ASIAN DEVELOPMENT BANK
Independent Evaluation Department

SPECIAL EVALUATION STUDY

ON

ASIAN DEVELOPMENT BANK SUPPORT

FOR DECENTRALIZATION

IN INDONESIA

In this electronic file, the report is followed by Management's response and the Board of Directors' Development Effectiveness Committee (DEC) Chair's summary of a discussion of the report by DEC.

Evaluation Study

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Asian Development Bank Support for Decentralization in Indonesia

Independent Evaluation Department

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
AusAID	–	Australian Agency for International Development
BAPPENAS	–	Badan Perencanaan dan Pembangunan Nasional (National Development Planning Agency)
CAP	–	country assistance plan
CERDP	–	Community Empowerment and Rural Development Project
CIDA	–	Canadian International Development Agency
CLGSSDP	–	Community and Local Government Support: Sector Development Program
COSS	–	country operational strategy study
CPS	–	country partnership strategy
CSP	–	country strategy and program
DFID	–	Department for International Development of the United Kingdom
DGWGD	–	Donor–Government Working Group on Decentralization
DPL	–	development policy loan
DPOD	–	Dewan Pertimbangan Otonomi (Regional Autonomy Advisory Council)
DPSP	–	Development Policy Support Program
DRSP	–	Democratic Reform Support Program
DSF	–	Decentralization Support Facility
IEM	–	independent evaluation mission
IFI	–	international financial institution
IT	–	information technology
KDP	–	Kecamatan Development Program
LGFGR	–	Local Government Financial Governance Reforms
LGFP	–	Local Government Financing Project
MOF	–	Ministry of Finance
MOHA	–	Ministry of Home Affairs
MSS	–	minimum service standard
NAPFD	–	National Action Plan for Fiscal Decentralization
PGRI	–	Partnership for Governance Reform in Indonesia
PHC	–	primary health care
PPME	–	participatory planning, monitoring, and evaluation
SCBDP	–	Sustainable Capacity Building for Decentralization Project
SES	–	special evaluation study
TA	–	technical assistance
TCR	–	technical assistance completion report
UNDP	–	United Nations Development Programme
USAID	–	United States Agency for International Development

NOTE

In this report, "$" refers to US dollars.

Key Words

indonesia, adb, asian development bank, performance evaluation

Director General	H. Satish Rao, Independent Evaluation Department (IED)
Director	H. Hettige, Independent Evaluation Division 2, IED
Team Leader	G. Crooks, Senior Evaluation Specialist, Independent Evaluation Division 2, IED
Team Members	F. De Guzman, Evaluation Officer, Independent Evaluation Division 2, IED C. Roldan, Assistant Operations Evaluation Analyst, Independent Evaluation Division 2, IED

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The guidelines formally adopted by the Independent Evaluation Department (IED) on avoiding conflict of interest in its independent evaluations were observed in the preparation of this report. Gabrielle Ferrazzi, Rodrigo Lachica, Jr., and Machfud Sidik were the consultants. To the knowledge of the management of IED, there were no conflicts of interest of the persons preparing, reviewing, or approving this report.

APPENDIXES

Attachments: Management Response
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EXECUTIVE SUMMARY

Background

This special evaluation study (SES) presents the findings of an independent assessment of the Asian Development Bank's (ADB's) support for decentralization in Indonesia since the start of such support in 1998. The evaluation is intended to inform the preparation of the new country partnership strategy. It is not intended to evaluate government decentralization performance. Decentralization is a broad area, and this evaluation focuses on ADB support for facilitating the decentralization process, as well as support intended to strengthen regional (provincial, district and municipal) governments and institutions. The SES was carried out through a combination of studies, interviews, and document review conducted in Indonesia and at ADB headquarters. The individual components were (i) background analysis of the decentralization sector, (ii) analysis of strategic fit, (iii) assessment of ongoing and completed ADB projects, (iv) assessment of the impact of policy-oriented advisory technical assistance (TA), and (v) survey of key informants. An assessment was also made of current good international decentralization practice.

Drivers of Change

Reforms were a response to serious economic and political problems following the Asian financial crisis of 1997 and the change of government in 1998, and included decentralization, public administration and financial reform, and reallocation of government power. A further driver was the need to maintain a unitary state and the integrity of its boundaries, and accommodate pressure for regional autonomy. In 2001, there were 27 provinces and 292 districts and cities; by December 2008, this number had increased to 33 provinces and 491 districts and cities, with a population of about 220 million. Decentralization was also intended to give local communities influence over local matters that affect them, using national legislation to ensure national standards and equity between regions.

Government Strategy

Some tentative steps toward decentralization had already been made prior to the “reform era,” but these initiatives paled in comparison to the “big bang” decentralization that was set off with Law 22/1999 on Regional Government and Law 25/1999 on Fiscal Balance between the center and the regions. The two laws were politically urgent for the government, but were formulated separately by the Ministry of Home Affairs (Law 22/1999) and the Ministry of Finance (Law 25/1999). Due to this urgency, they were drafted rapidly and while bold in many respects, they could have been clearer and better integrated. Subsequent reforms have only partly addressed two key sets of issues: (i) the lack of clarity in the legal framework and weaknesses in national coordination between key government bodies and the implementation of decentralization; and (ii) the disparate treatment of the administrative and fiscal aspects of decentralization leading to divergence between the standards that are set for public services and the resources that are allocated.

ADB Strategy and Assistance

In a variety of strategic documents, ADB has supported the decentralization process since 1998 at the center and in the specific areas of basic social services (health and education), development administration, and environmental management. Initial support was in response to the Asian financial crisis and the need for community development following the

"big bang." Later support focused more on the challenges facing public financial management and fiscal decentralization. The decentralization-focused program loans began with the Local Government Financial Governance Reform (LGFGR) Sector Development Program, which was designed to enable more effective local government public services through an improved fiscal, budgetary, and financial management framework. In addition to the above-mentioned strong focus on public financial management, ADB assumed a responsive stance to government needs, particularly as the scope of the challenges became apparent. Support was provided to rearrange strategies and practices to conform with decentralized forms of governance through separate advisory TA projects for (i) onlending, (ii) environmental impact assessment process, (iii) urban infrastructure, and (iv) minimum service standards. ADB has also provided support for decentralization in the health and education sectors in Indonesia.

Strategy Assessment

In terms of strategic positioning, ADB's governance strategies and assistance programs have broadly responded to the key priority areas of decentralization. They have also been fully aligned with ADB's strategic priorities of improving governance through building capacity and strengthening institutions at subnational levels (including provinces, states, municipalities, and local communities) and reducing poverty through improved service delivery and regional equity.

ADB's strategies for each phase of decentralization appear to have been relevant to the strategic needs of the government, but with hindsight ADB may have underestimated the speed, scale, and the requirements of Indonesia's decentralization program, especially the readiness and capacity of institutions. A further key issue is the allocation of responsibility between the three principal government agencies—the Ministry of Finance, National Development Planning Agency (Badan Perencanaan dan Pembangunan Nasional [BAPPENAS]), and Ministry of Home Affairs—for the decentralization process. ADB could do more to share and coordinate with, and learn lessons from, other development partners' support for decentralization. Strategic positioning is rated *substantial*.

Program Assessment

Relevance has been variable with initial support being necessarily rapid rather than designed in detail, although succeeding interventions have been more focused and responsive. Overall relevance is rated *relevant*.

Effectiveness has been influenced by the way in which assistance has been provided. ADB's core decentralization loans and supporting TA projects have been effective in supporting required policy reforms. However, they have been less effective in developing the institutions and processes needed to implement the required policies. Effectiveness has also been affected by inappropriate designs in some cases and the lack of available expertise at the regional level. Effectiveness is rated *less effective*.

In terms of efficiency, core decentralization loans have suffered from implementation delays and several have been extended. Reasons for these delays include issues arising from both government and ADB. For ADB, some delays were caused by lengthy response times from ADB headquarters, although this is somewhat explained by the necessary prudence and diligence required in procurement in the light of potential corruption issues. Overall efficiency is rated *less efficient.*

Although difficult to measure (there is a time lag before outputs become outcomes), sustainability of outcomes is likely as legislation and associated regulations have been delivered. For those TA projects which have delivered procedural improvements or detailed research into particular aspects of decentralization, sustainability is likely, as the outputs of these TA projects are of continuing usefulness to government. Sustainability is rated *likely sustainable*.

For impact, ADB has had some undoubted impacts on the process of decentralization. The LGFGR program loan underpinned the requirement for necessary changes to legislation and supporting regulations at a time when urgent changes were required. Sector-based decentralization support loans (together with their supporting TA projects) have attempted to foster the introduction of sustainable decentralized education and health services, albeit with mixed results. Capacity building TA projects have tended to add more value to individuals rather than to the institutions for which they work. Some TA projects have been recognized to be of high quality by other technical advisors. Value addition is rated *modest*.

Overall Assessment

Irrespective of the urgent need for assistance, interventions taking place during periods of rapid economic, political, and administrative transitions face the risk of becoming irrelevant and ineffective, with short-lived outputs and unsustainable outcomes. In terms of ADB performance, this has meant finding a difficult balance between the need to ensure the effectiveness and efficacy of deploying scarce TA resources, and the need to support important policy processes during a period characterized by risk and uncertainty. ADB responded promptly to a rapidly changing situation, but the very nature of the situation precluded detailed analyses and programming. Subsequent support has attempted, with some success, to provide a sound policy framework for decentralization. This support might have been more effective and sustainable if backed by more TA designed to develop the capacity of decentralized institutions to improve systems and procedures, rather than TA focused on the training of individuals. The overall rating is *partly satisfactory*.

ADB performance has been affected by the lack of staff at the Indonesia Resident Mission with deep knowledge of decentralization. Additional capacity is needed to design and guide the various loans and TA provided. Although the resident mission is actively involved in decentralization projects from the design of the terms of reference to implementation, the perception of some senior government officials expressed to the independent evaluation mission is that the resident mission is a conduit to ADB headquarters, with key decisions being taken in Manila. This perception could be addressed if capacity were to be increased. ADB and other agencies have invested heavily in capacity development, but results have sometimes been disappointing. A less ambitious approach could have been adopted given the complexities of the decentralization program. Performance has also been affected by poor disbursement as a result of serious procurement issues in the case of some loans.

Lessons

Key lessons identified include the needs for:

(i) increasing the number of professional staff based in the resident mission for the analysis and management of projects and programs;
(ii) being consistent in terms of substantive focus (which should be agreed with government) and delivery instruments;

(iii) speeding up the process of getting from the identification of a defined need to project implementation;
(iv) prioritizing efforts to optimize coordination and policy dialogue with government and other development partners; and
(v) ensuring that sufficient resources are committed to the analysis and dialogue required for project design and preparation.

Recommendations

The following are recommendations for consideration by the Southeast Asia Department during the preparation of the country partnership strategy.

Continue support for developing the policy framework for decentralization with project- and program-based support, complemented by more decentralized assistance, such as support for institution building, at local levels. The government is increasingly assertive in policy development and has welcomed support that is facilitative. The new country partnership strategy may present an opportunity for ADB to reassess current support whereby the majority of support has been given in the form of policy-based interventions. It is also possible that the demand for fiscal support may lessen over time following the easing of the recent global financial crisis (para. 98).

Continue addressing government priorities for decentralization by focusing ADB's interventions on past successes (in public financial management reform and capacity development) and support further improvement of the coordinated decentralization framework. A comprehensive legal and regulatory framework for decentralization is not yet in place. For example, the revision of Law 32/2004 and similar reform streams do not yet have government-recognized proposals (para. 99).

Further deepen coordination with other development partners (including the donor working group and other forums) in supporting government decentralization activities. International and Indonesian experience with decentralization reforms suggest that often too many reforms are attempted at the same time, overburdening central and local governments. There should be a phased and well coordinated effort between ADB and other development partners (para. 100).

H. Satish Rao
Director General
Independent Evaluation Department

I. INTRODUCTION AND BACKGROUND

A. Introduction

1. This special evaluation study (SES) presents the findings of an independent assessment of the Asian Development Bank's (ADB) support for decentralization in Indonesia since the start of such support in 1998. The evaluation is intended to form input into the preparation of the new country partnership strategy (CPS). It is not intended to evaluate government performance. Decentralization is a broad area, and this evaluation focuses on ADB support to the facilitation for the decentralization process, as well as support intended to strengthen regional governments and institutions. “Regional” government is intended in this study to denote provincial, district, and municipal government levels as a group. This study also examines sector programs and other public sector management support where the focus of the support centered on, or gave significant attention to, decentralization.

2. Since 1998, ADB has approved $1.04 billion for four core decentralization projects (Appendix 1), and $14.85 million for technical assistance (TA) projects spread over 12 projects and programs (Appendix 2). Other support provided by ADB included policy dialogue and implementation support by staff. In addition, ADB approved $1.27 billion for sector-based decentralization support loans, and $2.93 billion for public sector management support loans with decentralization components.

B. Scope and Objectives

3. This SES assesses the strategic positioning, relevance, efficiency, effectiveness, sustainability, and impact of ADB’s completed and continuing decentralization support program and operations in Indonesia from 1998 to 2009. It also aims to derive lessons, good practices and recommendations to guide future ADB decentralization support. In addition, the performance of ADB in designing and implementing assistance to decentralization is assessed. Details of scope objectives, approach, and methodology are given in Appendix 3.

C. Approach and Methodology

4. The SES was carried out through a combination of studies, interviews, and document review conducted in Indonesia and at ADB headquarters. Individual components were (i) background analysis of the decentralization sector, (ii) analysis of strategic fit, (iii) assessment of ongoing and completed ADB projects, (iv) assessment of the impact of policy-oriented advisory TA, and (v) survey of key informants. An assessment was also made of current good international decentralization practice.

D. Limitations

5. The SES has the following limitations:
   - (i) The assessment of individual project outcomes is limited to projects that have been completed and for which project performance evaluation reports or project completion reports are available.
   - (ii) Ongoing assistance is assessed against evaluation criteria as at the end of 2009.
   - (iii) It excludes preparatory TA projects as the issues relating to these are seen in the ensuing projects.

II. DEVELOPMENT CONTEXT AND GOVERNMENT PRIORITIES

A. Background

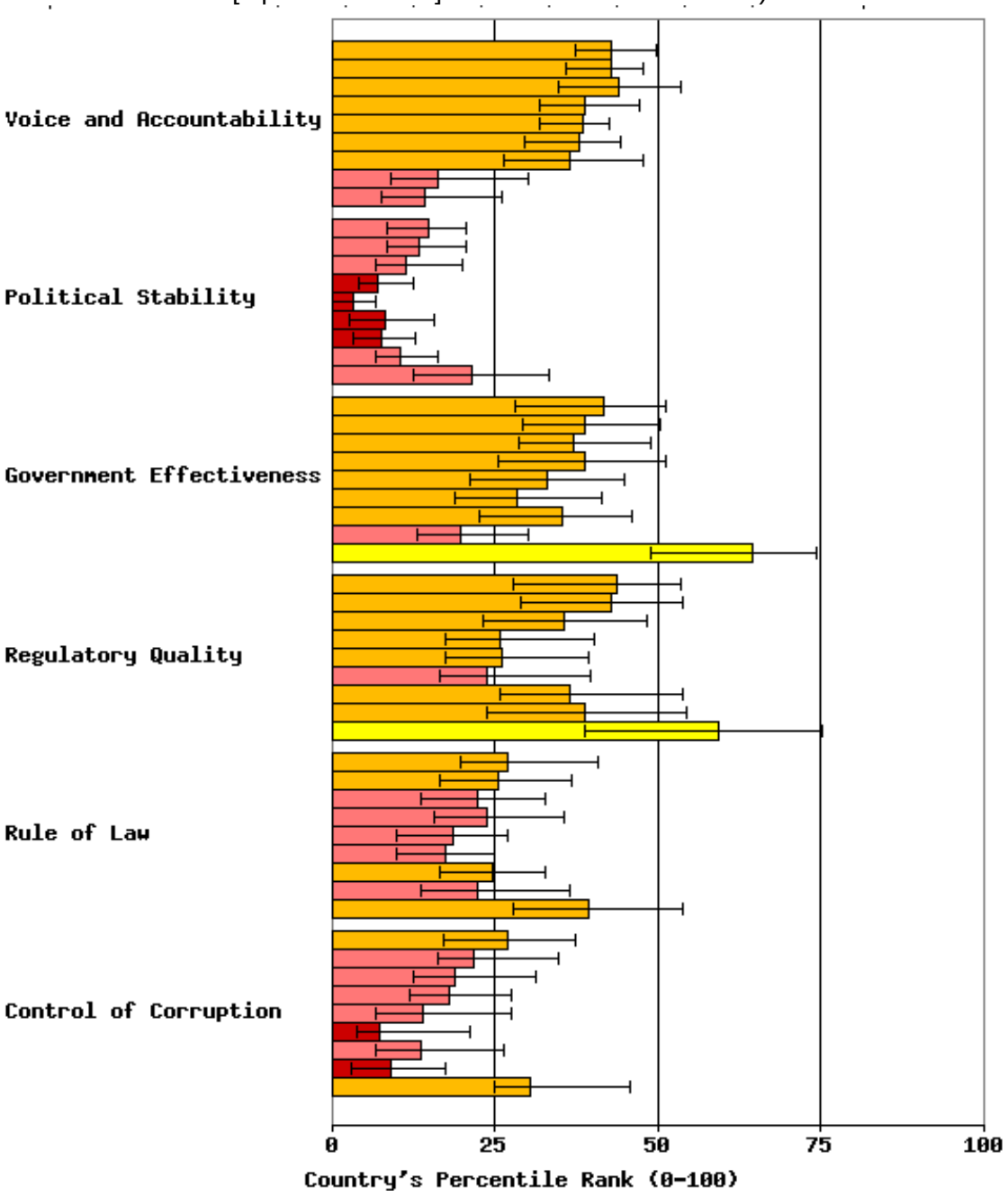
6. **Country context.** By December 2008, Indonesia had a population of about 220 million and consisted of 33 provinces and 491 districts and cities. The number of districts and cities has risen from 292 since decentralization began in earnest, after the broad reforms that followed the change of government in 1998.[1] Provinces and districts and cities enjoy considerable autonomy as a result of the decentralization efforts since 1999.

7. **Governance context.** Indonesia's decentralization effort should be seen in the context of its overall governance reform efforts, where there have been some notable results in some areas and little progress in others. The relative position of Indonesia in relation to other countries since 1999, shown in the World Bank governance indicators in Figure 1, suggests that there is an overall but slight improvement in governance, particularly in "voice and accountability." The decentralization initiative of the government undoubtedly accounts for a more lively and democratic polity at local level, empowered by more responsibility and resources. Some consistent improvement in combating corruption (starting from low levels) is also seen, suggesting that, while corruption has been more visible at local levels, perceptions of runaway corruption at the local level due to decentralization may be too extreme.[2]

[1] United States Agency for International Development (USAID)–Democratic Reform Support Program (DRSP). 2009. *Stock Taking on Indonesia's Recent Decentralization Reforms Update 2009 – Draft Main Report*. Jakarta. March.

[2] T. Rinaldi et al. 2007. *Fighting Corruption in Decentralized Indonesia - Case Studies on Handling Local Government Corruption*. World Bank. Washington, DC. May.

Figure 1: World Bank Governance Indicators for Indonesia 1996–2008
(comparison between 2008, 2007, 2006, 2005, 2004, 2003, 2002, 2000, 1998, 1996 [top-bottom order] with 90% confidence limits)[a]



Note: The governance indicators presented aggregate the views on the quality of governance provided by a large number of enterprise, citizen, and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, and nongovernment and international organizations. The aggregate indicators do not reflect the official views of the World Bank, its executive directors, or the countries they represent. The indicators are not used by the World Bank Group to allocate resources or for any other official purpose.

[a] Higher percentile indicates an improvement.

Source: D. Kaufmann, A. Kraay, and M. Mastruzzi. 2009. *Governance Matters VII: Governance Indicators for 1996–2008*. Washington, DC.

8. Decentralization is generally undertaken to lead to better service provision and more effective local governance in general. However, the relationship between decentralization and poverty reduction is not straightforward and is debated in literature. Fears have been voiced that decentralization may exacerbate poverty and inequality in Indonesia.[3] Table 1 shows uneven and modest progress in poverty reduction and suggests that other economic events have had more influence than decentralization arrangements.

Table 1: Indonesia: Percentage of Population Below the Poverty Line

Year	Total
1998	24.23
1999	23.43
2000	19.14
2001	18.41
2002	18.20
2003	17.42
2004	16.66
2005	15.97
2006	17.75
2007	16.58
2008	15.42

Source: Badan Pusat Statistik. http://www.bps.go.id/eng/download_file/booklet_leaflet/booklet_ okt2009.pdf

9. Assessments of the service-level impacts of decentralization are also difficult to make. Perceptions surveys have shown that by 2006 there was considerable satisfaction with the process.[4] More objective measures are lacking, as minimum service standards are still not adequately tracked, but it appears that there has not been a great deal of progress.[5]

B. Decentralization

1. Drivers of Change

10. **Economic transformation and political transformation.** Reforms came as a pragmatic response to deep-seated economic and political issues. Learning from the lessons of the Asian financial crisis of 1997 and the change of government in 1998, Indonesia embarked on a new phase of reforms—the *era reformasi*. Decentralization, public administration and financial reform, and reallocation of government power are just a few of many wide-ranging and radical reforms. These changes are clearly driven by a desire to achieve higher economic growth and sustainable development, as well as poverty reduction. Central planning proved to be inadequate in responding to problems plaguing the economy, leading to both decentralization reforms through a greater role and voice to regional governments, and the development of local government capacities in the delivery of services.[6] Indonesia is still

[3] See statements of World Bank and the Government of Indonesia–United Nations Children's Fund in G. Ferrazzi et al. 2003. *Social Protection in Indonesia: Reforms in the Context of Decentralized Governance*. ADB Contract ADM/02-593. April.

[4] W. Widyanti and A. Suryahadi. 2008. *The State of Local Governance and Public Services in the Decentralized Indonesia in 2006: Findings from the Governance and Decentralization Survey 2 (GDS2)*. The SMERU Research Institute. Jakarta. February.

[5] See the Regional Government Service Provision section of USAID–DRSP (footnote 1).

[6] Departemen Dalam Negeri Republik Indonesia. 2002. *Kebijakan Desentralisasi Dan Otonomi Daerah: Permasalahan Dan Tantangan*. Ceramah Direktur Jenderal Otonomi Daerah Pada Acara Diskusi Kebijakan Desentralisasi dan Otonomi Daerah dalam Jangka Panjang. Jakarta. 27 November.

undergoing a fundamental political transition from centralized rule to a decentralized multiparty democracy, and an independent civil society is rapidly gaining strength.[7]

11. **Maintaining a unitary state, integrity of national borders, and accommodating pressure for regional autonomy.** In the aftermath of the 1997 Asian financial crisis and the change in government in the following year, some of the resource-rich provinces found new opportunities to voice their desire to break away from the control of Jakarta. To demonstrate the new government's decisiveness and to keep all regions of the country united, the central government prepared new laws that would devolve significant authorities to the lower levels of government.[8]

12. **Improving regional equity.** Decentralization was also intended to give local communities influence over local matters that affect them, using national legislation to ensure national standards and equity between regions.[9] Decentralization provides a means to address decades of overcentralized government and a way to meet widely differing needs, given an equally large disparity in the costs of delivering these services (footnote 7).

2. Government Strategy

13. Some tentative steps toward decentralization had already been made prior to the reform era, such as the district pilot conducted in 1994–1996,[10] but these initiatives paled in comparison to the "big bang"[11] decentralization that was set off with Law 22/1999 on Regional Government and Law 25/1999 on Fiscal Balance between the Center and the Regions. The two laws were politically urgent for the government, but were formulated separately by the Ministry of Home Affairs (MOHA), which formulated Law 22/1999, and the Ministry of Finance (MOF), which formulated Law 25/1999, with little preparation and public debate. While bold in many respects in recognizing the need for action, they could have been clearer and better integrated. The principles expressed in these laws resonated with those associated with decentralization elsewhere—enhanced local democracy, greater people's participation and empowerment, equity and justice, recognition of the potential and diversity of regions, and strengthening of the regional legislatures. However, the key underlying driver for the government's strategy was to appease regional grievances. A summary of key laws and regulations concerning decentralization is attached as Appendix 4.

14. The laws brought about significant changes. Most basic services were made the responsibility of districts and cities. Regional political structures, particularly the councils, were made stronger. A minimum of 25% of domestic revenues flowed to regional governments through a formula-based general transfer grant (*dana alokasi umum*)—22.5% to districts and cities and 2.5% to the provincial level. By late 2001, the central government had transferred 239 provincial and 3,933 district and city offices, more than 16,000 implementation units, and about 2.1 million civil servants to the regions.[12]

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[7] ADB. 2001. *Country Operational Strategy: Indonesia*. Manila.

[8] K. Mera. 2004 (preliminary). The Big Bang Decentralization in Indonesia and the Lessons Learned. http://usccis.org/tools/software/original/public/fileforward.php?Id=3132&PHPSESSID=84f3326255c1c93de5af41d1cf9add92

[9] ADB. 2004. *Country Governance Assessment Report: Republic of Indonesia*. Manila.

[10] C. Beier and G. Ferrazzi. 1997. *The District Autonomy Pilot Program: A New Approach to Decentralization in Indonesia*. Nord-Süd. First Quarter. pp. 94–101.

[11] The "big bang" approach refers to radical decentralization that quickly moved the country from a centralized system to a decentralized one.

[12] World Bank. 2003. *Indonesia—Selected Fiscal Issues in a New Era*. Poverty Reduction and Economic Management Unit. East Asia and Pacific Region. Report 25437-IND. 14 February, p. 36.

15. This first wave of decentralization was soon followed by a growing awareness of the need to complete the framework and provide implementation support. The "big bang" created political and administrative change but highlighted issues needing clarification and the need for improvements in the follow-up regulations (both government and ministerial). However, these short-term measures were not enough, and by 2002 policy makers were moved to review the framework more fundamentally, making a commitment to bring about a more robust decentralization and regional autonomy framework.[13] Some of the issues identified by them were

(i) unclear distribution of functions between the levels of government;
(ii) unclear role of the governor as representative of the central government;
(iii) ineffective system of supervision of regional government, with district and city heads tending to by-pass governors and the central government;
(iv) inability of the current intergovernmental fiscal system to ensure equity between resource-rich and resource-poor regions, and a mismatch between the assignment of expenditures and the assignment of revenues;
(v) absence of policy coordination with sector laws and regulations, leading to contradictory regulations in sectors such as forestry and mining;
(vi) unsatisfactory accountability mechanism, which focused on the annual report of the regional head to the council;
(vii) lack of capacity at the regional level to properly implement the new decentralization framework, particularly in planning and financial management; and
(viii) lack of central government programs to support institutional development and capacity building in the regions.

16. The foundational laws were revised in 2004, called a period of "consolidation." By this time, the government had seen three full years of implementation. It wished to not only add clarity to the legal framework but also to curb the excesses seen in some regions, such as punitive local business taxation and/or charges and oversized regional bureaucracies. However, the revised laws remained general on all of the key reform points and had to be followed by a larger number of regulations than in the original framework, a process that has still not been completed. The new (emerging) framework needed further improvements, with some reforms proving to be regressive (e.g., a return to village government) or left unresolved (e.g., functional assignment, role of the province governor), or avoided altogether (e.g., civil service). The 2006 stock taking study on decentralization reforms identified positive developments, including governance innovations in some regions and a more lively civil society that was becoming more involved in regional governance.[14]

17. While these reforms were in progress in the regions, regional governance was benefiting from a broader tide of public financial management reform. Three new laws (Law 17/2003 on State Finances, Law 1/2004 State Treasury, and Law 15/2004 State Audit) placed public expenditure management reaching down to the regional level on a more sound footing. Some provisions in these laws, however, did not mesh with the existing decentralization framework, creating uncertainty at regional government level. Efforts to clarify streams of legislation have been seen since then, but these have had mixed success. Limiting efforts in this direction was

[13] See, for example, the discussion between the Government of Indonesia and development partners in the Consultative Group for Indonesia. 2001. *Decentralization Matrix of Actions: Decentralization Working Group*, follow-up to the CGI quarterly review meeting of 20 February.

[14] USAID-DRSP. 2006. *Stock Taking on Indonesia's Recent Decentralization Reforms - Main Report*. Prepared by USAID-DRSP for the Donor Working Group on Decentralization with funding provided by Decentralization Support Facility (DSF), USAID, and Australian Agency for International Development. Jakarta. August.

the absence of coordination between key stakeholders. There is no coordinating institution for the three agencies involved with decentralization—MOHA, MOF, and National Development Planning Agency (Badan Perencanaan dan Pembangunan Nasional [BAPPENAS]). An example of such unclear legislation is given in Box 1.

Box 1: Example of Unclear Legislation

Law 32 of 2004 said that the minister of home affairs shall control the budget deficit of each region. On the contrary, Law 33 of 2004 said that the finance minister shall establish the maximum limit of cumulative amounts of national budget (APBN) and local budget (APBD) deficits.

Article 175 (Law 32 of 2004 Concerning Regional Government)

1. The minister of home affairs shall control the budget deficit of each region.
2. The regional administration must report the surplus or deficit position of the regional budgets to the minister of home affairs and the minister of finance every semester within the current budget year.
3. In the event that the regional administration fails to meet its obligation as referred to in para. 2, the central government may postpone the distribution of the balance funds.

Article 83 (Law 33 of 2004 Concerning Fiscal Balance between the Central Government and the Regional Governments)

1. The finance minister shall establish the maximum limit of cumulative amounts of APBN and APBD deficits.
2. The cumulative deficits referred to in para. 1 may not exceed 3% of gross domestic products of the current year.
3. The finance minister shall establish criteria for APBD deficits and the maximum limit of APBD deficits of each region and each budget year.
4. Infringement of the provisions referred to in para. 3 shall be subject to penalty in the form of delay in the extension of the balancing fund.

Source: Respective quoted laws.

18. In 2009, both foundational laws were again being examined for possible revision (even before all the implementing regulations for the 2004 laws were completed). The MOHA aimed to steer the laws through the last Parliament before its mandate expired in 2009, but was unable to do so and aims for passage of the laws in 2010.

19. It was originally foreseen that by 2007 Indonesia would have concluded its consolidation of decentralized governance and would be entering the stage of stabilization (footnote 6), but a stable policy and legal framework seems to be elusive. Policy and legal stability is being affected by the lack of suitable policy and legislative processes that could fashion together the minimum level of consensus to address the key issues of decentralization, such as the number of regions, the roles of the levels of government (including villages), and the balance between the councils and executives, among other things. Development partners recognize this issue in the management of decentralization, but have not been able to do much about it. Impeding a more useful role is their inability to establish an agreed and effective platform for achieving the principles of the 2005 Paris Declaration (recently localized as the 2009 Jakarta Commitment[15] with respect to the decentralization of local governments. The Jakarta Commitment recognizes that "implementation of decentralization remains complex and continues to pose challenges". It sets out the need for strengthening country ownership through strengthening capacities, improving aid governance and expanding the aid dialogue. However, the proposed regular dialogue mechanism has yet to become fully effective and as yet there is no clear forum where aid agencies and government could coordinate efforts to support decentralization.

[15] Available at http://www.a4des.org/index.php?option=com_content&view=article&id=48:the-jakarta-commitment&catid=57:jakcomm&Itemid=64.

20. Civil servants are not allocated according to institutional needs. Decentralization has left central ministries and some regional governments overstaffed while other regional governments face serious shortages of crucial staff. Budget experts, accountants, auditors, and human resource management experts are in short supply in all regional governments. At the start of decentralization, there were no major problems in the transfer of around 2.5 million civil servants because few had to make a physical move and none lost their jobs. There is an urgent reform need for a program or a mechanism for relocating professional civil servants from institutions where they are redundant to institutions where there is a shortage of their skills (footnote 9).

21. The Ministry of National Education appears to have successfully decentralized its education responsibilities, and around 1.5 million teachers have been transferred to local-level control. Many problems remaining in the education sector relate to the budgetary system, financing issues, and civil service regulations. The case of decentralized education clearly shows the current problems in budgeting and in the civil service system and the need for reforms to support the effective decentralization of fundamental public services (footnote 9).

22. Decentralization has considerably expanded the scope of regional governments to generate revenue locally, primarily through taxes, user charges, and income from regional enterprises. Before 1997, regional governments had levied a large number of local taxes and charges, which, despite their low revenue potential, imposed high costs on the economy. In response, Law 18/1997, the original law on regional levies and taxes, aimed at confining regional taxes to a closed list and instituting a system whereby the MOF approved additional tax proposals. Law 34/2000, which replaced Law 18/1997, while still retaining a list of regional taxes, gives regional governments greater flexibility to add new taxes supported by regulations approved by the regional parliaments. Some regional governments have increased their own revenue by more than 50% through such measures since decentralization was introduced. However, the number of such taxes, which, in the absence of effective central review or oversight, are introduced without much analysis, has adversely affected the business environment in some regions.[16] The government has agreed to transfer rural and urban land and building taxes together with the duties on the transfer of ownership of land and buildings, while retaining the remaining three sectors of plantation and/or estate, forestry, and mining. These measures will further increase the local revenue base.[17]

23. Major challenges remain in a number of areas. There are two broad sets of problems: (i) the lack of clarity in the legal framework; and (ii) a lack of coordination at the national level leading to disparate treatment of the administrative and fiscal aspects of decentralization, and a consequent divergence between the standards that are set for public services and the resources that are allocated. In addition, the national government is yet to establish comprehensive monitoring and evaluation systems for monitoring decentralization progress (footnote 9). There is no overall plan for decentralization which covers both fiscal and administrative requirements and the last two medium-term development plans (2005–2009 and 2010–2014) contain no clear guidance on the issue of coordination. [18]

24. **Revenue–expenditure balance.** There is a mismatch between the revenues that are assigned to local governments and the expenditure responsibilities that are assigned to them. On the revenue side, the idea is to guarantee a transfer to local governments of 25% of net domestic revenues, plus a share of natural resource revenues in the form of intergovernmental

[16] World Bank. 2003. *Decentralizing Indonesia*. Washington, DC. (in footnote 9).
[17] USAID. 2009. *Stock Taking on Indonesia's Recent Decentralization Reforms.* Jakarta.
[18] The MOF is currently moving to finalize the development of a long term Grand Design for Fiscal Decentralization.

transfers. There is no evidence of any comprehensive analysis of the expenditure budget for subnational governments implied by this assignment of functions, and no analysis of the adequacy of the 25% revenue transfer, although both UNDP and the World Bank have carried out performance evaluation reviews for some provinces. By 2008, transfers to the regions amounted to 29.49% of domestic revenues. Of total provincial revenues, almost half are raised by the provinces themselves, while districts and cities cover less than 10% (footnote 9). Existing legislation provides for budget limits for subnational governments but there remains a real concern within the central government that local borrowing will grow out of control if rules are loosened and access to market instruments is allowed in the short term.

25. **Local government capacity to deliver services.** A major issue is whether the provincial and local governments can properly discharge their new expenditure responsibilities. This will require a concomitant takeover of relevant administrative functions that are still centralized or unduly influenced by central government, including personnel management, data processing, procurement, and contracting.

26. **Onlending.** Although procedures for on-granting of TA funds are well established, onlending of ADB funds is not currently possible. This creates a major obstacle to ADB's potential contribution toward development outside the center. Law 33/2004 deals with the fiscal balance between the central government and the regions (defined as provincial and local governments). According to this Law, regions may borrow directly from domestic sources but must course external loans through the central government. In effect, this Law effectively prohibits foreign aid agencies from lending directly to subnational governments. Prior to 2001, both ADB and the World Bank were involved in onlending, particularly to local water enterprises (perusahaan daerah air minum [PDAMs]). This funding was almost entirely provided through the Subsidiary Loan Agreement (SLA) with only relatively small amounts provided through the government's Regional Development Account (RDA).

27. According to figures from the MOF Regional Finance Information System, ADB subnational lending prior to 2001 amounted to some 218 loans worth Rp847 billion, or 15% of total donor subnational lending of around Rp5.7 billion. Of this lending, around two thirds went to borrowers in Java–Bali and one third to Sumatra with only 2% to other areas. Sixty-seven percent of the ADB total went to PDAMs. Repayment of these loans was poor, with some 51% in arrears. The World Bank arrears rate was lower (36%), but this may be explained by the greater focus of the World Bank lending on Java–Bali, an area with better repayment rates.[19]

III. ADB STRATEGIES FOR DECENTRALIZATION ASSISTANCE

A. ADB Strategy

28. ADB's past strategies are set out in Appendix 5. ADB has supported the decentralization process, both at the center and in the regions (provinces, districts, and municipalities). Regional support has focused on the specific areas of basic social services (health and education), development administration, and environmental management. ADB's strategy for Indonesia's decentralization has been set out in the 2001 country operational strategy study (COSS)

[19] B.D. Lewis *Onlending in Indonesia: Past Performance and Future Prospects.* Bulletin of Indonesian Economic Studies, Vol. 43, No. 1, 2007:35–57. Jakarta.

(footnote 7) and the 2002 country strategy and program (CSP) for 2003–2005. These were followed by the CSP for 2006–2009.[20]

29. **Country operational strategy study 2001.** A full COSS was drafted in 2001, which proposed a decentralized pro-poor and bottom-up approach to future development. Decentralization was considered a crucial conditioning element in nearly all proposed ADB activities. However, the COSS referred to Indonesia's decentralization as "an extremely ambitious transfer of responsibilities and financing decentralization is said to involve the largest peacetime transfer of government staff in history." It cautioned on the considerable risks involved since the process demanded a very complex set of plans and actions that would have major implications for the planning, design, processing, and implementation of all development projects.

30. Decentralization was seen as a major risk affecting the provision of social sector services and social infrastructure. Maintaining services during a difficult transition would entail substantial capacity strengthening of local governments. The strategy sought to improve the legal and regulatory framework for providing basic services under the decentralized system, including involving the private sector. It cited the poor incentive structure as constraining investment in these services, and weak financial management practices undermining their sustainability. The 2001 COSS noted the difficulties in launching administrative decentralization since local government capacity was weak. It cautioned that transferring revenues to local governments, without well-defined expenditure obligations, monitoring, and administrative safeguards, could encourage the spread of corruption to lower tiers of government (footnote 7).

31. **Country assistance plans (2000–2003).** The country assistance plans (CAPs) reflected ADB's continued support in assisting the government's decentralization efforts through capacity building of local governments, and increased community and civil society participation. Sector support to promote decentralization was also envisaged in agriculture, transport, health services, basic education, urban development, and environment as follows:

(i) **Agriculture.** ADB was to assist in the decentralization of agricultural support services and greater promotion of participatory approaches.

(ii) **Transport.** ADB was to support the decentralization of government functions to provinces and districts through strengthening of institutions and policies to improve transport.

(iii) **Health.** ADB was to support decentralization through devolution of authority and clear accountability in planning, implementation, and evaluation.

(iv) **Basic education.** ADB was to address the need to develop local management capacity and to ensure better provision of basic education for the poor in the context of decentralization.

(v) **Urban development.** Key policy reforms that were to be supported included decentralization of control over organizational structure, budget, expenditure, and personnel resources to districts to improve both accountability and the demand-based provision of key services.

(vi) **Environment.** ADB was to support the development of local government environmental management agencies (Badan Pengendalian Dampak

[20] ADB. 2002. *Country Strategy and Program 2003–2005: Indonesia*. Manila; and ADB. 2006. *Country Strategy and Program: Indonesia 2006–2009*. Manila. Other strategic documents included ADB. 2000. *Country Assistance Plan (2000–2002)*. Manila; ADB. 2000. *Country Assistance Plan (2001–2003)*. Manila; CSP update in May 2001 (2001–2003); ADB. 2001. *Country Strategy and Program Update (2002–2004): Indonesia*. Manila; ADB. 2003. *Country Strategy and Program Update 2004–2006: Indonesia*. Manila; ADB. 2005. *Country Strategy and Program Update: Indonesia 2005*. Manila.

Lingkungan Daerah [BAPEDALDAs]) since the district agencies were in the process of being constituted to bear primary responsibility for environmental management under the decentralization framework.

32. Another key area of ADB support in the promotion of good governance was to combine assistance for decentralization of government functions with a more intensive involvement of nongovernment organizations and local community organizations in monitoring programs and project implementation, particularly in the provision of safety nets. ADB also intended to work with the government to reexamine the capacity building activities and implementation arrangements of all ongoing projects to assess their appropriateness in the decentralized framework. The aim was to support the government's efforts for orderly transfer and delegation of its functions to local levels and to ensure more participatory development management in the future.

33. **Country strategy and program 2002.** The CSP 2002 introduced a more geographic focus, though refinements were deemed needed to suit decentralization so that it would align with local potential, needs, and capacities. Innovative thinking was required in adopting localization, applying a range of criteria consistent with strategic priorities, which was likely to prominently feature governance-related capacity and need-based poverty (footnote 20). Primary focus areas included (i) local capacity building; (ii) rural development, including rural infrastructure, marketing and support services, and microfinance; (iii) urban governance; and (iv) basic urban services, infrastructure, and shelter (inclusion was conditional upon improvement in governance, especially in project implementation). Decentralization was recognized as posing challenges, requiring harmonized procedures for projects implemented by local governments and requiring district poverty indicators.

34. **Country strategy and program 2006–2009.** In the last CSP for Indonesia (2006–2009), ADB identified improved decentralization as one of the five areas of engagement. ADB support was to focus on more sustainable, transparent, and equitable fiscal decentralization to provide local governments with the means to improve the quality as well as the volume of service delivery. ADB would also continue to support the government's decentralization agenda through policy reforms and capacity development.

35. The main laws and regulations governing the administrative and financial aspects of decentralization had been issued, but revisions were expected. The ADB program supported the massive national effort by aiding policy formulation and capacity building. Support for capacity building was to be both within and across sectors. As the program period covered the difficult initial post-decentralization years, the intention was that almost all projects in the program would address issues in areas of policy, capacity building, or implementation related to decentralization.

36. The CAPs and succeeding CSPs reflect a gradual focusing of activity from the very broad range of proposed activities in multiple sectors in the CAPs to a centering on cross-sector, as well as sectoral, decentralization activities in the CSP 2006–2009, with a particular focus on fiscal decentralization. The broad approach reflects, in some part, the huge requirements for assistance and the lack of prioritization of assistance requirements by the government. Strategies focused on clear government demands would have been more likely to have been achieved.

B. ADB Assistance

37. **The starting point—crisis response and community-driven development.** ADB's support for decentralization was initially rooted in its response to the establishment of a social safety net on the heels of the multifaceted crisis that swept through Asia, and particularly Indonesia, in 1997–1998. Hence, the ADB-financed Social Protection Sector Development Program sought to improve health and education service delivery through decentralized implementation mechanisms that existed at the time, with an eye toward the emerging reforms (that had not yet solidified in the regulatory framework). As the decentralization policy became legally enshrined and gained momentum, ADB used the social safety net entry to introduce policy-based lending to strengthen community-based service delivery in the urban and rural sectors. The policy reforms proposed under the Community and Local Government Support: Sector Development Program (CLGSSDP) in 1999 stressed decentralization.[21] The CLGSSDP loan supported the program of decentralization, while the investment component sought to provide employment opportunities for the poor through locally planned and executed investments in basic infrastructure and services.

38. The subsequent Community Empowerment and Rural Development Project (CERDP) was essentially cast in the same mold as the investment portion of the CLGSSDP, but with a greater focus on community-based organizations rather than district government. As the CERDP report and recommendation of the President indicates, the project was well aligned with the 2000 ADB CAP for Indonesia, which identified the need to develop a diversified rural economic base, create and strengthen rural–urban link, improve institutional capacity, and enhance the quality of human resources for community development.

39. These ADB efforts to develop local infrastructure through community initiative reflected the pattern seen also in the World Bank investments at that time: the village infrastructure projects and Kecamatan Development Program (KDP) and the Urban Poverty Project. While these efforts began to refer to the government's newly promulgated decentralization policies and/or legislation by 1999, they were not much different from the community-driven efforts of the preceding few years and did not significantly engage with the new challenges presented by the government's decentralization program. In one respect though, they were anticipatory, recognizing that the focus on district and city autonomy would need to be complemented with the strengthening of subdistrict, village, and community organizations if regional autonomy was to be felt equitably and at the lowest levels of society. The ADB CERDP efforts went beyond the World Bank village infrastructure project and KDP in relation to the government's decentralization program by recognizing that the community development staff of the MOHA was being devolved to provincial and district and city governments. Through the CERDP, ADB responded to this recognition with training so that the transferred staff could function effectively in their new decentralized environment.

40. **Focus of support on public financial management and fiscal decentralization.** A strong focus of ADB support for the decentralization of the local government sector emerged early in the reform era as ADB directed resources to meeting the public financial management challenges faced at both national and regional levels. The first direct support given to decentralization came in the form of TA directed at the MOF. The Local Government Financing Project (LGFP) aimed to prepare a framework for regional government financing from both domestic and international sources and to recommend restructuring of supporting institutions. This

[21] G. Ferrazzi. 1998. *Indonesia's Decentralization Process - An Assessment in the context of the Current Economic and Political Crisis*. Jakarta. ADB in cooperation with GTZ Support for Decentralization Measures (SfDM), Contract ADM/98-294.

support would not only address weak public financial management at regional government level, but also pave the way for ADB lending that was under some pressure to respond to the new decentralized environment with loans directed by regional governments. Onlending would be one of the issues tackled in the LGFP. The objectives and outputs for LGFP were significantly revised in mid-2005 and tied to the Sustaining Decentralization and Local Governance Reforms TA program. This was a late-2004 addition that aimed to harmonize the fiscal decentralization framework and prepare the National Action Plan for Fiscal Decentralization (NAPFD). Notwithstanding the lack of traction on the original aims of LGFP, the jointly managed TA projects were applied to developing a policy matrix for a proposed loan program and the preparation of the related project loan (the Local Government Financial Governance Reform [LGFGR] program). Moreover, it is notable that, with the NAPFD, ADB was responding to the lack of a comprehensive plan for decentralization reform.

41. The decentralization-focused program loans began with the LGFGR program designed to enable more effective local government public services through an improved fiscal, budgetary, and financial management framework. This $300 million loan, approved in December 2005, had one disbursement for the 1-year program duration. The policy matrix was quite broad in terms of fiscal decentralization and went further to strengthen and harmonize the legal framework for regional autonomy and to improve the functional assignment of finances.

42. The LGFGR program loan was accompanied by a project loan of SDR20.7 million to last to the end of 2008 to upgrade and/or expand the regional financial management information system (*Sistem Informasi Keuangan Daerah* [SIKD]) to 100 more regional governments, develop a harmonized financial management information system to implement public expenditure and fiscal management reforms, and streamline review of draft regional regulations (*peraturan daerah*s) on taxes and charges to ensure consistency with higher laws and regulations. An advisory TA of $500,000 was intended to strengthen the technical capacity of the new Regional Autonomy Advisory Council (Dewan Pertimbangan Otonomi [DPOD]) over a 12-month period starting in February 2006 and ending in January 2007. These three related interventions represent an attempt to harmonize the unwieldy and conflicting strands of the decentralization framework.

43. As the LGFGR program was being implemented, ADB prepared its CSP 2006–2009. In line with its experiences with the LGFGR program and other support, it made governance improvements and anticorruption efforts key themes. Decentralization and local government finance and governance were seen as important issues in this regard and were placed among the five main operational areas of engagement: (i) developing infrastructure, (ii) deepening the finance sector, (iii) decentralization, (iv) achieving Millennium Development Goals, and (v) managing the environment and natural resources. The LGFGR program was deemed to be useful in improving decentralization and accelerating achievement of the Millennium Development Goals by strengthening regional government capacity and contributing to a more transparent, effective, and efficient policy and legal environment for fiscal decentralization, financial management, and service delivery.

44. Accordingly, once the LGFGR program was concluded, it was followed by a second phase, prepared by the end of 2008. This second LGFGR program consisted of a program loan of $350.0 million to be disbursed conditional to policy matrix actions having been carried out, and TA of $1.5 million to support the ongoing development of the reform agenda in regional government financing and governance (contained in the NAPFD and the policy matrix for the eventual subprogram 2) and its implementation, and provide timely policy advice to the government. Additional TA was used for achieving midterm support goals. In the LGFGR

program, the desired longer-term impact was “more effective and efficient delivery of basic public services by regional governments.” The longer-term impact sought under the second LGFGR program was broadly similar: “improved efficiency, effectiveness, and interregional equity of regional government spending.” The continuation and deepening of some thematic areas under the LGFGR program revealed the large challenges faced and the long-term commitment and magnitude of the resources required to effect desired changes.

45. **Thematically broader support for decentralization.** In addition to the above-mentioned strong focus on public financial management, ADB assumed a responsive stance to government needs, particularly as the scope of the challenges became apparent. Support was, therefore, provided to rearrange strategies and practices to conform to the new decentralized form of governance desired. This was pursued through separate advisory TA projects for onlending, the environmental impact assessment process, urban infrastructure, and minimum service standards.

46. In the CSP update 2002–2004, ADB recognized that the challenge was “to build capacity in a sustainable fashion and in coordination with the international community.” Beginning in 2002, ADB used a project loan to bolster regional capacities. The $42.22 million Sustainable Capacity Building for Decentralization provided assistance to 40 district and city regions to assess their capacities and develop plans to raise those capacities on a broad range of governance processes. This effort responded to the newly formulated government Framework for Capacity Building for Decentralization, issued jointly by the National Development Planning Agency (Badan Perencanaan Pembangunan Nasional [BAPPENAS]) and the MOHA.

47. In keeping with the CSP, ADB also sought to engage with development partners and to place the decentralization support within a broader governance context. Starting in 2001, it worked with the United Nations Development Programme (UNDP) and the World Bank to establish the Partnership for Governance Reform Program (overseen by a joint Government of Indonesia, nongovernment organization, and development partners board) funded by a trust fund with contributions from the European Union, Department for International Development of the United Kingdom (DFID), the Netherlands, and others. This facility provided TA and seed funding for initiatives in good governance, with decentralization being one of eight areas of support.

48. **Decentralization support to sectoral programs.** ADB has provided support to Indonesia in the health and education sectors, beginning in the early days of decentralization. Programmatic direction for these efforts derives from ADB’s sector and governance policies. ADB’s 1999 health sector policy[22] emphasizes access for all basic health services that are effective, cost-efficient, and affordable. As indicated earlier, the CSP 2002 (footnote 20) focuses on good governance and capacity for long-term sustainable development, including meeting local development needs through decentralization. The Decentralized Health Services Project loans (the first in 2000 or $65 million, and the second in 2003 for $100 million) sought to develop better coordination of public and private service provision at the regional level (Decentralized Health Services Project) and to help improve the health of the population in the project area through better primary health care services focusing on the needs of women, infants, children, and the poor (Second Decentralized Health Services Project). As in the case of general governance processes, capacity building activities at all levels of government provided much-needed managerial and clinical skills to deliver quality decentralized primary health care services.

[22] ADB. 1999. *Policy for the Health Sector*. Manila.

49. A similar investment was made in the education sector, beginning with the Decentralized Basic Education Project in 2001. This $100 million project loan, running until mid-2008, aimed to improve poor children's enrolment, completion, and learning outcomes from basic education in 21 districts. It also supported the decentralization of basic education management in the context of administrative and fiscal decentralization.

50. **Macroeconomic program lending supportive of decentralization.** Program lending has taken support routes. The first (para. 37) has a direct connection to the development or refinement of decentralization policy, particularly fiscal decentralization, whereas the second has been driven by broader macroeconomic policy concerns—and decentralization is a minor element in the mix. This "dual-track" approach was expected to support broader macroeconomic reforms, while continuing the in-depth sector reforms through ongoing and proposed programs (e.g., for local government finance) while avoiding overlaps.

51. The macroeconomic-driven support has been undertaken in conjunction with the series of development policy loans of the World Bank, stemming from the framework provided in the World Bank's country assistance strategy for 2004–2007.[23] These were seen as vehicles for high-level policy engagement to generate renewed momentum on macroeconomic and crosscutting reforms. The government's Medium-Term Development Plan (and other policy documents) served to guide the policy-oriented collaboration between ADB, World Bank, and the Government of Japan, resulting in the common policy agenda contained in the second Development Policy Loan/Development Policy Support Program (DPSP).

52. Four annual loans of $200 million each were provided through the DPSP series, which began in 2004. While their macroeconomic concerns were common, the focus of the decentralization component varied and there was a lack of continuity for components directly related to decentralization. For example, the first DPSP loan focused on debt management, the investment climate, and improving the regulatory environment with little direct reference to decentralization. The second DPSP loan addressed provincial treasury issues including financial reporting. The third loan aimed to clarify procurement procedures for community-driven development programs funded under the national budget, and to implement transparent accountability arrangements for both central government funding and regional development accounts. The fourth loan supported the institutionalization of a government system for program evaluation and the increase of the community block grant to maximize employment and poverty impacts.

53. **Development partner activities.** ADB and the World Bank have been active in Indonesia long before the reform era, with program and project loans and TA. Some attention to decentralization was built into these activities, though within the constraints of prevailing government policies. The most direct support to decentralization began in 1992, through the GTZ Support for Decentralization Measures. Once the reform floodgates opened, several development partners oriented their offerings to support more directly Indonesia's decentralization reforms. Notable development partners include the Canadian International Development Agency (CIDA), DFID, United States Agency for International Development (USAID), Australian Agency for International Development (AusAID), and UNDP.

54. These development partners have worked together to coordinate their assistance, through the Donor–Government Working Group on Decentralization (DGWGD). Appendix 6 provides a mapping of decentralization activities of development partners in Indonesia. Since 2005,

[23] World Bank. 2003. *Indonesia: Country Assistance Strategy FY2004–2007*. Jakarta.

development partners have also used the Decentralization Support Facility (DSF), founded by ADB, DFID, UNDP, and World Bank, to add resources, coordinate among development partners, and more recently to engage on project coordination with the government.

55. The development partners have worked on most facets of decentralization at both national and regional levels, with varying results. Some reform areas have received relatively little attention due to low demand on the Indonesian side (e.g., civil service reform) or growing capacities of national government units/policy networks (e.g., for some financial transfer mechanisms). Over time, the allocation of responsibilities has improved and coordination has allowed multiple development partner involvement in some fields with positive results.

IV. STRATEGY ASSESSMENT

56. This chapter discusses the basis for rating the "strategic positioning" and "impact" of ADB assistance which are then considered in the overall assessment. ADB performance (which is excluded from the overall assessment to avoid double counting) is also separately discussed at the end of the chapter.

A. Strategic Positioning

57. ADB's governance strategies and assistance programs have broadly responded to the key priority areas of decentralization in Indonesia. Initially, ADB strongly supported governance reforms in Indonesia, especially during and after the 1997 Asian financial crisis. Before the crisis, ADB's country strategies were consistent with national development plans. During the crisis (1997–2000), ADB remained engaged with the government, providing funds to support the government's recovery effort and transition to decentralization. In the uncertain operating environment of the transition years (2001–2004), ADB programs were relevant but were slow to channel adequate resources, delegate authority, and develop new modalities to suit the changed nature of the client.[24]

58. ADB has been responsive to the needs of the government but was unable to adjust quickly enough to the changing needs and new realities of decentralization. ADB should work increasingly through existing government systems in support of government programs, and with and through other development partners that have the capacity to work effectively at the national and local levels. The crisis and subsequent democratization and decentralization process have diluted capacities within line agencies and at the local level (CSP 2006–2009, footnote 20). ADB has also supported decentralization through capacity building at various levels. However, more links must be built between government levels to ensure sustainability (CSP update, footnote 20). ADB has also been assisting government to achieve greater decentralization of government functions. Since the adoption of the CSP 2006–2009, new government regulations on the creation of local governments and expenditure assignments across different levels of government help better clarify the rationale and arrangements for regional administration. Moreover, the new regulations have made the release of fiscal transfers and shared revenues more predictable and transparent.

59. ADB's decentralization strategies in Indonesia have also been fully aligned with ADB's strategic priorities of improving governance through building capacity and strengthening institutions at subnational levels (including provinces, districts, municipalities, and local communities) and reducing poverty through improving service delivery and regional equity.

[24] ADB. 2005. *Country Assistance Program Evaluation for Indonesia*. Manila.

60. **Consistency between the ADB strategy and government needs.** ADB's strategies for each phase of decentralization appear to have been relevant to the strategic needs of the government. However, ADB may have underestimated the speed, scale, and the requirements of Indonesia's decentralization program, especially the readiness and capacity of institutions. Indonesia decentralized faster than any other country in the region. The "big bang" took place in the absence of a comprehensive policy framework. This critically affected ADB's efforts in effectively providing adequate support to Indonesia's decentralization efforts. A further key issue is the division of responsibility within government for the decentralization process, with the three principal agencies being the MOF, BAPPENAS, and MOHA. The situation has been further complicated by the involvement of two different types of coordinating ministries: economics (for the MOF and BAPPENAS), and security (for the MOHA). The DPOD has not been able to function as expected, in part due to absence of coordination between BAPPENAS, MOF, and MOHA. This effectively means that true coordination responsibility resides only at the level of the president, with no other individual or institution having overall responsibility for implementing decentralization.

61. **Relationship with other development partner support.** Since the disbanding of the Consultative Group of Indonesia in 2006 when government took full responsibility for donor coordination, coordination between ADB and development partners has been variable. Some development partners were not aware of ADB activities. The two main coordination forums are the DGWGD and, since 2005, the DSF, which development partners have used to pool resources, coordinate among development partners, and more recently to provide resources that government allocates in the form of projects (nationally executed in many cases).

62. The DGWGD, now chaired by AusAID, continues to meet, but with a low level of activity and with reduced link with government. Individually, development partners continue to engage with the government bilaterally to develop and implement projects. The DSF is where several development partners interact with BAPPENAS, MOF, and MOHA, but it is focused on a specific project list that has been decided by the government. These projects exist in relative isolation from the projects run by development partners as individual entities. There seems to be little reason or incentive for most development partners to actively participate in the DSF once ministries have divided up the trust fund resources. ADB is not a funding member of the DSF and has, therefore, been confined to participation in steering group meetings, which only reflect the detailed discussions that have taken place between funding members at management group meetings. However, following a meeting with the independent evaluation mission (IEM), the members of the DSF decided to share the details of their discussions with ADB, and have started to do so.

63. Several development partners commented to the IEM that they were unaware of ADB's current and potential future program of support for decentralization. This may be a result of ADB's nonparticipation in the DSF but it also reflects the lack of willingness for other development partners to share their program details with ADB. Even so, ADB could do more to share with, and learn lessons from, other development partners' support for decentralization.

64. Based on the discussion in paras. 57–63, the overall, strategic positioning is rated *substantial*.

B. Impact

65. ADB's support for decentralization has been largely based on a series of program loans which have attempted to leverage policy changes through the provision of fiscal support, backed up by a series of TA projects. In some (but not all) cases, these projects have been designed to support policy reforms proposed in loan policy matrixes. It is notoriously difficult to attribute value addition from program lending as many other factors (other development partner activity, political will, changing economic circumstances, etc.) affect outcomes. It is also difficult to separate the benefits to the economy of fiscal support from policy development support. However, ADB has had some undoubted impacts on the process of decentralization. The LGFGR loan underpinned the requirement for necessary changes to legislation and supporting regulations at a time when urgent changes were required. Sector-based decentralization support loans (together with their supporting TA projects) have attempted to foster the introduction of sustainable decentralized education and health services (para. 48).

66. ADB's recent support for capacity building has had variable results, with value added more to individuals rather than to the institutions for which they work. Training needs assessments have not always been carried out and the IEM could find no evidence of training follow up or tracer studies to facilitate an informed view of the effectiveness or otherwise of the training provided. In particular, no assessments appear to have been made of the value added to institutions through capacity building.

67. Some TA projects have been recognized to be of high quality by other technical advisors in both government and development partners. For example, assistance given to analyze administrative procedures in new region creation, in the TA project on Supporting Effective Institutional Framework for Fiscal Decentralization,[25] was well designed although the results were not woven into a proper exchange with relevant government units. The TA for Preparing the second LGFGR included an analysis of property taxation, which was well received by the government.[26]

68. Impact is assessed *modest*.

C. ADB Performance

69. The design and implementation of decentralized projects has tested the capacity of both government and ADB. For example, projects under implementation have involved some 200 districts. ADB lacks adequate resources for project supervision and monitoring, and results are difficult to measure.

70. A particular issue affecting performance is the level of resources at the resident mission. To some extent, ADB can make use of the analysis and initiatives of other development partner's (as it does with the World Bank, for example), and it can glean some information and views from consultants working on TA projects. However, additional capacity is needed to design and guide the various loans and TA provided. Flying-in staff from Manila to discuss policies and instruments with resident mission staff, counterparts, and development partners is far less preferable to having a permanent capacity in the resident mission. The dialogue with the

[25] ADB. 2005. *Technical Assistance to Indonesia for Supporting an Effective Institutional Framework for Fiscal Decentralization Reforms*. Manila (TA 4682-INO, for $500,000, approved on 3 November).

[26] ADB. 2007. *Technical Assistance to Indonesia for Preparing the Second Local Government Finance and Governance Reform Program*. Manila (TA 7010-INO, for $700,000, approved on 3 December). The World Bank expressed appreciation of the quality of this analysis.

government, and the coordination with development partners, calls for the presence of staff in the resident mission with deep knowledge of decentralization and familiarity with the intergovernmental issues of Indonesia. Also, several senior government officials expressed to the resident mission that it was perceived as a conduit to ADB headquarters with key decisions being taken in Manila. The World Bank stated a wish for a stronger ADB presence in Indonesia to provide more balance to development partner support, which is primarily led by the World Bank.

71. ADB and other agencies have invested heavily in capacity development but results have sometimes been disappointing. A less ambitious approach could have been adopted, given the complexities of the decentralization program. ADB and other development partners were understandably unprepared for the rapidly changing nature of the client. More administrative and staff resources are required to work in a decentralized regime. For example, an ADB evaluation of four capacity building TA projects in support of decentralization assessed ADB's overall performance *less than satisfactory*. Its performance during project preparation was satisfactory for the Capacity Building for Participatory Planning, Monitoring, and Evaluation TA, Urban Sector Development in a Decentralizing Environment TA, but unsatisfactory for the Decentralized Administrative Systems TA and the District-Level Financial and Budgetary Systems TA. The reason for the lower ratings is the inappropriate initial designs of the Decentralized Administrative Systems TA and District-Level Financial and Budgetary Systems TA. They were inconsistent, too ambitious, and devoted insufficient attention to institutional, aid coordination, and capacity development issues.[27]

72. Irrespective of the urgent need for assistance, interventions taking place during periods of rapid economic, political, and administrative transitions face the risk of becoming irrelevant and ineffective, with short-lived outputs and unsustainable outcomes.

73. **Portfolio management.** The 2009 country portfolio review mission found that ADB performance had been affected by issues arising from the implementation of the SCBDP and LGFGR loans. In the LGFGR case, the issues centered on poor disbursement, but in the case of the SCBDP more serious issues have arisen, which were confirmed by the IEM. In particular, three contractors had been blacklisted by ADB for fraud and corruption and others are still under investigation. In one district, the only firm submitting a bid was already barred by the World Bank for similar reasons. The IEM was questioned by the MOHA as to why there had been delays in issuing no-objection letters for contract awards. In view of the above findings, it would seem prudent of ADB to continue to exercise caution before issuing no-objection letters.

74. Overall, ADB performance is rated *modest*. The overall strategy rating is *partly satisfactory*.

V. PERFORMANCE

75. The program evaluation is based on the criteria of relevance, effectiveness, efficiency, sustainability and impact, and is centered on core decentralization interventions. A summary of findings for each project is attached for core loans (Appendix 7) and TA projects (Appendix 8).

[27] ADB. 2005. *Technical Assistance Performance Evaluation Report: Capacity Building to Support Decentralization in Indonesia*. Manila.

A. Relevance

76. The positioning of ADB's strategy has been variable. The initial decentralization loan, the CLGSSDP, was an integral part of a larger assistance package of $2.8 billion provided by ADB as an immediate response to the Asian financial crisis. It was not anchored in the country programs and strategy for Indonesia but responded to an immediate requirement from government for assistance. The later LGFGR loans benefited from a longer gestation period and good interaction with key stakeholders and were rooted in the CSP. They focused on a key government requirement to enable the local governments to deliver basic public services more effectively and efficiently and were consistent with the implied ultimate goals of the government decentralization program.

77. In terms of program relevance, the CLGSSDP was a broadly scoped sector program and somewhat vague on assistance scope, due largely to the lack of a clear overall plan for decentralization, and the short time frame available for preparation. Succeeding loans have incorporated the experience and lessons learned from previous interventions. The design of the LGFRGR program took into account the implementation environment and related capacity constraints and agreed with government that the best way to support reforms, particularly in local government finance and governance, is through a phased and focused approach over the medium term that addresses the reforms incrementally and gradually. The design of the SCBDP directly addressed capacity constraints, particularly in the areas of management information systems development, human resources, and asset and financial management. The design drew on the findings of a sample survey of capacity building needs as part of project preparation. The study showed that regional governments lack and are in urgent need of capacity building, particularly on management information systems and human resource, asset, and financial management. Both ADB and the Government of Indonesia have been working with other development partners in Indonesia on this particular need in supporting decentralization.

78. The overall rating for relevance is *relevant*.

B. Effectiveness

79. Although it is impossible to attribute directly to ADB the effects of program lending, ADB, along with other development partners, provided incentives and support to the government to strengthen policy legal and legislative frameworks for decentralization, while at the same time providing the fiscal support needed by government. Therefore, ADB's core decentralization loans and supporting TA projects have been effective in attempting to leverage required policy reforms. However, they have been less effective in terms of developing the institutions and processes needed to implement the required policies. An example is the variability in the effectiveness of TA projects and capacity building programs. Under the SCBDP, the intention was to derive capacity building action plans and build the capacity of service providers. The IEM reviewed the training activities undertaken under the project in a *kabupaten* (district) in Banten Province, which showed that 15 core courses had been provided to officials in the district during 2008–2009. However, the schedule of courses conducted provided to the IEM shows that many participants received consecutive training in a wide range of subjects over a relatively short period of time. The head of the *kabupaten* was enthusiastic about the internet and information technology (IT)-related training that he had received, but was not using the computer in his office as he regarded this as the responsibility of his staff and not himself. This shows the risks associated with an undue focus on the number of course participants rather than the quality and usefulness of the training. For example, between 2 April 2008 and 30 June 2009, 60 Eselon IV staff received training for a total of 128 days, or more than 50% of total available working days. The IEM was also informed that

there had been no follow up to the training in terms of its usefulness both to individuals and to the organization as a whole.

80. This example highlights a difficulty with the model of support for policy reform driven by program lending supported by TA, particularly for capacity building. The transfer of personnel and skills from the center to the regions precipitated a number of TA projects from several development partners aimed at supporting both transferred and existing staff. However, the IEM found little evidence that the skills imparted had become embedded in recipient institutions. Rather, the focus was on the numbers trained and the breadth of coverage.

81. For sector-specific interventions, the 2005 country assistance program evaluation found that, although sector-specific projects to improve service delivery formulated under decentralization for education and health attempted to adapt to the decentralized framework, capacities to follow proposed mechanisms and services were not available at the district level. In addition, there was little participation in project design by local governments and civil society organizations.

82. Effectiveness has also been affected by the continued implementation of inappropriate designs. The introduction of the financial management system under the LGFGR program has not been as comprehensive as originally envisaged. The IEM was shown the voluminous hard-copy reports received by the MOF for the districts on a quarterly basis, from which manually copied data is inputted to budgeting and other systems, both within the MOF and in line ministries. The issue appears to be that the new system is not compatible with legacy systems, and the database is not sufficiently disaggregated to permit the construction of on-demand reports by non-MOF ministries. In addition, the IEM was informed that the delays in procurement meant that the hardware being purchased was now outdated (as was also reported by the MOHA in relation to the SCBDP). By March 2010, 56 of the original 171 districts had informed the MOF that they did not want to proceed with system implementation.

83. Overall effectiveness is rated *less effective*.

C. Efficiency

84. The core decentralization loans all suffered from implementation delays and several have been extended. Reasons for these delays include issues arising from both government and ADB. Government raised several times with the IEM the issue of delayed no-objection letters causing delays in the selection of suppliers, such as the procurement of IT equipment (for the LGFGR program and the SCBDP) and the selection of trainers (for the SCBDP). In the case of the SCBDP, procurement issues caused delay in the purchase of IT equipment, particularly for batch 2 service providers. When coupled with the delayed government approvals for the national management systems for the capacity building providers database, this has caused implementation delays.

85. It is important to note that, although some delays have occurred as a result of lengthy response times from ADB headquarters, delays have also been caused by the necessary prudence and diligence required in procurement in the light of potential corruption issues, such as those associated with the SCBDP.

86. Overall efficiency is rated *less efficient*.

D. Sustainability

87. The sustainability of project outcomes is difficult to measure. From the perspective of policy reforms, to the extent that legislation and associated regulations have been delivered, they are likely to be sustainable although they cannot be solely attributed to ADB's interventions (as already discussed). For capacity building activities, the question of sustainability is problematic as it is difficult to assess the long-term benefits gained from capacity building activities in the absence of tracer studies and the benchmarking and ex-post measurement of institutional performance. For those TA projects which have delivered procedural improvements (such as the TA on Supporting Effective Institutional Framework) or detailed research into particular aspects of decentralization (such as the TA for Preparing the Second LGFGR), sustainability is likely, as the outputs of these TA projects are of continuing usefulness to government. Overall sustainability is, therefore, rated *likely sustainable*.

88. The overall assessment rating is *partly satisfactory* based on ratings of strategic positioning (para. 64), relevance (para. 78), effectiveness (para. 83), efficiency (para. 86), sustainability (para. 87) and impact (para. 68).

VI. CONCLUSIONS, LESSONS, AND RECOMMENDATIONS

A. Conclusions

89. The 1999 "big bang" decentralization had the effect of fragmenting government in an uncoordinated and somewhat chaotic fashion. The process was deeply rooted in the political need to maintain national cohesiveness rather than, for example, improving the efficiency of service delivery. ADB responded promptly to a rapidly changing situation, but the very nature of the situation precluded detailed analyses and programming. Subsequent support has attempted, with some success, to provide a sound policy framework for decentralization, although this support might have been more effective and sustainable if backed by more TA designed to develop the capacity of decentralized institutions to improve systems and procedures, rather than TA focused on the training of individuals.

90. The government informed the IEM that it felt that what was described as the "pendulum of decentralization" may have moved a little too far in the direction of autonomy, and has decided that it needs to return to a more central position with a better balance between the devolution of power and decision taking to the regions and central government. The next stage in decentralization will include the consolidation of the role of regional (provincial, district, or municipal) government. This may present an opportunity for ADB to be proactive in developing a more balanced portfolio by assisting regional administrations through the development of regionally-based projects in addition to central policy-based lending to central government.

B. Lessons

91. The IEM has identified a number of lessons common to a greater or lesser extent to ADB and other development partners providing support to decentralization in Indonesia.

(i) Increasing the number of professional staff based in the resident mission for the analysis and management of projects and programs (paras. 69–70).
(ii) Being consistent in terms of substantive focus (which should be agreed with government) and delivery instruments (paras. 57–58).
(iii) Speeding up the process in getting the identification of a defined need to project implementation (paras. 84–85).

(iv) Prioritizing efforts to optimize coordination and policy dialogue with government and other development partners (paras. 60–63).
(v) Ensuring that sufficient resources are committed to the analysis and dialogue required for project design and preparation (paras. 76–77).

C. Issues

92. The key agencies have different agendas, and it is widely believed that the government agency theoretically responsible to bring more coordination to the process, the DPOD under MOHA, needs to strengthen its coordination role. The absence of an operational champion or coordinator for the process of decentralization renders it difficult for ADB to effect lasting change. In the past, this issue, coupled with the lack of strong coordination between development partners, has not seriously impacted on ADB interventions as there has been such a broad decentralization canvas. However, with the broad policy framework now increasingly in place, the opportunity for ADB may lie in supporting a more regional "demand-led" approach rather than a focus on a central government "supply-driven" approach.

93. There is no single model of decentralization that could be described as best practice. Box 2 sets examples of some good practices for development partner support. Appendix 9 presents a brief analysis of good practice from various programs in other countries.

Box 2: Good Practices for Development Partner Support for Decentralization

Entry Points and Exit Strategy

There is value in supporting all levels of actors involved in decentralization through:
(i) assisting the national actors to develop policy and a legal framework and ways of supporting local government;
(ii) working with local government directly to apply the new framework in the context of enhanced local governance and feeding back to central government analysis and suggestions on changes still needed;
(iii) supporting intermediary levels of government to play their strategic bridging role between the national and local level; and
(iv) supporting other institutions that are part of the policy and capacity development network (local government associations, academe, civil society organizations) as the main strategy for sustainable capacity for decentralization reforms.

Development partners are more effective when they have a clear exit strategy in mind, based on institutional capacity and performance which
(i) gives sufficient time and intensive support to both government and other actors, rather than fluctuating support that never reaches a critical mass though is perhaps drawn out over a long period of time; and
(ii) invests in policy networks and capacity development providers that will play greater roles once development partner support is ended.

Institutional Partners

The lack of proper coordination between agencies concerned with decentralization has meant that development partners generally are pressured to link with a specific partner (there may be a common administrative door for all projects as well). Development partners need to find ways of
(i) flexibly supporting several national organizations that have important overlapping or complementary mandates for decentralization and local governance;
(ii) forging links with several local governments, and their associations, seeking to give voice to them; and
(iii) enlisting nongovernment actors as well, particularly to address the demand side.

If meeting resistance to the above, development partners should consider:
(i) the cost, in effectiveness, of being “prohibited” from engaging with both government and civil society;
(ii) the possibility of giving attention to various actors through separate projects of the same development partner to avoid unmanageable internal project tensions;

(iii) ensuring there is a division of labor between development partners so that all key actors in need of support are reached; and
(iv) working initially from the “demand” side (civil society), and later (if at all) with government (e.g., relying on community-driven development; enhancing policy oriented advocacy).

Coordination of Aid and Capacity Development Modalities

Bilateral aid agencies generally offer grants, while international financial institutions (IFIs) offer larger loans and some grants (often channeled through the IFIs by bilaterals). IFIs tend to work largely at national level where large loans are easy to make, leaving the more administratively heavy task of interacting with local government to bilateral agencies. This division of labor works if
(i) IFI loans, with future policy conditionalities or triggers are well complemented by technical assistance (TA) grants/projects that help government and other actors to achieve the policy aims; and
(ii) the budget support and sector loans that are the realm of IFIs promote the same/complementary reforms and essential messages as those of TA-focused projects of bilateral agencies.

Effective development partner assistance entails covering the field of capacity development including individual, organizational, and systems, and selecting what is appropriate, including
(i) what is uppermost or urgent in the minds of government—development partners must be seen to be useful and not a distraction;
(ii) readiness of partners to engage in the more challenging, and potentially threatening (to some) organizational and systemic changes;
(iii) capacity of development partners and/or executing agencies to provide technical assistance that is competent in facilitating organizational and system level changes; and
(iv) the important role of policy dialogue between development partners (not just implementing technical advisors in projects) and government partners to reach consensus on the aims and scope of cooperation.

Harmonization and Alignment

To align with the Paris Declaration, greater emphasis needs to be placed on
(i) efforts to support the government in generating more coherent and participatory policy in the process, making it easier for development partners to achieve alignment;
(ii) assessing the results of supported policies and the effectiveness of the support provided by development partners;
(iii) joining bilateral and IFI support in more effective ways;
(iv) incorporating gender mainstreaming, particularly in support directed to the national level where it has been most lacking; and
(v) understanding the effect of decentralization reforms on poverty reduction, conflict, and corruption.

Development partners need to establish more formalized mechanisms to share information and lessons and achieve harmonization to
(i) respond more appropriately to capacity needs, avoiding large gaps or needlessly duplicating efforts;
(ii) increase learning and adaptation among development partners and government; and
(iii) forge common approaches, avoiding working at cross-purposes (e.g., inconsistencies between support given to the ministry concerned with local government and sector ministries).

Source: Independent evaluation mission.

94. Indonesia has adopted a "learning by doing" approach to decentralization, citing the unique geography of the country as a reason. Perhaps, more could be done to highlight to the government the successes and failures elsewhere so that lessons can be learned from where programs have failed or succeeded. For example, in the Philippines, ADB's decentralization support consists of two reform program clusters with the first phase focused on national agencies providing oversight to local governments. The second phase is focused on local government service delivery effectiveness and efficiency, public expenditure monitoring, and revenue mobilization (i.e., own-source revenue enhancement and improving the information sharing between local government tax collection and the Bureau of Internal Revenue). Key contributions of ADB to policy reforms in the Philippines have led to

(i) formalized coordination among local government oversight agencies through a joint memorandum circular;
(ii) strengthened public financial and expenditure monitoring of local government units;
(iii) automatic release of the internal revenue allotment for local governments; and
(iv) enhanced tax information sharing between local governments and the Bureau of Internal Revenue.

95. A recent initiative that is gaining momentum in the Philippines is the implementation of the policy for direct subnational lending. The Government of the Philippines has recently approved an executive order identifying tier-one local government units, which are qualified to avail themselves of borrowing from multilateral institutions such as ADB. This is one of the advocacies of the LGFGR program supported by ADB. This could be a longer term goal for Indonesia. Moreover, Indonesia's local governments do not currently have the established governance systems required.

96. In Indonesia, some sections of the government expressed to the IEM the need to focus assistance toward the regions as well as to the center.

D. Recommendations

97. The following are recommendations for consideration by the Southeast Asia Department during the preparation of the CPS.

98. **Continue support for developing the policy framework for decentralization with project- and program-based support, complemented by more decentralized assistance, such as support for institution building, at local levels.** The government is increasingly assertive in policy development and has welcomed support that is facilitative. The new CPS may present an opportunity for ADB to reassess current support whereby the majority of support has been given in the form of policy-based interventions. It is also possible that the demand for fiscal support may lessen over time following the easing of the recent global financial crisis. Suggested areas of facilitative support include:

(i) strengthening of financial data, reporting, evaluation and monitoring systems that feed into national supervision, nationally designed policies, and support to regional government;
(ii) provision of financial accounting procedures and software, processes, and information to the public from these systems;
(iii) financial asset management by regional government;
(iv) development of local government capacity to take on nonsovereign loans and potentially to borrow on financial markets (including issuing bonds) in the longer term;
(v) budget framework changes for assigning and maximizing revenues at the local level; and
(vi) anticorruption efforts that focus on procurement systems and other financial procedures in local government.

99. **Continue addressing government priorities for decentralization by focusing ADB's interventions on past successes (in public financial management reform and capacity development) and support further improvement of the coordinated decentralization framework.** A comprehensive legal and regulatory framework for decentralization is not yet in place. For example, the revision of Law 32/2004 and similar reform streams do not yet have government-recognized proposals. Implementation of this recommendation may require:

(i) clarifying with government the respective roles in decentralization of the key ministries and agencies;
(ii) understanding the key elements of the proposed Grand Design for Fiscal Decentralization; and
(iii) complementing future support for the capacity development of individuals with an increased focus on the development of the processes, procedures, and structures required to foster sound institutions at local levels.

100. **Further deepen coordination with other development partners (including the donor working group and other forums) in supporting government decentralization activities.** International and Indonesian experience with decentralization reforms suggest that often too many reforms are attempted at the same time, overburdening central and local governments. There should be a phased and well coordinated effort between ADB and other development partners. This may require:

(i) ADB to further deepen its active involvement with other development partners;
(ii) Exploring with development partners and government the possibility of a more integrated role for the donor working group, DPOD, and related bodies; and
(iii) Contributing to a coherent multi-donor road map for decentralization support, predicated on a comprehensive reform program from the government.

DECENTRALIZATION SUPPORT LOANS IN INDONESIA

Loan Number	Project Name	Amount ($ million)	Funding Source	Approval Date
A. Core Decentralization Support Loans				
1677	Community and Local Government Support Sector Development Program – Policy Loan	200.0	OCR	25-Mar-99
1678	Community and Local Government Support Sector Development Program – Project Loan	120.0	OCR	25-Mar-99
1964	Sustainable Capacity Building for Decentralization	42.2	ADF	10-Dec-02
2192	Local Government Finance and Governance Reform Sector Development Program	300.0	OCR	3-Nov-05
2193	Local Government Finance and Governance Reform Sector Development Project	30.0	ADF	3-Nov-05
2478	Second Local Government Finance and Governance Reform Program Cluster (Subprogram 1)	350.0	OCR	4-Dec-08
	Subtotal	**1,042.2**		
B. Sector-Based Decentralization Support Loans				
Education				
1863	Decentralized Basic Education	100.0	ADF	29-Nov-01
	Subtotal	**100.0**		
Health				
1810	Decentralized Health Services	65.0	ADF	14-Dec-00
2074	Second Decentralized Health Services	64.8	OCR	19-Dec-03
2075	Second Decentralized Health Services	35.2	ADF	19-Dec-03
	Subtotal	**165.0**		
Social Protection				
1622	Social Protection Sector Development -Program Loan	100.0	OCR	9-Jul-98
1623	Social Protection Sector Development -Project Loan	200.0	OCR	9-Jul-98
	Subtotal	**300.0**		
Multisector				
2263	Infrastructure Reform Sector Development Program (Subprogram 1)	400.0	OCR	21-Nov-06
2264	Infrastructure Reform Sector Development Program – Project Loan	26.5	ADF	21-Nov-06
2475	Infrastructure Reform Sector Development Program (Subprogram 2)	280.0	OCR	17-Nov-08
	Subtotal	**706.5**		
	Total	**1,271.5**		
C. Public Sector Management Support Loans with Decentralization Components				
Economic and Public Affairs Management				
1866	State-Owned Enterprise Governance and Privatization Program	400.0	OCR	4-Dec-01
2228	Development Policy Support Program	200.0	OCR	21-Dec-05
2305	Second Development Policy Support Program	200.0	OCR	20-Dec-06
2394	Third Development Policy Support Program	200.0	OCR	17-Dec-07
2488	Fourth Development Policy Support Program	200.0	OCR	16-Dec-08
2521	Public Expenditure Support Facility Program	1,000.0	OCR	3-Jun-09
2563	Countercyclical Support	500.0	OCR	7-Oct-09
	Subtotal	**2,700.0**		
Public Expenditure and Fiscal Management				
2126	State Audit Reform Sector Program (Program Loan)	200.0	OCR	13-Dec-04
2127	State Audit Reform Sector Program (Project Loan)	25.001	ADF	13-Dec-04
	Subtotal	**225.0**		
	Total	**2,925.0**		
	Grand Total	**5,238.7**		

ADF = Asian Development Fund, OCR = ordinary capital resources.
Source: Asian Development Bank database.

TECHNICAL ASSISTANCE IN DECENTRALIZATION IN INDONESIA (1999–2009)
(as of 11 September 2009)

TA No.	Project Name	TA Type	ADB Amount (TASF) ($)	JSF ($)	Other Sources ($)		Total Amount ($)	Approval Date
3177	Capacity Building to Support Decentralized Administrative Systems	AD	0	500,000	0		500,000	25-Mar-99
3178	Capacity Building for Setting Up District-Level Financial and Budgetary Systems	AD	0	460,000	0		460,000	25-Mar-99
3179	Capacity Building for Participatory Planning, Monitoring, and Evaluation	AD	0	1,540,000	0		1,540,000	25-Mar-99
3233	Strategy for Restructuring Public Services	AD	0	488,000	0		488,000	30-Jul-99
3326	Urban Sector Development in a Decentralizing Environment	AD	0	600,000	0		600,000	8-Dec-99
3777	Fiscal Decentralization	AD	500,000	0	0		500,000	19-Nov-01
3798	Local Government Capacity Building for Decentralization	PP	0	713,000	0		713,000	14-Dec-01
3813	Support for Partnership for Governance Reform in Indonesia	AD	0	750,000	0		750,000	18-Dec-01
3909	Support for Good Local Governance	AD	100,000	0	0		100,000	27-Aug-02
3967	Local Government Provision of Minimum Basic Services for the Poor	AD	0	0	750,000	United Kingdom	750,000	4-Nov-02
3999	Improving the Climate for Investment and Productivity in Indonesia: An Approach to Long-Term Poverty Reduction	AD	150,000	0	0		150,000	25-Nov-02
4023	Monitoring System for Capacity Building	AD	0	0	1,200,000	Netherlands	1,200,000	10-Dec-02
4282	Local Government Financing	AD	0	600,000	0		600,000	18-Dec-03
4479	Gender Responsiveness Public Policy and Administration	AD	0	0	400,000	United Kingdom	400,000	14-Dec-04
4543	Sustaining Decentralization and Local Governance Reforms	AD	0	900,000	0		900,000	23-Dec-04
4682	Supporting an Effective Institutional Framework for Fiscal Decentralization	AD	500,000	0	0		500,000	3-Nov-05
4683	Preparing ADB Support for PNPM in Rural Areas	PP	600,000	0	0		600,000	3-Nov-05
4762	Pro-Poor Planning and Budgeting	AD	1,800,000	0	300,000		2,100,000	16-Jan-06
7038	Enhancing the Legal and Administrative Framework for Land	AD	500,000	0	0		500,000	20-Dec-07
7184	Local Governance Finance and Governance Reform	AD	1,500,000	0	0		1,500,000	4-Dec-08
	Total		**5,650,000**	**6,551,000**	**2,650,000**		**14,851,000**	

AD = advisory, ADB = Asian Development Bank, JSF = Japan Special Fund, PNPM = Program Nasional Pemberdayaan Masyarakat, PP = project preparatory, TA = technical assistance, TASF = technical assistance special fund.
Source: Asian Development Bank database.

APPROACH AND METHODOLOGY

1. **Approach.** The overall approach to performance assessment and rating focuses on a review of the strategic positioning of the Asian Development Bank's (ADB's) program of support to decentralization, supported by an assessment of the relevance, efficiency, effectiveness, sustainability, and impact of individual interventions.

2. **Background analysis of decentralization.** Building on the information contained in this paper, an analysis was undertaken of the key dynamics of decentralization in Indonesia, noting the government's objectives and strategy, current institutional and governance structures, center-region relations, and the role of emerging political actors and civil society and the role played by development partners.

3. **Good practice assessment.** An assessment was made of good practices in decentralization in order to review how the support and approaches to decentralization taken in Indonesia compare with international efforts.

4. **Analysis of strategic fit.** The relationship between ADB's assistance program, as set out in strategic documents including past country strategies and programs and the government's strategic objectives, was assessed. This focused on both the overall program and the relevance of individual program components to the strategy.

5. **Evaluation of ADB projects.** Both past and continuing projects were evaluated against the criteria of relevance, efficiency, effectiveness, sustainability, and impact. This involved an in-depth review of project completion reports, project performance evaluation reports, back-to-office reports, and past evaluations. Any completed projects which have not been covered by past evaluations were subjected to validation through document review and/or field visits. Continuing project evaluation focuses on relevance and efficiency to date. For each loan, a summary sheet was prepared.

6. A field visit was undertaken in a province where ADB has made considerable investments related to decentralization. The selection considered regions where ADB has contributed with a combination of capacity development project, sector projects, and technical assistance (TA).

7. **Assessing impact of policy-oriented advisory technical assistance.** Advisory TA projects were also evaluated against relevance, efficiency, effectiveness, sustainability, and impact using a review of all available existing documentation, including technical completion reports, TA papers, and other findings, such as the stock taking studies of decentralization reforms undertaken by other development partners. Key stakeholders were interviewed for a selection of TA projects.

8. **Survey of key informants.** Throughout the evaluation, the opinions and experiences of key informants were sought both through structured questionnaires and through interviews and meetings with project beneficiaries, nongovernment organizations and/or private sector, and other development partners.

SUMMARY OF KEY LAWS AND REGULATIONS CONCERNING DECENTRALIZATION

1. Efforts to shift to decentralization began in 1999 with the adoption of two laws that set the direction toward a decentralized Indonesia: (i) Law 22/1999 on Regional Governance, and (ii) Law 25/1999 on Fiscal Balance.

2. More laws, decrees, and regulations were adopted that promoted local participation in the governance of urban affairs, resulting in changes in the duties and responsibilities of the different levels of government (central, provincial, and municipal).

A. Regional Finance

1. Regulations

3. **Regulation 104/2000.** The regulation focuses on "fund of balance" funds originating from state revenue and expenditure budget and allocated to the regions to finance decentralization. It provides the formulas to be used to distribute central government transfers to the regions: general allocation funds, special allocation funds, shared revenues from land and building taxes, fees for acquisition of rights to land and buildings, and revenue from natural resources.

4. **Regulation 105/2000.** The regulation focuses on regional financial management and accountability. It provides a guide for preparing local government budgets, procurement of goods and services, as well as standards of financial management for local officials. Its goal is to ensure transparency and accountability. As a safeguard against anticorruption, the regulation requires local officials to ensure that the goods and services they procure are necessary for public policy.

5. **Regulation 106/2000.** The regulation focuses on financial management and responsibility in the implementation of deconcentration and secondment. It deals with deconcentrated tasks and the central government's spending on development, for which almost all funding comes from foreign sources and is cofinanced in part by the central government, wherein the latter retains control over the funds and subcontracts projects to the regions as deemed necessary.

6. **Regulation 107/2000.** The regulation focuses on regional government loans. It sets limits on local borrowing; the regions may receive long-term loans for financing infrastructure that is designated as a regional asset and is revenue-generating, i.e., the regions are able to repay the loans. The projects must also provide benefits to the public. The maximum available limit for short-term regional loans is one-sixth of the regional revenue and expenditure budget funds from the current year. Total debt can never exceed 70% of the previous year's local budget (APBD) general revenues; the ratio of revenues to debt service payments in a given year is limited to 2.5:1. Further, Ministerial Decree KMK35/2003 clarifies the rules for onlending to the regions. Local governments may borrow from foreign sources only with the approval of the central government.

7. **Regulation 11/2001.** The regulation (or regulation on local government financial management) focuses on regional finances. It encourages full cost recovery for services, wherever appropriate. To clarify the link between inputs and expected outputs, it also specifies that local governments will use performance-oriented budgeting for budgeting and reporting financial performance. Also, it obligates the regions to submit information about their finances,

including regional borrowings, to the central government, and it specifies the format and frequency. It also defines measures of recourse that the central government can invoke in the event the regions fail to submit the needed information.

8. **Government Regulation Peraturan Pemerintah (PP) 54/2005 on Regional Borrowing.** The regulation, issued by the government as an implementing guideline for Law 32/2004 and Law 33/2004, regulates the realization of regional loans,[1] including the conditions and purpose under which a loan may be requested and the overall procedure or mechanism for the regional government to apply for allocation of a loan to the central government. It also states that regional governments are not allowed to borrow directly from foreign sources. The regulation emphasizes the limiting of outstanding regional debt at 75% of the previous year's non-allocated regional revenue and expenditure budget and explicitly prohibits a regional government from borrowing as long as it has outstanding arrears on government loans. The cumulative lending limit for regional loans is stipulated by the minister of finance, and the cumulative lending limit of the central government and regional government shall not exceed 60% of the gross domestic product in the existing year.

9. **Government Regulation PP 2/2006.** This government regulation on procedure for realizations of loans and/or grants and allocation of foreign loans and/or grants, regulates the flow of foreign loans and/or grants at the central government level. Acting as representatives for the central government are the minister for national development planning and the minister of finance. As regulated, the government is authorized to receive foreign loans, and the said authority is operated by the minister (chapter II, article 2, paras. 1–2). Institutions that are eligible to request for allocation of foreign loans and/or grants to the central government are state ministries and/or institutions, state enterprises, and regional governments. Having reviewed the proposals, the central government then decides on the implementation of loans and/or grants.

10. **Ministry of Finance Regulations 52/PMK 010/2006 and PMK 53/PMK 010/2006** (superseded by PMK 52 and PMK 5). Ministry of Finance (MOF) Decree 52/PMK 010/2006 deals with guidelines on projects with foreign aid grants, while MOF Decree 73/PMK 02/2006 focuses on fiscal capacity mapping for passing foreign loans from the central government to regional governments in the form of grants (on-granting).

2. Laws and Decrees

11. **Law 22/1999 on Regional Governance.** This law revised the assignment of functions and redefined the roles of institutions at all levels of government. The law assigned most government functions to the districts and provinces, except for areas such as international policy, defense, judicature, monetary and fiscal policy, and religion. Unlike the situation before decentralization, the provinces were assigned no hierarchical relationships with districts, and performed mostly coordinating and other tasks the districts could not perform.

12**.** **Law 25/1999 on Fiscal Balance.** This law provides the legal foundation for fiscal decentralization, delineating the new division of revenue sources and intergovernmental transfers. The law provides for (i) sharing property and natural-resource revenues (land and buildings, property transfers, forestry, mining, fisheries, gas, and oil); (ii) creating a general

[1] Defined in chapter 1, article 1, para. 9 as all transactions that resulted for a region to receive a certain amount of funds or to receive benefit that has monetary value from other party and that the region will be held accountable to perform repayment. The general principles of regional loans are that (i) the loan shall be an alternative source to finance APBD and/or to endorse fund insufficiency, and (ii) the loan is used to finance activities initiated by and under the authority of a region (chapter II, article 2, paras. 1–2).

allocation fund (*dana alokasi umum*); and (iii) creating a special allocation fund (*dana alokasi khusus*).

13. **Ministry of Finance Decree 347a/2000 Concerning Regional Development Account.** The decree identifies sectors eligible for local development account loans and sets the limits on outstanding regional debt at 75% of the previous year's regional revenue and expenditure budget.

14. **Law 34/2001.** This law is the most relevant legislation on regional taxes, which expands on the Fiscal Balance Law and revises Law 18/1997 to provide the legal framework for all regional government taxation and charges. It makes a number of significant changes to local taxing and charging authority and to the allocation of tax bases across provinces and local governments. Most importantly, the law empowers local governments to create their own new taxes subject to limits on tax rates by the central government for purposes of nationwide conformity. Local governments must also meet certain criteria for approval by elected people's regional representative councils. In addition, the law states that any local government regulation (*peraturan daerah* [PERDA]) creating a new tax must be presented to local citizens before it can be enacted. Finally, the law requires local governments to submit the "new tax PERDA" to the central government for review after ratification by regional representative councils. The central government retains the power to revoke any new tax that contravenes the public interest and/or contradicts laws of a higher order.

15. **Law 33/2004 Concerning the Fiscal Balance.** This law, which supersedes Law 25/1999, deals with the fiscal balance between the central government and the regions (formerly provincial and local governments) as well as regional borrowing. According to Law 33/2004, regions may borrow directly from domestic sources but must course external loans through the central government. The law also states that long-term loans may be contracted only for projects that are revenue generating or are short-term loans for bridging finance.

16. **Law 28/2009 Concerning Regional Tax and Charges.** This recent law appears to effectively replace Law 34/2001. Regional governments are now prohibited from collecting taxes other than those in a closed list set out in the new law.

B. Regional Government

1. Regulations

17. **Regulation 25/2000.** The regulation supports the Regional Governance Law regarding the authority and functions of the central government and the provinces as autonomous regions. It assigns specific service responsibilities to the central and provincial levels, with local governments responsible for "everything else."

18. **Regulation 20/2001.** The regulation focuses on fostering and supervising local governance. It ensures that local governments function in accordance with the plans and stipulations of existing laws and regulations. The regulation authorizes the central government's regional representative. The "fostering" referred to in the regulation pertains to guidance, training, directives, and supervision of local government.

19. **Draft Regulation on Urban Management and Governance.** The draft regulation requires urban governments to involve and consult the public in planning, implementation, and

monitoring. A key feature of this regulation is the convening of an urban forum (*forum kota*) for stakeholders' participation.

20. **Ministry of Home Affairs Regulation 13/2006: Local Government Financial Management.** The regulation focuses on the management of local government finance.

21. **Government Regulation PP 38/2007.** The regulation deals with the division of government affairs among the central government, provincial governments, and district and city local governments.

2. Laws and Decrees

22. **Law 22/1999 on Regional Governance.** The law specifies the political and administrative responsibilities of the central, provincial, and local governments within a decentralized structure of government. This law eliminates the hierarchical relations between the provincial and local governments. The local governments, previously known as city and rural districts (*kotamadya* and *kabupaten*), have become fully autonomous, with mayors (*walikota*) and rural district heads (*bupati*) selected by elected local assemblies (*dewan perwakilan rakyat daerah*). Instead of the previous practice of reporting to provincial governors, these heads now report to the local assembly, making them responsible to the local electorates. In the new system, the provinces have no hierarchical relationship with the local governments; they have a coordinating role and perform what the local governments are not yet equipped to undertake. However, the provinces retain their hierarchical relationship with the central government and continue to have the status of self-directed regions and administrative regions under the president.

23. **Draft Law on Regional Government-Owned Enterprises.** The draft law empowers local governments to establish, dissolve, or restructure government-owned enterprises without the approval of the central government. It also vests them with full authority to select from various existing organizational forms—sectoral offices (*dinas*), regional technical implementation unit (*pelaksana teknis daerah*), autonomy programs (unit swadanas), government-owned enterprise, BP Indonesia—to provide for services without prior approval of the central government.

24. **PP UU 32/2004 Concerning Regional Government.** The decree, which supersedes Law 22/1999, defines the delegation of government authority from the center to the regions and explains the division and/or delegation of government affairs.

SUMMARY OF ADB DECENTRALIZATION STRATEGY AND FOCUS

CAP 2000–2002	COS 2001	CAP 2001–2003
ADB will continue to assist government decentralization efforts to increase transparency, accountability, and efficiency of public services and to increase participation of civil society in the development process. In agriculture, ADB will assist in addressing a number of unfinished items on the policy agenda including decentralization of agricultural support services and greater promotion of participatory approaches. In transport, ADB will support the decentralization of government functions to provinces and districts. Decentralization of health services, accompanied by devolution of authority and clear accountability in planning, implementation, and evaluation will continue to be a central theme of policy reforms supported by ADB. In urban development, key policy reforms that need to be supported include decentralization of control over organizational structure, budget expenditure, and personnel resources to the district to improve accountability and demand-based provision of key services. In the implementation of the decentralization policy, the following	Two of the five focal points of ADB's COS include improving regional equity through balanced regional development, especially targeting the rural areas and less developed islands. This will demand supporting decentralization. ADB operations in Indonesia will focus on improved governance in managing natural resources, particularly with decentralization of responsibility. The COS proposes a decentralized pro-poor and program approach to future development. Decentralization is a crucial conditioning element in nearly all ADB activities over the envisioned time horizon. In legal and judicial reform, ADB has provided assistance to revise laws in the energy, finance, and social sectors, and support the decentralization process. This work should continue and specific efforts should be within the coordinated efforts of the partnership for governance and tied closely to broader sector commitment. High-priority sector areas for continued work include corporate governance, decentralization, environment and natural resource management, nonbank finance, and private sector infrastructure investment. In providing support for civil society, ADB will widen the involvement of stakeholders in ADB operations. Avenues to achieve meaningful results include ADB's support for decentralization and environmental protection. Unbalanced regional development needs to be addressed in several ways including supporting decentralization. It is necessary to build capacity at the local level; support reorganization at the central level; and review or revise a host of rules, regulations, and laws. ADB must promote institutional reforms that strengthen the capacity of local governments to undertake program planning processes	A major priority of ADB assistance is the support for the government's ambitious decentralization program. Most ADB loans approved in 1999–2000 have components to support decentralization through capacity building of local governments and increased community participation and civil society participation. The support for decentralization will continue in 2001–2003, particularly through the social sector projects. Future support for decentralization will require substantial streamlining and better coordination in the forward program. ADB's support for decentralization also involves greater involvement of NGOs and local community organizations in various sectors. ADB is also working with the government to reexamine the capacity building activities and implementation arrangements of all ongoing projects to assess their appropriateness in the decentralized framework. The aim is to support the government's efforts for orderly transfer and delegation of its functions to local levels and to ensure more participatory development management in the future. The government is receiving advisory technical assistance from ADB for capacity building to support decentralized administrative systems and for setting up financial and budgetary systems at local government levels. ADB will support the decentralization of government functions through appropriate capacity building measures for environmental management at the provincial and district levels. The support will aim to strengthen local government agencies' capacity and increase beneficiary participation for terrestrial and marine resource management, biodiversity conservation, and mangrove and coral reef rehabilitation. ADB will carry on its capacity building support started in 2000 for the decentralized management of marine and coastal resources, which will support the establishment of an integrated marine and

CAP (2000–2002)	COS (2001)	CAP (2001–2003)
will need careful attention: (i) community participation to ensure a demand driven approach; (ii) increased public-private partnerships in basic services; (iii) improved efficiency in the operation and maintenance of existing and new facilities; (iv) greater access of the poor to basic services; (v) balanced regional development; and (vi) enhanced capacity of local governments in administrative functions, revenue generation, fiscal planning, and budgetary procedures. In the environment subsector, ADB will need to support the development of local government environmental management agencies (Badan Pengendalian Dampak Lingkungan Daerah [BAPEDALDAs]) since the district agencies are in the process of being constituted to bear primary responsibility for environment management under the framework of decentralization. Another key area of ADB support for promoting good governance is assistance for the decentralization of government functions and more intensive involvement of NGOs and local community organizations in monitoring program and project implementation, particularly in the provision of safety nets. ADB's future assistance in various sectors will aim at supporting the	and make public decision making more transparent and accountable. ADB has supported the decentralization process, both at the center and in the specific areas of basic social services (health and education), development administration, and environment management. ADB should continue its efforts to support the decentralization process, in particular, (i) working within the partnership to support regional governance initiatives; (ii) assessing the capacity of local government partners; (iii) ensuring that, within each sector, projects are consistent with local government capacity and appropriate capacity building exercises are undertaken; (iv) working with the aid community to coordinate capacity building exercises, especially with bilateral funding agencies; and (v) assisting government agencies to develop consistent strategies and implementing plans for decentralization, helping them move from an operational focus to one of setting standards, providing technical assistance, and enforcing regulations. In the urban sector, ADB's strategy is to assist decentralization and urban social reconstruction by directly and indirectly targeting poor beneficiaries, which will require a geographical approach. Care must be taken to ensure that the decentralization process enhances service delivery, particularly to the poor and disadvantaged. In the health sector, strengthening local technical capacity and marshaling local support for health services will be the immediate priority. Decentralization will facilitate community participation, directly and with the assistance of NGOs, in identifying local health needs and implementing locally appropriate solutions. This COS is firmly rooted in strengthening government capacity, including improving governance and decentralization in managing the environment and natural resources. The mandate of the agencies responsible for natural resource management may need review and	coastal resources management planning system, and the strengthening of the new Ministry of Sea Exploration and Fisheries. In transport, ADB will support the decentralization of government functions in respect of transport services to the provinces and districts. ADB will provide advisory assistance to strengthen institutions and policies to support decentralization of the transport sector. ADB's TA program also supports adoption of a regional socioeconomic development approach to investment in transport infrastructure in the context of the government's policy of decentralization. ADB's support for decentralization of health services will assist the devolution of responsibilities and accountability in planning, implementing, and evaluating local governments. ADB will also support decentralization through capacity building activities, both at local and central levels. This will include redefinition of the role of, and reorganization of, the Ministry of Health and the Ministry of National Education, in line with the new regional autonomy legislation. Decentralization of basic education will be a major area of ADB assistance. It will address the need to develop local management capacity and to ensure better provision of basic education for the poor in the context of decentralization. ADB's assistance in the urban sector will support the government's decentralization policy, and target its urban sector assistance at poverty reduction through social development initiatives. ADB will support the BAPEDALDAs, since these district agencies will bear the primary responsibility for environmental management under the government's decentralization program.

CAP 2000–2002	COS 2001	CAP 2001–2003
government's efforts to delegate its functions to provincial and district governments. Assistance in this area will be considered not only through future projects but also by reexamining the appropriateness of implementation arrangements of all ongoing projects.	restructuring. Greater decentralization and public participation in decision making and resource allocation, guaranteed public access to information, and a range of institutional reforms are required. Accurate mapping of natural resources is required for smooth implementation of decentralization and sharing of revenues between the central government and the local government. ADB's assistance in these areas will specifically require institutional capacity building at provincial and district levels and development of a genuine partnership between local governments, civil society, and local communities. Implementation of the structural reform program, particularly in the finance sector and with respect to governance and decentralization, must be closely monitored to assess progress. This task will involve monitoring the issuance of administrative decrees and government resolutions, organizational and administrative change, and enactment by Parliament of economic laws and other related instruments.	

CSPU 2002–2004	CSP 2003–2005	CSPU 2004–2006	CSPU 2005	CSP 2006–2009
The forward program will support governance reform, with interventions mainstreamed into all areas of COS focus. The program stresses decentralization. Anticorruption initiatives include support for audit reform, particularly in the context of decentralization. One of the major changes in the program compared with the previous CAP is the particular emphasis on	The CSP's broad strategic focus includes meeting local needs through decentralization and identifying local development partners and geographic focus, and addressing rural and urban development challenges at the local level. Primary focus areas include (i) local capacity building; (ii) rural development, including rural infrastructure, marketing and support services, and microfinance; (iii) urban governance; and (iv) basic urban services, infrastructure, and shelter	There are no major developments since the last CSP that would appear to warrant any amendment to the overall approach of the CSP. ADB will help implement the Water Law and facilitate decentralization of the management of irrigation schemes to regional governments and water users' associations. ADB's health sector program focuses on strengthening decentralized regional health services. In supporting decentralization in the health sector, ADB works in close collaboration with other development partners.	ADB has supported decentralization through capacity building at various levels. However, more links must be built between levels to ensure sustainability. ADB supports the implementation of the decentralization laws through TA projects and its lending program. The 2005 program provides strategic support to the government in critical areas. ADB's operations provide for	ADB's strategy identifies improved decentralization as one of the five areas of engagement. ADB support will focus on more sustainable, transparent, and equitable fiscal decentralization to provide local governments with the means to improve the quality as well as the volume of service delivery. ADB will continue to support the government's decentralization agenda through policy reforms and capacity development. Through follow-up activities to

CSPU 2002–2004	CSP 2003–2005	CSPU 2004–2006	CSPU 2005	CSP 2006–2009
support for decentralization in view of the major decentralization process under way. The main laws and regulations governing the administrative and financial aspects of decentralization have been issued, but revisions are expected. The ADB program supports the massive national effort by aiding policy formulation and capacity building. Advisory TA is planned to support the Regional Advisory Council, bring changes in public financial arrangements, and improve center-local financial relations. Assistance is programmed to encourage private sector participation in infrastructure development in local areas, and amend the policy and regulatory environment. Support for capacity building will be both within and across sectors. As the program period covers the	(inclusion was conditional upon improvement in governance, especially in project implementation). Decentralization was recognized as posing challenges, requiring harmonized procedures for projects implemented by local governments, and requiring district poverty indicators. The rapidly changing institutional structure requires continual review of the economic context of poverty and program of assistance. ADB's efforts will focus directly on anticorruption, legal and judicial reforms, and decentralization. The program will focus on improved local governance to provide better service delivery and to meet the challenges in rural and urban development at the local level. Efforts with other funding agencies will be closely coordinated through frequent meetings of the Working Group on Decentralization. In the agriculture sector ADB's program will emphasize improving market access, providing market-based production incentives, improving the management of research under		(i) continuing support for the implementation of the government's decentralization policies (through a proposed local finance sector development program loan).	ongoing support for state audit reform and sustainable capacity building for decentralization, ADB will help enhance local public service delivery, particularly for education and water supply and sanitation, in selected provinces and districts. Delivery of social services cannot be improved without continuing to develop capacity to strengthen the decentralization framework, putting local government finances on a more sustainable basis, and introducing financial accountability to local governments.

CSPU 2002–2004	CSP 2003–2005	CSPU 2004–2006	CSPU 2005	CSP 2006–2009
difficult initial post decentralization years, almost all projects in the program will address issues in areas of policy, capacity building, or implementation related to decentralization. Project assistance is planned to draw up institutional arrangements to address cross-sector needs such as planning and financial management capacities, public procurement, project implementation, and general administration in a sustainable manner. Assistance will also be provided to help improve decentralized management of natural resources. Basic service provision must be monitored for signs of disruption caused by decentralization in health, education, and social protection.	decentralization, and supporting infrastructure investment. In urban development, recent project administration work has revealed significant weakness in implementation capability at the local level—in procurement, contracting, and supervision. Oversight capability in national agencies similarly needs strengthening. ADB will help urban local governments improve shelter planning and management systems in partnership with the private sector and civil society organizations. In health sector, local capacity for new roles and functions under decentralization still requires strengthening. The center also needs support to adapt to new roles and functions, and requires capacity building. Support for decentralized education will involve strengthening school-based management capacity and securing the participation of civil society and NGOs in school planning and management. In transport sector, decentralizing the			

CSPU 2002–2004	CSP 2003–2005	CSPU 2004–2006	CSPU 2005	CSP 2006–2009
	administration to local governments and financing transport infrastructure using innovative private and public partnerships will have significant impact. In the financial sector, under decentralization, a municipal financing system will be introduced, developed, and supported to ensure that adequate and balanced development continues.			

ADB = Asian Development Bank, CAP = country assistance plan, COS = country operational strategy, CSP = country strategy and program, CSPU = country strategy and program update, NGO = nongovernment organization, TA = technical assistance.
Source: Asian Development Bank.

KEY DEVELOPMENT PARTNERS INVOLVED IN DECENTRALIZATION

1. The decentralization/local governance policy field is heavily populated with technical assistance (TA) projects and policy loans from several development partners. The following is a list of the key efforts:

(i) Asian Development Bank:

Second Local Government Finance and Governance Reform loan (approved in 2008), with capacity development TA.

(ii) Australian Agency for International Development (AusAID):

(a) Australia Technical Assistance Management Facility for Economic Governance, ending 2009.
(b) Local Governance and Infrastructure for Communities in Aceh, ending January 2009, follow up expected.
(c) Australia–Nusa Tenggara Assistance for Regional Autonomy, new phase expected post-2009.

(iii) Canadian International Development Agency (CIDA):

(a) Governance Reform Support Phase II, ending 2010.
(b) Public Expenditure Analysis and Capacity Harmonization, Sulawesi, starting 2009.
(c) Service improvement (BASICS), Sulawesi, starting 2009.
(d) Support to Indonesia's Islands of Integrity Program for Sulawesi, starting 2009.

(iv) Decentralization Support Facility:

(a) Decentralization Support Facility (to 2009, possibly 2011).
(b) Support Office for Eastern Indonesia (until 2010, then on its own).

(v) GTZ:

(a) Good Local Governance (ending 2009).
(b) Support for Good Governance (ending 2009).
(c) Advisory Support Services for Decentralization (ending 2009).
(d) Capacity Building for Local Governance in East Kalimantan (ending 2009).
(e) Aceh Local Governance Program (ending 2009), Aceh Governance Stabilization Project (ending 2010).

(vi) United States Agency for International Development:

(a) RTI-Local Governance Support Program (ending 2009).
(b) RTI-Democratic Reforms Support Program (ending 2009).

(vii) World Bank:

(a) Initiatives for Local Governance Reform (ending 2009).

2. Almost all of the programming listed above comes to an end in 2009. CIDA has some new projects centered in Sulawesi (such as Better Approaches to Service Provision through Capacities in Sulawesi) that are just starting. Other aid agencies foresee continuation of programs in some form.

3. The substantive focus of these development partners is shown in Table A6.

Table A6: Development Partner Focus

GTZ (ASSD, GLG, SGG, CB)	USAID-RTI (DRSP, LGSP)	CIDA (GRS)	DSF	Others (ADB, WB, AusAID)
Revision of Law 32/2004 (national, MOHA) Mass organizations law (national, MOHA) Midterm development plan (RPJMN) 2010–2014 on decentralization Functional assignment , especially on deconcentration shift (BAPPENAS) Processes for district development planning and budgeting (Java, Yogyakarta, NTT districts) Service standards and service provision in selected sectors (national, MOHA) Civil society instruments for improving services (Ministry of Administrative Reform [MenPAN], districts) Administrative procedures law (MenPAN) Disaster management (districts) Capacity building assessment, planning, and service provider strengthening (East Kalimantan districts)	Revision of Law 32/2004 (national with MOHA and via CSO networks) Mass organizations law (national, MOHA) Stock taking studies of reforms (2006 and 2009, Government of Indonesia and development partners) RPJMN 2010–2014 on civil society (BAPPENAS) Village/*kecamatan* (subdistrict) development research/CSO network development	Financial management (district) RPJMN 2010–2014 on decentralization (national, BAPPENAS) Service delivery mechanisms (national, MOHA) Deconcentration shift to DAK (BAPPENAS)	Transfers Taxes Borrowing Regional statistics Surveys Alternative service delivery Optimizing best practice and replication Subnational investment climate reform	AusAID TAMF III – supporting Supreme Audit Board (BPK) (does audits for regions) WB–ILGR–Transparency, participation, accountability regulations in some districts and cities ADB: Policy loan preparatory TA

ADB = Asian Development Bank, ASSD = Advisory Support Services for Decentralization, AusAID = Australian Agency for International Development, BAPPENAS = National Development Planning Agency, BPK = Badan Pemeriksa Keuangan, CB = capacity building, CIDA = Canadian International Development Agency, CSO = civil society organization, DAK = Dana Alokasi Khusus, DRSP = Democratic Reforms Support Program, DSF = Decentralization Support Facility, GLG = Good Local Governance, GRS = Government Reform Support, ILGR = Initiatives for Local Governance Reform, LGSP = Local Governance Support Program, MOHA = Ministry of Home Affairs, NTT = Nusa Tenggara Timur, SGG = Support for Good Governance, TAMF = Technical Assistance Management Facility, USAID = United States Agency for International Development, WB = World Bank.

SUMMARY OF FINDINGS FOR CORE DECENTRALIZATION LOANS

A. Community and Local Government Support Sector Development Program and Project (Loans 1677 and 1678)

1. The Community and Local Government Support Sector Development Program and Project (CLGSSDP) was a combination of two loans—a program loan of $200 million designed to support the comprehensive decentralization reform program of the government, and a project loan of $120 million, which funded poverty reduction projects. Both were designed in 1998–1999 as a quick-disbursing emergency response measure to the economic and political crises gripping the country at that time. The primary objective was to improve socioeconomic well-being; support the government's ongoing decentralization efforts through increasing the capacity of the districts to implement local public services; and empowering villages and civil society in participatory development, transparency, and accountability in local governance.

2. **Relevance.** While the program was said to be an integral part of a larger assistance package of $2.8 billion provided by the Asian Development Bank (ADB) as an immediate response to the Asian economic crisis, it was not anchored in the country partnership strategy for Indonesia. Its design was, therefore, somewhat unfocused with an unclear scope of assistance. In addition, the absence of an overall decentralization plan meant that the program and project were not designed as part of a broader government strategy, thus limiting their potential for adding value in the long term. Rating: *less relevant*.

3. **Effectiveness.** Even with the reported slightly improved levels of infrastructure services and jobs generated in the targeted beneficiary communities, no measurement was made as to how the project had contributed effectively to poverty reduction and community empowerment (if at all) and also how the program had improved administrative and fiscal autonomy and local government capacities (e.g., civil service reform implementation and decentralizing environmental management). Rating: *less effective*.

4. **Efficiency.** There were serious delays of almost 2 years due to the inability of the government to provide counterpart funds or an alternative disbursement mechanism, which put the investment (project) loan at risk. It was the same with the program loan, which was also delayed. Other than the economic internal rate of return calculated by the project completion review mission, little data is available and only a limited assessment can be made. Rating: *less efficient*.

5. **Sustainability.** It is less likely that local institutions and communities will continue to participate without the incentive of funds support for the system. Rating: *less likely sustainable*.

6. **Institutional development and/or other impact.** The project completion report gives a good summary of development impacts, but more could have been done to (i) have specific measures on poverty reduction and monitoring systems; (ii) review the status of decentralization reforms; and (iii) elaborate on policies relating to level or quality of local community involvement and participation in decision-making, particularly in governance. Rating: *modest*.

7. **Lessons.** Lessons identified include (i) decentralization and poverty reduction are two distinct core issues that cannot be fully addressed through a single design intervention; (ii) development partners must be mindful of absorptive capacities of recipient developing member countries to undertake critical programs; (iii) the action agenda for sustainability should be laid down at the start of the program and/or project, not as an afterthought during implementation; and (iv) fraud and corrupt practices must be given adequate attention so that appropriate measures are put in place and proper context.

B. Sustainable Capacity Building for Decentralization Project (Loan 1964)

8. The Sustainable Capacity Building for Decentralization Project (SCBDP) aimed to develop the institutional and operational capacities of 38–40 regional governments (*kabupaten* [regency] and/or *kota* [municipality and/or city]) in their service delivery through the following components: (i) capacity building action plan development and implementation; (ii) capacity building of service providers; (iii) information and communication technology supported coordination, management, and standard setting.

9. **Relevance.** The sample study done (as part of project preparation) showed that regional governments lack, and were in urgent need of, capacity building, particularly for management information systems and human resource, asset, and financial management. Both ADB and the government have been working with other development partners in Indonesia on this particular need for supporting decentralization. Rating: *relevant*.

10. **Effectiveness.** The significant delays in early implementation reduced the effectiveness of other outputs, e.g., the role and participation of the National Capacity-Building Review Board and the capacity building-action plan implementation by the regional governments. The cancellation of the planned revolving fund may have had adverse effects in the overall attainment of project objectives. Rating: *less effective*.

11. **Efficiency.** Project implementation was delayed by almost 2 years (40%), and most activities were set back. This had serious repercussions for the achievement of targets, especially in regional governments that were lagging behind and had weaker capacities to cope with and fast-track implementation of their respective capacity building action plans. Despite closing date extensions, assurances, and mitigating measures, there remain serious problems with sustaining project gains and achieving targets. Rating: *less efficient*.

12. **Sustainability.** Mainstreaming of capacity building-action plan into the regional governments' annual plan and budget remains crucial to sustaining the program. Commitments from both the central and regional government and their enthusiastic participation should be maintained to ensure achievements of outputs. Rating: *less likely sustainable*.

13. **Institutional development and/or other impact.** Performance on the envisaged key changes, i.e., acquisition and delivery of capacity building services, and the structure for standard setting, monitoring, evaluation, and coordination of the national capacity building process, was varied in the different participating regional governments. Rating: *Modest*.

C. Local Government Finance and Governance Reform Sector Development Program and Project (Loans 2192 and 2193)

14. The Local Government Finance and Governance Reform Sector Development Program and Project included a $300 million (single tranche) program loan, a $30 million project loan, and an advisory technical assistance (TA) grant of $500,000 (to enhance the capacity of the Intergovernmental Regional Autonomy Advisory Council [Dewan Pertimbangan Otonomi {DPOD}]). This package of assistance was intended to enhance the effectiveness and efficiency of local governments in delivering public services by strengthening the policy, legal, and regulatory framework for decentralization. Specifically, this sought to implement reforms in public expenditure and financial management through the development and upgrading of related financial management information systems.

15. **Relevance.** Both the government and ADB took into account the implementation environment and related capacity constraints and agreed that the best way to support reforms, particularly in local government finance and governance, was through a phased and focused approach over the medium term that addresses the reforms in an incremental and gradual manner (based on stakeholder consultations). This was expected to enable the local governments to deliver basic public services more effectively and efficiently consistent with the ultimate goals of the decentralization program of the government. Rating: *relevant* (as designed in support of decentralization).

16. **Effectiveness.** Although there is very limited data inputs on the outcomes and key outputs (while implementation is ongoing), the significant delays in project implementation have likely reduced the effectiveness of the project in achieving targets. There are specific issues affecting effectiveness. For the program loan, these are (i) weak intergovernmental coordination, (ii) weakness in resolving local government debt arrears, and (iii) constraints relating to fiduciary governance. For the project loan, these include (i) technical capacity in financial management, and (ii) change in political leadership. Rating: *less likely effective*.

17. **Efficiency.** Implementation is suffering from serious delays, and there have been governance issues with some suppliers providing key services. Rating: *less efficient*.

18. **Sustainability.** It is too early to judge.

19. **Institutional development/other impact.** It is too early to assess.

D. Second Local Government Finance and Governance Reform Program Cluster (Loan 2478)

20. The Second Local Government Finance and Governance Reform Program Cluster (Subprogram 1) aimed to provide for policy, administrative and legal changes, and capacity building initiatives over the medium term. It is a program cluster for the Second Local Government Finance and Governance Reform Program and its two subprograms. It involves (i) a loan of $350 million equivalent for subprogram 1, and (ii) a TA grant of $1.5 million.

21. **Relevance.** The program forms part of a continuing effort that seeks to address some of the key remaining issues that constrain regional governments from effectively delivering public services. Rating: *highly relevant*.

22. **Effectiveness.** It is too early to evaluate, although early indications are that the government is embracing the need for continuing reform. Rating: *likely effective*.

23. **Efficiency.** There is no indication whether the single tranche approach is able to spur efficient use of resources and how the government is expected to generate resources for the program. Rating: *too early to tell*.

24. **Sustainability.** The program does not have a sustainability mechanism and a resource mobilization strategy. The regional governments are least expected to be financially independent without adequate and equitable sources of funding. Rating: *too early to tell*.

25. **Institutional development/other impact.** The program (ongoing) is geared toward having impacts on institutions (i.e., regional governments) and other development agenda (e.g., health and education). Rating: *too early to tell*.

SUMMARY OF FINDINGS FOR DECENTRALIZATION TECHNICAL ASSISTANCE PROJECTS

A. Overview

1. Twenty technical assistance (TA) projects were reviewed as part of the study. There is a paucity of documents (e.g., technical assistance completion reports (TCR), monitoring reports, and project updates) which should describe major accomplishments and provide a useful assessment of project performance, identify key issues, and propose mitigating measures. For these projects, only one technical assistance performance evaluation report (covering four TA projects) and 11 completion reports were prepared. There were at least eight TA projects that have nothing but approved proposals (TA report) and brief project profiles.

B. Summary Notes on Major Technical Assistance Projects with Completion Reports (excluding the performance evaluation report for the four associated TA projects)

1. Capacity Building to Support Decentralized Administrative Systems (TA 3177)

2. The TA was to assist the government to reorganize and set up decentralized administrative systems at the district level (municipality and/or city [*kota*] and regency [*kabupaten*]) in line with the new decentralized structure as envisaged in Law 22/1999 on Regional Government. Its scope covered (i) preparing a plan for the reorganization of district governments, (ii) developing improved mechanisms for public disclosure of information at the district level, and (iii) developing measures for effective implementation of legislation at the district level. It was carried out in three interrelated phases: (i) developing a strategic plan for district government reorganization, (ii) introducing local codes of accountability, and (iii) introducing the skills of reorganization.

3. Project reports have indicated that government policy and technical inputs to the TA were inadequate in the early stage (March–August 2000). The pace of actual decentralization preparation was slower than anticipated at TA design. The Ministry of Home Affairs (MOHA) was unable to provide effective counterpart guidance until it subsumed the Ministry of Regional Autonomy in August 2000. The overall Community and Local Government Support: Sector Development Program (CLGSSDP) coordinator, the National Development Planning Agency (Badan Perencanaan dan Pembangunan Nasional [BAPPENAS]), was unable to resolve these TA counterpart agency difficulties.

4. The TA final report described achievements against the three project objectives, including a major contribution to the government's decentralization capacity building needs assessment study. It also showed the limitations of achievements, including the lack of a detailed plan for staff training. The TA project produced 36 discussion papers for consideration by government and other stakeholders and three "advisory reports" that responded to special requests from the MOHA. There were 29 recommendations to the central government and six for the pilot regions on (i) managing the complexity of decentralization, (ii) law reform for good governance, (iii) revising the decentralization laws, (iv) organization at the local level, (v) local accountability, and (vi) professional development and training.

2. Capacity Building for Setting Up District-Level Financial and Budgetary Systems (TA 3178)

5. The purpose of the TA was to assist the government build capacity in support of decentralized fiscal systems in line with Law 25/1999 on Fiscal Balance. It was intended to assist government to set up district financial and budgetary systems. TA outputs were to be (i) an analysis of existing district financial and budgetary systems, (ii) appropriate systems to fit the new structure, (iii) an implementation plan for setting up the new systems, and (iv) an assessment of the related staff and training needs.

6. The final report included a useful synthesis of the TA's niche contribution in the context of the overall decentralization planning and implementation program. The suggestions and recommendations were influential at operational and senior levels within the government throughout 2001 because the MOHA had regained stewardship of the decentralization program, and because the Asian Development Bank (ADB) remained intensively engaged with the MOHA and the Ministry of Finance. The recommendations on internal audit were sufficiently detailed for immediate implementation by regional governments. The TA contributed substantively to the October 2000 Consultative Group of Indonesia, particularly the training needs assessment for regional financial staff.

7. ADB's standard TA format providing intensive specialist support over a relatively short period may not be well suited to the volatile and lengthy transition process that is Indonesia's decentralization program. The format lacks flexibility, and effective exit strategies are difficult to achieve. Flexible, longer-term support, such as that envisaged in the TA cluster approach, may be more effective.

3. Capacity Building for Participatory Planning, Monitoring, and Evaluation (TA 3179)

8. The TA's objectives were to (i) design a participatory planning, monitoring, and evaluation system (the participatory, planning, monitoring, and evaluation [PPME] approach) for all involved government levels and communities to implement the investment project; (ii) identify key criteria and indicators to be used for macrolevel monitoring of project inputs, outputs, and impacts; (iii) develop a project performance monitoring system for collecting, recording, and analyzing updated information on project implementation; and (iv) identify strategies to strengthen and institutionalize public and community participation in policy making and planning processes at the district level.

9. A consortium led by BMB Management Consultants carried out the TA implementation. The consultant produced 51 reports in Bahasa and English, including additional publications that became necessary while implementing the PPME approach. The final report fully incorporated ADB's comments and concisely presented TA activities and recommendations. Other major publications include the manual of the PPME approach (three volumes); training modules for different government levels and communities; and handbooks for facilitators and local governments, and on conflict management, in addition to numerous progress and field trip reports.

10. Further, the consultant developed monitoring indicators and a management information system and transferred its operation to the project management consultant. To facilitate the institutionalization of the PPME approach, the consultant developed guidelines for its sustainability. However, the PPME approach strongly focuses on assisting the poor and women

based on the project objectives and is, therefore, difficult to reconcile with many communities' decision-making hierarchies. The PPME approach required the poor to participate in the planning process to improve their access to basic infrastructure, bypassing to some extent, a hierarchy that is usually dominated by rich village elites. The PPME approach was accepted as long as the Community and Local Government Support Project provided funds, hence, it was not sustainable.

4. Urban Sector Development in a Decentralizing Environment (TA 3326)

11. The TA was designed as a standalone advisory TA project but supportive of the CLGSSDP with focus on urban development. It was intended to (i) promote more efficient and effective urban development and management in Indonesia, (ii) enhance local government awareness of decentralization requirements, and (iii) help the government identify the policy reforms needed to enhance the efficiency of urban sector development and management.

12. In the final report, the recommendations included the following 10 possible program areas: (i) streamlining legal and regulatory guidelines for local planning, (ii) capacity building in national policy analysis and urban strategy formulation, (iii) reforming the system of local capital investment, (iv) strengthening economic development capacities of local and provincial governments, (v) developing mechanisms to promote inter-jurisdictional cooperation that has a region-wide impact on economic growth, (vi) strategic urban planning and investment programming, (vii) supporting governance metropolitan areas, (viii) increasing use of information technology and knowledge exchange among local governments, (ix) reducing urban poverty, and (x) monitoring governance conditions and accountability.

13. The TCR recommended that in the future, such links between program areas should be built into the TA designs to ensure that ADB's activities are perceived as coherent and complementary.

5. Strategy for Restructuring Public Services (TA 3233)

14. The two important outputs of the TA study, i.e., computing net fiscal impact and formulating strategies for restructuring public services, were accomplished. The total net fiscal loss or impact (NFl) of the Unit Pelaksana Terenis was $1.11 billion per annum. This represented 1% of gross domestic product or 20% of the current budget deficit. NFl increased by one-third for the sector as a whole, while the NFl for the five largest ministries rose by 49% in real terms from 1996/97. The Ministry of Health has the largest NFl, which at Rp2.28 trillion per annum, represents a five-fold increase from FY1996/97 to FY1999/2000. This was a very significant finding. Previous estimates of this net fiscal loss were not accurately undertaken. These outputs help the government to mobilize support for, and accelerate fiscal reform and restructuring of, the public service.

15. Overall, the TA provided valuable outputs and advice to the government to continue the important structural reforms initiated during the financial crisis. Importantly, it trained government staff to undertake complex financial analysis and formulate strategies for restructuring the public service to reduce fiscal burden and improve management efficiency. The executing agency used existing TA findings to formulate pricing policies for public services and to implement restructuring reforms in these services.

6. Fiscal Decentralization (TA 3777)

16. The TA was closely coordinated with the World Bank and Japan Bank for International Cooperation who carried out similar activities but in different regions. The key findings included the following:

(i) **District fiscal profiles.** The TA established a database for regional and local budget, which, when combined with socioeconomic data, has since found many applications both by the government and other development partners.

(ii) **Regional public expenditure reviews.** As intended in Law 25/99, there has been a major shift of revenue and expenditures from central government to local governments. There are now substantial budget surpluses in many of the local governments, in contrast to the budget deficit and debt situation of the central government. These shifts in budgetary allocations have led to sharply increased routine expenditures at the regional level.

(iii) **Grant transfer and/or onlending policy.** A surprising view emerging from the analysis of the fiscal position of local governments is that they have not been borrowing enough, as measured by potentially sound projects, but too much in terms of debt repayment and arrears performance.

17. Three factors contributed to the success of the TA. First, close coordination between ADB, Japan Bank for International Cooperation, and World Bank during the fact-finding stage avoided overlaps and ensured good understanding of the TA by the counterpart agency. Second, TA implementation was timely in the sense that interest in the topic was at its maximum in this early stage of implementation of fiscal decentralization. For example, all national and regional workshops were well attended, as was the final tripartite meeting, which lasted 5 hours. Third, the use of highly competent local consultants ensured excellent cooperation with the nine local governments in three different provinces.

7. Support for Partnership for Government Reform in Indonesia (TA 3813)

18. The objective of the TA was to support development of good local governance and of greater participation in policy development and implementation at the local level. The TA assisted the Partnership for Governance Reform in Indonesia (PGRI) to create regional and cross-regional liaison structures by locating consultants in four regions (Banda Aceh, Jayapura, Medan, and Yogyakarta) for defined purposes and on fixed terms to help improve public and corporate governance at both regional and local levels.

19. This TA differed from many other TA projects in the sense that (i) it did not define a specific area for reform but rather a broad mandate for the consultants to support implementation of the PGRI strategies and priorities in a few selected regions; (ii) ADB only financed the consultants' remuneration and out-of-pocket expenses—all operational expenses were borne by the PGRI; and (iii) the outputs were not clearly defined reports (except for inception, final, and progress reports) but workshops and stakeholder consultations on democratization and governance issues, which was in line with the way the PGRI mainly operated at the time. The TA clearly helped both the PGRI and local governments to deliberate and make progress on contentious issues through workshops and stakeholder consultations. However, the sustainability of such outcomes is hard to gauge, although the fact that the TA led to still-ongoing PGRI programs in a few key regions indicates a sustainable outcome at least in these regions.

8. Local Government Provision of Minimum Basic Services for the Poor (TA 3967)

20. The overall goal of the TA was to enable local governments to carry out their responsibility to provide basic services to the poor. The key activities included (i) providing direct support to local governments incorporating obligatory function and minimum service standards (MSS) into the planning and budgeting cycle; (ii) estimating the per capita cost of financing obligatory function and MSS, including the cost of alternative delivery mechanisms to support implementation of obligatory function and MSS, for benchmarking and calculating specific grants; and (iii) based on experiences gained from interaction with local governments, developing, and testing guidelines for incorporating obligatory function and MSS in planning and budgeting, organizational and human resources development, and monitoring and evaluation.

21. The TA team developed a tool, planning and budgeting with MSS, to help quantify the resources required to close the gap between the current service levels and the MSS for selected public services in basic health, basic education, and general government services. The team also identified the institutional issues and constraints on the introduction of obligatory function and MSS at the local levels and identified the roles and capacity building needs of other key stakeholders such as the local parliament, civil society, and the local communities.

22. Key recommendations included the need to differentiate levels of responsibility and to clearly divide regional government obligations between those that are obligatory and those that are optional. The MOHA needed to be strengthened to coordinate effectively the design and monitoring of obligatory function and MSS responsibilities. In particular, as costing and budgeting were only partly taken into account in defining obligatory function and MSS, financing is a critical area that needs to be addressed. One mechanism of financing could be through the general purpose transfers. However, adequate capacity building is needed for central and local government agencies to be able to properly cost obligatory function and MSS.

9. Local Government Financing (TA 4282)

23. The TA was initially approved to (i) strengthen central and local public sector financial management, (ii) implement new onlending mechanisms, and (iii) establish an improved local government financial information system. Following slow start up and management difficulties from mid-2005, the focus of objectives was substantially revised to emphasize preparation of new program and project loans under the Local Government Finance and Governance Reform (LGFGR) program. Hence, in mid-2005, the objectives and outputs were significantly revised, following which the Local Government Financing TA and related Sustaining Decentralization and Local Governance Reforms TA were managed jointly. The revised core objectives and (closely related) outputs for the joint TA projects were agreed upon by the government and ADB to be (i) supporting the meeting of all policy matrix conditions under the proposed program loan, (ii) supporting preparation of the proposed project loan, and (iii) eventually supporting early phases of implementation of the project loan.

24. The major lessons identified in the TCR include (i) internal management problems in the early stages of the TA needed to be addressed by stronger management structures and a team leader; (ii) significant startup delays were experienced due largely to lack of government ownership; (iii) consultant recruitment efforts to identify good candidates are critical to TA performance and need greater attention; (iv) greater coordination with regional representatives is warranted to properly gauge demand and ownership; (v) individual consultant performance was mixed and warrants improved recruitment, management, and monitoring; (vi) ADB and/or

government administrative processes were often slow and need to be addressed; and (vii) there is need for continuation of efforts under the ongoing TA projects with regard to future development of the second phase of the LGFGR program.

10. Gender Responsiveness Public Policy and Administration (TA 4479)

25. The expected impact of the TA was to improve gender equality and women's empowerment in line with Millennium Development Goal 3. The outcome was to help regional governments increase women's participation in political decision making and to improve the gender responsiveness of regional policies and programs. The TA had three outputs: (i) increased capacity of women as present or future candidates of local representative bodies to influence political decisions at the district level; (ii) increased capacity of district administrations to design, monitor, and evaluate programs and projects at the local level; and (iii) a national action plan for mainstreaming gender in regional governments prepared and adopted by the State Ministry for Women's Empowerment. During the inception phase, as a result of a shift in government priorities, the third output was revised to support for the State Ministry for Women's Empowerment gender mainstreaming policy change initiative.

26. The TA was rated successful. It was relevant, efficient, and effective, and gender mainstreaming is on its way toward becoming sustainable under a new presidential regulation. Some of the best practices identified by districts themselves in a best-practices workshop included (i) combining the gender-responsive governance training with a practical planning and budgeting exercise linked to trainees' real-world work and the 2007 budget cycle; (ii) formally creating structures and mechanisms (e.g., task units) for gender mainstreaming at the subdistrict and village levels where women's empowerment divisions do not have a presence; (iii) arranging for citizenship education and gender-responsive governance trainees to make presentations to their district legislatures; (iv) providing capacity development aimed at women people's representative council (*dewan perwakilan rakyat daerah* [DPRD]) members; and (v) producing a detailed alumni book to all training participants to facilitate contact between government and civil society graduates from the same district and between districts.

11. Sustaining Decentralization and Local Governance Reform (TA 4543)

27. The TA was initially approved as stand-alone TA with the initial focus being on supporting the finalization of a coherent regulatory framework for regional financial management and to prepare the National Action Plan on Decentralization. From mid-2005, the focus of objectives was revised somewhat to emphasize preparation of new program and project loans under the LGFGR program. From mid-2005, the government and ADB decided to manage this TA jointly with the Local Government Financing TA.

28. The original terms of reference provided for six substantive deliverables. Because of the change in focus, initially desired results were not fully achieved. In terms of overall government achievement, two of the required deliverables were rated *low*, two were rated *good*, and two were rated *excellent*. In terms of the specific contribution to assisting the government to achieve the desired results, the ratings were three deliverables rated *low*, two rated *good*, and one rated *excellent*. Other deliverables are assessed together with similar deliverables in the Local Government Financing TA.

29. Major issues or lessons learned that were identified (together with the Local Government Financing TA) include (i) startup delays were experienced due largely to delays in government approvals; (ii) consultant recruitment procedures are critical to performance as rushed

recruitment is not ideal for identifying the best candidates; (iii) greater coordination with regional representatives is warranted; (iv) the quantum of ADB staff resources was not always optimal in relation to the size and complexity of program and project loans that this TA helped prepare; (v) individual consultant performance was mixed and warrants improved recruitment, management, and monitoring; (vi) ADB and/or government administrative approval and clearance processes were often slow and need to be addressed; (vii) joint TA projects were large and complex, spanning many directors general across three ministries including planning for 171 regional governments leading to coordination difficulties; and (viii) there is need for continuation of efforts under the ongoing TA projects with regard to future development of the second phase of the LGFGR program.

12. Supporting an Effective Institutional Framework for Fiscal Decentralization (TA 4682)

30. The expected impact of the TA was to strengthen the capacity of the (Regional Autonomy Advisory Council [Dewan Pertimbangan Otonomi {DPOD}]) for intergovernmental coordination to enhance effectiveness of decentralization reforms. The outputs of the project addressed the three major areas outlined in the original terms of reference: (i) fiscal decentralization, (ii) regional autonomy, and (iii) capacity building. On fiscal decentralization, subtasks were (i) non-quantitative methods for evaluating fiscal decentralization proposals, (ii) deconcentrated funding alternatives, and (iii) interjurisdictional service delivery. On regional autonomy, output was to analyze the multitude of issues surrounding *pemekaran* (rapid increase in the number of local governments), brainstorm the issue with stakeholders through a workshop, and present findings and/or recommendations in a report. The third output was to prepare a capacity building plan for the DPOD secretariat after analyzing its strengths and weaknesses.

31. The major lessons learned were (i) the startup delays were because the DPOD secretariat had no prior experience in managing a donor-funded project; (ii) projects greatly benefit from a strong and active political champion as a counterpart, government ownership and involvement throughout the project is critical to ensure success, change in executing agency affected the project as the new executing agency initially had very little knowledge of or direct interest in the TA and its implementation; and (iii) any future projects with the DPOD secretariat should factor in the overall political viability of the DPOD. The secretariat is only as effective as the influential ministries within the DPOD allow it to be, and that willingness is not apparent.

SITUATING ADB SUPPORT FOR DECENTRALIZATION IN INDONESIA WITHIN INTERNATIONAL LESSONS AND GOOD PRACTICES

A. Introduction

1. This appendix supports the special evaluation study (SES) on Asian Development Bank (ADB) assistance for decentralization in Indonesia, covering investments over the 10 years 1999–2008. ADB has made significant investments in support of decentralization and local governance in Asia and, in particular, in Indonesia, through a combination of loans and advisory and preparatory technical assistance. The SES presents the opportunity to reflect not only on ADB's investments in terms of the governance context of Indonesia, but also on how the support and the approaches to decentralization taken in Indonesia compare with international efforts. Specifically, ADB wishes to situate the Indonesian experiences, and its own support, within the emerging good practices in decentralization—to help it to be more effective in future assistance to the Government of Indonesia in this area.

2. Observers of decentralization have noted that in recent decades, decentralization has been attempted in most developing countries of a significant size. Manor comments on the "astonishing" range of initial starting conditions.[1] The literature has mushroomed accordingly under a broad range of related labels, including decentralization, devolution, autonomy, and local government.

3. Discerning good practices from a field that is rather new in literature and has little in the way of widely shared concepts, typologies, and analytical frameworks is a daunting task. In some countries, particularly in Asia, decentralization is too recent to be able to assess outcomes or to extract lessons on approaches taken. Even so, the literature is beginning to address this gap, and it is possible to say something meaningful about what has been tried and what changes have come about.

4. This paper necessarily spreads its net widely, examining writings that are comparative and summative. It treats process and outcomes, endogenous efforts, and those aided by development partners. Information and views on Indonesia's journey to decentralized governance is more readily available, and personal involvement in several aspects of decentralization, through various development partners, is also used. Discussions with the ADB team undertaking the SES and selected key informants in Indonesia (Decentralization Support Facility [DSF], Indonesia Resident Mission, GTZ, Canadian International Development Agency [CIDA]) rounds out the sources employed.

5. The appendix is organized in the following themes:

(i) **Scope of review and basic definitions (section B).** The section presents the typology used for decentralization and the reason for expanding the scope of the paper to encompass local governance. The approach to good practices is also explained.

(ii) **Benefits of decentralization and local governance, lessons, and emerging good practices (sections C, D, and E).** The outcomes of decentralization and local governance reform efforts internationally are briefly surveyed, and lessons and emerging good practices are identified, including those related to development partner support for decentralization and local governance.

[1] Manor, J. 1999. *The Political Economy of Democratic Decentralization*. Directions in Development Studies. Washington, DC: World Bank.

(iii) **Lessons and good practices in Indonesia's efforts in decentralization and local governance (section F).** A brief summary of key characteristics of decentralization and local governance in Indonesia is provided to highlight the key developments over the last decade and identify the lessons and good practices that are specific to Indonesia.

(iv) **Development partner and ADB support for decentralization and local governance initiatives (section G).** The pattern of support provided by development partners is noted, and particular attention is given to that provided by ADB.

B. Scope of Review and Basic Definitions

6. Decentralization is seen through many lenses. Even so, it is by necessity a view from the center and one that focuses on the government system. Box A9.1 provides a typology that serves to clarify types of decentralization. It is important to know which is being attempted or what mix is in play.

Box A9.1: Simplified Typology of Decentralization

Deconcentration is the delegation of administrative tasks by a central government organization's headquarters to its representatives or branches dispersed over the national territory in a functional and/or administrative pattern that serves that organization.

Agency tasks are assigned to general purpose local government or a special purpose and/or semi-autonomous agency to be discharged on behalf of the assigning central government and/or organization.

Devolution is the transfer of functions, requisite power, and resources to local government that has considerable discretion and is democratically accountable to its citizens.

Source: Independent evaluation mission.

7. From this intergovernmental perspective, key elements that must be given consideration in decentralization efforts include

(i) decentralization policy-making process, encompassing actors, platforms, and processes for finding agreement and producing official policy and legal products;
(ii) territorial structure of levels of subnational government and their interrelationships;
(iii) functional assignment, defining roles, scope of action, and performance expectations;
(iv) fiscal arrangements to allow local government revenue collection and equalizing transfers, in line with functional assignment;
(v) planning systems, coordinated between levels and reflecting functional assignment;
(vi) supervision and support, including information systems, upward reporting, and capacity development opportunities for all levels;
(vii) organizational structures and personnel that are sufficient in numbers and skills to discharge assigned functions; and
(viii) representative and participatory mechanisms to ensure accountability to the public.

8. The above list, particularly item (viii), makes it advisable to extend the rather strategic governmental view by adding local governance, to bring into the picture the local and nongovernment perspective. This will be the approach used in this appendix, and "decentralization and local governance" will be the understood focus when the term

decentralization is used. Where it is important to underscore this unified view, the full term will be used.

9. As seen in many developing countries, decentralization is promoted and assisted by many development partners and international financial institutions (IFIs). Particular attention will be given to the findings in the literature on the ways that aid agencies and/or IFIs have tried to help decentralization and local governance reforms, and to what effect.

10. The appendix avoids aiming too high in the search for what is working in decentralization and local governance. There may well be consensus on some best practices, e.g., in the way aid agencies can support decentralization,[2] but much of the field is still too messy to support such expectations. It will identify patterns, lessons, and good practices, with an orientation to "good enough practices" in the approach championed by Grindle[3] and supported by the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD-DAC)—minimal conditions that can serve to improve institutional performance, rather than the complexity of all possible reforms that might characterize an idealized long-term situation.

11. The review encompasses any region in the world that can offer some lessons and good practices, but Asian sources will be emphasized. Naturally, considerable room is given to explaining the Indonesian scene.

12. The governance outcomes examined worldwide are those that are the desired ends of Indonesia's efforts, i.e., improved welfare and competitiveness. But these are rather high-order goals, and it is more appropriate to focus on the means by which Indonesia seeks to achieve them, i.e., through democratization, participation, improved service delivery, and equity.[4] It is also worthwhile pushing beyond these to note how decentralization measures up on other important governance areas that are the growing focus of literature—governmental efficiency, poverty reduction, conflict reduction, corruption reduction, sustainable development, and gender equality.

C. Benefits of Decentralization

13. Before extracting good practices, it is worth noting where decentralization has had some success, where it has had little, or where the results are not yet clear. It needs to be said that decentralization is being done in a great number of ways. While it is reasonable to draw inferences from the effort and coherence of the design process, the outcomes of decentralization take time to be realized, particularly if the institutional changes are complex. Many would agree that 10 years is not an unreasonable period of time before significant results should be expected. Some Asian countries cannot boast of such a long engagement.

14. Common laments regarding the body of literature include the rather anecdotal nature of decentralization evidence,[5] lack of systematic studies,[6] and lack of agreement on what the

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[2] See, for instance, the website http://www.dpwg-lgd.org, which contains some best practices in donor aid effectiveness areas.

[3] M.S. Grindle. 2005. *Good Enough Governance Revisited*. A Report for DFID with reference to the Governance Target Strategy Paper, 2001. Harvard University, February.

[4] Elucidation of Law 32/2004.

[5] J. van Zyl et al. 1995. Decentralized Rural Development and Enhanced Community Participation - A Case Study from Northeast Brazil. *Policy Research Working Paper 1498*. World Bank.

[6] D. Conyers. 1990. Centralization and Development Planning: A Comparative Perspective. In P. De Valk and K.H. Wekwete (eds.), *Decentralization for Participatory Planning?* Avebury, UK: Aldershot.

available evidence is saying. The mixed findings have been rather perplexing, but the wide range of findings can in part be explained by disparate definitions of decentralization.[7] Assessments have been hindered by methodological challenges in what is a very complex area of study. The accumulating evidence has rectified some of these shortcomings in the literature, but not entirely. Nonetheless, the reviews of studies of decentralization shown in Table A9 allow for some cautious statements to be made on the key benefits expected of decentralization, and the concerns that have arisen in the course of decentralization reforms (see Box A9.2 for a condensed list).

Table A9: Empirical Studies on the Impact of Decentralization[a]

Indicators	Positive Impact	Little or No Impact/Unclear	Negative Impact
Improved services	Sanwal 1987; van Zyl et al. 1995; Manor 1996; Faguet 2008; Uchimura and Jutting 2009	Ruffing Mangelsdorf 1988; Ingham and Kalam 1992; Crook 1994; Khan and Cheema 2007	
Democracy or power sharing	Dilla and Gonzales 1995; Souza 1996; Heller et al 2007	Slater 1977, 1989; De Montricher 1995; Souza 1996; Ribot et al. 2006	Slater 1977, 1989; Asibuo 1992
People participation or CSO engagement	Sanwal 1987; Mutizwa-Mangiza 1990; Parker 1995; Dilla and Gonzales 1995; Manor 1996; Heller et al. 2007; Blair 2000	Cohen and Hook 1987; Vengroff and Salem 1992; Ingham and Kalam 1992; Crook 1994; Gilson et al. 1994; Manor 1996; Wiens and Guadagni 1996; Ayee 1996; Roy 2008	Asibuo 1992; Veltmeyer 1997
Transparency or accountability in government	Dilla and Gonzales 1995; Manor 1996; Blair 2000; Wang and Yao 2007	Crook 1994; Ayee 1996	Sundar 2001; Khan and Cheema 2007
Local government related corruption	Manor 1996		Prud'homme 1995; Casson and Obdzinski 2002
Public sector efficiency	Sanwal 1987; van Zyl et al. 1995; Manor 1996; Wang and Yao 2007	Prud'homme 1995; Wiens and Guadagni 1996	Asthana 2003
Allocative efficiency or tailoring development to local conditions	Manor 1996	Gilson et al 1994; Crook 1994; Prud'homme 1995	Akin et al 2005
Group, community, or jurisdiction equity	Manor 1996; UNESCAP 2001	Gilson et al 1994	Prud'homme 1995; Agrawal and Gupta 2005; Wardell and Lund 2006

[7] D. Conyers. 1983. Decentralization; the latest fashion in development administration? *Public Administration and Development*, 3. pp. 97–109.

Indicators	Positive Impact	Little or No Impact/Unclear	Negative Impact
Poverty alleviation	Sanwal 1987; Mutizwa-Mangiza 1990; Johnson 2001; Faguet 2008	Watson 1992; Wiens and Guadagni 1996; Manor 1996, 1999; Crook and Manor 1998; Blair 2000; Crook and Sverrisson 2001; Cross and Kutengule 2001; James et al. 2001; Johnson 2001; Hernandez-Trillo and Crook 2003; Jarillo-Rabling 2008	
Income or economic growth	Palmer and Engel 2007	Manor 1996; Davoodi and Zou 1996; Woller and Phillips 1998; Palmer and Engel 2007	Davoodi et al. 1996
Mobilizing local resources	Mutizwa-Mangiza 1990; Parker 1995	Crook 1994; Manor 1996; Bahl 1999	Mutizwa-Mangiza 1990
Planning from below		Cohen and Hook 1987; Bienen et al 1989; Gilson et al. 1994; Manor 1996	
Sustainable development	Ostrom et al 1993; van Zyl et al. 1995; Parker 1995; Manor 1996	Wiens and Guadagni 1996	Jiang 2006
Political or fiscal stability (including conflict)	Diprose and Ukiwo 2008		Prud'homme 1995; Tanzi 1995; Diprose and Ukiwo 2008

CSO = civil society organization, UNESCAP = United Nations Economic and Social Commission for Asia and the Pacific.

[a] The categories in Table A9 are not well demarcated, but allow a rough assignment of findings from the literature—the list of studies is not exhaustive. The studies indicated are largely empirical, or review several empirical studies. A study may be placed in more than one category or indicator, depending on the scope of the study.

Source: Independent evaluation mission.

Box A9.2: Expected Benefits and Concerns in Decentralization

Classic list of expected benefits include enhanced local democracy, increased participation, improved service delivery, and greater resource mobilization.

Concerns that have arisen include the effect on income and growth, achievement of equity, gender equality, poverty reduction, corruption reduction, and sustainable development.

Source: Independent evaluation mission.

15. **Local democracy.** When decentralization incorporates a political dimension by creating or empowering a local government that is democratically formed, it leads to greater local

democracy. If deconcentration is the modality chosen, then this is obviously not the case. The quality of local representative democracy varies considerably, depending on the relationship of the representatives of the people with their constituents, the executive side of local government, and with higher-level government. Higher-level government can decentralize and find ways of limiting or undermining local government,[8] retaining greater central control than the design initially heralds. It is important to also recognize that democracy gains made through decentralization are limited by the scope of typical reforms. Decentralization can only fulfill its promise in this regard if typical (core) reforms are accompanied by greater access to information, increased transparency in local government processes, a strengthened judiciary that will address corruption and legal inconsistencies, and a media that will disseminate information and place local government under scrutiny.

16. **Participation.** While one rationale for decentralization is that it will spur direct participation in local governance, the evidence on this outcome has been mixed. It seems that the design must be specifically oriented to this aim—it will not happen automatically due to the tendency for local elites to capture local governance and to shape processes in ways that are not inclusive. Enhanced participation calls for local governance mechanisms and composition that allow local government to be more responsive and participatory. It happens best when local government encourages lower level government, civil society organizations, and the public to take advantage of opportunities to engage in local governance. It must be also appreciated that elite capture itself does not always mean stagnant participation (or lack of other benefits that are aided by participation, services, income opportunities). Heterogeneity in elite structures can allow local organizations to align themselves and bargain for benefits within a competitive elite configuration.

17. **Service delivery.** This outcome is reported, but is significant when certain conditions are met, in particular when the decentralizing government aligns its own spending to complement local spending, and when it exerts vertical accountability. Moreover, it is more likely to be realized when mechanisms for local accountability and participation are established or strengthened. Strongly organized civil society is helpful in wresting service improvements from local government, but even where such social capital exists it does not always lead to service improvement. Conversely, when the mentioned conditions are not met, service quality and reach can in cases diminish as a result of decentralization.

18. **Resource mobilization.** The greater feeling of ownership over local government and the ability to see improvements that correspond with expenditures encourages tax payers and/or users to pay taxes and/or charges and make other contributions necessary to obtain the desired level and quality of services.

19. **Income and growth.** Decentralization can, in some circumstances, fuel growth and incomes. This depends on the particular local government's orientation to the market and its commitment to facilitating economic development. It also depends on local communities being able to confirm their ownership rights on resources and negotiating with capital for compensation or participation in resource exploitation and economic enterprises.

20. **Equity.** The other side of decentralization's possibilities for growth is that natural endowments and institutional factors will allow for different growth trajectories, which are less influenced by the central state, leading to a wider variety of outcomes, and possibly to less

[8] Where multiple levels of local government are indicated, this report will use the term subnational government to include all of the levels—local governments are then the levels that lie below the meso-level state, province, or region.

interjurisdictional equity. It also must be noted that equitable development within a jurisdiction that has received new powers over natural resources, for instance, is often not achieved.

21. **Gender equality.** Most decentralization initiatives do not consider gender equality in their design, although the issue may arise in the implementation of the reforms. Some success is seen in the representation of women in local councils and the executive, but less progress is noted in the more daunting task of reflecting participation and spending patterns to respond equitably to women's needs.

22. **Poverty.** Progress in poverty reduction can occur, but again, as with participation and service delivery improvements, a determined effort has to be made. Local government needs to be responsive and needs to foster participation, particularly of marginalized groups, so that these groups can voice their needs and take a greater role in development.

23. **Conflict.** Decentralization offering political power, additional responsibilities, and resources can be used to counter separatist or regional tensions and conflict. It works to maintain national integrity by appeasing local elites or broader movements. Creating new local governments is a related strategy for achieving the same ends, though sometimes it is directed to solving local conflicts more than center–periphery discord. Poorly done, decentralization and new local government creation also can fan the flames of intergroup rivalry and conflict. Allowing local discretion, with inadequate control and guarantees, can encourage local majorities to run roughshod over the rights of local minorities, generating local conflicts that can expand and threaten national values and stability. In some cases, decentralization, by coming too late or not being properly implemented, can serve as a stepping stone to eventual independence for separatist movements.

24. **Corruption.** There are arguments and weak evidence for both an increase and decrease in corruption from decentralization. It appears that local elite capture is prevalent in many cases, but it exhibits itself in high levels of corruption when supervision from decentralizing levels is low, and when mechanisms of public scrutiny (media, direct participation) are not well developed.

25. **Sustainable development.** Decentralization can give local government more control over natural resources, and this can be used to manage them more sustainably. But if local government is captured by elite interests, including capitalists who have no attachment to the region other than for exploiting resources, then the opposite is more likely.

D. Emerging Lessons and Good Practices in Decentralization and Local Governance

26. The above highly condensed, and in cases still tentative, findings on decentralization outcomes suggest that the specific policies, implementation strategies, and country context are of utmost importance. Decentralization has certainly not been a panacea, and it has disappointed in practice many hopeful views. In some circumstances, it has delivered the expected results. This makes it all the more important to focus on the contingency factors that are emerging as key determinants of success. These relate to both the design and implementation of decentralization policies.

27. In this section, lessons and good practices relating to decentralization efforts in general (as opposed to the more narrow focus on development partner support) are provided. Section E will elaborate on the specific role of development partner support in decentralization efforts. The

content of both sections is drawn from specific studies (listed in matrix form in Table A9) as well as overviews of approaches noted in specific regions or development partner portfolios.[9]

28. While all of the findings captured can be viewed as good practices, some specific illustrations are also highlighted in yellow boxes; grey boxes relate to lessons.

29. Central government requisites:

(i) It has been noted that decentralization works best when the center is relatively strong or takes steps to centralize in some respects. Some degree of leadership in policy making to draw together key ministries is needed to create coherent policies and a consistent legal framework. Political will and capacity to reorient the roles of national organizations is also needed to shrink their size and rebuild skill sets to reflect the revised distribution of governmental functions.

(ii) Central state capacity must also be found to refashion supervision of local government to ensure that its actions are consistent with national values (e.g., constitutional and international commitments) and development objectives.

(iii) The central government also needs to engage with local government in more structured and equitable ways, avoiding the token or preferred selection of specific local government partners, shifting instead to a more institutionalized approach. In particular, agreements on ways of interacting with local government associations need to be established and honored.

(iv) In view of the above, paying attention to the capacity needs of central actors involved in decentralization is as important as focusing on local actors that are newly empowered.

Box A9.3: Regular Dialogue between Local Government and the Central Government in Sri Lanka

The Federation of Sri Lanka Local Government Authorities brought together all local governments in Sri Lanka and engages with the Ministry of Local Government Affairs on important issues relating to local government, such as selecting representatives to sit on the national committees established for local government policy reforms. The federation is invited to regular monthly meetings with the ministry.

Sources: United Cities and Local Governments. 2009. *UCLG Position Paper on Aid Effectiveness and Local Government*. Prepared by the International Cooperation Agency of the Association of Netherlands Municipalities (VNG) and Federation of Canadian Municipalities, December.

[9] J. Schalkwyk. 2009. Overview of CIDA's Decentralization and Local Governance Programming in Asia. Prepared for CIDA Policy Branch, May 23 draft; Norad. 2008. Lessons Learned from Norway's Support for Decentralization and Local Government Reform in Developing Countries. *Report 22a/2008*. http://www.norad.no; World Bank. 2008. *Decentralization in Client Countries. An Evaluation of World Bank Support, 1990–2007*. World Bank Independent Evaluation Group. http://www.dpwg-lgd.org/cms/front_content.php?idcat=38; Development Partners Working Group on Local Governance and Decentralization. 2007. *Alignment Strategies in the field of Decentralization and Local Governance: A Review of Country Practices and Experiences*. http://www.dpwg-lgd.org/cms/front_ content.php?idcat=39; Swiss Agency for Development and Cooperation. 2007. *Decentralization in SDC's Bilateral Cooperation: Relevance, Effectiveness, Sustainability, and Comparative Advantage*; Development Partners Working Group on Local Governance and Decentralization. 2006. *Survey on Support to Local Governance and Decentralization: Final Report*; and OECD-DAC. 2004. Lessons Learned on Donor Support to Decentralization and Local Governance*. DAC Evaluation Series*. http://www.dpwg-gd.org/cms/front_ content.php?idcat=39

Box A9.4: Oversight Committee in the Philippines

This oversight committee is composed of Senate and House of Representative members, leagues of local government units, the Department of Interior and Local Government, Department of Budget and Management, and the Bureau of Local Government Finance in the Department of Finance. The oversight committee was active in the early years of devolution on personnel transfer issues and in responding to field implementation problems.

Source: Independent evaluation mission.

Box A9.5: Activity Mapping in Himachal Pradesh (India)

A comprehensive legal approach to decentralization in the 1990s had not achieved much in practice in Himachal Pradesh. Functions that were nominally given to the village council (*panchayat*) were not followed with staff or funding. A renewed effort, begun in 2007, saw a few sectors (e.g., water, agriculture) take the lead in identifying the functions in more detail and linking these to requisite funds and personnel changes. Other sectors followed over time, and the new design has recently been "notified" (legalized). Success is not assured, but it is now clearer what the devolution package looks like.

Source: Independent evaluation mission.

30. Decentralization design and management of implementation

(i) Proper design of decentralization, including gaining alignment from donor support, is the responsibility of the central government (state). However, the state needs to approach the design in ways that gives policies and strategies sufficient legitimacy with key stakeholders and ensures feasibility of implementation. Establishing multi-stakeholder oversight of decentralization implementation can be helpful, particularly if the oversight body encompasses stakeholders (e.g., parliamentarians, local government associations). Using such a body or a related platform to facilitate donor harmonization and alignment with the government policies is also very important.

(ii) Clarity in reform aims (democratization, better services, etc.) and decentralization modalities (e.g., devolution, deconcentration, agency tasks) is helpful. Stakeholders benefit from a strategy that sets out piloting, phasing, responsible organizations, coordination mechanisms, and timing—even if inevitably they will need revision as the process unfolds.

(iii) Key policies of decentralization need to be appropriately reflected in the legal framework, assignment of functions, financial provisions, guidance on organizational structures, supervision, etc. It is critical that the new legal instruments are properly situated in terms of the hierarchy of legal products and that it is made clear how conflicting provisions and legal products are superseded.

(iv) Ensuring that all key building blocks are included is important, and that they are sequenced appropriately. Too often, funding is not well matched to functions, for instance, or the planning approach is not reconfigured to allow for more independent planning on new responsibilities. Supervisory mechanisms are generally poorly refashioned in the design and later have to be retrofitted. There is not enough evidence to say that decentralization must proceed in a "big bang" (comprehensive and one time) approach versus a phased approach. The comprehensive approach may test the capacity of all parties; the phased approach may be more practical and allow for learning and sector replication, but it may inordinately draw out the process and not gain the possible synergies of

deeper and comprehensive approaches (that favor the establishment of a general purpose local government).

(v) Communicating what is being considered and the agreed plan and/or strategy to all stakeholders is essential to gain implementation support and coherence.

31. Functional assignment:

(i) Functional assignment should flow from larger decisions on the territorial structure and decentralization modalities employed to achieve decentralization aims. Within this larger framework, purposeful decisions need to be made on the appropriate construction of functional assignment, general competence, specified list (*ultra vires*), or a suitable hybrid.

(ii) A clean division of roles and responsibilities between different levels of government is advisable, though there will always be some grey areas. It is important to make clear if a level of subgovernment has a hierarchical or supervisory role over a lower level.

(iii) A significant degree of devolution is necessary to attain the full promise of decentralization. This implies a genuine political role of local government, as well as making the overall weight of functions significant, to realize meaningful general purpose local government.

(iv) Attention should also be given to reflecting national imperatives in the form of obligations or mandates imposed through mechanisms that ensure compliance with performance expectations (e.g., standards of basic service provision).

(v) Situating functional assignment properly in the legal framework to avoid the clash of organic law and sector law provisions will be important. The organic law could set the general construction and principles, and the sector laws the specific functions.

Box A9.6: Functional Assignment Needs an Architecture and Clear Approach

Cambodia's National Committee for Subnational Democratic Development (NCDD) has led the effort to expand decentralization beyond the 2001 commune reforms to encompass all other subnational levels (provinces, municipalities, organic law [*khan*], and districts). A new organic law was issued in 2008, and some central line ministries have already identified functions to transfer to subnational levels. Despite having a clear mandate to oversee functional assignment, the NCDD has yet to provide policy guidance to these central line ministries on functional assignment. The effort lacks a common view of the functional assignment architecture and mode of decentralization, phasing, and timetable. These gaps are likely to hamper implementation of the organic law.

Source: Independent evaluation mission.

32. Revenue assignment:

(i) Decentralizing states have an easier time letting go of expenditure functions than money raising functions. The latter powers should encourage local government to raise their own revenues. If there is little scope for own revenues, this will create financial dependency on the center that goes beyond what is rightfully needed for equalization purposes, suppressing taxpayer's sense of ownership of local government, people's involvement in local government activities, and the scrutiny of its performance. Inordinate revenue centralization also tempts central government organizations to spend in ways that infringe on local government functions, regarding its organizational and/or role adjustment.

(ii) Local revenue generation must be significant as even 15%–20% of total budgets can begin to have a salutary effect. Too many countries that are decentralizing

have actually seen a reduction in own revenue generation as a percent of local expenditures (as transfers increase).

(iii) Borrowing powers can enable local government to speed development, but safeguards need to accompany those powers to prevent moral hazard that comes from central bailouts. A market orientation needs to be encouraged where this is feasible.

Box A9.7: Subnational Government Revenue Assignment in Some Organisation for Economic Co-operation and Development (OECD) Countries

Adherence to standard public finance theory and "politics" have lead to large vertical fiscal imbalances in subnational government finances. There is growing acknowledgement that subnational governments will only act responsibly if they are able to increase or decrease their revenues in ways that are publicly accountable. This rarely happens in least developed countries. It happens in some OECD countries, e.g., Canada, where the following stringent criteria are approximated, especially at provincial level:

- Own-source revenues enable at least the richest subnational government to finance all locally provided services primarily benefiting local residents from its own resources.
- Subnational government revenues burden only local residents.
- Subnational governments bear significant responsibility at the margin for financing the expenditures for which they are politically responsible.
- Subnational government taxes do not unduly distort the allocation of resources.

OECD = Organisation for Economic Co-operation and Development.
Source: R.M. Bird. 2008. Tax Assignment Revisited. *Institute for International Business Working Paper Series*. IIB Paper No. 17.

33. Intergovernmental transfers:

(i) Beyond the stated need to devolve significant tax raising powers, governments need to carefully consider the mix of general purpose transfers and special purpose and/or matching grants. The transfers need to reflect expenditure needs, financial capacity, and local revenue generation efforts. They also need to be relatively stable and predictable, with transparency and simplicity (this is rather hard to achieve) to allow stakeholders to understand the basis for the transfers.

(ii) General transfers need to have true discretion, with performance standards (e.g., on what local government must do) being achieved through suitable instruments that balance local government autonomy with the need to keep local government on track toward important national goals.

(iii) Financial management capacity at local level to track expenditures and ensure accountability to central government and the public is extremely important. This is particularly important if local government is also to enter the market place to borrow funds.

Box A9.8: Predictability of Financial Transfers in the Philippines

To lend predictability and transparency, some countries fix a percentage of a major tax, a group of taxes, or total domestic revenues as the pool of resources to be allocated to subnational government through intergovernmental transfers. In the case of the Philippines, this percentage is significant and set in the Local Government Code. The Internal Revenue Allotment shares 40% of the gross national internal revenues (in the third year prior to the allocation year) and accounts for 94% of total transfers.

Source: Y.H. Kim and P. Smoke. 2003. The Role and Challenges of Intergovernmental Fiscal Transfers in Asia. In P. Smoke and Y. H. Kim (eds.) *Intergovernmental Fiscal Transfers in Asia: Current Practice and Challenges for the Future*. Manila: ADB.

34. Organizational structures and personnel:
    (i) New responsibilities mean new (or inherited) staff that must be reoriented to the new LG context. Flexibility needs to be given to set structures that match the new workload and to manage personnel (numbers, qualifications, motivation, etc.) to be aligned with the new tasks.
    (ii) Incentives to set efficient structures, maintain optimum levels of qualified staff, and use a variety of delivery mechanisms (involving internal innovations as well as nongovernment actors) need to be built into the system.
    (iii) Mobility and/or portability mechanisms to allow movement for career, cross-pollination, and nation building should be designed at the central level, while still allowing for use and development of local talent and, where appropriate, affirmative action that allows previously marginalized groups or regions to feel they are taking a greater role in local government.

Box A9.9: One-Stop Shop for Permits in Viet Nam's Local Government

Viet Nam was one of the first decentralizing countries to pilot one-stop shop, beginning in 1996. It worked with local government to establish over 1,000 units at province, district, and commune levels. These addressed construction certification, business registration, housing permits, investment permits, citizen complaints, and more. Business and citizen opinions of their efficacy have generally been favorable.

Source: Ministry of Home Affairs. 2004. *One-Stop Shop in Public Administration Reform to improve Public Service Delivery – Viet Nam's Case*. Action Reflection Note.

35. Supervision and support of local government:
    (i) Giving local government new responsibilities does not allow the central government to absolve itself of responsibility for these matters. The central state is still responsible for some national policy objectives (federal units have a similar responsibility in the case where they are charged with creating the local government system). This means guiding the development of the local government system, ensuring that the stated values and objectives underpinning the system are realized. In practice, this means having in place data and reporting systems that can adequately track performance at an aggregated level that is not overly intrusive, but yet meaningful to the objectives that are relevant to the guiding role of the national government.
    (ii) In large countries, the role of intermediary-level governments on supervision and support to lower-level government needs to be carefully set, making clear the decentralization modality at work at these intermediary levels.
    (iii) Thoughtful construction of higher-level government powers to review and revoke local government decisions and/or regulations is important. The status and power of the review and/or revoking body must conform to the basic understanding and legal positioning of local government within the large national division of powers among state institutions, and decentralization of these to the "local state."
    (iv) Auditing bodies need to be properly established and anchored to the executive or legislatures in accordance with the underlying intent. Public access to audit and other performance assessments needs to be well considered.
    (v) Having a court system that is able to dispense justice, and thus punish governmental malfeasance or rectify incompetent regulation making, encourages good local governance and discourages central-level abuse of its own framework laws and regulations.

(vi) Having a capacity development strategy that mirrors the challenges entailed in the decentralization reforms and implementation can work to anticipate the bottlenecks that can arise, and accelerate implementation that stays on track.

Box A9.10: Commitment to Capacity Development for Decentralization in Kerala (India)

The role of capacity development is well appreciated in Kerala's decentralization effort. All levels are supported—state, district, block, and local. For instance, a massive training effort cascading down through master trainers has been mounted for several years. This has been accompanied by easy to use handbooks and toolkits and a help line. Capacity development provision has also been opened to nongovernment entities, and local government association has been given an advisory role.

Source: N. Ramakantan. 2009. *Decentralization and Local Government Reforms in Kerala: Strategy for Capacity Building*. Kerala Institute of Local Administration. Paper presented at the CLGF Conference 2009-Research Colloquium, 26 May.

36. Mechanisms for local accountability:

(i) Local accountability can be enhanced by giving recourse to the public when it suffers from irresponsible service delivery or burdensome or discriminatory regulation. This may include being able to report to complaint centers, access to an ombudsman office, or having access to the court system.

(ii) Representative local government needs to have credible selection processes that ensure group representation (women, poor) and a meaningful political role.

(iii) A strong framework for local government will also have built into it participatory mechanisms in planning and service delivery arrangements for instance. Similarly, it will have built in obligations for local government to share information or have some set procedures for budgets, performance reporting, land expropriation, etc.

Box A9.11: Civil Society Oversight of Local Government Budgets in Brazil

The *Instituto Brasileiro de Análises Sociais e Económicas* (IBASE) in Brazil has been working for 2 decades to promote active citizenship. It does so in part by building the capacity of citizens and civil society groups and their related networks to analyze budget information, and use budget information to seek changes in the way central and local governments respond to citizens. These efforts have lead to improvements in the budget process, levels of citizen budget literacy, budget transparency, and citizen engagement. Some impact on budget policies has also been noted, leading to improvements in the quantity and quality of pro-poor public expenditures.

Source: P. de Renzio and W. Krafchik. 2006. *Lessons from the Field - The Impact of Civil Society Budget Analysis and Advocacy in Six Countries*. Practitioners Guide, International Budget Project. September.

E. International Good Practices in Development Partner Support for Decentralization and Local Governance

37. Development partner support for decentralization and local governance has been seen for several decades. While it is reasonable to link the success of development partner support to the realization of objectives or outcomes of decentralization, as outlined in section C, development partners have additional considerations that pertain to the processes employed in decentralization reform. These have more to do with the lessons and good practices indicated in section D. Because of the lag and long result chain between decentralization reforms and welfare improvements, success of development partner support is in large part defined by how well partner countries are able to undertake reforms that reflect lessons on process and to what degree they incorporate substantive features that are deemed to be good practices.

38. Several aspects of development partner support figure prominently, reflecting the aid effectiveness discourse that has gained momentum over the last decade—entry points and exit strategy, institutional partners, aid and capacity development approaches, and harmonization and alignment.

39. Entry points and exit strategy:

(i) There is value in supporting all actors involved in decentralization, and there is a consensus that development partners can be particularly helpful in the following:

(a) assisting the national actors to develop policy and a legal framework and ways of supporting local government;

(b) working with local government directly to apply the new framework in the context of enhanced local governance and feeding back to central government analysis and suggestions on changes still needed;

(c) supporting intermediary levels of government to play their strategic bridging role between national and local level; and

(d) supporting other institutions that are part of the policy and capacity development network (local government associations, academe, civil society organizations) as the main strategy for sustainable capacity for decentralization reforms.

Little is said about development partners supporting central organizations to slim down and reorient themselves to changed roles, though this redefinition is said to be needed. It may be that there is little demand from government and an acknowledgement that this is difficult territory for development partners.

(ii) Development partners are also more effective when they have a clear exit strategy in mind, one that has to do with institutional capacity and performance (rather than national average income levels, for instance). In this respect, there is growing consensus on the merits of decentralization and local governance support that

(a) gives sufficient time and intensive support to both government and other actors, rather than fluctuating support that never reaches a critical mass, though perhaps drawn out over a long period of time; and

(b) invests in policy networks and capacity development providers that will play greater roles once development partner support ends.

40. Institutional partners:

(i) Development partners generally are pressured to link with a specific partner (there may be a common administrative door for all projects as well), but the nature of decentralization reforms suggests that it is preferable for development partners to find ways to

(a) flexibly support several national organizations that have important overlapping or complementary mandates for decentralization and local governance;

(b) forge links with several local governments, and their associations, seeking to give voice to them; and

(c) enlist nongovernment actors as well, particularly to address the demand side.

(ii) When meeting with resistance to the above configuration, development partners need to consider the following:

(a) the cost, in effectiveness, of being “prohibited” from engaging with both government and civil society;
(b) the possibility of giving attention to various actors through separate projects of the same development partner to avoid unmanageable internal project tensions;
(c) ensuring there is a division of labor between development partners so that all key actors in need of support are reached; and
(d) working initially from the “demand” side (civil society), and later (if at all) with government (e.g., relying on community-driven development; enhancing policy oriented advocacy).

41. Aid and capacity development approaches:

(i) Development partners can only offer the instruments that their governments or organizational mandate allow. Bilateral aid agencies generally offer grants, while IFIs offer larger loans, and some grants (often channeled through the IFIs by bilateral agencies). It is not surprising then that IFIs tend to work largely at the national level where large loans are easy to make, leaving the more administratively heavy chore of interacting with local government to bilateral agencies. This is a division of labor that can work if the following is also taken into account:
(a) IFI loans, with future policy conditionalities and/or triggers are well complemented by technical assistance (TA) grants and/or projects that help government and other actors to achieve the policy aims; and
(b) the budget support and sector loans that are the realm of IFIs promote the same complementary reforms and essential messages as those of TA projects of bilateral agencies.

(ii) Effective development partner assistance entails working with the entire range of capacity development possibilities—individual, organizational, and system level—and being able to judiciously select what is appropriate. This determination needs to acknowledge or encompass
(a) what is uppermost or urgent in the minds of government—development partners must be seen to be useful and not a distraction;
(b) the readiness of partners to engage in the more challenging, and potentially threatening (to some), organizational and systemic changes;
(c) the capacity of development partners/executing agencies to provide TA that is competent in facilitating organizational and system changes; and
(d) the important role of policy dialogue between development partners (not just implementing technical advisors in projects) and government partners to reach consensus on the aims and scope of cooperation.

42. Harmonization and alignment:

(i) While the Paris Declaration has common principles and performance indicators, many countries are charting their own course within this common frame. The localized approaches reflect local circumstances and the varying role of development partners. This is particularly relevant to the decentralization and local governance reforms, which is complex and has seen a wide range of approaches. Recently, greater emphasis has been placed on
(a) efforts to support government in generating more coherent and participatory policy in the process, making it easier for development partners to achieve alignment;

(b) assessing the results of supported policies and the effectiveness of the support provided by development partners;
(c) joining bilateral and IFI support in more effective ways;
(d) incorporating gender mainstreaming, particularly in support directed to the national level where it has been most lacking; and
(e) understanding the effect of decentralization reforms on poverty reduction, conflict, and corruption.

(ii) Development partners have always coordinated in some fashion, though cognizant of the costs of coordination. Presently, they are establishing more formalized mechanisms to share information and lessons and achieve harmonization, with the aim being to
(a) respond more appropriately to capacity needs, avoiding large gaps or needlessly duplicating efforts;
(b) increase learning and adaptation among development partners and government; and
(c) forge common approaches, avoiding working at cross-purposes (e.g., inconsistencies between support given to the ministry concerned with local government and sector ministries).

F. Lessons and Good Practices in Indonesia's Efforts in Decentralization and Local Governance

43. As of 2010, the Indonesian experience is only about a decade old, and it is still unfolding. To date, the approaches used by the government and related stakeholders, and results achieved, are highlighted in Box A9.12.

Box A9.12: Positive Lessons from Indonesia's Decentralization and Local Governance Reforms

- It is quite possible for a deep and comprehensive ("big bang") approach to be carried out without chaos ensuing or serious reduction in service provision, even when the central state is not very strong.
- Rapid decentralization was a helpful state response in the early days of political upheaval following the end of the New Order regime, helping to maintain national integrity by dampening separatist sentiments.
- Negotiating deep forms of regional autonomy (special autonomy) can bring insurgents to the table to negotiate peaceful coexistence within the unitary state.
- Development partner support at national and regional level can be helpful to policy development and its application at local level and in encouraging good practices and innovation.
- Local innovation does occur to some extent endogenously and spurs some imitation and increased local demand.
- Democratic decentralization sets in motion forces that promote increasing government openness to stakeholder involvement in policy development.
- Local policy or advocacy networks and capacity development service providers do increase with democratic decentralization and gain capacity to play an increased role.
- Over time, government becomes more concerned with the effectiveness of development partner support and exerts more leadership.

Source: Independent evaluation mission.

44. Less unanimity will be found on the less positive aspects or lessons that arise from the Indonesian experience. The list can be expected to vary depending on the lenses used. Mayors (*bupati*) are in general quite pleased with developments over the last decade and would like to maintain the gains and avoid being reined in. Governors would like an extended role, borrowing power from the center, in particular to control district and/or city governments. Regional elites are doing well, particularly if they are able to mount successful regional government creation drives. Papuans are less pleased than populations in Aceh or any other region.

45. Viewpoints that aim for a wider public good perspective are less sanguine about the success of decentralization in Indonesia. For instance, academic assessments are quite bleak,[10] and some national parliamentarians are equally disappointed.[11] Navigating through all of these views and using the international good practices list noted in section D as the backdrop, the list of shortcomings or cautionary notes in Box A9.13 might find wide agreement.

Box A9.13: Cautionary Lessons from Indonesia's Decentralization and Local Governance Reforms

- Transfer of power and resources to local government does not in itself guarantee that important decentralization objectives will be achieved (e.g., poverty reduction, better services, participation).
- Democratic decentralization and other forms of decentralization can get stuck at one level of government (district and city), foregoing the benefit that could come from new and empowering institutional arrangements at *kecamatan* (subdistrict) and village level.
- Continuous concessions to local elites through new region creation undermines other promises of decentralization, particularly speedy service improvements.
- Poorly elaborated building blocks (data reporting, sanction and incentives for performance, supervision, civil service reform) severely limit success.
- The inability to harmonize the assignment of functions in the organic law and/or regulations with the provisions found in sector laws and/or regulations creates uncertainty among stakeholders and intergovernmental conflict.
- Decentralization can deepen financial dependency on the central government as fiscal imbalances become more severe due to a lack of revenue assignments (90% of district and city revenues derive from transfers).
- The lack of a significant local tax component, and market orientation to borrowing, limits fiscal discipline and is reflected in suboptimal borrowing levels, low level of citizen scrutiny of regional government, and runaway regional (territorial) splitting.
- The inability to gain cabinet and political cohesion and avoid turf battles over policy leads to a less robust and legitimate framework and a lack of whole government commitment to policies.
- Increased participation has not been institutionalized, and building up policy and advocacy networks that can gain access has proved to be difficult.
- Central organizations have been allowed to ignore the implications of decentralization on their own organizations. They maintain bloated structures and persist in spending on areas that should be decentralized.

Source: Independent evaluation mission.

[10] C. Lay. 2010. Desentralisasi Asimetris Bagi Indonesia, Makalah Yang Disajikan Pada Seminar Nasional Menata Ulang Desentralisasi dari Perspektif Daerah. Yogyakarta: 25 January.

[11] Ryaas Rasyiid, former Minister for Home Affairs and Regional Autonomy, in A. Rachman. 2009. Regional Autonomy Has Failed. *The Jakarta Globe*. http://www.thejakartaglobe.com/news/article/12045.html

46. It is quite possible to distill good practices from the Indonesian experience in the sense of using lessons to inform future practice. It is less obvious what the "ready to use" good practices, taken directly from experience, might be. The practices that come closest to being good, and might fit under the label of good governance, include those found in Box A9.14. These are rather broad in scope, referring to higher-level policies or stances of the government.

47. Beyond the good practices highlighted in Box A9.14, the government (in this case the Ministry of Home Affairs) has a particular understanding of good practices focused on the practices of regional government. There is little reflection on the decentralization processes that are the domain of central government. The Directorate for Capacity Development and Local Government Performance Evaluation intends to collect and disseminate good practices focused on service delivery. These are micro-level good practices that generally have been found useful when properly implemented in a number of countries. Local government associations also are beginning to document some of these and to place them on their websites. One-stop licensing centers and industrial zone development are among the least controversial. Reducing basic education fees and local health insurance schemes are attempted practices that have less obvious support in theory or practice.

Box A9.14: Good Practices in Indonesia's Decentralization and Local Governance Reforms

There was a quick reaction and speedy passage of a revamped and bold law on regional government in 1999 in the face of vociferous regional discontent—buying time for later elaboration and fixes in the framework.

The choice of emphasis was on devolution within an explicit set of decentralization modalities, wherein the most basic services were devolved to districts or cities with corresponding staff and assets.

Predictability and transparency in the large block grants are the mainstay of financial transfers to regions.

Effort to clarify mandates of regional governments was made by setting performance expectations as minimum service standards.

Strong linkages were made by certain government units with policy networks in certain phases of policy development and legal drafting as seen in the case of regional planning and village governance.

Regional governments were encouraged to assess their own capacity development needs and find ways of meeting those needs from government and other service providers.

There was a willingness to negotiate with separatist forces in Aceh with genuine commitment, employing high level officials and neutral international intermediary (Martti Ahtasaari of Crisis Management Imitative).

There was a willingness to keep improving policies and legal instruments, including the constitution itself (amended in 2002 for regional government issues and more changes are mooted).

A belated but appropriate decision was made to take the lead role in the Decentralization Support Facility, a development partner initiative to pool funds that was awkwardly introduced by a subgroup of development partners supporting decentralization and local governance.

Source: Independent evaluation mission.

G. Development Partner Support for Decentralization and Local Governance Initiatives

1. General Support

48. ADB and the World Bank have been active in Indonesia since long before the reform era with program and project loans and TA. Some attention to decentralization was built into these

vehicles, though within the constraints of prevailing government policies. Bilateral agencies provided the most direct support to decentralization, starting in 1992, with GTZ Support for Decentralization Measures. Once the reform floodgates opened, a decade later several development partners oriented their offerings to support more directly Indonesia's decentralization reforms. Notable development partners include CIDA, Department for International Development of the United Kingdom (DFID), United States Agency for International Development (USAID), Australian Agency for International Development (AusAID), and United Nations Development Programme (UNDP).

49. These development partners have worked together to coordinate their assistance, through the Donor–Government Working Group on Decentralization (DGWGD). Since 2005, development partners have also used the DSF (founded by DFID, the World Bank, ADB, and UNDP) to pool resources, coordinate among development partners, and more recently to provide resources for the government to allocate in the form of projects (nationally executed in many cases). The birth and trajectory of this World Bank-managed trust fund has not been well viewed by all development partners.[12] The Government of Indonesia ultimately took control of it, an outcome that is also viewed by some as a lost opportunity to fashion a suitable platform for dialogue and alignment.

50. Development partners have worked on most facets of decentralization at both national and regional levels, with varying degrees of results. Some reform areas have received relatively little attention due to low demand on the Indonesian side (e.g., civil service reform) or growing capacities of national government units and/or policy networks (e.g., for some financial transfer mechanisms).

51. Development partners recognize the government's weakness in the management of decentralization, but have not been able to do much about it. Impeding a more useful support role in this respect is their inability to establish an agreed and effective platform for achieving the principles of the 2005 Paris Declaration (recently localized as the 2009 Jakarta Commitment) in the decentralization and local governance sector.

52. Despite the challenges, some development partners do meet informally or encourage their technical advisors to do so when needed. A division of labor has not been formalized, but it does appear that ADB and the World Bank have stressed financial management issues, financial reporting to the central government, financial accounting systems in the regional government, and procurement systems. Bilateral agencies do work in these areas as well, but more on the regional planning and budgeting side. Service delivery issues have generally been the domain of bilateral agencies. In some cases, coordination has led to several development partners supporting the same reforms, but in concert and with some positive results; the effort on minimum service standards is a case in point.

53. The Donor Working Group on Decentralization, now chaired by AusAID, continues to meet, but at a low level of activity and with reduced links with the government. Individually, development partners continue to engage with the government bilaterally to develop and implement projects. The DSF is where several development partners interact with the National Development Planning Agency (BAPPENAS), Ministry of Finance, and Ministry of Home Affairs, but it is focused on a specific project list that has been decided by government. These projects exist in relative isolation from the projects run by development partners as individual entities.

[12] T. Walsh. 2005. *Perceptions of Development Partners and Evidence on Aid Effectiveness in Indonesia*. Report submitted to Department for International Development. 14 September.

There seems to be little reason for most development partners to show up in the DSF once the ministries have divided up the trust fund resources. For that matter, there is also little point in having the DWGD meet, unless it is willing to deal with what the common denominator should be in reform support and how the various instruments of development partners can come together more effectively—these discussions do not seem to be on the agenda.

54. In addition to the more formal structures mentioned above, a like minded group (CIDA, USAID, GTZ, and occasionally AusAID) continue to meet, and more frequently as of late (every few weeks) to share information on their pipeline projects and devise ways of linking these and reflecting aid effectiveness principles. They intend to relate to government as a group where necessary. In the current context, this approach seems to have the better prospects of leading to harmonization than what the DSF as presently configured has to offer.

2. Observations, Lessons, and Good Practices in Development Partner Support for Decentralization and Local Governance

55. Democratic decentralization and meaningful local governance has been a more arduous journey for Indonesians and their supporters than might have been imagined in 1998 when the winds of change appeared to be sweeping away the New Order regime. Much did change, but some deeply entrenched elites and poor practices persisted. In some respects, the loss of a centralizing figure, coupled with a more plural polity, made it even more difficult to attain coherent policy and consistent implementation. This certainly has been the case in the field of decentralization and local governance.

56. The genesis of decentralization and local governance reforms should have alerted all to the very political nature of these reforms. They were ushered in by a desperate government concerned above all with appeasing resentful and emboldened regional elites. The design did not properly incorporate some important elements that literature now indicates as critical, particularly civil service reforms and proper attention to the demand side. Some retrofitting has been done, but in a style that lacked rigor and did not include wide discussion to gain consensus and legitimacy.

57. Development partners have provided much national and regional support, but the approach has been scattered and there has been little synergy among development partners, insufficient analysis of challenges and opportunities, and little support to help the government be more strategic, participatory, and consistent with its policies. Coordination among development partners has been evident at times, but it cannot be said to approach the standards embedded in the Paris Declaration. The rather unclear roles and relationships seen in the Donor Working Group on Decentralization, DSF, and the informal like-minded group, speak of the difficult evolution of development partner harmonization and the search for a platform for alignment with government. The DSF is now firmly under the government's lead, but it is poorly constructed and mandated to play a meaningful role on substantive reform issues or in government–development partner dialogue and pursuit of aid effectiveness. Key structural barriers include incomplete/two-tier development partner composition, short time horizon (to 2011), short duration of activities (several months in most cases), prohibition to work directly with nongovernment actors, and inability to use funds flexibly to forge links with the larger development partner projects in decentralization and local governance. Development partners seem unable to imagine how the DSF structure could become the embryo for a more suitable policy dialogue and sector wide resourcing platform that truly reflects the Paris Declaration.

58. The uncoordinated approach of development partners also indicates that there is still not much analysis, particularly of the political economy variety that can inform development partner support. For instance, there is no unified view on whether the development partner intent should be to cover as many regions as possible, or to undertake pilots in a few regions that can later be scaled up. A common view on the balance between “supply-side” and “demand-side" support is also not evident. Perspectives are still short term and lack exit strategies. There is no prioritizing of reforms among development partners, and their efforts are scattered over too many reform areas, keeping the government from focusing on a few achievable reforms, and doing them well.[13]

59. Working against a sustained and well calibrated support strategy from development partners are some institutional hurdles that plague development partners in particular, and have little to do with the Indonesian government:

(i) persistence of the impulse to ascertain and ensure individual development partner attribution, or at least distinguish the development partner’s support efforts in some way;
(ii) high turnover of development partner staff concerned with analysis and/or management of aid programs in Jakarta and in home office;
(iii) shifting country aid policies in terms of substantive focus (sometimes not negotiated with Indonesia) and delivery instruments;
(iv) insufficient analytical efforts and capacity (particularly of the “political economy” variety) and project development capabilities in development partner offices in Jakarta;
(v) related to point (iv), insufficient decentralization of analytical, project development, and project management tasks within development partners (to their Jakarta offices);
(vi) slow process in getting from identification of need or request to implementation of instrument (loan project, TA, etc.);
(vii) insufficient commitment or institutional flexibility to find the right structure for policy dialogue and resourcing of decentralization and local governance reforms; and
(viii) inability to ameliorate analysis, dialogue, and project preparation, due in part to pressure to disburse planned funds.

60. Notwithstanding the sobering picture depicted above, there are a few good practices evident in the development partner-government interaction on decentralization and local governance in Indonesia. There may be wide agreement with Box A9.15.

Box A9.15: Good Practices of Development Partners in Indonesia’s Decentralization and Local Governance Support

- Twenty-two development partners have signed the Jakarta Commitment, a localized set of aid effectiveness principles and directions, government led, and responding to the Indonesian context.
- A like-minded donor group is working in a practical way to make headway on harmonization and alignment for specific decentralization and local governance projects they are supporting.
- Bilateral donor-funded decentralization and local governance projects in particular are expanding their civil society organization partners, including journalists and religious organizations and making greater efforts to link these to government.

Source: Independent evaluation mission.

[13] This last weakness in reform support is seen in many other countries. OECD-DAC. 2004 (footnote 10).

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MANAGEMENT RESPONSE TO THE SPECIAL EVALUATION STUDY ON ASIAN DEVELOPMENT BANK SUPPORT FOR DECENTRALIZATION IN INDONESIA

On 6 August 2010, the Director General, Independent Evaluation Department, received the following response from the Managing Director General on behalf of Management:

I. General Comments

1. We appreciate IED's Special Evaluation Study (SES) on ADB Support for Decentralization in Indonesia. The SES is based on evaluation of four core decentralization projects and programs, 12 supporting technical assistance (TA) projects, and other sector-based loans with fiscal decentralization components approved since 1998. The SES findings and recommendations are timely as ADB is currently preparing its County Partnership Strategy (CPS) 2011-2015. We accept IED's assessment that ADB support for decentralization in Indonesia has been "partly satisfactory". The SES recognizes that many of the assessed interventions took place when Indonesia was undergoing rapid economic, political, and administrative transitions. While ADB's core decentralization loans and TAs have been effective in supporting necessary policy reforms, they have been less effective in developing institutions and processes required to implement the policies. ADB support would have, in hindsight, been more effective if it had been backed by more appropriately designed TAs to develop the capacity of decentralized institutions.

2. We would like to note that the ability of the SES to draw definitive conclusions is partly complicated by some of the implemented programs and TA projects having had mandates broader than supporting fiscal decentralization. A number of the program loans and TAs with a core focus on fiscal decentralization were implemented more recently, including the Local Government Finance and Governance program. The SES recognizes that recent ADB interventions have been more focused and responsive to the needs of the Government. These interventions have already incorporated lessons from past experience. To reduce delays in implementation, they have been increasingly implemented through the country systems, which have improved with support for public finance management and procurement reforms.

II. Comments on Specific Recommendations

3. **Recommendation 1. Continue support for developing the policy framework for decentralization with project- and program-based support, complemented by more decentralized assistance, such as support for institutional building, at local levels**. We agree. ADB will continue its support for policy reforms in decentralization through its ongoing Local Government Finance and Governance program. Successful decentralization in Indonesia will continue to require substantial institutional development support, especially at the local and to some extent at the central levels. We will continue to consider alternative, more effective approaches to support specific areas of capacity and human resources development. Development partners have recently made progress in increasing capacity building support at local levels. Given the scope

of the task, future ADB interventions can build on this positive trend. While the majority of recent loans to Indonesia have been policy-based loans, in recent discussions, the Government and ADB have agreed to gradually increase the proportion of project loans over the medium term. We fully understand the importance of addressing on-lending to support local development needs, and are considering alternative financing mechanisms. Progress in developing these mechanisms will open opportunities for improving the balance between project- and program-based interventions supporting fiscal decentralization.

4. **Recommendation 2. Continue addressing government priorities for decentralization by focusing ADB's interventions on past successes (in public financial management reform and capacity development) and support further improvement of the coordinated decentralization framework.** We agree. As noted in the SES, a comprehensive legal and policy framework for fiscal decentralization is not yet in place. Further support is needed to revise Law 32/2004 to clarify obligatory functions of the regional governments. In addition, it is necessary to support efforts to issue implementing regulations for Law 28/2010, which requires the transfer of property tax administration to the regional governments by 2013 to improve accountability. To further support a coordinated decentralization framework, the ongoing Local Government Finance and Governance Reform Program and TA will support the Government in developing the Grand Design for Fiscal Decentralization, which will set fiscal decentralization priorities and long-term directions. The program also supports efforts to improve the capacity of the Directorate General of Fiscal Balance in conducting regular consultations with stakeholders, enhancing flows of fiscal decentralization information, and developing annual progress reports. ADB will identify specific areas where assistance can be provided, such as public financial management and procurement.

5. **Recommendation 3. Further deepen coordination with other development partners (including the donor working group and other forums) in supporting government decentralization activities.** We agree. Although much has been achieved, Indonesia's decentralization reforms are evolving, and key tasks in both policy reforms and capacity development remain. A phased approach with well-coordinated development partners' support is the most effective way to carry the remaining reforms forward. Preliminary discussion is underway with the World Bank on possible cofinancing support for fiscal decentralization. In line with their progress in increasing capacity building support at local levels, development partners have indicated their interest in aligning their TAs with future ADB support for fiscal decentralization. ADB has participated actively in the fiscal decentralization working group.

DEVELOPMENT EFFECTIVENESS COMMITTEE OF THE BOARD

Chair's Summary of the Committee's Discussion on 11 August 2010

Special Evaluation Study: Asian Development Bank Support for Decentralization in Indonesia (DOC.IN.156-10)

Discussion Highlights

1. Director General, IED, emphasized that Indonesia is a unitary state governed by a single unit, where all other administrative units exercise their powers according to what the central government chooses to delegate to them. Decentralization has been taking place in such a unitary system of government. IED acknowledged that Management is agreeable to the recommendation of the special evaluation study (SES).

2. Senior Advisor, SEOD, acknowledged IED's assessment of ADB's support for decentralization in Indonesia as partly successful, noting that the support took place during rapid economic, political and administrative change, following a shift from a highly centralized government system to a decentralized system. Both ADB and Indonesia have been in a steep learning curve, exerting efforts to respond to issues more effectively and doing things the right way. Also noted was ADB's support during the reform period, from budgetary support followed by assistance to sector development programs, capacity building, and specific policy measures.

3. One DEC member commended ADB staffs' efforts for working extremely well under a very difficult situation when massive conflicts were ongoing at the time of the reform. Nonetheless, much still needs to be done including coordination among donors. Another DEC member expressed disappointment that given the amount invested by ADB in Indonesia's decentralization, the Bank could have been a key player and at the core of development partners' coordination. Similarly, the US$1.2 billion investment should have been met with adequate staff resources for Indonesia Resident Mission (IRM), with the necessary skills and expertise that could meet the core areas of ADB's strategy for Indonesia. One DEC member reiterated the lack of adequate resources in IRM over the years, while another member viewed that the partly satisfactory rating could also partly be attributed to the inadequate authority delegated to IRM.

4. A DEC member opined that while policy advisory support may have a negative impact on internal revenue mobilization; the long-term impact should include enhancing the internal revenue mobilization. The DEC member also noted that the SES does not emphasize the urgency to put in place a comprehensive legal and regulatory framework for decentralization. DEC Chair inquired whether there is a results framework that could evaluate the effectiveness of the programs, given that decentralization involves highly politically charged issues.

5. Director, IED2 acknowledged that there are gaps needing to be filled, and emphasized that ADB needs to be involved not only on the fiscal aspects of decentralization but also on the administrative aspects. In terms of coordination, there is also the need to obtain the support and coordination of the government. Country Director, IRM is optimistic that the government would be supportive of ADB's engagement. The government acknowledged its role in the programmatic approaches to decentralization, and government ownership is quite evident.

6. IED staff mentioned that the government appreciates the learning-by-doing approach, and given the very complex situation, ADB had been in the right position to continue its engagement in the sector.

Conclusions

7. DEC commended IED on the study and complimented ADB for having remained engaged in Indonesia through some difficult times in the post-Asian crisis period after 1997.

8. DEC noted that program assistance was rated less effective and less efficient, but members gave due consideration to the context that the country was going through at the time.

9. Some members noted that there is considerable scope for improving technical assistance, improving donor coordination, increasing the speed of intervention particularly through augmenting resources at RM level, and also emphasizing the importance of revenue mobilization by local governments.

10. DEC hoped that the valuable findings from the SES will be duly incorporated in the next country partnership strategy for Indonesia.

Ashok K. Lahiri
Chair, Development Effectiveness Committee