicators are seldom readily available."

In Central America, decentralising management responsibilities directly to schools did improve educational performance in the primary education sector, vis-à-vis decentralising authority from the central government to provincial and local governments, which had little effect. In Russia, decentralisation might have actually lowered the quality of public services. Examples from India showed that devolved authority could be captured by local elites, with the poor continuing to have little influence.

Equity

Ameliorating income differences is one valid objective of decentralisation. However, the reverse could also be the outcome. In federally decentralised India, poverty alleviation has been a national success, though its pace has decelerated in recent years. However, poverty has become increasingly concentrated in the north and east, while the southern states have enjoyed the rise and rise of economic activity. The south's main cities – Bombay, Hyderabad, Bangalore and Madras – are now international software centres, each with its own international airport and special ties to such places as Singapore and Silicon Valley. The north's poverty rate in the late 1990s was about 50 percent higher than the south's, compared with a gap of only 7-8 percent in the 1980s (Stackhouse, 2001).

As noted by Hal Hill (1999), “inequality is generally more the result of income differences between individuals within a given region than to differences among regions. Therefore, providing more resources to poorer regions will not necessarily address the problem of regional pockets of poverty unless there is also better regional targeting”. Nevertheless, comprehensive decentralisation to community levels can indeed improve regional targeting of poverty eradication. As noted by the World Bank (1999, p.111), recent studies have indicated that “local officials and community groups are better placed to identify and reach the poor than central authorities”. In Albania, local officials had greater success in targeting the poor than expected, as did elected neighbourhood committees in Uzbekistan. In Bolivia, with decentralisation enabling local communities to influence their local governments, the composition of local public expenditures subsequently shifted in favour of the poor.

The World Bank (1999, p.111) concludes that a combination of national and subnational effort is needed in order to target the poor successfully. “In general, the bulk of the funding needs to remain a central government responsibility, but the better information available to local officials can be tapped by involving local governments in the delivery and management of social services”. In this manner, the central government’s supervisory function is also needed to ensure that redistributive goals are satisfied.

Macroeconomic Stability

The fiscal effect of decentralisation relates to this concern over macroeconomic stability. This is because decentralisation reduces the central government’s control over public resources, hence limiting its ability to adjust the budget in response to shocks. Deficit spending by local governments, if left unchecked, could also compromise the central government’s macroeconomic policies, such as in reigning in inflation.

The World Bank (1999, p.111) draws two useful observations in this regard:

- “when revenues are decentralised before expenditure responsibilities, central governments are forced to maintain spending levels with a smaller resource base. This can generate large central government deficits, at least temporarily”;
- “separating taxing and spending powers allows subnational governments to incur only a fraction of the political and financial costs of their expenditures, especially when most local resources are funded out of a common national pool of tax revenue.”

Various experiences also suggest that implementing decentralisation in a hurry increases the chances of macroeconomic imbalance. This may involve vaguely defined expenditure responsibilities, and overspecified transfers and revenue sharing. This means not only that the differential capacity of districts to absorb functions is not sufficiently accounted, but also accountability is not adequately addressed, opening the door to abuse and misuse of funds. This increases the likelihood of a substantial additional central government deficit; a risk that Ehtisham Ahmad & Bert Hofman (2000) believes to be present in the ongoing decentralisation program in Indonesia. As noted by Burki, Perry & Dillinger (1999, p.51):

“Econometric results reported here – on a worldwide sample – suggest that fast decentralisation normally leads to higher overall public expenditures and serious problems in macroeconomic management. Indeed, the results show strong evidence that increases in subnational expenditures and deficits are associated with subsequent increases in national government spending and deficits. The results also show, however, that in the long term, deeper decentralisation is not associated on average with higher deficits – or surpluses – although it is associated with larger overall expenditures if states do not collect their own revenues.”

The Indonesian Decentralisation Program: A Comparative Look

As briefly discussed above, Indonesia implemented limited decentralisation, namely deconcentration in the 1970s and, at best, a light semblance of democratic decentralisation in the early 1990s (in the sense that, through *keterbukaan*, the citizens were supposed to be able to demand greater accountability from government officials). However, until before the Asian crisis started in 1997 Indonesia lagged far behind in comparison with many of its neighbours.

In particular, the Philippines enacted a far-reaching decentralisation program in the early 1990s – one of the most radical pieces of legislation in the nation’s history (Brillantes, 1998). The Local Government Code of 1992 transfers to local governments throughout the country substantial powers and functions (health, agriculture, social services and parts of environmental management and infrastructure) as well as assigns a greater share from the Internal Revenue Allotment (IRA) to finance the additional functions. Importantly, the Code also encourages cooperation between civil society and local governments. A private institution, ARD Inc., has regularly monitored its implementation through periodic Rapid Field Appraisals (RFA), with the support of the US Agency for International Development (USAID). By the late 1990s, generally favourable assessments were presented (Brillantes, 1998):

- While there were reported IRA funding shortfalls, local governments had prudently borrowed from banks and innovatively sought other financing sources, such as BOT arrangements, joint ventures, bond flotation, etc.;
- Increased cooperation between different levels of government – both vertically and horizontally – became more apparent and local governments had started to take ownership of appropriate national programs implemented in their respective localities;
- There was an increase in local government-private sector partnerships, mechanisms for civil society participation had been gradually institutionalised and innovative ways in organisational development had been introduced.

A range of factors can be attributed to the success of the Philippines’ decentralisation program, namely its established democratic institutions, ready participation of its civil society organisations, relatively well-prepared decentralisation rules³ and significant assistance from aid donors. Certain “policy gaps” are perceived to have occurred in the field of environmental management, where only partial decentralisation was effected. More significantly, the decentralisation program has failed to date to appease three decades of separatist strife in the country’s largest island of Mindanao in the south (comprising 15 provinces and 13 cities).

In Papua New Guinea, two important decisions made in 1995 highlighted the country’s decentralisation endeavour. First, a National Planning Office was established, separating planning from finance, and second, an organic law was enacted, vesting provincial and district governments with substantial resource mobilisation powers and spending autonomy. The subnational entities are now responsible for all rural development activities, public health, education and infrastructure. However, this decentralisation drive has not been anchored on a stable political footing and has since been drowned in a pile of domestic troubles. Poor governance, riddled with endemic corruption, has been one major problem, as well as over 12 years of bloody civil war in the resource-rich island of Bougainville (where

³ This was despite a view that a number of circulars and issuances from national government bodies, such as the Department of Budget and Management, the Department of Justice, the Commission of Audit and the Department of Interior and Local Government, have undermined the “spirit” of autonomy. Such issuances include a ban on local government from issuing business permits for lottery outlets and agents of the Philippine Charity and Sweepstakes Agency, an authority that should have been sanctioned by the Code.

the Panguna mine until 1988 contributed 44% of the country's exports and 20% of the government's total revenue) (Suter, 1998). High crime rates, el Nino, leadership struggles and global economic slowdown have further exacerbated economic stagnation that has subsequently hindered the decentralisation program.⁴

Nevertheless, Indonesia's current decentralisation program (starting on the first of January 2001) is more ambitious compared with the experiences of its two neighbours. Furthermore, it is being implemented at a time of dire economic distress as well as heightened secessionist conflicts. The thrust of the effort is also explicitly directed toward the district. Fundamentally, the program involves devolvement of particularly substantial powers and resources to the district. Not only that the local government presently plays a wide spectrum of functions, including urban services, primary and secondary education, public and basic health services, environmental management, planning and local economic development, but also the bulk of fiscal resources will now be retained by local administrations. This represents a complete turnaround of the situation prevailing over the past three decades in the archipelago, when the central government accounted for about 80 percent of total fiscal outlays. To complete the process, district administrations will also be accountable to local legislative councils (DPRDs), rather than to the Ministry of Home Affairs.

In effect, Indonesia is embarking on a big-bang style of devolution -- whereby most, if not all, known forms of decentralisation (political, administrative, fiscal transfer of authority and, indirectly, market decentralisation as well) are packed into a swiftly paced program. As deliberated further in the next chapter, the resultant challenges confronting the nation are similarly huge. To what extent possible benefits of decentralisation can be realised also remain hostage to the outcomes of the country's tumultuous, ongoing political and economic changes. Unfortunately, several unfavourable factors (as those prevailing in the PNG case and the absence of positive factors from the Philippine case) are present in the equation, such as hastily drafted decentralisation laws, secessionist struggle, large initial interregional disparities and highly unequal natural resource endowments, relatively weak civil society institutions, weak administrative capacities in many regions and widespread practices of corruption. However, Indonesia's great economic potentials (nationally speaking), its tradition of technocratic economic management and an anticipation of sustained political stability following the ascension in late July 2001 of Megawati Sukarnoputri to the country's fifth presidency also hold out hopes for the program. One such hope is that even if the program will be partially reversed (in line with the new government's integralist aspirations), it will still offer better outcomes than taking the original prescription within protracted political uncertainty.

⁴ For example, due to the deteriorating global economic climate and self-inflicting wounds, PNG's central bank has recently revised down the country's economic growth in 2001 from the budgetary forecast of 3.1 percent to 0.1 percent (*AFR*, 2 August 2001, p.10). This has naturally clipped the ability of local governments to mobilise needed resources, hence curtailing their ability to deliver services as well.

CHAPTER 2 : DECENTRALISATION IN INDONESIA

For over three decades until 1997/98, the Indonesian archipelago was united under the integralist control of the Suharto regime. Under the New Order, regional government was primarily “deconcentrated”. In other words vertical agencies of the central government, the *kanwil* and *kandep*, had responsibility for many areas of government business in the regions. At this time there was very limited scope for autonomy in certain state-owned enterprises and agencies. Deliberate mirroring of the civil structures with those of the military provided the mechanism to crush dissent before it could develop into any significant force. Technocratic management of the economy allowed it to grow by 7 percent on average per annum. In the process, absolute poverty rates fell from 60 percent of the population to 11 percent, adult literacy went from 56 percent of the adult population to over 90 percent today and life expectancy increased by some 20 years to 65 today (The World Bank, n.d.). Some perceived that these gains balanced the control exerted by the government in most areas. However, these impressive figures masked significant inequalities across the archipelago.

The sudden and dramatic collapse of the economy in 1997/98 destroyed this long-standing formula of political management for the ethnically diverse and geographically dispersed nation. As the economic and political crisis generated a new openness, it became apparent that the New Order had left a heritage of bitterness in many regions outside Java towards Jakarta and the Javanese-dominated bureaucracy.

Origins of decentralisation

During 1997/98 a diverse array of actors in the districts and provinces sought to reverse the injustices and inequities left behind by Suharto’s 32-year rule. In the resource-rich regions there were demands for ensuring that a larger share of the profits generated from the exploitation of local natural resources remain in the region. Calls for clean local government accompanied demands for corrupt officials to resign. In many instances, NGOs together with local communities demanded the cancellation of forest concessions and agricultural and timber plantation leases and an end to the transmigration program. Some community groups even occupied confiscated land and demanded compensation from companies who had logged or mined their traditional lands (McCarthy & Warren, 2000).

At the same time, district and provincial politicians, students and businessmen raised a number of problems previously deemed to be too sensitive. A major grievance was that, during the New Order, significant decisions were taken in Jakarta without sufficient consultation with the regions and without adequate accountability and transparency. This had allowed powerful interests at the centre to enrich themselves while regional communities felt they were left on the margins. At the same time the ability of the regions to openly negotiate for their own priorities had been impaired under the rather monolithic system of centralised control. This had diminished the opportunities for regional communities to express their aspirations and otherwise improve their well-being.

During 1997/98, some regional figures demanded immediate autonomy, while others considered directly taking a percentage of the incomes of foreign companies working locally in disregard of State regulations. In the most resource-rich and the most disenchanting provinces of Papua (Irian Jaya), Aceh, Riau and East Kalimantan, some even discussed ceding from the unitary republic of Indonesia.

In response, government ministers began openly to discuss their fears of national disintegration, and the Indonesian elites made the political decision to undertake major decentralisation. The decision can be seen as an effort to pre-empt unfavourable consequences of the de facto inability of the central government to maintain a centralised unitary state.⁵ As regional autonomy was now seen as a way to avoid national disintegration, decentralisation had become a matter of national urgency. In 1998 the

⁵ From a different angle, it can be interpreted as the product of maneuvering by the well-organised and still active pro-decentralisation forces (that had come together under Rudini’s leadership of Home Affairs from 1988-93) that sought to move upstage in a time when sectoral forces of the bureaucracy were weak (few funds for projects), and the central machinery of Golkar was in disarray.

highest legislative body, People's Consultative Assembly (MPR), issued a decision instructing the government to move ahead quickly on decentralisation.

Over time, reform efforts in this area particularly focused on two issues:

1. Creating a form of government that would enable regional communities – in a transparent and accountable fashion – to make decisions regarding their own affairs in a way that reflected their own interests and aspirations.
2. Creating a more equitable and just division of revenue between the central and regional governments.

These concerns were reflected in two laws – Law No.22 on regional government and Law No.25 on regional fiscal balance, respectively. An internal departmental team from the Ministry of Internal Affairs associated with Prof Dr Ryaas Rasyid (later the Minister for Regional Autonomy) first drafted Law No.22. At the same time the Department of Finance and other government agencies, both in the centre and the regions, were involved in drafting the second financial law, Law No.25. The Habibie government was eager to press ahead with reform during the limited time available before the general election. After limited consultations, these laws were passed in May 1999 and were scheduled for implementation by May 2001. The MPR session of August 2000 brought this date forward to the first of January 2001.

Law 22/1999:

- Defines decentralisation as involving “the delegation of governance authorities” by the central government to “autonomous regions”. Regional autonomy then consists of the authority of these autonomous regions “to govern and administer the interests (*kepentingan*) of the local people according to its own initiatives, based on the people’s aspirations, and in accordance with the prevailing laws and regulations” (Law No.22 §1). This accords with the more “pure” form of decentralisation discussed earlier, that is the transfer of authority to electorally accountable subnational governments.
- Specifies central government powers over key national functions such as defence, judiciary, foreign relations and the monetary and fiscal system. It devolves authorities over most of the functions that affect people directly, including urban services, primary and secondary education, public and basic health services, environmental management, planning and local economic development.
- Provides that districts and municipalities would continue to carry out “co-governance” (*tugas pembantuan*) tasks under the authority of the central government, and with its financial and other support.
- Places autonomy at the level of district/city rather than the province, leaving the roles of provinces restricted largely to inter-district functions and governance and management of deconcentrated central government functions.
- Makes local administrations accountable to elected local councils (DPRDs), rather than to the Ministry of Home Affairs.
- Most of the implementing capacities of central government vertical agencies (*kanwil*) will be taken over by local government agencies (*dinas*), which will have full control of personnel and organisation structures.

Law 25/1999:

- Reverses the undue centralization of Suharto’s New Order when central government spending accounted for over 80 percent of total government outlays. The law stipulates that a minimum of 25 percent of domestic revenues be transferred to local governments
- Sets out a formula for a budget grant mechanism allocating “equalisation funds” (*Dana Perimbangan*) to finance regional requirements in the context of implementing decentralisation” (Law No.25 §1). The most significant element of the “equalisation funds” is the General Allocation Fund (*Dana Alokasi Umum*, or DAU), a fund allocated from national budget “with the objective of equalising the financial capacity across regions to fund their expenditure needs” (Law No.25 §1).

- Stipulates that some 15 percent of oil, 30 percent of natural gas, and 80 percent of mining, fishing, and forestry net-after-tax revenues will be retained by the producing localities, the host provincial governments and other relevant local administrations.
- Specifies that the bulk of centrally collected property tax revenues will also be allocated to the regions.

It is important to note that Law 22/1999 fails to clearly specify the management responsibilities and division of responsibilities of regional and central government in many areas. This is most probably because the legislation attempts to find a way to accommodate the wishes of those demanding far-reaching change as well as the more cautious inclinations of central government planners steeped in the New Order tradition of deconcentrated regional government. Many formulations leave matters either ambiguous or open to determination by later implementing regulations.⁶ This leaves open the possibility for different stakeholders to interpret the meaning of legal clauses in accordance with their specific perceptions and interests.

National and regional elections were also a major step forward in building a nationwide political constituency for decentralisation. In the 1999 General Elections, 48 parties contested the elections, instead of the same three Suharto-created political groupings that had participated in such elections in the two decades to 1997. For the first time in 40 years, local assemblies at the provincial and district/city levels were democratically elected (Forrester, 2001). Now representatives from the regions have a voice in legislatures at both these levels.

Stakeholders of decentralisation (see also Appendix B)

The central government

While the centre is the decision maker of decentralisation, it is now mired in difficult problems and insolvency. As such, there are concerns that the central government may be tempted to slow or reverse this process in order to meet its own fiscal commitments -- particularly to international debt repayments and especially if its planned reduction of domestic subsidies for fuel, electricity and other items, results in social unrest.

Decisions in Jakarta tend to reflect particular interests at the centre – including a reluctance of vested interests to give up control over resources associated with a more centralised system. For instance, as Forrester (2001: 27) has reported, the failure to implement fully the formula for allocating the “equalization funds” (specifically the DAU) has introduced a bias in favour of populous, richer regions.

The presidency

As Forrester (2001) has noted, it is no coincidence that the regional autonomy laws were passed in 1998 when the President and several other key officials, including Ryaas Rasyid himself, were non-Javanese. Since this time the Wahid government paid less attention to decentralisation, and the State Ministry for Regional Autonomy was abolished in August 2000. A protracted power struggle between the president and the legislative also distracted the central government from decentralisation concerns. From late July 2001, a new president with a strong nationalist fervour, Megawati Sukarnoputri, has come to power. The centre’s original decentralisation decision can be seen as an effort to prop up dwindling ruling legitimacy

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Article seven of Law No.22/1999 states that:

(1) The authority of the region shall include authorities in all fields of governance, except authority in the fields of international policies, defence and security, judicature, monetary and fiscal, religion and authority in other fields.
 (2) Authority in other fields as intended in paragraph (1) shall cover the policies on national planning and macro national development control, the financial balance fund, state administration and state economic institutional systems, human resources development, natural resources utilisation as well as strategic high technology, conservation and national standardisation. Moreover, article 12 states that further clarification on the provisions regarding to the “other fields” mentioned in article 7 would be specified by later government regulations (PP). This left open the possibility of later reinterpretation of the authority given to district/city governments in key areas.

in the wake of economic and political crises. However, if the instalment of the new government quickly improves economic conditions, such legitimacy concerns among central government officials may subside. With many public servants at the centre stand to lose lucrative extra incomes (often considered essential supplements to their meagre salaries) through the transfer of functions to the regions, the central bureaucratic machinery could be significantly geared to backtrack the decentralisation process in the coming months. The appointment of a top military general (i.e. Lieutenant-General Hari Sabarno) to head the powerful home affairs ministry (which oversees the country's provinces) is a strong indication of the central government's tougher stance, including toward the two secessionist provinces of Aceh and Papua.

Sectoral department

Under the New Order the sectoral departments (such as Education, Health and Public Works) played the key role in delivering services in the regions at the required national standard through regional branches of the central government (*kanwil* and *kandep*). Under Law 22 and 25, the deconcentrated functions of these vertical agencies were to be absorbed by regional government agencies. Consequently, as the role and level of funding of the sectoral agencies in service delivery was to be reduced, the sectoral departments were set to be major losers in the decentralisation process.

Under regional autonomy, the sectoral departments primarily have responsibility for setting standards and norms, giving directions, and providing training and supervision. While they will need to develop a new understanding of their tasks if they are to achieve their mandates, there are indications that they lack enthusiasm for regional autonomy. According to officials within the Ministry of Home Affairs and Regional Autonomy (MoHARA), the Lack of guidelines (*pedoman & bimbingan*), directions, training and supervision can partly be explained by reluctance of central government agencies to come to terms with reduced power and privileges under regional autonomy.⁷

At the same time many laws governing areas of sectoral activity (for example, the laws governing land tenure) persist from the earlier period. While these laws do not accord with the decentralisation process and will have to be revised, at present they remain valid. Conflicts between different areas of legislation can provide sectoral agencies reasons for resisting delegation of authority.

As Nicol and McCarthy have recently reported, it now appears that the sectoral agencies have been able to exert influence through their ministers and through the DPR commission/committee system by which the national budget is developed. In this way they have managed to lobby "effectively to maintain their operational budgets in the form of the Deconcentration Funds (DF)", maintaining control over "a development budget that is half the size of the block grants the central government have provided to the districts/cities". This gives sectoral agencies "the greatest power to influence, even dictate, what many regional governments actually do. While the leverage they can exert in the richer districts/cities may be limited, it is likely to be significant in the poorer ones that are struggling to meet their commitments with the limited DAU funds at their disposal. In essence, districts/cities have limited independent resources to carry out decentralised functions placed in their hands under Law 22" (Nicol and McCarthy, 2001). The central government could once again use funding to enhance its control of regional government.

Nicol and McCarthy (2001) have concluded that, "while deconcentration and co-governance were to continue to be important under Law 22/1999, the law aimed to further the autonomous role of district/city administrations. Yet, the continued prominence of the sector agencies particularly accentuates deconcentration/co-governance. This must be managed carefully if it is not to unduly distort the legislative intentions and principles upon which regional autonomy is based".

⁷ Interview, MoHARA, July 2001.

District/city government

There are major concerns whether the districts/cities are sufficiently prepared, or have the capability to cope with their new tasks. After over 30 years of following instructions from the centre, according to one report regional governments are in a state of “culture shock”. Moreover, there are indications that there is the shortage of district staff and regional legislative (DPRD) members with required experience and knowledge. A lack of resourcefulness in finding new solutions and poor decision making reflect these problems.

On 1 January 2001, the date of the official transfer of authorities to regions, there were 336 Kabupaten and Kota in Indonesia. As the decentralisation laws treat the districts (*Kabupaten*) and city (*Kota*) as the major units of government authority, these governments are the clear winners in the process. This means that they are likely to resist – either openly or tacitly – any attempts to further decentralise controls over key functions.

However, a number of critical issues have emerged.

1. The press continues to carry reports of on-going funding problems and complaints by district/city governments that the DAU block grants allocated for 2001 inadequate to the costs of paying the salaries of reallocated staff and running devolved government functions. In some cases, districts have used development funds to pay budget for civil servants, leading to critical shortfalls in key areas such as health. They have also stimulated regional governments to prioritise raising revenue over other activities, contributing to the widely reported taxing practices that are detrimentally affecting regional communities and businesses alike. For instance, levies on trucks, docking privileges and veterinary services have been slapped on business (The Jakarta Post, 4 April 2001). There have also been many reports of district/city administrations generating revenue through logging and other natural resources activities to make up for the shortfall with environmental consequences. At the same time, some districts have refused to take on responsibility for government activities if they are costly to run (e.g. psychiatric hospitals).
2. In the fast transition to regional autonomy, district/city administrations have had to formulate local regulations (*perda*) in the absence of guiding regulations from the central government. At least some of these regulations contradict higher laws. In 2000 the MPR has instructed that regional regulations will need to be brought into line when higher regulations are introduced later. However, as it is likely that districts/cities will resent actions which they believe attempt to curtail their powers, this may well prove a difficult task.
3. There have been many reports of regional, ethnic and special interests affecting decision-making by regional governments at the expense of wider priorities. For instance, many regions prefer to employ “children of the region” (*putra daerah*) and have been reluctant to take staff from other regions or have otherwise selected staff based on extra-professional criteria. In some cases officials, without the appropriate background have been placed in positions because of their ethnic identity. While the new laws require that an official occupying a particular position has a particular echelon status, in some cases district administrations have ensured a *putra daerah* occupies this role by changing the scale of the organisation. These dynamics affect the distribution of staff and the professionalism of government administration.
4. As DPRDs now have the power to elect district/city heads or hold them responsible for problems, the power relationship between the executive and legislative arms of regional government has changed. Many reports indicate that money politics affects the selection of heads. In the ensuing mêlée of wheeling and dealing, reports emerge that regional governments and DPRDs attend to the welfare of the members rather than of the region’s overall welfare.

Provincial governments

With the decentralisation laws devolving most political and fiscal authorities to district-level governments, provincial administrations are among the losers in the decentralisation scheme. For instance, provincial governments seem to have been particularly unhappy about a clause (§4) in Law 22/99 that stated that autonomous regions "shall respectively be independent and shall not have a hierarchical relationship to each other". Moreover, some 90 percent of the DAU and 80 percent of natural-resource funds will go directly to the districts/cities level.

In accordance with provisions in Law 22/1999 regarding deconcentration, the central government can delegate supervisory and other powers to the provincial governments.⁸ This places the provincial government in a potentially conflictual relationship with district/city governments. However, the revisions of laws 22 and 25 currently being prepared are likely to reinstate the prominent role of the provinces in the governing process. In the meantime, unclear understanding of responsibilities and authorities during the transition period and divergent understanding of regulations between provincial and district/city agencies are leading to conflicts between districts and the province over staff, assets, jurisdiction and responsibilities.

Subdistrict-level and village-level governments

In the old system, the deconcentrated central government structure went below the district level to the subdistrict (*Kecamatan*) level. The camat, or head of the kecamatan, was responsible for general governance in his territory, and hence was considered a "level of the administration". Under the new laws, the camat becomes part of the autonomous regional administration and can no longer be considered as a separate administration. In Jakarta, which has a separate law covering its autonomy (Law 34/1999), the citizens of kecamatan elect an advisory council to advise the camat on any matter of administration.

Law 22/1999 also legislates village (*desa*) government, providing for more democratic processes and for a village council, and allows districts to prepare by-laws on village government according to the prevailing culture of the region.

Civil servants

Indonesia's traditionally weak civil service is another facet of the problem. Niessen (1999, p.331) identifies the recruitment system as an obvious part of the problem. Every year, requests for new personnel were channelled upwards to the State Minister of Utilisation of the State Apparatus, which determine the amount and type of vacancies per government unit. Subsequently, appointment procedures followed the "top-down" track. From a reservoir of applicants, the national departments first made their selection, then the provincial governments, and the municipal governments had no option but to accept the leftovers. It often occurred that the municipal government requested technical and financial experts, but were left with no alternatives than to accept new recruits with academic degrees (or even less) in social sciences or humanities. As a consequence, professionalism and specialisation within the municipal administration were difficult to develop. As ambitious and capable officials were generally found at the provincial level or in Jakarta, human resources in district/city governments tended to be poorly developed. This is the heritage from the past, and it is unclear how the recruitment process will change after decentralisation.

Nonetheless, following the implementation of the laws, some 1.7 million central government civil servants have been transferred to the payrolls of local governments, and an unknown number of others are still to be transferred (estimated between 2.1 and 2.6 million in total). Some districts and cities will simply not have enough resources to pay them, while others may simply refuse to take some of the new

⁸ A government regulation (PP20/2001) effectively grants the central government a veto over any regulation or decisions from district/city governments that contradict 'the general good or higher regulations'. This veto power can be delegated to the provincial government.

staff onboard. For the transferees themselves, the feelings will be mixed. The 1.7 million have simply moved from *kanwil* (or territorial office of a department) to a provincial government office, or from *kandep* (or departmental office in district) to a district office, in the same city, hence with minimum disruption to their lifestyle, although job security, job satisfaction, and above-salary allowances may be at risk. Newly incorporated ex-centre employees may be among the first to be removed from office in the event of a budget shortfall in any local governments although the law does not allow regions to fire them. Proposed further transfers of staff, from provincial capital to districts, or from Jakarta to regions, have not yet started.

Regional civil society

Civil society in the regions has emerged since the end of the Suharto era.

- District and provincial politicians, students and businessmen, academics, officials, NGOs, government decision-makers, party leaders and other key figures participate in numerous seminars and discussions which, together with revitalised regional assemblies, ensure a lively debate of local affairs.
- Regional associations and organisations have also developed with critical concerns regarding regional affairs.
- The local and national press reports on many of these discussions, with many new regional publications and editions. A large amount of newsprint and broadcasting content discusses decentralisation and local government affairs.
- In every region, there is an array of community-based organisations supporting social development (including many religious organisations), transparency (often identifying themselves as Corruption Watch, Council Watch, Bupati Watch), and business development (including associations of hawkers and unemployed).

Consequently there is increased public participation in the planning process, especially in regions that have long established NGOs and civil society organisations (CSOs) who are active in capacity building within the community (see Indonesian decentralisation mission report 2001).

However, the revitalised regional civil society is still seeking ways to make its voice heard in distant Jakarta and ensure that central government decision-makers take regional public opinion seriously. During discussions aimed at winding back decentralisation, especially during the emerging debate over proposed changes to Laws 22 and 25, regional civil society may yet find their voice.

Business

Corporate players have generally viewed decentralisation with caution. Their immediate concerns have been whether its implementation will increase the cost of doing business, through higher transaction fees, increased taxes, new corruption and more burdensome bureaucracy. Decentralisation is seen by some businesses as leading to the rapid expansion of domestic trade barriers. For example, a study has found that the city of Makassar in South Sulawesi was planning two new tax forms and 10 more levies; the city of Pontianak in West Kalimantan was drafting five new taxes and three new levies to bring the number of local taxes to 10, and levies to 17; the regency of Pontianak itself planned 10 new tax forms and 12 new levies (JP, 4 April 2001). In Jakarta, the city administration has reportedly increased all kinds of levies, from using a public toilet and parking to having an artesian well, in order to boost revenue.

These fears of the business community may be unfounded with regard to certain enterprising regions, or they may be significantly compensated by other incentives and facilities. Reports indicate that many regions have begun to revamp their administrations in order to attract investment. The new province of Bangka Belitung, for example, has offered a free use of land for new investors; the recently established province of Gorontalo has promised to complete processing any investment applications within two days; the city of Solo in Central Java has vowed not to charge any extra fees for granting building and operational permits and has established a special P.O. Box to lodge complaints (*Kontan Online*, 12 March

2001). Many regional governments have also signalled plans to undertake investment road-shows overseas.

Many other regions are preparing development strategies based on an as-yet undeveloped economic theory of people's economy, emphasising small and medium enterprises and cooperatives. Small-to-medium-size enterprises have generally grown faster in the early years of the recovery than the larger corporations. However, such new strategies could also lead to distortionary policies, where attempted protection for small business may constrain the activities of larger businesses. With established large firms customarily lobbying provincial officials, district-focused decentralisation could temporarily deal a setback in their operations.

Donor community

The donor community has been led by GTZ in the area of decentralisation. A recent survey suggests that there are at least 76 ongoing/committed activities of donor agencies that are focused on decentralisation, with funding of more than US\$2.87 billion (Indonesian decentralisation mission report 2001). The majority of funds and activities are supported by the World Bank and ADB. Included are 13 bilateral donor activities (including two Australian-supported projects), with funding of US\$384 million allocated to decentralisation support activities. Generally speaking, donors look forward to the creation and facilitation of new projects within the decentralisation framework, not only so that this may allow them to participate meaningfully in the country's historical change, but also (perhaps wrongly) because decentralisation has raised poverty-alleviation expectations.

Opportunities and Risks

Even during a period of political tranquillity and economic prosperity, implementing such wide-ranging reforms would present a major challenge to a large and highly diverse country such as Indonesia. While decentralisation is rightfully a national priority, unfortunately in the short-term Indonesia faces significant challenges, and this has implications for ongoing regional devolution. An orderly program is simply not possible at this stage due to Indonesia's adverse economic and political circumstances and the magnitude of the change to which it has committed. A great deal of uncertainty and disorder is evident in the rush to implement the complex administrative and institutional changes related to the decentralisation program. The outcomes remain difficult to predict at this stage.

However, the enthusiasm of the regions for assuming new responsibilities suggests that for some, the decentralisation program, despite its chaotic implementation, represents the best hope for Indonesia's future. This contrasts with the seeming half-heartedness of some in the centre to implement the laws.

There is a pressing need to move to a less centralised system, and Indonesia's donors need to offer abundant assistance for this difficult project. This should offer some "safety net" provisions, bringing in needed expertise and experience to help pinpoint possible design faults and pre-empt potential problems. Donor-funded programs could help enhance local capacities and strengthen civil society to increase the benefits of decentralisation, affect poverty alleviation and improve service delivery in remote areas. As discussed in the first part of this study, the decentralisation program offers many benefits. Yet, it also poses considerable risks.

1. *Weakness of central institutions*

Risks involved: Political and administrative setbacks to the decentralisation program

The centre is politically weak. The central authorities have been plagued by a protracted leadership crisis, interethnic and religious conflicts, while the central institutions of law and order the army and the police are overstretched, as well as weakened by the American military sanctions. In effect, the centre lacks the power to either restrain over-assertive regions or assist weaker ones.

It is known that the likelihood of successful decentralisation programs is enhanced if the role of the national government (or provinces vis-à-vis lower administrative levels) can be maintained or even strengthened in key areas. In decentralised systems higher levels of government need to play a key role in setting and supervising minimum standards, in strategic areas such as primary education, through better information systems and legal instruments. After 30 years of ensuring the implementation of minimum service standards, the centre should have adequate capacity to perform this task. The question is whether it will continually be distracted by its own problems. Lastly, the change in political leadership may result in an attempt to delay the progress of the decentralisation, or to change the design of the process. This could cause setbacks, uncertainties and conflicts.

2. *Massive and rapid decentralisation*

Risks involved: Confusion, budgetary and macroeconomic imbalances, corruption, friction during transfers of administrative staff.

The devolution of power is massive and the pace of implementation is rapid. As Geoff Forrester (2001) puts it: “Decentralisation is stunningly comprehensive political and administrative change”. In the process, there may be mismatches, or a risky sequencing of decentralisation. Ahmad & Hofman (2000) identify as the key risks:

- The implementation of revenue devolution provisions in advance of an effective decentralisation of expenditures, including the administrative staff.
- Vaguely defined expenditure responsibilities and overspecification of revenue transfers may introduce unwanted budgetary imbalances.
- The process may encourage corruption, as defined responsibilities (i.e. function) are addressed after finance.
- Another problem, as Indonesia has experienced, concerns the transfer of administrative staff from the centre to the regions to undertake the effective implementation of devolved expenditures.

3. *Weak implementing institutions*

Risks involved: Confusion, corruption, lack of accountability, substantial corrective requirements, including preparation of curative and/or follow-up rules, inefficiency, rising domestic trade barriers, economic isolation among the regions.

Because the central bureaucracy is not well prepared and/or is half-hearted with decentralisation, some central agencies make decisions that are not well coordinated with the regions or other parts of government. This can lead to resistance, conflict and policy failure. This is exacerbated because key sectoral laws (such as the mining and agrarian laws) have not been revised in line with decentralisation. Regions have little experience in policy development and financial planning and expertise is scarce. There will be many mistakes made by the regions and these will need correction in time. In the absence of administrative arrangements to monitor minimum standards set by the central government, local leaders may be inclined to avoid accountability and distort information flows.

Meanwhile, under Law 25/1999 regions have the responsibility of financing more of their own spending.⁹ As noted earlier, under regional autonomy local governments have been creating a large number of local taxes and levies. The districts/cities need these revenues

⁹ This is regulated under Law 34/2000, the new law on regional taxes. This law reversed Law 18/1997, a law which severely restricted the ability of most regions to raise independent revenue.

to plug local budget gaps and to finance large new projects, such as bridges, ports, mosques and industrial parks. However, the concern is that these will distort prices of commodities and trading activities, and may in the end negatively affect economic interaction between regions and across the country.

4. *Centrifugal forces*

Risks involved: Disruptions to the decentralisation process, continuing violence in restive provinces, regional dissatisfaction

Secessionist tendencies are significant, especially the two restive regions of Aceh and Papua. Furthermore, there are also “second-tier” secessionist provinces, including Riau, North and South Sulawesi, East Kalimantan and Maluku, which may opt for or threaten to declare independence as part of the bargaining process. With certain secessionist regions set to get special concessions from the central government, other regions may find this unacceptable or seek to follow suit. For example, MPR has agreed that both Aceh and Papua should have even wider autonomy. A law has been passed giving the Special Territory of Aceh a wider autonomy, and a special team has been set up in Papua to prepare the draft law there have requested the right to reject any national law and replace it with their own. A major revision of Laws 22 and 25 could exacerbate centrifugal tendencies.

5. *Fiscal constraints*

Risks involved: Setbacks to the decentralisation program, centre-periphery disputes over resource sharing, budget difficulties in financially weak regions.

The transformation is taking place under gloomy economic condition, with a technically bankrupt central government unable to provide adequate funds to ease the transition. The central government’s deteriorating budgetary conditions are at the forefront of current donor concerns. The IMF recently noted that the deficit could shoot up to 6 percent of GDP (Rp 87 trillion), compared with the original projection of Rp 52 trillion (3.7 percent of GDP). Some 60-70 percent of the anticipated jump in deficit could be due to higher interest rates (on government-backed bank recapitalisation bonds) and a devaluated rupiah. The World Bank estimates that every percentage point increase in interest rates is expected to increase the government’s bond servicing by some 0.3 percent of GDP, while a depreciation of 1,000 rupiah/dollar on a net basis would add some 0.15-0.2 percent of GDP to the budget deficit. During the period in which this paper was written (June 2001), domestic interest rates rose by about 5 percent and the domestic rupiah depreciated by about Rp 3,500 from their respective original positions.¹⁰

These fiscal constraints may force the central government to delay and/or reverse some aspects of the original decentralisation plans. The effect could be financially crippling to the weaker provinces. For instance, only recently has the centre finished calculating the share of oil/gas, mining and fishery revenues payable to the regions (*Decentralisation News*, 15 June 2001). The payment is yet to be made and calculation of the forestry revenue is yet to be completed. Furthermore, in a last-ditch effort to avert a budget crisis, the central government may have to slash 20 percent from an already meagre development spending of Rp 44 trillion, to the likely dismay of the regions. It also contemplates on issuing the first-ever deficit bonds later this year and expects resource-rich provinces to take them. This could be a source of future conflict.

¹⁰ Nevertheless, at the time this paper was revised, the rupiah has appreciated by 20 percent from its low position in June 2001 and interest rates appear set to go down in subsequent months.

6. *Weak judicial system*

Risks involved: Corruption, mismanagement.

The justice system continues to be ineffective against corruption. Quoting Hong Kong-based Political and Economic Risk Consultancy (1999):

“Despite a wave of condemnation of corruption in the wake of the downfall of President Suharto, official efforts to probe high-level corruption cases remain half-hearted. This is not so much the result of lingering fear of the former president as it is the result of the realization that serious investigations could backfire on incumbent government officials who have abused their powers to gain wealth in the past... Meanwhile, the collection of illegal levies at lower levels of the bureaucracy remains rampant.”

In this situation, it remains to be seen whether decentralisation would foster or deter corruption in the regions, especially as the centrally-managed legal system will likely remain weak for years. Corruption has always been a key issue in decentralisation. Allowing local government leaders greater discretion to affect intersectoral resource allocations and local implementation strategies is often necessary to draw out the best in all local governments. However, without adequate transparency, this also opens the door to abuse.

7. *Inequality*

Risks involved: Worsening horizontal inequity, stagnant intra-state imbalance, social unrest, inter-regional conflict, disintegration pressure

Whereas decentralisation is often expected to be a panacea for poverty, there have been contradictory statements about the presumed effect. Two factors determining the effectiveness of decentralisation in combating inequality are (The World Bank, 1999, pp.109-10):

- the extent to which regional governments have the fiscal capacity to deliver a comparable level of services to their population (addressing horizontal inequity);
- the ability and willingness of regional governments to improve income distribution within their borders (tackling vertical inequity within the province/district).

With regard to Indonesia's decentralisation, the formulae for fund allocation to regions actually do not support horizontal equity, at least in the short term. Instead of equalising uneven distribution, if it were implemented thoroughly, Law 25/1999 would shift funding from the centre to the resource rich areas in the outer islands.¹¹ However, the weaker regions in Indonesia, with inadequate local resource bases, may well face relative impoverishment. While the revised formula for distributing the equalization fund (i.e. the DAU) may prevent the funding for these regions from sinking in absolute terms, the richer regions may quickly leave them behind, especially if the weaker regions fail to innovate and revamp their administrations into investment-friendly regimes. The danger is that they may seek to tax their way out of trouble, which can in turn exacerbate the situation. Furthermore, with a fiscal crisis looming at the centre, even the integrity of the

¹¹ As noted earlier, the failure to implement the equalisation formula means that the redistributive intentions of Law 25/1999 have not been met.

DAU could be compromised. As a result, the possibilities of social unrest and inter-regional conflicts (such as border tax disputes, externality problems, etc.) should not be ruled out.

Whether decentralisation could reduce intra-state inequity is also not a certainty. Experiences worldwide suggest that, given a chance local communities can effectively tackle this problem. The question is whether there is political will to allow this, and this may vary from province to province. Donor activities can also make a big difference in this respect.

Meanwhile, the two largest functions to be transferred to *Kabupaten* and *Kota* are education and health. In most regions, the staff transferred in these two sectors alone account for well over half of the total staff, and in some the salaries account for up to 70 percent of the total regional budget. There has been significant international concern that, as in other countries, health and education standards will fall with decentralisation. Early indications show that while there are risks that standards may fall, most regions in fact see health services as a key component of poverty alleviation, and education as a key to development. The problems that are emerging include imbalances in some regions, especially small provincial capitals with large hospitals and many schools serving populations beyond their borders, expenses for specific medical treatments such as for HIV/AIDS, and future staffing, as staffing is still centrally controlled. Another problem is that the central government has not yet developed an administrative mechanism for guaranteeing minimum service standards under a decentralised system.

Prospects

Given Indonesia's uncertain political and economic outlook, a number of short-term difficulties can be identified.

- The disorganised nature of the implementation process leaves it vulnerable to inefficiency and abuse.
- The fiscal weakness of the central government causes budgetary constraints in the regions, prompting the introduction of new local taxes. This hampers business activities at a time of global economic slowdown.
- A likely short-term outcome of decentralisation is also greater inequality between regions, especially as fiscal constraints at the centre and the failure to fully implement the equalisation formula hinder greater equalisation efforts.

However, decentralisation in Indonesia appears to be an inevitable process. It is increasingly difficult for the regions' wishes to be brushed aside with the traditional rhetoric that "Jakarta knows best". Already there are significant political changes at the district (*kabupaten/kotamadya*) level with elected regional parliaments (*DPRD*) answerable to the people of the *kabupaten/kotamadya*. As Law 22/1999 deliberately separates the *DPRD* from the district/city government, i.e. the legislature from the executive and makes the executive responsible to the legislature. Despite the need for time for this to become effective, it may in the longer term ensure greater political participation, more transparent local regulations and more effective control of district officials.

Implementation blues. In Indonesia there is a history of legislation being promulgated and never implemented; of legislation with no follow-up enacting regulations; of the co-existence of mutually contradictory laws; and of enacting regulations that differ dramatically from that which was envisaged in the original legislation.

There are also disputes over the meaning of legislation. For instance, at district/city level there was a perception that the enacting regulations to Law 22/1999, *PP25/2000*, deviated from the substance of Law 22/1999. According to this law, local government was to be non-hierarchical, in that both the provincial governments and the district/city governments were responsible directly to the central government. There is a view that the enacting regulations

give a greater power to the provincial government -contrary to Law 22/1999- and so facilitate the central government's continued control of regional government¹². However, the law was somewhat ambiguous on this matter. As article 9 determines, the provinces are also vested with the authority the central government has delegated to them. Accordingly, the central government can delegate supervisory functions to provincial government, and in this way reassert central government control over aspects of regional government. During 2001 a number of laws have been passed that reassert provincial government authority vis-à-vis the districts/cities.

The government regulation (*PP25/2000*) also contributed to implementation problems. PP 25 listed the powers retained by the central and provincial governments in 25 fields but failed to set out the powers of the city/district administrations. As it left these powers unspecified, this created considerable confusion in the regions. The roles and responsibilities of different government bodies and different layers of government have yet to be clearly defined. Consequently, uncertainty, misunderstanding and confusion abound among all parties about the meaning and direction of the decentralisation process (Vriens, 2001). The abolishment in 2000, by President Wahid, of the Ministry of Regional Autonomy¹³ that was responsible for introducing the legislation has added to the confusion. The President was also reported to have agreed to a planned revision of the two laws due to difficulties in implementing them (*Bisnis Indonesia*, 4 April 2001).

While it is not unusual for any legislation to require revision and review, decentralisation legislation is especially vulnerable to the exigency of those who see regional autonomy as a threat to their authority and to their vested interests. Indonesia has had a formidable bureaucratic hierarchy, which oversees a chain of central government control right down to the smallest village. There are many in those chains who seek to maintain the status quo, or at least minimise change.

Even in a decentralised democracy either the central government itself or the central government in tandem with local government must share many areas of responsibility. In certain areas of governance co-administration is legitimate. While this is provided for in Law 22/99, it will require a shift in the practices of government if it is to be effectively achieved. Moreover, the process of conceptualising regulations to achieve it is still in process.

Misuse of public funds. The implementation of regional autonomy is to be supervised by MoHARA. A council for assessing regional autonomy has been established, incorporating central government ministers (the MoHARA is chairman), other central government representatives, local government appointees (from the three associations of regional governments), and representatives of the regions themselves. However, the regional representatives and the regional government representatives account for just over 50 percent of the members and civil society organisations have been blatantly left out. This, together with the managerial issues discussed by Nichol and McCarthy (2001), ensures weak supervision. Whilst strong managerial oversight is absent and local political accountability is yet to take hold, transferring resources without effective responsibility is inviting misuse of public funds (Ahmad & Hofman, 2000; McCarthy & Warren 2000). In other instances, projects may also be designed and implemented wastefully.

Macroeconomic imbalances. Decentralisation, unfortunately, is taking place in dire national economic circumstances. The central government is financially hard-pressed and under severe pressure from the IMF to slash its burgeoning fiscal deficit. The elites, who can help reduce this deficit simply by getting along better (thereby strengthening the rupiah and

¹² Interview with *Kanwil* representative, West Java June 2000.

¹³ The Ministry of Regional Autonomy has become part of the Ministry of Home Affairs and Regional Autonomy (Schiller, 2001)

lowering interest rates; two key issues in the deficit, have continued to be at each other's throats. As such, the centre's financial commitment to the region could be occasionally compromised along the way, in the form of late payment or underpayment. This may exacerbate the fiscal conditions in some regions, leading to the proliferation of new taxes. In fact, reports have indicated that this has already occurred in scores of districts within the archipelago.

Even if the central government can fulfil all transfers to the regions effectively, another macroeconomic problem is in the offing. While expenditures cannot be devolved in a hurry, the floor on transfers to the DAU of 25 percent of domestic revenues could generate a substantial additional central government deficit. At the same time, the districts will probably be unable to use effectively the additional transfers, except perhaps to increase staff salaries (Ahmad and Hofman, 2000).

Worsening regional disparities. Decentralisation in Indonesia is now deemed likely to be an uneven phenomenon. Given the scope of the changes involved, decentralisation is a long-term process, and it may well take at least 10 years before Indonesia can fully make the transition to a decentralised system of government. In the meantime, it is unrealistic to expect immediate success, or to judge the situation against an idealised vision of successful decentralisation. Consequently, it will be perhaps a decade, or two more political cycles, before a proper assessment of the overall success of the process can be made. In the meantime, hopefully, resource-rich outer island provinces who felt marginalised by the New Order development policies will be able to enjoy a fairer share of the wealth generated from the exploitation of their area. The danger is that the process may contribute to inequality between resource-rich and/or enterprising provinces and the rest of the archipelago. The central government, constrained by the near collapse of its budgetary condition, either does not have the capacity or the political will to equalise the process.

CHAPTER 3: STRATEGIC FRAMEWORK

Background

The purpose of this chapter is to help conceptualise a strategic framework for aid operation in decentralised Indonesia. It seeks to outline major areas where potential aid projects can be identified and developed, and to deliberate on a number of issues as decentralisation evolves and may influence future foreign aid arrangements in the country. However, it is beyond the scope of this chapter to actually work out possible individual aid projects or assess ongoing ones. The discussion presented here is largely theoretical, and opportunities were not available to canvass the actual field.¹⁴

In any case, in view of Indonesia's ongoing political transformation, a degree of uncertainty with the decentralisation program can be anticipated in the coming months, up to the next couple years. In effect, part of the discussion presented here may subsequently require updating. By the time this report is finalised (August 2001), the new administration of President Megawati Sukarnoputri is widely anticipated to have the program reviewed, in an attempt to "minimise wastage" and "reduce regional inequality" (*BusinessTimes*, 11 June and 9 May 2001). One possible change under the Megawati presidency, but also one that will prove highly contentious in the region, is a switch from regency-based decentralisation to a province-based arrangement. This is to address the accumulating perception that many Indonesian regencies, especially those without adequate local resources or those occupying strategic ports and/or regional centres of commerce, are proliferating nuisance taxes that could in time strain themselves to economic ruin. However, it remains to be seen whether taking the wholesale switch to the province is a better option to raising awareness among regency officials of the importance of free flows of goods and services and seeking to tackle disparities on a case-by-case basis.

The aid perspective: an overview

The current guiding principles for aid assistance in Indonesia are poverty alleviation, sustainable economic recovery and democratisation. In conjunction with decentralisation, the scope for aid is massive as Indonesians welcome (and need) help virtually in every step of the way. At the national level (the centre), macroeconomic management associated with regional borrowing restraints figures prominently in the task; a point already emphasized by the IMF through the government's successive Letters of Intent. The World Bank and the IMF have been providing technical support in the area. The operation of the DAU could also be enhanced by models and experiences from other decentralised countries. Meanwhile, sectoral and microeconomic concerns represent numerous potential, big and small, aid projects. For example, domestic trade policies under a decentralised regime are already a focus of an USAID project, as was the development of commercial law. Similarly, environmental standards and policies, research and policy support measures in the areas of education, health, labour, law and technology development all call for coordination among the regions, hence the need for a central institution to provide leadership.

Institutionally speaking, a national competition council or a national efficiency committee is a desirable establishment to have, in order to help safeguard collective interests or prevent regions from endorsing long-term damage to their own local economies. Such a council or committee should identify and take action (or recommend an action being taken by the central government) against unacceptably distortionary or restrictive policies that may be erected by local officials to the detriment of inter-provincial trade, etc. and should also help initiate a dialogue process to raise general awareness. Help with development planning for each of the regions (involving economic growth forecasts, local expenditure and inflation targeting, policy development, etc.), especially the weaker ones, is also a valid aid area.

¹⁴ No attempt is made to list projects that are already in place or are being planned.

Human resources will likely continue to be a major area of aid involvement, both in the centre and the regions. Needless to say that Indonesia's chronic problem of overemployment and underpayment in the public sector will not go away easily with decentralisation. Training has been and will continue to get aid provisions in this regard. In the spirit of accountability, accounting could be a timely area for training Indonesian public employees, both in the centre and regions. The regions will obviously need to equip themselves to manage their significantly expanded fiscal authority. For that matter an effort to push for national accounting standards within the public sector is a relevant proposition, one that will likely get political support from the central government. While there are obvious obstacles to realising such a project (cost, uneven bases, motivation, etc.), current internet technology could be utilised to deliver at least part of the training and minimise costs, with occasional regional workshops called for to bolster knowledge. However, should this project be pursued in a piecemeal manner, for example by concentrating on a few poor regions, the sure benefit of a national standard could be lost. In fact, if such a standard is successfully adopted within the public sector, it could usefully spill over to the private sector.

Tackling poverty has always been a priority aid program. As discussed in the previous chapters, there is no proof yet that decentralisation will help ameliorate or worsen the state of poverty in Indonesia (even as regional disparities are set to worsen in the short- to medium-term future). Nevertheless, anticipations that empowered local authorities will strive harder (or be electorally forced to do so) to help out the poor in their respective localities have risen, bringing hopes for improved cooperation with aid donors and consequently more effective aid delivery. However, such anticipations could be flawed. While experiences thus far correlate local communities with a more effective poverty alleviation effort, decentralisation to the regency does not guarantee autonomy, let alone increased funding, to lower-tier organisations. Meanwhile, some poverty incidence arguably is a factor of its wider social and economic environment, in the sense that if a regency or province is economically impoverished any sustainable alleviation of poverty is difficult to achieve. In fact, the maintenance of living standards of the poor may have to be continuously (and artificially) propped up. In any case, traditional approaches to poverty alleviation remain as relevant in post-decentralisation as in the pre-decentralisation period. These include facilitating access to productive assets (such as land and credit), supporting women's participation in economic activity, bolstering basic services (health, clean water, education, vocational training) and improving productivity (including technology transfer).

To make various aid projects more effective, involvement of NGOs as well as professional associations is essential. This is in line with the democratisation objective of decentralisation, which is another priority area for aid. With many local governments probably preoccupied with building power bases and networks, the role of NGOs could be crucial: pushing for accountability, identifying social needs, bridging the gap between communities and local governments, and helping spread awareness and community acceptance of various development endeavours (including family planning, use of pesticides and prevention of HIV/AIDS). As such, numerous aid projects could benefit from having NGOs as their partners, along with the local government. This is especially so since decentralisation potentially strengthens NGOs' political standing. Many of the possible aid projects illustrated above could also benefit from the participation of NGOs and professional associations. Accounting is one obvious area.

Role of AusAID: an overview

As a mid-sized aid player in the field, AusAID is well placed to target national niche projects and support the decentralisation transformation in select regions. To serve an effective aid function, several principles can be considered:

- the need to focus on regions that will likely lose out in the decentralisation process;

- the need for a presence in the centre, if limited, so as to maintain the big picture perspective and help develop the “enabling environment” for effective decentralisation;
- the importance of having one or two successful small projects, rather than scores of projects with dubious benefits;
- the need to develop a regional targeting approach through greater involvement of local people in project design and implementation. Very little research has been done on the impact of decentralisation from a regional perspective. Most reports on decentralisation reflect the views of the centre. Even foreign and domestic academic research in this area often has a centrist point of view. As most governance activities currently focus on the national level, the decentralisation process in Indonesia will require a change in mindset from most donors, moving from a centric approach to a more regional approach.¹⁵ (*See Appendix E*);
- the imperative of donor coordination, as there is a large number of donors supporting decentralisation activities yet limited absorptive capacity at the regional level. There are the obvious benefits of avoiding duplicity, reducing inefficiency and exchanging notes;
- the need to foster replicability over the longer-term period, whereby less successful regions can learn from the more successful ones. While cross-country comparisons (e.g. between less successful regions in different countries) can provide useful insights, cross-learning opportunities between different regions in Indonesia will be the most relevant and useful.

Needless to say, AusAID’s organisational priorities as well as its support for Indonesian decentralisation determines its approach. For this reason, a SWOT (strength-weaknesses-opportunities-threats) analysis is provided. AusAID’s Indonesia program has strengths with its experience in poverty alleviation programs, a focus on Eastern Indonesia (where the relative incidence of poverty is higher, but also where potential development achievements are present given their relatively low bases), a training program already in place and existing support to health services and environmental management (Figure 1). Arguably, decentralisation could boost the relevance and political prominence of some of AusAID’s ongoing activities, as attention shifts to the regions. Perceived threats that may constrain the agency in realising its program rest in the high probability of decentralisation “roll back”, as well as the willingness and ability of local governments to cooperate in their new roles. Security is another concern as it could potentially jeopardise even well planned projects. The threat level from region to region obviously will vary and it will require careful investigation on site to pick the right region with appropriate local support. Importantly, decentralisation will open up ample areas (such as natural resource management, forestry, agricultural productivity enhancement and upland farming system) for new, region-focused aid initiatives. In the past, many such projects encountered major problems as powerful corporate interests that stood to lose from better management of affairs sought to stifle those endeavours.

¹⁵ Only recently have key players started to pay attention to this gap. Donors and universities across the country are starting programs of research on the implementation of regional autonomy, from which a dialogue can be expected on the evolving needs for support of the process. IBRD and the Scandinavian countries are the leading donors in this area, with Australia participating through the support of SMERU. The World Bank will commence the Longitudinal Survey of Indonesian Decentralisation (LSID) later this year. The objective of the survey is to provide a basis for empirical evaluation of the Indonesian decentralisation process over the next few years, focusing at the local level. The study serves three purposes: to inform the policy debate surrounding Indonesian decentralisation, to provide inputs to the World Bank’s subnational strategy in Indonesia, and to advance the international research agenda on decentralisation (World Bank 2001).

Figure 1 : SWOT Analysis of AusAID's presence in decentralised Indonesia

AusAID Country Program	MAJOR OPPORTUNITIES	MAJOR THREATS
	<ul style="list-style-type: none"> ▪ Support the decentralisation process ▪ Strengthen the democratic processes ▪ Support the development of civil society ▪ Contribute to poverty alleviation in a decentralised society 	<ul style="list-style-type: none"> ▪ Lack of political will in the centre to commit to decentralisation ▪ Political instability ▪ Weak legal system ▪ Land and environmental issues remain controversial ▪ Rural areas remain poor with very limited economic development ▪ Limited Australian expertise or AusAID experience
<p>CURRENT STRENGTHS</p> <p>Focus on poverty alleviation/ safety nets/ proposed micro-finance project.</p> <p>Support for decentralisation processes at central level.</p> <p>Support for training in key areas (IASTP).</p> <p>Focus on Eastern Indonesia</p> <p>Focus on health, environment, education.</p>	<p>Reach the poorer parts of the society as a result of decentralisation.</p> <p>Provide expertise for central government to fulfil its new role.</p> <p>Provides a large number of short, in-country training courses in key areas such as financial management.</p> <p>Build on existing projects.</p> <p>Build on existing expertise in health, education and environment new approaches are required as decision-making process is decentralised.</p>	<p>Local governments lack the political will to address poverty. Using the process of decentralisation requires new approaches currently not adopted.</p> <p>Central government may be unwilling to really support the decentralisation process, lack of collaboration between government departments.</p> <p>Currently the project is not handled at the regional level, the key role is played by central government agencies although the target groups are local governments.</p> <p>Security may influence geographical area.</p> <p>New approaches are not adopted</p> <p>Environment worsens as a result of decentralisation. Assistance in this area may have very limited impact given impediments.</p>
<p>CURRENT GAPS</p> <p>Natural Resource Management/ Forestry/ Agricultural productivity/ Irrigation/ Upland farming systems.</p> <p>No specific focus on local governments and local governance (although this will change with the proposed civil society/NGO project).</p>	<p>Major opportunities exist for assistance. The World Bank has reconsidered earlier decisions and will pursue a new land registration project, option to participate.</p> <p>Training for NGO's, media and political parties.</p> <p>Lack of skilled human resources to perform the new tasks provides opportunities for training.</p>	<p>Past projects have encountered major problems.</p> <p>NGO's may lack professionalism, direct involvement with political parties may create problems.</p> <p>Lack of human resource policy may result in limited longer-term impact.</p>

Conceptualisation of Strategic Framework

Policy guidelines

As mentioned above, poverty alleviation, sustainable economic recovery and democratisation are the three guiding principles for aid provision in Indonesia and the ones promoted by the Australia-Indonesia development cooperation program as well. Part of democratisation is the decentralisation process. Since 1997, AusAID has given improved governance a high priority within the Indonesia Country Program. The following policy guidelines support this priority:

- Support for improved economic and financial management, through capacity-building work with public sector institutions in areas such as debt management, supervision and bank restructuring.
- Assistance with decentralisation, including implementation of new legislation and strengthening of local administration, planning and regulatory frameworks and financial management practices.
- Assistance to promote effective legal systems and the rule of law, including through training and capacity-building for judicial and supervisory institutions, human rights bodies and legal NGOs.
- Strengthening the capacity of civil society organisations, including professional groups, the media, academic think tanks as well as advocacy and development NGOs.
- Continued support for human resource development, through technical assistance, scholarships and short-term training to build the capacity of Indonesian institutions and increase skills.

Entry points

The Indonesian government has developed a National Framework for Capacity Building. It basically identifies the major problems and agendas in the decentralisation process that require significant attention and may be targeted by donor agencies. The framework sets out nine dimensions to use as a basis for discussion, including eight cross-sectoral issues:

- General governance regulatory framework for regional autonomy
- Organisational development
- Human resources management
- Regional finance and financial management
- Support and strengthening of regional parliaments and civil society
- Planning systems
- Local economic development
- Managing the transition and supervisory role of the central government
- Development of capabilities of sectoral agencies in priority sectors

However, the above framework is a reflection of the central government's perceptions of the needs of regions. The actual needs of the regions may be quite different, and different regions may have different needs. At this stage little is known about the demands from or needs of the various regions.

For example, AusAID's Indonesia Australia Specialised Training Project Phase II (IASTP-II) provides a large number of in-country short training courses. There is a significant provision for training activities that focus on training for officials from the regions. Currently the central government has a

major say in the topic selection and contents of the courses. The recent mid-term review of this project (held concurrently with the decentralisation mission) raised the issue that the project should be handled at the regional level and that the role of agencies at the central level should be reduced, in the context of a lack of clarity over the division of responsibilities between different levels of government.

For these reasons, the entry points for possible project intervention are based on the policy guidelines informing the Australian aid program as described above, rather than the Indonesian government framework. When more feedback and findings are available from the regions, these entry points may be subject to change. Therefore flexibility with the entry points is desirable.

We have defined the entry points as location, sector and focus. There is already some consensus about the geographical focus of the various donors. Given the goal of poverty alleviation, there is a range of options for sectoral approaches. Local governments should be the ones that select the sectors that require assistance based on their own perception of urgent needs. These needs will differ by region. As shown in chapter two of the paper, some local governments in Indonesia will respond relatively more positively than others to the decentralisation efforts. Those factors that influence success such as administrative and fiscal capacity, local leadership, and the strength of civil society vary dramatically between different parts of Indonesia. As the decentralisation process is quite complex and evolving, the entry points, under the heading “focus”, also directly targets local government and governance issues. Governance issues comprise the mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences.

This leaves two options:

- AusAID focuses on those areas where it has existing knowledge and expertise, such as health, education and the environment. It then identifies those local governments that need assistance in one or more of these areas. The difference decentralisation can make in this regard is that -for better or worse- the ideas, wishes, likes (or dislikes) and administrative bureaucracy (or efficiency) of local officials and partners will carry more weight in project implementation.
- Local governments can indicate in which areas they need help, and ask AusAID for relevant expertise. A pro-active gesture from AusAID will likely be welcome here, for example by inviting local governments and/or institutions to submit funding applications for a project (or projects) in defined sectors and target regions. It is important to ascertain that the application process is not onerous, but neither should it be too lenient. It should be noted that in some cases aid money from scores of donors could be chasing too few recipients (absorptive capacity problem), as has been the experience for many years to date. This is partly because donors have not invested adequately in identifying new local partners, or have not trusted potential new partners. With decentralisation in mind, new partners could be what many aid programs need at this stage.

Regional Targeting Approach

As substantial decision-making powers have gone to the regions, aid work in the provinces and regencies requires a new approach. We argue that local government should be the key focus. However, the current agreement on aid is between the government of Indonesia and the government of Australia, with no direct agreements allowed between the Australian government and provinces and/or regions in Indonesia. A separate memorandum of understanding between the Australian government and a region in Indonesia may partially solve that problem.¹⁶ Nevertheless, as the centre is responsible for developing the “enabling environment” within which effective decentralisation is based, the approach will also require essential feedback loops to the centre. Because asymmetrical decentralisation is unavoidable in any decentralisation process (i.e. decentralisation will vary across regions), an overall “blanket” program is also inappropriate.

Location

We propose two major criteria for the selection of an appropriate locational focus that takes into account both the historical focus of the Australian aid program as well as current realities:

- A significant Australian project presence so that support for decentralisation can complement current project activities and outcomes in sectors such as health, education and the environment;
- Locations where there is adequate security for personnel so that work can proceed smoothly. However, some areas of eastern Indonesia, West Papua, Maluku and West Timor, have significant security problems which make work there inadvisable.

If these two main criteria are used to select geographic sites, there is a shortlist of six possible locations. They are Bali, NTB, NTT (but not West Timor), East Java, South Sulawesi, Southeast Sulawesi. Within these areas, more detailed investigations are needed to identify particular *kabupaten* as sites for project activities.

To further refine the locational focus, as suggested in the mission report (AusAID, 2001), other criteria could include the following:

- Commitment of local officials and DPRD members to effective decentralisation, good governance, development of civil society participation and agendas of environmental sustainability, economic growth and delivery of effective services.
- Technical issues of the state of systems and professional development - neither being fully developed, nor undeveloped with limited potential - but having both as a base of development and potential for further improvement;
- Absorptive capacity given existing donor projects and a range of reforms and changes outside the proposed agenda;

¹⁶ In some countries such arrangements with lower levels of governments exist, for example in India, where the World Bank lends directly to state governments. In Vietnam, in a move to speed up community-based development, the government decentralised the approval process for those projects funded by international non-governmental organisations (*FEER* 17 May 2001, p. 12).

- Logistical and support issues for project operation and management, including transport, communications, infrastructure and advisor accommodation.

Sectors

As mentioned earlier, the sectoral focus could be guided by AusAID or by particular local governments in the geographical areas outlined in above.

If we assume that AusAID will guide the sectoral focus, given the SWOT analysis and the focus on poverty alleviation, it *may be* that education, health and water sanitation, and local business development/agriculture are three key sectors. *However, we would like to stress that this focus could include other sectors where Australia has competitive advantage. We believe that helping establish a national competition council is one such area AusAID can offer.*

Health and sanitation

Health is a central feature of any poverty alleviation program and is a crucial building block for a productive population, a robust economy and an equitable society. However, the economic crisis has severely undermined earlier efforts and previous gains. Under the new decentralisation laws, 249 regencies and 65 municipalities will absorb responsibility for planning, financing and managing health and family planning programs. This represents an opportunity, as many donors active in the health area recognise, that the Government's "top-down" approach adopted in the past needs rethinking. However, decentralisation also has the very real potential to undo much of the past success. Therefore some donors are already providing assistance to the Government to clarify responsibilities at central, provincial and district levels, to garner commitment of local governments to invest in primary health care, and to develop standards for accountability and sustainability (USAID, 2000). AusAID's Healthy Mothers Healthy Babies project was one of the first projects to develop a strategy on decentralisation issues affecting health (AusAID, 2001).

A range of initiatives may be introduced here, including discussion on independent hospital administration (in which several regencies in a province, or several regencies in several provinces, can participate) whereby the Australian model, with its strengths and weaknesses, is also presented. Australian medical expertise in certain areas, such as radiology, and treatment of liver disease, cancer and tuberculosis can also be introduced. This is not done by "big ticket" spending, but simply by maintaining a small presence in a strategic provincial capital, where referred patients from various regencies can attend and young doctors can also learn.

Education

Various research studies analysed the impact of decentralisation on education. The overall impression is that decentralisation may actually improve the effectiveness of education, as a commonly recurring recommendation to increase overall effectiveness is a school-based management model combined with a semi-autonomous school board. Furthermore, this sector also provides the potential to address decentralisation issues at both the regional and the provincial level, with clear feedback loops to the centre and traditional "central support systems" in relation to teacher education, standards and core curriculum setting. Lastly,

AusAID already has several major projects in this sector and is thus well-positioned to support decentralisation efforts affecting education. Helping build new schools or building additions is one conventional way to channel aid, but also one with very limited impact. Helping the regions empower themselves is obviously a preferred option. One possibility is to provide assistance for local officials to identify relevant comparative advantages to develop and integrate into the local-content component of the curriculum. This can range from tourism and hospitality industries to forest and natural resources management. As confirmed by experiences elsewhere, it is essential to include school representatives in the process in order to maintain relevance and effectiveness.

Agriculture and local economic development

Only a very few regions have the capacity to assess their development potential and plan their economies, and even fewer have experience in the use of regulatory powers to maximise the benefits of economic development for the wider community. Furthermore, the economic crisis has had a severe impact in some regions on local economic development. Economic development for the rural regions cannot be separated from agricultural development and the development of marketing of rural produce. Yet many donor agencies, including the World Bank, the Asian Development Bank, GTZ and AusAID have cut back their assistance to agriculture, at a time when it is becoming even more important. One immediate area of need is local development planning, as the local governments assume an expanded role. However, because this is traditionally also an area targeted by so many donors, often resulting in sub-optimal use of advisors in BAPPEDA (Regional Development Planning Agency), comparing notes with other donors is needed. AusAID might consider providing agriculture advisors in this respect. There remain numerous specialised sectors, such as technology upgrade in agriculture, tackling salination problems, cattle fattening techniques and disease control and genetic improvement of crops, available for further aid work.

Focus

The location and sector approaches, however, require a sharper focus. Local government and local governance are areas that are crucial to successful decentralisation and democratisation in Indonesia. In this regard, the enabling role of the centre is fundamental

Local Government

Few of Indonesia's 320 local governments have significant capacity to undertake the devolved functions as envisaged under the current laws, and even in cases where the skills and technical resources are available, they are often poorly managed. Assistance is required, especially in budgeting and financial management.

Support for the establishment and development of independent associations

Such associations could include regional and national associations of cities, *kabupaten* and local officials, e.g. local government finance officers. To date, regional local government associations are new, and have yet to develop programs for capacity building. There are a small number of

professional associations that can support capacity building of its members, and more are needed.¹⁷

Civil service reform

One area of reform that has yet to be considered is the reform of the civil service system, from the reward system to hiring and firing, career-path planning, job classification and training. MenPAN is currently considering new policies, with support of CIDA. IBRD and ADB have offered further support once political will has been established.

Support for regional parliaments

There are gaps in the capacity of DPRD's and their secretariat staff that can be addressed by skills development through training.

Management

Regions also have little experience in management, as distinct from administration. The ideas of quality management, and continual improvement of organisations are new and there is a need to assist through example and rewards for excellence.

Financial and accounting problems

Taxation and revenue raising are a key priority in the regions. However, there is limited experience in this area. For example, little attention has been paid to the effects of newly introduced local taxes on their own, and other, regional economies, as well as the national economy. Awareness of the costs of collection of new taxes versus the revenue collected is necessary. The increase of unofficial taxes is another area of concern as it further distorts local economic development.

Local governance

The interface between government and citizen at the local level is the area of "local governance". Governance in this sense relates to issues of access ("to take into account"), accountability ("to account for") and participation. Issues of access relate to budgeting, development planning and allocation of resources. Issues of accountability relate to good financial management and information systems, transparent procurement and public reporting flows. Lastly, participation relates not only to a culture of "need to share" and active engagement, but also to formal mechanisms for participation. However, participation by citizens, business and NGOs in local government is poorly developed in Indonesia. Civil society in the regions is in its infancy and there are gaps in many areas. Some regions have no local industrial or trade base and no strong social institutions active in traditional areas such as education and health.

Decentralisation and increasing autonomy will require new partnerships in both new and traditional areas. Media groups, citizen associations and NGOs will need to become focal groups for setting community priorities, developing investment plans and resolving conflicts. Local government will need to develop mechanisms for enabling and engaging participation through

¹⁷ For example, the United Kingdom has supported quality management in the livestock sector but few other programs have been developed to support quality management in regional government.

open hearings, citizen-accessible budgets and procurement information and participation is essential to force government to be accountable.¹⁸

Some donors have active programs in this area, such as UNDP's BUILD project, and USAID's PERFORM, but they affect only a small portion of the country. AusAID has only just tendered its Civil Development and Civil Society Project. Universities may also present exciting opportunities for a range of social control and social work functions, including the creation and maintenance of a transparency index, organising monthly dialogue or bi-monthly dialogue between government officials and civil organisations and short-term social work in remote villages. Students usually have a high degree of idealism and enthusiasm and the universities often are willing to contribute to cost and/or provide facilities. However, projects should be managed in such a way that they do not inspire militancy emotions.

Nexus with Higher Levels of Government

The central government has important roles to fulfil including:

- Quality control and monitoring
- Technical assistance / capacity building
- Overall coordination
- Setting and ensuring the meeting of minimum standards

These roles can only be fulfilled adequately if information from the regions is available. For this reason feedback loops to and from the centre are fundamental to a "regional targeting approach" to development assistance. Part of the feedback process is the sharing of information.

Importance of learning systems

No one can be presumed to have the formula for successful decentralisation, *particularly* for the more remote and poorer areas that will have the hardest time. Learning by doing becomes imperative. To do that requires strong information systems, documentation of experiences, experience transfer between localities and between centre and localities etc. This kind of transfer usually doesn't happen by accident; it takes sustained effort often facilitated by outside technical assistance on the part of donors like AusAID who are involved long term.

Entry points at the central level

The central government needs to change a culture of project implementation to one of guidance and supervision. This is a difficult process, as central government departments will be reluctant to relinquish control over aid revenue. Creative solutions are required to find ways around this impediment.

¹⁸ The use of customer satisfaction surveys to provide a voice for citizens in regard to government services may be worthwhile considering. USAID started this initiative using surveys to improve water and other services to directly measure the satisfaction of women with water quality and to ensure that survey findings are incorporated into water authority improvement (USAID, 2000, p. 21).

In order for the central government to carry out its new tasks, it firstly requires a cultural and attitudinal change from implementor to facilitator. Then it will require a coherent enabling framework expressed as a set of regulations on supervision (appropriate indicators of performance) and minimum service standards.

There are three key departments that play an important role in guiding the decentralisation process. Many activities associated with creating an enabling environment do take place in MoHARA, which also works closely with the Ministry of Finance and the inter-ministerial Coordinating Board for Regional Autonomy (DPOD). Over the next two to five years, there are appropriate capacity-building activities that could be designed to support MoHARA. The Ministry of Finance could also use assistance to analyse the impact of fiscal decentralisation, refine funding mechanisms and propose solutions to issues that arise. Lastly the DPOD also plays an important role with assistance to analyse local government capacity, clarify roles and functions, train local officials and implement decentralisation measures.

FIGURE 2 : WORKING TEAM TO IMPLEMENT DECENTRALISATION

<i>(Team Keppres 157)</i>	
Chairman	Minister of Home Affairs and Regional Autonomy
Secretary	Director General for General Regional Governance
Vice-Secretary	Head of BAKM, MoF
Members	Vice-Secretary, Cabinet Secretariat Head, Civil Service Board, BKN Head, National Institute of Administration, LAN Head, Government Auditor, BPKP Secretary, each Coordinating Ministry Secretary, State Ministry for Administrative Reform Deputy for Regions and Resources, BAPPENAS Deputies, Vice President's office Secretaries General of all government departments Secretaries of all non-departmental institutions

Team	Function	Chairman, Vice-Chairman, Secretary
Sub-team I	Permanent secretariat Authorities	MoHARA MoHARA, MoF, MoHARA
Sub-team II	Organisation	MenPAN, MoHARA, MenPAN
Sub-team III	Personnel	BKN, BPKP, MoF
Sub-team IV	Finance and assets	MoF, BPKP, MoF
Sub-team V	Documentation and archives	National Archives, MenPAN, MoHARA
Sub-team VI	Regional capacity building	MoHARA, BAPPENAS, MoHARA
Sub-team VII	Special functions	MoHARA, others as required by issue
Working Group	Monitoring, evaluation and response	MoHARA, MoF, BAPPENAS

Given the importance of the health and education sector, the Department of Education and the Department of Health could also be appropriate points of support.

Entry point at provincial level

Currently the provincial government has limited power under Laws 22 and 25, but the role is expected to expand under the current revision of these laws. Provinces are best placed to deal with interregional conflict resolutions and policy-making that affects more than one region. For example, the provinces are supposed to play a role in the minimum services standards (SPM). The central government prepares the guidelines for the minimum standards to be applied in each region. The provinces then set the minimum standards for all regions within that province. But as the province is not hierarchically over the districts, the SPM is set by deconcentrated authority of the central government to the governor. This may change under the current revision of the laws.

At this point in time, no recommendations can be made regarding the possible entry points on provincial level. Once the revision of the law is completed (expected in mid-to-late 2001), there will be clarity regarding the specific roles of the provinces.

Project Interventions

Design Principles

The underlying principles for decentralisation reform as outlined by Minogue (1998) could provide some very useful guidance for possible project intervention. If we use Minogue's work and adapt it for the Indonesian context, the following principles emerge:

- Support the central government to set the overall legal framework and guiding strategy.
- Focus on society: culture, equity, justice, politics and poverty issues.
- Fund outcomes rather than inputs. That is, make plans based on the outcomes desired rather than focusing attention onto administrative rationing. These outcomes should affect the community.
- Meet the needs of citizens rather than the bureaucracy.
- Invest in prevention rather than cure.
- Concentrate on earning resources, not just spending.

In addition, further guidance could include:

Build on existing networks

Australia has a strong track record in providing assistance in the areas of the environment, education and health. It will continue to build on this expertise in the future. Currently the required expertise to conduct such assistance is available in Australia. There is also a strong relationship between a number of Australian and Indonesian universities. Especially in the training and research areas, these strong ties may offer possibilities of further joint activities. Another area in which Australia has expertise is in data and statistics between the Australian Board of Statistics (ABS) and the Indonesian Central Bureau of Statistics (BPS) through government sector linkages program. An immediate area of cooperation between ABS and BPS is in the development of social resilience statistics.

Form close association with key consultants

It is very important that AusAID forms close associations with key consultants to the decentralisation process, especially GTZ and USAID. Some of the activities of these organisations in Indonesia can be used as examples for AusAID, for example USAID's PERFORM projects¹⁹ (see mission report 2001).

Use successful examples from the Indonesian experience

This can be very important to foster change. Whereas there have been general principles identified as prerequisites to successful decentralisation worldwide (see chapter 1), micro-examples from within the Indonesian context will be the most readily replicable in other parts of the archipelago.

Support for local media

The media has taken a pioneering role in this, with many new regional publications and editions, and a high proportion of content on decentralisation and local government affairs. Support to the media generally involves training and consultation (e.g. by becoming a co-sponsor of a seminar).

Support for local political parties

The political parties at the regional level are at a formative stage. Nonetheless, as they supply representatives for the DPRD's, they play a powerful role in the local government. Although it is a sensitive area, indirect or direct funding is required to improve the professionalism of these often recently established parties.

Therefore, it is recommended that there is assistance for independent associations of local governments and officials to become sustainable sources of ideas, best practices and advocacy for the continued strengthening of effective, participatory local government.

Support for associations

Regional local government associations are new, and have yet to develop programs for capacity building. There are a small number of professional associations that can support capacity building of its members, and more are needed.

Feedback loops to the centre

This could include:

¹⁹ PERFORM (performance-oriented regional management) provides assistance to MoHARA and MoF on decentralisation policy, working closely with GTZ on capacity building. It also is developing the PDPP participatory medium-term investment planning methodology to cover all sectors.

- Statistical information from local governments fed back to the Central Bureau of Statistics Findings of SMERU.
- Feedback on the experiences at the local level to support drafting sectoral laws and regulations at the central level.
- Local levels of government are allowed to issue by-laws; these bylaws need to be fed back to the centre so the centre has an understanding of legal developments on a local level.²⁰
- SPM monitoring results fed back from the provinces to the central government.
- Reviews of annual reports of heads of regions.
- Audit reports of local governments.
- Successes in the decentralisation process on a local level that may be useful for other local governments.
- Successful approaches applied in aid projects that may be duplicated elsewhere in Indonesia or that may have implication for policy-making at the central level.

Opportunities for Poverty Alleviation Under Decentralisation

Poverty alleviation

General

It needs to be emphasised that there have been contradictory statements about the presumed effect of decentralisation on equity, and we believe that no *a priori* relationship can be ascertained. What decentralisation *certainly* does is remove the shackles on “repressed” regions, i.e. areas that are being held back from pursuing innovation or greater local fiscal mobilisation due to a non-facilitative central-level environment.

Whether decentralisation produces greater horizontal and vertical parities depends on:

- the quality and quantity of fiscal transfers;
- the planning/accountability framework (do poorer regions have the incentive and ability to set their own agenda with funds transferred? Experiences in other countries suggests often not);
- the extent of capacity problems and difficulty of implementation (are fundamentally different models needed in rural areas, for instance?);
- presence of civil strife (highly relevant in Indonesia);
- the existence of “spatial poverty traps”, i.e. areas that are falling further behind because of a “vicious circle” effect;

The levers the central government has to promote equity thus need to be clearly defined.

These might be:

1. Funding (block grants financed through intergovernmental transfers).
2. Capacity building (particularly needed is a comprehensive program for poorer areas).
3. A facilitative planning framework.
4. Establishment of peace and order.
5. Possibly, though not typically successful, to introduce incentives for foreign investment etc. to locate in remote areas.

²⁰ Although these regulations require formal central approval, this seems an impossible task for the central government given the huge amount of additional regulations issued by local government.

6. National anti-poverty scheme which provides general guidelines but which gives ample autonomy and flexibility at the other end.

The danger is that there is an unavoidable and basic tension between strengthening intergovernmental transfers (which are presumably coming from taxing the most productive regions and sectors of the economy), and killing the incentives to mobilise local resources (in both resource-rich areas -which will see the transfers as a “tax”- and resource-poor areas, which will become “lazy” and dependent on the centre for transfers).

For these reasons, there is a need to stress a comprehensive capacity-building program within the framework of the mechanisms available to government to promote equity in decentralised systems, and to carefully address the trade-off just mentioned.

Indonesia

Currently, decentralisation policy has provided few clues on how regions are to tackle poverty and empower marginalised groups. Nevertheless pro-poor considerations are being pushed as part of the allocation of the central government’s revenue back to the regions. In the Indonesian context, it is important to keep in mind that poverty incidence is mostly due more to differences among individuals within provinces or even regions rather than to differences between provinces or regions. Rich regions may still have a high incidence of poverty. Drastic redistribution across regions will only be successful if targeting is improved within the regions themselves. This largely depends on the abilities and political will of local governments to engage in redistribution.²¹

The Indonesian government has recently established a Coordinating Agency for Poverty Reduction (Badan Koordinasi Penegakan Kemiskinan, BKPK), with a new approach to poverty alleviation that is more supportive of efforts of the poor to help themselves. Most regional planning initiatives in local governments profess to be pro-poor, and the DAU formula review is likely to place greater emphasis on providing additional funds to cover local poverty programs.

The regional targeting approach outlined above supports the measures for poverty alleviation, such as:

- Improving the targeting and delivery of basic services, particularly health, water supply and sanitation for poor rural communities and basic education.
- Improving sustainability of livelihoods for poor communities, such as income generation through increased use of participatory and community-based approaches to development.

Reaching the Poor

In some respects, decentralisation has brought the locus of decision-making to the poor, and in the longer term, this should have a significant impact on the effectiveness of public sector initiatives. Certain policy areas such as agriculture and health care are now broadly under the control of local governments (Dillon, 2001). As pointed out in the World Development Report (World Bank 2000, p.111), local officials and community groups are better placed to identify and reach the poor than their counterparts in the centre. However, there are the issues of local capacities, adequate funding and, to prevent poverty alleviation effort from turning into short-term consumption support, the wider economic prospects.

The regional targeting approach does not mean that the central government should not play any role. A substantial part of the funding for the regions comes from the central government

²¹ Although there are problems in this process as decentralisation tends to empower areas that are more, not less, dominated by local elites.

(and this will not change in the short-to-medium-term future). The central government also needs to play a key role in monitoring the redistributive process to ensure that poverty alleviation is addressed. If the central government is to exert a positive influence on policies in these areas, it will require new approaches. One such approach is the use of matching grants programs (Dillon, 2001).

Implications for AusAID

As mentioned earlier, associating decentralisation with a recipe for successful poverty alleviation is flawed. As such, we believe that traditional poverty alleviation approaches already used by AusAID are continued (see discussion in above). There are indeed differences decentralisation can make on the anti-poverty program, including increased (or reduced, for that matter) spending and enhanced consultative processes with grassroots institutions. However, there is no guarantee that this can be easily and universally achieved. In any case, decentralisation may allow aid agencies to focus more on smaller pockets of poverty, hence dealing more directly with the people most in need. Consequently, AusAID may want to design a project which can be implemented simultaneously in a relatively large number of impoverished regions, whilst allowing a degree of flexibility in each of the project outlets. In addition, the following should be continued:

Support the role of NGOs

The role of NGOs is crucial in reaching the very poor. The work of organisations, such as Bina Swadaya²², shows that NGOs can be very successful in reaching the poorest groups in society. In addition, university students can also be recruited for short-term activities (two or three weeks at a time). For the students, such activities can be part of their extra-curricular activities entitling them to academic points. Possible activities include visits to impoverished villages where groups of specialised students discuss farming techniques, health, sanitation, education for children, family planning and so on.

Cross sectoral activities

Improvement in the health status of women and children is dependent on the availability and use of quality primary health care services. This will require strengthening capacity at the local level to have adequate local finances and implement these services. It will require correction of problems in key health systems, including clinical training, supervision, use of data for decision-making and logistics management. The capacity of the NGOs and private sector must also be further strengthened to promote program sustainability. There are also important connections between AusAID's gender program, and the proposed CSO/NGO project to improve the rights of women and children and issues of violence against women.

Other potential areas of collaboration are decentralisation activities regarding water quality and sanitation. There are direct links with economic issues in food policy and rice pricing issues (and the increase in local levies and taxes); accessibility and affordability of rice has a direct impact on nutritional and micronutrient status. This offers scope to have an integrated approach that combines existing and new AusAID projects.

The World Bank LSID study

The proposed World Bank LSID study is of utmost importance to AusAID as it can provide crucial information to design or redesign its projects targeting the poor in Indonesia. In addition, AusAID could complement this study with an in-depth qualitative, case-study-type work in various local areas that would add depth to the Bank's presumably more quantitative approach elsewhere. AusAID could also design a portfolio of projects that are based not just

²² Bina Swadaya means self-reliance development foundation. As a result of the decentralisation process Bina Swadaya set up 23 regional offices in various parts of Indonesia. Ten of them are self-funded and the other 13 are expected to be self-sustainable in the coming two years. Various NGOs, including Bina Swadaya, firmly believe that aid funds should be directed to the NGOs in the regions rather than funnelled through NGOs at the central level, unless the funding is earmarked for projects at the central level.

on the criteria described above, but in terms of *diversity* of conditions. This would maximise the relevance of the policy experiments conducted and the potential applicability of the various lessons learned coming out of the capacity-building efforts.

Sharing of information

A range of donors is active in poverty alleviation. The decentralisation process has created enormous changes, and right now there is limited knowledge on the possible longer-term impact of this process on the poor. Any information available needs to be shared. This applies to sharing between the donors, between NGOs, between government departments (horizontal and vertical) and other stakeholders (see also above).

Benchmarking

The chairman of the Coordinating Agency for Poverty Reduction, H. Dillon, suggested that one option to be explored is the establishment of poverty reduction benchmarks to recognise different regions in the country that have been successful in poverty reduction. Dillon (2001) believes that such a benchmarking system, if combined with public recognition, could inspire local governments to focus their efforts squarely on poverty reduction. AusAID may wish to consider participating in such a program for Eastern Indonesia.

Principles for other countries

The decentralisation process in Indonesia is in its early stages and caution is required in drawing major lessons from the process at this stage. Significant changes to Indonesia's two decentralisation laws and/or significant "roll-back" via numerous restrictive implementing regulations can be expected down the road. In retrospect, many of the valuable lessons gained from a large number of decentralisation programs worldwide have been overlooked in the Indonesian case. These include:

- Failure to make the rules of decentralisation explicit and reasonably permanent. Instead lengthy "patch and mend" processes can now be anticipated amid widespread confusion.
- Decentralisation disproportionately benefits the resource-rich provinces. A successful decentralisation design is one where all parties can see the benefits of the scheme. Indeed, after three decades of relative impoverishment in many regions in the country, most provinces, regencies and districts in Indonesia are looking forward to a change. However, the mood could turn spiteful once some regions realise how much they will be left behind or how (in a few deficit regions) decentralisation would impoverish them further. Hence, the revenue-sharing formula should have been better geared to collective needs.
- The sharing of responsibilities between the national and subnational governments in terms of macroeconomic management and income redistribution was not carefully planned. Whereas such cooperation is deemed vital, no regulatory framework for this is available to date.
- The national government has experienced difficulties in allocating funds and royalties to the regions. The delays are believed to have prompted, at least partly, the proliferation of unwanted taxes in some regions.
- There are no rigorous electoral rules in place yet, especially for lower-tier elections. This makes an unfinished agenda for the absolutely essential accountability of local officials, leaving doors open to abuse and corruption, at least in the short term.
- Early indications have suggested that mismatches between finance and function are evolving. For example, whereas health and education will be the primary responsibility of the local government, funds transferred from the centre in certain cases will be barely sufficient to pay for salaries. This may cause a drop in the quality of such services.

Indonesia's chaotic implementation of its hastily devised decentralisation laws is understandable. It perhaps highlights a common irony that unfortunate circumstances often generate the most effective political push for decentralisation, which is a necessary reform best served in better circumstances. The reality of today's Indonesia is that a high dose of decentralisation has been applied and Indonesians need to come to terms with its main and side effects. For other countries contemplating designing a comprehensive decentralisation program, a few major guidelines can be drawn from the Indonesian experience:

- Decentralisation is best prepared and implemented in peaceful and stable (economic and political) circumstances. Visionary leaders are needed to make such moves.
- Substantial amounts of time are required to prepare the legislation, deliberate upon it and consult the people before enforcement is scheduled.
- Gradual implementation is almost certainly a better option than the big-bang style adopted in Indonesia.
- Ample transition is necessary, especially if decentralisation takes place during periods of political and economic upheaval.
- Secessionist struggles may not subside along with the push for decentralisation.

CONCLUSION

Beyond the grand design (the macro-aspect of decentralisation), we believe that micro-lessons of decentralisation processes are best shared within a country. This is because the institutions, customs, norms, rules and practices are similar within a national jurisdiction. Thus, regions and subregions can learn from other regions, and provinces from other provinces. The differences between regions are vast, let alone the differences between countries. Only in very limited cases, mainly for the central government, is it effective to study processes of other countries. For example, the Indonesian government did study examples of other countries in dealing with general and special grant allocations and that seemed a useful exercise.

Like in many other things, decisions often must be made in unfavourable circumstances. Indonesia has decided to decentralise in a difficult environment and for that matter it is best to focus on the positives and on efforts to realise the potential benefits on offer. Given the pervasive nature of the decentralisation laws, the transformation occurring in the society is drastic and all encompassing. Aid provision, more than ever, has consequently become a crucial constituent in the challenging process.

Whereas confusion and frustration may escalate in the coming few months, we believe that the nation will eventually adjust to the workings of decentralisation. A few urgent issues must be addressed in the meantime, including the inherently unequal nature of certain aspects of the program and inadequate local capacities. Nevertheless, the Indonesian case holds out some longer-term promises and in that regard is in line with the experiences in other countries as outlined by Manor (1999):

1. Reversing the neglect of institutional development, since the devolution of powers and resources to a local level will itself enhance capacity at those levels.
2. Promoting greater participation and associational activity, through local elections and increased contact or petitioning of elected representatives etc.
3. Enhancing the responsiveness of government institutions, especially through democratic decentralisation, by enhancing the speed, quantity and quality of responses.
4. Increasing information flow between government and people.
5. Making development projects more sustainable.
6. Enhancing transparency.
7. Promoting accountability.

8. Providing early warnings of potential disasters -when things are going to blow up, they do so locally more quickly and thus can be fixed.
9. Cultivating leadership.²³
10. Making development programs more flexible so that they suit local conditions.

Any aid provisions that can usefully promote the above points will certainly be appreciated by this fledgling yet enormously important nation.

²³ As so well illustrated by Josuf Wanandi, quoted in *Newsweek* (May 21, 2001): “One of Suharto’s worst legacies that he left no leaders standing to take over; out of a country of 220 million people, we have only Megawati.”

Appendix A

TERMS OF REFERENCE

Decentralisation and Development Cooperation: Issues for Donors

Background

1. Over the past decades there has been a global trend towards decentralisation of government responsibilities and fiscal resources to provincial and local government. A number of factors appear to be driving this trend, including: a growing acceptance of the idea that people should participate in the decisions that affect them; recognition of the potential technical efficiencies resulting from decentralisation; lessons drawn from the economic failure of centrally planned economies; the emergence of educated, urban middle classes keen to engage in public management activities; and the need in many developing countries to maintain national unity in ethnically, racially, or culturally diverse societies.
2. Decentralising government is a difficult process, presenting enormous challenges, particularly for developing countries given a lack of institutional capacity at sub-sovereign levels of government. In this context, a key question for AusAID is: what lessons can be learned from past experiences with decentralisation and more importantly, be applied to developing countries in general and to developing countries in the Asia-Pacific region in particular?
3. Since 1 January 2001, Indonesia has begun implementing a far-reaching program of decentralisation. The Government of Indonesia's decentralisation reforms are intended to encourage stronger national integration, expanded public participation, and improved effectiveness and efficiency of government. Through its Indonesia Development Co-operation Program, Australia is supporting Indonesia's decentralisation process via a range of different mechanisms in a variety of sectors.
4. AusAID will soon be undertaking a programming mission to draw together relevant information available with regards to decentralisation, both in Indonesia and elsewhere, and to identify current and proposed AusAID activities supportive of decentralisation in Indonesia. The second phase of the mission will see an in-country team visit Indonesia in order to formulate recommendations regarding a strategic framework for future Australian assistance to Indonesia in support of decentralisation. More detailed terms of reference for that mission are attached.

OBJECTIVES OF THE STUDY

5. In support of the upcoming Indonesia programming mission, AusAID is commissioning a parallel study focussed upon broader aid and decentralisation issues. Building upon the research and analysis carried out during the programming mission, a more extensive examination will be undertaken utilising additional information and analysis on other decentralisation processes (both in developing and developed countries). The study will aim to draw out broad "lessons learned" that can be utilised by AusAID when working in environments where decentralisation processes are underway.

SCOPE OF SERVICES

6. In performance of the specified services, the Contractor will:
 - (a) Review all relevant material provided by AusAID; and
 - (b) Consult with relevant stakeholders, as appropriate, including:
 - (i) AusAID officers, at post and desk;
 - (ii) team members involved in phases 1 and 2 of the programming mission;
 - (iii) members of the Government of Indonesia;

- (iv) academics, in Australia, Indonesia and elsewhere;
- (v) other donors involved in decentralisation activities in Indonesia, including but not limited to GTZ and USAID, and elsewhere.

7. The Contractor will:

- (a) Review and analyse significant instances of decentralisation in both developed and developing countries, with a view to drawing out “lessons learned” from previous attempts at decentralisation. With appropriate use of country examples, the Contractor will:
 - (i) briefly canvass the theoretical issues related to decentralisation, including models of decentralisation and their various advantages and disadvantages;
 - (ii) detail relevant forms of decentralisation (eg. central government to local government, ministry headquarters to ministry district office, state institution to non-state actors, etc.) previously adopted by nations with similar objectives to Indonesia’s and analyse why the particular form was chosen and its advantages and disadvantages;
 - (iii) analyse the links between the type of state structure in place - for example, federal or unitary - the model of decentralisation adopted and the outcomes of the decentralisation process;
 - (iv) analyse the extent to which both functions *and* resources have been devolved and the advantages and disadvantages of the various approaches identified;
 - (v) detail the extent to which states have instituted explicit sets of rules to govern the division of national political power between national and sub-national interests;
 - (vi) examine the relationship between various decentralisation strategies and economic growth;
 - (vii) examine the impact of decentralisation on poverty.
- (b) Undertake a case study of decentralisation in Indonesia. In particular, the Contractor will:
 - (i) expand on the strategic issues in respect of decentralisation identified in the concept paper to be submitted at the completion of phase 1 of the programming mission referred to in paragraph 4;
 - (ii) briefly examine the 'stakeholders' of the decentralisation process in Indonesia, including a brief analysis of their motivations, objectives (stated and otherwise), domestic support (politically and in the broader Indonesian community) and likely influence on the decentralisation process;
 - (iii) analyse the opportunities and risks involved in undertaking decentralisation in a rapidly evolving and dynamic political environment such as Indonesia’s;
 - (iv) analyse the prospects for Indonesia’s decentralisation process achieving its objectives, including an examination of constraints and flaws in the decentralisation program being implemented;
 - (v) examine if, and how, various recent political changes in Indonesia, including the emergence of new actors in civil society, are affecting the decentralisation process;
 - (vi) keeping in mind AusAID’s objective of poverty reduction, analyse the advantages and disadvantages of decentralisation in Indonesia in respect of poverty reduction, particularly in respect of the impact of decentralisation on social services, eg. health, education, environmental issues and resource use.
- (c) Draw together the analysis and information presented in parts (a) and (b) above and examine, in detail, how AusAID, and aid donors more generally, can effectively apply “lessons learned” to the current process of decentralisation in Indonesia. In particular, the Contractor will:
 - (i) identify in what, if any, areas AusAID should attempt to promote change in the decentralisation approach adopted by Indonesia, including identifying *how* AusAID can attempt to promote said change;

- (ii) identify what opportunities exist, or should be developed, for AusAID to promote change in the decentralisation approach adopted by Indonesia that would significantly increase the impact of decentralisation reforms on poverty alleviation;
- (iii) identify a set of principles that may be used to guide AusAID's engagement with the decentralisation process in other countries in the Asia-Pacific.

Reporting

8. The Contractor is required to submit a paper, no longer than 50 pages, summarising the findings of the Study. The paper must be submitted in a format suitable for publication.
9. At AusAID's discretion, the Contractor may be required to present the findings of the Study at several seminars (possibly ranging from seminars for AusAID staff, to seminars at academic institutions, development banks, etc). Seminar costs will be on a reimbursable basis, with timings to be determined in negotiation with the Contractor.
10. The Contractor is required to submit the final report on or before 30 June 2001.

Appendix B

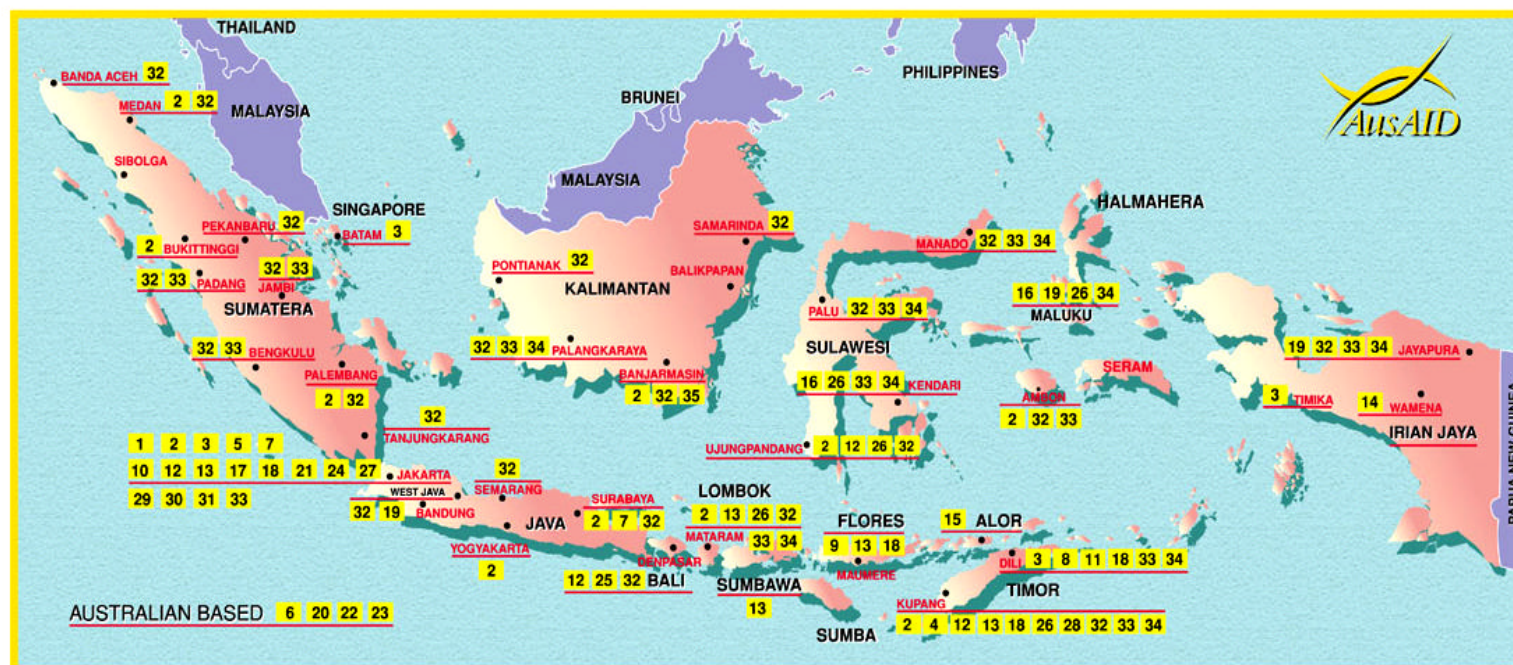
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<p>18. Propinsi Sulawesi Utara</p> <p>18.234. Kab Bolinong 18.235. Kab Minahasa 18.236. Kab Sangihe Talaud 18.237. Kota Bitung 18.238. Kota Manado</p> <p>19. Propinsi Gorontalo</p> <p>19.239. Kab Boalento 19.240. Kab Gorontalo 19.241. Kota Gorontalo</p>	<p>20. Propinsi Sulawesi Tengah</p> <p>20.242. Kab Banggai 20.243. Kab Banggai Kepulauan 20.244. Kab Buol 20.245. Kab Donggala 20.246. Kab Morowali 20.247. Kab Poso 20.248. Kab Buol Toli-Toli 20.249. Kota Palu</p>	<p>21. Propinsi Sulawesi Selatan</p> <p>21.250. Kab Bantaeng 21.251. Kab Barru 21.252. Kab Bone 21.253. Kab Bulukumba 21.254. Kab Enrekang 21.255. Kab Gowa 21.256. Kab Jenepono 21.257. Kab Luwu 21.258. Kab Luwu Utara 21.259. Kab Majene 21.260. Kab Mamuju 21.261. Kab Maros 21.262. Kab Pangkep 21.263. Kab Pinrang 21.264. Kab Polewali Mamasa 21.265. Kab Selayar 21.266. Kab Sidrap</p>

		21.267. Kab Sinjai 21.268. Kab Soppeng 21.269. Kab Takalar 21.270. Kab Tana Toraja 21.271. Kab Wajo 21.272. Kota Pare-Pare 21.273. Kota Makassar
<p>22. Propinsi Sulawesi Tenggara 22.274. Kab Buton 22.275. Kab Kendari 22.276. Kab Kolaka 22.277. Kab Muna 22.278. Kota Kendari</p> <p>23. Propinsi Bali 23.279. Kab Badung 23.280. Kab Bangli 23.281. Kab Buleleng 23.282. Kab Gianyar 23.283. Kab Jembara 23.284. Kab Karangasem 23.285. Kab Klungkung 23.286. Kab Tabanan 23.287. Kota Denpasar</p> <p>24. Propinsi Nusa Tenggara Barat 24.288. Kab Bima 24.289. Kab Dompu 24.290. Kab Lombok Barat 24.291. Kab Lombok Tengah 24.292. Kab Lombok Timur 24.293. Kab Sumbawa 24.294. Kota Mataram</p>	<p>25. Propinsi Nusa Tenggara Timur 25.295. Kab Alor 25.296. Kab Belu 25.297. Kab Ende 25.298. Kab Flores Timur 25.299. Kab Kupang 25.300. Kab Lembata 25.301. Kab Manggarai 25.302. Kab Ngada 25.303. Kab Sikka 25.304. Kab Sumba Barat 25.305. Kab Sumba Timur 25.306. Kab Timor Tengah Selatan 25.307. Kab Timor Tengah Utara 25.308. Kota Kupang</p> <p>26. Propinsi Maluku 26.309. Kab Maluku Tengah 26.310. Kab Maluku Tenggara 26.311. Kab Maluku Tenggara Barat 26.312. Kab Pulau Buru 26.313. Kota Ambon</p>	<p>27. Propinsi Irian Jaya Proposed new regions: Sermi, Kerom Waropen, Teluk Bintuni, Raja Ampat Teminabuan, Kaimana, Asmat, Tanah Merah/Digul, Bade, Merauke Kota, t Bintang Mountains, Toli Kera and Manokwari Kota. 27.314. Kab Biak Numfor 27.315. Kab Fak-Fak 27.316. Kab Jayapura 27.317. Kab Jayawijaya 27.318. Kab Manokwari 27.319. Kab Merauke 27.320. Kab Mimika 27.321. Kab Nabire 27.322. Kab Piniiai 27.323. Kab Puncak Jaya 27.324. Kab Sorong 27.325. Kab Yapen Waropen 27.326. Kota Jayapura 27.327. Kota Sorong</p>
<p>28. Propinsi Maluku Utara 28.328. Maluku Utara 28.329. Halmahera Tengah 28.330. Kota Ternate</p>	<p>29. Propinsi Banten 29.331. Lebak 29.332. Pandeglang 29.333. Serang 29.334. Tangerang 29.335. Kota Cilegon 29.336. Kota Tangerang</p>	<p>30. Propinsi Daerah Khusus Ibukot Jakarta</p>

MAP OF INDONESIA



AUSTRALIAN DEVELOPMENT COOPERATION PROJECTS IN INDONESIA

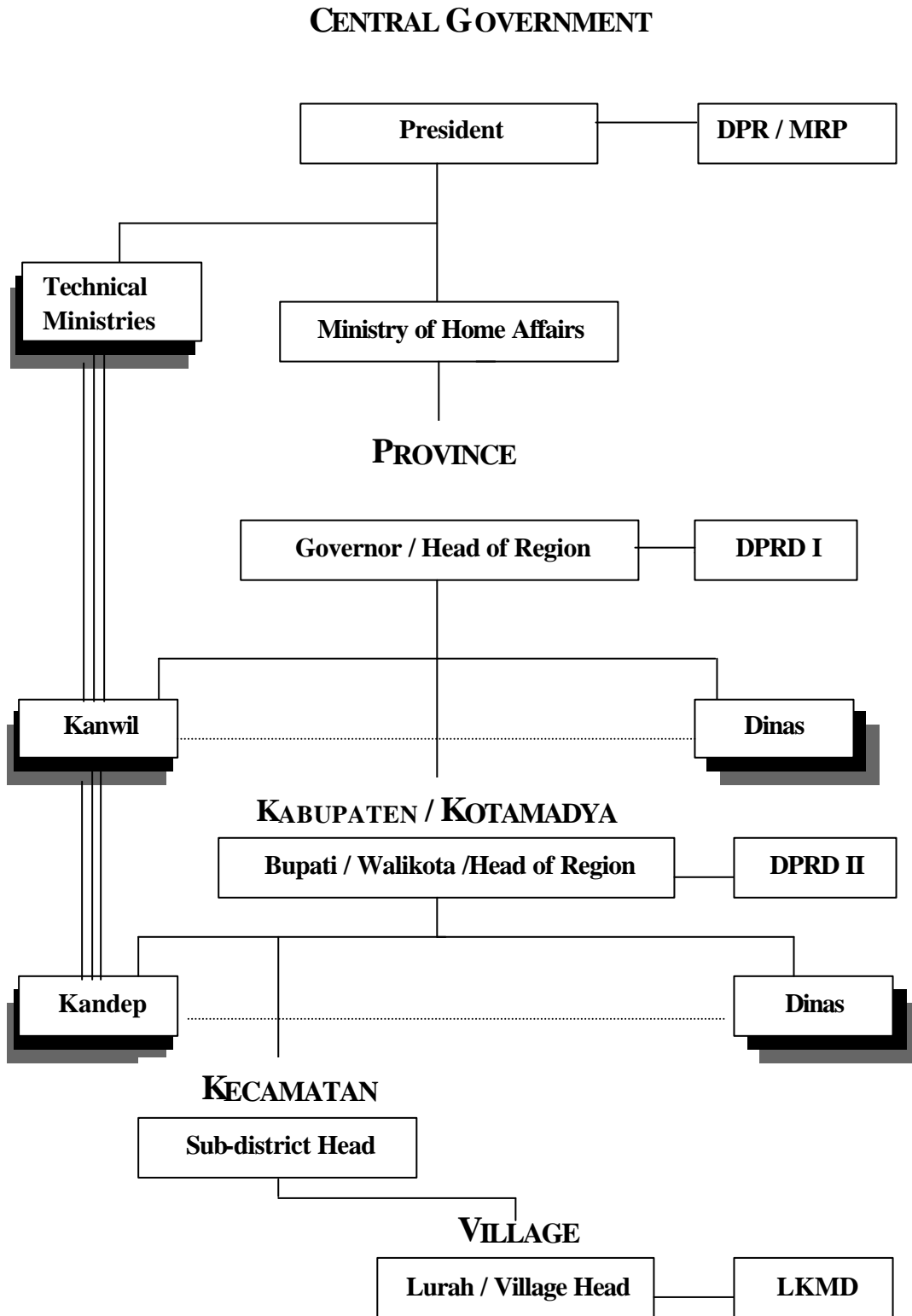
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|---|---|---|---|
| 1 Australian Development Scholarships | 11 Bobonaro Highland Rural Development | 21 Komnas HAM Capacity Building Project | 27 Social Monitoring & Emergency Response Unit |
| 2 Specialised Training Project | 12 HIV AIDS & STD Prevention & Care Project | 22 Government Sector Linkages Program | 28 Coral Reef Rehabilitation & Management |
| 3 Partnership for Skills Development | 13 Women's Health & Family Welfare Project | 23 Private Sector Linkages This program has undertaken a number of projects in Indonesia ranging from feasibility studies to medical and agricultural projects. | 29 Technical Advisory Management Facility |
| 4 NIT Basic Education Adviser Project | 14 Jayawijaya Watch Project | 24 Small Activities Scheme This innovative and flexible program provides assistance to small projects in a large number of locations Indonesia wide. | 30 BPKP Technical Assistance Project |
| 5 Maintaining Basic Education Enrolment Program | 15 Alor Community Health Project | 25 Bapedal Wilayah Denpasar | 31 Electoral Assistance |
| 6 ANU Indonesia Project | 16 Healthy Mothers, Healthy Babies | 26 Emergency Medical Supplies | 32 Rural Area Telecommunications |
| 7 BAPEDAL Pollution Control Project | 17 Indonesia Australia Medical Research Project | | 33 Improvement of Regional Environmental Laboratories |
| 8 East Timor Water Supply and Sanitation Project | 18 Intensified National Tuberculosis Assistance Program | | 34 Photovoltaic Solar Rural Electrification |
| 9 Flores Water Supply & Sanitation Reconstruction & Redevelopment Project | 19 UNICEF Safer Motherhood Program | | 35 Banjarmasin Powerline Upgrade. |
| 10 UNDP World Bank Advisory Group | 20 Australia Indonesia Development Area Initiative | | |

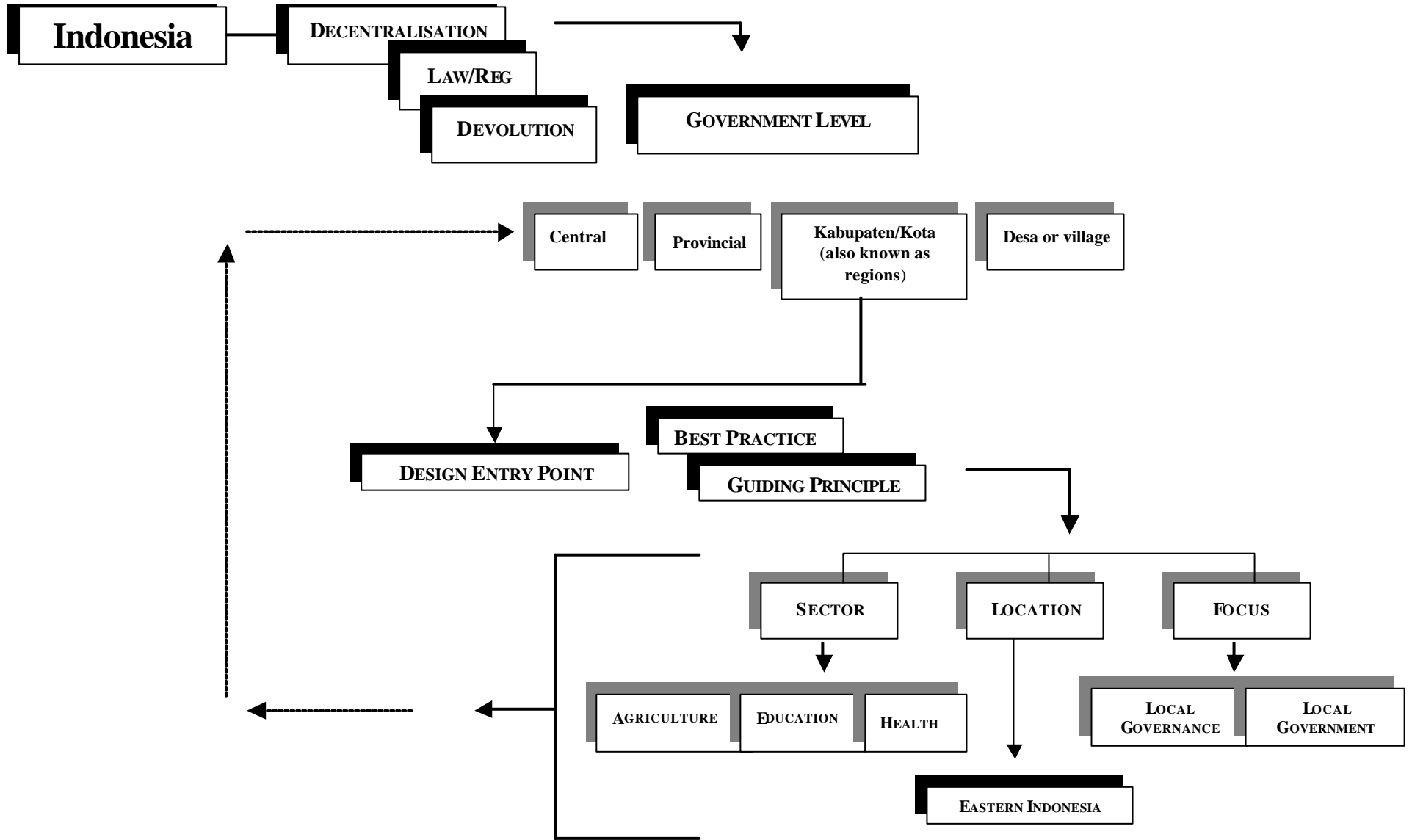
Appendix D

REGIONAL AND LOCAL ADMINISTRATION

Deconcentration

Decentralisation





Appendix F

USAID JAKARTA SUCCESS STORIES APRIL 2001

What's Happening at the Local Level?

Donor and GOI Consensus on Decentralisation Capacity Needs: At the recent CGI Meeting on Decentralisation, GOI endorsed a “National Framework of Capacity Building Needed to Support Decentralisation”. This framework was developed with assistance from USAID and GTZ, and will be used by the GOI and the donor community for programming assistance in decentralisation in a coordinated manner. The framework has been presented to the Vice President. During the CGI, the ADB announced it would structure its upcoming decentralisation technical assistance loan in accordance with the framework.

Re-engineering Provincial Leadership from Top Down to Bottom Up in West Java: The Provincial Government of West Java has recently completed a series of participatory dialogues to gain input from citizens on the future development of the province. The dialogues involved all levels of local government, civil society, NGOs, and the private sector. The provincial planning department has prepared an interactive CD-ROM with the results of this open planning process, which is being made available on the web.

Local Administrations Innovate with E-Government: All the local governments participating in USAID's Building Institutions for Good Governance Program are receiving computers and internet access. Many local governments have already taken the initiative of using the internet to improve transparency and communications with citizens. Several local governments' budgets, such as that from the city of Surabaya, are available on the web.

In South Sulawesi, Takalar became the first local government agency in Indonesia to provide e-government services to the public. The 24-hour service, called SIMTAP (Management Information System Under One Roof), is a collaborative effort between the Regency of Takalar and the phone company. Takalar promotes this program as a “one-stop public service” and paperless government, where citizens can process requests for identity cards and building permits, and pay their property taxes. Internet access to Takalar's e-government is made available to this predominately agricultural community at the local government office. Takalar's website also provides citizens with information about local development activities and e-mail is now being used for inter- and intra-office communication.

Decentralisation: Bringing Government Closer to the People in West Sumatra: Local governments across Indonesia are embracing regional autonomy. The impacts of local control are varied and there are plenty of stories out there about the worse-case situations; but a number of local governments are also truly committed to improving local democracy and increasing citizen involvement in directing local development. One province that is taking the opportunity to re-evaluate how local government operates is West Sumatra. The Governor of West Sumatra in consultation with the local governments is looking at restructuring the administrative system along the lines of traditional governing structures in order to make local government more democratic, improve local government services and increase citizen involvement. USAID's “Building Institutions for Good Governance” project will investigate the situation in West Sumatra and determine if assistance on issues of organisational restructuring will be beneficial to the province's efforts.

Innovations that Improve Customer Service, the Jember Water Company: Indonesia's public services have never been noted for strong customer service. Now under regional autonomy, many government are changing this. One good example is the Jember Water Company (PDAM). Normally, receiving services from the PDAM is difficult at best. Inadequate supplies, poor distribution systems, expensive connection costs and corruption have all led to very low coverage where only 30% of the urban population receive a reliable supply of piped water to their homes. The fact is most PDAM have experienced long delays in collecting outstanding invoices and many have extraordinarily high levels of bad and uncollectable debts.

The reason for the high incidence of bad debts has much to do with the methods for invoicing and collection.

At most PDAM, customers do not receive their bills by mail. The ordinary procedure is for customers to arrive at the PDAM to get their monthly invoice. There are no notices or any other method employed to advise the customer that they have any invoices outstanding or amounts that they owe. Often, when the customer arrives at the PDAM, they must queue for hours to wait for the bill. People who must go to work must take hours off from work just to pay their bills.

PDAM Jember sought to alter this cycle of frustration. They reasoned that in order to provide service and increase their cash flow, the invoicing and collection system needed to be made more customer-friendly. PDAM Jember and the phone company entered into an agreement that allows customers to access their accounts via the telephone and informs the customer of their most recent invoice. PDAM Jember worked with three local banks to make payment simpler. Computers at the bank record the total outstanding invoices, collect the payment from the customer and immediately credit the account of the PDAM.

This system has not only made payment quick and easy for customers but significantly improved cash flow for PDAM. The true meaning of a win-win solution means all parties benefit. Here PDAM benefits from improved cash flow, customers benefit from ease of payment, the phone company benefits through increased system usage, and banks benefit from fees and fund deposits in their bank.

Real Citizen Participation in Local Government Decisions: Ordinary Indonesians have rarely had more than a “say yes” role in decisions made by their government, which made its plans without asking for real input and then “socialized” them to people. With decentralisation, local governments are rapidly opening up to real input from citizens and local NGOs. A review of USAID/Indonesia’s CLEAN-Urban project shows that community participation can be effective, systematic and comprehensive. Work with nine target local governments to implement a new, highly participatory, all-sector planning process (PDPP) shows that:

- All nine found that by working with local NGOs and community facilitators, they were able to carry out Community Needs Assessments in every sub-district (344).
- In all nine, community-generated projects were put forward, prioritised by local communities, and included in draft and final total local government development plans.
- In all nine, FY2001 budgets include funding for more than 1,000 priority community-generated projects. The budgets also include funding for finishing those PDPPs still in draft form, and for rolling over the plans next year, with more participation.

Obviously, all local government planning needs can’t originate in individual sub-districts, and PDPPs do include projects put forward by a variety of stakeholders. In the nine target local governments, non-political representative City Forums were created to guide the PDPP process, provide community-wide inputs, and review draft and final plans. The PDPP process begins with creation by the local government of a mission/vision statement. In both instances where City Forums rejected the administration’s vision, the PDPP was prepared and finalised using the Forum vision statement. Target local governments had populations of between 1 and 3 million, with both urban and rural populations.

Local government response to the PDPP can realistically be characterised as “wildly enthusiastic”. More than 70 have already given written commitments to implement PDPPs, including pledges of funding, staff, and facilities, and the interest shown by many more has USAID scrambling to meet the need. They have also committed to making their PDPPs highly participatory, despite often prickly and adversarial relations with local NGOs and community groups. Leaders of local governments know that they need participation in local decision-making, but acknowledge that their administrations do not have the skills and capacity to accept and manage real participation. Mayors and bupati see that by making participation comprehensive and systematic, the PDPP offers a constructive approach to solving fundamental issues of citizen participation in planning and budgeting.

More Stories of Local Level Initiatives:

PDPP Success Stories

Mr. Suryo, the head of the Budget Committee of the legislature of Kediri, is active pushing for adequate budget allocations to implement PDPP, and undertakes frequent field visits to check on PDPP implementation. This is the first time the legislature is actively participating in development planning and implementation. Mrs. Sri, Deputy Head of the Budget Committee, an active participant of PDPP training, now disseminates the PDPP approach to other members of the legislature. In response, the legislature fully endorses the PDPP approach and prepares to be actively involved in the consultation process to bring the PDPP to fruition. The legislatures of Jember and Kediri plan to include the community based approach developed by the project into their local government regulations.

Mr. Mohamad and Mr. Usman of the local legislature of Pasuruan district actively participated in PDPP training, are active members of the technical team, and now regularly mediate in conflicts between private entrepreneurs and the community concerning development planning goals and project objectives. In response, the private sector and community groups now actively participate in the formulation of a local development strategy that will become the basis for the PDPP.

In Tulungagung, the City Forum invited community representatives to participate in the discussion of priority investment needs. One such community proposed investment in a bridge to link two low-income neighborhoods. The City Forum recommended that this investment be included in the PDPP, and the local administration has accepted their proposal. This is a clear result of a community participation process that did not occur previously. So far, however, sufficient funding for the proposal is not yet available.

In order to sustain the community participation process after project technical assistance ceased, the local governments of Kediri, Tulungagung, Malang district, Jember, Sidoarjo and the city of Probolinggo allocated their own matching funds to replicate the community stimulation grants provided by the project during the previous years for selected communities.

At the time the PDPP team in East Java started providing assistance in corporate planning, the PDAMs of Malang, Tulungagung and Kediri were about to borrow millions of US dollars each for a scheme to expand their service coverage in a bid to become more profitable. The PDPP team showed that the loans might drive the PDAMs into bankruptcy, and that they had more chance of becoming viable by building capacity to operate more effectively and efficiently. As a result, the PDAMs deferred the loans in favor of strengthening corporate management.

Appendix G

HISTORICAL OVERVIEW

Regional Government During the New Order

To fully comprehend the current reforms, the magnitude of the shift, and the problems entailed, it is necessary to understand the restrictive nature of regional government in Indonesia as it was regulated by Law No. 5 of 1974. The official purpose of this law was to give the provinces a reasonable amount of local decision-making power. There were two systems of transferring power to regional administrations: decentralisation [*desentralisasi*] and deconcentration [*dekonsentrasi*]. There was also a sharing of responsibilities or co-administration [*tugas pembantuan*].

As Niessen (1999, p.105) notes, the New Order regional government legislation developed “a rather complex arrangement of parallel administrations for autonomy and deconcentrated regional government”. This complex arrangement meant that the Governor held two executive positions. He was the head of an Administrative Territory Level I [*Wilayah Administratif*] directed under a system of deconcentration by a central government bureaucracy in the province [*Kanwil*]. At the same time he was head of the province which was also an autonomous region with its own bureaucracy [*Dinas*]. The same system operated at the District Level II [*Kabupaten/Kotamadya*]. The *Bupati/Walikota* was the head of an Administrative Territory Level II which was directed under a system of deconcentration by a central government bureaucracy [*Kandep*]. Each district was also an autonomous region with its own bureaucracy. Central government directives were passed by the provincial governors to the *bupati* or *walikota* then to the *camats*, who were heads of the sub-districts [*kecamatan*], and through the *camats* to the village leaders of all the villages in the country.

Under the system of co-administration [*tugas pembantuan*] certain tasks were performed by the administration of the autonomous region, but under the full authority and responsibility of the central government (Niessen, 1999, p.83). In other words, districts carried out particular tasks under the authority of the central government and with central government financial and other support. The districts also carried out autonomous tasks independently, albeit according to existing statutes and with the provision that regional laws did not contravene national or provincial laws. Because of the centralised nature of the system, independent autonomous activity was limited.

President Suharto’s New Order government witnessed a massive inflow of funds from the oil boom of the 1970s. These funds, augmented by increased foreign aid to the new regime, made it possible for the government to embark on extensive and ambitious national development programs. Central government programs, carried out by the government in all parts of Indonesia, underscored the role and the strength of the central government (MacAndrews, 1986, p.1). The programmes also strengthened the role of the provincial governments as the central government sought to give responsibilities to its bureaucratic apparatus in the provinces. This was in fact “deconcentration” and did not encompass regional autonomy. The Indonesian bureaucratic hierarchy remained a “top-down” structure; control remained vested with the central government in Jakarta.

There is a distinction between local government and local administration. The vertical arrangement of the *wilayah administratif* existed to raise the level of control and to guarantee the smoothness of the implementation of central government policy. Provincial governors and district leaders were primarily expected to execute policies, not to make them. To ensure that district leaders understood their role clearly, both the army and the central government had a presence in every province and in every district. Most central government ministries had regional offices at provincial level. Some ministries also had offices at the district [*kabupaten/kotamadya*] level. These district offices [*kandep*] corresponded with the relevant department [*dinas*] of the local authority. The “*dwi fungsi*” concept meant that the head of a local department could also be head of the local office of the equivalent ministry. While the vertical arrangement of the *wilayah administratif* was guaranteed to implement the central government’s policy, it was also intended to streamline the provision of services to the regions. It did, however, give rise to complex problems of divided responsibility for services and for financial accountability.

While the 1974 law placed the focus of regional autonomy at Level II, the transfer of responsibility for public services to the district was done in stages according to the ability of the district concerned. Consequently the status of districts varied considerably. Although services were transferred to the region as a realisation of the principle of decentralisation, the final responsibility for those services remained in the hands of the central government: the government could readily withdraw services that were already transferred as regional services.²⁴

Under the taxation system implemented by the New Order, the government collected revenues at the centre, and reallocated them as central subsidies (*sumbangan daerah otonom*). As provincial and district governments were given little authority to raise their own taxes, central government subsidies were the major source of regional government income. In theory, this practice would create equitable development across the nation. However, in calculating the subsidy a region should receive according to a presidential instruction (*Inpres*), the central government chose a demographic formula rather than assess the region's economic contribution according to resources or export income. The consequence was that regional governments in resource-rich areas with small populations received inadequate funding for development, frustrating their long-term potential. Most of the value-adding industrial activities occurred in the more highly developed and populous metropolitan centres especially on Java where the industrial and service infrastructure was concentrated. The less populated regions in the "outer islands", despite their abundance in natural resources, developed slowly with restrictive or smaller subsidies. Inevitably the economic potential of the resource-rich 'outer islands' suffered by comparison with densely-populated Java. Political dissatisfaction with the status quo intensified and became the foundation for significant problems.

Towards Regional Autonomy

A dramatic fall in oil prices in the mid-1980s meant that the New Order government had less income to spend on regional development. This shortfall provided an opportunity for resource-rich provinces like Aceh, Riau and Irian Jaya, who felt that the central government had exploited their natural wealth without returning a fair share of the revenue, to press for greater autonomy (Richardson, 2000).

In response, the New Order government introduced Government Regulation No. 45/1992. This regulation stated that some matters not affecting national interests²⁵ could be dealt with by district, that is level II, governments (Malo, 1997, ch.3). Administrative offices [*dinas daerah*] were established by the regions but their function was limited because the hierarchical transfer of authority from the central government continued through the provincial government. Previously, while subject to the principle of deconcentration, the transfer of projects was accompanied by the transfer of personnel, money and the necessary equipment. It is not surprising that, without fiscal support, this regulation had very little impact on the decentralisation process in Indonesia.

Because MoHARA found implementing Government Regulation No. 45/1992 problematical, they conceived a radical plan to trial a District Autonomy Pilot Programme [DAPP]. The program, initiated in 1995, involved 26 separate districts in a two-year pilot with the stated aim to increase regional autonomy (Yusuf, 1997). Most ministries and provincial governors were supportive and cooperative. However, some sector departments, as well as some of the provincial governments, would only devolve certain functions or certain parts of projects which limited the authority of the regional governments. The inability or the unwillingness of the provincial governments to transfer resources was particularly detrimental to the scheme. A further complicating factor was that projects transferred in the form of

²⁴ The 1974 Law also made it possible for autonomous regions to be abolished. The granting of autonomy to a regional government was seen as a way to improve the effectiveness and efficiency of regional administration. If a region was not able to manage its own regional services and remained dependent on a subsidy from the central government, then that region could be abolished. It was even possible to abolish one region and establish a new region. An Advisory Board of the Autonomous Regions, which consisted of several Ministers presided over by the Minister of the Interior, advised the President about the activities of the regions.

²⁵ This included security and defence, the judiciary, foreign affairs and fiscal matters.

“decentralisation” were not sufficiently distinguished from those transferred in the form of “co-administration”. As well, the projects selected for the pilot scheme were not necessarily those to which the districts gave priority. Consequently, this “top-down” approach to decentralisation resulted in dissatisfaction at all levels of government (Yusuf, 1997).²⁶

While there were specific complaints with organisational structures of DAPP, of greater importance was the lost opportunity for widespread discussion between the central government and the regions concerning regional autonomy. The central government delayed the extension of the program to other districts (Yusuf, 1997). Even so, it was considered an important step in promoting decentralisation and in creating some political momentum (Beier, 1997).

In mid-1997, the Indonesian economy experienced a severe economic crisis resulting in a dramatic plunge in the value of the rupiah. Major companies defaulted on their loan repayments, interest rates soared, and unemployment and inflation rose dramatically (Niessen, 1999, p. 342). One of the Suharto government’s responses to the deepening financial crisis was to promulgate Law No. 18/1997, which limited local control of finances in local government. District governments had to limit public works because local income [*Pendapatan Asli Daerah: PAD*] was restricted. All tax retributions had to be sent from the districts to the central government. The central government guaranteed and paid the salaries and wages of the district bureaucracy, plus a small incentive payment.

However, there was no funding for local government development or enterprise. Subsequently, with the appointment of President Habibie, the system of funding by Presidential Instruction [*Inpres*] was also terminated, which left the district administrations in a parlous state.

Niessen (1999, p. 342) suggests that by 1998 “the hatred against the New Order which had been simmering in the hearts of the Indonesian people came to a head”. Certainly, the ousting by the Suharto government in 1996 of the popular Megawati Soekarnoputri from the leadership of the Indonesian Democratic Party, anticipated the final stage of Suharto’s presidency. The run-up to the general elections of 1997 witnessed widespread protests that confirmed disillusionment and discontentment with the policies of the New Order government. There were serious allegations of intimidation and fraud (Niessen, 1999, p. 342). Even so, the government party, GOLKAR, recorded a resounding victory in the 1997 elections. Furthermore, in March 1998, President Suharto was re-elected for another five-year term. He appointed B.J. Habibie his vice-president.

A number of disparate crises were rapidly engulfing the New Order administration. There were widespread crop failures, while the economic crisis [*krismon*] began to affect every stratum of Indonesian society. The rupiah depreciated to about one-fifth of its mid-1997 value (Niessen, 1999, p. 342). The IMF was prepared to help Indonesia but President Suharto’s reluctance to reform the economy caused the IMF to renege on a promised loan. The Indonesian currency continued to slide while the price of consumer goods soared. The brutal killing of five students in May 1998 in Jakarta ignited a series of riots and vehement protests. So severe was the crisis that President Suharto was forced to resign in favour of B.J. Habibie. But the protests continued unabated.

In the regions, both bureaucrats and leaders in the private sector were already complaining that Law No. 5/1974 was too centralist and that every decision the regional government made had to have prior agreement from Jakarta (Siagian, 1998). Increasing concern was expressed in the regions about autonomy or the possibility of severing themselves from the Republic of Indonesia, giving examples of Eastern Europe and the break-up of Soviet Union (Carey, 2001). In this atmosphere of reform, local communities, student groups and NGO activists attempted to reverse the excesses of the previous regime. They were eager to take advantage of Habibie’s fragile power base (McCarthy & Warren, 2000).

Habibie presented himself as a reformist, promising new elections and a reformed government. Acting under a mandate from MoHARA, a team of seven academics [*Tim Tujuh*], under the leadership of Ryaas

²⁶ Yusuf (1997) notes that the “top-down” approach extended even to the setting of organisational structures for *dinas*, supposedly autonomous district agencies.

Rasyid, rector of the Institute for Government Studies, worked to fashion a legislative framework aimed at producing a truly representative government from the 1999 elections (McBeth, 1998). The team recommended that, parallel to electoral reform, there should be reform to legislation concerning local government. Even before the 1999 elections, Law No. 22/1999 to reform local government, and Law No. 25/1999 concerning fiscal arrangements between the central and regional government, were promulgated.

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