

III DEVOLUTION AND DECENTRALIZATION

The ideologies of modern nationalism... arising as they do out of intense concern with massive social reconstruction, show a strong tendency toward neglect, even an outward denial, of important variations in domestic cultural patterns... The vivid memory on the part of the elites of the New States of colonial divide-and-rule policies, as well as a fear of the strong divisive tendencies they quite accurately perceive both within themselves and in the mass of the population, leads them to regard any explicit or frank concern with internal diversity as subversive of the whole nation-building effort and to view, or to try to view, their own society in a much too uniform and global, even stereotypic a manner. With regard to national economic planning this leads to a failure to cast proposals in a form which attempts to take maximum advantage of the peculiarities of various local traditions, to an unwillingness even to consider differentiated plans for different cultural and social groups...

– Clifford Geertz (1963)

“Le roi est mort, vive le roi” (the king is dead, long live the king).

INTRODUCTION: WHY DEVOLVE?

In developing countries, devolution of government services—the handing over of all authority to local governments—or decentralization—the reassignment of some authority for selected functions—has become increasingly

common in the past few decades (Cheema and Rondinelli 1983). This trend mirrors the generally successful decentralization that has taken place in a number of industrialized countries, such as New Zealand, Poland, and Hungary. In Asia, it is usually closely associated with the move away from highly centralized systems of government, with reform movements marked by demands for more competitive politics, greater popular participation in government, and perhaps most notably in Indonesia, a demand for a fairer local share of the bounty of natural resources. In countries as disparate in size and political systems as the Philippines and Nepal, there have been recent forceful moves to decentralize government. In others, such as Mongolia, which are setting up democratic government structures for the first time, decentralized government has become the model to follow.

Demands for decentralization are not new in Asian countries. In both Nepal and Indonesia, for instance, greater local autonomy has been under discussion for nearly four decades. In recent years, new factors have emerged that have accelerated the process, however. One is the impact of globalization. Better communications have made people at all levels of society more aware of what is occurring around the world, as well as of what is happening in their own countries. In this rapidly shrinking world, comparisons and informed judgments are much easier to make and more opportunities are available to be involved in governance.

A second factor is the impact of the enormous economic and social changes that have occurred in the last 20 years. Liberalization, privatization, and other market reforms all require a different mode of governance. These changes have also underlined the limited capacity of central governments to handle adequately all the demands placed on them. In the future, a State's activity will have to be limited by its capabilities; if these mean devolving responsibilities, that process must occur.

Allied to both of these factors is the growing demand for participation. Although this varies among countries, many local communities are no longer satisfied to accept the dictates of a central Government. There is a strong, growing voice for

participation in governance. Even highly centralized systems in countries such as the Soviet Union have been replaced by much more participatory, localized governments. More generally, in almost all transitional countries, the retreat of Marxist-Leninist ideology was accompanied by rapid decentralization, first of economic power and then of political power.

The perceptions of donors, which reflect the thinking of major sources of development financing in many countries, have also changed. Traditionally dealing only with central governments in their lending operations, believing that central governments alone had both the responsibility and capability to manage development, donors have recently shifted to supporting better governance and with it, greater local participation and autonomy.

Consequently, decentralization of government is now sought in nearly all developing Asia. It encompasses the transfer of both administrative and financial authority, since it is understood that without adequate fiscal resources decentralization will not work. It also involves the participation of local civil society, whether this be citizens' groups or nongovernment organizations (NGOs). Its potential benefits are clear. It will strengthen the overall responsiveness of government in the country, better match the provision of government services to local needs, and more effectively support and utilize the local economy. It will also bring government closer to people; through participation, it will create more accountable, transparent, and, it is hoped, more capable governance.

Yet decentralization is not a panacea that will solve all problems. It requires full political will. Unfortunately, while this will is often expressed in rhetoric, it is not always backed up with full commitment. In Bangladesh, for example, the central Government introduced elected people's councils to please the donors, but power remained firmly in central government hands (Crook and Manor 1994). In addition, decentralized governments do not always adhere to the principles behind their own creation when dealing with other

local bodies. Thus, in Pakistan, provincial governments can be found treating municipalities as subordinates, a return to earlier centralized attitudes (World Bank 1997).

Political will is not sufficient by itself. Clear legal and administrative mandates are also highly desirable. The time needed for their establishment, however, may just create excuses for inaction by central authorities. Thus, more fundamentally, decentralization requires intensive interaction among stakeholders. But the process has no universal blueprint, given the varied and usually complex political, administrative, and social systems found in the developing countries.

Decentralization also has dangers. If not well managed, central governments could lose control over the macroeconomy as the result of uncoordinated local decisions. Regional disparities could be exacerbated, leading to economic and social tensions. Local governments could also fall under the sway of particular local interests, thereby undermining State power and accountability.

Thus, decentralization is a double-edged sword. It is clearly the way to go if the people want it, but it is not a simple or quick remedy for all of society's problems. Nor is it a process that is anywhere near complete in Asia. This is well illustrated by the three case studies that follow. In Indonesia, the Government, under strong political pressure in an uncertain new era of reform, moved quickly to formally decentralize its highly centralized political and administrative systems. Political pressure has also provided the impetus for decentralization in the Philippines, which has undergone considerable and fairly successful legal decentralization since 1991 with the active involvement of a vibrant civil society. In contrast, reforms in the PRC have been largely economic rather than political. Nonetheless, despite few formal changes in legislation and a limited civil society, the PRC has achieved considerable decentralization through the sweeping economic reforms that allowed local governments a good many decision-making powers.

COUNTRY EXPERIENCES

Indonesia

Since its independence from colonial rule in 1947, Indonesia has seen a constant dialogue between forces pushing for, and mostly achieving, a centralized State and those seeking greater local autonomy. Set up as a unitary State under the 1945 Constitution, which gave the central Government strong executive powers, Indonesia between 1945 and 1965 undertook a number of experiments to give greater autonomy to its provinces. These included an attempt in 1948 to set up three levels of autonomous regions, consisting of the province, the district, and the village; the plan was never implemented. At different times in the 1950s, fairly extensive powers were delegated to lower levels of government, but regional rebellions and the near disintegration of the country had led by 1959 to a greater concentration of authority than before.¹ This tendency was accelerated with the advent of the New Order (Order Baru) period in 1965, which saw the establishment of a strong centralized Government under President Suharto. During the New Order period, little real decentralization occurred, and even when it did, it was administrative and financial in nature, and not political, since the political system was tightly controlled. This has changed dramatically since Suharto's fall and the collapse of the New Order Government in 1998. With the arrival of the era of *reformasi* (reform), Indonesia has once again swung back to trying to give greater autonomy to its various regions and to decentralize government.

Basic to these swings between centralized and decentralized government in Indonesia has been one dominating theme: the need for national unity. National unity has not

¹ Presidential Decree No. 1 of 1959 markedly reduced the powers and autonomy of the provinces that had been provided in earlier legislation. It remained in effect until superseded in 1974 by Law No. 5 on Basic Principles of Regional Administration.

been easily achieved due to Indonesia's size, large population, and island geography, with marked economic and social disparities among its various regions, an unequal distribution of its population, marked ethnic diversity, and religious differences. Indonesia covers a land area of 1.9 million square kilometers, has 13,667 islands, a population of over 200 million, around 300 ethnic groups, and, while predominantly Moslem, has three other officially recognized religions (Christianity, Buddhism, and Hinduism). Some 62 percent of its population lives on the small central island of Java, with the balance spread unequally throughout the outer islands. There is a world of economic, social, and cultural difference between, say, the strongly Muslim, resource-rich province of Aceh in the westernmost part of the country and the predominately Christian and resource-poor province of Nusa Tenggara Timor (NTT) in the east. Even where a province may appear to be rich in resources, such as Irian Jaya, the wealth derived from those resources is usually not distributed within the province. Given these disparities, one can appreciate the constant search for ways of establishing national unity at every stage of Indonesia's postcolonial development.

With the political and macroeconomic stability that was achieved in the early years of Suharto's rule, coupled with large inflows of oil revenues and official development assistance, rapid growth and development followed in nearly all parts of the country. This was achieved, however, by retaining an authoritarian political system that allowed only very controlled participation by the greater part of the population in government and in decision making. The events of May 1998 and the overthrow of Suharto have ushered in the Reformasi Era, in which the restrictions of the New Order period are being swept aside. Today all levels of society are seeking participation.

The New Order Period

The New Order period that began with Suharto's accession to power in 1965 was characterized by a strongly centralized Government committed to national unity;

establishing firm political and administrative control was made the first priority. A strong central government apparatus was built up in the first decade, with powerful central sectoral ministries, centrally appointed governors in the country's 27 provinces, and centrally approved district heads. The state ideology, Pancasila, was widely used to emphasize the importance of national unity.² A strong and dominant government political party, GOLKAR (from Golongan Karya, or "functional groups"), was established (Reeve 1985), which received the compulsory support of all civil servants at election time. The educational system was tightly controlled, with bans on student political activities and the use of blacklists to restrict public-sector employment opportunities, particularly in the early 1980s, for students regarded as not fully conformist.

Within this framework, development was given first priority and used as a political tool, first to stabilize and then to develop the country. As a political tool, the considerable inflow of funds³ devoted to development from the late 1970s onwards helped establish a pervasive patronage system, using project funds to pay additional honoraria to the country's large civil service. Since it is estimated that a middle-ranking civil servant has to augment his or her salary by at least 70 percent in additional earnings in order to make ends meet, access to projects and the honoraria they provided in fact became the criterion of a successful posting in the civil service.

Development budgets increased rapidly in the 1970s; in the latter years of that decade the development budget had grown to be the same size as the routine budget, from half its size in 1969/70 (Booth 1986). Thereafter, this growth slowed and was then reversed: during most of the 1990s, the

² First put forward by President Sukarno in a 1945 speech, Pancasila was extensively used as the ideological basis of the New Order. The third of its five principles emphasizes the need for national unity. All civil servants from 1979 onward were required to attend periodic Pancasila training courses (Morfit 1986).

³ These came mainly from oil taxes, which contributed 60 percent of all government revenues by 1980/81, including those from foreign borrowing (Booth 1986).

development budget averaged slightly less than two thirds of the routine budget. A large part of this was dispersed to local governments in the form of bloc grants, providing the major part of the budget available to both provincial and district levels of government: in the early 1990s, for instance, 76 percent of the provincial and 82 percent of the district budgets on average came from central government grants (GTZ 1998).

This system was highly effective in bringing about the development of Indonesia in this period. In all parts of the country there were new roads, clinics, and schools. Major agricultural and food programs such as rice intensification (BIMAS, from the Indonesian acronym for “mass guidance”) were introduced that benefited large segments of the population. Economic growth was rapid, supported by a well-planned macroeconomy run by a small group of central civil servants, most notably in the Ministry of Finance and the National Development Planning Agency.

In this system, little attention was given to decentralization and local autonomy. The emphasis of the New Order Government in retaining complete centralized control generally precluded this. Yet various forces were, in fact, working towards this end. The rapid development of the country’s communications and educational system led to greater mobility. There was increased urbanization and, in general, greater contact with the outside world. Economic and social development brought new wealth to many provinces and created a new, better educated and more articulate middle class that, within the confines of the centralized system, became increasingly aware of its rights. This, in turn, reawakened the dormant provincial desires for autonomy that had been so strong in the earlier periods of Indonesia’s independent history.

Thus, some moves towards decentralization took place at various times throughout the New Order period. On the one hand, there were attempts to formalize (although not to implement effectively) administrative and fiscal decentralization of the government system. At the same time, some decentralization took place in individual sectors such as agriculture, health care, and urban services. In the case of

agriculture and health care, this decentralization continued a process that had started in the 1950s, prior to the New Order. In the case of urban services, it occurred in the 1980s, as the limited capacity of the central Government to handle local urban development became clear.

The foundations for administrative decentralization were provided in 1974 with the issuance of Law No. 5 on the Basic Principles of Regional Administration. This established the basis for Center-province relationships. It set out the functions of local government at the provincial and district levels, stating that the district would be the level that might at some stage become autonomous. The law made it clear, however, that any such autonomy would be dependent on the capability of each of the country's more than 300 districts and would not, as envisaged in the 1945 Constitution, be automatic. In this the law marked a significant change from the earlier accepted notion that autonomy was the right of local governments. Now local governments would have to show that they had the capacity to handle their own administrative and financial affairs before they would be considered for any autonomy.⁴

While the Law of 1974 was useful in providing the broad outlines of the division of powers and functions between the central and local governments, nothing was done for a considerable period to implement it. The first necessary backup regulation was not issued until Regulation No. 45 of 1992, passing some of the functions of the central sectoral ministries to the lower levels of local government. This was consistent with Indonesia's practice of first establishing a policy with a broad enactment and then, very gradually, spelling out the details of implementation with government regulations.

⁴ The 1945 Constitution had provided for "very broad autonomy" (*otonomi seluas-luasnya*). This was now replaced with autonomy that was "real, dynamic, and responsible" (*otonomi yang nyata, dinamis dan bertanggungjawab*). In this definition, "responsible" was equated with a district's capacity. In the 1980s, several attempts were made by the Ministry of Home Affairs (which oversaw local government administration) to classify Indonesia's districts according to their capacity. This classification was then to be used to determine which districts would be eligible for autonomy. See Smoke and Lewis (1998).

Implementation indeed proceeded very slowly; pressure continued to grow within the country for more local autonomy and finally, in 1995, a pilot district program was introduced.

This District Autonomy Pilot Program was an attempt by the Government to introduce some measure in response to growing calls to move the promised decentralization ahead. As with many other programs in Indonesia, it was initially tried out as a pilot project with one district in each of 26 provinces targeted for the decentralization of a wide range of central functions. These came from 16 sectors and, in addition to general government, comprised agriculture, forestry, mining, trade, health, education, fisheries, plantation crops, livestock, transmigration, social affairs, cooperatives, tourism, labor, and industry.

The aim of the project was to achieve better local resource mobilization and improve services, as well as to bring about greater local participation in government and strengthen local initiative. Unfortunately, the pilot project met with little success, due mainly to two factors. First, many of the functions finally given to the districts after intense negotiation with various central ministries were not ones easily taken over by a district government. In addition, the districts lost some functions that they were already carrying out well, which now reverted to the provinces in compensation for ones the latter had lost. One example was the reversion of the profitable issuance of permits to engage in trade from the district to the provincial level. Second, the planned transfer of central government funds to the districts to meet the considerable costs of taking over the new functions did not push through. Thus, many districts were either unable to reorganize their offices to handle the new duties or were severely hampered in doing so.

Fiscal decentralization proceeded even more slowly. Throughout this period the largest part of local government budgets consisted of central government grants; little attempt was made to mobilize local resources. A law passed in 1956 had, in principle, given the provinces between 75 percent and 90 percent of the proceeds from natural resource and export revenues, and it was expected that this tax sharing would cover about two thirds of local government expenditures. This

law was never fully implemented, however, and the proposed distribution was replaced by the central Government's Subsidy for the Autonomous Regions.

The 1974 Law on Basic Principles of Regional Administration, which provided only some general stipulations on local taxes and fees, became the only guideline available on the fiscal relationships between the Center and the provinces. This gap in fiscal authority led local governments to introduce a wide variety of local taxes, levies, and fees. None of these provided large revenues, however, and some cost more to collect than they yielded in receipts. Finally, a new central fiscal act was passed in 1997 that established clearly the taxes that could be levied at both the provincial and district levels. This act, Law No. 18 on Regional Taxation, rescinded most of the small and unwieldy taxes that had emerged in many areas, replacing them with three taxes at the provincial level and six at the district level. Thus, the total number of taxes was reduced, while the potential revenues of both provincial and district governments were enhanced.

Yet even with this revised tax base the local governments' dependence on central government grants continued. At the same time, the central Government shared control of very little in the way of the tax revenue that accrued to it: an analysis of 1993 data on shared taxes and sources of revenue showed that 92 percent was controlled at the central level, less than 5 percent went to the provincial level, and just over 3 percent to the district level (Panggabean 1997).

Sectoral Decentralization during the New Order Period

Although administrative and fiscal decentralization proved difficult and generally did not progress far in the New Order period, moves were taking place to decentralize responsibilities in other areas. Provincial and district planning boards (*bappeda*) were created by legislation in the late 1970s and early 1980s; however, it took a decade or more before these boards were adequately staffed and fully functional (MacAndrews 1986). At the sectoral level, some decentralization occurred in the areas of urban services,

agriculture, and health. In all three cases this decentralization eventually led to some improvements in the provision of services.

Indonesia's effort to decentralize *urban development* is of relevance to rural Asia because of its rationale and approach. A major factor in the decision to decentralize was the recognition of the inadequate management performance of central government agencies. This inadequacy resulted in long delays in the implementation of urban projects by central ministries and a decline in the quality of many projects. It also resulted in a lack of flexibility in design so that urban projects often did not fit local conditions. To deal with these problems, the Indonesian Government initiated a process by which central agencies were to support local agencies until adequate local capacity was built up. This approach potentially provides a model for decentralized, integrated rural services (e.g., for irrigated agriculture).

In 1985, the Ministry of Public Works launched one of the most successful efforts to decentralize urban development, the Integrated Urban Infrastructure Development Program (IUIDP). Aimed at introducing an integrated approach to replace sector-specific infrastructure development (e.g., roads versus water supply), the IUIDP empowered local governments to determine, plan, and implement projects in accord with local priorities. Of critical importance, local governments were given assistance to prepare and implement five-year comprehensive investment plans, to raise additional revenues, and to strengthen their technical and administrative capabilities. The principles underlying the IUIDP were formalized in the 1987 Statement on Urban Development Policies and subsequently reiterated in the Five-Year National Development Plan.

The second major initiative was the setting up of the Urban Development Coordination Team in 1987. This involved the National Development Planning Agency and the Ministries of Home Affairs, Finance, and Public Works and aimed to coordinate the formulation of integrated urban development policies. This quickly became the channel for donor funding,

including that of ADB, with most ensuing projects being decentralized to local governments. New financing for urban development was provided in 1985 by enacting a land and building tax and by setting up an urban loan facility through a new Regional Development Account, which was also used to coordinate donor loans for urban infrastructure and services.

In the *agriculture sector*, decentralization began very early, as far back as the 1950s. At that time, most of the services provided to small-scale farmers, including extension, seeds and planting materials, plant protection, post-harvest processing, and soil and water conservation, were moved first to the provincial level and then later to the district level (plantations remained at the central level, however). At both levels, four separate offices were established for food crops and horticulture, smallholder estate crops, livestock, and fisheries. These offices, following the usual Indonesian practice, reported to the local head (whether the governor or the district head), but received technical direction and guidance from their respective directors general in the central Ministry of Agriculture (MOA) in Jakarta. Although common in the Indonesian local government system, this double supervision and reporting caused confusion at times, but the local offices at both levels were generally free to carry out their duties on a day-to-day basis.

It is noteworthy, however, that little donor support was ever provided to help build up the capacity of these local offices. Donor loans, particularly those of the World Bank, always seemed to be given to MOA for national programs. In fact, the extensive World Bank support led to a considerable duplication of agricultural extension services. The World Bank funded the setting up of large-scale agricultural extension services to support the national BIMAS rice campaign; these duplicated services already provided at the district level. Later it funded new Rural Extension Centers at the district level that remained under central control and often did not cooperate with the other district-level agricultural offices. It was only in 1994 that a new institution, the Agricultural Information and Extension Center, was set up in each district specifically to integrate extension services.

Indonesia has been experimenting with a decentralized agricultural research system since 1992, when there was a major reorganization of MOA's Agency for Agricultural Research and Development (AARD). A 1994 ministerial decree established 17 Assessment Institutes for Agricultural Technology (AIATs) in the provinces to regionalize research and promote development of farm technologies suited to individual agroecological zones. This reorganization is currently being evaluated (Manwan et al. 1998) and there are still many problems to be threshed out. The role of the central organization is not yet clear, and some of its assets (e.g., the gene banks), which should have remained centralized, were given to the newly-formed provincial institutions. Both ADB and the World Bank have provided funding to support this decentralization. However, the general management of the AIATs remained under AARD, while the decentralization process suffered from a chronic lack of resources. The share of the national development budget for agriculture, forestry, and irrigation declined from 30 percent to 10 percent during the 25 years prior to 1998. Furthermore, in the Five-Year Development Plan in effect through 1999, more than 60 percent of this combined budget was earmarked for irrigation.

Moreover, there was continuous conflict between MOA and its agencies and the local governments as to what financial resources should be delegated. If Indonesia's laws dictated that funds must be appropriated to support decentralization, central officials read this to refer only to the routine budget and not to the development budget, whereas local government officials naturally felt they should also get a share of the development budget. The lack of funding affected not only the implementation activities of the local offices but also their personnel policies. Without a share of the development budget for projects and project honoraria, as noted above, these local offices could not provide the added financial incentives necessary to attract and keep competent staff.

If agriculture experienced some attempts to decentralize, albeit undermined by the lack of funding and

central support, a better picture can be seen in the *health sector*. As in agriculture, partial decentralization efforts took place as far back as the 1950s, when health affairs were transferred to the provinces in Java, Sumatra, and Kalimantan. This pattern was followed in 1969 when Irian Jaya became a province and again in 1976 in when the province of East Timor was created. No services were transferred to the four provinces comprising Sulawesi or to the provinces of Maluku, Bali, and NTT. It was not until 1987 that these initial steps were consolidated under a new regulation, No. 7, for the nationwide decentralization of health affairs. This, like so many attempts to standardize decentralization in Indonesia, was difficult to implement in all provinces, due to their considerable differences in size, budgets, and local resources. The regulation also failed to spell out clearly which functions should be handled at the provincial level and which at the district level. In practice, the districts, through the local health offices, carried out nearly all implementation. At the subdistrict level, the community health centers (*puskesmas*) reported to the district office.

Health services in Indonesia have benefited from a pilot integrated budget system introduced in 1993/94 that brought together the routine and development budgets. This allowed a greater share of the development budget to be used at the district level and, in turn, provided projects and project honoraria that greatly assisted the local health offices in attracting more qualified staff.

The Reformasi Era

With the collapse of the New Order regime in May 1998 and its replacement by the Reformasi Era, the decentralization of authority became an urgent political preoccupation. After the centralized system of the Suharto regime, the pent-up desire for more autonomy led to strident demands for the almost immediate decentralization of government authority and the opening up of the rigidly controlled political system. The aim

was to pass the necessary laws, political, administrative and financial, by the time of the first general elections of this era in June 1999. Some of the major legislation had been passed by late 1999, but an enormous task remained of preparing implementing guidelines and revising related regulations in order to eliminate conflicts with the new political and administrative reforms.

Three electoral laws were the first to be processed. These allowed for the free establishment of political parties, as well as more representative, and responsible, assemblies at the local level. They also laid out the rules for the June 1999 elections, as well as for local elections to be held a year later. Together, these laws opened up the political system at all levels. They also provided the political changes necessary to back up the administrative and financial measures for decentralization.

A further landmark development was the preparation of the new Law on Regional Government. Its drafting, and the heated debates in the National Assembly before it was finally passed, showed how difficult it was going to be to implement decentralization in so large and diverse a country. It was drafted by a special committee comprising government and university representatives that was set up by the Ministry of Home Affairs in June 1998, almost immediately after the fall of the Suharto regime. Intense discussions ensued, with no fewer than seven drafts of the law being processed before a final draft was sent in February 1999 to the National Assembly to be ratified. Unfortunately, the very limited time allowed to prepare the legislation precluded any extensive consultation, within or outside government, on the law's makeup.⁵

The drafters faced a number of major issues. One was whether both the provinces and the districts were to be given autonomy. After considerable debate it was decided that the provinces would be given limited autonomy, but full

⁵ Only one meeting was held with local government representatives. This occurred in late October 1998, when 40 district heads were called into Jakarta to be briefed. In general, few people in either the public service or civil society in Jakarta knew what was being proposed.

autonomy would be given to the country's districts and municipalities. The districts will now be responsible for all local affairs, including finance and the recruitment and administration of staff, with the central Government retaining responsibility only for external affairs, defense and security, justice, fiscal affairs, religious affairs, and strategic matters.

A second issue was how to ensure autonomy and local accountability in the autonomous districts. This was achieved by making the district heads entirely responsible to an elected local assembly, which would also appoint them; they would no longer have to answer to the central Government for any of their actions. Prior to this, both the provincial governor and the central Government had to approve the appointments of district heads, who were accountable to the provincial governor. In addition, to ensure full community participation at the village level, a new village institution was to be set up. Called the Village Representative Body (Badan Perwakilan Desa), it would replace the present Village Consultative Body and would consist of freely elected community members.

A third issue was how to ensure adequate financing for this decentralization. This was to be done by providing a central government bloc grant to fund the newly autonomous districts: up to 55 percent of central government revenues, large enough to meet all devolved costs. It was to be distributed based on a formula that would take into account the diversity of the different districts in population, size, and levels of development.

To back up the administrative and political reforms, a Fiscal Law⁶ was drafted by the Ministry of Finance and passed in April 1999. It governs the financing relationships between the central and local governments. It retains some central control over national finances, but delegates considerable powers to the local districts for budgetary affairs. The large

⁶ Although popularly referred to as the Fiscal Law, its formal title is the Law on the Balance of Funding between the Central and Local Governments.

bloc grant to fund the autonomous districts will be based on a proposed formula to counterbalance the existing inequalities among districts.

Little thought was given to the process of implementation. In this there will be numerous potential problems to solve. One is the extent to which, given the strongly vested interests left over from the New Order period, the new Reformasi Era Government will fully devolve functions to the districts and municipalities. It may well be that in the process it will try to retain its previous central authority by delegating only limited responsibilities.

A second issue is the time required for implementation. Initially, a year's transition was envisaged, but this was later increased to five years. Even though political necessity probably dictates quick implementation, the proposed transition period is clearly too short. Given the diversity and size of Indonesia, the process is more likely to take a decade or even longer.

A third problem is that of reallocating central government staff. It is expected that as many as 22 of the present 39 existing central ministries/agencies will no longer be needed, with the remainder becoming greatly reduced in staff. This will entail the relocation of tens of thousands of central civil servants to the district level and require considerable planning for their deployment, as well as for their salaries and conditions of service.

Fourth, there is the question of the adjustment costs, which will be sizable in terms of infrastructure and transfer of personnel. Additional offices will have to be built to accommodate the expanded district-level governments. No estimates as yet exist, but given the considerable constraint on Indonesia's national budget due to the effects of the economic crisis, funding to support the proposed decentralization may continue to be very difficult.

Finally, assuring that district officials can handle their expanded roles will take time and require a massive capacity-building effort. Yet few steps have been taken so far to introduce training programs to upgrade skills at the

district level. Given the large number of districts in Indonesia, it may again take a decade or more to build up an efficient district-level civil service.

With the formation of the first Reformasi Government in late October 1999, headed by the new President Abdurrahman Wahid, concrete moves to decentralize were quickly initiated. Some ministries were abolished and new ones were created, including a Ministry for Regional Autonomy. In the remaining months of 1999 and in early 2000, the process of moving authority and decision making to the district level began in earnest. Large and formerly powerful ministries such as Public Works were reorganized, cutting back both on their central functions and staff. Central ministry budgets that had formerly been predominantly allocated and spent from the Center were now moved down to the local level. The Ministry of Health, for example, proposed to move 86 percent of its annual budget in 2000 to the regional administrations, as against 41 percent in 1999. Yet many local areas, particularly resource-rich provinces such as Aceh and Riau, wanted a far quicker process.

Notwithstanding all the potential problems that will have to be faced, Indonesia is under strong political pressure to decentralize rapidly. This departs sharply from Indonesia's previous history of revising its institutional arrangements slowly by adopting broad legislation and then, over a long period, allocating the necessary resources to bring about full implementation. The pace of the new decentralization policy carries dangers. If not well implemented and funded it could fragment the country's present fragile unity. It also needs time so that clear relationships can be established between the various levels of government, with ways worked out to deal with the significant economic, social, and political differences among regions. However, whether Indonesia's old vested interests and power groups will allow decentralization to proceed fully remains an open question at this time.

The Philippines

The Philippines initially saw some progress in decentralization between 1946 and 1972,⁷ but this ended with the advent of the dictatorship of President Ferdinand Marcos in 1972 and the introduction of a more highly centralized Government. It was only with the fall of Marcos in 1986, and with it the restoration of democracy and formal democratic structures, that rapid moves took place to decentralize a number of central government functions to local government units (LGUs). The 1987 Constitution provided for autonomy in local areas. This was followed by a cabinet-developed strategy in 1990 laying out a four-pronged program for decentralization, including a legislative foundation, pilot projects in 14 provinces to improve the capacity of LGUs, and bloc grants to support implementation (UNDP 1993). Then in 1991, a Local Government Code was introduced that moved a number of central government functions down to the Philippines' more than 43,000 LGUs (78 provinces, 83 cities, 1,527 municipalities, and 41,351 *barangays* [villages or local administrative units]) so that they could better respond to the particular needs of their areas.

The 1991 Local Government Code

The 1991 Local Government Code (the Code) was based on the 1987 constitutional provision that ensured the autonomy of local governments. It had five main features:

- It moved to LGUs the responsibility for various services that were earlier managed by the national government.

⁷ Moves in this direction included the granting of expanded fiscal and regulatory powers in 1950 to municipal and city governments, the granting of legal status to the *barangays* (villages) under an elective council, and the passing in 1967 of a Decentralization Act increasing the financial resources and powers of the local governments. The second Presidential Decree of martial law, PD2, in 1972, also set up a system of regional offices for national government agencies.

These included health; social welfare services; environment (partially devolved: forest management, protected areas and wildlife, environmental management, mines and geosciences, land management, and community-based forestry); agriculture (extension, on-site research, and community irrigation); locally-funded public works; education (the school building program); tourism; telecommunications and housing projects for the provinces and cities; and other services, such as investment support.

- It moved to the LGUs the responsibility for the enforcement of certain regulatory powers, such as the reclassification of agricultural lands, environmental laws, the inspection of food products and quarantine, the national building code, and the processing and approval of subdivision plans.
- It provided for the participation of civil society in local governance by allocating seats to NGOs and people's organizations in key local bodies.
- It increased the financial resources available to LGUs by broadening their powers of taxation, providing them with a specific share of the revenues generated in their area from natural resources (e.g., mining, fisheries, and forestry) and increasing their share of national taxes (the Internal Revenue Allotments, or IRAs) from 11 percent to as much as 40 percent. The Code also enhanced the ability of local governments to generate revenues from local fees and charges.
- Finally, it laid a foundation for the development of more entrepreneurship by local governments. To encourage more businesslike and competitive behavior, it allowed local governments to enter into build-operate-transfer arrangements with the private sector, to float bonds, and to obtain loans from local private institutions.

To implement the Code, an interagency Oversight Committee was set up. This included the LGUs, through their respective leagues (the Leagues of Provinces, Cities, and Municipalities); national government agencies, such as the Bureau of Local Government Finance of the Department of Finance, the Department of Budget and Management (DBM), and the Department of Interior and Local Government (DILG); and members of Congress. Finding that too many trivial issues were coming to it for adjudication, the Oversight Committee set up Transition Action Teams in May 1995 at the regional and provincial level to facilitate settlement of the less complex issues.

As implementation got under way, a Master Plan (1993–1998) for the Sustained Implementation of the Local Government Code of 1991 was prepared. Approved by President Fidel Ramos in October 1994, it served as the framework for the Code's implementation. The Plan identified three major phases of the implementation. Phase One (1992–1993) would be a changeover phase that involved the transfer to local governments of devolved functions with funding and personnel. Phase Two (1994–1996) would be a transition phase during which the national government agencies and local governments would institutionalize their adjustments to the decentralized arrangements. Phase Three (1997 onwards) would be a stabilization phase, when it is assumed that the local governments would have built up adequate capacity to manage local affairs and the national government agencies would provide support and technical assistance. Unfortunately, the complexities of implementing the Code, along with national elections in 1995 and 1998, delayed this timetable and it is now likely that the stabilization phase will start only in 2000.

Sectoral Progress in Implementing the Local Government Code

In the **health sector**, the Department of Health (DOH), having the largest number of central personnel (some 46,000) to be moved to the LGUs, perhaps inevitably met a number of problems in relocating staff. These included working out

satisfactory career paths for the devolved personnel, their nonabsorption by the LGUs, and lower salaries. At one stage, these issues became so contentious that massive rallies and demonstrations by devolved health staff took place, resulting in a bill being passed by both houses of Congress in 1995 to recentralize the delivery of health services. President Ramos vetoed this bill and the devolution of health services continued.⁸ Nonetheless, local governments have been required to pay the upgraded salaries of devolved health workers according to a pay scale prescribed by the Magna Carta for Health Workers and passed by Congress, about which more below.

On a more positive note, health boards were set up at the local level to develop strategic health plans responding to the special needs of the local areas. These boards also encouraged participation of the various actors, including civil society organizations. While these boards are active, with a recent survey showing that over two thirds meet regularly (Perez 1998), DOH reports that they still are not run fully by the local governments and receive most of their funding from DOH.

In general, it appears that both the financing and delivery of local health services have been sustained or even improved since devolution. A 1994 World Bank study showed that financing provided for health services had either remained unchanged or improved in more than 90 percent of the Philippines' municipalities during the initial years of devolution (World Bank 1994). A DOH report describes the initial six years of devolution of the health sector as a period with a "marked improvement in the overall health and nutrition of the population" (Philippines Department of Health, 1998). A comparison of health statistics between 1992, when devolution had not fully taken place, and 1997, when it had been implemented for nearly five years, shows a marked increase

⁸ On the other hand, in January 1998, President Ramos indicated that he would support the retraction of devolution in the case of the Department of Social Welfare and Development. While he never signed the executive order, this idea still has some support in the Philippines today (Porio 1998).

in the number of pregnant women making at least three visits to a health center, as well as in the numbers of users of family planning and dental care (Perez 1998).

Although encouraging, these indicators should not be accepted uncritically. On the one hand, it is difficult to disentangle the effects of devolution from exogenous factors—including trend effects and other changes in public and private programs—that would influence the demand for, and provision of, prenatal care, family planning, and other health services. Moreover, Heaver and Hunt (1995) expressed the concern that devolution could maintain or even exacerbate the pre-devolution inequities in the provision of social services. In part, this could arise because local administrations in relatively poor regions have weak capacity for revenue generation. Devolution brings little benefit if health financing simply remains unchanged at an unacceptably low level.⁹ At the same time, devolution has left many decisions on the levels and types of social service provision to the often politically inspired whims of mayors and local councils. The anecdotal evidence of Heaver and Hunt indicates that there had been significant regional variability in the relative prioritization of social services vis-à-vis roads and other physical infrastructure. Within the health sector, priority has often been given to building new facilities rather than improving the quality of existing facilities. Since poor communities are likely to have the greatest need for social services, a central government role will continue to be appropriate to ensure minimal provision of essential services until such time as local governments can take on more of the financing burden.

In *agriculture* a number of problems were met in the first few years of devolution. In the case of personnel, the LGUs rejected a small number of the relocated central staff when it was thought that their transfer would lead to a duplication of personnel at the local level. Many of the devolved personnel also felt that their move to the LGUs meant the end of their

⁹ The point will be made again in Chapter VII in regard to the impact of decentralization on education in the Philippines and PRC.

careers, particularly as far as promotion was concerned.¹⁰ There is also a general shortage of funds for training, which was particularly dismaying to devolved personnel used to more plentiful funds at the central level.

On the program side, the unequal distribution of extension workers is a long-standing problem that has not been solved by devolution. In 1997, the National Capital Region accounted for 25 percent of all agricultural extension workers compared to just 9 percent in Region VI, which has the highest percentage of farmers and fishing communities in the Philippines (CCAMD 1997). The LGUs handle implementation but do not have any inputs into the agricultural planning and policy formulation process, which has been retained at the central level, often resulting in badly coordinated programs. Because a clear division of responsibilities has not been worked out, there is still overlap in the extension services provided by the central Department of Agriculture and the LGUs. The LGUs also receive inadequate technical support from the regional offices. This is due mainly to the very low budget allocation that the regional offices receive—just 6 percent of the total Department of Agriculture budget in 1997 (Razon-Abad 1998).

In the area of irrigation, the devolution of locally-funded communal irrigation projects also created problems, for it was found, after their transfer in 1992, that a number of them could not be completed. Even after the transfer of functions took place, some local governments and farmer groups continued to ask for central financial assistance (NIA 1995). This highlighted the fact that the respective roles of the central irrigation agency and the LGUs had neither been clearly defined nor adequately explained to farm communities (see Chapter V).

As *social affairs*—covering the welfare of children, youth, the elderly, and women; nutrition; and family

¹⁰ This applies to all devolved personnel irrespective of their department. While there are many opportunities for promotion at the central level, these are very limited in the LGUs, where the highest appointed positions are as municipal, city, or provincial administrators.

planning—had always been implemented at the community level, the devolution of the functions of the Department of Social Welfare and Development went fairly smoothly. However, there have been marked differences in the handling of these functions by different LGUs. Many of the revenue-poor LGUs were unable to create special service units and simply integrated social affairs into other existing agencies. For example, in Caloocan City, Metro Manila, social services were merged with agriculture and urban-industrial services. With no independent budget, social services suffered badly. Local budgets are also generally very limited, with the central offices retaining a disproportionate share of the overall resources (Porio 1998). On the positive side, some LGU social service units have established effective working relationships with community organizations and private business groups, providing them with additional resources. Some LGUs have also created programs that are very responsive to local needs, such as the Program for Preventing/Eliminating Child Labor in Lapu-Lapu City, Cebu.

Interactions between Government and Civil Society

The 1991 Local Government Code provided a prominent role for civil society. In this it had support from the 1987 Constitution, which stipulates that the State should encourage NGOs and community-based organizations that promote the welfare of the nation. The Constitution also stipulates that the State should respect the role of independent people's organizations (POs) in order to enable the people to pursue and protect their legitimate and collective interests. To do this, the State committed itself to the establishment of adequate consultative mechanisms.

To this end the Code specifically provided for NGO representation in various local bodies, including the local Development Councils, School and Health Boards, Peace and Order Councils, and Prequalification Bids and Awards Committees. The Code also provides an opening for NGOs to participate directly in local legislative bodies (*sangguniang bayan*)

by providing them the opportunity to determine the various sectoral groupings in such bodies. By 1998, more than 16,000 NGOs and POs throughout the country had been accredited for possible membership in these local bodies.

Many NGOs and POs have also come together through various formations and national coalitions to examine the provisions offered by the Code and to develop strategies to respond to them. One example is the National Coordinating Council on Local Governance that operated from 1993 to 1996. This served as an umbrella network for NGOs that developed, inter alia, advocacy strategies to implement fully the Code's provisions for NGO participation in local governance. In 1996, the Institute of Politics and Governance also served as the focal point for a number of NGOs in disseminating information and advocating NGO and PO interests, as well as heading the NGO/PO working group to review the Code.

Progress, Lingering Problems, and Prospects

The Local Government Code has now been in force for several years. It has been marked by many instances of success, but there have been problems as the Code was implemented. Some of these problems have been solved, but others still remain and present definite hindrances to full devolution. In aspects such as coordination and participation, good progress has been made. In the decentralization of finances and capacity building, progress is more mixed.

Intergovernmental cooperation. Vertical collaboration and cooperation has improved between the different levels of government—the provinces, cities, municipalities, and barangays. There has also been an increase in horizontal cooperation among local governments at the same level. Local officials have organized themselves into the Leagues of Vice Governors, Vice Mayors, Philippine Councilors, and the National Movement of Young Legislators, among others. Of late, they have consolidated their forces into the League of Leagues.

Local governments have also begun to take ownership of national programs, whereas before these programs were often seen as impositions by the national Government. Nonetheless, central government departments, including the DBM, DILG, and the Department of Justice (DOJ), continue to issue instructions that conflict with the autonomy intended by the Code. For example, although the Code authorizes local governments to issue licenses and permits to regulate legitimate activities, DOJ and DILG have in some instances issued contradictory instructions exempting activities from the need to secure local permits. For another, participation in seminars by local governments, even if funded locally, continues to be regulated by central authorities.

The Code has also led to positive steps in the areas of ***participation and local governance***. Over the past five years, various consultations have been undertaken by the NGO community to propose amendments to the Code and to study pending legislation on popular participation and electoral reform. Participation in local governance may have reached a plateau, however, considering that many local special bodies have not convened regularly, while elections for sectoral representatives have at times not been held. Slow progress in these and other areas has led to frustration among certain sectors of the NGO/PO community, leading to reexamination of the strategy for participating in local governance and to advocacy of further reforms at the local level to ensure that participation is meaningful. The NGO/PO community has entered into tactical alliances with other actors, such as the leagues of local governments, to advocate common causes.

LGUs were at the forefront of the push for decentralization well before the adoption of the Local Government Code. In the late 1980s, the LGUs began to organize themselves into strong advocacy groups that pressed for the enactment of a Code as mandated in the 1987 Constitution. More recently, various leagues of LGUs have emerged at the province, city, municipality, and barangay level, proposing major amendments to the Code, including reforms in the allocation of the IRA funds that would address the inequitable distribution and allocation of financial

resources. As provided for in the Code, these leagues have become a potent force in advocating the cause of local autonomy at the national level.

The leagues have resisted unfunded mandates (discussed below) that distort local planning and budgeting processes. They have also entered into strategic alliances with like-minded sectors of society, including the NGO/PO community. Some of the leagues are now able to fund and sustain secretariats that provide professional support and assistance to league members.

Budgeting and finance. In contrast to the encouraging, albeit incomplete, movement toward participation and local governance, progress in financial devolution has been slower. To back up decentralization, the Code had promised adequate financial resources, which in practice were not fully provided. Initially, there was certainly a significant increase in the local share of the Internal Revenue Allotment. This grew every year, rising from 9.4 billion pesos in 1991 to more than 71 billion pesos in 1997. Given this increased share, it was not unusual to see local government budgets triple and even quadruple. But this sum was still inadequate to cover the LGUs' costs of administering the newly decentralized functions as well as the costs of national government personnel devolved to them. A recent estimate of the deficit between LGU revenues and expenditures shows an annual gap of between 5 billion and 6 billion pesos (DILG 1998). Although increased funding is always desirable, it is not always feasible; the gap might also be reduced if there were a better allocation of funds by the individual LGUs.

While the IRA still constitutes the main source of the budgets of most lower-income municipalities, many local governments, especially at the provincial and municipal levels, find it inadequate to cover the costs of devolution. To address this, a recent effort was mounted by the interagency Oversight Committee to create a devolution adjustment fund. This fund would be carved out of the IRA allocations of local governments for possible redistribution to local governments based on their needs (Manila Bulletin 1998).

Hopefully, this initiative will begin to redress the problem of "unfunded mandates," whereby central government agencies

have continued to formulate and develop programs and projects at the national level, then instructed local governments to implement them—without financial support. Indeed, the countryside development funds and budgetary initiatives and insertions of many individual members of Congress are often larger than the budgets of entire provinces! In addition, many local governments have been unable to afford the salaries of national government personnel devolved to them. This has been particularly true in the health sector, where, as noted above, the local governments have been required to pay the upgraded salaries of devolved health workers according to a pay scale passed by Congress and considered by many local governments as yet another of the unfunded mandates that put local government budgets under considerable pressure.

National government institutions (executive and legislative) continue to dominate the allocation of financial resources in the politico-administrative system. Despite the devolution of responsibilities to local governments, budget allocations to national departments of health, agriculture, social services, and environment have actually grown over the past five years. The IRA, while indeed increasing the budgets of LGUs, constitutes only 14 percent of the national budget, the bulk of which is controlled by the national Government.

Fortunately, the Code encouraged the LGUs to go into business with the private sector and, where appropriate, to adapt private-sector strategies to generate resources, which began to occur in some LGUs after a few years. The LGUs also launched more vigorous tax collection campaigns to supplement locally generated resources. They have begun to explore borrowing from banks, both government and private, to finance local development efforts.¹¹ In addition, local governments have stepped up efforts to access funds from external sources, including Official Development Assistance, and to get their

¹¹ In practice, loans are usually obtained from the government banks, because this is where the LGUs deposit their funds. Private banks are reluctant to make loans to LGUs since they are forbidden to place a lien on local government deposits under the Local Government Code. In contrast, the public banks have an informal arrangement with the LGUs to take loan payments out of their accounts.

full share of revenue from natural resources located within their jurisdiction. They have also become more innovative in mobilizing local resources, including build-operate-transfer arrangements, joint ventures, and bond flotation.

Local capacity building. There is still a great deal to be done to build up the capacities of the LGUs. One of the major sources of concern before the implementation of decentralization was the perceived lack of capabilities among local government personnel. Efforts have been made to develop and implement various training and capacity-building programs to enhance the skills of individual local officials, ranging from general financial management to presiding over meetings and on to general techniques for preparing local legislation. While such individual skills are needed, “capacity building” should also enhance more broadly the capacities of local government institutions, structures, and processes. Moreover, specific assistance is desirable to encourage and enable local government to develop partnerships with the private sector, civil society, and international organizations. Enhancing their entrepreneurial abilities and developing their corporate powers as envisioned in the Code should be a key part of the capacity-building process.

National Support and Monitoring. Better support for decentralization is also needed at the central government level. The interagency Oversight Committee that should play a lead role in the process is severely hampered in its work by the lack of a secretariat with full-time staff. In addition, the legislated five-year review of decentralization has yet to take place; NGOs and the League of Local Governments are undertaking the main ongoing reviews of the decentralization. At one stage in 1996/97, the DILG did initiate a process of consultations on needed amendments to the Local Government Code. These amendments were proposed to the President in October 1997, but no action ensued.

Overall, the Local Government Code of 1991 provided the framework for the Philippines to decentralize selected central government functions to the local level. It transferred considerable powers to local communities in general, and to local governments in particular, to enable them to respond to the unique needs and

demands of their localities. As in Indonesia, the move has been crucial for the archipelagic Philippines, which is characterized by geographical, cultural, and economic diversity at various levels. There are still a number of problem areas to be dealt with, but given that the political impetus for devolution remains, devolution should eventually be fully implemented.

The PRC

The PRC represents quite a different example of decentralization from that seen in either Indonesia or the Philippines. Instead of the more formal and legalistic transfer of authority that has occurred in the Philippines and is underway in Indonesia, the PRC has undergone a process of de facto decentralization in the last two decades. In this process, there has been no national decentralization legislation such as Indonesia's Law on Regional Government or the Philippines' Local Government Code, but rather a series of decisions, relating primarily to the financial system, that have constituted a considerable transfer of power to local governments. Moreover, in taking steps to decentralize government revenues and expenditures first, with the responsibility for delivering public services following later, the PRC avoided some of the problems occurring in other countries where central governments have delegated the responsibility, but not the wherewithal, to local administrations.

In this process the PRC authorities appear to have taken an innovative experimental approach to implementing changes. Policies were tried out, sometimes on a large scale and making use of the vast size and diversity of the country; if not successful, such experiments were discarded. Thus, the PRC Government, after allowing local authorities to undertake social experiments, learned the appropriate lessons and then generalized from them.¹²

¹² The correct lessons were not always learned. Thus, collectivization in the 1950s, which in the beginning did lead to productivity growth, was quickly and wrongly generalized to the rest of the PRC during the Great Leap Forward, with disastrous results (J. Y. Lin 1990).

Decentralization from the 1950s Onward

Chapter II recounted how the frequent upheavals caused by the internal dissension in the top echelon of the PRC Communist Party had led by the late 1970s, on the eve of the Deng Xiaoping reforms, to the weakening of the central government organs. The PRC's organs of local government, however, had been increasing in strength. Despite these changes, the formal fiscal arrangements remained highly centralized, with the Center enjoying almost total control over the expenditures of local and provincial governments. Revenue-sharing contracts, under which the Center and local governments bargained over the share of revenues that were to be kept by the parties, were used by the Center to equalize income between rich and poor provinces, rather than to allow the local governments any decision making.

There had been various moves in the 1950s to reallocate revenues to the local governments. Decentralization measures in 1951, 1954, 1956, and 1958 all foreshadowed the later reforms of the 1970s and 1980s (Lardy 1975). After these moves, centralization was subsequently tightened again at two points, the first in 1961, due partially to the huge recession caused by the Great Leap Forward, and the second in the mid-1970s, when the Center regained control of the financial system after the upheavals of the 1966–76 Cultural Revolution. Thus, the financial reforms that began in the late 1970s need to be seen against the background of a highly centralized, if not overcentralized, system.

The first change came in 1977 with the introduction on a trial basis of a fiscal devolution program. This was based on contractual arrangements between the Center and the provinces and took place initially in two provinces, Jiangsu and Sichuan. In Jiangsu, for instance, a contractual arrangement was set up whereby it could retain 42 percent of all revenues, with total control over their disbursement. The main benefit of these contractual arrangements was that there was a clear division of responsibilities as well as of finances; from the central Government's point of view, its revenues were

guaranteed. From the perspective of provincial leaders, little was sacrificed in exchange for the financial autonomy they received; thus they wanted greater autonomy (Shirk 1993). The arrangements were also aimed at giving the provincial government incentives for local revenue generation and collection.

Also in 1977, ten provinces and municipalities directly administered by the State Council were selected for another experiment linking expenditure with revenue: local governments would retain a part of above-target revenue. This initially left the selected provinces with more revenues, but a large central budget deficit in 1979 led to cancellation of the arrangement.

The demand for reforming the financial system, however, remained strong. The top leaders saw that the delegation of powers (*fen zao chifan*, or eating out of separate kitchens) provided effective local incentives for collecting revenue and also stimulated economic growth.

Consequently, in 1980, additional changes were introduced that set up revenue-sharing formulas between the central and local governments. These differed from province to province, but with few exceptions had a five-year time span (Beijing's, Tianjin's, and Shanghai's formulas were on a year-to-year basis [Shirk 1993]). Under them, the central Government was responsible for major investment projects and the local governments were responsible for day day-to-day economic activities and the operation of the local administration. In the early 1980s, the formulas were adjusted to reflect the rapid economic and policy changes taking place. Finally, in 1983, most local governments, with the exception of a few large cities and the provinces of Guangdong and Fujian (Shirk 1993), changed to a uniform system whereby all local revenues were divided between the province and the Center.

A further change occurred in 1985, when tax reform took place. The effect of this was to make revenues shared between the central and local governments the main part of the budget. This, in turn, ensured that local governments had a strong incentive to vigorously collect shared revenues.

Impacts of the Recent Decentralization

Most of these adjustments, it appears, were at the expense of the Center, leaving it in a severely constrained financial position. Among many steps taken to deal with the situation, the Center handed over more and more responsibility to the provinces. These included price subsidies, housing and urban infrastructure construction, education, health, and many other budget items (Shirk 1993). Below the province level, counties became responsible for social services, particularly education, and for administration. Townships and villages became responsible for community-run schools (Wong 1997; West 1997). In health care, a county would run the general hospital(s), an epidemic prevention station, and a maternal and child health station, while the township or village would look after the small health center or health station.

The reforms induced provincial and local governments to use their enhanced financial resources to invest in development activities. They also provided local governments and State enterprises with economic incentives to improve efficiency and productivity. The success of the township and village enterprises (TVEs), described in Chapter II, was merely a spectacular example. Revenues raised from these investment activities, particularly the profits from TVEs, did not have to be shared with the central Government. Overall, fiscal decentralization thus became a major feature of the PRC's industrial as well as countryside reform.

While the high degree of fiscal decentralization appears attractive, there is no question that a price has been paid in terms of equality. Despite mechanisms at all levels of government to equalize fiscal burdens—e.g., higher revenue shares to be paid to the central Government in richer provinces and lower or even negative shares in poorer ones—considerable inequality has remained. In fields where quantitative measures of the output of public services are available, wide disparities exist. Thus, in Shandong in 1993, 83 percent of primary school graduates continued on to junior high schools, compared with

only 42 percent in poorer Guizhou province. Similar contrasts can be drawn using other measures such as teachers' academic credentials and school facilities (West 1997).

It also appears that as a result of fiscal decentralization, there was an overall decline in infrastructure investments, a lack of funds for agricultural research, and a drop in student enrollment in rural schools, particularly in senior high schools (Lin and Zhong 1996). In the case of infrastructure, a development indirectly related to decentralization—the decline of the communes—caused local governments to lose their power to mobilize rural labor without wage payment. With projects now requiring a local budget for materials and wages, local governments were able to undertake fewer projects and infrastructure deteriorated. Telecommunications services, for example, had seen rapid increases in the rural areas from the 1950s through 1978, after which investment declined considerably (Lin and Zhong 1996). The agricultural research and extension network built up in the 1950s and 1960s had worked well, but was seriously affected by the reduction in budgets above the county level, where local governments had to force the agricultural research institutes to become more self-supporting. In education, with funding now provided at the local level, there was less money for school construction and operating costs, and enrollments declined.

Overall, the central Government in the PRC has considerably reduced its role in local affairs, to the benefit of local governments. In addition to decentralizing government finances, it accomplished this by reorganizing the agricultural production system, lifting the mandatory quotas that farmers were expected to deliver to the State, and devolving power to local authorities. In many of these instances, the approach was experimental. When the agricultural production system was reorganized, the initial decision was taken almost surreptitiously by a few local authorities, who allowed the production teams to experiment with the new household responsibility system. In other cases, for example in the devolution of power to the local governments, the change resulted from bargaining in an explicit, and at times formally contracted, give-and-take manner.

That the local authorities (at various levels from provinces downward) were able to take such initiatives indicates that political power in the PRC was much more dispersed than generally thought. In its various policy initiatives, whether fiscal devolution, agricultural reform, or rules regarding the retention of profits by TVEs, the central Government had to negotiate constantly with other loci of power.

LESSONS LEARNED

The experiences with decentralization in these three countries and elsewhere in Asia provide interesting lessons that will apply in some degree to nearly any country undertaking the process:

- Full and continuous **political support** must be mobilized at all levels if decentralization is to be successful. In Indonesia, the early attempts to decentralize did not reflect such a commitment and the highly centralized Suharto Government took 18 years to begin implementing the 1974 decentralization legislation. In the Philippines, commitment has been firmer and decentralization is moving ahead.
- Once the decision is made to decentralize, governments should **move quickly**. In most countries, there is a momentum that needs to be capitalized on, as seen in the Philippines and Indonesia. While this may reduce detailed preparatory planning, experience has shown that teething problems can usually be resolved, perhaps with even better solutions, during the process of implementation. The dilemma of the simultaneous needs for urgency and caution in decentralization underscores the need for full political will and commitment to the long time frame required for it to succeed.
- **Clarity and precision** are needed in all enactments and in the devolution of responsibilities. The

differing interpretations in Indonesia on the sharing of development budget resources illustrate what can happen when the details are not carefully spelled out.

- Full **participation** of local governments, political leaders, and civil society is needed at all stages in carrying out decentralization policies. Local representatives know best the potentials and problems of their areas. A capable and well-functioning local government will only result from a fully participatory process that involves all stakeholders. This includes the public and private sectors, civic organizations, and NGOs. Democratization will obviously be complementary to decentralization by contributing to greater participation, accountability, and transparency by all concerned.
- The PRC presents the principal exception to the rule that decentralization involves **political as well as administrative and financial transfer of functions**. In general, if any one of these is left out, the process is constrained. In Indonesia, the lack of political decentralization in the Suharto era would certainly have hampered any decentralization that might otherwise have occurred. In the Reformasi Era, the political element is strong and its continuation will be critical to ensuring full local participation in and support for decentralized local governments.
- Adequate **financial resources** are needed. The decentralization experience in both the Philippines and Indonesia shows the process being undermined by lack of funding. But central governments simply do not have the funds or capacity to satisfy all needs. To raise additional resources, local governments must have the autonomy to tax and to mobilize the involvement of the private sector. They will also need freedom to borrow and to privatize, as in the Philippines and to a limited extent in Indonesia. Creative approaches must be sought to develop local

public-private partnerships and to exploit opportunities for coproduction between concerned stakeholders.

- Adequate **capacity** must be built up, and this takes time. While more capacity often exists at the local government level than is given credence by donors, local governments and institutions still need extensive support as they learn how to take on devolved functions. For this, the provision of appropriate training for relocated and existing local government staff is essential. Capacity will vary among local governments, so tailored approaches are also needed.
- Decentralization is **not an alternative to central authority**. A measure of each is needed. As noted in Chapter II, in any society, some functions—macroeconomic management, national finances, and the judiciary system (rules and many property rights)—need to be controlled at the central level, while others can be better performed locally. Although little comprehensive evidence exists, the scattered examples presented above suggest that decentralization may be associated with a decline in the quality, accessibility, and—among regions—the equity of rural services for agricultural research, irrigation, education, and health care. Inasmuch as the central Government will still be collecting most of the taxes in the country, it should pay close attention to this issue and design the revenue share-out to correct the inequality that would otherwise occur. In addition, the regulation of essential goods and services (regardless of how they are financed and provisioned) constitutes one of the comparative advantages of central Government, a point that will be returned to in the next four chapters.
- The difficulty of ensuring **accountability** also constitutes an important caveat about devolution. Devolution may appear to bring government “closer to the people,” but it does not automatically follow

that it will be more responsive. As is widely realized now, for governments to function well from the point of view of the people being ruled, there must be a vibrant civil society. And this must be mobilized not just to push through the devolution program, but also to keep an eye on the local government units when they are up and running. There are too many local governments (and not only in developing countries) that are venal and corrupt.

- Finally, greater *intergovernmental coordination* is desirable. Local governments are likely to experience many common problems in adjusting to decentralization. In the Philippines the various leagues of LGUs and local government officials are providing useful forums to review and articulate responses to the shared problems.

To conclude, some degree of decentralization is now an almost inevitable process in most developing countries as a result of the economic and social changes of the last two decades. The growing complexity of rural development dictates the need for more participatory governance. Nonetheless, the dangers of uncontrolled decentralization are real. Too many local governments borrowing funds indiscriminately or coming under the sway of particular groups can easily destabilize a national Government in any country. Thus, decentralization needs to move forward with caution.