

DECENTRALIZATION POLICY FOR POVERTY REDUCTION

**POLICY PAPER OF MINISTER OF HOME
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FOR POVERTY REDUCTION
Policy Paper of the Minister of Home Affairs
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I. STATUS OF DECENTRALIZATION IMPLEMENTATION

A review of the current status of decentralization implementation reveals several issues with significant implications for the development of a poverty reduction policy:

First, the first year of decentralization implementation (2001) has been marked by the increased devolution of authority from the central government to the provinces and to the regencies and municipal governments. This process has necessarily included the devolution of authority for designing a poverty reduction policy. The first year of the decentralization process has focused on issues regarding relative roles and responsibilities, budgets, and monitoring and evaluation mechanisms for government programs, including a poverty reduction program.

Second, fiscal decentralization has had a significant impact on patterns of budgetary allocations for poverty reduction. In comparison to the former system, the new fiscal decentralization policy has significantly reduced central government access to budgetary resources for poverty reduction. On the other hand, regional governments now have wider discretion in deciding budgetary allocations for poverty reduction in their budgets (APBD).

Third, decentralization has influenced the policy decision-making process, which has changed from a single centralized mechanism to a process, which provides greater discretion to regional governments. A sustained poverty reduction program must be initiated based on cooperation among the various government institutions within a framework of stronger and more coordinated planning, organizing, implementation and supervision. In the context of decentralization implementation, the role of the central government center on issues of guidance, supervision, regional autonomy management and development, and monitoring and evaluation while regional governments will increasingly develop policies and approaches and implement specific programs.

Fourth, as a practical consequence of the link between poverty reduction and decentralization policy, priority activities include the resolution of inconsistencies between existing regulations and Law Number 22 of 1999 and modification of the law itself.

With specific reference to decentralization, recent developments regarding key issues are as follows:

A. Transfers of Responsibilities and Their Implications for Regional Organizational Structures, Personnel, Assets and Documents

Initial steps to transfer responsibilities between levels of government during the early stages of the decentralization process were marked by a considerable amount of debate due to:

1. Differences between the regencies' and cities' initiatives in establishing "Lists of Authority" and the speed at which sectoral departments and other units of central government adjusted relevant sectoral regulations to Law Number 22 of 1999;
2. Inconsistencies between important paragraphs of Law Number 22 of 1999, for example between Paragraph 119 concerning regencies' and cities' authorities and Paragraph 7 (2) concerning of sectors other than those of the central government;
3. For some regions, there was a "*mismatch* " between the General Allocation Grant (*DAU*) and the local government's budget needs which were determined by the government's organizational restructuring process and the transfer of personnel, assets and documents. This "mismatch" made the problems of decentralization more complicated.

At present, the transfer of authority process has achieved the following:

1. A majority of the regions have completed regional regulations concerning their authorities, organization and personnel;
2. Most departments and other units have individually finalized their regulatory frameworks in accordance with Law Number 22 of 1999 (for example: mining, forestry and others);
3. In a limited number of situations, problems in the adjustment of departmental regulations to Law Number 22 of 1999 and the speed at which authority transfers to the regions have been made has led to some tension between various governmental levels;
4. There are some inconsistencies and contradictions in a number of paragraphs within Law Number 22 of 1999, which have caused difficulties in the process of transferring of authority. Steps to address this problem over the next several months will include:
 - a. Intensive dialogs among the various levels of government;

- b. An acceleration in the adjustment of existing sectoral regulations to Law Number 22 of 1999;
- c. Modification or revision of a number of inconsistent or contradictory paragraphs within Law Number 22 of 1999.

B. Establishment of Minimum Service Standards (*Standar Pelayanan Minimum*)

1. Minimum Service Standard Concept (*Konsep Standar Pelayanan Umum*)

Minimum Service Standards (SPM) are intended to provide guidance to the regions in delivering services to their residents in accordance with their authorities. *SPMs* will assist governments in the delivery of services and facilitate and sustain regional accountability by providing tools for residents to measure service delivery

In establishing *SPMS*, the role of central government is to establish Minimum Service Standards Guidelines (*Pedoman Standar Pelayanan Minimum/PSPM*). In the regions, the Governor of each province, as the representative of the central government in the region, shall determine *SPMs* based on the guidelines and in accordance with the existing conditions of each region.

SPMs should serve as references for the regions in calculating their required budgets to finance minimum service delivery to the public. *SPAMs* shall be utilized by regional governments to determine, through the use of Standard Spending Assessments (SSA), the cost of delivering a particular service. By totaling all such calculations, regional governments will be able to assess the aggregate cost of providing services to their constituents. *SSAs* will also help regional governments in developing a fairer approach to financial equalization by comparing "fiscal need" and "fiscal capacity". In the future, the existence of *SSAs* will, based on the "*money follows function*" principle, form the basis for the drafting of a "grant system" which strengthens the existing DAU and DAK equalization grant system.

2. Progress in Establishing Minimum Service Standard Process

Overall, 11 department and non-departmental governmental agencies have completed initial development of their *SPM* guidelines. However, there are some difficulties, which remain:

- i). A legal basis for *SPM* implementation, either government regulations (PP) or presidential decrees (*Keppres*) do not yet exist.

The current *SPMs*, which are still in the development process, are based on ministerial decrees (*Kepmen*) by each sectoral minister. A presidential decree (*Keppres*) is still in the drafting process.

- ii) The existing SPMs within each department are, in general, too technical in its nature and it is difficult to distinguish between technical standards and service standards. This is likely to create problems for the regions during in the implementation process. The SPMs need further evaluation or review from experts and the regions, as the end user should also be involved in the evaluation process.

C. Fiscal Decentralization

Some critical issues regarding fiscal decentralization, which arose during the first year, included:

1. Transparency in defining the mechanism for equalization fund allocation;
2. Transparency in the utilization of equalization funds in each region;
3. Fairness in the allocation of the DAU;
4. Sufficiency of the DAU allocation for each region, consisting of.
 - a. Sufficiency measured by the need of the routine budget for the transfer of personnel; and
 - b. Sufficiency measured by the need of additional funds for salary increases.
5. A limited DAK allocation, in total amount or breadth. which so far has been limited only to reforestation.

Transparency in determining allocation mechanisms will be improved through an academic evaluation by an independent team from four leading universities. Allocation criteria have been changed which address fairness and sufficiency concerns. Recommendation from the team have been discussed and adopted by the Regional Autonomy Equalization Council (*Dewan Perimbangan Otonomi Daerah/DPOD*) and have been discussed with the DPR. There is some concern that the DPR will use political considerations rather than the rational recommendation of the independent team in determining 2002 DAU allocations.

An important issue related to fiscal issues and a poverty reduction program is the Special Allocation Grant (DAK) diversification. In accordance with Law Number 25 of 1999, DAK shall be directed towards supporting special needs in the regions. However there still is considerable debate among government institutions regarding the definition of "special need" and possible uses include:

1. Unanticipated regional needs;
2. Projects to address national priorities.

The Minister of Home Affairs, regarding the above, has sent a letter to the Minister of Finance and the State Minister or the Head of the National Development Planning Agency dated August 19, 2001 concerning the DAK 2002. He recommends use of the DAK for:

1. Coast regions and island groups;
2. Cross-boundary projects;

3. Provincial, municipal and reGENCY road improvements and maintenance;
4. Counterpart funds for foreign borrowing;
5. Poverty Reduction.

However, until the present time there has been no clear indication whether this proposal has been adopted in the State Budget (*APBN*) 2001.

D. Guidance and Supervision

Important issues regarding guidance and supervision include:

- a. Guidance programs by each department that will enable the regions to execute their authorities, especially related to programs of technical competence, budget allocations and service management;
- b. Supervision mechanisms for regional regulations, especially those of concerning tax and user charges, as stipulated in Government Regulation (PP) Number 20 of 2001;
- c. Supervision mechanisms by the Governor for regional regulations other than user charges;
- d. Adjustments to be executed by the regions after having received feedback regarding "repressive" regional regulations

During this initial stage of decentralization, however, the implementation of supervision programs by the departments are not yet optimal. The departments must be assisted in quickly developing supervision programs, especially during the development of the 2001 budget.

A second problem has been differences between the enactment of regional regulations and their supervision by the central government as stipulated in Government Regulation Number 20 of 2001. To intensify these supervision programs, some important steps have to be taken as follows:

1. Formulation of a guidance and supervision team on regional regulations in accordance with Government Regulation (PP) Number 20 of 2001;
2. Formulation of guidelines for supervision activities which are delegated to the governors, and;
3. Completion of evaluations of regional regulations through closed evaluations for regional governments or open evaluations for the public.

E. Monitoring and Evaluation

Monitoring and evaluation are closely related to the issues of transfer of authority, fiscal decentralization, decentralization management and development, and guidance and supervision. Monitoring and supervision comprise:

1. Development of a comprehensive monitoring and evaluation system;
2. Development of a regional development planning and control system;
3. Communication mechanisms between each department, the regions and other "stakeholders" or inter-government institutions through coordination from the Ministry of Home Affairs for critical issues that needs immediate solutions;
4. Interconnections between monitoring and evaluation mechanisms, especially for solving critical issues with "feedback" from "repressive" supervision mechanisms;
5. A stronger relationship between monitoring and evaluation mechanisms and issues such as transfer of authorities, modification of existing regulations and revision Law Number 22 of 1999. The development of such a comprehensive monitoring and evaluation system requires further testing.

In relation to the monitoring and evaluation issue, quarterly Regional Autonomy Implementation reports through the Presidential Decree Number 157 Team are prepared by the Task Force (*Satuan Tugas ISatgas*) for Monitoring and Evaluation.

F. National Coordination Team

A coordination mechanism, both between central government institutions and between central government institutions and the provinces and regencies and cities, has been developed and activated. The Presidential Decree Number 157 Team has initiated several tasks divided into sub-teams. The scope of work includes:

1. Provide support to accelerate the completion of regulatory revisions which are carried out by each department;
2. Provide support to develop technical guidelines for each department;
3. Provide support for the national capacity building framework to support the decentralization process;
4. Provide support for the development of an integrated monitoring and evaluation system;
5. Provide support for the process of evaluating and perfecting Law Number 22 of 1999.

G. Modification of Law Number 22 of 1999

The steps being taken towards finalizing Law Number 22 of 1999 are as follows,

1. Consensus building among concerned parties regarding background, objectives, targets and stipulations within Law Number 22 of 1999, which need further revision;

2. Involvement of related parties: regional governments, regional government associations, universities, experts and others, to accommodate their ideas and interests concerning the consistency of regional autonomy implementation within the Unitary State of the Republic of Indonesia (*Negara Kesatuan Republik Indonesia/NKRI*); and
3. Ongoing work on the revision of the law is expected to be completed by November 2001

H. Community Participation

Decentralization has provided the opportunity for greater *community participation* in the development process includes the poverty reduction program.

However, law Number 22 of 1999 (*UU no. 22 tahun 1999*) has not provided access to the community to monitor, evaluate and participate in regional governance management. Therefore inclusion of rights for communities to take part in regional governance execution is now being developed in line with the modification of Law Number 22 of 1999.

Despite this, and in light of the importance and value of participatory approaches, effort are underway to increase the role of communities in addressing poverty issues and these will continue in a systematic, comprehensive and integrated manner.

II. DECENTRALIZATION AND POVERTY

The provision of wider decentralized authority to the regions has given the regions greater opportunities to participate in the poverty reduction program. The regions have greater discretion to decide development priorities including development programs for poverty reduction. In addition, within the framework of regional autonomy implementation, regions also have greater discretion in institutional aspects, personnel management, and natural resources management.

In the context of poverty problem solving, regions must identify past and ongoing poverty reduction programs in their own jurisdictions and formulate their own approaches to poverty reduction within the context of decentralization.

A. Past and Ongoing Poverty Program

National development is always directed toward increasing peoples' prosperity or the national welfare as stated in the 1945 Constitution. Efforts to increase peoples' prosperity among others focus on efforts to reduce poverty.

The total Indonesia population, which was categorized as poor at the end of 1960, was 70 million or 60% of the total population. As a result of the development process the number

of poor people has declined significantly and by 1993 the number had been reduced to 25.9 million people or 14% out of the total population.

In 1993, the government introduced programs that increasing efforts to solve poverty problems through Presidential Instruction (*Instruksi Presiden*) Number Year 1993 concerning increasing poverty education activities. The program focused on the development of economic productive entrepreneurs, provision of basic rural infrastructure and provision of basic infrastructures for health and education. The program was able to reduce the number of poor people significantly. However due to the economic crisis in 1997, the number poor population increased to 47.9 million in 1999 or 23 % of the total population.

Poverty is a complex problem, not only related to low income and low food consumption, but also related to poor health and educational rates, community powerlessness in the process of public decision-making (voicelessness), and other problems of human development. Therefore; efforts to solve poverty problems must be conducted comprehensively, involving all social life aspects, and implemented in a coordinated fashion.

In efforts to solve poverty problems, the government has introduced a number of poverty reduction programs, among others: (1) Presidential Instruction on Under-developed Rural (*Program Inpres Desa Tertinggal/IDT*); (2) Credit for Proper Technology Utilization for Poverty Reduction Program (*Program Kredit Pendayagunaan Teknologi Tepat Guna dalam rangka Pengentasan Kemiskinan/KP-TTG Taskin*); (3) Credit for Agriculture Program (*Kredit Usaha TanilKUT*); (4) Cash Subsidy for Gasoline Program (*Program Dana Tunai Subsidi Bahan Bakar Minyak*); (5) Grant for Rural Development Program (*Program Inpres Bantuan Pembangunan Desa*); (6) Regional Empowerment To Overcome the impact of Economic Crisis (*Program Pemberdayaan Daerah dalam mengatasi dampak Krisis EkonomilPDM-DKE*); (7)Urban Labor Intensifying Program (*Program Padat Karya PerkotaanIPKP*); (8) Program of Community Empowerment through derived from Gasoline Subsidy Infrastructure Development (*Program Pemberdayaan Masyarakat melalui pembangunan prasarana bersumber dari Subsidi Bahan Bakar Minyak/PPM Prasarana Subsidi BBM*); and several other programs.

At present, efforts to solve poverty problems are conducted through a number of development programs, among others: (1) Sub-district Development Program for Rural Region (*Program Pembangunan KecamatanIPKK untuk kawasan pedesaan*); (2) Urban Poverty Reduction Program (*Program Penanggulangan Kemiskinan PerkotaanIP2KP*); (3) Community Empowerment for Rural Development; (4) Program of Rural Economic Development through Saving and Loan (*Program Usaha Ekonomi Desa Simpan PinjamUED-SP*); (5) Additional Food for School Children Program (*Program Makanan Tambahan Anak SekolahIPMT-AS*); (6) Special Market Operation for Rice (*OPK-Beras*); (7) Program to Overcome the impact of Energy Subsidy Reduction for 7 Activities sector (*Program Penanggulangan Dampak Pengurangan Subsidi EnergiPPD-SE untuk 7 sektor kegiatan*).

The management of the above programs has been and continues to be very centralistic in its nature, with regional governments only involved at the implementation stage. As a result, regional government responsibilities are relatively low, control over the implementation is weak, there is a lack of transparency and accountability in the implementation mechanism and beneficiaries are unable to control the effectiveness of the programs. Comprehensive evaluations carried out either through structural channels by the government apparatus or through functional channels by independent institutions have indicated that the programs were not executed in a coordinated fashion with each program executed separately in accordance with the interest of each executor institutions. Although not diminishing the successes of the programs, it must be admitted that the implementation of the poverty reduction program still indicates several weaknesses. Poverty reduction programs must be placed within the framework of decentralization.

B. Relation between Decentralization and Poverty Reduction

The decentralization program, which has been in effect since January 1, 2001 has led us into a new paradigm of regional governance execution through a wide, real, proportionate, and accountable transfer of authority from the central government to the regions. The manifestation of this transfer of authority is seen in the regulations, structures, natural resources utilization and financial equalization efforts between the central government and the regions in accordance with the regional autonomy principles of democracy, equalization and fairness, and effective and efficient management of the regions' resource potentials.

With this changing paradigm, efforts to overcome poverty and increase public service quality to the poor have become the responsibility of the regions. Regional governments must handle the existing poverty problems fast and effectively without waiting for or depending on instructions from the central government. Regional governments and legislative councils (DPRD), acting with greater authority, possess more accountability and freedom to take important and strategic decisions with regard to poverty problems and the need to increase service quality to the people.

Decentralization, viewed as a process to "bring the local government closer to the community", possesses the potential to sustain poverty reduction efforts by increasing poor community participation in the public decision making process and providing assurances that government will **fulfill** basic social needs and provide better services through the efficient utilization of limited natural resources. On the other part, decentralization also has the potential to aggravate poverty problems due to the role of local elites who are not always "pro-poor". These local elites can create conditions which hamper poverty alleviation by, for example, introducing burdensome taxes or reducing the role of 'government supervision" of issues related to equalization and justice.

Ultimately, the impact of decentralization on poverty reduction is dependent on the ways in which it is implemented at the regional and central levels.

C. Policy Framework and Poverty Reduction Program within the Decentralization Framework

In line with decentralization policy, efforts to address poverty shall concentrate on six *policy agendas*:

1. Develop the poverty reduction policy as a "National Movement Against Poverty" (*Gerakan Nasional Penanggulangan Kemiskinan*), so that all parties: central government, regional government, the business world, non-government institutions, and universities have a common commitment and play active roles in combating poverty;
2. Establish regional governments as the main institutions responsible for the poverty reduction program management;
3. Develop regional governments' capacity in the implementation of regional autonomy within the context of poverty reduction efforts;
4. Increase the regional governments capability in providing basic public service facilities including for the poor, through the development of Minimum Service Standards (*Standar Pelayanan Minimum*)
5. Conduct comprehensive poverty reduction activities-within the framework of community empowerment efforts;
6. Increase effective utilization of overseas assistance in poverty reduction program financing.

A danger with the decentralized poverty reduction program implementation is the possibility of resistance by central government institutions. On the other hand, in cases where policy issues overlap or where cross-border incidences of poverty are evident, regional governments may refuse to address problems. In these situations, it is the central government's obligation to handle the problem. Therefore, the management of certain poverty-related problems still has to be carried by the central government such as provision of public services for health and education for poor people.

Within the framework of the poverty reduction policy agenda discussed above, there are nine main poverty reduction efforts, which should be implemented:

1. *"Stakeholders " Commitment Strengthening Program* to raise stakeholders' role in reducing poverty through a "National Movement Against Poverty";
2. *Regional government Capacity Strengthening Program*: capacity strengthening for regional executives, legislatives, rural government officials and non-government institutions. Through this, regional governments are expected to be able to solve their own poverty problems.
3. *Minimum Service Standards Program for every type of basic public service, including services for the poor community that should be provided by the Regional Government*. An essential element of decentralization is the ability to increase basic public service delivery effectiveness. To operationalize this, regional governments

must be able to develop simple, efficient, low cost, qualified and accessible public service delivery mechanisms. Therefore regional governments must be able to develop Minimum Service Standards (*Standar Pelayanan Minimum*) for each basic public service, including services for poor community;

4. *Economic Empowerment of Poor Communities Program* which provides capital investment aid to poor communities, investment credits to small and medium scale entrepreneurs, strengthens micro financial institutions, and develops community based rural infrastructure to provide access for the Door community to manage and market their products. At present, a number of such programs are being implemented: the sub-district development program (*Program Pengembangan Kecamatan/PPK*), Urban Poverty Reduction Program (*Program Penanggulangan Kemiskinan Perkotaan/P2KP*), Regional. Economic Development Program (*Program Pengembangan Ekonomi Daerah/PEMD*), and" Community Empowerment for Rural Development (*Program Pemberdayaan Masyarakat untuk Pembangunan Desa/PMPD*);
5. *Basic Health Service Provision Program* such as provision of additional food aid for elementary school children, babies and children under five years of age; support for breast feeding; provision of food for poor families, development of village community rice barns, provision of basic health services at Community Health Service Centers (*Posit Kesehatan Masyarakat/Puskesmas*) and Community Integrated Services (*Pusat Pelayanan Masyarakat Terpadu/Posyandu*), and provision of special allocation funds for general and Regional Hospitals;
6. *Basic Educational Services Provision Program* such as provision of special allocation funds for scholarships for poor communities, special allocation funds for elementary school operation and maintenance, special allocation funds for elementary school rehabilitation, and development of village libraries;
7. *Emergency Food Provision Program* provision of special allocation funds to regency and city governments for poor community food procurement;
8. *Slum Improvement Program* by providing special allocation funds for regency and municipal governments for slum area improvement.
9. *Aid Program for Poor Children and Widows* through provision of special allocation funds for regency and municipal governments for educational aid for poor children and economic aid for poor widows;

The implementation of these poverty reduction programs must be conducted in a coordinated fashion among all relevant institutions as follows:

1. Coordination of poverty reduction policies and strategy formulations;
2. Coordination at the implementation stage;
3. Coordination of monitoring and evaluation efforts including activities to respond to community feedback.

To increase transparency and accountability in this poverty reduction program, some mechanisms need to be introduced:

1. Channeling of funds for poverty reduction programs from the central government to the regional government must lone through "Specific Funds *Allocation/Dana Alokasi Khusus/DAK*" mechanism, and must be allocated in ,the regencies' or cities' local budget (*APBD Kabupaten/Kota*)" and "earmarked" for poverty reduction program
2. Regional Governments must prepare counterpart funds (matching budget) within their local budgets, so the local legislature and the community are able to control the budget allocation process and regional governments have a sense of responsibility for the poverty reduction program;
3. Particular activities conducted through regional poverty reduction programs must reflect local needs, be based on community management ad facilitate communities playing active roles throughout the implementation process;
4. Supervision, monitoring and evaluation of poverty reduction program implementation must involve independent parties, like non-government institutions, community based organizations, universities, and the press;
5. Identification of "the poor" must be conducted through a "bottom-up" system: starting from Rural Community Consultations (*Musyawah Masyarakata Desa*) within the Rural Community Strengthening Council (*Lembaga Ketahanan Masyarakat Desa/LKMD*) forum because rural community themselves are most aware of incidences of poverty. Present data and information on poverty are not accurate and do not reflect actual conditions.

D. Prospect and Obstacles of Poverty Reduction Program Implementation

The Government has a strong commitment to increase efforts at poverty reduction. This commitment is shown by the government consistency in implementing a number of poverty reduction programs such as: the Sub-district Development Program (*Program Pengembangan Kecamatan/PKK*), a program to overcome poverty problem in rural areas; the Urban Poverty Reduction Program (*P2KP*), and the Rice Market Special Operation Program (*Program Operasi Khusus Pasar Beras/OPK- Pasar Beras*).

Within the decentralization policy framework, including both administrative decentralization and fiscal decentralization, the poverty reduction program implementation shall become part of regional governments' responsibilities. This will ensure that poverty reduction activities will be adjusted to local needs and that regional governments will determine their own program management pattern, including provision of financial support through APBD. This decentralized poverty reduction program management will also encourage community and non-government institution participation to control and evaluate the implementation process. By doing so, it will increase the transparency and accountability of overall poverty reduction program management and directly support improvements in standards of living and overall community welfare. This has been clearly stated by the Minister of Home Affairs to the Governors and Regents/Mayors through Minister of Home Affairs letter Number 444. 1 2076/SJ of 12 October 2001 concerning. "The Efforts to Strengthen Poverty Reduction".

However, in the implementation of an overall poverty reduction program, certain potential obstacles exist:

1. The possibility of resistance from certain central government institutions. For example, some sectoral agencies may be unwilling to decentralize budget allocations for poverty reduction programs through *specific grant* mechanisms, because this will partially reduce their control of poverty programs;
2. The possibility of local elites who are not "pro-poor" in their approach and not supportive of local budgetary allocations for poverty alleviation;
3. The possibility of poverty reduction program mismanagement, either in the determination of target populations or in the channeling funds to poor communities;
4. The possibility of lack of access for local community and independent institutions in controlling government decision-making policy on poverty reduction program activities and financing.

The obstacles mentioned bear the potential of impacting the effectiveness of poverty alleviation programs.

111. REGIONAL CAPACITY BUILDING TO SUPPORT REGIONAL AUTONOMY

To increase the regional governments role in overcoming poverty problems, efforts towards regional capacity building to maximize program implementation are necessary. Regional capacity building is multi-dimensional in its nature and involves stakeholders comprehensively.

UNDP states that capacity empowerment involves three dimensions:

1. *System Dimension:* empowerment of the system directed toward basic regulations, law and policy formulation;
2. *Organizational Dimension:* empowerment of organizations and structures, strengthening of the decision making process within organizations, improvement of work and procedures, building relationships;
3. *Individual Dimension:* support to individuals should increase potential capacity, work ethos, motivation, individual characters so that each individual can execute his or her role, main task and functions optimally.

Regional capacity building principles are:

1. Multi-dimensional in nature with long, medium and short- term orientations;
2. Comprise multiple *stakeholders:* Government, Province, Regency/City and Villages including the private sector and community organizations;

3. *Demand-driven* in nature, where capacity building needs are not a "top down" process, but derive from stakeholders who require capacity building. Therefore, the process of needs formulation has to be transparent and accountable;
4. Guided by national policy: the State Broad Guidelines (*Garis-garis Besar Haluan Negara/GBHN*) of 1999-2004 which states that wide and real regional autonomy development should be through community, economic and political institutions, legal and religion bodies, traditional institutions and community organization empowerment. Capacity building should also be guided by National Development Program (*Program Pembangunan Nasional/Propenas*) (Law Number 25 of 2000).

To accelerate regional decentralization regional capacity building development within the framework of decentralization implementation, overall management should be carried out by Sub-Team VI within the Presidential Degree Team (Tim Keppres 157/2000). The membership of this Regional Capacity Building Team derives from a number of governmental departments. The tasks of the Team are to coordinate, monitor and facilitate ideas on regional capacity building including ideas, which are sustained by donors.

Specifically, Regional Capacity building-Sub Team VI is responsible for the following matters:

1. Coordinate information regarding regional capacity building from all stakeholders;
2. Conduct coordination with regional governments regarding regional capacity building programs;
3. Facilitate access for regions to regional capacity building programs which are financed by the government and donors;
4. Identify and coordinate regional capacity building programs which shall be carried out either by sektoral departments or regional governments;
5. Identify local needs ("need assessment") accordance with priorities and needs of the regions;
6. Identify service provides and formulate a "database" of information regarding these.

Sub Team VI, in carrying out its tasks, has involved regional government association, professional associations, non-government organizations (NGO), donors and communities. To support decentralization implementation, Sub Team VI has formulated a national framework for capacity building (*National Framework for Capacity Building to Support Decentralization*).

Based on the results of study and discussion, there are 8 initial agendas, which define the scope of capacity, building in support of regional autonomy:

1. Regulatory Framework;
2. Institutional Development;
3. Human Resource Development;
4. Regional Finance Management;

5. Strengthening of regional legislatures and civil society;
6. Development Planning;
7. Regional Economic Development;
8. Management of the transition period.

Possible programs within each agenda are as follows:

1. Regulatory Framework

This activity involves formulating and completing the unfinished legal framework to create a strong legal basis to accelerate overall regional autonomy implementation. This will comprise laws and regulations, which are no longer valid or need adjustment because of the enactment of Law Number 22/1999 and Law Number 25/1999. A priority shall be the formulation of laws that urgently needed and the need to address overlapping or conflicting laws and regulations.

2. Institutional Development

This will strengthen regional government institutions in order to create optimal institutional relationships, work systems and clear procedures;

3. Human Resource Development

This will increase human resources capability (SDM) to ensure that the regions possess sufficient qualified personnel to execute their authorities effectively, efficiently and in an accountable manner.

4. Regional Finance Management

Activities here will empower regional governments to manage "cost centers" and "revenue centers". It is expected that with this program the regions shall be able to raise revenue capacities and strengthen fund utilization so as to achieve "better value for money".

5. Regional Legislative Council (*DPRD*) and Civil Society

This program is intended support the DPRDs so that they can execute their functions effectively, as a "Checks and Balances" institution with respect to the Executive. The program will also increase DPRD accountability to the communities and create community and NGO access in channeling their aspirations to DPRD. Also included will be community and NGO capacity building to facilitate their participation in the "local governance" process.

6. Development Planning

This effort will increase regional governments capability in development planning including public service improvement -planning, especially service for poor communities.

7. Regional Economy Development

This activity is directed toward capacity building to increase the abilities of the regions to develop economic development plans, design specific activities and implement these. Attention will also be paid to inter-regional cooperation.

8. Managing the Transition

This activity is intended to manage the short-term implications of changing roles, responsibilities, budgets, personnel etc. at the central level especially but also within the regions.

There are seven types of stakeholders who will be involves in the capacity building process:

1. Departments and other institutions (*LPND*) at the central level related to regional autonomy. There are 11 of these with responsibilities to be executed by the regencies and cities (Paragraph 11 of Law Number 22/1999):
2. Provincial Governments
3. Regency/Municipal Governments
4. Provincial Legislative Councils (*DPRD Propinsi*)
5. Regency/Municipal Legislative Councils (*DPRD Kabupaten/Kota*)
6. Community associations, non-governmental organizations and civil society;
7. Service providers: institutions, which have the potential to provide capacity building services such as training agencies (*Diklat*), universities, and private training institutions.

Funding for regional capacity building can be derived from:

1. State Budget (*APBN*)
2. Provincial Budgets (*APBD Propinsi*)
3. Regency/Municipal Budgets (*APBD Kabupaten/Kota*)
4. *Grants*
5. *Loans*
6. Other sources.

For Budget Year 2002 proposed sources for financing include the State Budget (*APBN*) either in the form of *DIP* and/or co-administration fund. Regional governments have also been requested to allocate funds in their budgets for capacity-building.

The National Framework for Capacity Building is expected to provide stakeholders with an overall strategy towards capacity building, an identification of initial capacity building needs and potential service providers. This will permit the regions themselves to

determine their own needs, modes of implementation and financing needs and availability.

The limited availability of funds is of concern. Evidence from the regions suggests that most regions do not have sufficient funds to finance their own capacity building programs. A large percentage of available funds (from Own Sources Revenue/PAD and General Allocation fund/DAU) is committed to financing "overhead costs" particularly salary and allowance for personnel from the executive and legislative branches.

A second concern centers on the use of particular funding mechanisms. At present, there is no clear indication regarding the development of financing mechanisms to channel loan funds from donors to the regions. Basically the regions do not have direct access to borrowing from the overseas sources and, therefore, the regions still depend on support from the central government to finance their capacity building.

IV. FOREIGN COOPERATION AND "AID EFFECTIVENESS"

One of the conditions for the success of poverty alleviation efforts is how far the Government is able to utilize funds from overseas donors effectively and efficiently, considering that the majority of funds for poverty reduction derive from overseas donors.

The Government receives fund from foreign sources either in the form of grants or loans. Although these have been utilized to accelerate meaningful development in Indonesia, they have created a situation where the Government is trapped in a continual cycle of long-term debt, interest payments and commitment fees.

The decentralization process has provided the opportunity to increase the effectiveness and efficiency of funds from overseas sources. However, the new authorities of the regions within the framework of regional autonomy can also create potential problems. The impact of foreign loans and/or grants is very much related to the proper implementation of decentralization.

Emerging problems regarding the utilization of funds from donors include:

The dominant role of the central government in the decision-making process regarding projects and activities to be financed by donor funds has reduced the regions' flexibility in selecting projects in accordance with local priorities. Approaches to debt management have been to some extent contradictory with regional financial management principles. Project policy decisions have not always been in agreement with the aspirations of the regions with the result that they have not had a "sense of belonging".

In addition, borrowing approaches so far have been "supply side" rather than "demand side" oriented. Therefore, the majority of programs or projects, which were financed by foreign loan, did not embrace "cost recovery" and did not have significant impacts on regional economic growth.

The limited capacities of the implementing institutions in managing foreign loan projects has caused fund absorption rates to deviate from agreed schedules and thereby automatically led to 'commitment fee' accumulation. In addition, because of the accumulated late payments low interest rate loans were less beneficial than they should have been.

Many Debt Coverage Ratio (DCR) and Revenue Improvement Plans, as supporting for the acquisition of foreign loans, were incomplete due to the limited technical capability of the regions and the "appraisal" team in assessing the feasibility of regions to borrow.

Limited "counterpart budgets" in the regions, either for grants or loans, have had a significant impact. This is not only because of the unavailability of funds but more importantly because the DPRD was not involved in the budgeting process.

In addition, debt management units tend to be ad-hoc unit in nature (e.g. PMUs and others), which has meant that debt management evaluations have not been part of overall public finance evaluation. In particular, reports and evaluations of projects financed by overseas grants or loans have been less effective due to lack of inter-departmental coordination in planning, implementation or in supervision.

Concerns over the possibility of misuses of funds from loans and grants were due to the lack of transparency of procurement systems the lack of control systems over fund utilization on loan and grant funded projects.

In the context of grant from overseas, in general, the problems are related to aspects of control coordination, utilization and selection of project location, Usually grant utilization is very much influenced by the donor' "interest". In addition, the selection process for experts did not always address GOI needs. On the other hand, from the donor point of view the Government of Indonesia did not always provide counterpart funds, local experts or other "in-kind" requirements. There is an impression that the role of Government within the framework of fund management for the regions is not clear yet.

The decentralization policy, which gives wider authority to the regions, is expected to enable the regions to develop their own initiatives to explore their financial resources effectively, including policy direction, institutional format, and financial management including management-of funds from loans and grants. The decentralization process also must be associated with transparency and accountability by increasing the role of communities ("stakeholders") to bear the debt burden by supporting tax and/or retribution rate increase, or even if necessary provide guarantees or purchase municipal bonds issued by regional governments.

Within the framework of overcoming the above problems is necessary to raise regional capacities related to: (1) program priority formulation; (2) DCR calculation and RIAP selection; (3) Cash-flow analysis; (4) Procurement procedures; (5) recording systems and financial audits; (6) reporting and supervision systems. More generally, patterns of cooperation with donors need to be examined and strengthened.

At present the mechanism for regional loans that the central government borrows funds regional governments. This mechanism also government receives funds from overseas is a "two-step loan" process, which means from overseas and then lends them to the applies to grants from overseas. The central and then channels them to the regional government and NGOs. In some cases, grants from international NGO are directly transferred to regional governments and regional NGOs.

Within the framework of decentralization implementation as stipulated in Law Number 22/1999 and Law Number 25/1999, Regional Governments are permitted to borrow or receive grants directly from overseas after acknowledgement and approval by the central government. In this case, the "two-step loan" or "subsidiary loan agreement" mechanism is no longer valid. However regional governments must comprehend and be aware of the implications and risks of borrowing on their long-term regional finance structure. Therefore it is important that the central government introduce a number control and supervision mechanisms while providing regional governments with wide authority to manage their loans. The central government must establish criteria, standards, and norms that must be conveyed to the regional governments and the communities transparently so that they can be understood and implement consistently.

In connection with this loan channeling system, donors should stress that loans and grants should be included APBD, with the consequence that the funds must be channeled to the treasuries of the regions. This will support the region in properly implementing its cash management function including the provision of counterpart funds or "budget sharing" in accordance with the conditions agreed upon between the donors and the regional governments. It is also important to note that simplification of formats and documents should be designed to support channeling mechanisms and work flow orientation.

For central government loans to the regional governments to support strategic policies such as poverty reduction, it is recommended that these be channeled through the DAK instrument, as this will benefit both parties. From the central government's point of view this will support the strengthening of regional approaches to debt management and assist them in preparing "budget sharing" for project implementation. On the other hand, for the regions it will give them freedom and authority to manage funds because these have been allocated in their APBD and local staff are very familiar with their APBD management instruments.

The steps being taken and will be taken to support the effectiveness of the management of the above funds are:

1. Preparing general guidance for regional loans as follow up to Government Regulation (*PP*) Number 107 Year 2000 concerning Regional Borrowing.
2. Preparing Planning and Utilization mechanism for Special Allocation Funds (*DAK*) {revision of Government Regulation (*PP*) Number 104 of 2000}
3. Developing the possibility of establishing a more independent Municipal Development Fund (MDF) as compared to the Investment Fund Account (*Rekening*

Dana Investasi) or the Regional Development Account, which are both Minister of Finance special accounts. The basic concept of the MDF is as a financial institution with funds derived from the donors, managed independently and professionally and not under the control of a certain department.

4. Preparing a national framework for capacity building as a guide to coordinate capacity building activities and interface with donors more effectively in order to achieve national objectives and prevent overlapping in programs or location. The donors are expected to use this document for both loans and grants within the national framework to sustain regional autonomy implementation.
5. Continuation of discussions, coordination and cooperation with some donors to prepare grant management policy, including grants from international NGO.