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Alternative Mechanisms of Service Delivery

Legal and Regulatory Framework Review

Volume 1

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AMSD – Legal and Regulatory Review

MASTER CONTENTS LIST

VOLUME 1 of 2 MAIN TEXT (this Volume)

VOLUME 2 of 2 APPENDICES

FOREWORD

This Report presents a review of the Indonesian legal and regulatory framework that might support or obstruct the promotion of alternative mechanisms of service delivery (AMSD).

The objectives of the project in relation to promoting alternative mechanisms for service delivery (AMSD) within regional governments are:

- (i) assistance to government in the rationalization of different institutional arrangements for the delivery of sub-national public services; and
- (ii) aid in the development and implementation of new (contracting) methods for service delivery.

The Report has been prepared as part of a contract between the Decentralization Support Facility (DSF) and Hickling Corporation of Canada. The Report aims to identify the legislation currently in place and on which AMSD could be built, as well as gaps and possibly inconsistencies. Wherever possible, criteria for assessing the utility of legislation have been included, as the development of the framework is likely to be an ongoing activity of Government, especially as it helps regional governments improve service delivery.

The Report has been finalized some 20 months into the contract. At this stage, work completed consists of:

- (i) preparation of an inception report and initial assessments
- (ii) some investigation of the extent to which the various AMSD strategies might already be happening under decentralization
- (iii) preparation of documents describing eight (8) basic strategies for that underpin AMSD and
- (iv) discussion with regional government officials on four occasions concerning the viability of developing pilot projects that will use the AMSD strategies to improve service delivery
- (v) preparation of a Blueprint for promoting AMSD;
- (vi) preparation of a Pilot Project Planning Report
- (vii) preparation and conduct of a 3–day initial pilot planning workshop with PDAM Cilegon
- (viii) preparation and conduct of a 3–day initial pilot planning workshop with RSUD Lebak
- (ix) preparation and conduct of a 3–day initial pilot planning workshop with *Dinas Penduduk dan Catan Sipil Kab. Serang (Ducapil)*
- (x) A feedback workshop in Serang concerning the pilot workshops; and
- (xi) A national level workshop describing the project and findings to key stakeholders.

The eight (8) strategies of AMSD are:

Strategy 1 - Clarify objectives, roles and authority

Strategy 2 - Cover the Cost of Service Delivery
Strategy 3 - Raise the Consequences (Rewards and Punishment)
Strategy 4 - Put the Customer “in the driving seat”
Strategy 5 - Empower Service Delivery Organizations and Employees (without losing control)
Strategy 6 - Change Service Deliverer Organizational Culture
Strategy 7 – Change Sector Structure; and
Strategy 8 - Involve the Community and Private Sector

A key tool in the deployment of these strategies is the use of a “Flexible Performance Agreement” (often called a “Performance Contract”) between the “owner” and the “operator”. This agreement provides a mechanism for mobilizing the “meta-strategy” of AMSD (providing more autonomy to the operator in return for increased accountability).

This Report aims to describe the current proximate legal and regulatory framework that the eight strategies would work with. It provides the basis for understanding where the strategies already have “support” and where the framework needs addition or can be improved.

Its structured is as follows:

1. After the introduction, the general-purpose decentralization law (32/2004) is assessed with respect to the role of core administrative agencies – “steering organizations” – focusing on matters of roles goals and standards. The other set of normative rules, the financial management laws, are also briefly assessed as they establish many of the core administrative rules for regional governments.
2. Each of the 6 chapters after that, after briefly describing one of the AMSD strategies, identifies and assesses available legislation that seems relevant to deployment of the strategy.
3. In each of these chapters, the regulatory framework needed for successful deployment of the strategy is highlighted and suggestions made of what a detailed assessment should consider.
4. Each of these chapters also concludes with a summary and suggestions for actions to improve the framework.
5. The final chapter draws some overall conclusions and recaps on the fundamental objectives of AMSD with respect to improving sector structure and relationships between sector actors.

An Executive Summary at the front of the Report brings together the main findings and suggested actions, while extensive Appendices, including lists of legislation, example legislation and “case study” material have been included. This is to help demonstrate just how much legislation there is and to ensure the material gathered to prepare this report is readily available in one place for future reference.

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LIST OF TERMS AND ABBREVIATIONS

| | |
|----------------|---|
| accountability | Responsibility for an activity, accompanied by rewards and recognition for good performance, and adverse consequences for performance that is unreasonably poor |
| AMSD | Alternative Mechanisms of Service Delivery |
| APBD | Regional budget |
| APBN | National budget |
| Badan | A organizational body or board of government, generally intended to be independent in terms of professional decision making IN Indonesia it is more than just a “Board” |
| BAKD | Directorate General for Regional Financial Management, Department of Home Affairs |
| BAPPEDA | A regional government planning board |
| BAPPENAS | The Indonesian National Development Planning Agency |
| BAWASDA | The internal audit body of regional governments |
| BHP | <i>Badan Hukum Pendidikan</i> , autonomous educational entities able to be created under Law 9/2009 |
| BIGG | Building Institutions of Good Governance, a USAID funded project completed in 2004 |
| BKD | <i>Badan Kepegawaian Daerah</i> , the human resource management office of regional governments |
| BLU | <i>Badan Layanan Umum</i> , a semi-autonomous service delivery agency of a national department able to be created under PP 23/2005 |
| BLUD | <i>Badan Layanan Umum Daerah</i> , a semi-autonomous service delivery agency of a regional government dinas able to be created under PP 23/2005 |
| BOS | <i>Biaya Operasional Sekolah</i> , a national fund for subsidizing school operations |
| BPK | <i>Badan Pemeriksa Keuangan</i> , the national audit office |
| BPKP | <i>Badan Pemeriksa Keuangan Pembangunan</i> , the national internal auditor for development projects |
| BPPSPAM | A body managed by the Department of Public Work for promoting and regulating water supplies |
| BUMD | <i>Badan Umum Milik Daerah</i> , a regional government–owned enterprise |
| BUMN | <i>Badan Umum Milik Negara</i> , a national government–owned enterprise |
| Bupati | Political and administrative Head of a district |

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|-----------------------|--|
| CEO | Chief Executive Officer |
| CIDA | Canadian International Development Agency |
| contractualization | A form of AMSD particularly practiced in New Zealand |
| corporatization | Restructuring SDOs into autonomous corporate form |
| Customer satisfaction | Customer's perception of the degree to which the customer's requirements have been fulfilled |
| Daerah | Regional |
| DAK | <i>Dana Alokasi Khusus</i> , a special purpose grant from central government |
| DEPDAGRI | Department of Home Affairs |
| Desa | Village (over 70,000 in Indonesia) |
| Diklat | Training and education body of a government or a agency of government |
| Diklatan | The activity of training and education |
| Dinas | The most common organizational form for a Service Delivery Organization of regional government |
| DKI | <i>Daerah Khusus Induk</i> , the Special Region (of Jakarta) |
| DPOD | <i>Dewan Pertimbangan Otonomi Daerah</i> , a inter-ministerial committee chaired by the Minister of Home Affairs to advise the President on policy with respect to decentralization |
| DPRD | Regional parliament |
| DPU | Department of Public Works |
| Ducapil | Dinas in regional government concerned with population administration |
| effectiveness | Extent to which planned activities are realized and planned results achieved |
| Efficiency | Relationship between the result achieved and the resources used |
| EIA | Environmental Impact Assessment |
| FPA | Flexible Performance Agreement |
| Goal | The result that a programme or organization aims to accomplish |
| GRS | Governance Reform Support Project funded by CIDA and implemented by Hickling Corporation; concerned with improvement of the core administrative capacity of government with respect to regional government |
| ICT | Information, Communications Technology |
| Indicator | A parameter useful for determining the degree to which and organization has achieved its goals or objectives |

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|----------------|---|
| Inpres | Presidential Instruction |
| IRR | Internal Rate of Return |
| ISO | International Standards Organization |
| ISO 9000 | A series of standards concerning quality management systems. ISO 9000:2000 concerns the fundamentals and vocabulary, ISO 9001:2000 describes minimum requirements and ISO 9004:2000 provides guidelines for performance improvement |
| Issue | A fundamental policy question or challenge that affects the success of a program. It involves conflicts of one sought or another |
| kabupaten/kota | Local level regional government |
| Kecamatan | The next administrative unit below kabupaten/kota |
| Kelurahan | An urban village, below kecamatan level |
| Kepmenkes | Decree of the Minister of Health |
| Keppres | Decree of the President |
| Keputusan | Decision |
| Kewajiban | Obligation |
| Key | Something that is crucial in providing an explanation or interpretation |
| KPI | Key Performance Indicator |
| Krismon | Local term for describing the economic crisis that struck Indonesia in 1998 |
| Langsung | Direct (cost) |
| LNDP | <i>Lembaga Non-Department Pemerintah</i> , a non-departmental organization of Government |
| management | coordinated activities to direct and control an organization |
| MenPAN | The State Ministry of Administrative Reform |
| MoF | Ministry of Finance |
| MOHA | Ministry of Home Affairs (DEPDAGRI) |
| MTEF | Medium Term Expenditure Framework, a budgeting tool for linking planning and budgeting |
| non-conformity | Non-fulfillment of a requirement (or a specified need) |
| NPM | New Public Management, another term for AMSD perhaps focusing more on managerial and behavioral aspects |
| NSPK | <i>Norms, Standar, Prosedur dan Kriteria</i> : norms, standards procedures and criteria, a new term in legislation in Indonesia describing the general structure and content of legislation |

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| Objective | A statement of a desired result to be achieved (often within a specified time) |
| Ortala | The regional government organization responsible for organizational design |
| PBB | Performance Based Budgeting |
| PDAM | <i>Perusahaan Daerah Air Minum</i> , or Regional Water Company, owned 100% by the local government of the area in which it operates |
| Pelayanan | Service |
| pembantuan | Assistance |
| PEMDA | <i>Pemerintah Daerah</i> , regional government the owners of most regional SDOs |
| Peraturan | Regulation |
| PERDA | Local law |
| performance | The degree to which an objective has been achieved |
| Pergub | Governor's Regulation |
| Permen | Ministerial Regulation |
| Permendagri | Regulation of the Minister of Home Affairs |
| Permeneg | Regulation of a State Minister |
| PermenEKON | Regulation of the Minister for Coordination of Economic Affairs |
| PERPAMSI | The National Association of Water Companies |
| Perpres | Presidential Regulation |
| PMK | Regulation of the Minister of Finance |
| PNPM | <i>Program Nasional Pembangunan Mandiri</i> , the national community development program |
| Policy | A statement of intent by top management |
| PON | <i>Pekan Olah Raga Nasional</i> ; a sports carnival organized every two years by a province on a rotating basis |
| PP | <i>Peraturan Pemerintah</i> a Government Regulation, one less in the legal hierarchy than a Law |
| Procedure | Specified way of carrying out an activity or process |
| Process | A set of inter-related activities that transforms inputs into outputs |
| product | Result of (the system's or organization's) processes |
| PSO | Public Service Obligation, a performance-based subsidy or contract |

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| PUM | The Directorate General of the Ministry of Home Affairs responsible for general affairs of regional government, including service delivery |
| Quality | The degree to which a set of inherent characteristics fulfils requirements |
| quality management | Coordinated activities to direct and control an organization with regard to quality policy, objectives, planning, control, assurance and improvement |
| requirement | A need or expectation that is stated; generally implied (by custom or common practice) or obligatory |
| Result | An output or outcome that is being strived for |
| Rp | Indonesia currency of Rupiah |
| Rp M | A unit of one million rupiah |
| SDO | Service Delivery Organization: can be a dinas, a UPT, “office”, BLUD, BUMD, a public private partnership, individual or corporate entity that delivers service to the public |
| SMART | An acronym for Simple, Measurable, Accessible, Relevant and Timely, which are the criteria for good objectives and performance indicators |
| Stakeholder | Person or group having an interest in the performance or success of the Program – they can be affected by or can affect the future of the System |
| strategic objective | A performance target which, when actioned, turns intent into results |
| strategic plan | A plan for achieving strategic objectives |
| Strategy | A set of plans, programmes, premises or patterns of behavior or activities that constitute a source of direction for top management’s decisions and other actions |
| SWOT | Strengths, Weaknesses, Opportunities and Threats. An analytical technique for assessing the influences on an organization |
| System | A set of interrelated or interacting elements |
| top management | Person or groups of people who direct and controls (the particular system) at the highest level |

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EXECUTIVE SUMMARY

This Report reviews the Indonesian legal and regulatory framework that might support or obstruct the promotion of alternative mechanisms of service delivery (AMSD). AMSD, or “MAPP” as it has been translated in Indonesian, is a term used especially in Canada to describe an array of strategies and tools that government can use to deliver services in “not the normal way”. “Alternative” is used in the sense of “alternative lifestyle” or “not traditional”. For practical purposes, AMSD is used to simply mean changing delivery mechanisms from the way they are currently delivered using one or more of eight strategies.

The objectives of the AMSD project overall in relation to promoting AMSD within regional governments are:

- (i) assistance to government in the rationalization of different institutional arrangements for the delivery of sub-national public services; and
- (ii) aid in the development and implementation of new (contracting) methods for service delivery.

After examining the situation in Indonesia, eight (8) generic strategies were suggested as encompassing AMSD, although not all might strictly be classed as “AMSD” in other countries. The strategies are:

- Strategy 1 - Clarifying objectives, roles and authority
- Strategy 2 – Paying for performance, including covering the cost of service delivery from service charges/sales wherever possible
- Strategy 3 - Raising the consequences (rewards and punishment)
- Strategy 4 – Putting the customer “in the driving seat”
- Strategy 5 - Empowering service delivery organizations (SDO) and employees (without losing control over policy)
- Strategy 6 – Changing SDO culture
- Strategy 7 – Changing sector structure; and
- Strategy 8 - Involving the community and private sector.

A key tool in the deployment of these strategies is the use of a “Flexible Performance Agreement” (often called a “Performance Contract”) between the “owner” and the “operator”. This agreement provides a mechanism or institutional space for mobilizing the “meta-strategy” of AMSD (providing more autonomy to the operator in return for increased accountability).

Against this background, the Report aims to describe the current proximate legal and regulatory framework within which the eight strategies work. The Report provides the basis for understanding where the strategies already have “support” and where the framework needs improving or additions.

Chapter 1 introduces AMSD and two key concepts about it; that (i) there are eight generic strategies for deployment using a number of tools to improve service delivery and (ii) by use of these tools the “sector structure” is improved, meaning roles, goals, authority and accountability, or relationships, are clarified and incentives improved.

Assessment of the legal and regulatory framework with respect to is a major task and should concentrate at first on identifying the presence or otherwise of legislation, gaps and inconsistencies, but in time also consider in detail how the regulation is achieved of inputs, processes and outputs. This is because of AMSD's focus on shifting control from inputs to outputs and results. The Assessment method also concentrates on (i) selected aspects (ii) establishing the main criteria for further (future) detailed assessment and (iii) assessing the degree to which the framework is integrated and aligns objectives. Each chapter ends with a summary of conclusions and suggestions.

Chapter 2 on clarifying roles identifies the key legislation classed as the “core administrative rules” (the word “rules” being used to signify the spectrum of formal and informal institutions that determine outcomes, as opposed to “legislation” or “laws and regulations”, being the formal written rules). Law 32/2004, administered mainly by MOHA, is the main instrument describing the architecture of regional government and regulating the relationship between the tiers of government. Subsidiary legislation relating to minimum standards of service (PP 65/2005), functional assignments (PP 38/2007) and organizational structure (PP 41/2007) regulates the standards regional government should aim for in obligatory and optional functions using specified organizational structures. As PP 38/2007 requires regional governments to prepare new legislation with respect to their obligatory and optional functions and central agencies to support the effort, a real opportunity exists to clarify respective roles and authority. It is suggested the framework provided by these three regulations is useful, but that the overall strategic direction as well as details must still be worked-out.

Core administrative legislation also includes planning norms, standards, procedures and criteria under Law 25/2004 and the financing and financial management legislation of Laws 17/2003, 1/2004 and 15/2004. Regulation of the public sector production cycle is now reasonably complete. Overall, as the size of Appendices B.1, E.1, G.1 and M.1 suggest, there is a large amount of legislation accumulating that is probably not helping core administrative agencies clarify their roles and objectives with respect to other levels of the Government or to PEMDA service delivery organizations (SDOs). The sheer quantity also increases opportunities for inappropriate control over PEMDA and their SDOs, and reduces the incentive of these front line service delivery organizations to be innovative.

This problem is not confined to Indonesian government. One solution has been to introduce “performance contracts” (or as AMSD prefers to call them, “Flexible Performance Agreements”- FPAs) between the core administrators (the “steering” organization) and the SDO (the “rowing” organization). They can be between central and regional governments, or for AMSD in Indonesia, between SEKDA and the SDOs. To provide wide support for this approach the following is suggested:

1. Preparation by the Government of a “legal umbrella” or an enabling regulation that authorizes FPAs and that also establishes the “regime” that ensures the roles do in fact change – that it is not “business as usual” between the SEKDA and the SDO;
2. Including in the legislation the strengthening of information management to ensure the SDO is obliged to provide performance information; and
3. Preparation and dissemination of model FPAs (see Appendix C.1 for an example).

Prepared and dissemination by the Government of “model” PERDA as well as the FPAs that PEMDA could adopt or adapt would be useful.

Chapter 3 on financing assesses the legal and regulatory framework for paying SDOs to deliver services. There is a lot of legislation, mainly generated by MoF, BAPPENAS and BAKD with MOHA, but the framework appears weak with respect to revenue generation from service delivery; government is good at spending but not at raising revenues. And yet, as most service deliverers suffer from gross under-funding, finding ways to increase it in sustainable ways is essential. Given the large gap between needs and actual at present, the following actions are suggested (continuing the numbering from the above list of suggestions):

4. Continuing improvements in the macro-level financial framework of service delivery: i.e by harmonizing, simplifying and improving current normative rules under Laws 17/2003, 1/2004, and 33/2004, with a special focus on “paying for performance”.
5. Establishing activity-based costing rules, and allocating of salaries and related overheads to “direct costs” to make possible the calculation of performance (Permendagri 13/2006 and amendments);
6. Provision by Government of guidelines, and PEMDA improving local laws and regulations, relating to services and charges, focusing on processes that ensure predictability, transparency and participation, and therefore strengthen achievement of cost-reflective pricing and sustainability (this might also be looked at in the revision of Law 32/2004);
7. Insisting that the PERDA that are supposed to be prepared under PP 38/2007 contain more explicit rules to differentiate social, environmental, security and commercial objectives of SDOs; and
8. Introducing a Public Service Obligation mechanism within regional governments to pay SDOs for services delivered where the customer is deemed unable to afford the payment of cost-reflective prices.

The exact legislative solution to these problems needs working-out between the various central administrative agencies, but the AMSD pilot program can help develop, pilot and finalize model local legislation.

AMSD Strategy 3 (covered in Chapter 4) seeks to provide more consequences to SDOs for good (or otherwise) service delivery, especially using competition or a proxy for it. Law 1/2004 and PP 23/2005 regulating BLUDs, and Law 5/1962 regulating BUMDs are important because they allow creation of SDOs that should depend more on selling their services with “hardened” budgets, and thus raising the consequences for the SDO of delivering poor service. There is not a lot of legislation in this area but that for BUMN provides a good reference, especially that related to the threat of closure. As provision of most PEMDA services are essentially under non-competitive monopoly conditions, introducing cost-reflective pricing and more competition should be a fundamental objective under AMSD. If creating true market pressures are not feasible just yet, proxies for competition need ratcheting-up through such tools as benchmarking. Suggestions include:

9. Improving competitive pressures (ideally) through sector or special laws, but in the meantime providing guidelines to PEMDA with respect to increasing competition by, among various means, providing directions on separating functions, on competition and on assessing the distribution of benefits and costs, all for inclusion in PERDA that are expected under PP 38/2007;

10. Preparing model PERDA(s) and regulations for the newly created external enterprise fund organizational model (the BLUD under PP23/2005) that includes requiring that price-setting reflect “market rates” and that subsidies to it be performance-oriented;
11. Creating legislation that encourages establishment of internal enterprise funds, including ensuring costing systems enabling identification of costs and even identification of internal services, market-testing for a certain percentage of these, and ensuring that budgets are located with the purchasers, not suppliers;
12. Preparing guidelines that takes into account political views on which services may be contracted-out (out-sourced) and being specific about criteria for selection, or in fact even creating a “negative-list” naming those functions which may not be contracted-out;
13. Mandating the provision of performance benchmarking information by SDOs in all sectors and the establishment of benchmarking systems by the respective sector departments;
14. Raising of performance measurement and management competencies with leadership of the MoF and revision of Inpres 7/1999; AMSD pilots should all have access to training in this field; and
15. Development of a policy statement by Government in support of competition wherever appropriate and clarifying, among the range of issues, its position on incentive payments by SDOs to personnel, who may be motivate and rewarded with performance related payments.

Strategy 4 of AMSD seeks to return control over service delivery to the community as that makes it more sustainable and the SDO more responsive, so long as the SDO has incentives to serve and is empowered to act on customer perceptions. The legislation in this area is rather low level, with MenPAN playing an unusually large role in its formulation. Choice for the customer should ideally be available, but more attention in the first place should be given to assuring the quality of services from the perspective of the customer. Suggestions include:

16. Raising in the legal hierarchy, perhaps as subsidiary legislation to the new law on public services (Law 25/2009), the current set of low-level regulations promulgated by MenPAN. Concentrate on setting and measuring service standards and capturing customer complaints as well as (especially) taking action on the results of those measurements.
17. Discouraging exclusivity rules (explicit or implicit) in laws, regulations and PERDA. When PERDA are prepared for each sector under PP 38/2007, rules that support factors for successfully creating competitive customer choice (for example, providing vouchers, circumscribing “service districts - price-quality standards” and prescribing what information is to be published) should be written into the new instruments for establishing the sector structure.
18. Differentiating in regulations between SPMs needed by the Government and those “SPMs” (perhaps better called “customer standards”) used for deploying Strategy 4. They should reflect community interest and take into account the factors that enable the short-route accountability of SDOs to be improved.
19. Legislating to force the SDOs to act on SPMs, or customer service standards if SPMs cannot be used locally. Hence, make mandatory the development and publication in the community of Customer Service Agreements / Charters, which are currently not required

in the current legal and regulatory framework. If they do not appear in the new Public Services law (25/2009), they could also be trialed in the pilot projects.

20. The three new laws (14/2008 on access to public information, 37/2008 on the Ombudsman and 25/2009 on public services) is an opportunity for deploying this strategy. Development of the regulatory framework under them should be a priority.
21. Strengthening consultation requirements in the law and regulations to make it mandatory for PEMDA, especially stipulating generic processes that would provide good consultative outcomes, as such consultation is a basic competency of a good SDO. Again, if the centrally promulgated laws do not address the issue, the pilot project effort should.

Strategy 5 (organization empowerment) enables action on customer requirements; what good otherwise is an understanding of the needs of the community? The key requirement is to empower the SDO by shifting control to outputs/results. While (the maze of) core administrative legislation should be working in harmony to achieve this shift, it is not clear it is happening. The process could be facilitated at the local level by more “structural” solutions using PP 41/2007 on organizational structure. This is while waiting for the performance – based budgeting aspects of Law 17/2003 to filter through the entire system.

Suggestions include:

22. Developing and providing guidelines to regional governments concerning the mixing and matching of the different functions (such as regulatory and operational) under PP 38/2007 to the nine different organizational types available under PP 41/2007;
23. Clarifying the intent of PP 41/2007 with respect to controlling personnel numbers and its success or otherwise
24. Developing a set of model regulations for adoption / adaptation by SDOs wishing to become BLUDs that emphasize the claimed flexibilities while strengthening the accountability aspects through strategic plans, customer quality assurance programs, community boards etc
25. Establishing a system under the AMSD pilot projects to identify and feed back to central government “flexibilities” that would be beneficial;
26. Helping prepare model local laws and regulations in the pilot projects for traditional dinas, paying particular heed to adapting the set of rules governing BUMNs / BUMDs to strike a balance between flexibilities and accountability;
27. Following developments in how the government (BAKD and MoF) is setting up internal and external control systems for BUMDs; and particularly noting the “professional regulatory (supervision) body” approach to realizing independent, professional and sector-specific supervision mechanisms for service deliverers;
28. Evoking more frequently the powers under Article 222 of Law 32/2004 assigning a coordinating role to MOHA with respect to sectoral activity, so that the sectors, that have a stake in better sectoral performance, can be brought into the discussion on “autonomy with accountability”; and
29. Using Law 9/2009 on legal entities for education bodies as a case study for AMSD.

Another major tool for Strategy 5 (organization empowerment) is empowering employees. Granting authority to an SDO without it having employees able to perform might be

considered unwise. The maze of legislation administered by MenPAN and BKN nationally is slowly being reformed. It is suggested however that critical areas that can be covered in the legal and regulatory framework include:

30. Agreeing with the regional HRM office (BKD) respective responsibilities of core and line units
31. Also, agreeing the need to begin addressing staffing issues that inhibit development of a cadre of professionals for each “service delivery function” in PEMDA. Rules must cover (i) recruitment of competent personnel (ii) clarity of job descriptions and competencies require to perform in those jobs (iii) incentives and discipline (iv) promotion; and (v) capacity building.
32. Reducing spending on the so called “structural diklatan” (presently a prerequisite for promotion) and mandating more leadership development opportunities for promising personnel in the higher level education and training programs (and making that training mandatory before promotion).

Although beyond what is possible under the AMSD program alone, a “pilot” on improving the functioning of a new “modern HRM” office in PEMDA would be a valuable contribution to reform at present. A start would be to prepare a model PERDA that could be adapted or adopted by PEMDA willing to try this reform.

Empowered SDOs and empowered employees however are unlikely while their organizational culture remains highly bureaucratic. Changing the bureaucratic culture is the objective of Strategy 6. It is admittedly difficult, long-term and in fact never-ending. It involves touching employees’ hearts, minds and spirit.

Apart from bringing in more people from the private sector to dilute the culture (an issue under Strategy 5), a number of formal interventions do help, including:

33. Mandating the use of performance benchmarking systems to confront personnel with performance gaps.
34. Requiring participatory development of codes of ethics (“behavioral contracts”) at SDO level
35. Mandating the use of employee attitude surveys and complaint systems to act as a major input into capacity development action plans

Further, managers must begin giving attention to their staff (i.e. better leadership). Regulatory actions which will impact culture include:

36. Creating a number of “centres of excellence” in these “soft” matters (including in the public sector “diklats” such as the decentralized MOHA diklats (created under Perpres 1/2009);
37. Altering rules selectively at the provincial and local levels to increase the use of professional human resource managers, beginning with re-structuring and upgrade of the BKD-Ortala-Diklat organizational group in PEMDA;
38. Establishing certification systems of managers (particularly Echelon II) in a range of competencies, including leadership skills (and eventually in the function of “Service Delivery”) before or within a fixed time of appointment;

39. Providing more specialized training and education opportunities focused on culture change management, organizational development and work psychology etc (the soft sciences) to strength the SDOs' HRM function;
40. Introducing in SDOs more modern human resource practices through upgrading of the "personnel" function; starting with simple human resources management information systems (HRMIS) – give special attention to the recruitment, performance review and disciplinary process to impact culture; and
41. Mandating the development and follow-up of local-level corruption eradication action plans.

Strategies 7 and 8 have many of the features of strategy 1, 3 and 5. The legal and regulatory framework for altering sector structure (Strategy 7) and increasing community and private sector cooperation (Strategy 8) is the subject of Chapter 8 of the report. The legislation is not as high level as might be expected, with BAPPENAS administering most of it. Not withstanding the current plans for various regulations as follow-up to PP 38/2007 and PP 50/2007, the following is suggested with respect to community participation:

42. Using the pilot projects to help PEMDA prepare the PERDA on each sector structure required under PP 38/2007;
43. Identifying in what functions community participation is best sought – perhaps using school boards as the starting point for the model;
44. Regulating a range of options for the form of community participation including identifying what authorities should be awarded the community, given that past experience is that insisting on accountability can be difficult and certainly not all community-based organizations will remain functional (for example, many village cooperatives, school boards and some community-based water and sanitation schemes);
45. Clarifying the acceptability, role and constitution of community advisory (and governance) bodies for particular services / sectors, as AMSD includes a strong preference to citizen-centred service; and
46. Allowing these advisory groups to in time transform into more permanent "boards" that govern the sector(s).

With respect to private sector participation (Strategy 8), the already extensive efforts of BAPPENAS and some line departments should be leveraged, with special attention given to the "ideological" resistance that pervades deployment of this Strategy. It is suggested the following matters need attention in the legal and regulatory framework for promotion of PPP at regional level:

47. Clarifying specifically the functions that are clearly open to private sector participation, including those in the "social" as well as "infrastructure" services;
48. Raising of the regulatory framework in the legal hierarchy to PP level at least;
49. Laying out tariff and payment mechanisms that are difficult for PEMDA to change at will, so reducing uncertainty and risk to investors – with special attention to control in the regulations of political opportunism – perhaps modeled on using the mandatory tariff change process mandated by PP16/2005 regarding piped water;

50. Creating a model PERDA on private sector cooperation that improves the ground-rules for PPP, so improving certainty and lowering risks – including covering matters on the fate of existing (state) employees when a private sector operator takes over;
51. Vigorously promoting “start-up” support for the tool (even creation of organizations dedicated to the purpose) to overcome the negative ideological prejudices associated with the private sector providing public services; and
52. Establishing the supporting institutions, that typically includes independent regulation of economic issues, licensing of SDOs and creation of a technical support office for the SDO.

Most of the above suggestions concern improvements and additions to the current legislation. But, as with all of the AMSD strategies, a special focus is always needed on encouraging change of the bureaucrats' mind-set. This is a pre-requisite to changing the legislation, because they in the end are the ones who draft the legal and regulatory framework underpinning all of the mechanisms of service delivery.

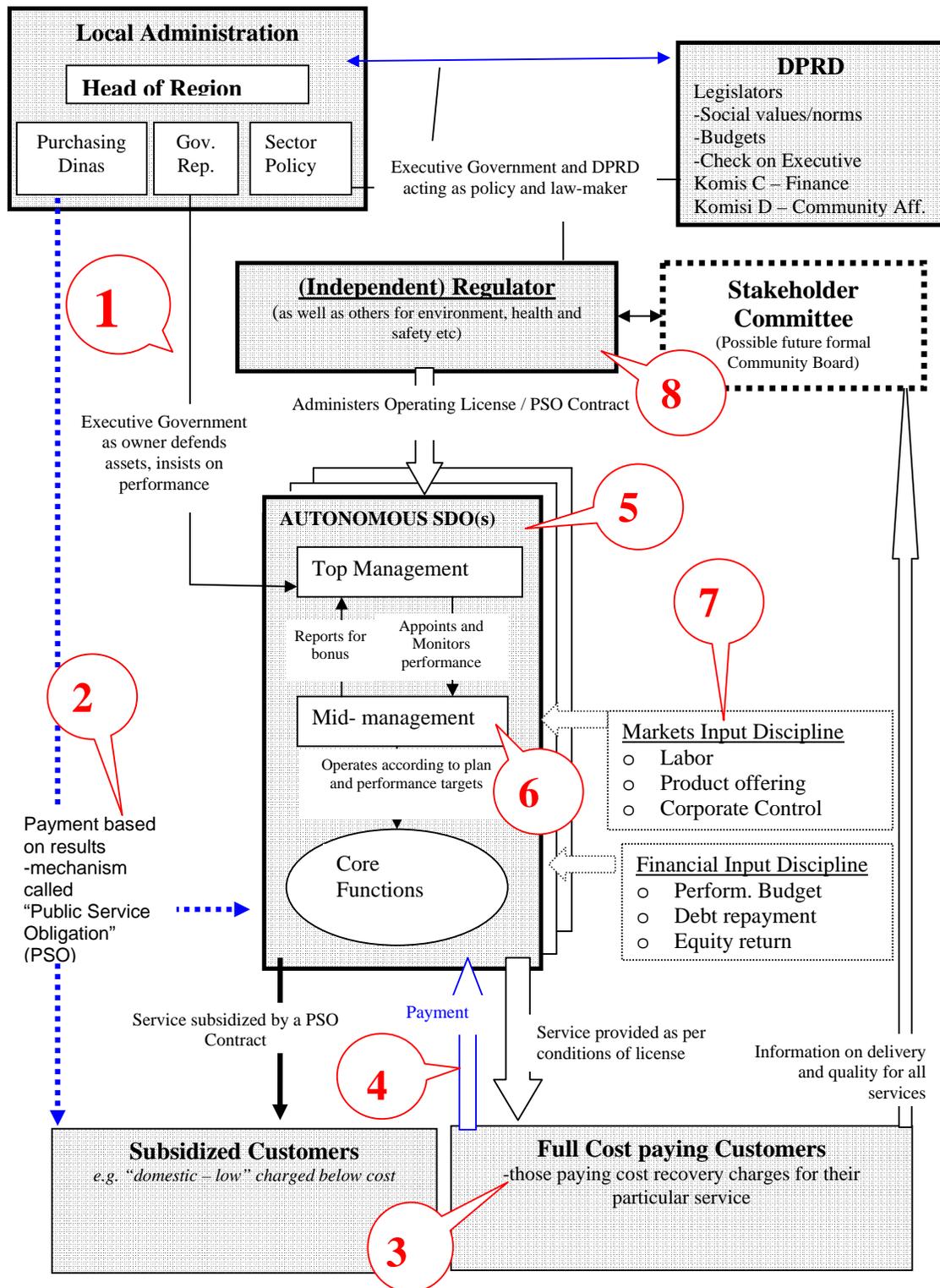
The final chapter draws some important conclusions, raises various cross-cutting issues and lists ten suggestions. Conclusions are:

- Existing laws and regulations exist that cover deployment of most AMSD strategies, but the framework is incomplete;
- Most AMSD strategies are being deployed, but they need joining-up and answers developed for the ideological critics of what can be perceived as a neo-liberal policy that overlooks equitable outcomes for the community;
- Too much of the legislation is “low-level” (e.g. community information from MenPAN) and poorly integrated (e.g. the current monitoring and evaluation rules);
- A series of new laws promoted by MenPAN beginning in 2008 may improve the situation with respect to community / customer participation;
- Whatever happens, better professional supervision of SDOs is needed, although relying on strengthened BAWASDA performance audits is unlikely to help much; they must focus on compliance with input and process rules;
- PP 41/2007 provides the possibility that institutional checks and balances can improve supervision and incentives; and
- The relationship between core administrators and SDOs needs redefining because the steering-rowing split requires different competences to be mobilized.

A detailed summary is provided of how each AMSD strategy improves the various relationships between players in a sector and also takes a “contractual perspective” on this improvement. **Figure ES. 1** shows how AMSD can clarify roles through contracts: It is suggested that in addition to that between the central and regional governments - basically Laws 32 and 33/2004 - the following “contracts” are examples:

1. “Performance contracts”: Between the steering and rowing organizations of PEMDA – the FPA of Strategy 1 (discussed in Chapter 2) that regulates the relationship between core administrative organizations and SDOs;

Figure ES.1: AMSD Strategies Clarify Roles through “Contracts”



2. “Public Service Obligations”: Between the government and the SDO for performance of public service obligations - the PSO of Strategy 2 (Chapter 3);
3. “Contracting-out”: Between government and a contractor for supply of certain services, ideally under competitive conditions – the external and internal enterprise funds of Strategy 3 (Chapter 4);
4. “Customer service charters”: Between the customer and supplier under Strategy 4 (discussed in Chapter 5);
5. “Management Contracts”: Between government representative and SDO and internally between Board and directors– as per Strategy 5 on empowering SDOs (Chapter 6);
6. “Behavioural contracts / codes of ethics”: Between the boss and subordinate – in Codes of Conduct / Ethics as advocated by Strategy 6 (Chapter 7);
7. “Budgets”, “Loan Agreements”, “On-granting Agreements”, reformulated “DAK/ Decon Agreements” etc: Between SDO and (generally) government. Any rules or specific agreement to use resources, including public resources, in certain ways;
8. “Cooperation / partnership contracts”: The cooperation / partnership contracts of Strategy 8 (Chapter 8) – community agreements, community boards and the like. When the partner is private, contracts such as Build Operate and Transfer (BOT), concessions and so on. “Licences” and “Regulatory Codes” might also be included as well as the standards, procedures and criteria on which independent professional regulation is undertaken

The effectiveness of contracts can be questioned when formal, or even informal, institutions of enforcement are absent can be questioned, but as the rule of law becomes more firmly established, the approach will become more effective.

This final chapter also highlights the Consultant’s belief that:

- (i) many of the AMSD strategies are in fact already being deployed in Indonesia but they are not identified as such and are not being used in a complementary manner; and
- (ii) gains will be substantial from deploying a number of the strategies simultaneously so that the necessary complementarities (synergies) required for success are captured.

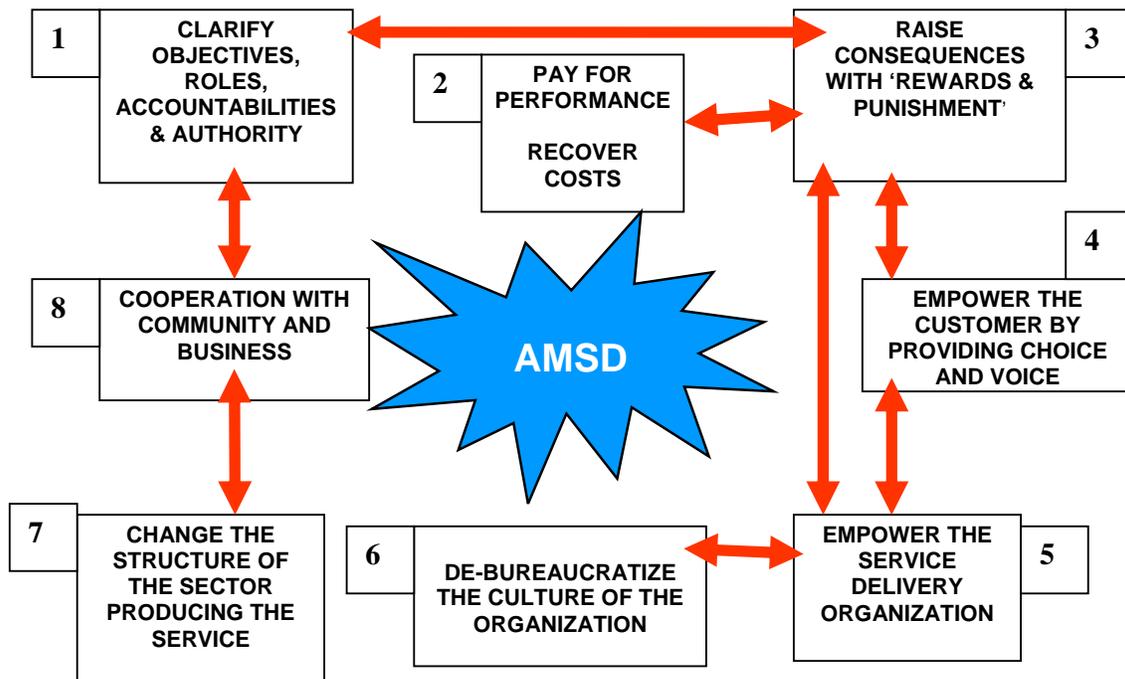
Figure ES 2 highlights some of the noted synergies between the strategies; for example, separating policy and implementation is of doubtful benefit if incentives for the SDO are not also improved as well as flows of performance information.

The Report concludes with ten broad suggestions synthesizing all those in the report: They are:

1. Draft a policy statement covering what the Government intends to do to improve service delivery and establish a high level coordination mechanism for service delivery improvement.
2. Give legal cover to the “Flexible Performance Agreement”.
3. Use the Flexible Performance Agreement to lead the way into improving steering functions.
4. While using the FPA to help clarify roles, continue improving PP 38/2007.
5. While using the FPA to set customer service standards, improve the MSSs mechanism under PP 65/2005.

6. Improve the local revenue generation framework.
7. Encourage competition and tell PEMDA that.
8. Train, train and train in financial management and performance measurement and establish the support institutions.
9. Make the customer the king, don't just dream it; starting with access to information; and
10. Improve organization design to clarify roles, create check and balances, and so provide incentives.

Figure ES 2: Complementarities Between AMSD Strategies



The above ten points captures most of the suggestions in the Report, which reviews the Indonesian legal and regulatory framework that exists or is needed to promote alternative mechanisms of service delivery. A key message of this report is that, like Strategy 1 for improving service delivery, the centre should get on and do their job of improving the legal and regulatory framework and allow, or make, regional governments get on and manage improved service delivery.

1. INTRODUCTION

1.1 Objectives

The Terms of Reference (ToR) of the Alternative Mechanisms of Service Delivery (AMSD) contract calls for a review of the legal and regulatory framework related to AMSD. The ToR says “review main legal and regulatory instruments relevant for alternative mechanisms of service delivery”. This is in the context of the overall objective of:

“Rationalizing the Use of Various Institutional Arrangements for Service Delivery

The work program in this area seeks to develop a blue print for rationalizing and strengthening the role of different types of local service providers, including Dinas (and their implementing facilities), BUMD, BLUD, and PT, among possible others. The relevant regulatory frameworks will be reviewed and a plan will be developed for using and improving (including any capacity building needs) the various institutional arrangements. The output from this work will be socialized via one or more workshops.”

This legal and regulatory review therefore provides input to the Blueprint for Improvement of Service Delivery.

Given that ultimately almost all activity of the public sector is aimed at providing services to the public, the review must be selective. It cannot at this stage go into great detail, but rather seeks to identify the laws and regulations that are considered most relevant to AMSD and its promotion, to point the way for future work and to suggest some of the criteria for development of a comprehensive framework.

In order to guide selection, reference is made to two key products of the contract to date:

- (i) the document titled “Description of Strategic Elements of Alternative Mechanisms of Service Delivery – November 2008”; and
- (ii) The (Draft) “Blueprint for Improvement of Service Delivery – January 2009”.

The description of the eight strategies and tools commonly deployed for improvement of service delivery is in document (i) above.

1.2 A Recapitulation of the Eight Strategies of AMSD

AMSD is a term coined in Canada to describe a set of reforms that focus on giving government agencies more autonomy in return for more accountability (although in Canada the term “Alternative Service Delivery” is more commonly used). Elsewhere in the world the reforms have gone by various other terms, including “new public management (NPM)”,

“contractualization” and “Performance Based Organizations”. Much of the movement was triggered by Margaret Thatcher’s reform in the UK in the early 1980s, the publication of “Reinventing Government” and the push provided by the Clinton/Gore administration in the USA with its “National Performance Review”.

AMSD was a response to the pressures on government in the 1980s and 1990s to improve public service delivery. It has developed based on existing institutions, capacities, missions, visions and values to the point that in many governments it is no longer “alternative”, but is considered the norm. AMSD in Indonesia will not be the same – it just cannot be adopted, but many of the strategies that underlay AMSD can be adapted for the institutional environment in Indonesia.

Based on the Initial Assessments - (i) Theory and Practice and (ii) Regulatory Framework - the following common AMSD dimensions or strategies are applicable for improving PEMDA service delivery:

1. Clarifying objectives, roles and authority
2. Covering the cost of service delivery
3. Raising the consequences (rewards and punishment)
4. Putting the customer “in the driving seat”
5. Empowering service delivery organizations and employees (without losing control)
6. “De-bureaucratizing” the service deliverer organizational culture
7. Changing sector structure
8. Involve the community and private sector.

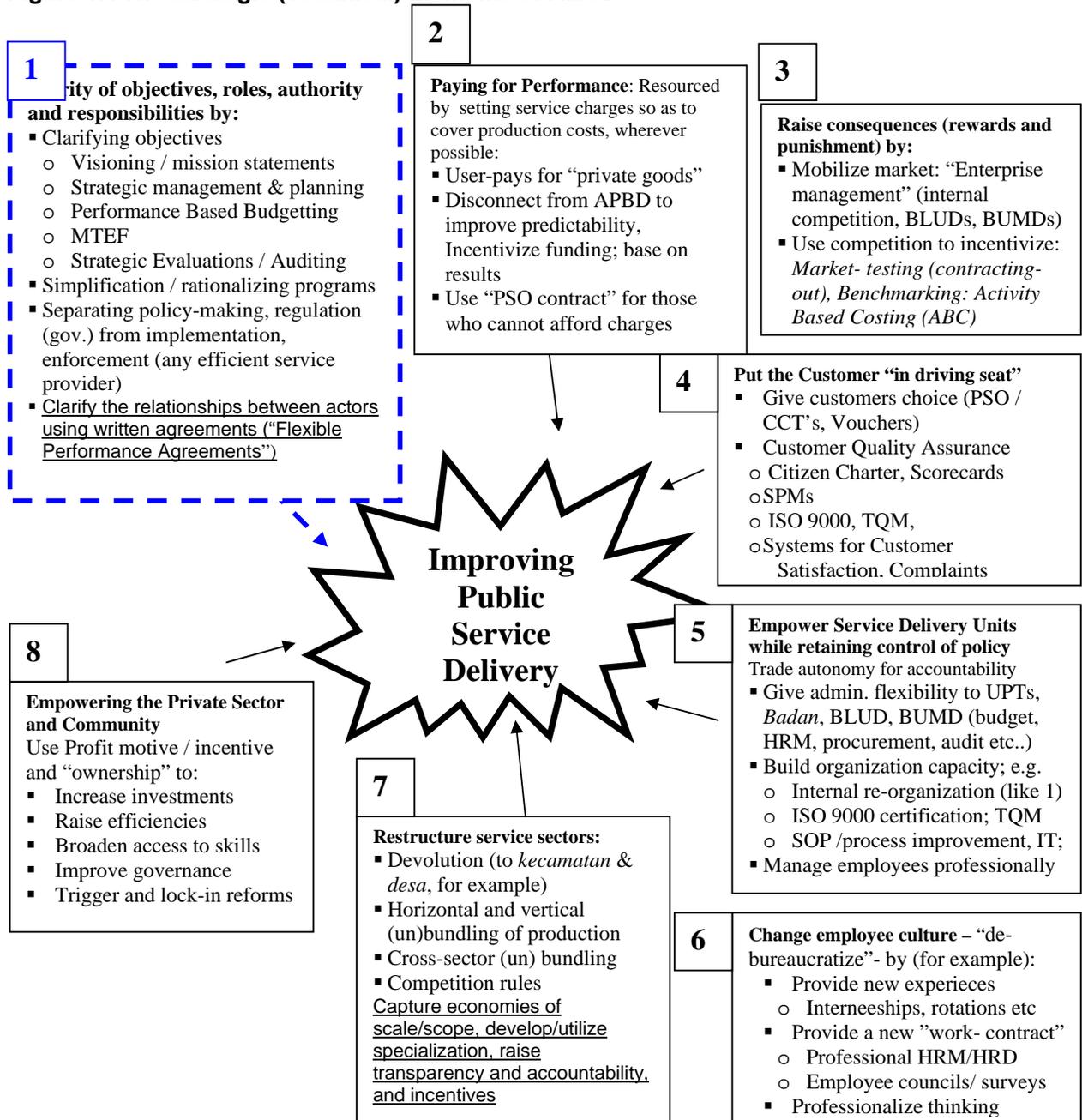
Figure 1.1 summarizes these eight strategies and the main tools suggested for their deployment. Each strategy is considered in more detail in the following chapters.

1.3 AMSD in terms of “Sector Structure”

The “structural” and “behavioral” aspects of AMSD have particular relevance in the Indonesian context because of their emphasis on putting Service Delivery Organizations (SDOs) “at arms length” - in other words, clarifying and formalizing the relationships between the owners (PEMDA) and the operators - their UPTs, Dinas’, public service bodies (BLUDs) and regionally owned enterprises (BUMDs). This clarity is achieved by a unambiguous specification of roles, authority and obligations, and therefore guidance on appropriate behavior. In a society where personal relationships are so important and informality of organization operation so prevalent, this changed emphasis is fundamental to achieving more professionalism in service delivery.

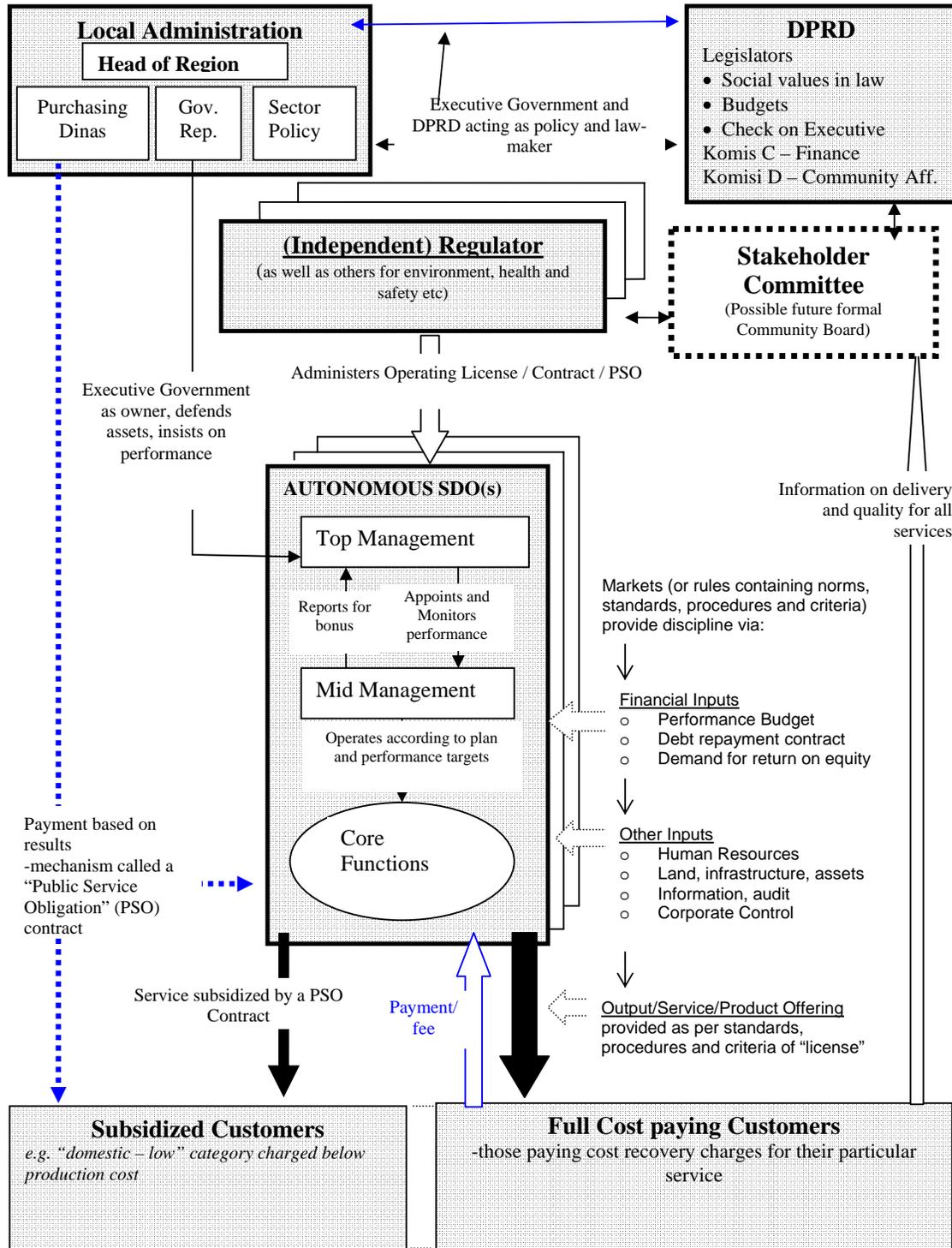
AMSD strategies favor “restructuring” sectors to improve clarity and simplification of objectives, transparency in payment based on incentives that encourage SDOs to deliver quality services or suffer the consequences. **Appendix A** describes the clarifying effect that introduction of a full set of AMSD strategies should ideally have on sector structure. **Figure 1.2** extracted from the Appendix depicts much of what the AMSD strategies seek to achieve - the establishment of autonomous, accountable SDOs that are at “arms-length” from core administrative agencies, are largely self-funding, disciplined, efficient and which listen to and act on community preferences, but remain under the control of the regional government.

Figure 1.1 The Strategic (Technical) Elements of AMSD¹



¹ The elements are not mutually exclusive, e.g. 1 and 7 are closely related as are 2 with 3,3 with 8 and 5 with 8

Figure 1.2 Sector Structure in the Future (Typical)



Source: Figure 2 of Appendix A; see Figure 3 of that Appendix for an explanation of how the eight AMSD strategies work to achieve this "autonomous but accountable" structure.

Experience shows that these strategies need a “process” that delivers them, a process that “controls” the system in which one or more of the strategies can be implemented. The key tools / processes in the deployment of the strategies are:

- (i) Use of a “Flexible Performance Agreement” (often called a “performance contract”) between the “owner” and the “operator”. This agreement provides a mechanism whereby the “meta-strategy” of AMSD (providing more autonomy to the operator in return for increased accountability) can be mobilized;
- (ii) “Performance management” of key personnel in the service delivery organization; and (most fundamentally);
- (iii) Measurement and monitoring of performance (in order to make effective the two previous tools).

It is acknowledged that this focus on performance is a major challenge for the risk-averse Indonesian bureaucracy, but the trend is undoubtedly in that direction.

1.4 Approach to the Assessment

1.4.1 Governed by Objectives

The objectives of a legal and regulatory assessment typically include:

- (i) identifying the presence of legal instruments (“rules”) relevant to the subject – in this case establishing sustainable service delivery. In this Assessment it includes the obstacles to or promoting use of the AMSD strategies, or more generically the rules clarifying delegation of authority, allocation of resources, freedoms in choice of modes of service delivery, mandatory information requirements and ability (including powers) to enforce the rules;
- (ii) identifying constraints imposed that inhibit sustained performance because of gaps in, overlaps, inconsistencies between, or frequent changes to rules - including those imposed under the central government framework;
- (iii) identifying constraints imposed that inhibit sustained performance because of unrealistic mandates being imposed - for example such heavy delegation of functions or tight control over inputs or tariffs that outputs such as coverage targets or service quality standards are impossible to achieve; and
- (iv) making an overall judgment about the credibility of the framework as perceived by key actors (and hence willingness to work by the rules).

This should be done at both the central and local levels. At this stage of this project only the central level has been considered.

1.4.2 First Concentrate on Identifying the Presence of Legislation

For the purposes of this Assessment, the framework established by centrally promulgated laws and regulations (“legislation” or more generally “rules”) is the target, and particularly as a first step, the identification of the presence of legislation. More detailed analysis will be needed as time, resources and experience from the pilot projects points to specific areas.

1.4.3 Handling Constraints from Gaps, Inconsistencies & Changes in Framework

As noted, this aspect of the assessment will not be the focus, but generic problems with the central government imposed framework include:

- (1) too many laws and regulations – often addressing a single-issue resulting in many that are never available to anyone who may be interested,
- (2) doubts concerning the applicability of the rules - especially now under decentralization,
- (3) selectivity - under decentralization, local governments are quite selective in what central rules they choose to adhere to anyway, whatever the legal situation,
- (4) “one-size-fits-all” - many of the central rules are one-size-fits-all, and so not seen by PEMDA to be relevant,
- (5) non-participatory development - development of the rules was not participatory, and so the background not well understood nor need accepted,
- (6) drafting quality - many are poorly drafted and so difficult to interpret consistently,
- (7) enforcement - there are no or few enforcement mechanisms; and
- (8) local preferences - the institutional arrangements do not reflect local preferences.

In the end, there may be large amount of legislation, but because it has not altered the “benefit- cost calculus” of its addressees, it is ineffective.

1.4.4 Keep in Mind Constraints on Inputs, Process, Outputs

In identifying the presence of rules and then in the (later and on-going) process of assessing them, the following may be important:

Rules that govern **Inputs**: (do the laws and regulations ensure supply of sufficient resources and certainty at minimal cost?)

1. Is there a clearly identified organizational unit (no matter how small) to implement each *urusan wajib* and *urusan pilihan*?
2. Does its structure make clear to the players what is to be done, where policy is made, who plans, who implements, who monitors etc?
3. Does the structure reflect the volume and type of activity required of it?
4. Does it comply with any criteria or standards specified in PP41/2007 or its subsidiary Permendagri on PEMDA structure?

Rules that govern **Processes**:

1. Have the principles of organization design (classical, neo-institutional or any others) actually been respected - especially with respect to conflicts of interest?
2. Was the process by which the organizational design was established considered "best practice"?
3. Is the organization structure congruent with the larger institutional environment (not duplicating other organizations roles, respectful of local culture, etc)?

Rules that govern **Outputs**: (do the rules actually help achieve results? Are they contributing to minimizing total transaction costs in the sector?)

1. For SDOs with a "front office function" – Do the rules help it deliver results (quantity, quality, timeliness, at a fair cost)?
2. For SDOs with a back-office function - the above for its "product", but further, do the rules help its "product" contribute to stability of the policy environment, stability in the regulatory environment or adequacy and predictability of resources for all organizations within PEMDA?

Inputs and how they are controlled by the core administrative agencies are particularly important for AMSD, because (inflexible) control sought through inputs is perceived to be one of the main constraints to SDOs performing better.

1.4.5 Organized Around the Eight AMSD Strategies

The assessment framework used is constructed around the 8 AMSD strategies / elements shown in Figure 1.1. Although these are convenient “constructs”, it is obvious that the content of existing laws and regulations will often spill-over between the various “boxes” of the Figure.

In this assessment little attempt has been made to assess the certainly present “unfunded mandate problem” – that would require a very detailed assessment of PP 38/2007 and sector budgets, among various legislation, and is better left to projects dedicated to that purpose.

Table 1.1 lists the 8 AMSD strategies and highlights some of the questions / issues that might be expected in relation to each strategy. As noted, the first challenge is to identify the main legal instruments of the framework imposed by central government with respect to that strategy.

Table 1.1 Some Possible Legal and Regulatory Issues for AMSD

| | AMSD Strategy | Possible Issues |
|----|---|---|
| 1. | Clarify of roles, objectives, authority and accountability Use of a “Flexible Performance Agreement” (FPA) between the “owner” (policy-maker and regulator) and “operator” (Service Delivery Organization) as a means to clarify the current maze. | <ul style="list-style-type: none"> • Is clarity enhanced by the whole framework in which regional governments operate? Is it consistent and strategically managed? Is Law 32/2004 helping or hindering the challenge? Does Law 17/2003 on state finances and Law 25/2004 on development planning also impinge? • Do central administrative rules lead to effective integrated processes for assigning functions, setting standards, planning, budgeting, implementation, monitoring & evaluation and back to policy adjustment? • How effective are civil service management rules? • Under what legal umbrella would a FPA fall? |
| 2. | Funding obtained locally for services delivered (typically “commercialization”) and used to enhance performance through “Public Service Obligation” | <ul style="list-style-type: none"> • Does Law 33/ 2004 on fiscal relations between tiers of government or other laws (i) create unfunded mandates and (ii) encourage generation of local revenues? |

| | | |
|----|--|--|
| | contracts. | <ul style="list-style-type: none"> • Roles of other financial related laws - (1/2004, 15/2004 etc)? • Where are the rules providing a framework for PSOs? |
| 3. | Enterprise management (commercialization/corporatization) and use of pseudo competition to provide rewards and punishment. | <ul style="list-style-type: none"> • What services could be commercialized? • What services could be delivered by non-government operators? • How to reward well performing organizations? • How to “punish” poor performing organizations? • How to introduce performance measurement? • How to introduce benchmarking? • What “rewards” can be offered individual civil servants? |
| 4. | Putting the customer “in the driving seat”. | <ul style="list-style-type: none"> • How to give the community more choice and more voice? • How to make “Minimum Service Standards” rules more effective? • How to orient PEMDA and SDOs to customer needs? • What changes to the legal framework can be made to improve “choice” and “voice” strategies, including consultation and participation? |
| 5. | Empower Service Delivery organizations by shifting control from inputs to outputs. | <ul style="list-style-type: none"> • How to accelerate the move of SDOs from Dinas to the more autonomous (and hopefully better performing) BLUD / BUMD organizational forms without loss of policy control? • How to identify and introduce flexibilities into planning, financial management, procurement, personnel management and other rules imposed in the current “one-size-fits-all” approach? • How to realize the objectives in Keppres 7/1999 on performance accountability of government organizations? • How to realize the performance-based budgeting and MTEF provisions of Law 17/2003? |
| 6. | Empower personnel by de-bureaucratization. | <ul style="list-style-type: none"> • How to change the bureaucratic culture to an entrepreneurial culture? • How does leadership get started and rewarded? • How to introduce and sustain merit-based system and reduce corruption/patronage? • How to improve capacity in a sustainable manner? |
| 7. | Change sector structure (vertical and horizontal bundling / unbundling) and degree of centralization / decentralization to | <ul style="list-style-type: none"> • Whether (the generic) PP 38/2007 is able to achieve this? • Role of sectoral (special purpose) legislation versus |

| | | |
|----|---|--|
| | achieve optimum efficiency and effectiveness | <p>generic (general purpose) legislation?</p> <ul style="list-style-type: none"> • Voluntary or mandatory cooperation in effecting changes? |
| 8. | Participation of the community and private sector in service provision? | <ul style="list-style-type: none"> • Are regulations needed that stipulate acceptable sectors / areas for participation? • What obstacles to participation exist? • What incentives can be provided? • How to encourage bureaucracy to engage with other actors? |

1.4.6 Focus Assessment on Selected Topics and Best Practices

Assessing each of the legal and regulatory instruments impacting service delivery performance is a mammoth task which will take some years to unfold as specific issues are raised. The Assessment by the Consultant has, after attempting to identify the relevant legislation, focused on select issues that are considered important overall and currently relevant to promoting AMSD. Nevertheless, considerable effort has been made to summarize and analyze selected laws and regulations. These summaries are gathered in the penultimate Appendix (Appendix O).

Further, although Law 32/2004 provides the macro framework for service delivery by regional governments, assessing its provisions in detail is not particularly fruitful at this stage, particularly as it is the (lower level) government regulations that stipulate details.

Finally, Strategy 7 (sector structure) and Strategy 8 (private sector and community participation) are not assessed in any detail because they are particularly broad topics and a number of their aspects (for example contracting and community boards) have been touched upon in the assessments covering preceding Strategies.

1.4.7 Highlight the Need for Integration

One problem with the legal and regulatory framework is its fragmented nature, the one-issue-one-regulation point made earlier.

Each Chapter ends with a reasonably detailed summary of conclusions and suggestions. Therefore, the final chapter, rather than repeating these, includes an overview of where the linkages exist. This is partly in response to one of the conclusions, that to make rapid and sustainable progress in improving service delivery, a number of the AMSD strategies need deploying simultaneously.

2. CLARIFYING ROLES, SETTING GOALS AND STANDARDS

2.1 Strategy 1: Clarify Roles, Objectives, Authority & Accountability

This strategy is often described as “the core strategy”. As the references in **Box 2.1** (summarizing the tools that are frequently used to deploy the strategy) show, much of the legal/regulatory framework underlying this strategy is taking shape in Indonesia. It is mainly the core administrative agencies of central government who are producing these rules, and although there is much criticism as to its complexity, timeliness and quality, it must be acknowledged that the importance of core administrative rules, if not the AMSD strategy, has been grasped.

This Assessment does not attempt to assess all of the laws and subsidiary regulations, as they are many, voluminous and still incomplete – see **Appendix B.1** for a list created from a database held by “The Legal Agency”². Key instruments can be tracked down therein. **Figure 2.1** offers a way of characterizing them based on the “program cycle” and shows what is thought to be the key laws and regulations while **Box 2.2** list what is thought to be the key legislation under each phase of the cycle. Most legislation covers multiple phases and possibly conflicts with other legislation, or at the minimum, imposes unnecessary reporting burdens.

Given that (i) this is the framework created at the central government level (ii) all regional governments and their service delivery organizations are expected to comply with this set of “core” or “normative” rules and (iii) the regional government core administrative agencies (SETDA, BAPPEDA, BKD, BAWASDA) must then reflect this framework in the PERDA for each of the services they are obliged to or choose to provide, it is not surprising that clarifying roles, objectives, authority and accountabilities is perhaps the current most challenging problems facing those concerned with regional government performance.

Examination of the tools in Box 2.1 that can be used to deploy the strategy raises a number of issues worthy of assessment:

1. Is the overall framework contributing to more autonomous regional governments and SDOs with clear objectives?
2. Given the burgeoning amount of “normative” legislation, is the AMSD premise correct that such legislation obstructs clarity and agency performance? Should the “clearing the decks” tools be considered for use in Indonesia?
3. Where in the legal framework is the use stipulated of “Flexible Performance Agreements” – the AMSD meta-tool sometimes known as “Performance Contracts”? Is establishment of “arms-length” autonomous agencies with clearly differentiated goals, including a separation of policy-making from operational roles, feasible in Indonesia at present?

² The Legal Agency is a business providing access to the some 16,000 laws and regulations promulgated by the Indonesia government since 1945.

Box 2.1 The Tools of AMSD Strategy 1 (Clarity)**Alternative Mechanisms Arising from the Strategy Element**

- A. Clarify direction / goals through strategic management
- B. Clear away programs that are not contributing to achievement of goals
- C. Uncouple the policy / regulatory functions (steering) from service delivery and compliance (rowing) functions.

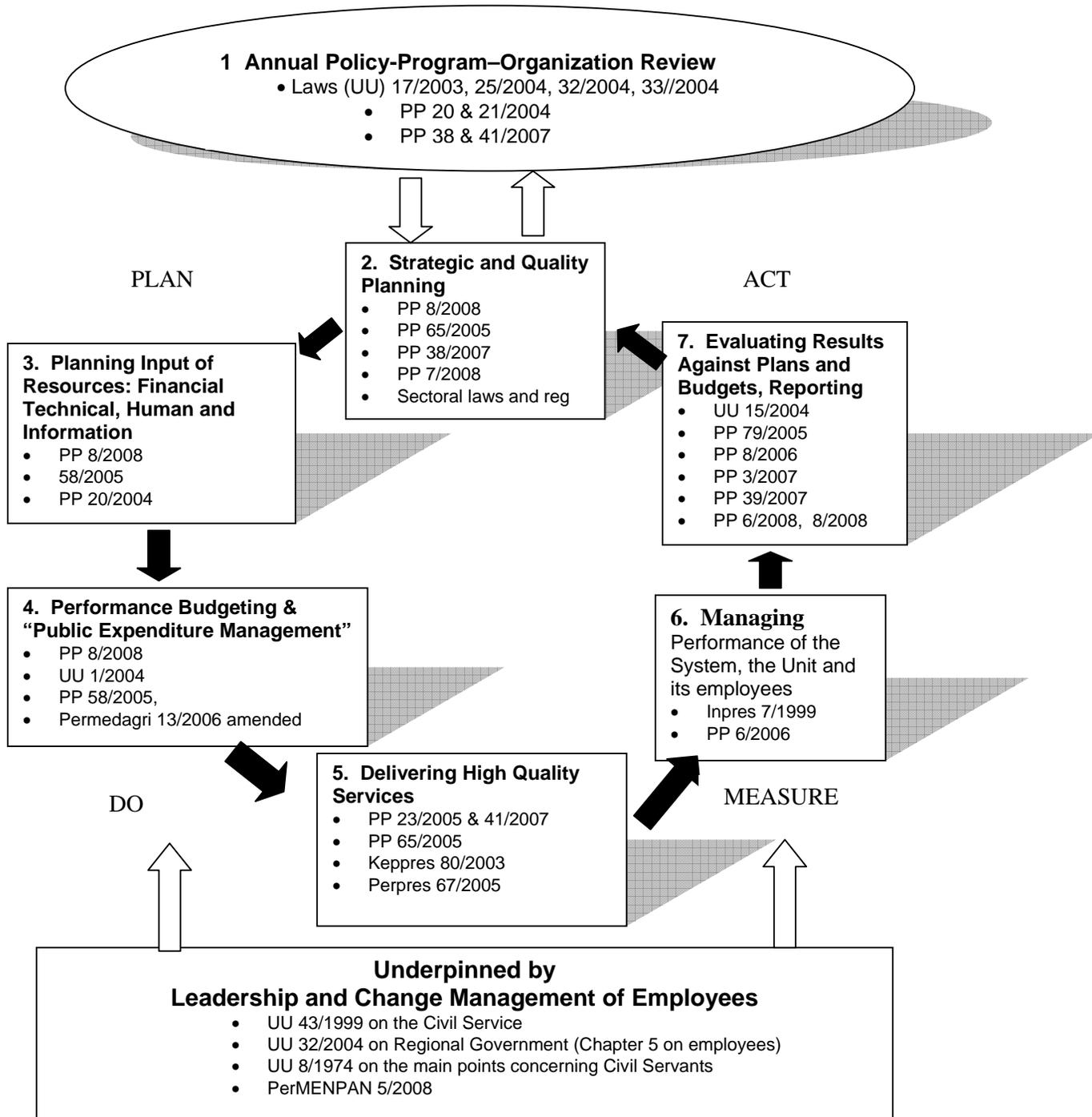
Tools for Implementing the Alternative Mechanisms

- A. **Clarity of direction:** Through strategic management (not just strategic planning), defining their vision and core purposes clarifies the policy outcome goals of government in any service. Strategic management then helps align all efforts of government to achieving those goals through effective use of; typically
 - 1. *Visioning processes* for the government and community – say in the MUSRENBANG process – UU 25/2004 on the national planning system.
 - 2. *Outcome goals* (for example as set by BAPPENAS in the National Government Workplan (RJPMN) – for example Perpres 19/2006 and budgeting under UU 17/2003.
 - 3. *Steering Organizations:* Empowered advisory boards, councils, commissions etc.
 - 4. *Mission statements* as a way of simply explaining to everyone the basic objectives.
 - 5. *Strategic Planning*, say as regulated in UU 25/2005 and PP 8/2008.
 - 6. *Performance- based budgeting* that defines the policy outcomes that legislators purchase – as required by UU 17/2003 and PP 58/2005.
 - 7. *Medium Terms Expenditure Frameworks (MTEF)*, being projected budget estimates – again as stipulated in UU 17/2003, PP 58/2005 and PP 8/2008
 - 8. *Modern (e) procurement.* Use of technology to improve efficiency, and transparency – as is being promoted by the newly created “Body” attached to BAPPENAS.
 - 9. *Strategic evaluation* that examines the chain of cause-and-effect – the formulation of which are now emerging in PP 8/2006, PP 39/2007, PP 6/2008 and PP 8/2008.
- B. **Clearing away non-essential (non-core) functions, programs and activities of government** that do not contribute to achievement of policy goals by stopping them, moving them to another sphere of government or allowing the private sector or community to perform them. e.g.
 - 1. *Program Reviews* that look carefully at specific programs as the need arises
 - 2. *Periodic Options Reviews* that require the routine examination of programs
 - 3. *Contracting –out* the service delivery and development of needed assets by the private sector
 - 4. *Asset sales* to move the responsibilities of ownership for assets that “clutter” the view.
- C. **Uncoupling Policy from Service Delivery** to create clarity of roles and “check and balances”. Allows policy-making organizations (like SETDA and BAPPEDA) to concentrate on policy – while delivery organizations like *Dinas Kesehatan* or Public Works concentrate on achieving a few clear missions.
 - 1. **New decrees related to organizational structure and main functions** – as may be envisaged in PP 41/2007.

Flexible Performance Agreements as the instrument to mobilize this and various other AMSD strategies

Source: AMSD Project document: *Description of Strategic Elements of AMSD*, Nov 2008

Figure 2.1 Core Administrative Laws and Regulations



1. As the Appendices listing all laws and regulations relevant to this cycle demonstrate, those instruments listed above are only a few of the total set. Clarity is the victim of such a large number of core administrative rules, often written with just a few issues in mind.
2. Appendix O provides a summary of selected laws and regulations.

Box 2.2 List of the Main Core Administrative Laws and Regulations**Annual Review of Policy-Program-Organization**

Law (UU) 17/2003 on State Finances; *UU No. 17/2003 tentang Keuangan Negara*

Law (UU) 25/2004 concerning the National Development Planning System; *UU No. 25/2004 tentang Sistem Perencanaan Nasional*

Law 32/2004 concerning Regional Government; *UU No. 32/2004 tentang Pemerintahan Daerah*

UU 33/2004 concerning Fiscal Balance between the Central and Regional Governments; *UU No. 33/2004 tentang Perimbangan Keuangan antara Pemerintah Pusat dan Pemerintahan Daerah*

UU 15/2004 on Auditing and Accountability for State Funds, *UU 15/2004 tentang Pemeriksaan dan Pertanggung Jawab Keuangan Negara*

Strategic and Quality Planning

PP 8/2008 on the stages, the compilation procedure, control and evaluation of implementation of the Regional Development Plan; *PP 8/2008 tentang Tahapan, Tata Cara Penyusunan, Pengendalian dan Evaluasi Pelaksanaan Rencana Pembangunan Daerah*

PP 65/2005 on minimum service standards; *PP 65/2005 tentang Standar Pelayanan Minimal*

PP 38/2007 concerning the Division of Functions between Central, Provincial and Local Governments; *PP No. 38 Tahun 2007 tentang Pembagian Urusan Pemerintahan antara Pemerintah, Pemerintahan Daerah Provinsi, dan Pemerintahan Daerah Kabupaten/Kota*

Select sectoral laws (like UU7/2004 on water resources and UU17/2008 on shipping) that require sector plans

Planning Inputs of Resources: Financial, Technical, Human and Information

PP 20/2004 on the Government Work Plan; *PP 20/2004 tentang Rencana Kerja Pemerintah*

PP 21/2004 on Compilation of Work Plan and Budgets of Ministries and Agencies; *PP 21/2004 ttg Penyusunan Rencana Kerja dan Anggaran Kementerian Negara/Lembaga*

PP 58/2005 on Management of Regional Government Finance; *PP 58/2005 tentang Pengelolaan Keuangan Daerah*

PP 7/2008 concerning Decentralization and Assistance Funds; *PP 7/2008 tentang Dekonsentrasi dan Tugas Pembantuan*

Permendagri 13/2006 Guidelines for Managing Regional Finances; *Permendagri 13/2006 tentang Pedoman Pengelolaan Keuangan Daerah*

Permendagri 59/2007 concerning the Second Amendment to Permendagri 13/2006; *Permendagri 59/2007 tentang Perubahan Kedua kepada Permendagri 13/2006*

Performance Budgeting and Public Expenditure Management

PP 58/2005 on Management of Regional Government Finance; *PP 58/2005 tentang Pengelolaan Keuangan Daerah*

PP 8/2008 on the Procedures for Formulating, Controlling and Evaluating Regional Development; *PP 8/2008 tentang Tatacara Penyusun, Pengendalian dan Evaluasi Pelaksanaan Pembangunan Daerah*

Delivery of High Quality Services

PP 23/2005 on Financial Management of Service Delivery Units (Enterprise Funds); *PP 23/2005 tentang Pengelolaan Keuangan Badan Layanan Umum*

PP 65/2005 on minimum service standards; *PP 65/2005 tentang Standar Pelayanan Minimal*

PP 41/2007 on Regional Government Organization Structure; *PP 41/2007 tentang Organisasi Perangkat Daerah*

Peppres 80/2003 on Implementation of the Procurement of Materials / Service for Government (as amended on 7 occasions); Keppres 80/2003 tentang Pelaksanaan Pengadaan Barang/Jasa Pemerintah

Box 2.2 List of the Main Core Administrative Laws and Regulations (cont.)

Perpres 67/2005 on Cooperation between the Government and the Private Sector in the Provision of Infrastructure
Perpres 67/2005 tentang Kerjasama Pemerintah dengan Badan Usaha dalam Penyediaan Infrastruktur

UU 37/2009 on Services to the Public; *UU 37/2009 tentang Pelayanan Publik*

Leadership and Change Management of Employees

UU 8/1974 on main points concerning Civil Servants; *UU 8/1974 tentang Pokok Pokok Pegawaian*

UU 43/1999 on Amendments to UU 8/1974; *UU 43/1999 tentang Perubahan atas UU 8 Tahun 1974*

PP 30/1980 on Rules related to Disciplining Civil Servants; *PP 30/1980 tentang Peraturan Disiplin Pegawai Negeri*

UU 28/1998 on running a country free of corruption, collusion and nepotism *UU 28 Tahun 1998 tentang Penyelenggaraan Negara Yang Bersih dan Bebas dari Korupsi, Kolusi, dan Nepotisme*

PP 101/2001 on education and training of civil servants; *PP No 101 Tahun 2000 tentang Pendidikan dan Pelatihan Jabatan PNS*

PP 42/2004 on development of the culture and code of ethics of the civil service; *PP No. 42 Tahun 2004 tentang Pembinaan Jiwa Korps dan Kode Etik PNS*

Managing Performance of the System, the Unit and its Employees (On-going Activity)***Performance on Organizational Unit***

Inpres 7/1999 on Performance Accountability of Government Institutions; *Inpres 7/1999 tentang Akuntabilitas Kinerja Instansi Pemerintah*

Inpres 5/2004 Formulating and Agreeing Performance; *Inpres No.5 Tahun 2004 tentang Penyusunan dan Penetapan Kinerja*

Perpres 9/2005 on Implementing the System for Performance Accountability of State Institutions; *Perpres No 9 Tahun 2005 tentang Pelaksanaan Sistem AKIP*

PP 8/2006 on Reporting Finances and Performance of Government Institutions; *PP 8/2006 tentang Pelaporan Keuangan dan Kinerja Instansi Pemerintah*

PP 39/2006 on Procedures for Controlling and Evaluation the Implementation of the Development Plan; *PP 39/2006 tentang Tatacara Pengendalian dan Evaluasi Pelaksanaan Rencana Pembangunan*

PermMENPAN 09/2007 on guidelines for Determining Performance Indicators in Government Institutions; *Peraturan Menneg Pendayagunaan Aparatur Negara 09/2007 tentang Pedoman Umum Penetapan Indikator Kinerja Utama di Lingkungan Instansi Pemerintah*

Menpan Regulation Per / 15/M.PAN/7/2008 dated July 10 2008 on General Guidelines on Bureaucratic Reform ; *Pedoman Umum Reformasi Birokrasi*

Various regulations in each sector

Assets of the Unit

Law 1/2004 on State Treasury Functions; *UU No. 1/2004 Perbendaharaan Negara*

PP 24/2005 on Government Accounting Standards; *PP No. 24/2005 Standar Akuntansi Pemerintahan*

PP 58/2005 on Management of Regional Government Finances; *PP No. 58/2005 Pengelolaan Keuangan Daerah*

PP 6/2006 on Management of Government and Regional Government Assets; *PP No. 6 /2006 Pengelolaan Barang Milik Negara / Daerah*

PP 38/2008 on Amendments to PP 6/2006; *PP No. 38/2008 Perubahan atas PP No. 6/2006*

Keppres 80/2003 on Procedures for Procurement of Goods and Services; *Keppres 80/2003 Pedoman Tatacara Pengadaan Barang dan Jasa*

Kepmendagri 12/2003 on Guidelines for Valuing Regional Assets; *Kepmendagri 12/ 2003 Pedoman Penilaian Barang Daerah*

Box 2.2 List of the Main Core Administrative Laws and Regulations (cont.)

Permendagri 17/2007 on Technical Guidelines for Managing Regional Government Assets; *Permendagri 17/2007 Pedoman Teknis Pengelolaan Barang Milik Daerah*

Performance of the Individual

UU 15/2004 on Investigating the Management of and Responsibilities for State Finances; *UU 5 Tahun 2004 tentang Pemeriksaan Pengelolaan dan Tanggung Jawab Keuangan Negara*

Evaluating Results Against Plans and Budgets, and Reporting

PP 79/2005 on Guidelines for Facilitating and Supervising Regional Government; *PP 79/2005 tentang Pedoman Pembinaan dan Pengawasan Penyelenggaraan Pemerintahan Daerah*

PP 8/2006 on Reporting Finances and Performance of Government Institutions; *PP 8/2006 tentang Pelaporan Keuangan dan Kinerja Instansi Pemerintah*

PP 39/2006 on Procedures for Controlling and Evaluation the Implementation of the Development Plan; *PP 39/2006 tentang Tatacara Pengendalian dan Evaluasi Pelaksanaan Rencana Pembangunan*

PP 3/2007 on the Report of Implementation of Government to the Central Government, the Accountability Report of the Head of Region to the DPRD and the Information Report of the Head of Region to the Community; *PP 3/2007 tentang Lapran Penyelenggaraan Pemerintahan Daerah kepada Pemerintah, Laporan Keterangan Pertanggungjawaban Kepala Daerah kepada DPRD dan Informasi Laporan Penyelenggaraan Pemerintahan Daerah kepada Masyarakat*

PP 6/2008 on Guideline on Evaluation of the Implementation of Regional Government; *PP 6/2008 on Pedoman Evaluasi Penyelenggaraan Pemerintahan Daerah*

This Assessment, after first identifying and describing the basic legal and regulatory framework for regional government, is particularly concerned with clarity (or otherwise) of objectives and of the relationships in framework, and ways of improving it, especially at local level. The organizational structure aspects of PP 41/2007 are assessed in the Chapter on Strategy 5 concerning organizational empowerment. We begin with an examination of the core or “normative” decentralization / regional government laws provide a basis for the more detailed Assessment.

2.2 The Decentralization / Regional Governance Laws**2.2.1 Law No. 22/1999 on Regional Government**

The movement to implement regional autonomy in Indonesia is not a new movement. Back in 1950, Indonesia enacted its second constitution, namely the 1950 Constitution of the Federal Republic of Indonesia (*RIS*) along with a multi-party system. The regions which were a part of the Republic were then named ‘*daerah swatantra*’ or autonomous regions, consisting of first-level autonomous regions (equivalent to ‘province’) and second level autonomous regions (equivalent to the present-day ‘district/city’). In 1955, general elections were held with a multi-party system. The failure of the government at that time to create

national stability caused then President Sukarno to take over powers exceeding the authority conferred to him, issuing a decree in 1959 to return Indonesia to the first 1945 Constitution. Since then, Indonesia has implemented a centralistic system of governance up until the downfall of the New Order regime of President Soeharto in 1998.

In 1999, the enthusiasm to re-establish regional autonomy was revived and given legal endorsement by the enactment of Law No. 22/1999 on Regional Government, (superseding Law No. 5/1974 concerning the Principles of Regional Government), with an extended period of implementation.

Law No. 22/1999 divided the governmental affairs, including most service delivery, into two groups, namely:

- (i) Affairs that are fully under the responsibility and authority of the Central Government, and
- (ii) Affairs fully under the responsibility and authority of the Regional Government.

The authority of the Central Government covered foreign political affairs, defence and security affairs, judicial, monetary and fiscal affairs, religious affairs and authority in certain other fields; whereas the authority of the Regional Government covered all affairs other than those declared as affairs of the Central Government.

To handle these affairs, the Law No. 22/1999 applied three approaches in undertaking government, namely: decentralisation, deconcentration and delegation as agent (*tugas pembantuan*), with the following definitions:

- Decentralisation is the handing over of government authority by the Government (central) to an Autonomous Region within the Unitary State of the Republic of Indonesia;
- Deconcentration is the conferring of authority from the Government to the Governor as representative of the Government and or central apparatus in the Region;
- Delegation is the assignment of tasks from the Government to the Region and Village and from the Region to the Village to carry out certain tasks accompanied by financing, facilities and infrastructure (the so-called *P3D* rule), as well as human resources with the obligation to report and be accountable for the implementation to the assigning party.

The objective and implementation of regional autonomy as contained in paragraph 'h' of the general elucidation of the said Law is:

To enhance and improve public service and welfare, including to develop a community life that is democratic, just, and equitable, and to maintain a harmonious relationship between the Central and Regions and between the Regions, in the framework of preserving the integrity of the Unitary State of the Republic of Indonesia.

Law No. 22/1999 became effective on 1 January 2001, however after three years of implementation it was realized that the Law had weaknesses and needed significant revision. The weaknesses included:

- Lack of clarity in the relationship between government structures, particularly between the district/city government and the provincial government, and between the regional governments;

- Unclear role of the Central Government/Provincial Government in providing guidance and supervision to the District/City Governments;
- Unclear mechanisms of accountability from the lower level government to the higher level government; and
- Unclear rules containing directives to achieve the goals of autonomy as described in the general elucidation of the said Law mentioned above.

In relation to the last point, it is quite surprising that there was not even one article or paragraph in Law No. 22/1999 explaining the purpose of implementing regional autonomy as mentioned above in a regulating provision. Law 22/1999 was seen to be a “rushed job” focussing on meeting “balkanization” threats in a time of crisis (*krismon*), more than a considered restructuring of the central – regional relationship.

2.2.2 Law No. 32/2004 on Regional Governments – Improved Autonomy

Law 32 /2004 was prepared to clarify the centre-regions relationship – the macro equivalent of AMSD strategy 1. It provides the architecture for regional government operations, including service delivery. The scope of the law is outlined in **Appendix B.2**, which contains the contents list of the law down to article level. The following describes the key features of the law from the viewpoint of what seems to be required to make clear roles and responsibilities.

a. Objective of Regional Autonomy - Public Services

Law No. 32/2004 supersedes the earlier Law No. 22/1999. The shortcomings in explaining the objective of implementing regional autonomy as mentioned above has been given first priority in this new Law. The first consideration (point a) in Law No. 32/2004 directs the Regional Government towards:

accelerating the realization of community welfare through the improvement of public services, with empowerment and participation of the people, and enhancing the competitive power of the region,

with attention to the principles of democratisation, equitable distribution, justice and the special characteristics of a region. Article 20 sets of the principles of good governance which are to be applied.

This consideration is then incorporated in regulatory provisions, such as Article 2 paragraph (3), which provides that the regional government shall implement autonomy in a broad sense in dealing with its affairs, *for the purpose of improving the community welfare, for better public services, and regional competitiveness.*

b. Relationship between Government Levels

The gap in relations between the Provincial Government and the District/City Governments seen in Law 22/1999 is resolved in Article 2 paragraphs (4), (5), (6) and (7). It requires that the regional governments, in handling their intergovernmental affairs, must build a good relationship with the (Central) Government (unspecified as to how this is to be done and the consequences of not doing it) and other regional governments. It attempts to cover the issues of authority, finance, public service types, utilization of natural resources and other resources. Relations in these areas must aspire to be conducted fairly, with the understanding that such

relationships will lead to better administrative and “areal” relations between the government structures.

However, unlike the AMSD strategic direction of clarifying roles, authority and accountabilities, the Law is not very specific and left it to over 30 pieces of subsidiary regulations to achieve that objective.

c. Distribution of Government Affairs

In Law No. 32/2004, the distribution of governmental affairs between the Government and the provincial Government and district/city governments is determined by Government and is formulated more clearly than previously. The Central Government has full authority over 6 governmental affairs, namely:

1. foreign politics
2. defence
3. security
4. justice
5. national monetary and fiscal affairs, and
6. religious affairs

while all other affairs can come under the authority of the regional governments – Article 10 paragraph (1) and (3).

The handling of affairs, other than the 6 mentioned above, by the Government, provincial government and district/city government is to be divided between the three levels of government based on the criteria of externality, accountability, and efficiency while maintaining good relations between the government structures; and is deemed by Government to constitute the implementation of inter-related authority between the Government, the provincial, district and city governments or between local governments – Article 11 paragraph (1) and (2). This assignment of functions is regulated by Government Regulation (PP) 38/2007.

Meanwhile, the regional government affairs are divided into (i) mandatory affairs, and (ii) optional affairs, where the mandatory affairs are to be handled according to the minimum standard of service (*SPM* in Indonesian) that will be determined by the Government (PP 65/2005) and be implemented in phases – Article 11 paragraph (3) and (4).

Further provisions regarding the mandatory affairs are found in Article 13 for the Provincial Government and Article 14 for the District/City Government. Both articles regulate 16 similar mandatory affairs, with the difference being only in the scope of the area, where the Provincial Government is responsible for affairs that cover the administrative area of two or more districts/cities, while the District/City Government is responsible for similar affairs within its own area. The 16 mandatory affairs are presented in **Table 2.1** below.

Table 2.1 The 16 Mandatory Affairs of the Regional Governments

| Mandatory Affairs of the Provincial Government and District/City Government as provided in Article 13 of Law No. 32/2004 | |
|---|---|
| (1) Planning and control of development; | (9) Facilitate the development of cooperatives, small and medium enterprises; |
| (2) Planning, using, and supervising the spatial lay-out; | (10) Controlling the environment; |
| (3) Maintaining peace and public order; | (11) Land affairs service; |
| (4) Providing public facilities and infrastructure; | (12) Population service, and the civil registry; |
| (5) Handling affairs in the health sector; | (13) Public administration service |
| (6) Conducting/providing education; | (14) Investment administration service; |
| (7) Resolving social problems; | (15) Conducting other basic services; and |
| (8) Service related to manpower affairs; | (16) Other mandatory services as provided by law |

The regional government affairs in the category of “optional affairs” includes government affairs that are “real” and have the potential to improve the people’s welfare in accordance with the conditions, specific characteristics, and potential of the region concerned – Article 14 paragraph (1). This category also includes marine affairs and fishery sector, agriculture, forestry, energy and mineral resources, tourism, industry, mining, and transmigration.

The utility of these rules is assessed below under PP 38/2007.

d. Clarifying Responsibilities and Service Standards

In Article 14 paragraph (3) of Law No. 32/2004 it is stated that more detailed arrangement for implementation of the provisions in Article 10, Article 11, Article 12, Article 13 and Article 14 shall be formulated in a separate Government Regulation; this Government Regulation should also include arrangement for the distribution of affairs and the minimum standard for services.

The requirements of the Law have been met by the issuance of:

- Government Regulation (*PP*) No. 65/2005 on Guidelines for Formulating and Determining the Minimum Standard for Services;
- Government Regulation No. 38/2007 on the Distribution of Government Affairs between the Government, Regional Provincial Government, and Regional District/City Government; and
- Government Regulation No. 41/2007 on Regional Apparatus’ Organisation.

The first two Government Regulations are assessed briefly in the following section. The question ultimately is whether they make clear roles, goals, authority and accountability without being too restrictive.

2.3 More on Clarifying Roles and Goals, Setting Standards

This section is important because improved service delivery includes among its ingredients clarity on roles, authority and accountability. Clear assignment of authority must be accompanied by agreement on performance indicators and their associated targets, if accountability is to become a driving force. The PPs on assignment of functions and minimum service standards should be available and functional to support whatever management model of service delivery is then used.

2.3.1 PP 38/2007 – Clarity of Roles by Distributing Functional Assignments

Clarity in these functional assignments is the cornerstone of improved service delivery. Clarifying roles, objectives, authority and the responsibility of a government also provides the foundation for improved accountability. To this end, the Government through the powers given to the Department of Home Affairs (DEPDAGRI) under Law 32/2004 issued Government Regulation (PP) 38/2007 on July 9, 2007 in an attempt to regulate more precisely how the division of authority over the various functions between central, provincial and local government is actually administered³.

This Government Regulation contains “decisions” regarding the Distribution of Governmental Affairs between the Government (central), Provincial Government and District/City Government. Article 2 states that other than the 6 affairs that are under the authority of the Government (what are typically known in other counties as “reserved powers”), there are 31 governmental affairs divided between the government levels and/or structures. These thirty-one affairs are the combining and further description of the 16 mandatory affairs (Article 13, PP No. 32/2004) and 8 optional affairs (which are determined by this PP as the implementation of provisions in Article 14 paragraph (2) and (3) of Law No. 32/2004). A breakdown of the 31 affairs is attached thereto.

The arrangement for joint distribution of the authority over 31 affairs is done by dividing the sectors into sub-sectors and sub-sub-sectors and detailed tasks will be prescribed for each level of government. *Logically, from the detailed tasks shall be identified the services that the Government is obliged to give to the people in the form of public service.*

The general pattern of dividing the tasks and authority arranged as follows:

- The Central Government (Ministry/Non-Departmental Government Agencies) is assigned the tasks and authority to:
 - (i) develop a system of regulation,
 - (ii) coordinate the related agencies at central and regional levels, and
 - (iii) provide guidance and supervision over the implementation of tasks.

The regulatory products of the Government (central) consist of *norms, standards/guidelines, procedures and criteria (NSPK)*, including *policies, strategies and plans* on a

³ PP 38/2007 superseded PP25/2000. It assigns functions across 31 “urusan” (sectors) to the three levels of government. Like many pieces of legislation however, how the law will be implemented and the administrative system for that implementation have not been elaborated in the PP.

national scale. However, for certain matters, the Government will also carry out certain operational tasks;

- The Provincial Government is assigned the tasks and authority to:
 - (i) develop policies, strategies and an operational plan for the provincial level,
 - (ii) to implement the national NSPK (regulatory products) at provincial level and or in the area whose jurisdiction covers more than one district/city government,
 - (iii) provide guidance and supervision on their implementation,
 - (iv) coordinate the related district/city governments in their implementation, and
 - (v) for certain matters shall carry out operational tasks.
- The District/City Government is assigned the tasks and authority to develop policies, strategies and operational plans for district/city level in order to implement the policies, strategies and plans as well as the NSPK set by the Central Government and/or provincial government; *The district/city level is where almost all forms of services are available and delivered to the people, in their respective areas.*

Scrutinizing the pattern of distributing governmental affairs mentioned above, the following is noted:

- There is a rule but no clear mechanism for arranging relations which guarantees sustainable harmonious relationship between the districts/cities, provinces and Central Government;
- The district/city government is ultimately the foremost institution in delivering almost all types/forms of public service;
- Therefore, the district/city government is the spearhead in creating a prosperous society, which is the most important consideration and objective in implementing regional autonomy;
- However, whether the roles, goals, standards, procedures and decision criteria are clear to regional governments and whether they have the resources and the authority to perform the functions as assigned is unclear (in fact many would say the answer is clearly “no”).

An example of the pattern in distribution of governmental affairs between the three levels of government is shown in **Table 2.2**.

Table 2.2 Example: Distribution of Governmental Affairs

| Sector of Affairs: (for example Education) | | | | |
|--|---------------------|---|--|---|
| Sub-sector | Sub-sector | Breakdown of Affairs into Tasks, and their distribution to: | | |
| | | Ministry/Government Agency (central) | Provincial Government | District/City Government |
| Policy | Policy and Standard | Determining national policies | Determining operational policy at provincial level, in accordance with the national policy. | Determining the operational policy at district/city level in accordance with the national and provincial policies. |
| etc. | | | | |
| Financing | (not detailed) | Formulating guidelines for the financing of all levels/types of education | (not involved) | (not involved) |
| | (not detailed) | Providing financial assistance for higher education, according to authority | Providing financial assistance for schools of international standard, according to authority | Providing financial assistance for pre-school education, primary and secondary education, and non formal education, according to authority. |
| etc. | | | | |

There are a number of areas that seem incomplete with the PP. PP 38/2007 perhaps acknowledges the incompleteness of efforts to clarify assignments to date by:

- requiring at Article 4 (2) that central agencies produce technical regulations in the form of Ministerial Regulations for functions that are entirely within their authority;
- authorizing the Government to issue a Presidential Decree concerning a “right to step-in” (Art 8(2)) if obligatory functions are not performed satisfactorily;
- mandating central agencies to develop “guidance rules”⁴ for those functions that fall within the authority of regional governments (see Article 9), all after coordination with DEPDAGRI;
- directing at Article 12 that regional governments (*PEMDA*) promulgate by the 9th July 2008, local laws:
 - “legalizing” the undertaking of obligatory and other functions, and

⁴ Such rules establish standards, procedures and decision criteria for allocating functions across spheres of government. PP 38 (and increasingly, Indonesian Government officials) use the phrase “norms, standards, procedures and criteria” (*NSPK*) when referring to the rules.

- describing how they intend to “regulate and manage” their responsibilities with respect to these functions (this will also serve to confirm the PEMDA’s understanding of the assignment of authority).

While it was recognized that the assignments may not be ideal and some follow-up action would be needed, a system to administer⁵ the PP, other than in the above articles, was not elaborated.

The underlying objective of the PP is to clarify the legal and regulatory framework within which services are delivered. It aims to formalize relationships and reduce the informal way in which many PEMDA approach service delivery. On this basis it is well aligned with the introduction of AMSD.

As noted, regional governments were therefore required to issue local laws (*PERDA*) by July 2008 setting out how they intend to regulate and manage their assigned responsibilities, and central technical agencies are to provide their “norms, standards, procedures and criteria” (rules) by July 2009. However, the “dimensions” covered by the rules are not well specified, thus making this process more difficult and the consequences of PEMDA issuing their own are uncertain.

To the present, very few PEMDA have issued any relevant *PERDA* and few of the central technical agencies have attempted to systematically develop or clarify sector rules in response to the PP. This is in spite of there being a stream of on-going disputes around the country over authority (for example, over the issue of licenses for mining, for communication towers, port locations and for use of road easements). On this basis, it appears to be falling short on clarifying roles and accountability.

Further, although the PP lays out the basics for administering functional assignments, it has a number of weaknesses⁶, among which are:

- the PP does not offer guidance for some functions either because it is not comprehensive or because it lacks clarity – for example there is little explanation of the frequently mandated need for “norms, standards, procedures and criteria”;
- it does not state the consequences for central agencies of not issuing the regulations, but after such date gives regional governments a free hand in interpreting PP 38/2007 and making their own functional assignments;
- it does not stipulate consequences for regional governments failing to comply with the requirement they produce *PERDA*;
- it does not describe any process for reviewing and adjusting the assignments;
- it is unclear how precisely the three criteria (externalities, efficiency and accountability) were applied in arriving at all the assignments;

⁵ The word “administer” is used to describe actions authorized explicitly or implicitly in the regulation. To improve the outcome of the PP however there may be in the end a need to improve systems of management (initiating actions to change the system) and governance (changing the rules, say through establishment of high-level Committees). The distinction between administration and management may be not material.

⁶ For a detailed analysis, covering a wider range of issues, see Ferrazzi, G; 2008; “Exploring Reform Options in Functional Assignments”; DSF / GTZ

- the accompanying explanation indicates authority is in fact to be exercised “concurrently” over all functions, thus reducing clarity and accountability;
- as the details are covered in 847 pages of the appendix to the regulation, they are sometimes difficult to locate and disseminate;
- the language used to describe the responsibilities, particularly by inconsistent use of the terms “regulate” and “implement”, is often very imprecise and abstract; and,
- there is a possibility that the criteria were not considered specifically by sectoral officials advising the drafters, but rather the assignments were determined more by current sector practice and “desires”, particularly of central sector agencies.

These weaknesses reflect more fundamental problems that include (i) the regulation not creating a system (including allocative rules) to identify and resolve problems with assignments, including processing disputes between governments, before or quickly after they arise and (ii) lack of clarity of roles with the terms “policy-maker”, “regulator”, “implementer” and the like being used very inconsistently.

Overall, lack of clarity of roles, of purpose and goals and of authority and accountability characterizes many service delivery functions at present. Lack of service standards further diminishes clarity.

2.3.2 PP 65/2005 – Clarity of Objectives via Minimum Service Standards

In relation with service standards, this Government Regulation contains definitions of (i) the minimum standard of service (MSS) (ii) basic service, and (iii) MSS indicators, as given below:

- (i) Minimum Standard of Service (MSS) is defined as: ‘provision regarding the type and quality of a basic service which is a mandatory affair of the region concerned and which every citizen is entitled to receive in minimum’;
- (ii) Basic Service is defined as: ‘a public service which is fundamental and absolutely essential to meet the needs of the public in their social and economic life and in governance’; and
- (iii) MSS Indicator is defined as: ‘a measuring rod for quantitative and qualitative achievement that is used to indicate the target size hoped to be fulfilled in achieving a certain MSS, in the form of input, process, output and/or benefit of the service.’

This Government Regulation contains general guidelines on the principles, formulation and application of MSS, and supervision and control in its implementation.

Pursuant to Article 3 of the Regulation, MSSs are to be developed by Government based on the following principles:

- MSSs are prepared as a tool of the Government and regional government to guarantee the quality of basic services and equitable access for all in the framework of handling the mandatory affairs;
- MSSs are set by the Government and is valid for all provincial governments and all district/city governments;

- The use of MSSs by the Regional Government is a part of conducting national basic services;
- MSSs are simple, tangible, easy to measure, open, affordable and accountable, with a time limit for attaining the MSS;
- MSSs are adjusted with the developments in need, priority, the national and regional financial capacity, institutional capacity and personnel in the regions in the sector being measured.

In determining the MSSs, the said Government Regulation provides directives as follows:

- The Minister/Heads of Non-Departmental Government Agencies formulate and determine the MSSs appropriate for the mandatory affairs, with reference to the laws and regulations that govern mandatory affairs – Article 4 paragraph (1) and (3);
- The MSSs should cover the types of basic service, MSSs have indicators and time limit – Article 4 paragraph (3);
- Formulating the MSSs is done through a process of consultation, for which the Minister of Home Affairs shall form a Consultation Team and act as coordinator of the various related ministries/agencies – Article 5;
- The results produced by the Consultation Team are delivered by the Minister of Home Affairs, in this case the Director General for Regional Autonomy, to the Regional Autonomy Board (*DPOD*) to obtain a recommendation to the Minister/Heads of Non-Departmental Government Agencies in the context of formulating the MSS – Article 6;
- In formulating the MSS, the Minister/Heads of Non-Departmental Government Agencies will follow the technical directives in the Regulation of the Minister of Home Affairs – Article 7 paragraph (2);
- Furthermore, to support application of MSSs, the Minister/Heads of Non-Departmental Government Agencies will prepare technical directives to regional government in a related Ministerial Regulation - Article 8.

In order to meet the provisions of the Government Regulation, the Minister of Home Affairs has issued a Ministerial Regulation regarding technical directives for formulating MSS;

Secondary legislation with respect to MSSs has been complete and some sectors have issued standards (see Chapter 5). The standards issued to date do not appear to have much ownership in the regions, appear to be technically oriented rather than community oriented and in general not meeting the criteria normally set for performance measures. From this perspective then, PP 65/2007 appears off-track for the time being as a tool to clarify objectives, improve accountability and generally enable Government to manage the regions through a results-oriented rather than input system.

Overall however, the Consultant believes PP 38/2007 and PP 65/2005 provide in principle a reasonable set of guidelines as to how service delivery is to work, although roll-out strategies and specific detail must be spelled out and improved further.

Clarity however begins to be lost once the bigger picture on decentralization of rules is considered, especially as to this day regulations concerning (i) the role of governors and (ii) the rules surrounding the making of local laws – both called for under Law 32/2004 - have not been promulgated.

2.4 Clarifying Objectives - Planning and Financial Management Legislation

One cannot assess properly the centre-regional relationship (or at regional government level, the core administrator-SDO relationship) without also looking at a number of other pieces of legislation, particularly financial management and national planning.

Reform of the Indonesian financial management system has run in parallel with Law 32/2004 (and its financial “brother”, Law 33/2004, which was basically meant to ensure that the resources were available to regional government to perform as intended under Law 32/2004). The next Chapter identifies key legislation, rooted in Laws 17/2003, 1/2004, 15/2004 and 33/2004, and for regional governments, PP 58/2005 and Permendagri 13/2006 and 59/2007.

The key issue in finance for the purpose of this chapter is assessing the degree to which the legal and regulatory framework is helping shift the expenditure management system to one where objectives and responsibility for their achievement are clear; one where the core administrators and legislators are able to control SDOs by outputs and outcome rather than inputs, and in which the SDO and community understand more clearly “who is doing what”. **Table 2.3** sets-out a broad classification of the types of expenditure control that may be operated by the government.

Table 2.3 Types of Control Over Service Delivery Organizations

| Level | Type of control | Control by | What is controlled | Mode of Accountability |
|-------|---------------------------|---------------------------------|--|---|
| 1. | External control | Core administrators | Inputs (number of personnel, wages, purchase of materials, services etc) | Compliance with each line of an itemized budget and all the rules of the government-wide PP58/2005 and Keppres 80/2003 regulations. All transactions can be pre-audited. |
| 2. | Internal control | SDO executive | Input classes Total wages, total administrative costs etc | SDO system and procedures complies with government-wide standards All transactions are post-audited |
| 3. | Managerial accountability | Managers of sections in the SDO | Outputs and total operating (running) costs | Accountability for outputs Ex-ante specification of outputs Ex-poste audit of results |

Source: Adapted from :Schick, Allen 1998; *A Contemporary Approach to Public Expenditure Management*; World Bank Institute

The listings of legislation on Figure 2.1 and Box 2.2 provide a hint at what is the current situation. Based on these, a number of widely agreed conclusions can be drawn about where Indonesia is in the levels in Table 2.3 for better central control of spending agencies:

- Most organizations across the Government of Indonesia are operating at Level 1 (in fact many would claim at less than this). Without going into detail, it is believed few would argue with the assessment that the intention to shift the control system, evident in Law 17/2003, still remains⁷, but has not progressed for a range of reasons – two being that (i) where to start on reform of the firmly entrenched current “input” system is unclear and (ii) incentives for change are weak because bureaucratic reform is not central to the political agenda.
- The regulatory framework for performance oriented financial control has been provided by Law 17/2003 related to state finances but it has not been supported well enough yet with detailed regulations, or in the actions of the core administrative units. Sporadic attempts to introduce performance-based budgeting in select regional governments (for example under the USAID sponsored “BIGG” and LGSP projects) has also stalled.
- Besides performance-based budgeting, the other key tool of the centre for performance management of SDOs is the Medium Term Expenditure Framework (MTEF), which provides the SDO with more predictability and a longer term horizon, thus helping connect planning to budgeting. Despite this tool also being mandated in Law 17/2003 and assistance to government from various donor projects, it has not been detailed or adopted formally (although a draft exists in DEPDAGRI).
- Strategic evaluation, despite a raft of recent legislation, is not yet being done, meaning budgets cannot be allocated based on performance considerations.

With respect to planning, Law 25/2004 with a 5-year perspective has also run in parallel with finance Laws 17/2003 and 1/2004 (that have 3-year perspectives) and Laws 32 & 33/2004, adding further to obfuscation of objectives, to who is in charge, to what the respective roles are and to what might be the consequences of failing to achieve planning targets. In particular, the objectives of national long-term, medium term and annual work plans (published each year in a Perpres are failing to filter down to regional governments through DEPDAGRI guidelines, and so, there is a perception that regional government plans and supporting budgets are not aligning with national plans on a range of issues, including service delivery.

Overall, the move to performance-based budgeting and improved certainty by use of MTEFs, which are the key tools for clarifying roles and objectives for SDOs, seems stalled. Part of the problem originates from low competencies in planning (inability to identify and set strategic objectives), developing performance indicators (relating objectives to programs/activities) and setting targets. To develop these quite sophisticated competencies across government simultaneously is very difficult. A stepped approach seems better – **Table 2.4** shows a common sequencing – from Step 1 to Step 9 - of how information on performance can be used to manage.

⁷ See for example, the presentations made by the Minister and various MoF officials at the seminar titled “International Conference on Modernizing the Budget System”, Jakarta, May 26, 2008

Table 2.4 Using Performance Information to Improve Performance

| Step | Activity | Purpose | Comments |
|------|--|---|--|
| 1. | Establish Variable and Fixed Costing regimes | Understand which costs vary with the volume of output, in contrast with fixed costs that are incurred regardless of the volume – as a basis for most performance management assessment. Then cost the programs/activities | PP 58/2005 and Permendagri 13/2006 has failed to do this well because personnel costs are basically classed as “fixed” |
| 2. | Performance Measurement | Provides basis for specifying expected performance and assessing managers and their organizations. Greatly improved by first developing strategic objectives | Budgets are not routinely being prepared with output oriented performance indicators |
| 3. | Performance Targets | Notifies managers of the specific results they are expected to achieve and establishes basis for assessing their performance. | Most results are still just inputs |
| 4. | Performance Reporting | Compares actual and targeted performance, with explanation of significant variances. Makes performance transparent and provides citizens/customers basis for judging the volume, quality, and cost of services. | PP 8/2006. PP 6/2008, PP 39/2007, PP 8/2008 all require performance reporting. Revised Inpres 9/1999 expected soon. |
| 5. | Performance Auditing | Independent assessment of the reliability and relevance of performance reports. | UU 1/2004, PP 79/2005. Doing independent professional assessment against KPIs is the challenge |
| 6. | Performance Benchmarks | (a) Provides basis for comparing performance with results achieved by other public or private producers; (b) Sets performance targets in reference to results achieved by most efficient producers. | Few benchmarks available. SPMs being developed. Some sector can provide benchmarks, not mainstreamed |
| 7. | Performance Contracting | Formal agreement between the government and internal or external providers setting forth amounts to be paid and outputs to be supplied. Performance-Based Pay Links all or a portion of a manager's pay to performance. | Largely unknown at present. Some “management contracts appearing (e.g. in MoF, DKI Jakarta, Gorontalo) |
| 8. | Performance Budgeting | Allocates resources on the basis of expected performance, with each increment in resources linked to a specified increment in output. | Not functional, despite requirements of UU17/2003 |

Source: Adapted from : Schick, Allen 1998; *A Contemporary Approach to Public Expenditure Management*, World Bank Institute

It is suggested that the introduction of Flexible Performance Agreements (i.e. performance contracts), despite being well down the list of steps, can help clarify and accelerate the process of changing the locus of control. More weight is being given to good planning process, and provided not all agencies are required to move in tandem, the process of FPA preparation can be used to do in the field for individual SDOs what may take many years for the centrally driven national framework to achieve.

2.5 Status Overall of the Core Administrative (Clarifying) Rules

Clarity in the rules for PEMDA requires them to take into account the suite produced by central government, not just Law 32/2004, although that admittedly is one of the main laws (if not main) they work within.

Appendix B.3 provides a listing and the status of the subsidiary legislation under each of the key core administrative laws:

- UU 32/2004 on regional government
- UU 33/2004 on the financial balance between central and regional governments
- UU 15/2004 of state audit function
- UU 1/2004 on the treasury function, and
- UU 17/2003 on management of state finances

that governs most of the operations of PEMDA. A summary of selected laws and regulations is provided in Appendix O.

As can be seen, not all secondary legislation is complete, let alone clarifications that come at ministerial decree level. This all clouds the ability of anyone to fully understand the principles being applied in design of the framework in which service delivery is to be performed. Specifically, the clarity of relationships between levels of government, within governments and between the core and service delivery organizations, seems to be the victim. PP 38/2007 and 65/2005 may have provided a general direction but the trail has become more confusing as the rules have accumulated.

This problem is not unusual in government – some would say it's the norm. One response of those promoting AMSD has been to propose use of “performance contracts” to cut through the jungle of rules. This approach has been at the centre of AMSD worldwide as the answer to clarifying objectives, roles and accountability between the core of government and the service delivery organizations.

2.6 Cutting Through the Jungle: Flexible Performance Agreements

Perhaps the defining feature of AMSD and its equivalents around the world is the use of a “contract” – or more correctly the “flexible performance agreement” or “performance contracts” - to clarify the relationship between the government owner and the SDO. The popularity of this instrument can primarily be ascribed to it:

- putting the relationship between policy-maker / owner and SDO “at arms length”,
- describing specifically the authority and accountabilities of each party,

- defining the meaning of “performance”,
- setting out the “flexibilities” or “autonomies” the SDO can expect to receive in return for the increased accountability, and
- providing a mechanism to sustain a dialogue between owner and operator about goals, roles, performance, authority, accountability and the obstacles to improved performance of service delivery.

IN EFFECT, THE FPA PROVIDES A MECHANISM FOR CUTTING THROUGH THE MAZE OF LAWS AND REGULATIONS FROM CORE ADMINISTRATIVE AGENCIES THAT IN TIME COMES TO OBSCURE ROLES, OBJECTIVES, AUTHORITY AND ACCOUNTABILITY WITH RESPECT TO SERVICE DELIVERY.

Box 2.2 provides a model for the main body of a FPA, while **Appendix C.1** includes both the main body of an Agreement and attachments of a performance scorecard of indicators and a list of “flexibilities” or “authorities” the SDO is granted.

The main issue with the FPA in Indonesia is probably “under what legal umbrella does it fall”? Specifically (1) is it a contract and (2) what “flexibilities” can in fact be granted to a SDO, if all are expected to comply with that maze of normative laws and regulations?

The first issue with this instrument is whether it is in fact a contract? The term “Performance Agreement” is used because we believe that enforceable contracts are not possible between one part of government and another. Hence the less threatening term “agreement”. Under what legislation this agreement would fall has not yet been identified.

The second issue of “flexibilities” is more difficult. Other than for BUMD and to a lesser extent BLUD, all the rules of government are meant to be universally complied with – be it by central departments, agencies, regional governments large and small, or the various commissions, bodies and other non departmental organizations (LNDP) unless specific exceptions are made.

At macro level this may be correct, but it is contended that on closer examination, it is likely that (i) for many situations there are no appropriate rules - i.e. there are gaps (ii) the rules will be found to be ambiguous and (iii) the rules are just plain inappropriate.

“Flexibilities” are assessed further in later sections related to financial management, empowered organizations (procurement and suppliers etc), and personnel management.

Appendix C.2 contains the only example of an instrument that resembles a FPA the Assessment has been able to locate in its review of all the Indonesian laws and regulation – and it only applies to BUMN and is in fact an agreement between individual manager and owner!

Again, the issue then is under what legal umbrella such an agreement would fall. Given Indonesia’s continental law background, there are sure to be asked questions as to “what laws says there should (or may) be a written agreement between the Head of Region and the Head of an SKPD setting out that relationship”?

Box 2.3 Example of a Flexible Performance Agreement (FPA)

| Main Body of Agreement Flexible Performance Agreement | |
|--|---|
| between | |
| Regency/City Regional Government of Sukamadju and Regional Drinking Water Enterprise of Sukamadju | |
| I. | Organization's Mission: (what is the most basic goal of the organization; why is there such a goal; and what does the "Mission Statement" sounds like) |
| II. | The most basic Responsibilities/Accountabilities of the Organization: " <i>Tupoks</i> " (main roles and function), e.g. provide service to all layers of society, provide water that can be consumed directly from tap, and does not suffer financial losses). |
| III. | Resources that will be provided during FPA III.1 Operational budget each year during the life of the FPA III.2 Investment budget each year during the life of the FPA III.3 Special conditions related to management of human resources III.4 Other resources (e.g. raw water with certain qualities) III.4 Special regulation regarding the system (s) for accounting, audit and reporting. |
| IV. | Expected Results (outcome or outputs) IV.1 Key Performance Indicators (KPI) at the organization level ⁸ (main outcome, not more than 5 to 10 KPIs that indicate achievement of goals) IV.2 Two KPIs from regional plan / RJPM (District level, not more than 2) IV.3 Role of the Service Delivery Organization / agency / company in providing policy inputs to the Regional Head and performance indicators of how well this task is performed. IV.4 The goal of the leadership unit of the Service Delivery organization – e.g. Board of Directors - itself (e.g.: enhance leadership capability, change organizational culture, etc.). IV.5 Methods to be used for measuring and reporting performance. IV.6 Methods to audit and measure performance so as to ensure that the process is accurate and fair. |
| V. | Approved Regulatory Flexibility⁹ V.1 In relation to budget management V.2 In relation to personnel management V.3 In relation to the procurement process V.4 In relation to other common/necessary services (i.e. "support services") required by the Regional Government. |
| VI. | Agreed Special Requirements VI.1 From the Regional Government/Regional Head standpoint (e.g.: if UFW is not lowered then it would not loosen the regulation on personnel) VI.2 From a SDO / agency/company standpoint (e.g.: Company is not asked to provide sudden contribution that is not linked with achievement of the company objectives, e.g. to finance PON (National Sport Week) activities). |
| VII. | Special expectation by Regional Government/Regional Head: (clarify any matters that is hard to measure yet need to be clarified, e.g. if the Board of Directors is requested by "authorities" to make a certain politically motivated contribution, then the request should be directly informed to the Regional Head). |
| VIII. | Accountability Regional Government/Regional Head: VIII.1 Who in the "steering organization" can be regularly met with to clarify direction, ascertain performance and or discuss issues? VIII.2 Explanation regarding a condition, in which Regional Government/Regional Head could intervene in the management of the organization (e.g.: during emergencies, or when the head is required by higher authorities to take certain actions). |
| IX. | Consequences IX.1 From a financial standpoint (e.g.: formula to calculate bonus if KPI targets are achieved – e.g. 20% if 80% of targets are achieved). IX.2 From a customer point of view; what happens if a service to the community is not according to standard as established by KPI or not according to the stipulation of laws and regulations? IX.3 From another perspective (adding or reducing flexibility in the FPA) |
| X. | Validity Period of the Flexible Performance Agreement X.1 3 to 5 years: (Ideally, long enough for Top Management / Board of Directors to have enough time to make careful changes in resource-provision and business processes). X.2 Period between reviews and adjusting the KPI targets (adjustments are only made if necessary, in order for the SDO/Board not to be confused by changes) |
| XI. | Procedure for FPA Amendment (Anytime based on the both parties' agreement) |
| Approved by Regional Head On behalf of District Regional Government of Sukamadju....Date: | Approved by Chief Director on behalf of Board of Directors of Drinking Water Regional Enterprise of ... |

⁸ See Appendix Attachment A for a typical "balanced scorecard" of performance indicators.

⁹ See Appendix Attachment B for typical "flexibilities".

2.7 Summary of Conclusions and Suggestions

This chapter has identified a large number of “normative” rules that should make clear the relationship between central and regional governments, by, among various means, distributing functions and setting standards. Unfortunately this is not happening very well. If it is not happening in the framework governing central-regional relations, it is unlikely to be happening at the local level between core administrative units and SDOs. Overall, there appears to be a need for more effort to make rules that clearly:

- define what performance consists of and how it is measured
- create an “arms-length” relationship between the “owners” and the service delivery agencies; and
- state who has the authority to change it.

If the maze of core administrative regulations being produced under Law 32/2004 and other laws are to be relied on, it may be a long time before clarity of roles, objectives, authority and accountability emerge. One impact of such a maze is that “none are effective”, ultimately returning the relationship between the core and line to one of “master-servant”. Regulatory reform/simplification is needed, as hinted at by Figure 2.1 and Box 2.2. The relationship between central government and regional government obviously needs improving, with the regulatory framework being the means. Better (and probably less) rules focused on performance determined by achievement of output and outcome standards, along with sufficient resources and autonomy in implementation should be aspired to.

It is suggested that a similar situation often exists in regional government between core administrative agencies (basically the Head of Region, DPRD, SETDA and BAPPEDA) and each SDO (or SKPD) – if not for volume of rules, then because of culture. Functions must clearly be delineated and standards set. PP 65/2005, PP 38/2007 (and PP 41/2007) could help guide this local effort, but do not yet do so very well (see later assessment related to PP41/2007 on organizational structure). From discussions in the three pilot projects, there appears to be no local laws at PEMDA level equivalent to the first two PPs that clarifies roles and sets service standards.

It is suggested the introduction of a Flexible Performance Agreement (FPA) is one way of improving clarity in this relationship between core administrators and each of their SDOs. It should cut through the maze of rules, provide a mechanism for dialogue, clarify who makes policy and who implements it, set objectives and standards and make budgets more certain.

The FPA can be authorized by a generic “local law” or set of rules that focuses on improving the relationship between owner and operator – one that creates an arms-length relationship, provides sufficient authority balanced with accountability and in general sets out as explicitly as possible the roles and objectives of each party – and that enables (in fact requires) an FPA to be concluded between each SDO and the core of government. This local law, which basically describes local government management arrangements, should of course be enabled by provisions in national laws, such as Law 17/2003 and Law 32/2004.

Appendix C.3 provides an example of such rules. It contains an extract of a law describing the structure for administration and management of a public sector in a particular (Australian) provincial government. Although it is intended to cover the case where Ministers have ultimate responsibility for public affairs, the principle of “arms-length” management are

clearly applicable even to Indonesia, be it in laws and regulations promulgated by central government, or at regional level.

The example also underlines the suggestion that creating more “contractual relations” between posts in the civil service should be done comprehensively in the law, and not just “tacked-on” to an existing civil service law in which other articles may not support the strengthened relationship.

Creating such “arms-length” rules are often resisted by decision-makers (those currently in power) because they can be seen to reduce their ability to rule as they wish – i.e. such regulations reduce their discretionary power. Again, the contention is that this can be handled by making rules about information and its management. **Appendix C.4** exhibits extracts of articles from a law that handles this situation by making explicit the duties and powers of the SDO and the “Minister”.

Having established more clarity and more incentives for performance in the overall legal and regulatory framework, the AMSD approach then concentrates on aligning resources, incentives and authority. The first area is money!

3. FINANCING THE DELIVERY OF SERVICES

3.1 Strategy 2: Cover Costs, Pay for Performance

Delivering services incurs production costs that obviously must be paid, from one source or another, either now or in the future. And most often, the higher the standard of service, the higher the cost of its delivery. User-pays, cost recovery by the SDO and subsidies for those unable to pay are key issues.

Sustainable delivery of services typically requires funding of the SDO that has the following characteristics:

- (i) covers the full cost of delivering the service,
- (ii) is provided over the life of the asset used to deliver the service (i.e. often over years),
- (iii) does not fluctuate excessively from year to year (thus enabling the SDO to plan),
- (iv) acts to discipline the SDO (i.e. provide a so-called “hard budget constraint”),
- (v) is put to efficient use, and
- (vi) results in the distribution of costs and benefits being perceived as fair.

As the references in **Box 3.1** (summarizing the tools that are frequently used to deploy the strategy) and **Appendix E.1** suggest, much of the legal / regulatory framework underlying this strategy is taking shape in Indonesia. Again, it is the Ministries of Finance and Home Affairs which are responsible.

The financing of new service delivery infrastructure is often the main topic of interest to many in Indonesian government (as opposed to efficiency), probably because very large investment is still required, unlike the developed world, where access is already high and the focus has firmly shifted to efficiency in use of existing assets.

The challenges at a macro level in funding service delivery are (besides keeping the framework clear and fully resourcing service delivery):

- Creating sensible rules that support governance processes leading to transparent service charge setting while encouraging PEMDA to maximize own-revenues without imposing nuisance taxes and charges (i.e. the case for cost recovery);
- Reducing the ever-present danger of “unfunded mandates” being foisted on regional government and similarly regional government foisting unfunded mandates on their SDOs, by insisting governments pay for service delivery, not SDOs; and
- Ensuring systems are in place for costing and accounting for service delivery expenditure.

Again, this Assessment does not attempt to assess all of the laws and regulations, as they are exceptionally voluminous – see for example Appendix E.1 for a list created from the database of “The Legal Agency”¹⁰. Key instruments can be tracked down therein. The focus rather is on identifying key laws and regulations, and issues, in relation to the AMSD strategy.

¹⁰ The Legal Agency is a business providing access to the some 16,000 laws and regulations promulgated by the Indonesian central government since 1945.

Box 3.1 The Tools for Strategy 2 (Financing Success)**Alternative Mechanisms Arising from the Strategy Element**

- A. User-pay mechanisms (typically payment directly to the service provider)
- B. Public service obligation (PSO): subsidy payments from government to the autonomous service provider(s)
- C. Public funding (public budget allocation).
- D. Equity financing: investments / injections (“shares”) in the service
- E. Debt financing: Funding by loans from various financial institutions (debt financing)
- F. Borrowing, using bonds (*obligas*) etc that have limited or do not use specific guarantees.

Tools for Implementing the Alternative Mechanisms

- A. **User-pay mechanism:** The most reliable source of funding is from the user of the service. This is possible if the service is not a pure “public good”. Key tools include:
 - 1. *Cost recovery tariffs:* based on some unit of service delivery; governed by UU 20/1997 regulating non-tax state revenue (*PNBP*), UU 32/2004 and 33/2004; and sectoral regulations (e.g. PP16/2005 on water services, which also regulates tariff setting and cost recovery procedures)
 - 2. *Service Charges:* for example as set by the government for waste management services – UU 32/2004, UU 20/1997 and related PP 22/1997
- B. **Public Service Obligation (PSO) mechanism:** subsidies paid for services that select users are unwilling and (especially) unable to pay for: - example at central level under UU19/2003 regulating State Owned Enterprises and PMK 49/2008 (PSO funds for poor passengers of ferries), PMK 121/2008 (PSO payments for postal services)
- C. **Public funding (public budget allocation) mechanisms:** The “traditional” way of funding:
 - 1. *Direct “votes”* from the local legislative body (APBD from DPRD) – PP58/2005, Permendagri 13/2006, 59/2007
 - 2. *Special Purpose Grants (“unconditional or “conditional”):* from higher levels – Under UU 33/2004 re DAK, Dana Dekon, Tugass Pembantuan; Grants under PP57/2005, PMK 168/2008, PP169/2008
- D. **Equity financing (“shares”):** Shares in the investment and risk; PP1/2008 for central government investment
- E. **Debt financing:** A financial institution or individual makes a loan:
 - 1. *Re-course lending:* The loan is secured by a guarantee provided by the “owners” – in theory – PP54/2005 on regional borrowing,
 - 2. *Non-recourse:* The lender takes an interest in the “project vehicle”, or does not seek a guarantee at all – see list of various PPs in Appendix B.3

Special Note: Basic competencies required for implementing this Element of an AMSD strategy are reliable costing (particularly Activity Based Costing) and accounting systems, and, for autonomous SDOs, ability to produce computerized financial projections.

Source: AMSD Project document: *Description of Strategic Elements of AMSD*, Nov 2008

The framework being constructed by the Government is extensive, but there may be a lack of good financing rules at the regional level, especially with regard to open transparent processes for setting service charges. This deficiency is brought on by, among various reasons, the volume of rules being generated at the centre. Further, a weak approach generally to regulating by process does not focus regional governments strongly on transparency and so works against successful routine adjustment of service charges.

It is suggested future AMSD efforts in helping particular agencies in PEMDA might first focus on creating one local law per regional government with transparent procedures that (i) help achieve the financing goal of cost recovery for as many services as possible (ii) contain transparent rules for tariff setting and cost recovery, and for those services where cost recovery is deemed not feasible, oblige establishment of subsidy schemes that encourage “payment for performance”, and (iii) improve accounting and activity costing systems.

Before assessing the framework in more detail, a general examination is made of the financing / financial management laws as a basis for the more detailed assessment. Then this detailed assessment will concern itself particularly with (i) revenue raising for SDOs because it is felt that that is an area that is not being well addressed and (ii) clarity in accounting for expenditure as a basis for establishing better user-pay and subsidy mechanisms. In this way SDOs will become more fully and more consistently resourced.

3.2 The Main Financial Management Laws and Regulations

3.2.1 A Listing of Key Laws and Regulations

In the context of public service delivery, there are an almost overwhelming series of provisions in the laws regulating administration of resources. The laws/regulations mentioned below are the main normative ones with provisions related to identifying, acquiring, managing and accounting for financial resources:

- Law 18/1997 on regional taxes and *retribusi* (charges), as amended by Law 34/2000¹¹
- Law 20/1997 on state receipts that are not taxes;
- Law 17/2003 on Management of State Finances;
- Law No. 1/2004 on the State Treasury;
- Law No 15/2004 on Control of State Finances
- Law 32/2004 on Regional Government (Chapter 8, with 39 articles provides general rules for raising revenues, expenditures, the role of BUMDs, asset management and processes related to budget management)
- Law 33/2004 on the Balance between Central and Regional Finances. It regulates:
 - (i) the revenues of:
 - shared resources (*dana bagi hasil* or *DBH* – covered by articles 11 to 26 and split into shared taxes and shares of natural resource levies - describes the proportions to central, provincial and local governments)
 - general allocation grant (*DAU* – articles 27 to 37 describes the formula to

¹¹ This law was superseded by Law 33/2009 (*Pajak Daerah dan Retribusi Daerah*), but until a range of subsidiary legislation is enacted, that for Law 18/1997 remains in force.

determine fiscal need, capacity and gap); and

- special grants (*DAK* - articles 38 to 42 sets rules for a funding mechanism designed to help regions perform functions that are their responsibility but for which they have limited financial capacity)

(ii) other grants and emergency funding

(iii) regional government borrowing – specific lending or through bonds

(iv) financial management matters such as spending unit plans and general financial management matters

(v) “deconcentration” (*decon*) and “tugas pembantu” (*TP*) assistance funds from central government to help regions perform functions that are formally the responsibility of central government

(vi) financial information system for regional governments; and

(viii) makes stipulations on transfer of *decon* and *TP* funding classes to the regular *DAK* mechanism in Article 108.

A series of “normative” or generic regulations with respect to budgeting and financial management procedures are available to support these laws, including:

- PP 58/2005 on Regional Finance Management;
- Regulation of the Minister of Home Affairs (*Permendagri*) No. 13/2006 on Guidelines for Regional Finance Management;
- *Permendagri* No. 59/2007, amending parts of *Permendagri* 13/2006;
- PP 54/2005 on Regional Loans – and subsidiary regulations of the finance minister;
- PP 57/2005 on Regional Grants and subsidiary regulations.

Further, “normative” rules are available (although not as many) specifically for the revenue generation activities:

- Government Regulation (*PP*) 22/1997 concerning types and the depositing of non-tax state revenues – and a long series of more specific finance minister regulations;
- PP No. 23/2005 on Public Service Agency (*BLU*) Finance Management covering both central and regional *BLU* (i.e. *BLUD*) – and finance minister regulations;
- *Permendagri* No. 61/2007 on Technical Guidelines for *BLUD* Finance Management.

Each sector also has rules that impact on financial matters – for example with respect to water supply and sanitation services, regulations relating to the basis for and process of setting service charges can be traced in the following:

- PP 16/2005 concerning water and sanitation services; and
- *Permendagri* 23/2006 regulating the tariff setting process of water enterprises.

A summary of selected laws and regulations is provided in Appendix O.

3.2.2 Revenues from Sales of Services

There are probably no equivalents at local level of Law 20/1997 regarding state income which is not tax (*PNBP*).¹², but it is worthwhile examining the key stipulations of that law, as a way of understanding how not to finance autonomous SDOs! Under Law 20/1997 concerning *PNBP*, the most relevant (and restricting) principles concerning the handling of *PNBP*¹³ are:

- Any *PNBP* to be received by a government entity must be specified under a law or under a government decree;
- All *PNBP* received by a government entity must be immediately deposited in a government account, not that of the SDO;
- All *PNBP* received are to be managed within the government budgeting system (*APBN*), not the SDO's;
- The Finance Minister designates government entities that may invoice or collect *PNBP* and the related services to be provided. Each year there are a number of government decrees issued that relate to specific types of *PNBP* and the amounts of the fees that may be charged by specified government entities;
- A government entity designated to collect *PNBP* may use a portion of the *PNBP* collected to carry out related activities, if approved by the Finance Minister. However, if a government entity is approved to use part of the *PNBP* collected, the *PNBP* collected nevertheless *must first be deposited in the government account and then the SDO entity must request that a portion of the funds be returned through the normal government funding processes*. This would mean that the SDO would have to wait a considerable period of time before ultimately being reimbursed for the costs it incurred in capacity development and delivery of services.
- Education and training are included in the list of activities which would qualify for use of a portion of *PNBP* collected.

Also relevant to the use of *PNBP* funds by designated government entities are: PP 22/1997 concerning Types and Depositing of *PNBP*; and PP 1/2004 concerning the Procedures for Submission of the Reports for the Planned and Actual Use of *PNBP*. Although SDOs could apply for status as an invoicer/collector of *PNBP*, this would be a very awkward way for SDOs to operate a cost recovery business. These restrictions were a main reason for the development of the BLU organizational form.

3.2.3 Law 33 / 2004 Weaknesses; and Complexity of Regulation

Lists of subsidiary legislation (PPs) under each of the Laws 17/2003, 1/2004, 15/2004 and 33/2004 are included in **Appendix B.3**. The true complexity perhaps can be appreciated by looking at just one stream of financial management, say capital expenditures. Expanding on the list of laws above, and giving special attention to those that regulate the capital financing of infrastructure and services, **Figure 3.1** shows what is believed are the main laws and regulations that currently just govern financing of service delivery infrastructure.

Law 33/2004 in particular is the main determinant of PEMDA financing, and therefore of financing for SDOs. The following issues ultimately impact on service delivery:

¹² Law 33/2009 now covers some of its principles, but details are awaited in the form of subsidiary legislation.

¹³ This analysis is based on work under GRS II in relation to establishing BLU.

- The management and collection system of Land and Building taxes – PBB of Article 12 – is in central government hands, thereby reducing incentives for PEMDA to keep up-to-date records on development and loosening the local accountability system;
- The allocation of the general block grant is reduced as the PEMDA raises its own revenues (PAD), thus serving to reduce incentives for cost recovery (see Article 32);
- Special Grants (DAK of Articles 38 to 44) are, despite the law, most often managed entirely by central ministries, reducing accountability and effectiveness at the local level and often making asset transfer and registration problematic;
- Similar problems exist for Deconcentration and Assistance Funds (Articles 87 to 100);
- Loans, a traditional way of funding infrastructure for service delivery, can only be used for “income generating projects” (Article 53 (3)) and bonds for projects “which generates income and brings benefits to the public” (Article 57(4), despite many essential services not being income generating by nature.
- It remains unclear whether the law truly is solving the problem of “vertical” and “horizontal” funding imbalances and may in fact be contributing to creation of “unfunded mandates”.

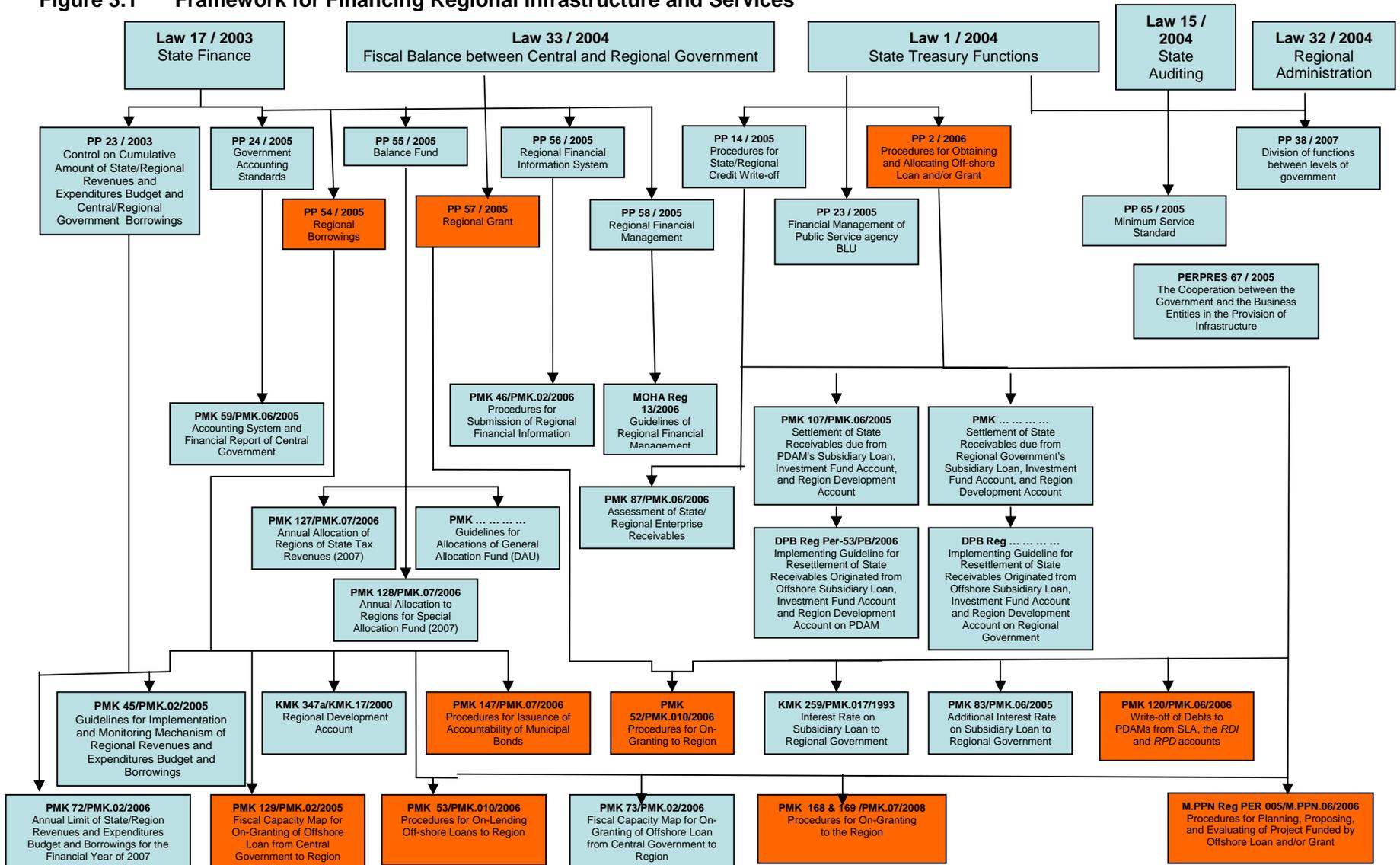
3.2.4 Overall: Complex, Inflexible and Not Incentiving

Overall, this set of normative laws and regulations should be effective in a general manner in regulating revenues and expenditure but among various problems, they can be accused of being (i) too inflexible through the “one-size-fits-all” approach they take (ii) too focused on expenditure and accounting for it and (iii) cause doubts when applied to certain agencies which are more autonomous – for example to BLUD and BUMDs and independent SDOs, which auditors seem particularly fond of attempting to make subordinate to the core administrative rules.

Further, the capacity to implement is low (as the large number of disclaimers on annual accounts prove), part of which may derive from the framework’s complexity.

Finally, as demonstrated by the issues with Law 33/2004, incentives for developing local revenues and using it in a system of improved local accountability for SDOs is difficult at present.

Figure 3.1 Framework for Financing Regional Infrastructure and Services



Source: Adapted from a presentation by D. Woodward

Unravelling and improving the regulatory maze that has developed around financial decentralization of regional government and its deleterious effect on their SDOs (especially on “ownership” and incentives) is an on-going program for central government for the foreseeable future. Increasing local revenue generation, ensuring investment funding mechanisms do not raise moral hazard i.e. are seen as “hard budgets” and are quickly accounted for (and depreciated) in regional government accounts are the main challenges.

Further general assessment of the strengths and weaknesses of state financial management laws and regulations is far beyond the scope of this Assessment, but there are four areas that the Consultants have come across which needs attention. The remainder of this Chapter focuses on paying for performance – and especially “payment” of SDOs for producing and delivering their services – and calculating the cost of production for which payment is required.

3.3 Strengthening the Revenue Side of Accounts

Governments are traditionally good at spending money but not so at raising it. And yet sustained financing of service delivery is founded on PEMDA selling more (if not most) services.

It may be a problem of locating and grouping appropriate rules from a long list, but the examination of the laws and regulations in Appendix E1 and in Figure 3.1 does hint at the dearth of rules concerned with the revenue-raising side of finances. PEM is displacing PFM. All governments must expend funds, but not enough focus is being placed on the other side – the revenue raising activities – the entrepreneurial aspects, so to speak. And not all sectors are equally addressed. For example water supply has its own regulatory regime, where many other government services do not.

It is suggested a focus on this matter, including study, is a worthy effort. It will require time and could be done thoroughly and in-depth during the implementation of the Blueprint (strategy) for promoting AMSD (in the second phase of implementing this project). The purpose of conducting a study of the related laws and regulations is to obtain a clearer picture about whether the framework of rules is adequate to support the sufficient and predictable allocation of resources for the implementation of service delivery through an “AMSD organization” while strengthening accountability processes.

3.4 Separation of Commercial from Other Objectives

A second issue, which is closely related to any debate on revenue-raising and cost recovery, is “for what service to whom and why”. This frequently causes problems is the multiple objectives placed on SDOs – on one hand being expected to achieve a range of social objectives - like services to all layers of society whether they can afford the service or not - while on the other being expected to act commercially (to generate *PAD*), not to lose money if not to make a profit and in general act in a business-like manner. SDOs often complain of suffering different messages from different committees of their Council.

The Assessment believes that this is another area that laws and regulations could be improved. The responsibilities of the managers of *dinas* and other SDOs should be clarified by making any commercial objectives explicit, if that is the Council’s desire, and then,

further, being explicit about the procedure when non-commercial objectives are also expected to be achieved. **Appendix E.2** provides an example (admittedly for a State-Owned Enterprise, the closest equivalents of which in Indonesia are the BUMDs such as regional-owned water companies, and perhaps BLUDs).

It is suggested that such explicit rules need developing because without them, funding provided to SDOs, even through such performance oriented mechanisms as “Public Service Obligations” (PSOs), may not even achieve their social objectives as accountability is diffused.

3.5 Framework for Payment of Public Service Obligations

A third and related area of particular concern is that of how to pay subsidies to SDOs in a manner that does not reduce their incentive to provide services to those who are deemed to be unable to pay the cost of the service (i.e. the poor).

A search of all the laws and regulation reveals little – in fact only in relation to central government owned BUMN – could a reference be found to “Kewajiban Pelayanan Umum”:- or “public service obligation” (PSO) – for payment to autonomous state entities for economy class travellers on ferries and trains, and for postal services. The regulations (from the MoF) are:

1. PMK No. 49/PMK.02/2008 on Procedures for Provision, Payment and Accounting of Funds for Implementing Public Service Obligations in Sea Travel for Economy Class Passenger – in other words a PSO payments for economy class passengers on ferries (*PMK 49/2008 tentang Tata Cara Penyediaan, Pencairan dan Pertanggungjawaban Dana Penyelenggaraan Kewajiban Pelayanan Umum Bidang Angkutan Laut untuk Penumpang Kelas Ekonomi*)
2. PMK No. 121/PMK.02/2008 on Procedures for Provision, Payment and Accounting of Funds for Implementing Public Service Obligations in Postal Services. (*PMK 121/2008 tentang Tata Cara Penyediaan, Pencairan, dan Pertanggungjawaban Dana Penyelenggaraan Kewajiban Pelayanan Umum Pos; and*
3. PMK No. 69/PMK.02 1 2007 on Procedures for Provision, Payment and Accounting of Funds for Implementing Public Service Obligations in Economy Class (*PMK 69/2007 tentang Tata Cara Penyediaan, Pencairan, dan Pertanggungjawaban Dana Penyelenggaraan Kewajiban Pelayanan Umum Bidang Angkutan Kereta Api Kelas Ekonomi*).

A note is included at **Appendix E.3** on designing and implementing PSOs. In Indonesia it seems the concept has been accepted at national level, but is unlikely to have appeared in the legal and regulatory framework for regional SDOs. It probably should because it places the responsibility for paying for services to the poor with the government while improving incentives of the SDO to be efficient.

One might argue that it is no more than “performance-based budgeting” (which is true), but whereas PBB is being (very slowly) introduced for all organizations within government under the direction of UU 17/2003, the PSO mechanism offers the opportunity to do it in a targeted

manner – for those SDOs providing services most in need of support to improve service delivery. Introducing a PSO contract is to the AMSD financial strategy what the FPA is to the clarity strategy. It is the financial equivalent of the FPA.

Box 3.2 outlines the subjects covered by a typical “contract” for a PSO. Key success factors include identifying those eligible, typically poor households (*MBR*), being able to calculate the cost of service, paying the SDO only when they the household receives the service, and ensuring consequences when this does not happen.

3.6 Identifying Expenditure to Calculate Payment and Measure Performance

The fourth issue concerns the costing of service delivery¹⁴ – which is needed as a prerequisite to charging cost-reflective tariffs and for accountability. Basically the rules under Permendagri 13/2006 and Permendagri 59/2007 on regional government financial management are not explicit enough to allow sensible costing of each service delivered. At best, round figures can be gained for sectors, but, other than for BUMD, overhead costs include salaries and are classified as *tidak langsung* (non-direct). They maybe “fixed” but surely should still be allocated to specific activities.

Related to expenditure is the issue of asset valuation and the calculation of the cost of depreciation. Currently, few capital expenditures are being entered quickly and accurately into regional government accounts, meaning depreciation is not being fully included in the calculation of service charges.

If costs for types of service cannot be calculated, it is not possible to produce sensible indicators of performance and therefore it is very difficult for legislators and the community to know what the full cost of delivering a service is and therefore to “pay for performance” (Strategy 2). Further, introducing “performance-based budgeting” (Strategy 1) and performance management (Strategy 3) is problematic.

3.7 Summary of Conclusions and Suggestions

Reference back to Figure 1.2 on sector structure shows that financing and financial management rules are critical to achieving sector structures in which roles, authority and accountability are clear. Revenue from sale of services should be maximized; where APBD is used to pay the SDO, it should be on a PSO (performance) basis and where asset creation is funded by a public budget, regulations should enforce a “hard budget” discipline on the SDO.

There are six areas that the Assessment has identified as needing further consideration. It is suggested improvements are sought based on the following:

¹⁴ See for example: GRS II Working Paper, 2009, *Activity-Based Costing* and GRS II Working Paper, 2009; *Direct and Indirect Costing*

Box 3.2` Typical Contents of a PSO Contract

PSO contracts between the government and SDOs are simply contracts for the delivery of certain services to low-income members of the community. These contracts should be established between the core government agency responsible for a sector acting on behalf of the Government, and the organization providing these public services. In structuring a PSO contract and negotiating it with a service delivery organization/supplier, the government agency should consider the following important points:

Recital: contract between the Government, represented by and the supplier ...(say RSUD)

The Obligations to be Performed

1. Definition of services (quantity, quality, timeliness and location)
2. Target group
3. Eligibility criteria of target group
4. Customer information / customer charter
5. Service level incentives

Administration

6. Terms and conditions of the contract
7. Dispute resolution
8. Definition of change events and adjustment mechanisms
9. Contract variations
10. Subcontracting / agency provisions
11. Default and termination
12. Confidentiality
13. Force majeure
14. Indemnity and insurance
15. Operating procedures
16. Legislative provisions

Costing

17. Costing methodology (including reference to specific costing studies)
18. Indexation
19. Responsibility and timing of reviews
20. Administration costs
21. Community service delivery costs

Payments

22. Billing arrangements
23. Funding methods and timing of payments
24. Payment terms
25. Price

Performance Monitoring and Enforcement

26. Performance measures
27. Reporting arrangements (timing)
28. Customer complaints procedures
29. Auditing
30. Penalties for non-performance

Other

31. Training requirements
32. Information and intellectual property
33. Automatic Expiration, if not renewed

1. Overall, there is a plethora of legislation which is largely based on a one-size-fits-all approach. It probably confuses PEMDA and raises the risk in their eyes of being innovative in relation to public financial management; continual simplification and encouragement to regulate whole systems and yet differentiating to whom it applies may seem like competing objectives, but should be pursued. The objective of granting autonomy applies to SDOs as much as to regional governments.
2. The predictability and sufficiency of resources (both from centre to the regions and from the regions to their SDOs) are problematic. Improving it is a major task beyond AMSD; the first step is to acknowledge that performance cannot be expected of SDOs if they do not have the resources to produce that performance;
3. The revenue raising side of service delivery appears to be poorly regulated in terms of processes that ensure predictability, transparency and participation, and therefore weaken the achievement of cost-reflective pricing and sustainability;
4. More explicit rules are required to differentiate social, environmental, institutional, security and commercial objectives of SDOs;
5. Introduction of a Public Service Obligation mechanism within regional governments to pay SDOs for service delivery where the customer is deemed unable to afford the payment of cost-reflective prices provides an alternative approach to the (currently stalled) introduction of performance based budgeting across the whole of government; and
6. On a technical matter, lack of activity-based costing rules, and the current allocating of salaries and related overheads to “in-direct costs” makes near impossible the calculation of real costs for each service and of performance, and therefore the wide achievement of the much sought-after cost-reflective pricing of services.

It is suggested the exact legislative solution to these problems needs working-out between the various central administrative departments, but that the AMSD program can help develop and pilot local legislation.

4. CONSEQUENCES (REWARDS AND PUNISHMENTS)

Most regional governments' service delivery organizations - Dinas/SKPD, Regional Government-Owned Enterprise (BUMD) and so-on - are monopolies, as certainly are its core policy-making, administration and compliance functions, performed by SETDA, BAPPEDA etc. There are few rewards for performing exceptional work and few punishments for not performing. There is no competition to discipline actions. There are few or no “markets” in these activities.

If there are no consequences for delivering good or bad service, why exert the effort, make change and take the risks that improving service delivery needs? Change involves some risks; but civil servants are not rewarded for taking risks and face considerable “punishment” if the risk eventuates, no matter how well intentioned.

4.1 Strategy 3: Increasing Consequences for Performance

Reward and punishment in the public sector is widely acknowledged in Indonesia as lacking. The challenge in the legal and regulatory framework is how it can be done “structurally” (i.e. in the form of correct inter and intra-organizational design for public service delivery, especially introducing competition using market mechanisms) and how it can be done fairly at the individual level.

As the references in **Box 4.1** (summarizing the tools that are frequently used to deploy the strategy) show, much of the legal / regulatory framework underlying this strategy is again taking shape in Indonesia. Service Agencies (BLUD) and BUMD organizational forms are an option for selling services. And again it is mainly the core administrative agencies of central government – especially the Ministry of Finance and to a lesser extent BAKD within the MOHA (with some exceptions, such as the Ministry of Education) – that are producing these rules, despite criticism as to their complexity, timeliness and quality. At least the importance of such alternatives for improving service delivery has not gone unnoticed by some in government.

This Assessment does not attempt to assess all of the laws and regulations, as they are voluminous – although a compilation has been made of those thought relevant to State-Owned Enterprises (BUMN) because they tend to lead in terms of concepts of incentives, autonomy and accountability for SDOs (see **Appendix G** for a list created from a database held by “The Legal Agency”). Some interesting instruments have been tracked down therein.

Examination of the tools (in Box 4.1) suggests a number of areas worthy of assessment:

1. The norms and formal rules that may exist for establishing which services can be provided in a more competitive environment basically by selling or “commercializing” them;

Box 4.1 The Tools for Strategy 3 (Raising Consequences)**Alternative Mechanisms Arising from the Strategy Element**

- A. Make service deliverers compete in the market – often called “enterprise management”
- B. Make service deliverers compete for the market – often called “managed competition”; and
- C. “Performance management” (for whatever alternative is chosen, at both the organization and individual levels).

Tools for Implementing the Alternative Mechanisms

Contracts are the basic tool for all three mechanisms. The tools for the three alternatives include:

- A. **Enterprise management:** where service deliverers earn their budgets by selling services in the market; e.g.
 - 2. **Corporatization** in which the government service deliverer falls under commercial law – possibly covered by the BUMD law (UU 5/1962, and certainly covered in the draft revision of that law) – ideally with independent governance.
 - 3. **External Enterprise Management** (or “*Revolving Fund*”) – as per PP 23/2005 for BLUDs (mandated in UU 1/2004) and UU 5/1962 concerning BUMDs
 - 4. **Internal Enterprise Management:** make internal service providers compete in the market to provide certain services to the SDO
- B. **Managed Competition:** where service deliverers earn their budgets by winning a competition against one-another for government work. e.g.
 - 5. **Competitive Bidding:** raises consequences and efficiency by forcing SDOs to compete to deliver services that are paid for by public money. It comes in three forms:
 - 1. *Public versus public competition;*
 - 2. *Public versus private competition –as is regulated by Perpres 67/2005.*
 - 3. *Private versus private known as “contracting-out” / “outsourcing” – probably covered by Keppres 80/2003.*
 - 6. **Competitive benchmarking:** Compares routinely performance with other organizations –the Penghargaan Abdi Negara awards from MenPAN are an early attempt to deploy this tool.
- C. **“Performance management”** – as is being introduced under Keppres 7/1999 on accountability of government organizations (and perhaps ultimately under UU 17/2003 on state financial matters and 43/1999 on the civil service). A management task of the executive (not the legislative branch) done by:
 - 7. *Setting agreed standards and targets*
 - 8. *Negotiating targets against which performance will be assessed:*
 - 9. *Measuring performance against targets*
 - 10. *Linking performance and rewards / punishments.*

Source: AMSD Project document: *Description of Strategic Elements of AMSD*, Nov 2008

2. The existence or otherwise of comprehensive set of rules (a framework) and model documentation that addresses all the behaviours needed to produce the correct incentives that the more autonomous organizational forms of BLUD and BUMD theoretically are able to mobilize;
3. The presence of sensible rules on customer payment for services (i.e. on commercialization) that support a process of achieving cost recovery for as many services as possible;
4. Incentives for PEMDA to establish internal enterprise funds; and
5. Determining when to use the various forms in order to maximize competition and consequences without suffering too many “market failures”, and when the occasional but inevitable failure does happen, what then to do.

This Assessment concerns itself with most of the above, especially the general theme of “competition”, because it is felt that that is an area that is not being addressed. However, before assessing it in more detail, an overview of the framework for encouraging competition and providing consequences gives a basis for the more detailed assessment.

4.2 Enterprise Management

4.2.1 Allowing the Market to Provide Consequences

Introducing enterprise management rules (especially concerning commercialization of the product and corporatization of the SDO, and especially for so-called “external enterprise funds”) forces the SDO to survive by selling services to its customers – if the services are not to the customers’ liking and the customers’ have a choice, then the service is likely to be purchased from another provider.

The incentives to provide a good quality service are therefore strong because of the consequences for the SDO – no service, no pay if they are no longer funded from the government budget! The accountability is direct. The BLUD and BUMD organizational forms (created under Law 1/2004 and Law 5/1962 respectively) are good mechanisms to raise consequences and therefore well conceived, but implementing the theory faces a number of challenges, including:

1. Applying to services where the most customers are not willing to buy the service – for example policy, regulatory and compliance functions are true public good that benefit everyone and few are willing to pay for other than through tax. Further difficult classes of services are:
 - The service is in the public interest – the classic lighthouse example
 - Non-payers cannot be excluded – unfenced parks for example
 - Some customers who use the service are deemed to be unable to afford it – poor people with respect to health, education, water and sanitation etc (although one solution – with provisos - is the PSO mechanism);
2. A reluctance of many DPRDs to provide autonomy for any SDO which needs APDB funding, no matter what proportion of its overall funding that represents;
3. Many services are deemed by PEMDA to be “natural monopolies” and therefore turned into “statutory monopolies”, which means there is little competitive pressure even after

the enterprise has been established – Training Centres (Diklats) are a case in point, in fact most local services, rightly or wrongly;

4. PEMDA enterprises inevitably seem to be given social as well as commercial goals, but not the funding to undertake the activities to achieve these social goals;
5. The link between performance and accountability is often weak, no matter what the organizational form – so budgets are supplemented from APBD without performance conditions – producing the “soft-budget” syndrome; and
6. Intervention (micro-management) from elected officials and the executive.

Many of these difficulties may be addressed for BUMD in the planned revision by MOHA of the BUMD law (UU 5/1962)¹⁵. This Assessment will not venture into this area, often called “corporatization”. It is better at this stage to briefly assess the consequence aspects of the BLUD framework and other aspects of generating a more competitive environment for public service delivery, which Law 5/1999 concerning prohibition of monopoly practices and unhealthy commercial competition does not regulate.

4.2.2 Some Criteria for Assessing Rules on Enterprise Funds

Experience indicates that enterprise funds (and especially BLUDs that may be created under Law 1/2004) need a certain set of conditions – not unlike the commercialization and corporatization that goes with a general movement to government-owned enterprises - to be successful. The regulations should ensure:

- Managers can manage the SDO themselves like a business – and not like the public service with its many and rigid rules – they need managerial flexibility;
- Managers are given operational control;
- The politicians are “onside” – ensure they do not vote “soft budgets” but rather pay for performance, not inputs, if they must subsidize the SDO;
- That the core administrative agencies – BAPPEDA, SETDA, BAWASDA, BKD etc also understand the basic equation – more accountability will be demanded in return for the granting of more autonomy;
- The SDO can be held financially accountable – dedicated accounting systems, activity based costing and strategic plans are important; and
- Re-orientation of the SDO to the customer by insisting on customer surveys and the like to give the customer voice.

Attaining this condition during creation of the first BLUDs is obviously difficult and might suggest that corporatization (creation of a BUMD) could be seen as an easier and better option for PEMDA than moving their SDO to BLUD status. Any assessment of the BLUD framework under UU1/2004, PP23/2005 and subsidiary regulations should certainly examine whether the conditions above have been addressed. Typically the shift from Dinas to BLUD form should require:

¹⁵ The revision was listed in the National Legislative Program (PROLEGNAS) by the DPR for 2009, but did not go forward.

- 1 Clarifying first what the product (and related policy) is – is it a service the customer is prepared to pay for entirely at “market rates” (in which case the SDO might be corporatized directly) – or will it need a subsidy and is not expected to turn a profit?
- 2 Launching with business plans and performance indicators to help provide the autonomy with accountability;
- 3 Moving tariff/service charge setting out of the political realm into a set of transparent rules/processes that especially encourage customer participation in the process;
- 4 Letting the enterprise keep at least some “profits” as an incentive to invest and improve service;
- 5 Not requiring the enterprise fund to pay from their own resources for service delivery to customers who cannot afford the service (to keep incentives intact);
- 6 Allowing the managers of the enterprise to structure the organization according to the sectoral / business needs – not according to some predetermined hierarchal structure typically mandated for all governments;
- 7 Understanding the employees may resist the change – so get good managers!; and
- 8 Allowing time (say 2-3 years) for the enterprise to understand its business – support wisely in the meantime.

It is suggested that apart from a general mis-understanding of the motives for creating BLUDs, and the political will of DPRD, the greatest (technical) obstacle to deploying this tool is the current lack of functional accounting and costing systems within government. This weakness needs addressing urgently, even if it means establishing such systems on an individual basis (sector by sector or by regional government).

4.2.3 Where is the Internal Enterprise Management Tool?

The next tool under this AMSD strategy is “internal enterprise management”. It creates “profit” centres for internal service providers that then sell their services to other organizational units, including SDOs, within the government. They might be divided further into:

- Services that the SDOs can purchase from anywhere - including the private market place – for example, building maintenance, payroll, printing, travel, training and capacity development, ICT services etc; and
- Internal monopoly services that the SDO must use because it is thought by PEMDA that competition cannot be allowed - for example, perhaps: planning, treasury functions and certain audit functions.

No evidence was found by the Assessment that the government has regulated with the aim of encouraging or forcing PEMDAs into these arrangements, although the tool has been observed in informal use in some locations, for example with photocopying and binding services. Typically, to deploy the tool, a market discipline needs to be imposed on the internal service provider/cost centre through:

- 1 Specifying the services or types of services which may / must be delivered in this way;

- 2 Allowing the customer agencies to buy from wherever, not just the internal service provider;
- 3 Shifting the authority over the budget / funding from the enterprise fund / supplier (for example the Diklat) to the customer agencies (for example the Health Service and its hospitals);
- 4 Allowing the internal service provider to set its prices based on market rates;
- 5 Forcing the internal service provider to pay for all costs – including overheads (building usage, manager’s time, depreciation etc);
- 6 Requiring a portion but not all of any profit be returned to the general fund;
- 7 Providing “loans” for obtaining and improving capital equipment; and
- 8 Allowing budgets to be carried-over between years.

It is suggested that overall, in this area a central agency, such as Directorate Generals BAKD and PUM in the MOHA, working with the MOF and MenPAN could do much to promote the use of internal enterprise management. Again, good entry points would be (i) revision to the accounting systems to allow easier capture of cost and performance data (ii) identification of the internal services that are produced in the typical PEMDA and (iii) drafting of a clear policy statement on the matter.

4.3 Managed Competition

4.3.1 Competitive Bidding

This tool is the first major tool of “managed competition” and is often described as “competition for the market”. In its simplest form of delivering efficient inputs, it is central to the Indonesian system. However, under this mechanism in AMSD, SDOs compete for contracts to deliver services purchased by the PEMDA on behalf of the community.

Relevant legislation is minimal at present:

- UU 5/1999 on monopolies - but it is currently generally agreed the legislation does not apply to public services;
- UU 50/2007 on cooperative arrangements within government – but the law only addresses competition obliquely through regulating “cooperation”;
- Keppres 80/2003 providing the public procurement rules - but these are predicated on purchase of inputs from private providers only when the PEMDA sees fit and that are then combined to become outputs;
- Perpres 67/2005 covers the purchase (admittedly in a competitive manner) of services from private providers where investment by the private sector is desired – again only at the discretion of the PEMDA; and
- Permendagri 22 and 23/2009 under PP 50/2007 that MOHA/PUM that elaborate on some of the issues related to the above – but it will not have any element of compulsion and does not set out criteria for rationalizing choice of services that should be subject to contracting-out (i.e. to competition).

A summary of selected laws and regulations is provided in Appendix O.

Nowhere has the Assessment identified legislation that mandates/requires the following:

- Contracting-out (alternatively called “outsourcing”);
- Voluntary and regular “market testing” through contracting-out; and
- Compulsory competitive tendering for certain types of service delivery.

While it is accepted that there may be some services that are better shielded entirely from competition and, allowing for the so-called “fungal economies” (i.e. under-developed markets with supposedly a lack of qualified suppliers) in many regions, it is believed the services which could be delivered by the market are far more than most government officials (and possibly many Indonesians) believe.

Table 4.1 provides a list of pros and cons for contracting-out. PEMDA would find useful a list of criteria from central government to guide them on decisions as to what functions might be contracted-out.

Table 4.1 Advantages and Disadvantages of Contracting-Out

Advantages / benefits

| Benefit | Description of benefit | Explanation |
|-------------------|---|--|
| Specialization | Concentrating on those items in the value chain the organization has distinctive capability | Specialization yields economic efficiency overall if each organization is relatively more efficient than others at performing the item. Specialization also facilitates exploitation of scale. |
| Market discipline | Makes use of the condition in which the purchaser of an input is separated from the provider and a formal transaction happens under contract. | Market discipline results in a number of benefits – focus on the outputs, not inputs, contestability between suppliers, choice for purchasers and innovative work practices. |
| Flexibility | Ability to adjust scale and scope of services at low cost and quickly | A network of small produces in the value chain can adjust more quickly to changes in demand compared with large integrated organizations |
| Cost savings | Lower cost of inputs compared to in-house production because specialization and competition can be mobilized | Overall savings of up to 20%. Specialization and competition do not necessarily lead to lower quality |

Disadvantages / Costs (claimed)

| Cost | Description of cost | Explanation |
|-----------------------------|--|--|
| Coordination | As different items on the value chain are produced by different organizations, coordinated investment and production | Economic activity can be coordinated by prices or hierarchical “command and control”. Price coordination by the market is generally considered more efficient. |
| Cooperation relies on trust | Replaced the market coordination | Cooperation requires trust between the |

| | | |
|------------------------------|---|---|
| | mechanism with cooperation. | purchaser and supplier. Contracts help this, but in the end different organizations have different objectives and maintaining trust can be difficult. May not encourage investment in specialized assets. |
| Cost of transacting | Writing tender and contracts, searching for, selecting and negotiating contracts are all explicit costs of setting up a contracting regime. Implicit costs also involved because of the inability to specify in advance all requirements. Hold-up and other costs may appear. | Any change in the current structure will incur costs. They may be more than the current costs. If in total they are more than current, the new structure is not efficient as the existing. The “command and control” type of coordination that the a single organization enables may therefore be more efficient. |
| Cost of monitoring | An organization providing a service for another organization required monitoring. This incurs cost. | If produced by the same organization, there may be less need for monitoring, although this is doubtful. |
| Loss of control | The need to get complimentary assets working together requires control. Those with responsibility for overall delivery may have difficulty controlling the (unbundled) items in the value chain. | This view tends to see control as command over inputs. In fact the control may be a different form – of control over outputs and outcomes – see Element 5 |
| Hollowing out | Reducing the producer in size with most production activities by others | There are many successful “hollow” service delivery organizations. There must of course be organizations capable of the production |
| Loss of skills | Inability to produce and purchase the service because lack of in-house skills. | Skills are still in the market place – they just shift. |
| Loss of corporate memory | Collective knowledge may be diluted | Productive relationships with suppliers may be difficult to maintain. |
| Weakened innovative capacity | Contracting to others reduces incentives to solve problems one-self | Accepting low bids may lead to this. ON the other hand, competition encourages innovation |
| Transition costs | Moving from in-house to external production requires re-organization, which has costs of its own. | Any change in structure incurs costs. They just need to be minimized. Ultimately, total benefits must exceed total costs, including transition costs. |

Source: AMSD Project document “Description of the Strategic Elements”, Nov 2008

The criteria could include as follows:

All services may be contracted-out other than when:

- 1 *Safeguards are needed for ensuring public policy-setting remains in government hands – provision of security and guarding “due-process” would be generic examples*
- 2 *The contract will create a new monopoly and there are no plans to restructure the sector to lessen the monopolistic characteristics (e.g. to create an independent regulator)*
- 3 *Critical capacity of public organizations may be lost – for example, an ability to respond to a disaster; and*
- 4 *The public feel so negatively about involvement of the private sector that, politically, the change is deemed unviable.*

It is suggested that overall there is a need to be explicit with PEMDA concerning the acceptability of contracting-out each of the functions identified in PP 38/2007. Without this explicitness from central government (which would be seen as neutral and professional), the risks of a backlash from some parts of the public and from some state auditors may discourage PEMDA from seeking market solutions to service delivery bottlenecks.

4.3.2 Competitive Benchmarking

In those cases where market competition is not present but competitive pressures are still desired, a substitute for competition can be introduced through benchmarking – comparing the performance of one SDO with similar aspects of performance in another SDO.

Although this Assessment has not investigated sectoral regulations, it did not identify anywhere explicit requirements for PEMDA to provide performance information for benchmarking purposes. Some voluntary initiatives however are known-off:

- In water supply, the Association of Water Companies (PERPAMSI) have established a comprehensive system for their member PDAMs ¹⁶, and BPPSPAM attached to the Department of Public Works (*DPU*) is establishing its own version;
- River basin management organizations are beginning to benchmark performance under a DPU sponsored initiative;
- The Department of Health is thought to be developing a benchmarking system for hospitals; and
- State-owned enterprises (BUMN) can join a “process benchmarking” system being developed by the State Ministry for State-Owned Enterprises based on the American “Balridge Organizational Excellence” framework.

The closest regulatory instrument identified is the recently promulgated government regulation on evaluation of PEMDA performance (PP 6/2008) which contains indications that results of the evaluation will be used for, among various purposes, benchmarking of performance, although the term is not used explicitly.

The experience to date shows that success in use of this mechanism requires at least the following critical actions:

- Measure customer perceptions - as perceptions of “performance” can be very different between operators and customers;
- Measure performance with fewer rather than more indicators - although a balanced view is still necessary;
- Get ownership of the indicators and resulting measurements by the SDO – which almost certainly requires a continuing interest by the core administrative agencies and not only the SDO;

¹⁶ For an explanation in the English language, see McLernon (2005). *Completion Report – WBI Benchmarking Support (Phase 1) Services*.

- Publicize the results outside the SDO - to create the proxy for competitive pressure the tool relies upon for effectiveness; and
- Give rewards (monetary or “psychic”) for high performers.

It is suggested much more effort could be put into creating benchmarking systems. With respect to how such systems would be created and regulated, decentralization seems to have weakened the ability of central government to make mandatory their participation in such systems, so alternatives might be considered. These include (i) establishing a small set of mandatory indicators in each sector (modified SPMs?) (ii) providing a greater role for provinces and (iii) mandating more firmly a role for central agencies in information capture and dissemination, perhaps using DAK, de-concentration and *tugas pembantuan* funding as the incentive for participation by regional government.

4.4 Performance Measurement and Management

As may be appreciated from a reading of this chapter, a central theme is measurement of performance and its use in management of organizations and individuals to maximize their performance. This management approach is in its infancy in Indonesia, although some of the legal and regulatory framework is taking shape.

It cannot be overemphasized that:

IF THE INCENTIVES AND COMPETENCIES ARE NOT PRESENT TO MEASURE AND MANAGE PERFORMANCE, IT IS DIFFICULT TO OPTIMIZE THE BENEFITS FROM DEPLOYMENT OF THE CONSEQUENCES STRATEGY.

With respect to incentives, the most explicit requirements for and guidance on the matter that were located by the Assessment appear in:

- Law 17/2003 on Management of State Finances;
- Law 1/2004 on the State Treasury;
- Inpres 7/1999 titled Accountability of Government Organizations
- Regulation of the State Minister for Administrative Reform (PerMENPAN) 25/2006 concerning Guidelines for Evaluation of Performance of Public Service Units (*Peraturan Menteri Negara Pendayagunaan Aparatur Negara (PerMenPAN) Nomor PER/25/M.PAN/05/ 2006 Tentang Pedoman Penilaian Kinerja Unit Pelayanan Publik. ditetapkan pada tanggal 19 Mei 2006*)
- PerMenPAN PER/26/M.PAN/05/ 2006 on Performance Awards (*tentang Pedoman Penilaian Kinerja Pelayanan Publik Dalam Rangka Pelaksanaan Kompetisi Antar Kabupaten/Kota. ditetapkan pada tanggal 24 Mei 2006*)
- PerMenPAN PER/04/M.PAN/4/2007 on Performance Evaluation and Policy Revision (*tentang Pedoman Umum Formulasi, Implementasi, Evaluasi Kinerja Dan Revisi Kebijakan Publik Di Lingkungan Lembaga Pemerintah Pusat dan Daerah ditetapkan pada tanggal 16 April 2007*)
- Kepmendagri 47/1999 concerning assessing the performance of water companies; and

- A similar decree from the Ministry of Health concerning performance indicators for hospitals.

A summary of selected laws and regulations is provided in Appendix O. From experience in working with regional government and from general observations, it is felt that insufficient effort is being applied to developing the core competency of performance measurement and management within the government – both at a macro level and within individual organizations. For example, in the list of regulations above, one must descend to a Ministerial Decree of MenPAN to find technical guidance. Putting aside the lack of incentives as an issue, it is little wonder then that, although developing performance measurement (and then management) competencies appear on the critical path to achieving rapid performance improvement, it is not centre-stage in reform initiatives.

At this stage the focus of analytical efforts should be on identifying and establishing the basics for a system of performance measurement and management in the Indonesian context. The design of the initial workshops in the pilot regions considered the following cycle:

1. Clarify mission (TUPOKSI)
2. Identify critical issues
3. Set a balanced set of objectives, preferably participatively, and especially externally focused
4. Agree performance indicators related to those objectives
5. Gain top management support
6. Establish baseline conditions and begin to measure performance
7. Plan and take corrective action based on the measured performance
8. Include in corrective action the (traditional) education and training activities, which, however is unlikely to be the only capacity building activity needed
9. Expand corrective action to policy and institutional set-up / models
10. Adjust objectives and performance indicators based on results.

This cycle should be worked into the rules, or at least the current planning and budgeting rules checked to ensure performance indicators can be developed from the process and subsequently used to manage performance. BAPPENAS have developed some guidelines for central agencies and Bangda within MOHA are developing a Permendagri under PP 8/2008. **Box 4.2** offers a checklist of desirable characteristics against which a performance management system, as it develops, can be assessed.

It is suggested capacity development programs always include activities aimed at building capacity to measure and manage performance.

4.5 Rewards and Punishment at the Institutional and Individuals Levels

This assessment has not addressed either the macro (institutional / network of organizations) level, nor the micro (individual) level. The experience from the pilot planning workshops is that the individual level is where personnel thoughts quickly run-to in relation to this strategy, despite that not being the AMSD focus of Strategy 3.

Box 4.2 Tips on Performance Measurement and Management Systems

Principles

- (1) Top Management should establish and make clear the main functions and responsibilities of their organizations and be responsible for its performance
- (2) Top management orientation should be to the customer / stakeholders and management of strategic issues
- (3) Improved management results from improved processes
- (4) Peoples' abilities are best captured by their full involvement in work and its design
- (5) Linkages between processes needs to be understood – i.e. a systems approach
- (6) Continual improvement is a permanent objective
- (7) Decisions are based on knowledge of the system, which is best developed through measurement of performance and its subsequent analysis.

Advantages for PEMDA Service Delivery Organizations

1. Provides a systematic means to improve performance and reduces micro management by PEMDA executive
2. Shows where investment priorities lay
3. Assists the preparation of statutory performance reporting (LAKIP)
4. Motivates sections within the organization

Advantages for PEMDA Core Administrative Organizations

1. Provide relevant information in a simple format
2. Shows the good as well as the bad
3. Helps in the LAKIP process
4. Explains strategies and informs the strategy development process; and
5. Facilitates dialogue between stakeholders in the sector.

Problems to be Considered

1. Time and competency needed to develop SMART indicators and associated targets
2. Performance of the individual is often made overt, and so elicits a negative reaction
3. Developing measures not relevant to the intended strategy
4. Measuring things that are outside the control of the organization
5. Measuring things which are already known about the system
6. Too much reliance on "soft" data (e.g. survey results)
7. Poor definition of the indicator components
8. No baseline data
9. No correlation between the indicators, despite the emphasis being on "just measure the 3-4 critical success factors"
10. Soft or impossible target setting
11. No information systems in place to collect data, and poor reporting (communication) of the results
12. Indicators which may motivate the wrong performance
13. The collection of data becoming an end in itself rather than a means to understand, and therefore design of performance improvement activities.

At the macro level, consideration needs to be given to the incentives – such as the risk of bankruptcy and takeover - that PEMDA as an organizational unit have to measure and act on to improve performance. This is beyond the scope of the Assessment, but the overall direction in AMSD Strategy 2 of paying for performance rather than for inputs, and of Strategy 3 on raising consequences, is well worthy of study at the macro level.

On the other hand, at the individual level, major changes are needed in the incentives for personnel (see Strategy 6). During the pilot workshops, the Consultants heard of a number of instances where rules from the central government (for example Permendagri 13/2006 on financial management) are making it ever more difficult for provide financial incentives to personnel – for example, overtime payments are now made at Rp 50/hour and it is illegal to pay incentives/bonus to those who could clearly be motivated by such payments, for example, revenue collection officers. While concerns with respect to opening the door to rent-seeking are acknowledged, systems for providing incentives are also needed.

One last word is in order in relation to the consequences strategy. Improved performance is unlikely if the key individuals involved are not committed to the change. All the regulations in the world will have little effect if the benefits of the change are perceived by those in the system to not outweigh the costs.

Those already in leadership positions and benefiting from the existing system are unlikely to adopt performance measurement and management systems if there is not a force to move systems this way. This force is likely to be customer and community opinion, i.e. AMSD Strategy 4.

4.6 Summary of Conclusions and Suggestions

Little use is being made of competition or its proxies to create real consequences for good or bad service by organizations. The development of more autonomous organizational forms of BLUD and BUMD point in this direction, but regulations related to improving competition are not extensive in this area. The regulatory framework for BUMN points the way forward on improved incentives for organizations. Keppres 80/2003 and Perpres 67/2005 relate to competition but are “after-the-fact”.

Increasing consequences at the institutional and individual levels depends on sector structure (Strategy 7) and employee empowerment (Strategies 5 and 6) respectively.

It is suggested that improvements in the legal and regulatory framework can be made based on the following points taken from the preceding analysis:

1. Most public services in Indonesia are perceived as best operated as “monopolies”, so that even if they have not been made statutory monopolies, the anti-monopoly law 5/1999 does not apply to government. PEMDA rarely considers whether competition would benefit performance; sectoral laws reflected in PERDA might be examined further to look for a solution and even if SDOs are not corporatized and required to compete to deliver services, consideration be given to how “proxies for competition” (benchmarking, inspection and audit regimes, regulatory bodies etc) might be introduced into the SDO environment.

2. Successful mobilization of competition or its proxy conditions will be required for success with the enterprise fund approach that the BLUD organizational option establishes based on Law 1/2004 and PP23/2005; a model local law and regulations would be useful and should include mechanisms that push price-setting towards establishment of the service charges “by the market”.
3. No rules were identified that require or encourage PEMDA to create “internal enterprise funds”; they could be given incentives and rules made “proactive” in this regards. Law 1/2004 that opens the way to creation of BLU, and Keppres 80/2003 and Perpres 67/2005 might usefully be reexamined.
4. Costing systems and budget rules under PP58/2005 and Permendagri 13/2006 on financial management currently have not considered use of the internal enterprise approach in government.
5. Many services potentially could be contracted-out (out-sourced) but, besides overcoming ideological and labor resistance, there is no guidance (for example in Keppres 80/2003 and Perpres 67/2005) on which ones would be acceptable or successful. Guidance could be provided, either through stipulation of general selection criteria, or specific naming of sectors or sub-sectors/activities. Not all functions would be candidates.
6. Benchmarking is a fundamental tool to use as a proxy for competition; no regulations currently and explicitly make it mandatory for regional governments to provide benchmarking information at the service level where it would be most useful, or to participate in benchmarking schemes; the regulations should do so.
7. Performance measurement and management are fundamental competencies required of government if consequences are to be raised; rules, training and incentives need revision (with strong leadership from the MoF and MOHA) to introduce this system of management; organizations and PEMDA adopting AMSD strategies should re-organize to be at the forefront in the meantime.
8. Care is needed in regulations such as Permendagri 13/2006 to not close-off avenues for paying incentives to SDO personnel in the rush to regulate out of the system opportunities for corrupt practices.
9. While the caution of government with respect to promoting “neo-liberal” policies and guarding against market-failures is understandable, a clear policy statement in support of competition wherever appropriate as a means of providing consequences and ensuring efficiency would help create more consequences for good or poor performance.

5. PUTTING THE CUSTOMER IN THE DRIVING SEAT

In the language of economists, this strategy involves giving the community “choice” and “voice”. For political scientists, it is an experiment in “direct democracy”.

5.1 Strategy 4: Customer Empowerment and Direct Democracy

Regional government exist primarily to provide services of various kinds to its “owners” – the community and its citizens that the government represents. Government is of the people, by the people for the people. Increased focus on the communities needs by the SDO shifts the determination of what is “for the people” from elected representatives to a “contract” between the SDO and each customer.

The ability to understand what the community as a whole and the citizen as an individual desires and needs with respect to services should be a very important (core) competency. It should be present in any government and SDO aiming to improve service delivery.

Sustaining services that are of high quality requires gaining customer (and more so stakeholder) participation. The problem with this strategy is possibly the clash that may exist between the “representative democracy” paradigm which is still new in Indonesia, with the “direct democracy” that more developed countries are evolving to. And it should be noted that the quality-management movement’s “customer focus” is not necessarily directly transferable to public services, and certainly requires “customer” to be interpreted as the wider “stakeholder”.

The customer focus approach also tends to push service delivery in the direction of individualized, differentiated services, whereas current Indonesian values (at least as officially espoused) seem to favor uniform equal treatment for citizens.

Nevertheless, a lack of customer orientation is often the main complaint of many stakeholders when considering delivery of public services. **Box 5.1** summarizes the tools that are frequently used to deploy the strategy. As the references show, there is some but not much of the legal/regulatory framework to underpin the promotion of this strategy in Indonesia. The main sponsor has been MenPAN, which is unfortunate in some ways because much of their regulatory material seems low level, does not to reach regional government, or goes unheeded.

The problems of deploying the strategy at a macro level are likely to include:

- Overcoming resistance from existing monopoly providers and their legislative backers to efforts aimed at creating consequences for satisfying community needs;
- Designing processes for establishing and managing the setting of service standards in consultation with the community so they have consequences if they are complied or not complied with; and

Box 5.1 The Tools for Strategy 4 (Customer Empowerment)

Alternative Mechanisms

- A. Give customers the power to choose their service deliverer organization (SDO)
- B. Give customers the power to use public money to choose their preferred SDO; or
- C. Customer quality assurance: Establish systems that assure the quality of service to customers.

Tools for Implementing the Alternative Mechanisms

If the customer can in some way be given “power” – either by letting their money pay for services or giving them power to influence the decisions of the SDO - the SDO will pay more attention to customer needs. Alternatives are:

- A. **Customer Choice:** Customers are given the power to choose from where services are bought – for example some public hospitals do not differentiate from where the patient originates.
- B. **Competitive Customer Choice:** introduces consequences for SDOs. Public funds are provided direct to people/customers:
 1. *Customers choose their own competing supplier* (i.e. a competitive public choice system)
 2. *Cash Transfers (conditional or non-conditional)* – BLT and the free education and health services movement provide examples
 3. *Vouchers for accessing public and private SDOs* – a part of the DOS scheme for schools
 4. *Reimbursement program* - that pay the SDO when a customer chooses their services
 5. *Service-quality information system for customers* (e.g. publishing scorecards) – that help with the choice decision
 6. *Brokers* - a government funded office locates a selection of SDOs e.g. for capacity development / diklat. Also for SMEs.
- C. **Customer Quality Assurance / Insurance:** creates standards for customer service, guarantees, and re-dress for failures so that there are consequences for poor service; e.g.:
 1. *(Minimum) Service Standards:* say on quality, quantity, cost and timeliness – PP 65/2005 and Permendagri 6/2007, 79/2007; 62/2008.
 2. *Quality guarantees: money back or restitution of damages* – for example PLN with respect to power surges damaging electrical equipment.
 3. *Customer Service Agreements:* Set out the level of service and consequences – some PEMDA for some sectors (e.g. water supply) produce a PERDA which is somewhat similar.
 4. *Customer Charter / Code:* (or “Piagam Masyarakat”)
 5. *Certification / accreditation:* under recognized “organization / management excellence systems”; e.g. SNI / ISO 19:9000; TQM, 6-Sigma, etc
 6. *Customer Councils / Boards:* ideally with some power. e.g. School Management Boards – say as mandated in UU 19/2003 in the national education system.
 7. *Voice: Complaint systems:* makes SDOs track and analyze complaints and learn from the analysis – as is being promoted by MOHA /PUM with respect to the LGSP produced system – KepMenPAN 148/2003; Permendagri ... / 2007.
 8. *Voice: Customer Satisfaction Index:* As is regulated by PerMenPAN 25/2004

Source: AMSD Project document: Description of Strategic Elements of AMSD. Nov 2008

- Encouraging PEMDA and their SDOs to work participatively with stakeholders to improve “direct democracy” while they are still struggling with establishment of representative democracy.

This Assessment does not attempt to assess in detail the relatively few laws and regulations in this area, but rather to set-out some criteria and provide guidelines that might be used in time.

Many services already have a local law describing in loose terms the rights and responsibilities of the SDO and the customer, but these are often “one-sided” – in favour of the SDO. Efforts could focus on creating one local law per regional government that helps achieve the strategy goal of giving voice and choice to customers. East Java Province has such a law with this objective in mind (PERDA 11/2005 and Pergub 13/2006).

Box 4.1 indicates there is little legislative material available for the tool of competitive customer choice (which is perhaps not surprising given the threat such an approach presents to ensconced monopoly providers and their executive and legislator backers), but the instruments are more numerous for the less incentivized “customer quality assurance” tool. This suggests a number of areas worthy of assessment:

- 1 Pros and cons of competitive customer choice systems that would be covered in legislation for that tool, were it to be deployed more universally than at present;
- 2 Obstacles to establishing customer services standards, as the foundation for the whole re-orientation to the government-customer relationship that this strategy seeks to achieve;
- 3 Status of some other key tools in the customer quality assurance toolbox – especially the use of Customer Service Agreements and Customer Charters; and
- 4 Support for establishing the critical competence required of SDOs – the ability to consult - without which eliciting customer / stakeholder perceptions is impossible, thereby making it most difficult to fully deploy the customer quality assurance strategy because “performance” has not been defined through the eyes of the customer.

Before assessing the above in more detail however, an identification of the few key laws and regulations provides a basis for the more detailed, if somewhat select, assessment.

5.2 The Most Relevant Laws and Regulations

The following have been identified as probably the most relevant:

- Law 25/2009 on Public Services – passed by national parliament in September 2009
- Law 37/2008 the Ombudsman of the Republic of Indonesia, promulgated on 7 October 2008
- Law 14/2008 on Access to Public Information
- Law 8/1999 concerning Consumer Protection
- Law 28/1999 concerning Running the Country in Manner that is Clean and Free from Corruption, Collusion and Nepotism

- Law 32/2004 concerning Regional Governance;
- PP 65/2005 concerning Minimum Service Standards
- PP 68/1999 concerning Procedures for Implementing Public Participation in Running the Country
- KepMenPAN 63/2003 on General Guidelines on Implementing Public Services (*Keputusan Menteri Pendayagunaan Aparatur Negara (KepMenPAN) Nomor 63/KEP/M.PAN/7/2003 tentang Pedoman Umum Penyelenggaraan Pelayanan Publik*)
- KepMenPAN 25/2004 on Guidelines for Compiling a Customer Satisfaction Index in Service Units of Government (*KepMenPAN KEP/25/M.PAN/2/2004 tentang Pedoman Umum penyusunan Indeks Kepuasan Masyarakat Unit Pelayanan Instansi Pemerintah*)
- KepMenPAN 26/2004 on Technical Instructions on Transparency and Accountability in Delivering Public Services (*KepMenPAN Nomor KEP/26/M.PAN/2/2004 tentang Petunjuk Teknis Transparansi dan Akuntabilitas Dalam Penyelenggaraan Pelayanan Publik*)
- KepMenPAN on General Guidelines on Handling Public Complaints for Government Agencies (*KepMenPAN Nr. KEP/118/M.PAN/8/2004 tentang Pedoman Umum Penanganan Pengaduan Masyarakat Bagi Instansi Pemerintah*).

A summary of selected laws and regulations is provided in Appendix O.

Like the situation with performance measurement and management, much of the regulatory framework to date has been low-level instruments sponsored by MenPAN, leading to similar problems in terms of dissemination, understanding, compliance and impact. Customer choice is not addressed, however, with passage of laws on access to public information, on an ombudsman who will have regional branches, and on public services, there is potential for customer “voice” to be much louder.

5.3 The Obstacles to (Competitive) Customer Choice

The first step of giving the customer choice is far easier than the next, of using that choice to provide consequences to SDOs. People may be allowed to choose to send their children to one school or another, or to choose their public hospital or civil registry branch office, but unless the particular SDO can benefit from that choice, and has the autonomy and flexibility to respond to customer needs, the impact on service quality will be small.

This Assessment has not been able to identify laws and regulations that govern this tool, but there are a number of indications the tool will become important for the future. For example:

- since 2008 the central government has operated a “Cash Transfer” program known as *Bantuan Langsung Tunai – BLT – (Inpres 3/2008)* that is beginning to raise questions as to whether it would not be more effective if it was more conditional (at present the only condition is that the recipient be officially identified as “poor”); and
- ever-more provinces and kabupaten/kota are introducing PERDA that provide for free education and health programs for their citizens.

These programs may be more effective if the customer choice strategy was deployed:

- Instead of cash being given to poor families (BLT) without conditions, it (or more likely vouchers) could be given on the condition it be used to pay for accessing certain stipulated services – for example, obtaining civil registration documentation, school fees, health services, water connection fees, and so on (the customer has the money in his hand, thus forcing the SDO to respect more the customer’s needs).
- In the case of free education and health services, most SDOs in current programs are probably being reimbursed – perhaps fully but more likely not - for providing (free) services to eligible customers. Again, if vouchers were given to deserving families instead, they would have more voice with the school, hospital etc.

Thus, the obvious critical success factor for introducing consequences is choice for the customer. If the customer does not have an alternative supplier, i.e. has no choice, the classic ill-effects of monopoly on service (high prices and poor quality) will continue to confront the customer, although perhaps the SDO will be more attentive because of the need to extract payment from the individual, not the PEMDA Treasurer.

The experience is that providing choice through breaking the monopolies of SDOs can require exceptional effort from reformers to put in place the legislation. Indonesia will be no exception. **Box 5.2** set out some issues that any such legislation should address.

It is suggested that if alternatives must be made available systematically, then national and local laws should be vetted for provisions that create exclusivity, and amendments made. That requires winning the political battle¹⁷ - which will likely be fought over issues of equitable access. In addition to choices, there must be consequences for the SDO – rewards for those that are chosen and penalties for those that the community avoid. Standards must be set, measurements made and inspection/supervisory means devised for acting on the results.

The inspection / supervisory arrangements are likely to be different in each sector, depending upon the degree to which the quality of the service can be measured – the more difficult ones, such as quality of education, requiring more involvement of the customer.

5.4 Customer Quality Assurance

5.4.1 (Minimum) Service Standards - SPMs

Using customer quality assurance tools will have little impact if (i) there are not standards against which the service can be compared and (ii) there are no means to re-dress failures to provide services to the agreed standard.

Indonesia has started on a program of introducing such standards by mandating them under the regional government Law 32/2004, which includes development by central departments of proposed standards then to be approved by the Regional Autonomy Deliberative Council (*DPOD*), chaired by the Minister of Home Affairs.

¹⁷ The World Bank 1995 publication “Bureaucrats in Business” provides a good description of the measures one might take to analyse and manage the politics of reform in this situation.

Box 5.2 Factors in Creating Competitive Customer Choice

1. **Choice must be real.** There must be multiple Service Delivery Organizations (SDOs) available from which the customer can choose. The strategy cannot be used with natural monopolies (piped water distribution for example) because there is no choice. In some cases, for example with education and training, efforts can be made to (i) create more providers (ii) break up existing large SDOs (iii) subsidize and incentivize new SDOs start-ups and (iv) subsidize low income customers to increase the affordable choices. The strategy can also be applied internally – for example, the civil registry Dinas might encourage customers to select which office they attend and provide rewards to the offices that are favored.
2. **Politically acceptable:** particularly the system is perceived as equitable. The structure should not lead to inequitable access – for example, some households having a much wider range of choices than others
3. **Lower the entry barriers for new SDOs.** Support them, give them incentives, “holidays”, special rules for limited periods etc – start-ups will repay the costs by being more innovative because they are not hide-bound by old customs and rules. Encouraging, rather than closing down, small scale service providers in water supply and solid waste are an example. Provide performance information.
4. **Customers must have sufficient resources to seek better quality.** Funds follow the customer. Subsidize the customer if he cannot pay, not the SDO. For example, *Dinas*’ could control the training budget, not the Diklat
5. **The customer needs information:** about the quality and cost of the choice available. Particularly where quality cannot be measured easily – education, health for example – expert “regulators” need to assess the quality of service and disseminate to potential customers the information about the alternatives and quality results. Help to understand / assess needs.
6. **Government must “regulate” the market.** SDOs react strongly to incentives, so if there is no “policeman”, they will act to maximize their benefits, not the public’s. For example, if the new Law 9/2009 permitting universities to become independent profit seeking organizations does not regulate the way students are chosen, it is most likely the universities will not accept students from families who are unable to pay, namely poor facilities.
7. **Deceptive marketing from SDOs must be prevented** – if a provider claims excellence, it should be supported by the data from an independent regulator.
8. **The SDOs in the market must suffer consequences.** If some SDOs are not performing well, do not continue to support them – put in place rules that set out a staged set of increasing consequences.
9. **Educate stakeholders:** that market-driven solutions require, like real markets, some failures – make it clear some SDOs will be put out of business
10. **Help the previous (monopoly) providers adjust, under clear terms:** by providing capacity building support – for installing costing systems, marketing skills etc, for example.
11. **Relax control over the public sector SDOs:** to enable them to compete.

Subsidiary legislation identified to date includes:

1. PP 65/2005 concerning Guidelines on Minimum Service Standards

2. Permendagri 6/2007 on Technical Guidelines for Compiling and Adoption of Minimum Service Standards (*Peraturan Menteri Dalam Negeri Nomor 6 Tahun 2007 tentang Petunjuk Teknis Penyusunan Dan Penetapan Standar Pelayanan Minimal ditetapkan pada tanggal 7 Februari 2007*)
3. Permendagri 79/2007 on Guidelines for Compiling a Plan for Achieving Minimum Service Standards (*Peraturan Menteri Dalam Negeri Nomor 79 Tahun 2007 tentang Pedoman Penyusunan Rencana Pencapaian Standar Pelayanan Minimal ditetapkan pada tanggal 28 Desember 2007*)
4. Permendagri 62/2008 concerning Minimum Service Standards for select governance functions in Kabuptens and Kota covering civil registry, maintenance of security and order and natural disaster management (6 indicators in total)
5. Permenkes 741/2008 concerning SPMs in Health for Kabupaten and Kota
6. Permenkes 828 / 2008 concerning Technical Guidelines for Measuring SPMs in Health.

Appendix O includes summaries of selected laws and regulations.

Table 5.1 shows the details of the 18 indicators and associated minimum values for the health sector. SPMs are also believed to have been decreed (late 2008) in the environmental management sector. Hopefully they are better suited to engaging the customer.

Although the list of legislation is growing with respect to standards, there appears to be a lack of focus in the whole initiative at present. Some parties (especially central agencies) appear to believe the intention of the legislation is to create a macro level tool for managing performance of regional governments, while there are others (typically at regional level) who see the initiate more in local terms – as measurements of performance in relation to standards/benchmarks that can be used locally (and the context in which they are discussed in this Assessment).

In addition to the checklist in the earlier section on “Performance Measurement and Management” related to Strategy 3, legislation on establishment, use and maintenance of good customer service standards should ensure a number of objectives are attained. These objectives include¹⁸:

1. Consulting with stakeholders and customers in the design of SPMs and mechanisms that ensure re-dress/guarantee and accountability of the SDO (service agreements, complaint handling etc);
2. Designing standards that are specific, measurable promises and that take a balanced perspective – typically from the customers perspective of quantity, quality, continuity and cost. Avoid abstractions / vagueness. Include perspectives from owners and suppliers;
3. Keeping the standards to a minimum, say 5 per service at the most;
4. Stating clearly the commitment – “the SDO guarantees ..”and not the “The SDO will try...”, for example;

¹⁸ For further suggestions on service standards, quality guarantees and redress, see for example, various documents from the Canadian Treasury Board Secretariat, such as *Service Standards; a Guide to the Initiative* (1995). Included are detailed descriptions of success factors and pitfalls with this tool.

Table 5.1 Actual Service Standards for Health Services (Kepmenkes 741/2008)

| Indicator | Value |
|--|-------|
| Implementing Basic Health Services | |
| 1. Coverage of Pregnant women visits K4. | 95% |
| 2. Coverage of mid-wifery complications that are handled | 80% |
| 3. Coverage of help provided by competent health assistants in midwifery | 90 % |
| 4. Coverage of <i>Nifas</i> services | 90% |
| 5. Coverage of neo-natal cases that have complications | 80% |
| 6. Coverage of visits by the baby | 90% |
| 7. Coverage by Desa/Kelurahan of Universal Child Immunization (UCI) | 100% |
| 8. Coverage of services to children under 5 | 90% |
| 9. Coverage of food support for families with children receiving breastfeeding in the age range 6-24 month for poor families | 100% |
| 10. Coverage of children under 5 who receive nursing care | 100% |
| 11. Coverage of health network of students in lower school | 100% |
| 12. Coverage of family planning / contraception | 100% |
| 13. Coverage of presentation and treatment of diseased people | 100% |
| 14. Coverage of basic health services for poor people | 70% |
| Health Referral Services | |
| 15. Coverage provided for referral of poor people | 100% |
| 16. Coverage of emergency services level 1 given by hospitals in di Kab/Kota | 100% |
| Epidemiological Investigations and Overcoming Health Emergencies | |
| 17. Coverage of Desa/Kelurahan that suffer emergencies by doing epidemiological investigations within 24 hours | 100% |
| Health Promotion and Community Empowerment | |
| 18. Active Coverage of Desa | 80% |

5. Reviewing regulatory standards (as well as associated re-dress and accountability mechanisms) with SDO management, employees and their associations;
6. Creating communication activities than educate customers about the standards and their own responsibilities;
7. Identifying and empowering an independent technically competent outside party who is authorized to continually apply pressure to review performance against standards, monitor the complaints and governance systems and insist on re-dress;
8. Identifying and empowering an independent outside regulator who keeps under review the approved standards and the associated system that ensures consequences;
9. Publicizing prominently the standards and performance against them – for example, insisting on large displays in offices, newspapers, on the web etc;
10. Empowering employees of the SDO to consider how best to achieve and improve on the standards (see Strategy 6);
11. Enlisting the support of stakeholder groups, advisory groups, SDO boards and such governance level institutions to make the changes that are needed to achieve the standards (because the SDO will not itself if they understand no one cares);
12. Benchmarking results against peer SDOs;
13. Providing capacity development to SDOs to assist with improvement;
14. Consulting routinely with stakeholders and customers concerning their perspectives on needs and the standards; and
15. Avoiding the creation of unrealistic expectations that can only backfire.

In examining the minimum service standards stipulated for the health sector (and the Permenkes itself), it appears the SPMs have been set up for some other purpose than to explain to the customer what standards might be expected and what to do if they are not delivered.

It is suggested more attention is needed in establishing and making use of service standards that reflect community concerns and enable the “short-route” accountability of SDOs to the community to be improved.

5.4.2 Licences, Customer Service Agreements and Codes of Conduct

At present the accountability of the SDOs to the customer and community mainly runs through elected representatives. Because of the long chain of processes establishing the relationship, transparency and accountability is not good.

Customer service agreements, codes of conduct and so on aim to make the relationship between the SDO and customer more transparent and clearer, and so improve accountability. They aim to clarify the relationship and make explicit the authority and accountabilities of the various parties and provide a means to impose consequences on the SDO through the tool of service standards.

SDO-customer relationships are normally established in laws and regulations dealing with:

- consultation processes (like UU32/2004 on regional government),

- consumer protection laws (like UU 8/1999),
- ombudsmen laws (like the recently promulgated UU37/2008 establishing an ombudsman with regional branches),
- public services (like UU25/2009),
- sectoral laws, like population administration, water, health, electricity, gas, transport etc, and
- local law equivalents of the above (i.e. in PERDAs).

The Assessment has been unable to locate laws mandating specific agreements between the SDO and customers and did not have the opportunity to examine PERDA under the pilot work. It is believed however that requirements for SDOs to make more explicit the relationship with customers will not be in national or local laws, but should be.

One common framework for establishing a clearer relationship between SDO and customer is a process whereby:

1. The regulating authority issues SDOs with an “operating licence” (see **Appendix I.1** for an example of the obligations that such a licence impose on the SDO);
2. One condition of the licence is that the SDO must draft in consultation with customers and its technical supervisor (technical department for central government SDOs or “office” / Dinas for regional SDOs) a customer service agreement, which is often called a “standard form contract”;
3. The regulating authority then checks the proposed agreement against requirements specified in the licence or legislation that establishes the operating licence framework (see **Appendix I.2** for an example of the guidelines used by the regulator);
4. After review by the regulator and his approval, the relationship between the SDO and customer is deemed to be regulated by the customer service agreement, including any provisions relating to service standards, guarantees and re-dress mechanisms; and
5. The regulator and SDO publicizes the agreement (see **Appendix I.3** for an example of a brochure summarizing the SDO’s customer charter).

Two of the three pilot locations (Cilegon and Lebak) during the pilot workshops discussed major revisions to the PERDA governing their sector and may propose under the AMSD pilot projects the drafting of new local laws restructuring their sectors.

It is suggested that, if requirements for Service Agreements or similar such contracts are not made mandatory in the new law on public services, then an opportunity exists to include the requirement in the pilot regions when drafting these PERDA (which must comply with the provisions of Articles 139 and 140 of UU 32/2004). These could act as models for other sectors and regions.

5.5 Voice: Rules Needed to Improve Consultation and Participation

Success in deploying the customer strategy requires, among a range of factors, a basic competency of timely, participatory and meaningful consultation with stakeholders and customers (see **Appendix I.4** for typical criteria for quality consultation). This competency is

required in the government and the related SDOs, and it requires support in the legal and regulatory framework. In the presence of still weak representative democracy and without consultation of good quality, how is government to respond to community needs without this competency? An early step should be ensuring the rules in relation to consultation are useful.

The Consultants believe there is a very weak legal framework at present for consultation¹⁹.

Law 10/2004 governing law-making effectively makes public consultation optional during the formulation of a draft legislation because all it prescribes (at Article 53) is the following:

The community has the right to provide inputs, both verbally and in writing in the matter of formulating and discussion of draft Acts and draft PERDA²⁰.

Similar wording appears in UU32/2004. What then is the fate of consultation during preparation of the lower-hierarchy regulations, including local laws prepared under Act 32/2004? Because consultation during preparation of regulations under UU10/2004 is left open, effectively no consultation is required if sponsoring organizations choose so. Typically, the above words and little or no more are repeated in lower level regulations. Given this directly affects more than 500 PEMDA and indirectly the entire population, and there is potential for a significant amount of law being made in the regulations with low levels of consultation, this appears to be a major shortcoming in the current process.

In developed legal frameworks, the matter typically is handled by:

- General rules for participative, meaningful consultative processes being set-down in laws such as the regional government, Law 32/2004;
- Sectoral laws setting-out specific requirements, including delegating further to regulatory authorities the preparation of even more guidance;
- Consultation Codes of Practice being prepared and adopted by regulators and SDOs; and
- Consultation Plans being prepared and implemented by SDOs for specific purposes.

In this way stakeholders are informed well ahead of the event as to how the process will unfold and therefore are able to prepare properly and to contribute relevant information. As an example, it is common to include in the Consultation Code a generic description summarized in **Figure 5.1** of how consultation will proceed.

Finally, the framework should allow for the fact that consultation methods are not perfect and that rules should be created wherever possible to improve it. They should ensure²¹:

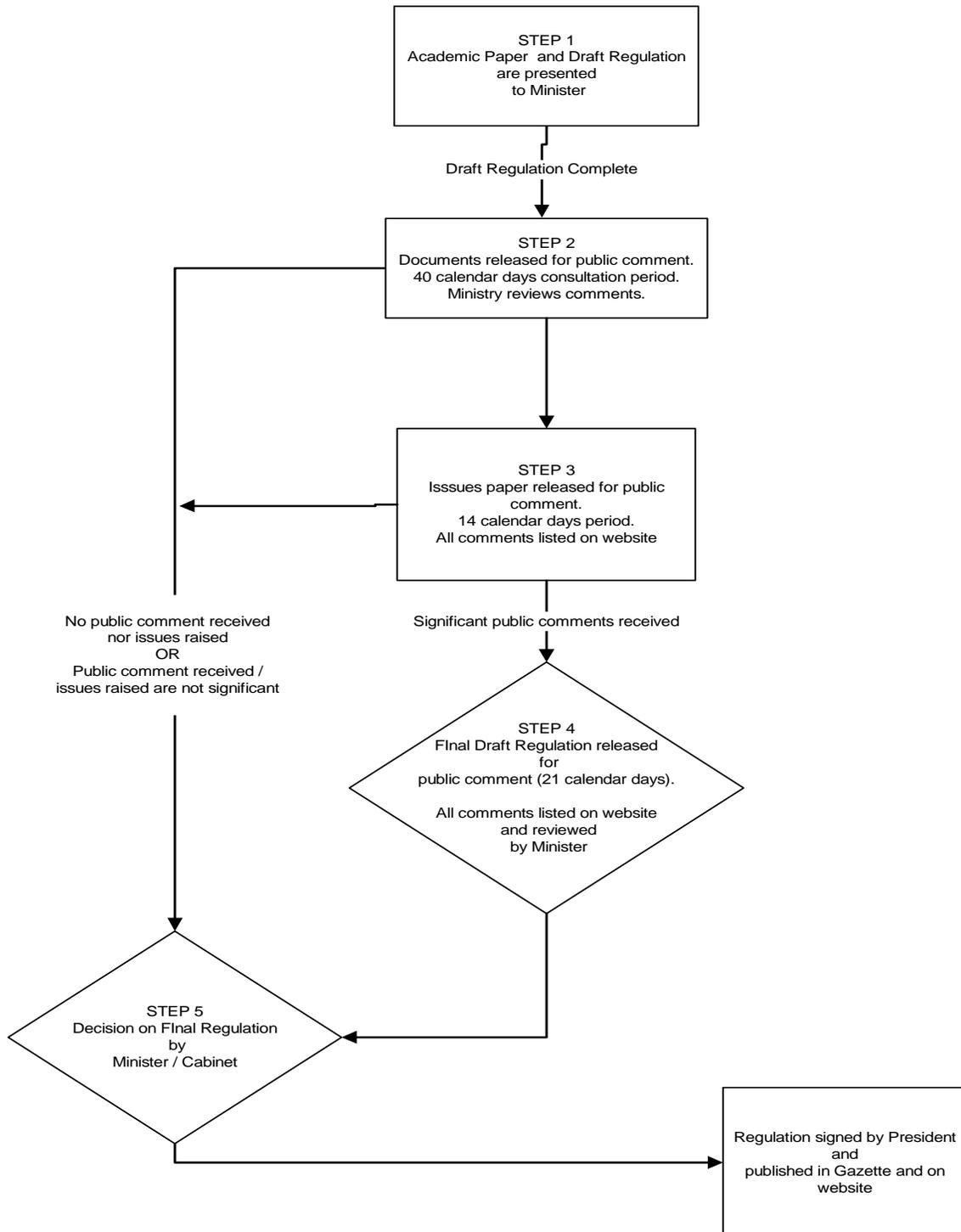
- Consultation is related to the regular planning cycle and in fact generally well ahead;
- It is only undertaken if there is intent to use the results, in order to avoid disappointment;

¹⁹ See GRS II, Working Paper *Suggestions for Improving the Process of Formulating Regulations*, June 2006 for a discussion of the legal framework. The paper was prepared by the Sub-project for support to MOHA for harmonizing regulations under Law 32/2004.

²⁰ A note in the Elucidation says “The right of the community in this respect is to be in accordance with the Regulations / Operating Procedures of the DPR / DPRD”. Overall, the rules on consultation are obviously not well formed.

²¹ See UK Cabinet Office (1998) *How to Consult Your Users: An Introductory Guide* among a range of useful publications on the subject

Figure 5.1 Example of a Mandatory Consultation Process



Note: After each step, the draft or final documents will be published on a dedicated website, copies provided to registered persons and hardcopies made accessible to the public.

Source: GRS II Working Paper “*Suggestions for Improving the Process of Formulating Regulations*, June 2006

- The process is designed to fit the situation – electronic polling may be feasible in DKI Jakarta but not in Papua;
- Timely publication of the proposed consultation and the process;
- Assurances are given and maintained on confidentiality and deliberate efforts made to overcome the reluctance to speak openly to government officials;
- Independent experts are used if needed;
- Multiple methods are deployed to triangulate perceptions;
- Wide consultation happens, not with just one interest group (think of stakeholders rather than just customers);
- Feedback is provided to consulted parties; and
- Undertake evaluation of all major consultations with a view to doing it better next time.

In terms of next steps, this assessment suggests a number of possible actions to raise consultation and more generally strengthen the relationship between deliverer and customer:

1. Ensure the revision of Law 32/2004 includes specification of better consultation processes;
2. Prepare a Permendagri or similar to guide development of detailed consultation processes;
3. Draft model clauses for PERDA that will regulate sector structure and the relationship between SDO and customer (typically two different PERDA); and
4. Include consultation processes in such model regional laws as part of the larger framework of using competitive customer choice and quality assurance tools.

This strengthening of the legal and regulatory framework with respect to the role of the community and stakeholders would much strengthen the likelihood that deployment of the customer strategy (AMSD Strategy 4) will improve service delivery. This done, the challenge is then to ensure the SDO has the autonomy to actually be able to improve service delivery. Providing this autonomy without loss of control by core administration of policy is the subject of the next Chapter.

5.6 Summary of Conclusions and Suggestions

Deployment of the customer choice strategy needs customers who can choose between SDOs for their service. Although recent programs in education and poverty alleviation in Indonesia are beginning to use conditional cash transfers and vouchers, no legislation was identified that systematically uses competitive customer choice to improve service delivery (other than perhaps Law 9/2009 on education institutions). Most rules are low-level. The less “powerful” customer quality assurance approaches are currently preferred.

Introduction of a system of minimum service standards will also improve customer “voice”. And a recent set of laws on public services (25/2009), ombudsman (37/2008) and access to information (14/2008) have potential to put the customer more in the driving seat.

The chapter's analysis highlights the follow points:

- 1 Very little choice is available to users of PEMDA services. The customer choice strategies are therefore not deployed easily, despite their power to improve services. Further, the instruments for forcing more choice into current systems are not obvious. Most regulations are low-level and concentrate on measuring service standards and capturing customer complaint, not taking action on the results of those measurements. Subsidiary legislation from recent laws will be important.
- 2 Exclusivity rules (explicit or implicit) in laws, regulations and PERDA should be discouraged. When preparing PERDA for each sector, rules that support factors for successfully creating competitive customer choice should be written into the new instrument for establishing the sector structure.
- 3 Service standards are a well recognized customer quality assurance tool under AMSD. The Indonesian *SPM* initiative (PP65/2005) taken by central government to establish (minimum) service standards appears to have different objectives than those when SPMs are used locally to assure service quality. Regulations should differentiate and make clear that SPMs used for deploying Strategy 4 should reflect community interest and take into account the factors that enable the improvement of short-route accountability of SDOs.
- 4 Even if SPMs are established which can be used locally, the SDO must commit to acting on them. Customer Service Agreements/Charters are a good method but there is no specific requirement for them in the current legal and regulatory framework. If they do not appear under the new Public Services law (25/2009), they could also be trialed in the pilot projects.
- 5 Three new laws (25/2009 on public services, 37/2008 on ombudsmen and 14/2008 on access to public information) provide a foundation for deploying this strategy, so the development of the regulatory framework under these laws should be a priority for action.
- 6 The basic competency required to deploy the customer strategy is good quality consultation with the community. But the key laws (10/2004 and 32/2004) and regulations do not make it mandatory nor stipulate processes that would provide good consultative outcomes. Again, if the centrally promulgated laws do not address the issue, the pilot project effort should.

Having achieved understanding of the community needs, the next challenge is actually being able to act on it. That is Strategy 5 (organization empowerment).

6. ORGANIZATION AND ADMINISTRATION OF SERVICE DELIVERERS

6.1 Strategy 5: Empower the Service Delivery Organization

Most organizations achieve better results when they have flexibility or autonomy over the inputs and processes they use to produce the results.

What is important is delivery of agreed results. So it is with service delivery organizations (SDOs). SDOs have the most experience, expertise and information about how to produce and deliver services – what are the needs for inputs of labor, technology, information, physical assets etc and what processes best produce the desired standard of output and ultimately outcomes and results. But they generally do not have good information about the results desired by the PEMDA executive. Having worked-out together objectives, preferably with the help of the community, they should be allowed to manage, or made to manage.

Deploying Strategy 5 requires a successful “deal” or “meeting of minds” between the core administrative organizations and the SDO, it being: “the SDO can have autonomy in return for accountability”. AUTONOMY = ACCOUNTABILITY. The strategy relates closely to Strategy 3 (incentives) but focuses on the technical administrative arrangements that bring to life the autonomy for accountability deal.

This strategy may be the most difficult of the AMSD strategies to implement in Indonesia for a number of reasons. It:

- requires the core administrative agencies to trust the SDOs more;
- threatens the core administrative agencies because they believe their power is shifting to the SDOs;
- confronts the view that the SDOs need even more regulation or “control” otherwise they will act even more perversely than at present;
- requires refining the rules to suit sectors and locations, which runs against the current trend to make “one-size-fit all”; and
- whatever the autonomy–accountability situation, the SDO must function excellently as an organization.

For those who doubt the usefulness of the strategy, examination of the case of PDAMs and regional banks is instructive. In the Consultant’s opinion, these organizations often far out-perform their peers in PEMDA. Two of the prime reasons are: their objectives are clearer and more measurable (Strategy 1) and they have sufficient autonomy over use of resources (Strategy 5). For example, the PDAMs have specifically crafted rules relating to tariff setting, finances, human resources and asset management. Personnel are employees of the company and not of PEMDA, for example.

The doubter should also perhaps heed the opinions of some Heads of Regions, who believe that the current administrative system is too rigid and so is dis-incentiving with respect to innovation.

Good or otherwise, much of the government reform since 1998 has contained threads of this strategy (e.g. the creation of independent commissions). This includes decentralization, which has been concerned with implementing organizational empowerment, albeit on a macro level and probably without the “accountability deal” particularly in mind. As the references in **Box 6.1** (summarizing the tools that are frequently used to deploy the strategy) suggest, a legal/regulatory framework underlying this strategy is taking shape in Indonesia in the form of SDOs with an arms-length relationship with core government, but their remain major challenges and gaps. For example, as one reads down the list of tools typically deployed, fewer references to laws and regulations are seen. It seems that the enthusiasm for organizational level autonomy is not complemented by administrative rules.

Some of the major challenges in the legal and regulatory framework are therefore:

- How to ensure organizational structure produces “good” autonomy, control and incentives and yet not close-down innovation;
- How to realize the objectives of Keppres 7/1999 and other regulations concerning raising the performance accountability of government organizations when there are a multitude of rules and high risks for the individual in doing so?
- How to identify and introduce flexibilities into planning, financial management, procurement, personnel management and other rules imposed by a “one-size-fits-all” approach?
- How to shift control from inputs to an outcome/output basis using the performance based budgeting and other financial management provisions of Law 17/2003 (especially in a decentralized environment in which competencies of some 3 million civil servant in the regions are minimal)?
- How to accelerate the move of SDOs from *dinas* status to the more autonomous (and hopefully better performing) BLUD / BUMD organizational forms?

This Assessment does not attempt to investigate all of the administrative laws and regulations, as they are voluminous – see Appendix E.1 as well as Appendices B.1, G.1, K.1 and M.1 for lists created from a database held by “The Legal Agency”. Key instruments can be tracked down therein, with patience.

Given that (i) this is the framework created at the central government level (ii) all regional governments and their SDOs are expected to comply with this set of rules and (iii) the regional government core administrative agencies (SETDA, BAPPEDA, BKD, BAWASDA) must then reflect this framework in the PERDA for each of the services they are obliged to or choose to provide, it is not surprising that specific, results-oriented rules for administering SDOs are not readily available, be it from central or regional government. It is a challenge even in the most competent governments.

Fixing the full set of rules will take time, so efforts should focus on creating local rules that help simplify the maze and to shift the control from inputs to outputs/outcomes.

Box 6.1 The Tools for Strategy 5 (Organizational Empowerment)

Alternative Mechanisms Arising from the AMSD Strategy Element

- A. Organization Empowerment
- B. Employee Empowerment

Tools for Implementing the Alternative Mechanisms

- A. **Organization Empowerment:** Control over management of inputs and process is moved to SDOs while “policy control” is increased by specifying more clearly desired outcomes. In other words, the form of control is changed, and specifically the rules for Dinas’, UPTs, BLUDs, BUMDs and other organizations are changed, often made more “flexible” using:
1. **Reform of Administrative Structures and Systems affecting the Organization:** Specific tools include:
 - (a) *Development of Autonomous Operators and Appropriate Core Organizations / Offices (“Regulators”)* to represent the core of government with the operators like BLUD, BUMD, private SDOs, etc. PP 41/2007 touches on this tool. PP 23/2005 regulates BLUD, UU 5/1962 regulates BUMD
 - (b) *Strategic planning systems as control devices* – UU25/2004, PP20/21 of 2004, PP39/2007, 40/2007, PP6/2008 and PP8/2008
 - (c) *Budget & financial planning, finance and audit systems:* results oriented: PP 58/2005
 - (d) *Procurement System:* More flexibility (rather than less) under procurement rules – Keppres 80/2003 and its 7 amendments to date
 - (e) *“Corporate” Governance Reform:* (Improve the Performance of “the Board”)
 - (f) *Managerial Improvement Programs*
 - (g) *Personnel System of the SDO:* Give managers operational control over personnel.
 - (h) *Audit System of the SDO:* Using audit to measure and manage performance.
 - (i) *Organizational Excellence Programs:* SNI ISO 19:9000, etc.
 2. **Site-based Management:** Moves select decisions from the often distant HQs to the site. Schools in Indonesia are being moved to this model.
 3. **Waiver Policies:** Specific permission is given to change classes of rules.
 4. **Special Waivers:** Organizations are specifically protected from intervention. The creation of “islands of excellence” in MoF, Sekneg etc. Also, creation of commissions, bodies etc appear to be a “back-door” approach to this tool.
 5. **Opting-out:** Allowing existing or new organizations to operate outside existing system. e.g. Special schools in Indonesia, charter schools and hospitals in England
 6. **Mass de-regulation:** Some administrations around the world have simply repealed en-masse regulations – for example by declaring void all regulations on a certain day!
- B. **Employee Empowerment**
1. **Professionalize the HRM/D function:**
 2. **De-layering Management:**
 3. **Break functional silos:**
 4. **Labor partnerships:** work with Korpri and labor unions
 5. **Work teams:** Establishment of “Tim Gugas-Tugas” etc
 6. **Employee suggestions programs:**
 7. **Employee perception surveys:** Understand what employees think about productivity and satisfactory work conditions

Where to start? This Assessment concerns itself particularly with PP No. 41/2007 because it regulates how regional government is structured and so influences strongly how control is exercised.

6.2 Organizational Empowerment: PP No. 41/2007 on PEMDA Structure

PP 41/2007 under the decentralization law regulates the basic structure of regional government. Its assessment could have been placed under Strategy 1 (separating roles) but has been included here because it is felt it highlights the need for better control arrangements on which “empowering organizations” rely.

6.2.1 Scope of PP: All Organizations, excluding BUMDs

Government Regulation No. 41/2007 under Law 32/2004 is a regulation concerning the organizational structure of regional government. It supersedes the earlier Government Regulation (PP No. 8/2003 on the same subject).

This government regulation concerns matters related to establishing the various organizations, including Service Delivery Organizations (SDOs) and provides the basis for regulating the relationship between the head of the region and the various SDOs (which is done in a Regional law – PERDA – that describes overall the structure of the regional government). The PP applies to all regional governments and includes:

- Procedures for establishing a “regional apparatus organisation”;
- Positions, tasks and functions of the regional apparatus;
- Size of the organisation and classification of regional apparatus;
- Regional apparatus organisation structure.

The regional government organization at provincial and district/city level is specified as consisting of:

- One Regional Secretariat;
- One DPRD Secretariat;
- Multiple Regional Service Delivery Offices (*Dinas Daerah*), including Regional Technical Implementing Unit;
- Multiple Regional Technical Institutions, including Inspectorates, Boards, Offices, Technical Board Implementing Units, General Hospitals;
- Multiple sub-districts and villages (*Kelurahan* and *desa*).

Importantly for AMSD, regional government-owned enterprise (*Badan Usaha Milik Daerah* = *BUMD*) and possibly regional public service agencies (*Badan Layanan Umum Daerah* = *BLUD*) are not included in the categories of Service Delivery Offices or Regional Technical Institutions. Included in this latter category is core administrative, regulatory or compliance agencies such as the:

- Regional Development Planning Agency (*Badan Perencanaan Pembangunan Daerah*)
- Regional Employee Affairs Agency (*Badan Kepegawaian Daerah* or *BKD*)

- The Internal Control Unit (Inspectorate or *BAWASDA*);
- Environmental Management Office (*Kantor/Balai Lingkungan*);
- Integrated Licensing Service Offices; and
- Civil Police (*Pamong Praja*).

The head of each of these units formally reports to the Head of Region through the Regional Secretary, an extraordinary responsibility when considering the *kelurahan* and *desa* can number in their dozens. PP 41 therefore concerns the “traditional” organizations of service delivery and forms the basis for determining the relationship between the “central administrative agencies” and the SDOs, whatever form they take.

Because of their importance as “the ultimate goal” for many services when thinking about an AMSD-based change, a special assessment of BLU(D) and BUMD is presented in the next section of this report. This assessment could also have been included under Strategy 3 (consequences), but it is here because these two forms of organizations and the rules associated with them serve to point the way to future reforms. The aim of Strategy 5 is to loosen suffocating administrative rules that focus mostly on controlling inputs rather than focussing on control through results. The separate and evolving legal and regulatory framework for BLUD / BUMD provides an insight into the direction that those in the core of government may take in the future.

It is suggested PP 41 places the Heads of all PEMDA dinas (SDOs) and technical institutions in a weak position with respect to the Head of Region and the Regional Secretary and on unclear terms with respect to one another. More consideration should be given to establishing an “arms-length” relationship between agencies and the senior executive to ensure “due process” is respected. More thought is also required as to who is regulator and who is operator, and what checks and balances exist.

6.2.2 Better Classification of Functions to Determine Organization Type

The general approach used for developing an organisation, according to PP No. 41/2007 is that a regional apparatus organization is formed because there are governmental functions/affairs that must be handled. However this does not mean that for every function a separate organization must be formed, as the functions can be grouped together or placed in a group with others. This Government Regulation refers to this as ‘classification’.

This PP also classifies the governmental functions as:

- (i) functions or affairs appropriate for handling by a Service Delivery Office (Dinas), and
- (ii) functions appropriate for a technical institution, which includes Inspectorate, agency or board and (oddly) hospitals.

The classification of functions into two groups can be seen in the table (**Table 6.1**) below.

Table 6.1 Classification of Affairs in Service Offices and Technical Institutions

| Affairs for the Service Delivery Offices , pursuant to Article 22 paragraph (4) | Affairs for the Technical Institutions , pursuant to Article 22 paragraph (5) |
|--|--|
| (1) education, youth and sports; | (13) development planning and statistics; |
| (2) health; | (14) research and development; |
| (3) social affairs, manpower and transmigration; | (15) national unity, politics and public protection; |
| (4) transportation, communication and informatics; | (16) environment; |
| (5) population and civil registry | (17) food security; |
| (6) culture and tourism; | (18) capital investment; |
| (7) public works including road construction (<i>bina marga</i>), waterworks, housing and urban development (<i>cipta karya</i>) and spatial planning; | (19) library, archives, and documentation; |
| (8) economic, including cooperatives and micro, small and medium enterprises, industry and trade; | (20) community empowerment and village government; |
| (9) land affairs; | (21) women empowerment and family planning; |
| (10) agriculture, including food crops, livestock breeding, inland fisheries, marine fisheries, plantations and forestry; | (22) employee affairs, education and training; |
| (11) mining and energy; and | (23) supervision and control; and |
| (12) income, financial management and assets | (24) health service. |

Roughly speaking, one could imagine that the set-up was that the left are “implementing” organizations while the right are “regulatory” organizations, but that is not the case. In practice, all these agencies are most often perceived as “product” oriented agencies (not regulatory or compliance oriented – perhaps with the exception of BAWASDA). The regulatory role over these “product” oriented agencies that present strong conflict-of-interest situations presumably was to be handled by the “core administrative agencies” of SETDA, or not considered at all. This point has great significance when it come to attempts to ratchet-up accountability, because it makes it difficult to begin creating “checks and balances” within each regional government.

It is suggested the criteria for differentiating functions have not been made explicit. Doing so with provision of the rationale would help PEMDA better design their structures to ensure conflicts of interest are minimized and to establish more “checks and balances”.

6.2.3 Steering vs. Rowing (the Roles of Dinas' vs. Badan etc)

In the framework of providing public service only the '*dinas daerah*' ('Service Delivery Organization / Office' (SDOs), and in certain cases the Technical Agencies / Institution (for example the General Hospital) have direct access to the people, while other organisational units only "give their support" (undefined) to these SDOs. In performing its tasks, the SDO may, if necessary, form a Technical Implementing Unit – a *Unit Pelayanan Teknis* (UPT).

Pursuant to Article 7 (for provincial governments) and Article 14 (for district/city governments) of Government Regulation 41, the Dinas is "the element implementing regional autonomy, to assist the head of region in running the government, which has the task of conducting the regional government's affairs based on the principle of autonomy and assignment".

The governmental affairs that are the task/function of the SDO (*Dinas*) include:

- (a) Formulating technical policies;
- (b) Conducting governmental affairs;
- (c) Conducting public service.

The main problem seen with the PP is the lack of specified relationship between the two types of organization. There appears to be a view that each sector needs only one or other type of organization and the concept that a sector needs one organizational unit that sets policy, another to regulate, others to implement, and yet others to monitor and force compliance and so on is missing. The "checks and balances" seen in more sophisticated government structures is largely missing, although supporters of PP 41 argue that those functions can be put inside whatever organization form is adopted.

There are a number of improvements that could be made concerning the above:

1. More specific guidance could be provided on what types of units are best suited to the type of function / service to be provided, that is the "urusan" detailed in PP 38/2007.
2. Guidance could be offered on the appropriateness or otherwise of mixing functions, e.g. organizations charged with formulating policies being mixed with organizations responsible for implementation of those policies; for monitoring and evaluation and for ensuring compliance and so on;
3. The "limits" of an organization based on some view of optimum efficiency (especially given the divided debate on pros and cons related to the mushrooming of commissions and other non-departmental organizational forms at central government level).

It is suggested that overall, like the improvements to regulate the vertical relationship, improvements could be made to ensure horizontal relationships are established on a firm basis. A specific sector could have a policy-maker, one or more implementers and a regulator, all with an arms-length, professional relationship between one another and with the Head of Region.

6.2.4 Improving Regulating Functions in "Technical Institutions"

Article 8 (for provincial governments) and Article 15 (for district/city governments) regulates the establishment of a regional technical agencies / institutions, including some which clearly provide service to the public (for AMSD purposes these have been called "SDOs"). The number of agencies and the number of "Echelon II" personnel is related. The technical institution is said to support the Head of the Region in running the government; its task (most

often, but not always – for example, hospitals) is to formulate and implement regional policies of a specific nature. This institution may be in the form of an:

- agency (*instansi*)
- board (*badan* or *Dewan*)
- office (*kantor*) and or
- general hospital (*rumah sakit*).

PP No 41/2007 allows the establishing of a ‘regional technical implementing unit’ (UPTD) within an Institution to carry out the operational activities and/or supporting activities when the work area of the institution covers one or more districts/cities (for institutions at provincial level) and one or more sub-districts (for institutions at the district/city level). The UPTD is part of the regional apparatus.

Like those parts of the regulation regulating Dinas’, the regulation provides no guidance (among various matters) on:

- Matching organizational roles, form, objectives and authority with its “product”. For example when would an *instansi* (agency) as opposed to a *kantor* be appropriate for a unit to serve a sector, say piped water?
- What criteria exactly guide the distinction between establishing a UPTD as opposed to a Dinas or other “implementing” organization?
- Besides the geographical criteria, what product/activities might determine whether a UPTD would be better to perform them than a Dinas or Sub-Dinas?

The classification and accompanying description in PP 41 is where one might expect to find a range of alternatives clearly set out. Unfortunately it does not – it appears caught between, on one hand, wanting to standardize and on the other, wanting to provide flexibility to suit local needs. And it enables plenty of conflicts of interest to emerge by allowing “regulatory” type organizations to create implementing units.

It is suggested the balance may not be right; in aiming for standardization and simplicity (and reducing Echelon II costs?) it appears to be making it difficult to separate and contain conflicts of interest between core administrative, delivery, regulatory and compliance roles.

6.2.5 Is Regulating Total Number of Organisations Beneficial?

Government Regulation No. 41/2007 also attempts to “standardize” the number of regional organizations by using three criteria namely:

- the amount of population,
- size of the area, and
- amount of the regional budget,

as determined in Article 19 paragraph (1). For this purpose, an assessment system (in numerals) is presented in the supplement to the Regulation. To assess the population and size of the area, the system places Java (including Madura) in one group and the rest of Indonesia (outside Java) into another group, where each group is classified further into 5 intervals, each having a different value (weight). Analogous to this, the amount of Regional Budget is also classified into 5 intervals, but no longer grouped into ‘Java’ and ‘Outside Java’.

This assessment system produces a total value for each province and district/city that will be used to determine the size of a regional government through the number of organisations it contains. For example, in Article 20 paragraph (1) it is stated that a Province with a total value of less than 40 may have the following organisation numbers:

- a. One Provincial Secretariat with a maximum of 3 Assistants;
- b. One DPRD Secretariat;
- c. Service Delivery Offices (*Dinas*), the maximum amount is 12 units; and
- d. Technical Institutions, with a maximum of 8 units, including Inspectorate, Planning Board, and Hospital.

More details regarding the number of regional organizations are given in Article 24 to 33 of the said Government Regulation. Because each organization is headed by a person with “Echelon II” rank, PP 41 effectively regulates the number of personnel of higher rank and so indirectly the “wages” bill of PEMDA.

For whatever the reason that the limit on total numbers of organizations has been imposed, it is of some concern for AMSD. AMSD favours the “one-organization – one mission” view of organizational effectiveness in government, whereas PP 41 appears to promote the opposing view, which is that lesser but larger public sector organizations are better.

This latter view’s claimed advantages include:

- Better coordination across sectors and between the “core administrative agencies” and the SDOs
- Lower overhead expenses, with less “executive” facilities in general and Echelon II personal in particular
- Simpler relations between the tiers of government, and
- Potentially fewer employers as “multi-tasking” may be increased.

On the con side, lack of focus, inflexibility and unresponsiveness to local needs and conditions, lesser accountability associated with multiple missions and dubious savings in relation to overheads and staffing may be cited.

Classical AMSD, with its focus on specialized, autonomous (arms-length), professional and accountable organizations in some ways conflicts with the general strategy of PP 41/2007, which appears to aim to contain / restrict the growth in numbers of regional government organizations. There is obviously much work to be done in this area of the legal and regulatory framework.

It is suggested that analytical work in the future might include testing the cost saving assumptions of PP 41/2007 using benefit / cost criteria. For example:

- Do the benefits represented by claimed savings in Echelon II and executive facilities outweigh the costs of (probably) lower efficiency in operations?
- Does the PP 41 approach produce a higher b/c ratio than the “atomized-structure” approach in which benefits accrue from increased clarity of mission and accountability, but supposedly at the cost of increased coordination and overheads?

6.3 BLUDs: Flexible and Autonomous, but Still Accountable?

PP 41/2007 provides the overall guidance on PEMDA structure, but does not regulate the decision on or provide detail about special organizational forms – such as the Public Service Delivery Agencies (BLUD) and Regional Government-Owned Enterprises (BUMD) - and their control mechanisms. **Appendix K.1** provides background notes on these alternative forms (plus further notes on the national form of the state-owned enterprise (BUMN), the law on private enterprise and the private investment law). The following section assesses the BLUD organizational form, and especially the possibilities that it provides with respect to flexibilities that could move control away from inputs to outputs and outcomes. Governance arrangements to raise accountability and customer responsiveness are also assessed.

6.3.1 BLUD Framework – Flexibilities, at What Cost?

When Laws 17/2003 and 1/2004 concerning state financial management were drafted, a need was felt for a more autonomous organizational form to provide services that are sold but for which it is not intended to profit. So, in addition to the various institutional forms (or management models) described above, Article 46 of PP No. 41/2007 states that the Regional Government may establish a 'regional apparatus' in the form of a public service agency (BLUD) based on the existing laws (primarily UU 1/2004 and PP 23/2005).

Further, Article 47 of the Regulation also enables Provincial and District/City Governments to form an 'integrated service unit' to enhance the community service in issuing licenses and permits which are across sectors; this is a joint effort between the elements of regional apparatus that handle the licensing function. The organizational guidelines and working procedure of the integrated work unit are determined by the Minister of Home Affairs after receiving considerations from the minister who manages governmental affairs related to efficiency of the state apparatus (MenPAN).

There are therefore alternative forms of SDOs to the dinas, but are the rules beneficial? Do they promote the "autonomy with accountability deal? Do they create "checks and balances"?

6.3.2 The Rules on Establishing and Operating a BLUD

The regulatory framework is completed by:

- PP 23/2005 concerning financial management of service delivery agencies;
- PP 58/2005 concerning management of regional state finances; and
- Permendagri 63/2007 concerning technical guidelines for financial management of BLUDs.

Aside from the question of what functions the BLUD organizational form is most suited to, the other question of particular interest is "does it achieve the autonomy with accountability" objective? That concerns providing flexibilities but also putting in place mechanisms of improved accountability – not only in performance measurement but also good governance.

The rules are interpreted by MoHA²² to mean that the following instruments must be created

²² See presentation by DR. Hari Nur Cahya Murni, MSi, Directorate General Bina Administasi Keuangan Daerah, Departemen Dalam Negeri titled "Gambaran Umum Peraturan Menteri Dalam Negeri No 61 Tahun 2007 tentang Pedoman Teknis Pengelolaan Keuangan Badan Layanan Umum Daerah"

by PEMDA in order to comply with the legislation:

Decision(s) of the Head of Region (Keputusan KDH) covering:

1. Formation of an evaluation team
2. Establishment of the BLUD
3. Tariffs
4. Appointment of non-civil servants

Regulation(s) of the Head of Region (Peraturan KDH) covering:

5. Relief from existing debts
6. Power to borrow funds
7. Establishment of an accounting system
8. Investment decision-making and procedures
9. Procurement of goods and services
10. Business and financing plan
11. Cooperation with other parties
12. Remuneration of personnel
13. Criteria concerning non civil servants in management and employee positions
14. Regulations concerning supervisory board
15. Appointments to the board
16. Service standards.

In other words, key issues surrounding financing, procurement, personnel and governance structures must be addressed first to ensure the flexibilities that might be introduced through these administrative systems are matched with increased accountabilities.

It is suggested the challenge is obviously in the detail – ensuring that accountability is not ceded inappropriately to autonomy. This concern may explain why many PEMDA are said to not be adopting the BLUD model. They are concerned granting flexibility / autonomy will lead to loss of control.

6.3.3 Claimed Administrative Flexibilities for BLUD

Table 6.2 exhibits the flexibilities for BLUDs that are claimed by the Government. They cover the functions of finance, cooperation, procurement, management of assets and of personnel. The BLUD has a number of other advantages also if the governance aspects are heeded – and if the experience of BUMDs is anything to go by – they should be because the governance aspects are likely to provide much of the “control”.

Whether the claimed flexibilities will be realized however depends upon the quality of the rules formulated by the PEMDA in establishment of the BLUD. It seems a risky strategy. Hence it is suggested that model “clauses”, if not whole *Keputusan* and *Peraturan* could be prepared that not only provide rules for increased autonomy, but also improve accountability and governance.

Table 6.2 The Flexibilities of BLUD Compared with Traditional Dinas

| | Aspect | Normal SKPD (Dinas) | BLUD |
|---|----------------------------------|--|---|
| 1 | Revenue | Revenue must be deposited into the general account for the PEMDA | Revenue deposited into the BLUD's own account. |
| | | Revenue must not be used directly to support the BLUD activities | Revenue may be used directly by the BLUD |
| 2 | Expenditure | Expenditures must not exceed the approved budget | Expenditures are flexible - budget limits are set in the BLUD annual budget – RBA. |
| 3 | Debt and liabilities | Must not incur debt from loans | May borrow / incur short term liabilities |
| | | | May borrow long-term with approval of the Head of Region |
| 4 | Investment | May not undertake investment | May make investments needed to support service delivery in it own right; Long term investment needs approval of Head of Region |
| 5 | Cooperation | May not cooperate with other parties | May cooperate with third parties |
| 6 | Procurement of goods | Must follow the rules of Keppres 80/2003 | Funds that are not sourced from APBD/APBN may be used to procure goods outside the rules of Keppres 80/2003 |
| 7 | Management of the assets / goods | May not write-off assets, both fixed and non-fixed | May write-off assets that are non-fixed |
| 8 | Personnel | Must be civil servants | May employ both civil servants and non-civil servants |

Source: Presentation of Dr Hari Nur Cahaya Murni, MSi, BAKD, MoHA

The first issue therefore concerns the reality of claimed flexibilities. The Consultant has not assessed specific examples of a *Peraturan* that establishment of a BLUD requires, but from discussion in the pilot location of Lebak (where the pilot project proposed is conversion of the RSUD to BLUD status), the issue appears to be whether the rules will in fact provide the desired flexibility, or in fact, either just be copies of the core administrative rules applied in a similar way, or so loosely drawn that improved accountability may be compromised.

The need for and potential of governance to provide the “accountability” parts to the autonomy-accountability deal have been and continue to be underestimated for BUMD, and may be so for BLUD. While the need for rules on financial administration are relatively easily understood and so produced, putting in place the rules that ensure transparency, participation, accountability, due process and responsiveness to community needs (i.e. good governance) have proved much more difficult for MoHA.

One suggestion is that, after reviewing the experience with BUMD, a “model” set of regulations relating to the non-financial arrangements in BLUDs be prepared that can be adopted or adapted by PEMDA as they establish BLUDs.

6.3.4 Typical Areas of Administrative Flexibilities

Some suggestions are provided in **Boxes 6.2, 6.3, 6.4** and **6.5** on “generic” areas of flexibilities that may be sought respectively for (i) financial management (ii) procurement (iii) human resources and (iv) support services.

Box 6.2 Typical Flexibilities in Financial Management

FPA Part V.1: Related to Financial/Budget Management (PP 58/2005 and Regulation of Minister of Home Affairs or *Permendagri* No.13/2006, or BLUD / BUMD version)

1. Internal distribution of “savings” so as to create new efficiencies in operational cost (“gain sharing”)
2. Internal distribution of “additional earnings” so as to encourage increases in the units’ income (“gain sharing”)
3. “Lump sum” budget per division/organization section, not a specified budget for division
4. “Lump-sum” budget to be easily reallocated among budget items; 2-year approval, 4 year outlook, rolling update.
5. “Guaranteed” borrowing facility from central sources against guaranteed “income” to be collected next year
6. “Guaranteed” facility from central sources without collateral to be used for investments and new breakthroughs in productivity.

1. Source: See Appendix C.1, “Model of a Flexible Performance Agreement”

2. FPA means “Flexible Performance Agreement” (or “Performance Contract”)

Box 6.3 Typical Flexibilities in Procurement Management

FPA Part V.3: In Relation to Procurement Process (Presidential Decree or *Keppres* No. 80/2003, or BLUD and BUMD versions)

1. Authority for the unit manager to make direct purchases (using credit cards)
2. Reduce the use of “special specifications”; buy commercial products only
3. Loosen the budget ceiling in order to be able purchase directly without complicated processes
4. Simplifying the auction process (electronic, etc.), including “authorization thresholds”
5. Simplifying process of complaint management of auction participants
6. Change the “low-price” approach to the “best value” approach (namely life–cycle costing)
7. Use more “pre-qualification” approaches and afterwards “limited auction”
8. Selection that emphasizes more on “performance first” criteria
9. “Framework” contract and multi-year contracts

Source: See Appendix C.1, “Model of a Flexible Performance Agreement”

The procurement function of Box 6.3 provides a particularly good example of the difficulties with finding a balance between flexibility/autonomy and accountability. Remembering that Keppres 80/2003 has been amended on seven occasions just since 2003, one summary of the problem might be that one side of the debate want more regulations and less flexibility, the other is seeking less regulation, or in other words, more flexibility. **Appendix K.5** exhibits a clipping on a debate surrounding procurement. A similar situation probably prevails with management of human resources.

Box 6.4 Typical Flexibilities in Human Resources Management

FPA Part V.2: Related to Personnel Management (Law No. 43/1999, related Government Regulations or PP and other, for BLUD and BUMD versions)

1. Simplifying classifications
2. Simplifying remuneration system
3. Authority over the process of seeking, selecting and terminating working relationship of personnel without the intervention of Regional Government / Regional Head / BKD
4. Authority to lease-in (outsource) personnel
5. Authority over the structural design of enterprise personnel management, action on those who lack discipline or identified as lacking in performance; all actions except for work termination
6. Authority over the design of disputes and grievance settlement process
7. Special remuneration mechanism: lump-sum, performance bonus, "golden-hand-shake; functional allowance, successful team allowance, etc.
8. Authority over the design of individual performance assessment system and providing "rewards and punishment"
9. Authority and finance to pay for individual performance bonus
10. Authority to design and undertake "gain sharing"
11. Flexibility to outsource personnel, use agencies/outsourcing
12. Authority over the decision and cost to build employee's capacity without having to follow regulations on services by Regional Government's Diklat for Education and Training.
13. Authority over "re-training personnel" and using them for other internal positions;
14. Free from directions controlling the minimum or maximum number of employees /personnel.

Source: See Appendix C.1, "Model of a Flexible Performance Agreement"

Box 6.5 Typical Flexibilities in Use of Support Services

FPA Part V.4: In Relation to use of other common/mandatory internal “Support Services” by the Regional Government

1. Flexible regulation regarding trips and reimbursement;
2. Freedom from regulations that force organizations to use buildings and other assets owned by the Government; managing facilities by contractor; using “lease” for facilities that are not state assets;
3. Freedom to purchase general services from the best sources (e.g. travel services, photocopy, printing, selection of buildings and assets to be used) and financial control to pay for such services (not paid by “central”);
4. Authority to enter into “service agreements” to provide necessary internal support service by Regional Government.

Source: See Appendix C.1, “Model of a Flexible Performance Agreement”

The BLUD alternative appears designed to deploy AMSD Strategy 5 of organizational empowerment with the approach being through the financial management aspects. The BLUD form is a key instrument for promoting AMSD but the concern is whether:

- the desired flexibilities in management will eventuate through translation of the broad directions in PP 23/2005 into clear and accepted rules on the ground; and
- the “governance” aspects (how rules are made that determine the allocation of resources and benefits) are keeping-up with those for financial management?

It is suggested the AMSD project can help with preparation of these core administrative rules, and begin to help with strengthening the accountability side through introducing stronger governance mechanisms.

6.3.5 Using Governance to Strengthen the Autonomy – Accountability Deal

Article 34 of PP 23/2005 that regulates BLUDs, authorizes the creation of a “supervisory board”, if desired by the PEMDA. The Consultant suggests this provides one key mechanism for strengthening the accountability side of the deal. The challenge is creating effective boards, because the experience with this approach has not been good in Indonesia (see the next section briefly assessing regional government-owned enterprises).

The main problems are:

- Mixed objectives of the board: is it to guard the interests of the community, PEMDA or the organization?
- The board being constituted with “constituencies” in mind (government, professionals, community for example) and thus tending to work against one another rather than as a team

- Asymmetries of information results in boards (and owners) lacking relevant information and therefore being unable to act as interested owners.
- Owners interfering with daily management of the SDO (perhaps because of lack of good performance information) rather than through the board, thus reducing managerial flexibility and initiative; and
- The core administrative organizational arrangements of PEMDA (starting with SETDA) are not re-adjusted to account for the different set of relationship needed to manage an SDO at “arms length”, i.e. through the board.

The rules concerning the duties and functions of a “representative of the owner” as well as the rules governing the relationship between those in PEMDA performing the ownership function and the SDO need developing. **Appendix K.3** covers the various roles expected in good governance set-ups and thus provides guidance on the content of a regulation that is needed in this area.

Beside the above “structural” arrangements of using a “board” for improving accountability, control via outputs and outcomes is most often attained using strategic and annual work plans and budgets. Leaving aside whether these plans address the correct objectives with realistic activities, a particular problem is injecting more certainty into the process of approval and change of them. Without this, the owner tends to regress to control through inputs. **Appendix K.3** covers suggested rules for routine preparation of annual work plans and budgets while **Appendix K.4** suggests some rules that could improve the relationship between owner / regulator and the SDO with respect to approval of strategic plans.

It is suggested that AMSD could help prepare model instruments that would include rules similar to the exhibits in the Appendices – boards and their constitution, strategic plans and budgets among other matters - thus improving the “autonomy with accountability” deal.

6.4 BUMDs: Even More Autonomous, but Still Accountable?

6.4.1 Key Differences between Line Organizations and BUMDs

It is not proposed to assess in any detail regional government–owned enterprises (BUMD), but rather to highlight the different legal and regulatory framework in which they operate. This provides a means to understand how BLUDs and dinas’ may be given more autonomy, without loss of control over policy-making by the core of government.

BUMDs are different to the normal *dinas* in a number of aspects:

- Profits: they are expected to earn a profit as well as fulfil certain social obligations;
- Service charges: They generally are expected (if not actually) to rely entirely for survival on selling services, sometimes in a competitive market, but more frequently in a market in which they are the dominant provider, typically a “statutory monopoly” such as water supply or waste collection, but also in other more developed markets, like banking;
- Taxes: any profit they earn is taxed by the central government as though they were a private business;

- Assets: their assets are separated from those of regional government, so in theory, they could be used as security for loans etc;
- Legal identity: the BUMD supposedly has a legal identity separate from that of the owners, like most private companies; and
- Governance: are required to be governed by an oversight board.

BUMDs thus have the many of the characteristics of corporate legal identities, even if they still fall under administrative law and not the commercial code. They aspire to be autonomous by nevertheless controlled by their owners, the regional government.

6.4.2 Internal Control: Resources, Boards, Plans and Budgets

Regional government-owned enterprises (BUMD) are not regulated in PP No. 41/2007 as they are “private” institutions, whose establishment and the way they are managed being regulated by the law on regional government–owned business enterprises, namely Law No. 5/1962. At the time of writing this report, a special law on BUMDs is in the process of being drafted to replace the current law.

The legal and regulatory framework that has grown up around BUMDs has tended to be tailored to realizing the “autonomy with accountability” deal. Matters such as governance and delegation of power, resourcing and management of resources (financial, human and physical), service delivery, performance management and accountability for BUMD are different to the general framework. **Table 6.3** lists the main legal instruments for regulating BUMD (using piped water enterprises as an example). Attention is drawn to the existence of rules concerning management of human, financial and physical resources (although procurement is an uncertain and contentious issue).

The enterprises often perform better than the dinas, although one of the main problems in achieving even better performance has been that the PEMDA administrative centre will not “let go”. Many BUMDs suffer from the owners - Head of Region and PEMDA core administrative agencies - interfering in day-to-day management. So-called “arms-length” relationships in many PEMDA have not developed between owners and managers, despite the framework of laws and regulations. The main reasons were identified in the previous section on BLUDs: (i) the centre will not let go of budget and power (ii) intermediary owners’ representatives are disempowered and (ii) the rules governing the relationship are not explicit and enforced.

Efforts at improving BUMDs need focussing on three areas related to the overall autonomy–accountability deal:

- better governance, which is mainly associated with the constitution and operation of governing bodies (boards), instituting good governance programs, improving the relationship between governors and owners and making the owners behave like good owners;
- better control, especially through the strategic planning and reporting documents, and result-based accountability mechanisms – especially with respect to procurement and management of resources; and
- better managers, which focuses on getting in new managers, making best use of existing stock of managers and providing incentives.

Table 6.3 The Main Instruments for Controlling BUMD (Water Supply Example)

| Delegation of Authority / Governance | |
|---|--|
| 1 Law 32 / 2004 on regional governance | Allows creation of BUMD (regional Government owned enterprise) |
| 2 Law 7 of 2004 (sectoral law) | The Water Resources Law, Article 40 covering water supply |
| 3 Law 5 of 1962 on SOE | Establishment of Local Government Enterprises (“PD” or “BUMD”) |
| 4 Permendagri 2 of 2007 | Organs and personnel of PDAM. Withdrawal of civil servants occupy leadership positions in State Owned Enterprises. |
| 5 Permendagri 3 of 1998 | Legal Forms for PDAMs – including PT |
| 6 Permendagri 7 of 1998 | Governance of PDAMs – especially Board of Supervisors |
| 7 Kepmendagri 50 of 1999 | Governance (Boards) of Local Government Enterprises |
| Resourcing | |
| 8 PP 16 of 2005 (sectoral) | Development of Drinking Water Supply Systems and Sanitation |
| 9 PP 54 of 2005 (loans) and PP 2/2006 (grants) | Rules on Management of Loans and Grants for Local Government / Enterprises |
| 10 Keppres 80/2003 on public procurement | Unclear whether it applies to PDAMs. Some PDAM are trying to free themselves from this rules |
| 11 Permendagri ¹ 23 of 2006 | Guidelines for regulation of Tariff Setting process in PDAM |
| 12 Inmendagri ¹ 8 of 1998 | Instructions for Implementing Tariff Setting in PDAM |
| 13 PP 6/2006 on assets | Management of central and regional public assets |
| Service Delivery / General Operations | |
| 14 Keputusan Bersama (Joint Decree) of the Ministers of Home Affairs and Public Works, Number 5 Year 1984 / Number 28/KPTS/1984 | Guidelines on organization, technical maintenance, structure and calculation of costs for determining the tariff, customer service, management of water supply in Ibu Kota Kecamatan and the management of public taps for PDAM and BPAMs. |
| 15 Permendagri 4 of 1990, dated 16 March 1990 | Methods of cooperation between Local Enterprises and Third Parties |
| 16 Inmendagri 9 of 1995, dated 28 March 1995 | Directions on the implementation of Permendagri 4 of 1990. |
| 17 Perpres 67 /2005 | The procedures for engaging the private sector in infrastructure investment and operations |
| 18 Kepmendagri ¹ 8 of 2000 | Guidelines on PDAM Accounting System |
| 19 Kepmendagri 34 of 2000 | Guidelines on PDAM Personnel Management |
| 20 Kepmendagri 43 of 2000 | Guidelines on Cooperation between PDAMs and Third Parties |
| Information / Performance Management | |
| 21 Inpres 7 / 1999 of 15 June | Accountability for Performance of Government Agencies |
| 22 SK Head of LAN, 589/IX/6/Y/1999 | Guidelines for Renstrada and Accountability Reporting |
| 23 SK Head of LAN 239/IX/6/8/2003 | Changes to Guidelines for Renstrada and Accountability Reporting |
| 24 Kepmendagri 47 of 1999 | Guidelines on Performance Evaluation of PDAMs |

Responsibility for development of the BUMD framework rests between the MoF and MOHA (DG-BAKD). It is suggested the AMSD project located in DG-PUM and elsewhere in government keep in close contact with BAKD concerning developments, especially now that governance is being accepted as an important area for improvement.

It is also suggested one part of the AMSD project should be to set up procedures for capturing information about desired “flexibilities” of SDOs, and especially those being granted BUMDs, by sector and region, and feeding them into the larger mechanisms for reviewing and updating laws and regulations.

6.4.3 External Control / Supervision: The Move to Independent Regulation

Another and important area where the BUMD framework is beginning to get ahead of traditional SDOs is in supervision, particularly “economic regulation”. This is so because:

- many BUMDs are statutory monopolies (water companies for example) and it is felt they need special supervision because they may abuse their monopoly – even when they are owned by the regional government;
- they often compete with private service deliverers and independent regulation is needed to ensure equitable treatment of all (for example regional banks compete with private and state banks under the regulation of Bank Indonesia); and
- the service deliverer is a private sector organization that insists on mechanisms for fair treatment in tariff setting and disputes, which the government sector manager may not be able to provide because of conflicts of interest.

As autonomy of the SDO increases, so does the need for supervision, especially for those enterprises such as water companies, which have been granted exclusivity in their jurisdiction. Independently of the BUMD law, a regulatory body for the Jakarta water supply concessions was established in 1999, and the draft revision of UU 5/1962 on BUMD contains requirements to separate regulatory affairs from implementation.

Currently, the government executive on one hand directs management and on the other hand is supposedly responsible for supervising the enterprise. Gamekeeper and poacher truly are one, making independent regulation meaningless. The conflicts of interest wrought by this situation means tariff setting is politically driven, the BUMDs are not disciplined by suffering hard budget constraints and the private sector are discouraged from investing because of lack of objective, independent regulation of the sector.

The response in many countries has been for the executive and legislators (somewhat surprisingly) to establish regulatory bodies at “arms-length” from themselves with power to make decisions about what organizations can operate in the sector, how they provide their services and the cost of those service. The body is required by law to:

- (a) facilitate efficient, effective and fair provision of services for the entire community
- (b) make independent, consistent and impartial decisions in an accountable manner;
- (c) act as the champion of the community at large; and (often)
- (d) promote competition in the sector.

The challenge is in turning this role into reality, especially in developing countries with weak institutions. Key questions to be addressed in the legal framework include:

- (1) how much discretion should the legislators award the Regulator;
- (2) what functions should be independent (especially with respect to pricing and licensing) on a scale between all-encompassing to minimalist;
- (3) how to construct checks and balances such that the Regulator is both independent but accountable;
- (4) the structure of the Regulatory institution, one or more persons for example; and
- (5) how to pay for the institution.

The answers depend largely upon local circumstances, but if there is a trend, it is to start with “light-handed” regulation. Establishing independence is critical and often laughed-off as asking the impossible, but careful construction of checks and balances is likely to make the resulting institution far more transparent and accountable than current arrangements. Independence is gained by wracking up accountability simultaneously; otherwise the situation is like that under corporatization, where more autonomy often is not granted because of the legislators’ fears that there will not be a concomitant increase in accountability.

Box 6.6 summarizes typical actions to increase simultaneously independence and accountability. But in doing so all the criteria for successful regulation need to be addressed. These criteria are: independence, accountability / transparency, efficiency, legitimacy and technical expertise.

The challenges are large to establishing in the legal and regulatory framework an institution of independent supervision in regional government for SDOs, but this institution is a major thread through any strategy to improve service delivery. Creating independent Regulatory Bodies as they are known in the developed world may not be possible for many reasons – costs, capacity, a culture of informality - all working against the initiative. Nevertheless, without someone looking over the shoulder of SDOs on behalf of the community, SDOs providing services in monopoly situation have little incentive to improve.

It is suggested that the AMSD project can benefit from monitoring developments in the BUMD framework:

- Relationships between key actors are beginning to be regulated through written contracts;
- The rules regarding management of a range of assets are being made more specific to sectors; and
- Particularly, attention is being given to improving professional sector-related supervision arrangements for BUMDs through development of the BUMD legal and regulatory framework as a guide.

On this last point, AMSD can learn from the realization that the normal state supervisory organs / auditors (Bawasda, BPK, BPKP and public accountants) face enough challenges in auditing financial matters let alone assessing whether SDO performance in a particular sector is good or otherwise, and then devising incentives to improve it.

Box 6.6 A Regulator of Service Delivery – Independent but Accountable**Rules to Improve Independence**

1. Appointing staff on professional criteria, not other criteria, such as position (Echelon)
2. Protecting Regulators from arbitrary removal from office by award of fixed tenure appointment (as in the case of Bank Indonesia)
3. Self sufficient funding of the Regulator from levies on the customers, not through ministerial budgets
4. Avoiding employing personnel associated in the past with the service deliverer / operators
5. Paying private sector competitive rates to staff and encouraging development of a long term professional staff
6. Barring Regulators from political activity, from holding financial interests in the industry and related industries during their tenure and benefiting from either party for a fixed period after their tenure
7. Transparency in decision making such as use of a collegial structure provided by a commission rather than a single Regulator,
8. Allocation of adequate resources and legal authority to perform effectively
9. Final decision making powers without reference to external bodies (such as the Mayor, Governor or Ministries)
10. Awarding the right to stakeholders to appeal decisions.
11. Contracting out (using consultants) for as many tasks as possible
12. Using existing Regulatory bodies that already have a reputation for independence, and
13. Establishing cross-sectoral Regulatory bodies that reduce the dependence upon a particular sector and enable limited skills of staff to be leveraged more.
14. Keeping decisions early in its life simple

Rules to Improve Accountability

1. Describing clearly in the establishing law the objective and duties of the Regulatory Body.
2. Using a Board rather than an individual, majority voting
3. Members appointed by DPRD, not Head of Region
4. Restricting the ability to delegate decision-making and the bodies powers
5. Requiring transparent decision making processes, such as
 - the conduct of public hearings on defined subjects, for example, for proposed tariff increases.
 - requiring all decisions to be in writing and supported by reasons.
6. Concentrating on the public reporting function with annual reports, websites, reading rooms , stakeholder discussions etc
7. Requiring approval of the Regulator's budget as any other government budget, including placing limits on discretionary changes to it that can be made by the Regulator
8. Keeping it small
9. Requiring annual independent audits of the body's accounts.
10. Requiring annual reports of the Regulatory Body be presented to parliament describing how the Regulator's actions have met its objective.
11. Ensuring mechanisms are available for appeal to courts of Regulatory decisions.

6.5 Empowerment Requires De and Re-Regulating Core Administration

The other side of the coin for Tools A.1 (a) to (d) in Box 6.1 is the way core administration runs. While the BLUD and BUMD framework discussed previously aims to re-structure (“put at arms-length”) the relationship between owner and SDO, the core administration must play its role (remember: “it takes two to tango”). If this happens, then all benefit; even for Dinas’ the relationship will be improved, as regulations controlling a range of behaviours become more results-oriented, particularly regulations covering the core administration concerns of:

- Finances and their management;
- Procurement;
- Management of human resources; and
- Assets.

Boxes 6.2 through 6.5 contain examples of where obstacles to achieving more autonomy are often found. Signs of the burgeoning load of regulation in this field are indicated in Figure 1.1 and the length of Appendices listing laws and regulations. Appendix K.5 highlights the problem with respect to procurement. Where flexibility and autonomy should be the objective, “control by input” still appears to be the paradigm. Giving more autonomy to SDOs requires different behaviour of core administration. Control is still important, but it should be through results, not inputs.

Overall, identifying the flexibilities (“autonomies”) in these control systems is not an easy task undertaken as a desk study (although the suggestions earlier provide some guidance). Flexibilities can be quite sector-specific. For example, PDAM Cilegon informed the Consultant that some PDAMs were seeking waivers from their Bupati/Mayor with respect to certain provisions of Keppres 80/2003 concerning public procurement, but whether they would also be appropriate for other SDOs, say the population administration service (*Ducapil*) Serang, may only be judged on a case-by-case basis. Granting exemptions on a general basis will also encounter stiff opposition from those in the centre who believe more regulation is needed, not less or better regulation.

While the general waivers, opting-out and mass-deregulation tools of Box 6.1 appear beyond what is feasible in Indonesia at this time, consideration should be given to granting special waivers and deployment of the other tools for SDO empowerment listed in Box 6.1. While the Assessment has not identified the existence of specific rules aimed at relaxing core administrative requirements, at this time the following should be considered:

| | |
|--|---|
| Tools that can be promoted now: | Tools to consider later: |
| Site based management (schools already!) | General waiver policies |
| Special waiver policies (PDAMs are already asking for it!) | Opting-out |
| | Mass de-regulation (with selective re-regulation) |

It is suggested that one part of the AMSD project should be to set-up procedures for capturing the desired “flexibilities” of SDOs by sector and region and feeding them into the larger mechanisms for reviewing and updating laws and regulations.

6.6 Sector Laws and Regulations Further Constrain and Complicate

The discussion to this point has concerned the laws and regulations sponsored by the central agencies that are the core administrators of government – MoF, BAPPENAS, MOHA, MenPAN.

In addition to the provisions of the core administrative legislation mentioned above, the regulations regarding public services are also regulated by the laws and regulation that govern the sectors concerned. For example:

| | |
|-----------------------------|---|
| Clean water service: | Law on Water Resources and subsidiary regulations, mainly administered by the Department of Public Works: UU 7/2004, PP 16/2005 and subsidiary regulations |
| Hospital services: | Law of Health mainly administered by the Department of Health: UU 23/1992 and subsidiary regulations |
| Population Administration: | Law on Population Administration UU 23/2006, PP 37/2007 and subsidiary regulations |
| Municipal waste processing: | Law on Waste Management administered mainly by the State Ministry of the Environment: UU 18/2008 and subsidiary regulations |
| Toll road service: | Law on Toll Roads |
| Education services: | Law on the National Education System UU 19/2003 and subsidiary regulations UU 9/2009 and subsidiary regulations |

This Assessment has not attempted to enter into these areas because each sector is complex, different sectoral institutional arrangements often prevail through force of law and habit, the degree to which the sectoral department dominates over the core administrative departments varies and arrangements are continually shifting anyway. As an example of differences:

- For water supply, because most SDOs are technically oriented PDAMs that are BUMDs, the Department of Public Work is active in assisting PDAMs with respect to technical matters, but all the regulations with respect to financial and institutional matters originate from MoF and MOHA.
- However, in hospital services, because they are not BUMDs and have a special category in PP41, the Ministry of Health is very active in assisting hospitals in all aspects and therefore one will find little involvement of other agencies, such as the MOHA.

It is believed however that the core administrative rules are recognized and best attempts made to follow them – planning and budgeting, financial management, procurement, monitoring, auditing and evaluation. On this basis, Strategy 5 to shift the form of control

remains relevant, perhaps even more so given that sectoral departments are prone to putting another layer on the core rules.

One relevant assessment question is the extent to which the opportunities to implement AMSD have been accommodated in the provisions of the said laws and regulations, or conversely, to what extent the regulatory provisions have hampered the implementation of AMSD. From this, recommendations for change can be formulated.

This question cannot be answered at this time, but going forward with the pilots, it will become apparent, at least with water supply, hospital services and population administration. It should be said that some innovation is likely to be found because the sectoral departments perhaps have more of an interest in the performance of their sector than the core agencies, and sectoral laws (especially recent ones like population administration and the education entity law) will have considered to some extent the range of factors that are needed to be addressed to improve performance.

It is suggested one example is the recent law on independent (higher) education institutions (UU 9/2009 *tentang Badan Hukum Pendidikan*) – see **Appendix N** – championed by the Department for National Education. This new law has adopted a slew of AMSD strategies and for that reason should be “benchmarked” because it is an extremely interesting case in point. It is suggested that the AMSD project should follow its development as the debate unfolds surrounding the law’s effectiveness.

It is also suggested that one strategy always worth considering in empowering SDOs is to do it in sectoral laws rather than to try make “one size fit all” in the core administrative rules.

6.7 Empowering Employees to Control Inputs

The second main tool for empowering the organization is to empower its employees. This can be done in a large and ever developing number of ways, but for the purposes of the Assessment, the focus is kept on professional “human resources management” (as contrasted with the cultural change of Strategy 6).

Appendix M.1 lists the plethora of laws and regulation that govern the management of the civil service and so provides the framework that largely determines the degree to which employees of Dinas and UPT, and public sector employees of BLUD can be formally empowered.

The autonomy-accountability deal also applies at the individual level, but in the Consultant’s opinion requires as much input from leadership “on-the-ground” as it does from laws and regulations.

6.7.1 Legal and Regulatory Framework

Despite the importance of leadership, with respects to the legal and regulatory framework, the following legislation (selected from the list at Appendix M.1) appears most relevant:

1. UU No 39/2008 concerning State Ministries

2. UU No. 43/1999 amending UU No 8 Tahun 1974 about the Main Features concerning Civil Service
3. UU No. 8/1974 about the Main Features concerning the Civil Service
4. PP 8/2009 on the Eleventh Amendment to PP 7/1977 concerning salaries of Civil Servants (*PP 8 Tahun 2009 tentang Perubahan Kesebelas atas PP No.7 Tahun 1977 tentang Peraturan Gaji Pegawai Negeri Sipil*)
5. PP 41/2007 on organization of regional state apparatus (*PP No. 41 Tahun 2007 tentang Organisasi Perangkat Daerah*)
6. PP 43/2007 on appointment of temporary workers as civil servants (*PP No. 43 Tahun 2007 tentang Perubahan atas Peraturan Pemerintah Nomor 48 Tahun 2005 tentang Pengangkatan Tenaga Honorer menjadi Calon Pegawai Negeri Sipil*)
7. PP 43/2005 on Civil Servants Occupying Multiple Positions (*PP No. 47 Tahun 2005 tentang Perubahan atas PP No. 29 Tahun 1997 tentang PNS yang Menduduki Jabatan Rangkap*)
8. PP 42/2004 on Developing a Espirt-de-Corp and Code of Ethics for Civil Servants (*PP No. 42 Tahun 2004 tentang Pembinaan Jiwa Korps dan Kode Etik PNS*)
9. PP No. 9 Tahun :2003 on Appointment, Transfer and Termination of Civil Servants (*tentang Wewenang Pengangkatan, Pemindehan, dan Pemberhentian PNS*)
10. PP 12/2002 on Promotion of Civil Servants (*PP No. 12 Tahun 2002 tentang Perubahan atas Peraturan Pemerintah No. 99 Tahun 2000 tentang Kenaikan Pangkat Pegawai Negeri Sipil*).

Appendix O includes summaries of selected laws and regulations.

6.7.2 The Impact of Current People-Management Practices

Currently employees of SDOs ultimately owe their loyalty to some one in Jakarta. The civil service is a central organ of state. This is a obviously a very conscious policy decision, and although a major reform is mooted, the effect of this regulatory framework noting. Few would argue the civil service system, which covers all tiers of government, needs major reform. In discussions with the pilot regions, the Consultant was informed that local administration of the Service is still fraught with problems – for example, it appears that corrupt, collusive and nepotistic practices still pervade the recruitment process – with bank loans even being available to help pay “entry” fees. While SDOs suffer from and are even part of this regime empowering personnel will be difficult. The overall effect of the current raft of regulations is to:

- Remove the power of SDOs (and even regional governments) other than BUMDs to manage one of their prime resources – people - in an autonomous manner;
- Reduce the flexibility of SDO managers attempting to match human resources needs with needs on the ground; and
- Obviate much of what modern professional HRM offices located at PEMDA or even SDO level would do.

6.7.3 Key Directions for More Flexible HR Practices

While waiting for a major overhaul of the civil service system by the Government, opportunities for introducing “flexibilities” (“autonomies”) in HRM at the regional level, wherever the opportunity presents, should be taken. Two directions are obvious, one involving managing the employees at the PEMDA level, the other to push management further down and into the SDOs:

- Work with regional core agencies responsible for HRM (mainly BKD) to improve selection, induction and other human resource management processes for personnel who on a day-to-day basis are assigned to the SDOs; and
- Take the direction seen in the BUMD framework of the creation of SDO-specific regulations/rules or “Guidelines” – see Appendix A for the recommended full set of SDO-specific guidelines.

These obviously must be based on the (slowly evolving) higher level and centrally determined regulatory framework for civil servants. A checklist is provided at **Box 6.7** of what should be covered somehow in either the central, sector-specific, PEMDA specific, or SDO specific manuals. “Performance contracts” could be a part of this system.

This approach is the HRM version of the Flexible Performance Agreement for Strategy 1 and the PSO contract under Strategy 2, i.e. clarify by cutting through the maze of HR regulations by “contracting” in some form at the local level.

It is suggested the AMSD project could help by drafting a SDO level HRM guideline with its pilots. This in fact was a suggestion emerging from PDAM Cilegon in their pilot planning workshop, where they concluded “Standard Operating Procedures” were need in various area of their business. It would have to be done in conjunction with the BKD in the relevant PEMDA.

6.8 Summary of Conclusions and Suggestions

This Chapter has assessed selected aspects of the legal and regulatory framework that supports or obstructs empowerment of SDOs, which is AMSD Strategy 5. The empowerment requires control over SDOs by core administration to be moved from inputs to outputs and outcomes (i.e. “results”).

PP 41/2007 was assessed with the focus on whether it separates roles to allow “checks and balances” to be established and the form of control to change. PP 41/2007 allows the existence of several options for SDOs at the provincial and district/city level; the institutional options cover:

- Service Delivery Offices / Organizations (*Dinas*);
- UPTD: technical implementing unit under the SDO (*Dinas*);
- UPTB: technical implementing unit under the Agency (*Badan*);
- Hospitals;
- BLUD: regional public service agency, which in some regions includes the hospital;

Box 6.7 Checklist of Regulations for Public Sector Employees**1. Objectives**

- Establish a professional and politically neutral civil service
- Define the institutions authorized to manage or monitor the CS
- Selection on merit with fair open competition
- Equal opportunity for entry, promotion and career
- Create a regime that encourages quality, impartiality and accountability in performance of duties
- Guarantee of a range of rights, benefits and other conditions that will attract and retain high calibre persons

2. Scope

- To whom do the rules apply (categorization) – just executives and administrators (functionaries), or all?
- Relationship to labour laws?
- How to identify functionaries?
- What rules govern others if not included here?
- How do others enter the functionaries' category?
- Does it apply to other employees (traditionally independent categories (auditors))
- Does it cover special appointments (contract advisors etc) – by whom and effect on permanent employees?

3. Cross-Government Management

- Are employees meant to be part of a greater system?
- If not, how will equity, standards, fairness and professionalism be maintained across all of government?
- Will employees be managed by a central "unit" or decentralized with a central unit coordinating only?
- Who will the unit report to ultimately?

4. Secondary Level Rules

- Can further rules (detailed) be easily made?
- Who may make these rules – common versus specific classes?
- Must the secondary rules be made in parallel with the main rules?
- Content of secondary rules prescribed
- Detail, non controversial issues
- Routine matters: numbers, ranks and distribution of posts, transparent recruitment and promotion procedures, performance appraisal processes, working hours, leave conditions, remuneration, discipline
- Who has authority to issue Codes of Conduct and Code of Ethics?

5. Cost of Establishing and Maintaining Employees

- By whom is the cost including all components determined?
- By whom is the total number determined?
- Control ultimately with a higher authority (governing body)?

6. Employee Entry to the System

- Are appointments to class and grade or posts (i.e. is it a career or a post system)?
- Is there consistency in the provisions based on the system chosen?
- Qualifications: usual and exceptional circumstances?
- Mode of Entry: by open competition? Examinations; procedures to preclude patronage or nepotism, prejudice and partiality?
- Legal relationship between employee and employer
- Between employee and SDO? Or employee and government?
- Who is authorized to enter into contract on behalf of SDO / government?
- Who independently oversees the recruitment system?
- Oath and failure to perform?
- Probation: by whom, with a process that avoids unfairness?

(Cont.)

Box 6.7 (cont.)**7 Conditions of Service**

- Confidential HMIS (Personal file)?
- Advancement and promotion
 - Decision by whom?, Fair, routine, fact based?
 - Link between promotion and remuneration?
 - Are bonus' available, decided by whom?
- Transfer – is it employee driven? Does it affect redundancy?
- Terminations:
 - Order of priority rules?
 - Is it clear termination can be made on what causes?
 - Is termination decided by higher authority than hiring authority?
 - Rights of terminated if permanent or temporary employees?

8. Duties of Employees: Special duties aimed at ensuring professionalism / probity / loyalty / efficiency / accountability?

- Duty to comply with lawful instruction, and procedure for refusing improper instructions?
- Duty to provide information?
- Duty not to perform other paid work?
- Duty of residence?
- Duty to allow assist and investigations
- Code of Conduct – stipulated, by whom, in what detail; how is it made relevant?

9. Discipline of Employee: Is there a system which is transparent and meets judicial quality standards?

- Are the grounds adequately identified?
- Penalties stated clearly?
- Who judges – superior or independent tribunal?
- Composition of tribunals how? Expect to be independent?
- Procedures to ensure a fair hearing?

10. Rights of Employees:

- Full listing? Specifics or not?
- Costed or not? Action if provisions are unaffordable?

11. Participation of Employees in Decision-making:

- Roles and authority of representative organizations (corp, unions)
- Individual or collective representation?
- Involvement in disciplinary proceedings?

12. Education /Training / Capacity Building

- A right? What system supports? Responsibility of whom?
- Mechanism for estimating costs and assuring inclusion in budget?

Source: *OECD (1996); Civil Service Legislation – Contents Checklist*; Sigma Papers: No. 5

- ULT – integrated service units.

If we add BUMD, BUMN and BUMS (private enterprise) to the above options, as those three institutions can also be assigned tasks by the Government to carry out public service, then there will be 9 institutions that can be considered as alternative institutions for delivering public service, or as *alternative mechanism for service delivery* (AMSD).

On this basis it appears the Indonesian legal framework provides the basis for developing the range of organizational forms that AMSD advocates. The devil lays in the detail.

The most obvious difficulty at present is breaking the mould of “one-sector-one-organization”, of creating “checks and balances” and of shifting the form of control over SDOs. This one-sector-one-organization understanding promotes a culture of unaccountability as different functions are put under one roof. Most sector SDOs combine policymaking, regulatory, implementing and monitoring functions all in one organization. Without the sharpness in focus on core product that an organization with lesser missions has, current SDOs find it difficult to focus on improving service; they are “gamekeeper and poacher” in one.

Actions suggested that would help improve the framework established by PP 41/2007 which underpins the power of SDOs include:

1. Being more specific about what types of functions are appropriate for the different types of organizations;
2. Emphasizing the appropriateness or otherwise of mixing functions; and
3. Debating and then being explicit about the underlying intention of PP 41/2007 to limit and standardize the number of PEMDA organizations and control total personnel numbers.

PP 23/2005 allows creation of regional “Service Delivery Agencies” (BLUD), which suggest the direction that the framework for empowerment should develop, i.e. SDOs designed for the task at hand. BLUDs seem able to meet better the empowerment equation of “autonomy (or at least flexibility) for accountability”. The challenge appears to be to strengthen the accountability side.

It is suggested the AMSD project help the pilots develop a model set of “BLUD regulations” that would give special attention to (continuing the recommendation number from above):

4. Flexibilities in relation to financial management, human resources management, procurement and use of support services;
5. Governance aspects, particularly putting the relationship between owner and BLUD at “arms-length”, stronger rules surrounding strategic and annual plans and reporting, and participation of the community through boards.

The framework developing around BUMDs provides a model for how SDOs can be empowered. The model is differentiation – specific rules for specific situations – which challenges the popular sentiment at present of ever more regulations of the one-size-fits-all type.

It is suggested that:

6. The AMSD pilot projects include deliberate efforts to identify and feed back to central government “flexibilities” that would be beneficial;
7. Help prepare local laws and regulations in the pilot projects, paying particular heed to adapting the set of rules governing BUMNs/BUMDs to strike a balance between flexibilities and accountability;
8. Follow developments in how the government is setting-up internal and external control systems for BUMDs; and particularly note the “regulatory (supervision) body” approach to realizing an independent, professional and sector-specific supervision mechanism for service deliverers;
9. Evoke more frequently powers under Article 222 of UU 32/2004 assigning a coordinating role to MOHA with respect to sectoral activity so that sectors can be brought into the discussion on “autonomy with accountability”
10. Treat Law 9/2009 on legal entities for education bodies as a case study for AMSD.

A major tool for organization empowerment is empowered employees. Granting authority to an SDO without ensuring it has the capacity to perform might be considered unwise. Most personnel of SDOs are civil servant regulated by a raft of laws and regulations, which need reform (in time) by central government. AMSD cannot help with this massive task but the local equivalent of it can be promoted by the drafting of guidelines and manuals for PEMDA and their SDOs that wish to become BLUDs, BUMDs, or are just Dinas’ wishing to improve using the AMSD strategies.

It is suggested critical areas to be covered in the legal and regulatory framework include:

1. Agreement with the regional HRM office (BKD) areas of responsibility and the need to begin addressing staffing issues;
2. Information systems
3. Recruitment of competent personnel;
4. Clarity of role, objectives, authority and responsibilities
5. Clarity of job descriptions and competencies require to perform in those jobs;
6. Incentives, discipline;
7. Promotion; and
8. Capacity building.

Reforming personnel rules is part of the challenge of empowering personnel, but a shift away from the debilitating bureaucratic culture is also needed. That is AMSD Strategy 6 and particularly requires leadership from good managers.

7. CHANGING EMPLOYEE CULTURE

This strategy focuses on the individual or personal level – the way employees see, feel about and understand their jobs. Deployment of the previous five strategies can help in the short term, but in the end the individual needs intrinsic motivation to keep up the good work. This strategy works on achieving that objective, one which some would declare as mission impossible in a bureaucracy.

7.1 Strategy 6: De-bureaucratization

Individuals experience their work culture through their everyday experiences – which come to them by:

- (i) cognitive²³ or rational experiences
- (ii) the way things typically happen in the organization, or habits; and
- (iii) emotional or spiritual happenings.

The bureaucratic culture has its benefits. It standardizes relations in a system of government in which the exception could not be tolerated because that may lead to abuse of the system in the absence of social or legal control, and it is very stable once established. But bureaucracy has its costs:

- Its managers are supposed to do the thinking and workers follow orders (thus depriving the SDO of use of all its employees intelligences/competencies);
- Its operatives are paid to perform like machines (the machine-bureaucracy) supposedly devoid of emotion, vision, aspirations and good intent (but in fact full of these);
- Those in the public spotlight must continually defend themselves from demands from politicians and pressure groups – thus self-preservation is often placed ahead of service to the community;
- It is a monopoly accompanied by all the ills of that condition – managers are not subject to competition and exposed to the customer’s anger and sanctions. Spending budgets and positioning for power are what is important to the majority of bureaucrats; and
- In Indonesia, with remuneration so low, the orientation can easily become one of rent-seeking and corruption, supposedly in the name of survival.

Box 7.1 summarise the types of tools (or “interventions” in the language of organizational development practitioners) that are frequently used to deploy the strategy.

Appendix M.1 lists laws and regulation concerning the civil service from a database held by “The Legal Agency”. Key instruments can be tracked down therein. As indicated by the lack of references in Box 7.1, very little has been found in regulations in this area other than those attempting to regulate anti-corrupt behaviours. The subject obviously does not lend itself to guidance from rigid rules. Regulatory activity in this area tends to be confined to MenPAN and the (largely un-recorded) practices of head of some departments, regional governments and, most often, head of SDOs.

²³ For a good discussion of this see for example Howard Gardner, 2006; “Changing Minds”; Harvard Business Press

Box 7.1 The Tools for Strategy 6 (Changing Employee Culture)

Alternative Mechanisms to orient behaviors to the public interest rather than self interest

- A. Change Minds: Change that focuses on the cognitive understanding of individuals.
- B. Change Habits: “experiential learning” to promote personal / professional growth.
- C. Change Hearts: emotional change that focus on the interpersonal interaction and styles.

Tools for Implementing the Alternative Mechanisms**A. Changing Minds:**

1. *Benchmarking performance*: Compare with other organizations and feedback results.
2. *Train change agents*: People to carry the new culture.
3. *Study groups and tours*: As team they identify issues, peers and exchange processes.
4. *Participative development of mission statements*: a wide understanding of “what”.
5. *Participative development of vision statements*: a widely shared view of “how”.
6. *Leaders using entrepreneurial language and signs*: metaphors and analogies.
7. *New employee orientation programs*: Inculcate the entrepreneurial culture from day one.
8. *Career planning interventions*: Help employees see the future. Some sectoral attempts to create career planning system (e.g. in PU for PEMDA)

B. Changing Habits:

1. *“Meet the customer” programs*: Forces employees to understand the customer.
2. *Walking in the Customer Shoes*: Programs that forces employees to endure the customer experience
3. *Job rotation*: forces employees to appreciate the difficulties faced by others. A PP exists, but is not used systematically
4. *Externships and internships*: Allows employees to work in other organizations.
5. *Contests*: Request employees compete to model the new behaviors: these are appearing in various locations
6. *Large-scale real time strategic planning*: Employees work with facilitators over a period. This was the logic of the initial AMSD workshops in Banten in 2008/2009
7. *Re-engineering the organization*.

C. Changing Hearts:

1. *Leaders create symbols and stories*: to become emotional
2. *Celebration of Success Events*: for individuals, teams and the organization
3. *Honor failures*: by, for example, ensuring that audits focus on the learning.
4. *New rituals*: Graduation & award ceremonies, meetings, speeches, etc. etc
5. *Bonding events*: Experiential outdoor learning for teams, for example.
6. *Improve physical work environment*: Simply invest in improving the “standard issue”.
7. *Re-design the work environment*: to improve teamwork for what ever the values.
8. *Invest in employees*: “walk the talk” that the employee is the most valued resource.
9. *Employee attitude surveys*: regularly conduct, analyse, feedback results and act on them.

Source: AMSD Project document: *Description of Strategic Elements of AMSD*, Nov 2008

If it is difficult to describe the desired dimensions of the new culture and to discern the rules that obstruct or support deployment of the strategy, at least it is worth outlining the capacity the organization should possess. The appropriate culture will give it the core capacity:

- To commit and engage
- To carry out technical, service delivery and logistical tasks
- To relate to its institutional environment and attract resources and support
- To adapt and self-renew
- To balance diversity and coherence²⁴.

Some of the culture challenges rooted in the current legal and regulatory framework are likely to be (with possible solutions):

- Explicitly requiring “leaders” to involve or motivate their subordinates (write it into the “tupoksi” regulations that capacity development is a standard duty?);
- Financing design and implementation of explicit, routine capacity development and culture change programs (use the draft Perpres on Capacity Development as the umbrella?);
- Designing an incentive system that rewards public service (*Abdi Negara*) and penalizes self-interested behaviour (a comprehensive “plan” in each region directed by the Head of Region?);
- Relocating those who obviously just cannot accept the new ways (find “parking lots” or make official “gardening-leave”?);
- Educating long-time managers to become leaders (re-focus “structural diklat”; and reward leadership?);
- Making leadership potential one criteria in recruitment procedures (adjust regulations; bring in private sector people on contract, again, adjust regulations);
- Improving security / trust while not tolerating incompetence (give managers more power to replace non-performers and resisters?);
- Measuring and selling success with obvious indicators (performance measurement of services?);
- Continually communicating success and the need for change (strengthened communication function?); and
- Ensuring more tolerance within government circles for risk and the distended timeframe that capacity development and culture change entails (MTEF, communications, Perpres cover?).

It goes without saying also that where a culture of patronage, corruption and impunity is found, it should be changed to one of merit, probity and accountability to the community.

²⁴ Baser, Heather & P Morgan; April 2008, *Capacity, Change and Performance – Study Report*; European Centre for Development Policy Management (ecdpm)

7.2 The Most Relevant Laws and Regulations

Reform of the bureaucracy is just beginning to gain momentum some 10 years into “reformasi”, so the stocks of regulations are sparse compared with the earlier mentioned AMSD strategies. Relevant legislation may be:

1. Law 25/2009 on Public Services (sponsored by MenPAN)
2. (Draft) Law on Administration of Government (sponsored by MenPAN)
3. (Draft) Law on Human Resources for Government Apparatus (sponsored by MenPAN)
4. Law 8/1974 about the Main Features concerning Civil Servants
5. Law 43/1999 concerning amendments to UU No.8 Tahun 1974 about the Main Features concerning Civil Servants
6. Law 28/1998 on Running a Country Free of Corruption, Collusion and Nepotism (*tentang Penyelenggaraan Negara Yang Bersih dan Bebas dari Korupsi, Kolusi, dan Nepotisme*);
7. Law 20/2002 on establishment of the Anti-Corruption Commission (KPK), as amended in 2009 (*UU 20 tahun 2002 tentang Komisi Pemberantasan Tindak Pidana Korupsi*)
8. Law 8/1987 concerning Protocol
9. PP 6/2008 concerning Evaluation of Regional Government
10. PP 42/2004 on Development of the Culture and Code of Ethics of the Civil Service (*PP No. 42 Tahun 2004 tentang Pembinaan Jiwa Korps dan Kode Etik PNS*)
11. PP 101/2000 on Education and Training of Civil Servants (*PP No 101 Tahun 2000 tentang Pendidikan dan Pelatihan Jabatan PNS*)
12. PP 30/1980 on Disciplinary Processes for Civil Servants (*PP No. 30 Tahun 1980 tentang Peraturan Disiplin Pegawai Negeri Sipil*)
13. Inpres 7/1999 on the Performance Accountability of Government Agency, issued on June 15, 1999
14. Inpres 5/2004 on the Acceleration of Corruption Eradication, issued on December 9, 2004
15. PerMenPAN 04/2007 (Regulation of the State Minister for Administrative Reform No. PER/04/M.PAN/4/2007) on General Guidelines for the Formulation, Implementation, Performance Evaluation and Revision of Public Policy in Government Agencies at Central and Regional Level, stipulated on April 16, 2007
16. SE 04/ 2005 (Circular of the State Minister for Administrative Reform) No. SE/04/M.PAN/2/2005) on the Improvement of the Quality of Public Service that is Free from Corruption, Collusion and Nepotism as a Follow-up to the Presidential Instruction No. 5 of 2004 on the Acceleration of Corruption Eradication, dated February 21, 2005
17. SE No. B/345/M.PAN/2/2005 on the Reporting of the Implementation of Presidential Instruction No. 5 of 2004, dated February 22, 2005

18. (Draft) Presidential Decree on the Framework for Capacity Building of Regional Government (sponsored by PKEKD in OTDA at Home Affairs).

Appendix O includes summaries of selected laws and regulations.

There is no immediately obvious gap in this legislation except one, that of gaining and acting on perceptions of the employee. Few of the Tools of Box 7.1 need strong legislative cover, although the Consultants believe elements of (i) benchmarking (ii) promotion and rotation (iii) Codes of Ethics and, as noted (iv) employee perception surveys could be strengthened immediately. The framework to enable use of the other tools may then need improving. The huge issue of course is changing the culture of corrupt (criminal and unethical) behaviour.

7.3 Changing Minds: Benchmarking

The Consultants are aware of only one sector where benchmarking is being practiced at present – water supply – and even that is not mandatory. Benchmarking results are not only useful for customers but provide to employees a rationale for change of behavior.

One initiative in benchmarking is run by PERPAMSI. Among various components of this system, besides technical excellence, the following are considered innovative:

- Voluntary but paying membership;
- Formation of a small benchmarking team in member water companies;
- Brief training of the members in technical and change management techniques;
- Production of a members “benchmarking code of practice” to which members agreed upon joining;
- A ranking and prize-award system; and
- Inclusion among the indicators of one that assessed employee perceptions about their workplace conditions.

This or other benchmarking initiatives of water companies have never been made mandatory. It could be, especially by relating it to evaluation of the performance of regional governments under PP 6/2008, PP 8/2006 or PP 39/2007.

Legal cover is also suggested in some way for the employee attitude index, because to this day it remains controversial and largely unused for a range of reasons, including concern from managers that it reflects poorly on their own leadership competencies and possibly concerns that managers have no legal authority to run it or acting on its results.

7.4 Changing Habits: Job rotation and Secondment

In the pilot workshops a number of personnel indicated dissatisfaction with regard to rotation (unexpected or impeded), promotion (problems with the performance evaluation process know as *DP3*) and with the ability and advantages of being able to run secondment programs into or out of the regional government The so-called *putra-daerah* issue. Although all these are professional HRM issues for Strategy 5, if they do not operate well, employee enthusiasm and culture is strongly affected.

7.5 Changing Hearts: Code of Ethics (“Behavioural Contracts”)

Development and use of a Code of Ethics is one popular approach to changing mindsets, habits and emotions (but like so many instruments of change, need reinforcement if they are to survive in what can be a hostile environment for new approaches, bodies and orientations).

PP 42/2004 sets out requirements, among various matters, on:

- all government agencies developing a Code of Ethics based on the broad guidelines of the PP;
- professions within the civil service also being requested to develop codes, again based on the guidance in the PP;
- creation of Ethics Boards ; and
- General powers are awarded to impose penalties for breach of ethics.

Unfortunately this regulation has had little or no impact. The reasons are many and worth noting as they point the way to making more useful this “behavior management contract”. It is generally agreed²⁵ that:

- New policies, rules and laws are unlikely to have a great affect by themselves
- Many problems arise from behavioral norms that are unwritten conventions
- Codes of Ethics / Conduct offer great potential to consolidate in one place the whole integrated set of norms and standards, but are often “single issue” focused
- Rules are often un-enforced
- Rules are often ambiguous and unenforceable, or costly to enforce; and
- Managers are reluctant to explain, demonstrate and apply the rules themselves.

Further, the HRM organizations in most PEMDA (BKD and Ortala) just do not function like modern, professional HRM offices and therefore a a force for change.

It is suggested that, among the whole range of modern functions, they could lead an effort to create a local law on management of the local civil service, and such matters as development of relevant differentiated Codes for SDOs. **Appendix M.2** exhibits some of the key clauses of such an instrument, including the requirement for an organization specific code and explicit listing of the underlying principles for management of employees and of conduct.

Guidelines for making a Code of Ethics more useful include:

- Draft the Code with participation of those to whom it will apply to improve the probability it will be seen as relevant;
- Be positive as well as negative, state the desired behaviors as well as the undesirable behaviors;
- Strike a balance between being too simple (and therefore unintelligible) and too prescriptive (and therefore risking being inappropriate);

²⁵ See for example Kernahan, Kenneth and Langford JW; 2006; p 184 to 200; *The Responsible Public Servant*; The Canadian Institute of Public Administration (IPAC)

- Use plain and non-legal language;
- Do not ignore the law or be inconsistent with it at all;
- Produce Codes at organization level rather than for whole civil services;
- Display the Code prominently in public places;
- Use the Code to foster communication in an on-going manner.

It is suggested that SDOs introducing AMSD strategies should consider working with BKD to develop a Code of Ethics as one of the activities in their Action Plan to deploy Strategy 6.

Codes of ethics should be living documents that get their life from being integrated into the way the SDO is structured and operates. The Code should be publicized and updated, with induction and training of employees including the Code and its contents.

It is suggested also that this training must be forthright about the negative effects of unethical and corrupt behavior on the quality of service delivery (the clipping at **Appendix M.3** is a reminder of this, often forgotten fact).

7.6 Summary of Conclusions and Suggestions for Entry Points

The laws and regulations on employee management cover a wide field, the problems seems to be in their details, enforcement and spirit. Improvements could be made in the first instance in relation to benchmarking performance, promotion and rotation of employees, employee participation and ethics.

Efforts under this AMSD strategy however are less focussed on the legal and regulatory framework than other strategies, but should consider:

1. Leadership development of promising personnel in the higher level (and mandatory for promotion) education and training programs - the so called “structural diklatan”. Presently they are prerequisites for promotion, and therefore popular, but they are heavily oriented to learning “the system” as passed down by ex-civil servants, not improving leadership or management;
2. The employees going into these leadership programs should have a real expectation that they will become top leaders and managers in time – a present the training is often reward for a particular contact, or based on seniority;
3. Creation of a number of “centres of excellence” in these matters (including in the public sector “diklats” such as the decentralized MOHA diklats (created under Perpres 1/2009);
4. At the provincial and local levels, major efforts to increase the use of professional human resource managers, beginning with re-structuring and upgrade of the BKD-Ortala-Diklat organizational group and its leadership in PEMDA;
5. Certification of managers (particularly Echelon II) in a range of competencies, including leadership skills (and eventually in “Service Delivery”) before or within a strictly fixed time of appointment (PDAMs are beginning to apply this with respect to appointment of most directors);

6. Improve design of recruitment and socialization processes and their rigorous implementation to ensure new, young and impressionable employees “kick-off on the right foot”;
7. Design and implementation of programs by each PEMDA to eradicate “KKN” and promote a modern, professional, merit-oriented cadre of civil servants;
8. More meaningful performance evaluations, requiring a complete reform of the current *DP3* process;
9. In SDOs: introduction of more modern HR practices through upgrading of the “personnel” function; and
10. In SDOs: participative development of a Code of Ethics, lead by senior managers.

Although it is probably beyond what is possible under the AMSD program alone, a “pilot” on improving the functioning of a new “modern HRM” office in PEMDA would be a valuable contribution to reform at present. The objective might be to make it a modern “civil service commission”.

A start at national level would be to prepare a model PERDA (describing modern management practices to be used in PEMDA and, among various practices, sanctioning performance agreements, mandating an anti-corruption program, improving on requirements for Codes of Ethics and setting out the various rights and obligations of employer and employee). Such a model could then be adapted or adopted by any PEMDA willing to try these reforms, which strike to the heart of changing employee culture.

8. SECTOR STRUCTURE AND COOPERATION

This Chapter briefly assesses the developing framework surrounding Strategies 7 and 8. Both are, in many ways, variants of Strategies 1 through 6, and especially Strategy 1 on clarity in roles, objectives, authority and responsibilities.

8.1 Strategies 7: Structure the Sector for Efficiency and Equity

AMSD strategy element 7 concerns the issues of:

- (i) division of functions between levels of government
- (ii) sector (market) structure, and
- (iii) regulations that ensure fair competition (operation of markets).

As noted, it is especially the service deliverer's side of Element 1, but structure also influences consequences (Element 3) and the attractiveness for the private sector (Element 8). The decision on what sector structure will apply rests with those responsible for Strategy 1.

The way that the production activities of the different sectors are grouped (arranged) is very sector specific, although the functions of policy-making, regulating, delivering services, compliance checking, capacity development etc should still be identified. A significant problem often is that they are not. In not clearly distinguishing roles, clarity of mission is lost, incentives that could be developed through the application of Strategies 1 through 8 missed, "specialization" opportunities foregone and in general, the chance for deploying incentives lost.

As the paucity of references in **Box 8.1** shows, identifying the regulatory framework cannot be done properly without assessing sectoral laws and regulations. So unlike the previous strategies that have the rules produced by the core administrative agencies of central government as the foundation, full assessment under Strategy 7 would require knowledge of rules produced by sectoral departments. Fortunately however, once sectors are examined at the region level, it is easier to follow how the sector is arranged and to plot alternatives that might be considered, at least for the regional government.

Another difficulty in the regulatory framework is that practices are often different from those formally written (for example, the school operational support scheme of BOS is funded by the central government, probably in contravention of Laws 32/2004 and 33/2004).

8.2 Sector Structure: The Most Relevant Laws and Regulations

There are three sets of legislation that ultimately need assessment:

- Sector laws (UU) and their subsidiary regulations – PP, Presidential regulations, Permen, etc
- The "lex generalis" of UU 32/2004 and subsidiary legislation (particularly PP 38/2007 and to a lesser extent PP 41/2007 on organizational structure, PP 19/2007 on Kecamatan and PP 72/2005 on desa); and
- Local laws (PERDA) and regulations within each regional government.

Box 8.1 The Tools for Strategy 7 (Changing Sector Structure)**Alternative Mechanisms**

- A. Changing the assignment of government functions between levels
- B. Horizontal aggregation (“horizontal bundling”) or dis-aggregation
- C. Vertical aggregation (“vertical bundling”) or dis-aggregation
- D. Cross-sectoral structure
- E. Changing the competition rules (for the service market or in the service market)

Tools for Implementing the Alternative Mechanisms

- A. **Changing the assignment of government functions:** based on effecting change in legislative – sectoral laws and regulations, PP 38/2007, and funding regulations. Criteria include:
 - 1. *Efficiency:* The assignment should encourage more efficient service overall, through:
 - a. Economies of scale – the concept that the larger the through-put, the lower the unit cost
 - b. Economies of scope – the concept that similar activities in the proximate area are better managed within one system
 - 2. *Spatial Externalities (or spillovers):* positive or negative affects on surrounding areas
 - 3. *Accountability through the political system:* the need for a collective choice mechanism.
 - 4. *Accountability to the customer, i.e. “consumer sovereignty”.*
 - 5. *Other:* (administrative, technical and compliance capacity / costs, characteristic of the services, equitable provision, preservation of the internal market, economic stability etc)
 - 6. *Assigned support functions:* who regulates, monitors performance, ensures environmental and other compliance?
- B. **Horizontal aggregation (“horizontal bundling”) or dis-aggregation (“unbundling”):**
 - 1. *Technical and environmental criteria:* Many service delivery problems require technological solutions.
 - 2. *Economic and financial criteria:* Depending upon the “cooperation” model used in the bundled service (ranging from informal through to total aggregation / amalgamation).
 - 3. *Political voice and accountability* through the political system
 - 4. *Administrative burden and transaction costs*
 - 5. *Legal and regulatory criteria*
- C. **Vertical aggregation (“vertical bundling”) or dis-aggregation (“unbundling”):** Vertical structure relates to the production process (the “value chain”).
 - 1. *Efficiencies through scope:* Can they be captured?
 - 2. *Costs of transition:* Changes of any types have costs.
 - 3. *Degree of cooperation to ensure quality of product:* How to manage poor quality input?
 - 4. *Coordination in planning and investment:* Optimal plans and least cost investments?
 - 5. *Cost of transaction:* Will the cost of specifying, bidding, negotiating etc be reasonable?
 - 6. *Risk of payment:* Will suppliers be less willing to operate in a market where payment is risky?
 - 7. *Contested resources:* Does the change reduce the possibility of conflict over resources?
 - 8. *Decentralization:* Does the change promote or hinder the policy of decentralization?
- D. **Cross-sector structure:** The same ownership, single management or other affiliations of SDs in more than one sector:
 - 1. *Efficiencies through scope:* Use of billing system for two services, as an example.
 - 2. *Risk of payment:* Reducing risk of payment for one service by use of another.
 - 3. *Financial sustainability:* By being able to use one more profitable services to pay for another.
 - 4. *Transparency:* Can cost allocations and tariff setting really distinguish the source of costs?
 - 5. *Competitive distortions:* Will the service deliverer use one service to support the other(s).
 - 6. *Management focus:* Can the team focus on all services in the multi-sectors under management.
- E. **Competition rules:** Once services become more commercialized, organizations will become interested in providing them because of the profit motive. Based on the rules (regulations) when the new bundled / unbundled structure is established, the market structure is likely to evolve, depending upon whether the rules allow (i) existing SDOs to merge or separate (ii) the ownership to change (iii) a monopoly to be created by exclusivity rules and (iv) competitive entry by other SDOs.

Source: AMSD Project document: *Description of Strategic Elements of AMSD*, Nov 2008

Under sector laws, it should be noted that often a sector will be governed by a number of laws; for example, activities in the health sector must respect laws related to child welfare, epidemics, social security, handicapped persons, food security, old age laws, nursing, medical practitioners and professions, medicines etc, beside the core health law, UU 23/1992.

Strategy 7 design typically is in the realm of economists and industrial organization specialists, with their objectives focussed on criteria that promote economic efficiency. However, an effective sector structure also requires political support because of the competing objective - that of distribution of costs and benefits requiring considerations of fairness and values (“equity”). In other words, the structure must consider that fundamental development question: should the nation benefit overall or should individuals be the focus?

In summary, a balance is needed that ensures the sector structure encourages simultaneous achievement of objectives associated with competition, choice, voice and equity.

It is suggested the AMSD program use this strategy at PERDA level, although under Article 222 of UU 32/2004, MOHA also should coordinate central level initiatives to improve sector structures that concern regional government. The whole strategy can appear somewhat abstract for many, but it is noted that the issue emerged in the pilot planning workshops in Banten for water supply and health, where there was acknowledgement that sector PERDA needed re-writing.

8.3 Can PP 38/2007 Force Improvement of Sector Structure?

8.3.1 It Provides Criteria for Structuring Sectors

Despite its limitations (being a lower level instrument and probably contrary to the interest of powerful and centralized sectoral interests), PP 38/2007 is the most explicit “umbrella” legislative instrument on capable of changing sector structure.

Further to the assessment of PP38/2007 under Strategy1, assessment from a perspective of “sector structure” is informative. The PP simply states (at Article 4) that the assignment of functions is based on:

- (i) efficiency
- (ii) externalities
- (iii) accountability, and
- (iv) (possibly) harmony (“keserasian”).

Article 9 reads:

1. *Minister/Head of non-ministerial government agency shall stipulate the norms, standards, procedures, and criteria, prepared for the implementation of mandatory and optional functions.*
2. *Stipulating the norms, standards, procedures, and criteria, as meant by paragraph (1), shall take into account harmony of relationship between the Government and regional government as well as among regional governments, as a single integrated system within the framework of the Unitary State of the Republic of Indonesia*

3. *Stipulating the norms, standards, procedures and criteria, as meant by paragraph (1), shall involve related stakeholders and having coordination with Minister of Home Affairs*

The elucidation of Article 9 reads:

Paragraph (1)

1. *Norms shall mean any regulation and provision which is used as a principle of local government administration.*
2. *Standards shall refer to any frame of reference which is used as a guideline on local government administration.*
3. *Procedures shall refer to any method or system used for local government administration.*
4. *Criteria shall mean any measure used as a basis for local government administration.*

Paragraph (2)

Harmony of relationship shall mean that government functions managed by different levels of government connect to each other (interconnected), depend on each other (interdependence) and support each other as a system by considering the extent of benefits.

Paragraph (3)

Stakeholders shall consist of elements from related ministry/non-ministerial government agency, local government, professional association and delegation from the community.

The harmony stipulations of Article (9) paragraph (2) appears to be the authority under which negotiation and discretion can be used more so than under other articles.

Currently in the regions the situation with assignment of functions appears not to be dramatically different from past times, as “funds may not have followed function” as much as anticipated by the designers of decentralization.

It is suggested however that understanding of the impact of PP 38/2007 is in its infancy, but it (or a more focused up-date) has the potential to drive dramatic sector restructuring because it is the only known legislative instrument that directs sectoral ministries to describe sector structure. It is suggested support for its improvement, whenever the opportunity arises, is a worthy cause

8.3.2 Despite Problems, It Can Guide Updating of Sectoral Laws

Apart from the difficulties noted in earlier Chapters including in the Chapter on clarity of roles, objectives, authority and accountability, there are a number of other obvious problems with assignments in the PP at present:

1. It is not explicit how the current assignments (in over 800 pages of attachment) meet the mandated criteria (and therefore can be changed almost at whim, especially by central agencies with budgets to spend);

2. The criteria themselves seem incomplete and possibly not providing enough guidance on how trade-offs are to be made. For example, how much weight is to be given accountability (which favors assignment locally) compared with the criteria of economic efficiency, which typically favors assignment to a centralized controller? Or is “efficiency” compatible with “equity” – the need to consider that all citizens of Indonesia are treated equally or fairly?
3. The PP requires sectoral ministries to describe sector structure in terms of “norms, standards, procedures and criteria” (*NSPK*), but other than the earlier explanations, there is no guidance on what is/are *NSPK*, in other words there are no “*NSPK* for the *NSPK*”.
4. In the end, sector structure is determined by higher level legislation, i.e. sectoral laws will always “trump” regulations in the legal hierarchy.

With respect to criteria, some possibilities for a more explicit set of criteria are suggested in **Box 8.2**. The criteria can be interpreted as a continuum, strict concerns with efficiency at one end (the top), concerns with equity at the other (the bottom). Of course, another interpretation might be as a circle with each end connecting “back-to-back” – i.e. in the end addressing equity concerns also helps address efficiency concerns.

An example of Strategy 7 that has largely gone unnoticed is the “devolution/decentralization” going on under PP 19/2007 concerning the role of kecamatans in PEMDA. As moves to push more of PEMDA activities down to kecamatan accelerate, there is an increasing understanding that authority must also accompany the move to make it more effect²⁶.

Restructuring based on current legislation will be fraught with challenges from established interests. PP38/2007 in the end may be found to be wanting and a higher level instrument called for (BAPPENAS for example have considered over the years the need for an Infrastructure Law), or more likely, much more attention given to sector structure issues in reformulated sectoral laws. There is obviously a stronger role to be played by MOHA and regional governments than at present in formulation of sector laws.

It is suggested that reform in sector structure in the meantime can begin at regional level sector by sector, where the need and the options are clearer.

²⁶ Consultant’s discussion with the Ausaid funded LOGIKA / PATEN consultants from Aceh. This issue also emerged at the Pilot Planning Workshop in Serang concerning population administration.

Box 8.2 Some Suggested Criteria for Assigning Functions of Government**1. Criteria of Economic Efficiency**

- Sub-criteria 1: Economies of scale – the concept that the larger the through-put, the lower the unit cost of production - favors centralized control.
- Sub-criteria 2: Economies of scope – the concept that similar activities in the proximate area are better managed within one system - favors local control.
- Sub-criteria 3: Spatial Externalities – positive or negative affects on surrounding jurisdictions of activities in the “system” – favors centralized control.
- Sub-criteria 4: Administrative and compliance costs / capacity – centrally administered systems are generally considered less efficient because of losses through information scale and skills deficiencies as compared with many, dispersed administrators - favors local control.

2. Criteria of Preservation of the Internal Market

- In the Indonesian Constitution UUD 1945 (?) – favors centralized control

3. Criteria of Economic Stability

- Favors centralized control.

4. Criteria of Characteristic of the Service (public, quasi-private, private)

- Favors local control with standards set under centralized control.

5. Criteria of Equitable Provision

- Select services (often service with pure public goods' characteristics) – favors centralized control – with specific local involvement to account for local information.

6. Criteria of Consumer Sovereignty

- Voter preferences determining the level of service – favors local control over the function.

7. Criteria of Political Proximity

- Proximity (geographic, communities of interest?) of local administration to local residents influence whether local administration is trusted to provide the service – favors local control.

Nb: Accountability may be included within a number of the above

8.4 Strategy 8: Cooperation with the Community and Private Sector

If Strategy Element 1 aims to ensure the core function of government – policy making, establishing governance systems and setting direction – is better performed by government, then Strategy Element 8 is to ensure other actors can and have the incentives to do all the things needed to deliver services. In the case of the community, it also opens the way for their direct participation in governance decisions related to the service.

Box 8.3 lists the mechanisms and tools commonly deployed under the strategy. Compared with sector structure, the legal and regulatory framework is more developed because of efforts in the last twenty years by the government to promote community development projects as a major plank of the poverty alleviation policy platform, and similarly, private sector participation in the infrastructure development platform.

8.5 Cooperation: The Most Relevant Laws and Regulations

A search of various lists produced the following legislation (which tends to originate from BAPPENAS, the MoF and the Office of the Coordinating Minister for the Economy):

1. PP 38/2008 amending PP 6/2006 concerning Management of Government and Regional Assets
2. PP 1/2008 concerning Investment by the Government (from UU 1/2004)
3. PP 50/2007 concerning Cooperation by Regional Governments (from UU 32/2004)
4. Perpres 77/2007 concerning List of Activities that are Closed and Activities that are Open to Investment with Conditions in the Investment Sector
5. Perpres 76/2007 concerning Criteria and Rules for the Compilation of a List of Activities that are Closed and Activities that are Open to Investment with Conditions in the Investment Sector
6. Perpres 65/2006 amending Perpres 36/2005 concerning Land Procurement
7. Perpres 36/2005 concerning the Procurement of Land for the Implementation of Development Projects
8. Perpres 67/2005 concerning Cooperation between the Government and Business Entities in the Provision of Infrastructure Keppres 80/2003 as amended concerning Guidelines for the Procurement of Good and Service for the Government
9. PMK 38/2006 concerning Directions for Implementing Controls and Management of Risks in the Provision of Infrastructure
10. PerMenEKON 04/2006 concerning Procedures for Evaluation of Cooperation Projects in the Provision of Infrastructure that need Government Support
11. Permendagri 3/2008 concerning Guidelines for Implementing Cooperation between Regional Government and Foreign Parties
12. Permendagri 22/2009 concerning Procedures for Cooperation (from PP 50/2007)
13. Permendagri 23/2009 concerning Supervision of Cooperation (from PP 50/2007)

Box 8.3 The Tools for Strategy 8 (Cooperation)**Alternative Mechanisms**

- A. Community Empowerment
- B. Private Sector Participation (PSP) alternatively known as Public-Private Partnerships (PPP)

Tools for Implementing the Alternative Mechanisms**A. Community Empowerment:** shifts operational responsibility as well as control and power:

1. *“Community empowerment programs”*: such as newly launched PNPM based on the former Urban Poverty Project (P2KP) and the Kabupaten Development Project (KDP); based on PP50/2007 concerning cooperation in the regions; PP7/2008 on De-concentration and Assistance Funds; and PMK 156/2008 concerning management of de-concentration and assistance funds
2. *Empowerment Agreements*: Specific agreements to share power.
3. *Community Governance Bodies*: community based “steering organizations” for example School Boards - see Kepmendiknas 44/2002.
4. *Collaborative Planning*: gives community organizations decision making authority – UU 25/2005 and the MUSRENBANG set of guidelines.
5. *Community-based Funding*: provides public funds to community groups – again, the PNPM poverty alleviation program – PP50/2007.

B. Private Sector Participation: Procurement generally regulated by Perpres 67/2005. Methods of involving the private sector include:

1. *Service contracts*: The government purchases service for a limited period – examples include the USAID/LGSP sponsored initiative by PUM – SE100/121/PUM/2009.
2. *Management contracts*: The government pays experts to manage the service.
3. *Lease contracts*: The government pays the contractor to provide assets.
4. *Build Operate Transfer (BOT)*: The contractor builds and operates the infrastructure, and finally transfers it to government ownership.
5. *Concession Contracts*: The government awards the exclusive right to deliver – Jakarta Water Supply has been managed this way since 1998.
6. *Build Own Operate*: Similar to BOT, but the ownership is not transferred back to government
7. *Divestiture*: extreme “privatization”, where the ownership of assets is sold to the private sector operator. This is often when government decides to exit entirely as an “operator” – the national privatization of BUMN is an example.

C. Intergovernmental Cooperation: various models on a continuum (PP 50/2007)

Source: AMSD Project document: *Description of Strategic Elements of AMSD*, Nov 2008

14. Permeneg PPN/Kepala Bappenas No. 3/2009 concerning Procedures for Compiling the List of Planned Projects for Cooperation with Business Entities in the Provision of Infrastructure - 3 Mar 2009.

Appendix O includes summaries of selected laws and regulations.

A number of points are raised by the listing:

- much of the legislation concerns procurement rather than establishing the range of institutions – like independent regulators - that are needed to sustain public private partnerships (PPP);
- even so, the functions in which cooperation is encouraged are not made explicit;
- although the decision as to which regulations apply probably hinge on whether it is (i) the private sector investing (ii) the government investing or (iii) the government just procuring goods and services from the private sector, PEMDA officials may not be clear on this; and
- the legislation is also heavily oriented to provision of physical infrastructure, whereas a lot of cooperation under the AMSD framework in Canada and elsewhere has been directed into more “social” services such as education and health.

It is further suggested that costing tools under earlier strategies are also important because without them the real costs of current service delivery cannot be exposed and rationale judgement made on whether to cooperate with the private sector.

8.6 Risks, Information and Negative Public Perceptions Need Managing

As noted previously, a key feature in the legal and regulatory framework for cooperation with the private sector is the low level at which regulations are made – there is no law and no PP for example providing a framework for what potentially could be very large investments and therefore risks faced by the private sector. Similarly at PEMDA level, although the Consultant has observed that a couple of PEMDA in Indonesia (for example Kabupaten Tangerang) have identified the risk and produced a PERDA that regulates how cooperation in PPP will be undertaken. This is considered valuable, although it can take time and expose the sponsor to the wrath of those who see no role for the private sector in the provision of public services.

PPP is a very popular AMSD tool in developed countries but is an emotive issue in Indonesia and has struggled to become widely accepted – because the legislative framework has been weak, information dissemination not managed strategically, and, anyway, poorly developed markets in the service. Evidence is seen in the backlash against the new education institutions law – BHP- see **Appendix N.1** and **N.2**. Further evidence is seen in previous legal challenges to the water resources Law 7 of 2005 that obtained a judicial review from the constitutional court. And a revised electricity law in 2002 was even rejected on constitutional grounds because it allowed private sector operators to provide retail services!

AMSD says it should not matter who the service provider is – public or private – so long as the service is provided as efficiently as possible. In practice, there are a number of barriers:

- The ideological barrier. The belief that the profit motive will cause private sector participants to disregard the social obligations that any public provider will always have – publicly or privately owned. This attitude has perhaps been strengthened over the years in Indonesia because of the current leaders where brought up in a time of “big –

government”, and the bitter experience of “crony capitalism” of the late 1980s and 1990s – not to mention the current backlash to the global economic crisis.

- There is so little performance information available that it is difficult for stakeholders to make judgments about the effectiveness and efficiency of current SDOs. The result is that many key decision-makers have little or no idea as to the relative efficiency of their SDOs and therefore are not sensitive to arguments that the service needs to be more efficient, even if that means more participation of the private sector.
- Poor understanding of relative roles of the private sector and public sector. Many PEMDA simply imagine that a private partner will invest and then walk away, leaving the existing operators to go about business as usual – which includes tolerating poor levels of cost recovery due to delayed increases in service charges, inefficient management practices, submission to local political whim and scant regard for the sanctity of the contract.
- The attitude of the SDOs themselves. Most enjoy a monopoly and have little pressure on them to improve performance – be it coverage, service or efficiency. While one might argue that it is in the interest of the SDO to engage with the private sector, there are obvious risks for the SDO such that a risk-averse public sector manager may judge private sector participation to be “not worth the effort”.
- Asymmetries of information. The latter two points highlight problems with information flows. The SDO has most of the information needed and others do not to mount an argument for or against cooperation. Combine this with their monopoly position, and the private sector will only ever be able to enter if the SDO manager agrees – unless he himself is directed by an owner or independent regulator.
- Unwillingness to create and invest in the supporting institutions needed when the partner arrives – particularly the independent regulator role.

It is suggested local legislation is needed in this area, acknowledging again the difficulty to produce it without goodwill from most stakeholders. **Box 8.4** suggests some matters which should be addressed in any legislation to lessen the risks perceived by the private sector.

8.7 Summary of Conclusions and Suggestions on Cooperation

Cooperation acknowledges that solutions to problems can sometimes only be achieved or are better provided through working with others. Those others might be the community, the “third” sector (NGOs) or the private (business) sector.

This cooperation however requires rules respecting cooperative decision-making, which the powerful legislative and executive branches often find distasteful. Legislation therefore has tended not to address “power” issues – community boards etc. The move to create a separate law for “desa” rather than wrapping it into Law 32/2004 as at present may reflect this understanding. At a minimum, for the tool of community participation, the widely acclaimed PNPM program has at least begun to create a vehicle that should encourage PEMDA to seek more cooperation with communities.

Box 8.4 Legal / Regulatory Framework and Credit Enhancements ²⁷

| No | Aspect | Issues / Finding |
|-------------------------|--|--|
| Aspects which impede | | |
| 1. | The agreement will require higher approvals | Past practice has been that decisions stop at PEMDA level. This is manageable for contractors. Whether sectoral PPs or Perpres 67/2005 will alter the situation is unfolding |
| 2 | Excessive bond / insurance / bid security | Has not been an issue. Perhaps too low in the past |
| 3 | Possible completion during life of contract | Not an issue, except where dramatic increases in coverage or service quality are required, or major investment has been made. |
| 4 | IRR will be recalculated ex-poste | Is currently not foreseen by national regulators, but may become an issue as the generally accepted IRR of about 20% is considered more fully in the light of economic stability. |
| 5 | No government involvement | Hard to avoid in Indonesia. Many investors in Indonesia like some involvement to provide some security. |
| 6 | Government procurement procedures applied to concessionaires | Has not been a major problem in the past, but Law 8/1999 and anti monopoly laws may make this more of an issue in the future. The type of contract design will need to address this issue. Theoretically, if the contracting mode is competitive, need no further competitive process. |
| 7 | Detailed Engineering Design before start | The contracting design approach should address this common barrier. |
| Aspects which encourage | | |
| 8 | Contractor free to choose areas, method etc | Government has in the past been very wary of “design and build” approaches. On the other hand, contractors complain not enough feasibility work has been done before they must offer firm bids. Needs good consulting studies. |
| 9 | Gov. willing to assist with planning approvals, licenses etc | Not so much of a problem if the government SDO partner is involved. |
| 10 | EIA and processing assisted by Gov. | Not a major issue with most regional services, but will be more so if sanction moves in PPP direction. |
| 11 | Credit enhancements possible | Just emerging. Minimum would be PEMDA to pay a subsidy for services to low income households. |
| 12 | Physical security guaranteed by Gov. | Supposedly not a problem, but government has made it clear guarantees cannot be provided. |
| 13 | Tax holiday possible | Being considered at present |
| 14 | Sales tax etc exemptions | Depends – PDAMs have not been able to get them. |
| 15 | Public liability limitations | Not an issue, but may become one |
| 16 | Land from Government | PP 36 / 2005 will help. |
| 17 | Value capturing possible | PEMDA have traditionally worked schemes involving land swaps etc. Just needs the sector to be more profitable. |

²⁷ At present this refers specifically to the stance of provincial / local government, but can be applied equally to the central governments stance.

It is suggested that the issues that should be addressed in the community empowerment framework include:

1. Identifying more clearly in what functions should the community participation be sought;
2. How or in what form is the community authorized to be involved;
3. What authority should be awarded the community, given that past experience is that insisting on accountability can be difficult and certainly not all community-based organizations will remain functional (just take for example many village cooperatives, school boards and some community-based water and sanitation schemes);
4. Clarifying the acceptability, role and constitution of community advisory (and governance) bodies for particular services/sectors, as AMSD includes a strong preference to citizen-centred service; and
5. Allowing these advisory groups to in time transform into “Boards” that govern the sector(s).

With the tool of public private participation, although it is popular with parts of central government – particularly core administrative agencies - the enthusiasm is not so apparent in regional government, especially existing SDOs. It is a very broad and complicated area. It is suggested however the following matters in the legal and regulatory framework for promotion of PPP at regional level need attention:

1. Clarifying specifically the functions that are clearly open to private sector participation;
2. Raising of the regulatory framework in the legal hierarchy to PP level at least;
3. Regulating tariff and payment mechanisms/processes that are difficult for PEMDA to change at will and so reducing uncertainty and risk to investors – with special attention to control in the regulations of political opportunism – perhaps modeled on PP16/2005 regarding piped water;
4. Creation of a model PERDA on private sector cooperation that improves the ground-rules for PPP, so improving certainty and lowering risks – including covering matters on the fate of existing (state) employees when a private sector operator takes over;
5. Vigorous promotion of and “start-up” support for the tool (even creation of organizations dedicated to the purpose) to overcome the negative ideological prejudices associated with the private sector providing public services; and
6. Establishment of the supporting institutions, that typically includes independent regulation of economic issues, licensing of SDOs and creation of a technical support office for the SDOs.

Finally, it is suggested that, as with all of the AMSD strategies, a special focus on encouraging change of the bureaucrats' mind-set is a pre-requisite (i.e. a focus on Strategy 6) - it is they in the end who draft the legal and regulatory framework needed to underpin all of the alternative mechanisms of service delivery.

9. MAIN CONCLUSIONS AND SUGGESTIONS

This Chapter draws some important broad conclusions on the legal and regulatory framework, revisits the “contract” view of AMSD and briefly summarizes the main suggestions. Rather than just repeat the previous conclusions, some different, perhaps more controversial perspectives, have been incorporated into the discussion.

9.1 Broad Conclusions

9.1.1 A Legal and Regulatory Framework Exists, but is Incomplete

AMSD as proposed for promotion in Indonesia consists of implementing, for any given SDO, at least one and preferably more of eight generic strategies using a range of tools. In going through each strategy, examples have been found of legislation to enable deployment for many, but not all of the tools.

The laws and regulations identified in this Review appear to provide a very general set of rules governing:

- (a) the outcomes hoped to be achieved from regional autonomy in terms of community welfare
- (b) the division of governmental affairs including the public services needed to improve that community welfare
- (c) funding mechanisms and management
- (d) organizations or institutions responsible for delivering the public services, and
- (e) the instruments of the regulatory system in the form of norms, guidelines, procedures, standards and criteria (NSPK).

In particular, among the plethora of legislation identified, that for minimum standards of service (PP65/2005), divisions of functions (PP38/2007) and regional government organizations (PP23/2005 and PP41/2007) address key variables and so offer particular hope of improving service delivery. If service standards are established and resources organized properly, some guarantee of community welfare is possible, even if at a minimum level.

However, quantity of laws and regulation does not guarantee that the desired public services can be delivered effectively and efficiently. Quality is important. In the midst of all the legislation, roles, goals, authority and accountability remain rather obscure. A mechanism or process that combines the key variables and makes roles transparent is to be developed. That mechanism could be the “Flexible Performance Agreement”.

So, although there is much legislation, key pieces are missing and others possibly duplicate, contradict or confuse, if for no other reason the sheer volume of it. The quality of its drafting is also an issue, particularly in the setting of standards, clarification of procedures and specification of criteria on which decisions can be taken. Some key legislation missing particularly relates to (i) performance contracting (ii) public service obligations (iii) performance management (iv) customer participation and (v) functions that may be assigned to the various organizational forms, the private sector and the community.

Legislation deriving from Law 17/2003 and 1/2004 on financing and alternative organizational forms is also available but needs better rules to strengthen accountability, through simplification, standardization and codification/consolidation, wherever possible.

There are also a range of factors less amendable to regulation which nevertheless may be important – the culture or “human conditions” in the government organizations that are responsible for handling the government functions or related public service. For example, the commitment of the top management to improve the quality of service delivery and the welfare of the people, the capacity of the human resources of the organization to adapt and learn, the ability of the systems and procedures to deliver ever more demanding services, and the ensuring availability of sufficient resources in a complex environment, and others, that have not been assessed here.

In summary, there is a framework available, but it is neither “joined-up” nor complete.

9.1.2 Legislation is Much, and Too Much is Low-Level

Having located and scanned a large amount of legislation, the Consultant is struck by not only the amount of legislation, but the question “why is much of it not implemented in the field”? Why are central administrative agencies not focussing on the key pieces and working hard to make that work? For example, the bundle of guidelines produced by MenPAN concerning customer perceptions and the like seems to be unheard of in the AMSD pilot governments.

It is concluded there has not been a “mental model” such as AMSD offers nor a coordinated strategy to keep legislative efforts focussed. The eight AMSD generic strategies offer a coherent framework within which to begin to sharpen and elevate the rules in the legal hierarchy. MOHA can act as the guardian of the model, in their role as being primarily responsible for facilitating regional government institutional development.

9.1.3 Monitor Impact of New Laws

A number of laws are emerging which may have a positive impact and on which AMSD can be promoted or “piggy-backed”. These include Law 14/2008 on access to public information, the Ombudsman Law 37/2008 and the newly passed Law 25/2009 on public services. These, combined with a draft law on public administration and another on management of human resources within the civil service, have the potential to improve service delivery through strengthening transparency and accountability mechanisms.

Appendix P contains a very select list of laws, regulations and ministerial guidelines the Consultant believes are most worthy of careful monitoring and up-grading.

It is concluded this set of laws and regulations and related developments are useful directions and should be closely monitored in future stages of the AMSD program. But of course, laws and regulations will mean little if there is not improved inspection, supervision and enforcement, part of which is determined by the quality of the regulations themselves. And if the SDOs are not given the resources and authority to respond to community needs, the legislation again means little.

9.1.4 Use Sector Structure to Establish Checks and Balances

From (i) assessing PP 41/2007 on organization structure (ii) the regulations related to more autonomous organisational forms for BLUDs and BUMDs and (iii) considering the culture of the civil service, it is apparent that creating the classic “checks and balances” within government is very much needed, but, even if the need is recognized, remains a major challenge. The four million or so civil servants are carefully managed to imbue the culture that they are “one big family” (*keluarga besar PNS*) – so understandably see themselves as such, thus obstructing the establishment of checks and balances within the organizational structure of PEMDA.

And yet AMSD is founded on creating and making use of these checks and balances – a structure in which organizations are dedicated to policy-making, others to regulating and yet others to implementing, collecting and feeding-back performance information and so on, all playing their roles and all joined by excellent information systems.

It is concluded that, as a start, strengthening role-definition, performance information systems and standards offer three good entry points. Specific roles need defining and reflected in the words of the legislation. Differentiation is needed, not homogenization.

9.1.5 Strengthened Supervision

Laws and regulation are mostly made to change current behaviours. Those behaviours will only change if the rules are enforced, and the rules are difficult to enforce if there are not clear standards, procedures and criteria in them. The AMSD strategy of empowering SDOs requires supervision to shift from input controls to control through outputs and performance.

It requires the core administrative agencies to “let-go”, for the SDOs to develop accepted performance indicators and probably establishment of new institutions such as inspectors, sector offices and regulators.

It is concluded that one-size-fits-all legislation such as PP 41/2007 on PEMDA organizational structure is not useful and needs review to encourage establishment of supervisory organizations within sectors that have the tools and incentives to perform that function. The tools are primarily specific service and other outcome/output standards. And of course, existing audit institutions such as Bawasda, BPKP and BKP must get the basics correct, of ensuring the underlying numbers can be relied upon, that standards, procedures and criteria have been set and that SDOs are complying with these rules.

9.1.6 Disconnect between the Core (Steering) and the Line (Rowing) Agencies

It is somewhat paradoxical that on the one hand the Indonesian civil service is encouraged to think of themselves as one big happy family and yet in reviewing the legal and regulatory framework there appears to be a considerable divide between those making the rules (central government) and those who must implement them (regional governments, and especially SDOs). Few would dispute the assertion that the framework taking shape is imposing considerable burden of regional government – especially with respect to reporting - with doubtful benefits.

It is concluded that a dialogue on roles is needed and that would best be held through the Associations, and that agreement is needed on the basic “performance information” needed to

make the “steering-rowing” split more functional. At the local level, the FPA provides the mechanism for supporting this dialogue, even if it is only for a particular sector.

9.1.7 The New Role of Core Administrators

Related to the previous conclusion, it is Strategy 1 that seeks to separate steering from rowing. It requires the centre (be it central government with respect to regional government, or the core administrative units of regional government with respect to their SDOs) to assume new, different roles. Many of the current difficulties originate from the “centre” not changing its roles and responsibilities as responsibilities are decentralized.

It is concluded that the following central core roles (basically from the strategic management cycle) need strengthening:

- Research and analysis of public policy issues
- Bringing together political / community leaders to help develop common missions and visions
- Developing whole-of-government outcome goals
- Keeping the goals in the public arena
- Educating political and community leaders and key stakeholders about strategic issues in achieving the goals
- Developing and managing strategic objectives and strategies to achieve goals
- Seeking support for policy changes from political and community leaders
- Purchasing inputs and services on behalf of the community to achieve strategic objectives
- Monitoring progress of strategies and compliance with the rules
- Evaluating results and drawing lessons
- Researching and analysing new policy issues and strategies
- Catalyzing new strategies and organizations to deploy them
- Coordinating the diverse players and actors across sectors using plans, facilitation, resourcing; and
- Reviewing, developing and applying good governance and due process rules.

Further, it is suggested the key is that the core must see itself as the purchaser of services on behalf of the community. Therefore it must have ultimate control of the resources (not the SDOs) and sufficient resources itself to do its new job; it must remain accountable and its personnel must be skilled supervisors rather than operatives. The continual temptation to become “operators” must be resisted and at the governance level, the SDOs (the line or operating agencies) should be listened to, but not be part of high-level policy-making; that is the responsibility of the steering organization. And, like most change, give this separation more time than less to succeed.

9.1.8 AMSD Will Have its Critics

During the report preparation a new law on autonomous education institutions (Law 9/2009) was promulgated by the government. This law contains many aspects of AMSD and has

created uproar in certain parts of the community – to the point it is being challenged in the Constitutional Court. This serves to warn that fundamental reforms to improve service delivery will not be easy. AMSD may be accused of being a “neo-liberal” approach – that may be so, but what other strategies have been as successful around the world as AMSD and its equivalents? Certainly not hierarchal, one-size-fits-all models.

Eight generic strategies have been identified that are well accepted elements of strategic approaches to service improvement – the challenge is how to deploy them in the Indonesian context, including that of an existing legal and regulatory framework, and for the proponents to remain true to their reform ideals in the face of certain opposition.

9.2 Sector Structure – Clarification using “Contracts” and “Standards”

Chapter 1 and Appendix A introduced the idea that AMSD aims to clarify roles, objectives, authority and accountabilities by “putting in writing” relationships between each of the key players, i.e. by creating contracts, even if they are not all formal, legally binding contracts.

Figure 9.1 shows Figure 1.2 relating to sector structure marked with the key areas that relationships (ideally “contracts”) will be established by the eight AMSD strategies. If AMSD is to improve structures and relationships by putting in place clearer agreements (contracts), a further key element required is explicit “performance”, which must be assessed by comparing actual against a “standard”.

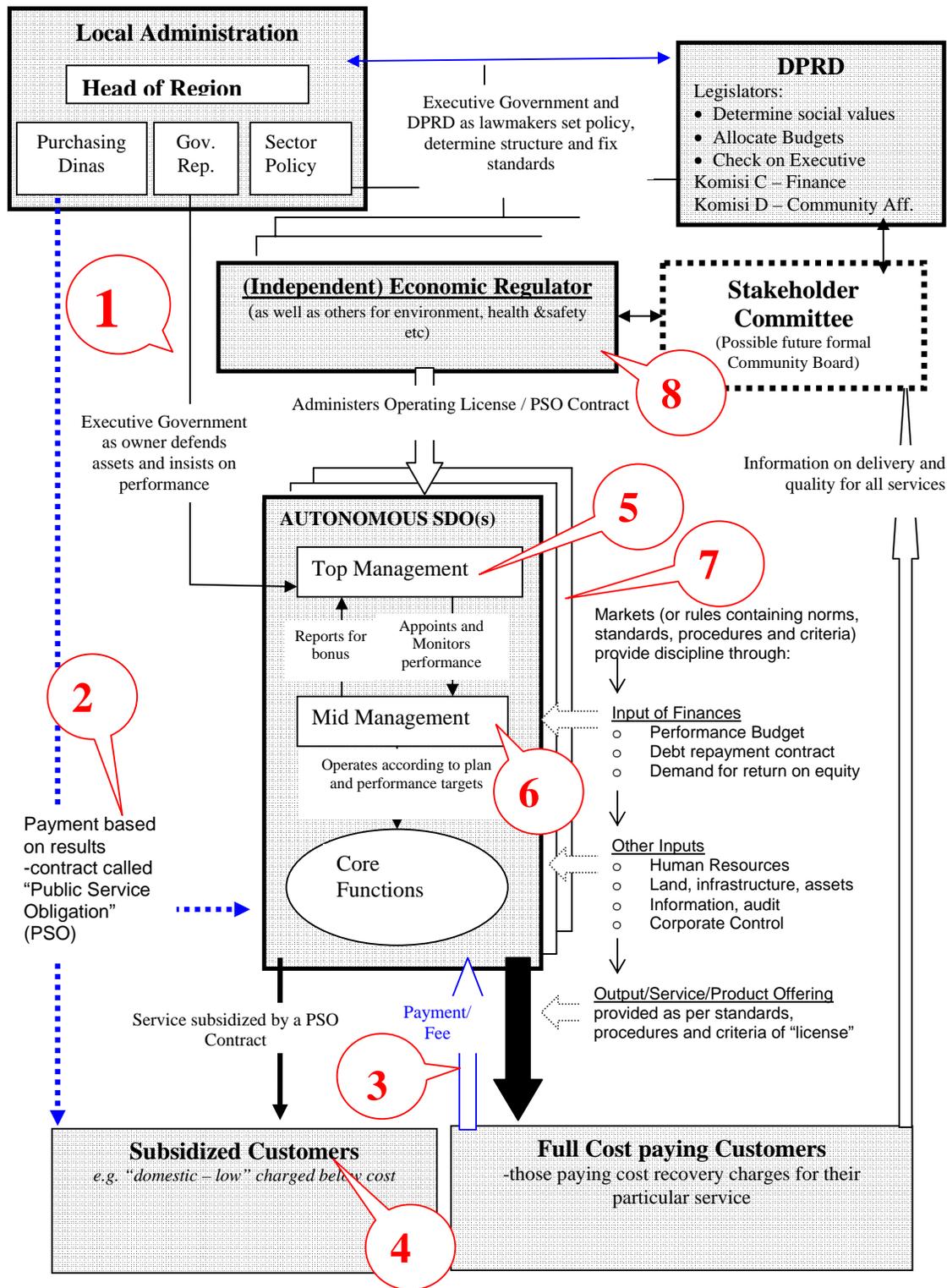
9.2.1 Where AMSD Improves Relationships and Structure

Key features of this sought-after structure that the eight AMSD strategies can deliver and which require back-stopping in the legal and regulatory framework are (see the numbered annotations on Figure 9.1):

- (1) Separation of policy making, operations and regulation with overall responsibility for system design being returned to PEMDA – with the FPA reinforcing this reassignment of roles (Strategy 1);
- (2) Funding designed to improve incentives to be efficient – i.e. funding that is sufficient and predictable, and linked to performance (Strategy 2);
- (3) Increased competition for the SDO; wherever possible it competes for the right to provide services. Consequences for good or bad service delivery are mobilized. The SDO will be more accountable through clear roles and responsibilities for its Top Management. Output standards will be set a performance will be measured, providing a range of possibilities for introducing a more merit-oriented management system – one where rewards and punishments are real (Strategy 3);
- (4) All customer and stakeholder needs are heightened by a range of activities aimed at “putting the customer in the driving seat”, which, somewhat counter intuitively, can mean making certain customers pay for the service or at least giving him options (Strategy 4);

Within the (newly empowered) and more autonomous SDO, developing plans and strategies, business processes, data and information systems, organizational performance measurement systems, and especially better leaders and managers with competent, motivate staff (Strategy 5);

Figure 9.1 AMSD Strategies Clarify Roles through “Contracts”



- (5) Again, within the SDO, de-bureaucratization of the employee culture, orienting the SDO's human resources management and development systems to results, merit and a caring workplace (Strategy 6);
- (6) Horizontal and vertical dis-aggregation / aggregation of the supply chain. Reducing restrictive practices and monopoly, by, in general, working to introduce multiple and specialized providers (Strategy 7); and
- (7) Providing a larger role for the private sector and community – be it as elements of a new governance arrangement (members of community advisory boards etc), providers of inputs (service contracts, etc) or as deliverers of the final (retail) service such as through management contracts, build-own and operate, BOT schemes or whole concessions (Strategy 8) – and the institutional arrangements that have been found to encourage this participation, such as creation of independent regulatory institutions.

It is suggested that the legal and regulatory framework, besides enabling these “contracts” needs to ensure the various standards, procedures and criteria related to them are clearly established, especially those regulating outputs and outcomes.

9.2.2 Examples of the Variety of “AMSD Contracts”

In considering the various players in Figure 9.1 and their relationships, a variety of “contracts” have been identified, for example:

9. Relations between the central and regional governments - basically Laws 32 and 33/2004 – which, if not regulated sufficiently by law, in many countries are often further clarified in “Memorandum of Agreement”
10. Between the steering and rowing organizations of PEMDA – the Flexible Performance Agreement (FPA) or “Performance Contract” of Chapter 2 regulating the relationship between core administrative organizations and service deliverers;
11. Between the government and the SDO for performance of public service obligations - the “Public Service Obligation” (PSO) of Chapter 3;
12. Between customer and supplier – the “customer service charters / agreements” of Chapter 4;
13. Between government and a contractor – the external and internal enterprise funds of Chapter 5 – the classic “supply of goods and services”, “contracting-out” or “outsourcing” contracts;
14. Between government representative and SDO – “performance contracts” as per Chapter 6 on empowering SDOs;
15. Between the boss and subordinate – besides employment contracts, in contracts as represented by “Codes of Conduct / Ethics” as discussed in Chapter 7; and
16. The “cooperation / partnership contracts”, such as BOT and concessions of Chapter 8.

It is suggested that by thinking of the relationships in these contractual terms, AMSD offers the opportunity to begin clarifying roles, objectives, targets, authorities and accountabilities without waiting for the slow process of improvement of the entire system in unison. They make explicit the relationships that otherwise go unseen and in which mutual expectations are never clarified.

9.2.3 Are “Contracts” Useful without Enforcement?

One may query whether all this is of any use if these “contracts” are not enforceable. Do the formal legal and regulatory institutions enable enforcement? Or can the informal institutions substitute for the formal? What is the outcome if both answers are “no”?

As noted by this review, the formal institutions are weak; formal contracts are unlikely to be enforced at present, but that is not to say the improvements should not point in that direction. The rule of law is increasingly being established in Indonesia. Informal institutions certainly provide enforcement, but it may be far from what should be in the written agreements.

It is suggested that a more formal regulatory framework is becoming possible, and even if the current culture in government is largely of old-style institutions of informality and patronage, the “contract” approach opens space for a dialogue to develop on mutual expectations among the parties.

9.2.4 The Essential Role of Standards, Procedures and Criteria for Moving Forward

Clarity in the relationships requires explicit understanding of the mutual expectations of the parties. These expectations are elaborated by the norms, standards, procedures and criteria (popularly abbreviated in Indonesia to *NSPK*) set down in the laws and regulations.

They not only provide a comparison or benchmark in terms of outputs, but also apply to inputs and processes required to produce the outputs. As Figure 9.1 highlights, although it would be nice and simple to image *NSPK* are only specified for the services delivered (output standards), concerns with governance make it inevitable that certain *NSPK* relate to inputs and processes – for example, how the budget is prepared, how assets are used, under what conditions funds will be invested and so on.

It is suggested that the specification of these *NSPK* in the legal and regulatory framework is where attention on improving it should be focussed. Their clear specification helps greatly to give the explicitness required in establishing the contractual, arms-length relationship of *AMSD*.

9.3 Complementary Actions for Successful Strategy Deployment

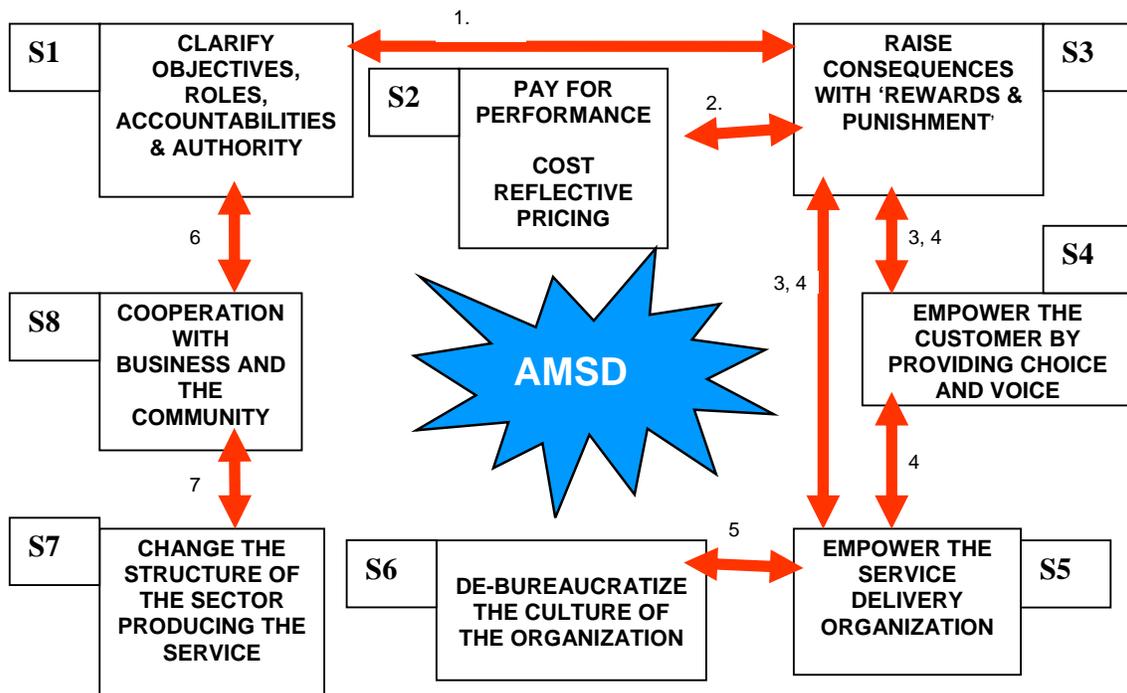
The *AMSD* strategies clearly are not isolated activities – the “boxes” of Figure 1.1 are convenient labels to isolate and describe a phenomenon or observation about human nature, but in practice, a number of the strategies need simultaneous deployment for change to be sustained. This Assessment has identified many pieces of legislation enabling parts of all eight strategies to be deployed, but the Assessment contends that too much of the legislation is developed without considering the bigger picture or strategy, such as that which the *AMSD* initiative can provide. **Figure 9.2** emphasises the importance of complementarities in respect to the eight strategies.

Examples of complementarities (or “synergies”) include:

1. To be effective, separating steering from rowing (Strategy 1) supported by PP 41/2007 needs consequences for the new organizations (i.e. simultaneous deployment of Strategy

- 3). Failure to rein in some BUMD once created under UU 5/1962 is an example, and may be repeated with the new BLUD option under UU 1/2004 and PP 23/2005;
2. Creating “enterprises” using BLUDs and BUMDs supposedly with consequences under Strategy 3 will not in fact have real consequences if the prices of their services do not reflect the real cost of producing them (i.e. Strategy 2), thus rendering this “enterprise-fund” or “corporatization” approach of Strategy 3 fairly ineffective.
3. Further, raising the consequences under Strategy 3 will have little impact if the SDO simply does not have the competencies, or more likely, is not given the flexibility / autonomy by its steering organization to respond to the consequences (an example is central government imposing MSSs on regional governments (Strategy 5) without considering the costs to meet the standards (Strategy 2) or providing incentives (Strategy 3)).

Figure 9.2 Complementarities Between AMSD Strategies



4. Empowering the customer (Strategy 4) is not going to work if there are no consequences (Strategy 3) to the SDO with respect to the customer opinion or the SDO simply does not have the power to respond (Strategy 5) – the customer satisfaction index promoted by MenPAN means little to Ducapil Serang when SEKDA does not require that indicator to be monitored and Ducapil have no budget to respond anyway.
5. An empowered SDO (Strategy 5) will not truly be empowered if its employees do not become more innovative by breaking the bureaucratic culture (Strategy 6) or the centre is prepared to trust them (Strategy 1) – insisting PDAM employees be subject to the normal

civil service rules, despite them formally being employees of the BUMD and not the state, is an example

6. Public private partnerships (Strategy 8) require the parties to concentrate on what each does best – government setting direction (Strategy 1) and the private sector producing good and services (Strategy 8). If one ventures into the realm of the other, expect trouble.
7. Rearranging the organizations in a sector (Strategy 7) to capture efficiencies in the production chain is of little use if the roles (Strategy 1) are not clear, overlap etc, the profit motive is not mobilized for the private actors (Strategies 3 and 8) or community not involved in decisions-making (Strategies 4 and 8). Water resource management provides many examples of the value chain being broken and of disempowered water user associations.

A key point with respect to capturing these synergies is that the legal and regulatory framework should facilitate deployment of the generic AMSD strategies, which are put together into specific strategies for sectors or locations. There is therefore not only a need for facilitating legislation but also for strategic plans. If legislation is currently patchy, then strategic plans are all but non-existent.

It is suggested help to government is needed with legislation, but also in improving strategy development processes and skills.

9.4 Some Broad Suggestions

The following broad suggestions are based on the Review (more detailed suggestions are included at the end of each Chapter):

1. *Draft a policy statement*: There appears to be a need for a high level “policy statement” with respect to service delivery and its improvement. This would legitimize the AMSD and any other strategies and make explicit to all that the Government is serious in its intent to improve service delivery. It would cover the generic strategies and make clear the roles of agencies within MOHA and other central agencies; it may provide general guidelines for regional governments
2. *Give legal cover to the “Flexible Performance Agreement”*: The key tool in deploying AMSD is the Flexible Performance Agreement (FPA). The legal umbrella under which such agreements fall is unclear and so should be clarified. It could be included in a revision of PP 41/2007 which regulates organizational structure and the basic lines of reporting and accountability. It could also be done at a higher level, such as in the revision of Law 32/2004 or the proposed Law on the civil service from MenPAN.
3. *Use the FPA to lead the way on improving steering functions*: The FPA is part of the larger effort needed to create proper “steering” organizations uncoupled from “rowing” organizations – to clarify which organizations are responsible for setting policy, for regulating, for implementing and for checking compliance and to separate these roles so that authority and accountabilities are easier to identify and manage. It is needed to create “checks and balances”. This is not an easy task but the planning, budgeting and now evaluation legislation in Indonesia does support the effort. The effort however is being hampered by over-regulation and the leaders (MoF, Bappenas, MOHA) not “walking the talk” on strategic planning and management. The more rapid adoption of a Medium Term

Expenditure Framework (MTEF) in budget management under PP 58/2005 and PP 8/2008 provides part of the solution, but getting the core administrative or “steering” parts of all governments operating better will take time. In the meantime adoption of the FPA for regulating the relationship between the core and line provides a simple “bottom-up” solution.

4. *While using the FPA to help clarify roles, continue improving PP 38/2007:* At the macro level, PP 38/2007 assigns functions between tiers of government and so helps clarify roles. However it appears that the assignments need to be further clarified, with particular attention to agreement on the varying roles, especially financing, as applied to a range of activities in each sector and perhaps ultimately the assignment being placed in the sector laws themselves.
5. *Improve the revenue generation framework:* The framework for financing and financial management is the most advanced of the frameworks. Apart from there being so much legislation, the “revenue” side of it also seems relatively weak. Given that success of decentralization probably requires regional government to generate substantial and reliable revenue streams from sale of many services, it appears local rules regulating processes that achieve this objective could be strengthened. Cost reflective pricing and the institutions needed for its achievement, such as tribunals, committees or economic regulators, could be emphasized, as could the link between payment, quality of service, accountability and sustainability.
6. *While using the FPA to set customer service standards, improve the MSSs mechanism under PP 65/2005.* PP 65/2005 establishing minimum service standards are a significant tool for managing the central-regional relationship at the macro level. However the initiative is in danger of becoming irrelevant if MSSs are not fully costed and funded, and established indicators chosen which are simple, measurable, attributable and relevant. For service delivery, customer service standards and targets established locally may be better, but the legislation for this approach is minimal.
7. *Encourage competition and tell PEMDA that:* The AMSD strategy of raising consequences is likely to be controversial in some quarters because it aims to use the market to provide the discipline SDOs need to improve service delivery. The accusation of “neo-liberalism” is not far from the lips of its critics! But most also acknowledge that rewards and punishments are lacking in the Indonesian public sector. The legal and regulatory framework is moving in the right direction with BLUDs and BUMDs being “autonomous” SDOs that rely more on revenue from sales to survive compared with other organizational forms. More effort could be put into clarifying for PEMDA the types of services that may be subject to competitive pressures, how to determine if the service is ready for competition and encouraging PEMDA to consider how competition can be introduced more widely in everything they do.
8. *Train, train and train in performance measurement:* All improvements in service delivery depend on developing competence to measure performance. In the first place this needs to be no more than demonstrating that the SDO “did what it said it planned to do” and ensuring mechanisms are available to independently check that. In time, more sophisticated performance measurement based on strategic planning will emerge.
9. *Make the customer the king:* Customer satisfaction and complaints system have been regulated (by MenPAN) but few systems have been developed or adopted by regional governments. The legislation is low level and probably would not be effective anyway because there must be consequences for regional government and their SDOs. Stronger

emphasis should be put on choice, community participation and benchmarking systems with feedback to the community to keep the accountability chain short.

10. *Improve organization design:* PP 41/2007 and the regulations on BLUD and BUMD provide at least 9 organizational forms for service delivery. Missing is clear guidelines for how to allow form to follow function. Each form needs rules that are respected to allow it to function in practice how it is supposed to function in theory. So, SDOs should be moved to the autonomous BLUD form wherever possible, but good legislation is required to commercialize the service and bolster the governance and control of the new autonomous forms.

The above ten broad suggestions synthesize the main suggestions in the Report, which has reviewed the Indonesian legal and regulatory framework that exists or is needed to promote alternative mechanisms of service delivery. One message of this report is that, like Strategy 1 for improving service delivery, the centre should get on and do their job of improving the framework and allow, or make, regional governments get on with devising strategies and managing improved institutions for service delivery.

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