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**Decentralization in Indonesia**

Prepared by Paul Smoke

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# Indonesia Case Study

In Asia, as in many other regions of the world, decentralization occurs in countries of all sizes and in highly diverse contexts. A few countries are large and have substantial and heterogeneous populations, while others are much smaller in area and have populations lower in number and less varied in composition. Some countries have attained middle income status, while others remain poor. A number of countries have some history of decentralization and democratization, while others have had little previous experience.

Despite the great variety, many Asian countries have chosen to pursue some form of decentralization. The way decentralization is structured and functions, however, is as diverse as the countries themselves, and not always in systematic ways. This variety results from considerable differences in country characteristics, histories and various political economy drivers that shape the dynamics underlying how public governance is managed.

In order to better understand decentralization in Asia, EC DEVCO B2 prepared a set of short case studies--on Bangladesh, Bhutan, Cambodia, Indonesia, Nepal, Pakistan, Philippines, Sri Lanka, Vietnam and Yemen. This note presents the case of Indonesia.

Indonesia is well recognized around the world for adopting what has come to known as “big bang” decentralization initiated in 1999 (Hofman and Kaiser 2004, Lamont and Imansyah 2012, Decentralization Support Facility 2012). What had been a highly centralized state in many respects quickly devolved major functions and a large share of national revenues to subnational governments. Many analysts predicted a collapse in the performance of local level service functions with such a dramatic reform, but these failures did not materialize. In many ways, Indonesia's decentralization can be considered to have been successful, at least up to a point. At the same time, some consequential problems have emerged, and there is growing attention to how to promote better performance of local governments.

## Underlying political economy context/drivers of decentralization

Indonesia practiced a form of decentralized management during the colonial period, effectively necessitated by the vast island territory it encompassed. Following independence, the county developed a strong central government to build national unity, a common approach to state development in ethnically diverse former European colonies. The strong central state provided a solid foundation for the development of the longstanding (and for a time very effective) authoritarian Suharto regime. Various types of decentralization efforts were undertaken during the Suharto era, but these were mostly in the form of deconcentration that strengthened the role of the provinces as agents of national ministries--local governments were not elected and accountability was primarily directed upward.

The Suharto government succumbed to the Asian economic crisis that emerged in 1997. The crisis exposed the nature, extent and results of centralized crony capitalism pursued by Suharto and ultimately forced him from power. Sharing power came to be seen as a way to preserve the extensive, diverse and softly unified state. Decentralization became part of the electoral strategy of the vice president, B. J. Habibie, who took over the presidency based on constitutional provisions when Suharto was forced out and wished to stay in power. Reform, however, primarily empowered local governments because of deep concerns that maintaining strong provinces with elected governments could fuel regional conflicts, federalism, or additional separatist efforts.

## Decentralization policy

Indonesia created a relatively extensive decentralization (devolution) framework. (Alm, Martinez-Vazquez and Indrawati 2004, USAID 2006, Lamont and Imansyah 2012, and Decentralization Support Facility 2012). There is strong expenditure decentralization, such that subnational governments manage nearly a third of total public expenditures and about half of development expenditure. Local governments must provide health, education, environment and infrastructure services and may provide others not specifically reserved the national government. Revenue decentralization is also significant, although more in the form of intergovernmental transfers than autonomous own source revenues. Regional assemblies are elected at both local and provincial levels every five years; beginning in 2005, citizens have directly elected their provincial governors and local government mayors.

Several foundational laws provide the details of the decentralization framework. Law 22 of 1999 laid out most of the basic institutional and administrative provisions outlined above. Law 25 of 1999 defined a new intergovernmental transfer system (primarily unconditional) and specified local government own source revenues (modestly enhanced by Law 34 of 2000) and borrowing rights. The original decentralization laws were replaced by Laws 32 and 33 of 2004, which moderately weakened local budgeting, staffing and revenue control. Additional definition of local revenues was provided Law 28 of 2009, which elaborated a limited list of subnational taxes.

Own source revenue powers are not nearly as significant as functional assignments. Subnational governments are entitled to a specified share of selected central tax and non-tax revenues. Motor vehicle, fuel, ground water and cigarette taxes are assigned to provinces (rates are regulated) but must be partly shared with lower levels. Local governments exercise limited autonomy only over a small number revenues and may also collect user charges. The previous system of extensive and fragmented intergovernmental fiscal transfers were combined into the Dana Alokasi Umum (DAU), a revenue sharing fund capitalized by a minimum of 26 percent of national domestic revenues. The largest share of the DAU is allocated to local governments. Special purpose transfers (Dana Alokasi Khusus—DAK) were introduced later and have grown (including in the form of performance based transfers), but in total are still much smaller than DAU funding.

Some important legal provisions are not strictly concerned with decentralization policy, but they support the environment for local democratic engagement. Constitutional amendments and the introduction of anti-corruption legislation promise freedom of information and transparency, although bureaucratic barriers and capacity constraints weaken the ability of citizens to exercise and use these civic rights. NGOs have some official protection, but their development and ability to play an activist role is limited by internal security policies.

## Basic structures, actors and mechanisms

Indonesia's governance system from its early years has used multiple layers of subnational administration. The highest tier consisted of provinces and the second tier of kota (cities) and kabupaten (districts), which are recognized as local government equals, although the former tend to be more urbanized. Additional levels below these two included the kecamatan (sub=districts) and desa (villages), but these served more minor formal roles.

The 1999 decentralization formally devolved power the higher subnational levels, primarily to the local governments for the political reasons explained above. There are now 34 provinces, five accorded special status—the national capital region (Jakarta), Aceh (with additional autonomy/special Islamic status), Yogyakarta (traditional sultanate with additional autonomy), and Papua and West Papua (accorded more modest special status based on resource and ethnic considerations)—and more than 500 kota and kabupaten.

Despite the provisions of the laws outline above, there have long been issues raised about a lack of clarity in the de facto performance of service functions among levels of government. Some of these instances may result from local government capacity issues, but there also seems to be excessive involvement of central government ministries in services that have been formally devolved to local governments (World Bank 2012). In some cases sectoral legislation has not been updated for consistency with decentralization laws, and sectoral actors tend to follow their specific legislation.

Several national agencies play important roles in decentralization. Primary responsibility for decentralization policy and supervision rests with the Ministry of Home Affairs (MOHA), although the Ministry of Finance (MOF), the National Planning Agency (BAPPENAS), multiple sectoral line ministries, and the Supreme Audit Board, among others, have typical national regulatory and oversight mandates in their area of expertise. Capacity building is supported by a national training body and a dedicated subdivision of MOHA. Lack of coordination across agencies has been a great challenge often reinforced by international development agencies. The multiple efforts to promote harmonized decentralization policies, most recently the Decentralization Support Facility, have not been very effective (Winters 2010, Smoke and Winters 2011, Decentralization Support Facility 2012).

## Decentralization outcomes

There is a general domestic and international consensus that decentralization has generated important changes in Indonesia (USAID 2006, Decentralization Support Facility 2012). There are potential governance benefits from decentralizing in a large and diverse country--local democracy has begun to develop as local governments have gained some powers and autonomy.

Local public expenditures on services have increased substantially and service delivery has improved in some sectors (Adrison, Martinez-Vazquez, and Nurhalim 2012), although there are also disputes about the extent and breadth of the gains (Lewis 2010, Lewis and Smoke 2013, World Bank 2012). The positive effects of decentralization have certainly not extended to all service sectors and reached all areas of the country, and there are issues with the efficiency of spending in some areas (Lewis and Pattinasarany 2010, World Bank 2012).

Despite a range of questions about local service delivery performance, there is also evidence that citizens generally feel reasonably satisfied with services, at least in certain sectors, including health and education (Kaiser, Pattinasarany and Schulze 2007, Lewis & Pattinasarany, 2009, and Lewis 2010. There are some variations by sector and jurisdiction, but the evidence on citizen perceptions of local public services generally trends to positive results. It is not entirely clear what these results mean, however, since citizen surveys are known to be subject to respondent bias and in this case Indonesians may have limited expectations relative to past performance.

Revenue generation at the subnational level increased substantially after decentralization. Local governments, however, raise a lower share of revenues (of course transfers and total revenues have risen dramatically) than they did prior to reform, and performance of some local sources has been weak (Smoke and Sugana 2012). Local government borrowing used to raise more resources, but it has fallen off in recent years (largely due to changes in the mechanisms that had been used for years to channel investment funds to local governments). This is a worrying development since local governments have large unmet critical infrastructure needs (Lewis and Niazi 2013). There is also documentation that some local governments do not spend all of the resources that are transferred to them, suggesting that they face limited incentives to raise funds from their own sources.

There is limited—scattered and uneven--evidence on governance-related outcomes. A number of studies, both quantitative and qualitative, point to some gains in capacity development and citizen empowerment (Eckhardt 2008, Skouflas 2011, Brinkerhoff and Wetterberg 2013) . Not surprisingly, nontrivial problems are also identified, and some studies have yielded mixed or more negative results, suggesting problematic elements, such as elite capture or corruption (Lewis 2005, Kristiansen and Pratikno 2006, Kaiser, Pattinasarany and Schulze 2007). These selected studies use different methods, target different local governments and cover different time periods, so definitive conclusions would require further investigation.

It is also important to recognize the strong community driven development (CDD) efforts in Indonesia, which started with parallel, development partner funded programs. The most prominent of these was the Kecamatan Development Program (KDP). The government ultimately took full responsibility for what is now the National Program for Community Empowerment (PNPM is the Indonesian acronym). There is considerable evidence that KDP and PNPM provided grassroots community services and developed capacity with low levels of corruption, and some evidence that it helped to raise incomes (Olken 2007, Olken et. al. 2013). There is not, however, any credible evidence that the CDD governance benefits have spilled over into the local government arena.

## The evolution of decentralization and local government performance

A central question for understanding the evolution of decentralization in Indonesia is why the system was able to perform as well as it did in the wake of a dramatic reform that some observers believed would inevitably undermine the delivery of services turned over to local governments. There are multiple possible explanations, but one line of thinking seems to be especially credible.

At the time of the decentralization, many of the devolved public services were already being provided in the local government jurisdictions under deconcentrated administrative arrangements, and many of the higher level civil servants who had been delivering these services and performing other functions were largely transferred to the local governments as their own employees. The new local governments faced an incentive to keep these staff members in place created by an intergovernmental transfer formula dominated by an allocation variable that measured a particular local government’s share in the national aggregate local government wage bill. Thus, the immediate arrangements for providing services did not change much when the devolution policy was implemented. Although possibly conceived to constrain the power of the new local assemblies, this approach ended up being a useful way to pursue the devolution transition in terms of keeping services intact.

Despite the unusual transition approach and the evidence of certain positive results summarized above, it is probably fair to fair to state that decentralization outcomes overall have not met expectations. Some local governments have been more successful than others, but many have not been able to play a particularly robust role in promoting territorial development and improving the general welfare of their constituents. Compared to many developing countries undertaking decentralization, Indonesian local governments were reasonably empowered, enjoyed competitive local elections, received generous access to resources and retained some technical capacity from the way staffing was initially handled. Why then has performance not been more uniformly strong and more progressively improved?

There are many opinions and debates over this question, but a number of factors seem to be important. First, some reform elements have not been well implemented and sufficiently supported. Many central actors (noted above) are involved. They have different views and face different incentives, and the government has not been able to develop a robust mechanism for coordinating the various stakeholders whose cooperation is required for consistent and effective reforms. Under these conditions, central government agencies have continued to play an excessive role in services that were formally devolved to local governments.

Second, the local governments are for the most part highly dependent on the central government for financial resources. This is inevitable in some areas, but Indonesia is a country in which at least some of the local governments have greater capacity to raise their own resources than they choose to exercise. Weak local revenue generation is both a symptom of deeper problems with intergovernmental and local accountability dynamics and an underlying governance factor that also contributes to service delivery performance problems.

Third, there has been insufficient attention to the development of local accountability mechanisms beyond basic elections and technocratic provisions for development planning, public financial management, participation, etc. These are important, but local governments must learn to genuinely deal with their constituents, who in turn must learn to hold local governments accountable. The development of such dynamics may have been constrained in some areas by PNPM, the successful CDD program mentioned above. Despite its genuine and valuable achievements at the community level, there are some concerns about its impact on local government dynamics and performance in providing network services that connect communities of the larger economy and stimulate development. Anticipated reforms to PNPM were supposed to link it to local government activities, but there has been very little done on this front.

Political economy factors underlie all of these dynamics. Central agencies resist aspects of devolution that weaken their own roles, and they have few or no incentives to cooperate with each other, especially in the absence of effective coordination. International development partners may bolster these competitive relations by engaging selectively with specific government actors whose interests and objectives they share. At the local level there has generally bee no great clamor for better services, perhaps in part because citizens do no know what to expect of local governments or how to place demands on them, perhaps because in part because they focus their limited engagement on small-scale PNPM services. Local governments receive substantial intergovernmental transfers provided through a formula that creates incentives to spend a large share on staff wages. Without local pressure for better services, reserves accumulate in some jurisdictions, undermining the need for local governments to collect local revenues from their constituents, an indispensible part of the local social compact.

This stylized scenario is only illustrative, but the types of incentives and dynamics it embodies will have to be considered in looking at how decentralization might be improved in Indonesia. At a minimum, it suggests a need to move beyond largely technical decentralization reforms that don’t deal with underlying problems. Real reforms require a more integrated approach to deal with fiscal systems, accountability challenges and capacity constraints that threaten implementation. It remains to be seen whether Indonesia is ready to tackle this challenge.

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