



# MAKING DECENTRALIZATION WORK

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## REAPING THE REWARD AND MANAGING THE RISKS

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Draft for discussion

MAKING DECENTRALIZATION WORK: REAPING THE  
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(UNSFIR)

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# MAKING DECENTRALIZATION WORK: REAPING THE REWARDS AND MANAGING THE RISKS<sup>1</sup>

## 1. Introduction

Indonesia is moving with some haste towards decentralized governance.<sup>2</sup> If the current schedule is maintained, regional decentralization will take effect from 2001. The primary drivers in this process are two new laws (law no. 22/1999 and law no. 25/1999) that were approved by Parliament in April of this year. One of the units within the central government (*Menkowsabngpan*) has been entrusted with the task of completing all implementation legislation by October of this year. While the current legislative framework may well entail a historical transformation of centre-region relations, some external stakeholders and representatives of regional communities have raised concerns about the design of post-2000 decentralized governance. The key point is that unless such design problems are addressed, Indonesia could end up with destabilization rather than decentralization.<sup>3</sup>

The purpose of this paper is to identify the nature of these concerns and to find mechanisms that the donor community could employ to respond creatively to the challenges that are likely to emerge in this domain. This is a major service that it can

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<sup>1</sup> This paper is part of a project on 'Reconstructing Regional Policy in Post-Crisis Indonesia' that is funded by UNDP, New York. Helpful comments have been received from Satish Mishra, Luc Spykerelle, Michael Meadowcroft and Gabe Ferrazzi. Any remaining errors are, of course, the author's responsibility.

<sup>2</sup> It is customary in the literature to emphasize different forms of decentralization. The simplest is *deconcentration*, a process whereby the central ministries assign specific functions or duties to field offices in the regions. Both budgetary and administrative authority, however, lie with the central ministries. Then there is *delegation*, where local governments are given responsibility for implementing policies that are determined centrally. Finally, there is *devolution* that is a statutory transfer of authority and responsibility for specific sectors (health, education etc) to local governments. Manor (1999, chapter 1) makes the important distinction between decentralization per se and democratic decentralization. See Manor, J (1999) *The Political Economy of Democratic Decentralization*, Directions in Development Series, Washington D.C.: World Bank. In the case of democratic decentralization, the local government is accountable to its citizens through regular elections as well as through other mechanisms, such as a free press and a robust civil society. It follows that democratic decentralization is feasible only in a context of national democratic governance. Using these criteria, Indonesia has embarked on a transition to democratic decentralization.

<sup>3</sup> As the World Bank (1999: 107) notes: 'Successful decentralization improves the efficiency and responsiveness of the public sector while accomodating potentially explosive political forces. Unsuccessful decentralization threatens economic and political stability and disrupts the delivery of public services'. See World Bank (1999) *World Development Report*, Washington D.C: World Bank.

provide to the new government that is due to be formed towards the end of this year. Such a message builds on the basic premise that decentralized governance can engender lasting benefits, but this really depends on a well-conceived strategy of managing the risks inherent in the reconstruction of the highly centralized state that has characterized the Suharto regime.

In attempting an evaluation of the current design of decentralization, the paper draws heavily on the following sources:

- Ø Extensive interviews with representatives of central government ministries (Home Affairs, BAPPENAS) and representatives of the donor community in Jakarta (GTZ, Ford Foundation, World Bank, CIDA-Bappenas project)
- Ø Background paper and briefing session on decentralization organized by UNSFIR with representatives of central government ministries (Home Affairs, BAPPENAS, Ministry of Finance) and the donor community in Jakarta (GTZ, World Bank, CIDA-Bappenas project), representatives of the international media (FEER) and NGOs (sample size: 25)
- Ø Extensive interviews and briefing sessions with local stakeholders (Bappeda, Kanwil/Dinas offices, media, universities, NGOs, Kadin) in four provincial capitals stretching from Bali to Irian Jaya (sample size: 75)
- Ø Briefing session organized by DFID on regional decentralization as part of formulating their country assistance strategy
- Ø An internal decentralization strategy memo for UNDP prepared by an MIT-based consultant
- Ø Bilateral discussions with SMERU.

The sample on which the evaluation of the decentralization laws is based is admittedly rather small and highly selective, but it reflects perceptions of stakeholders who can influence the policy making and the implementation process. Nevertheless, the caveat needs to be made that the data are perceptual and not anchored in rigorous statistical analysis of large-scale observations.

The rest of the paper is organized as follows. Section 2 briefly identifies the political and fiscal imperatives driving the decentralization agenda in Indonesia. It notes that, despite the manifold weaknesses of the centralized system of governance under Suharto, its significant achievement was the ability to contain regional disparities through an equalization scheme. On the other hand, the widely shared view is that the system lacked fiscal sustainability. Furthermore, no future Indonesian government can afford to ignore the new era of regional assertiveness that has emerged in the post-Suharto era.

Sections 3 and 4 move on to a compilation of the evidence on wide-ranging concerns about the design of the decentralization package based on evaluations by both representatives of the donor community and regional communities. Section 5 suggests a holistic framework for dealing with these concerns, while Section 6 brings the different threads of the argument in a concluding summary.

## **2. Setting the context: the imperatives of decentralized governance**

The previous regime created a great deal of fiscal dependency of the regions on the centre. Almost 90 per cent of all domestic revenues were owned by the central government, while subnational units typically depended for 60 per cent of their spending on transfers from the central government. This was at odds with most large developing states – whether unitary or federal. The fiscal dependency of the regions on the centre led to the stifling of local initiative and enterprise, as well as waste and inefficiency in the use of public resources. It was widely regarded to be unsustainable with the end of the oil price boom. However, the key redeeming feature of centre-region fiscal relations was that transfers from the central government were mildly equalizing.<sup>4</sup> Some studies indicate that regional disparities (as measured in terms of per capita, non-oil income) were slowly converging in Indonesia over the 1973-1993 period, although the evidence after that is

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<sup>4</sup> The evidence is reviewed in Hill, H (1996) *The Indonesian Economy since 1966*, Cambridge: Cambridge University Press, chapter 11.

less certain.<sup>5</sup> All the provinces experienced significant improvements in human development indicators – although there are concerns in the domain of child undernutrition in some provinces.<sup>6</sup> It is widely acknowledged that regional disparities in Indonesia would have been much worse in the absence of fiscal transfers from the central government. Indeed, when compared with other geographically compact countries in the region, such as Thailand, Indonesia has a good record on regional disparities.<sup>7</sup>

With the fall of Suharto in the wake of the 1997 financial crisis, the heavy hand of the centralized state could no longer keep its firm hold on assertive regions. The UN-supervised ballot on independence for East Timor, the seemingly interminable problems in Aceh and persistent secessionist tendencies in Irian Jaya have entailed a potent political brew that the incumbent government – or any government - can no longer afford to ignore. Hence, the political imperative of maintaining national unity has cast its ubiquitous influence on the decentralization agenda. The government has tried to respond to this by formalizing revenue-sharing formulae from natural resources and by granting a great deal of Kabupaten-level autonomy. Are these initiatives adequate and appropriate either in maintaining national unity or in realizing the potential benefits entailed in regional decentralization? The answer is a ‘contingent’ yes, contingent in the sense that it depends crucially on revisiting the design of the decentralization package, on the process that is used for its dissemination and implementation and in ensuring that complementary strategies are in place.<sup>8</sup>

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<sup>5</sup> See Garcia, J.G. and Soelistianingsih, L (1998) ‘Why Do Differences in Provincial Incomes Persist in Indonesia’, *Bulletin of Indonesian Economic Studies*, Vol.34, No.1

<sup>6</sup> See World Bank (1996) *Indonesia: Dimensions of Growth*, May, Report No. 15383-IND, Washington D.C.: World Bank, chapter 4. The spatial imbalances in child malnutrition are highlighted by Daimon, T and Thorbecke, E (1999) ‘Mitigating the Social Impacts of the Indonesian Crisis: Lessons from the IDT Experience’, *mimeo*, Cornell University Press.

<sup>7</sup> See Hill, H (1999) ‘Regional Development in Southeast Asia: The Challenges of Sub-National Diversity’, *Journal of the Asia-Pacific Economy*, Vol.2, No.3

<sup>8</sup> An evaluation by James Alm and Roy Bahl for USAID also emphasizes the need to get the design of decentralization right, the need to ensure that implementation issues are resolved and the need for donors to play an enabling role in these areas. In particular, they argue the case for a ‘White Paper’ on decentralization. See Alms, J and Roy, B (1999) ‘Decentralization Indonesia: Problems and Prospects’, June, Jakarta.

### **3. Regional decentralization: preliminary evaluation by some external stakeholders.**

This section represents a summary of views culled from interactions with, and documents prepared by: GTZ, World Bank/IMF, CIDA-Bappenas project, DFID consultants, UNDP consultant, SMERU.

#### GTZ

1. The time given to the drafting team that crafted the two new laws was too short
2. There was no involvement of civil society. It was primarily an internal exercise in MOHA, although it did involve some prominent academics<sup>9</sup>
3. No attempt has been made to engage in any ‘socialization’ of the decentralization package, despite the fact that budgetary provisions were made for a public awareness campaign
4. Despite this, the laws generally represent a major improvement over the past
5. A critical achievement is the development of a framework that ensures that Kabupaten-level governance is subject to democratic accountability
6. The laws represent a case of ‘big bang’ decentralization, with huge authority vested in Kabupatens, including personnel management – although the latter is subject to the stipulation that national standards and norms should be met.
7. # 5, however, is causing a problem by creating conflict of interpretation among various parties in government
8. There is still vagueness in the distribution of functions between different layers of government. Unless this is resolved, the process of implementation will be seriously impaired

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<sup>9</sup> GTZ has consistently argued the need for a participatory approach to the implementation of decentralization. See, for example, GTZ (1997) *Discussion Paper on Key Issues in Decentralization and Regional Autonomy in Indonesia*, Jakarta

9. Given #7, the October deadline cannot be met. Since the new laws specify May, '99 as the recommended schedule for the completion of the implementation legislation, this 'fast-tracking' seems to reflect undue haste.

#### World Bank/IMF

The decentralization process is proceeding with undue haste. There is a case for going slow until complications surrounding the design of decentralization governance are resolved. Such a major initiative cannot be achieved by signing a 'few pieces of paper in Jakarta'. It needs wider dialogue among all pertinent stakeholders.

The World Bank, as well as the IMF, has concluded an initial evaluation of the current decentralization package.<sup>10</sup> The key findings are:

1. The 'fiscal balance' law (no.25/1999) requires the central government to devolve resources amounting to 1.2% of GDP to the regions in addition to existing transfers. Unless this is matched by concurrent expenditure decentralization, the law – if implemented in its current form – is vulnerable to the risk of increasing the central government deficit.
2. The risk also exists that local government will waste resources unless functions across different layers of government are carefully specified.
3. Only five resource-rich provinces will gain significantly: Riau, Aceh, Irian Jaya, East and Central Kalimantan. Given that these provinces have above-average per capita income, the revenue sharing component of the law will increase regional disparities.
4. A major challenge facing Indonesia is the time pressure needed for completing the decentralization. The decentralization agenda is massive and the 2 years given for full implementation may not be enough.

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<sup>10</sup> See World Bank, 'Decentralization without Destabilization', undated document circulated at DFID 'Information Exchange Session', August 24-26, 1999, Arya Duta Hotel, Jakarta. See also Ehtisham Ahmad et al (1999) *Indonesia: Decentralization – Managing the Risks*, Aide Memoir to the Minister of Finance, International Monetary Fund, Jakarta, June.

5. The outstanding issues, both short-run and medium-term, that need to be resolved are the following. First, expenditure assignments across different layers of government need to be defined clearly and comprehensively. Second, it is necessary to prepare for major movement of personnel and projects that will inevitably be unleashed as a result of decentralization. The management of this process is not easy and is plagued with political complications. Third, it is necessary to design an equalization grants scheme - ideally phased in over a three year period - in order to respond to the increase in regional disparities that are likely to be triggered by the sharing of resource revenues (see, once again, #3 above). It is vital to ensure that the equalization scheme works as a viable conflict resolution mechanism in the long run. Fourth, it is critical to provide clarity to the regional borrowing framework that is often the 'soft underbelly' of decentralization initiatives in other parts of the world. It is not clear who is going to be responsible in the central government for giving approval to regional borrowing, whether loans of regionally located state enterprises will form part of the regional borrowing framework, and what oversight mechanisms will be in force in order to track financial transactions between regional development banks and the local government. Finally, accountability of local governments ought to be improved through the clear specification of a local tax base (which the new laws have not accomplished), by transparent financial reporting and management supervised by the central government and by clear specification of land property rights at all levels of government.

#### CIDA-Bappenas project

1. In setting the global context to the decentralization agenda, one can distinguish between the mature federation models of the OECD countries and the centralized model of the developing economies. In the former, decentralization is much easier because it is recognized as an entitlement of regional communities. In the latter, it is much more difficult because it entails breaking up of the powers of a historically entrenched centralized state. Indonesia falls in the latter category.

2. Given #1, Indonesia can benefit enormously from the lessons that it can learn from the mistakes committed by other previously centralized states in developing countries in their quest to decentralize. One can refer to the case of Brazil where the fiscal crisis experienced by the state can be traced to the weakly specified regional borrowing framework that gave the latitude to the regions to engage in deficit financing. One can also highlight the case of Sri Lanka where fuzzy assignment of functions and funding has been a perennial source of conflict between different levels of government.
3. The international experience with decentralization can be used to understand – and anticipate – some design problems that are likely to plague the implementation of decentralized governance in Indonesia. These can be elaborated as follows.
  - Ø The two laws are not – as yet – fully synchronized.
  - Ø The functional assignments are not well spelt out, particularly for the central government.
  - Ø The split between policy-making functions and service delivery role of the government is not clear.
  - Ø More attention should be given to the specification of national standards and norms within which local governments have to operate.
  - Ø The regional borrowing framework has not been carefully thought out.

#### DFID Consultants

1. There is a huge task entailed in upgrading the analytical and implementation capacity of local governments – but with adequate resources and the right spirit it can be accomplished.
2. Second, there are some activities that – despite decentralization – are best dealt with at the national level

3. Third, there is a danger that decentralization, if not well managed, could become a case of a sad transition from 'central control to chaos'. More needs to be done in engaging local communities in the decentralization process; otherwise self-destructive rumours on both the intent and consequences of decentralization will fill the vacuum.
4. Democratic accountability of local government is critical in ensuring that decentralization works in bringing government closer to the people.
5. Given #4, village democracy is key and there is a need to reinvigorate the *Adat* system that has traditionally governed village administration.
6. In the past, centralized control has led to a flourishing of destructive local monopolies in the natural resource sector. Some conspicuous examples were the citrus monopoly in West Kalimantan, the government control of rattan exports, and the government control of sandalwood trade in NTT. Such excesses can be prevented from re-emerging in an era of decentralized governance, but only if it is democratically accountable
7. Despite these concerns, decentralization must proceed at full speed. Otherwise, the momentum will stall to the detriment of national unity.

#### UNDP Consultant on Decentralization

1. The government's stated ambition of having a full set of implementation regulations in place by the October deadline is completely unrealistic, although some solid progress can be made
2. There is an enormous problem of coordination in preparing the regulations and moving beyond them
3. Such a coordination problem emerges from complex and contentious inter-ministerial and inter-governmental relations regarding decentralization. These historically entrenched relations can be ignored by senior politicians and technocrats only at their own risk
4. There is abundant international experience suggesting that moving too fast and without adequate coordination can be enormously damaging to the cause of decentralization.

5. Indonesia has not considered relevant international experience on decentralized governance in any serious way.<sup>11</sup>

## SMERU

1. SMERU has been entrusted with the task of monitoring progress in the removal of domestic barriers to domestic trade within the framework of the IMF's Letter of Intent.
2. However, the goal of removing barriers to domestic trade is now under threat because the two new laws on decentralization have failed to specify a local tax base that is least inimical to the flow of goods, services and resources across regional borders.
3. By failing to reinforce the capacity of local governments in their quest to generate adequate revenues through clearly assigned local taxes, Bupatis in the various Kabupatens may well have the incentive to utilize their autonomy to re-impose all kinds of levies and charges within their jurisdiction to the detriment of one of the principal goals of the current reform agenda

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<sup>11</sup> Some very recent examples of excellent comparative studies include Blair (1999), Burki et al (1999), Manor (1999) and Loehr and Manasan (1999). Blair (1999) focuses on Bolivia, Honduras, Mali, the Philippines, Ukraine, and the Indian state of Karnataka. See Blair, H (1998) *Spreading Power to the Periphery: An Assessment of Democratic Local Governance*, USAID, Program and Operations, Assessment No. 21. Burki et al (1999) deals with 14 Latin American countries. See Burki, S.J., Guillermo, E. Perry, and Dillinger, W.R (1999) *Beyond the Center: Decentralizing the State*, World Bank Latin American and Caribbean Studies, Washington D.C.: World Bank. Loehr and Manasan (1999) deal with the case of the Philippines. See Loehr, W and Manasan, R (1999) *Fiscal Decentralization and Economic Efficiency: Measurement and Evaluation*, CAER II Discussion Paper no. 38, February, Cambridge, MA: Harvard Institute for International Development. Manor (1999) deals with a wide range of countries spanning South Asia and Africa. See Manor, J (1999) *The Political Economy of Democratic Decentralization*, Directions in Development Series, Washington D.C.: World Bank. The findings of these studies are generally lukewarm. They emphasize the modest gains that have been extracted from decentralization, but also highlight the downside risks along the lines noted in the discussion under section 2 in the text. A series of 'interim case studies' by the UNDP on decentralization focuses on a very micro-level and deals with one or two decentralized sites per country. The conclusions are generally positive, especially with respect to local participation and accountability. They can be downloaded from [http://magnet.undp.org/docs/dec/Case\\_Studies](http://magnet.undp.org/docs/dec/Case_Studies).

#### **4. Regional decentralization: feedback from some local stakeholders in four provincial capitals**

This section draws on perceptual data generated from bilateral interviews and multilateral discussions with a range of local stakeholders – Bappeda Tk 1, Dinas/Kanwil offices, media, universities, NGOs in four provincial capitals: Denpasar/Bali, Mataram/NTB, Ujung Pandang/South Sulawesi, Jayapura/Irian Jaya. In addition, the representatives of the private sector (Kadin) were contacted in two provinces (Ujung Pandang, Jaya pura). The field mission took place over two weeks (August 1 – August 14, 1999). A total of 75 stakeholders were involved. The discussion primarily focused on their evaluation of the decentralization laws. They were also specifically asked to comment on the consultation mechanism that took place both in the pre-approval and post-approval stages and the various strategies they were adopting – or planning to adopt - to respond to the new age of centre-region relations.

The key findings may be summarized as follows.<sup>12</sup>

### Denpasar/Bali

1. The two laws explicitly recognize revenue sharing on the basis of natural resources, but such recognition is not give to tourism and crafts which are the special characteristics of Bali. Hence, ‘Bali lost while the other provinces at least gained something’. The local media argues that the province needs 50% of tourism-related earnings to be returned to provincial coffers in order to fund all kinds of local development activities. The concerns expressed in #1 above were expressed in a position paper developed by an academic from Udayana University and formally conveyed by the Governor of Bali to the central government prior to the drafting of the decentralization laws.
2. A briefing session of the decentralization package was organized in Nusa Dua after the laws were approved. These concerns were revisited – but there has been no follow-up action since then.
3. The viability of Kabupaten-level autonomy depends crucially on capacity building at the local level – and this will take time to accomplish.
4. The focus on Kabupaten-level autonomy will worsen disparities between Kabupatens and intensify local rivalry.

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<sup>12</sup> At a recent conference held in Bali (September 14-17), INFID (The International NGO forum on Indonesian development) acknowledged the benefits of decentralization, but also noted that the ‘...recently approved legislation risks significant negative consequences if the process of formulation and implementation is not improved’. It observes (pp.3-4): ‘...Law no.22/99 on local government would decentralize the preponderance of government functions to the district (kabupaten level), where institutional capacity, accountability to local stakeholders, and mechanisms for cooperation across jurisdictions cannot be assumed to be in place. In the absence of these conditions, there is a risk that conflict over resources, corruption, military influence, and environmental degradation could continue or even increase with decentralization. In addition, law number 25/99 on fiscal decentralization presupposes a consensus that does not yet exist regarding the appropriate formula for allocating revenues across provinces. Differential gains and losses that would result from the proposed formula could potentially increase inter-regional tensions...The two new laws ...have moved forward quickly...but their has been no public consultation of their content. Due to these flaws in process, INFID calls on the government to suspend implementation of the decentralization laws. Instead the new government, in cooperation with civil society organizations, should initiate bottom-up planning and consensus-building process to revise the legislation, while investing in the development of local capacity and accountability mechanisms’. See INFID (1999), ‘International NGO forum on Indonesian Development Statement by the 12<sup>th</sup> INFID Conference, Bali, Indonesia, September 14-17. The author is grateful to GTZ for drawing attention to this paper.

5. The focus on Kabupaten-level autonomy could derail the goal of the development of ecologically friendly and sustainable tourism in Bali – a claim that was made by NGOs engaged in activities pertaining to the protection and management of the environment (such as Wisnu Foundation). This is because Bupatis may succumb to the temptation of unrestrained property development in order to extract short-term gains.
6. Provinces in Indonesia represent the boundaries that roughly coincide with regional identities. This issue of regional consciousness cannot be met by Kabupaten-level autonomy.
7. Local activists were adopting various strategies to deal with province-specific concerns on decentralization. These include: lobbying the new legislators to go for a ‘standstill’ on the decentralization movement in its current form, using the autonomy of DPRD to seek amendments to the implementation guidelines, lobbying for presidential decrees to override provisions in the new laws etc.<sup>13</sup>

#### Mataram/NTB

1. Bappeda Tk1 organized a briefing session on the decentralization package – but only 2 Kabupatens (out of the 7) were involved.
2. The local correspondent for the Jakarta Post – who also happened to be a key player of a local NGO – was disappointed at the extremely low level of public awareness in NTB on the fundamental changes that are likely to occur in local governance. He expressed regret that the local media simply has played the role of stimulating public discussion on this issue.
3. While the prevailing degree of disparities was not as high in NTB as in the case of Bali, Kabupaten-level autonomy may still cause fragmentation and intensify local

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<sup>13</sup> A report in the *Jakarta Post* (September 27, 1999 under the section ‘Across the Archipelago’) notes: ‘Community leader have urged the province’s newly elected regional representatives to the People’s Consultative Assembly to seek special status for the province to be granted...One of the main reasons for the proposal is financial. Bali faces a dilemma in its provincial budget. It earns little from natural resources, which could be claimed in a profit sharing arrangement with the central government. Most of Bali’s income is derived from its huge tourist industry’.

rivalry. Some Kabupatens will do well – such as Sumbawa with its gold mine – but others could suffer. This was the view of a high-profile local NGO.

4. Province-level coordination is required to deal with the issues stemming from # 3 above.
5. Bappeda Tk 1 realizes that it is not possible to decentralize all services to Kabupaten-level in NTB because of its particular characteristics. Co-ordination is required for dealing with resources (such as water management) that cut across local jurisdictions.
6. The Dinas offices (education and health) that were visited did not have a clear sense of their future role because of lack of adequate briefing on the new administrative arrangements and their functions.
7. A prominent NGO felt that it is necessary to develop a network of local stakeholders who can act as the voice for raising province-specific concerns pertaining to decentralization. The same respondent urged the idea of a national convention on decentralization.
8. The university academic – head of research – approved Kabupaten-level autonomy, but conceded that he has not followed the issues and was not aware of any rigorous evaluation being undertaken by any particular group in his university.

#### Ujung Pandang/South Sulawesi

1. The IEDDP project leader of UNDP maintained that she has been active in organizing, and participating, in a series of workshops and briefing sessions on regional decentralization.
2. The concern of the above respondent was that the two new laws are not synchronized, particularly because the planned decentralization of resources do not match the proposed decentralization of authority
3. In an open forum that was held in Bappeda Tk 1, the overall mood was that the briefing sessions on decentralization were for information only and not for genuine participation and discussion. One NGO participant in the forum quipped: ‘ we are asked to listen, not to participate’.

4. The notion of Kabupaten-level autonomy was regarded as unattainable in the short run, that is, within the time frame of the decentralization package. It was not enough to have authority unless it is backed by adequate resources and both analytical and implementation capacities.
5. In a forum that was held at the University of Hasanuddin, some academics were openly contemptuous of regional decentralization. One felt that it was a recreation of the system of public administration that prevailed under Dutch colonial rule. The point was made that Kabupaten-level autonomy failed to respect regional identity and consciousness that do not necessarily coincide with Kabupaten-level boundaries.
6. The group at University of Hasanuddin (11) drew attention to a document entitled 'Declarasi Manado'. This document entailed the joint declaration by Rectors of 17 Universities in Eastern Indonesia that was submitted to Habibie prior to the drafting of the two new laws and urging him not to embark on a major decentralization program until the formation of the new government.
7. The group at Hasanuddin also noted that decentralization is best seen as a long-term process. It should start at the province-level and, over time, can naturally evolve to the Kabupaten-level. A JICA expert based in Ujung Pandang also made this point. He emphasized that decentralization should be seen as a natural process of evolution rather than an artificially time-bound activity.
8. The local media representative supported the decentralization laws, but as the discussion evolved, noted that he had little or no knowledge of the details. He also noted that the local press has not played any discernible role in initiating a public discussion on decentralization.
9. The local Kadin noted that decentralization would only be useful to the private sector if it improves the business environment. Currently, a cumbersome licensing system means that it takes, on average, two years to start up a new business. It remains to be seen how issues of that nature are tackled under decentralized governance.

## Jaya Pura/Irian Jaya

1. The spokesperson for BAPPEDA Tk1 noted that no formal briefing sessions on decentralization of a broad-based participatory nature took place in Jaya pura.
2. In an open forum that was held at Bappeda Tk 1, one observer made the point – also affirmed by others – that it was difficult to take the decentralization package seriously. A transitional government has initiated it. If the new government is sufficiently different from the incumbent government, it may simply reverse the entire process. One will thus have to wait and see.
3. The university academic – Head of Research at the local state university - approved the notion of Kabupaten-level autonomy, but appeared more interested in discussing the proposal to divide Irian Jaya into three provinces. He was preoccupied with organizing a seminar on the proposal and noted that it was extremely unpopular in Irian Jaya.
4. The NGO representative was keen to talk about the separation of Irian Jaya from Indonesia (as was a Bappeda Tk 1 official) and felt that the decentralization laws were peripheral to this issue.
5. The representative of the local media also appeared to profess ignorance on the decentralization laws and far more keen to discuss the proposed division of Irian Jaya into multiple provinces. He noted that his magazine was acting as an open forum for discussing the pros and cons of this proposal.
6. The private sector representative from Kadin professed complete ignorance about the new laws, but made the general point that his organization was primarily concerned with improvements in the business environment and would find decentralization useful if it furthered that cause.

## **5. Responding to concerns pertaining to the design of decentralized governance: a proposed framework**

Clearly, the perceptual data – and formal evaluations by some organizations – indicate widespread concerns about the design of decentralized governance in Indonesia. These concerns reflect both general issues and problems pertaining to particular provinces. What is to be done? Admittedly, the data relies on a very small and highly selective sample, but it also captures views of actors who have the potential to influence both the policy-making and implementation process. The purpose of this section is to propose a holistic framework that would enable the UNDP – as a representative of the donor community – to respond creatively to the concerns pertaining to decentralization as a means of assisting the new government to achieve particular goals.

There are two approaches that one can adopt in moving the decentralization agenda forward – although they should be seen as part of a spectrum rather than as mutually exclusive entities. For ease of discussion, it would be useful to make a distinction between the ‘implementation’ approach and the ‘first principles’ approach. In the case of the former, the donor community accepts the basic design of the decentralization as given and seeks to move it forward incrementally by focusing on the details of implementation. In the second approach, an attempt is made to revisit the basic design from the perspective of ‘first principles’ either through a direct amendment of the two laws or a ‘de facto amendment’ through careful crafting of the implementing legislation. This section argues that it is the latter that is more appropriate, although it recognizes the challenge that it could be seen as disruptive and, even worse, politically contentious.

### **The ‘implementation’ approach**

The logic underpinning the ‘implementation’ approach can be expressed in two ways. First, the basic design is appropriate, although the details need to be worked out carefully. Second, the basic design is flawed – or insufficiently specified – but the donor

community accepts this as a political constraint simply because it is embedded in new laws. The objective then becomes a case of trying to make the best of a bad situation by assisting the government with implementation and making improvements at the margin.

Whatever the nature of the logic, the strategy entails technical assistance to the government in crafting implementation legislation and in capacity building at the local level. However, if the evidence that is assembled here is regarded as credible, then the concerns expressed about decentralized governance often impinge on fundamental issues and also reflect issues that are specific to certain provinces. These issues and province-specific concerns cannot be satisfactorily resolved simply by tinkering with the process of implementation.

The notion of accepting the current design of decentralized governance as *fait accompli*, despite its manifest flaws, is even less defensible. One could argue that a fundamental obligation of the donor community is to assist the Indonesian government in making the right policy choices in a spirit of partnership and frank and forthright dialogue. Such an obligation cannot be fulfilled if donor assistance to projects and programs occurs while harbouring the knowledge that these projects and programs may be moving in the wrong direction. The fact that laws are in place does not mean that they cannot be subject to amendments in some form or another; otherwise one could never make a case for constitutional amendments.

#### 'First principles' approach

The basic premise is that apprehensions about flaws in the architecture of decentralized governance are widespread enough to be taken seriously. Any strategy that encourages the government to revisit core issues may seem to be disruptive and may even be exploited by vested interests in reversing much-needed reforms in centre-region relations. These risks are real and should not be discounted, but the pay-offs of a strategy that encourages the government to constructively revisit issues in regional decentralization are

high. These pay-offs stem from avoiding mistakes that are likely to be costly to reverse and from reaping rewards that flow from a properly designed and well executed decentralization program.

The ‘first principles’ approach builds on the notion of a ‘new’ paradigm on centre-region relations that UNSFIR has suggested in a previous contribution (entitled the ‘social accord’).<sup>14</sup> The purpose of this ‘new’ paradigm is to provide the Indonesian government with an analytical device – and even an ideology - that it can use to move the decentralization agenda forward.

The following elements can form part of the proposed paradigm.

- A mission statement for decentralization that moves away from narrow fiscal concerns and re-focuses the initiative as a creative partnership between central and local governments for attaining a poverty-free Indonesia in the new millenium. Such a mission statement has at its core the notion of nationally mandated standards in human development that all regional communities are entitled to.
- An understanding of the notion that successful decentralization requires a shared vision of allocating functions across different layers of government. This can assist in resolving the persistent concern that there is considerable confusion over the assignment of functions to the local government. It might also assist in resolving the latent tension impinging on the relationship between Kabupatens and provinces.
- An understanding that successful decentralization requires the adoption of the ‘multiple instrument-multiple objectives’ framework rather than the ‘single instrument-multiple objectives’ framework. This can assist in resolving concerns pertaining to regional disparities, the fiscal consequences of decentralization, perceptions of poor analytical capacity at the local level, the possible resurgence of

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<sup>14</sup> UNSFIR (1999) ‘Regional Decentralization in Indonesia: Towards a Social Accord’, mimeo, July, Jakarta

barriers to domestic trade and more generally in understanding the painful trade-offs that can emerge under decentralized governance. Most importantly, this framework enables one to have a realistic appreciation of the benefits of decentralization.

- An understanding that successful decentralization requires the active engagement of regional communities both in forming a vision and overseeing its implementation. This can assist in resolving concerns that the decentralization laws in Indonesia have occurred in a context of insufficient consultation and participation.
- Using the vehicle of a national convention to disseminate the ‘new’ paradigm of decentralized governance. This should be regarded as a highly visible national event that crystallizes a set of low-key, behind-the-scenes initiatives in improving the design of decentralized governance in Indonesia. It can also be used as a vehicle that incorporates feedback from experts from other countries that have undertaken decentralization programs.

#### A proposed mission statement on decentralization

The fundamental goal of decentralization in Indonesia is to act as a key instrument for empowering local governments across the regional communities of this archipelagic state to eradicate – or at least alleviate – poverty and enhance human capabilities - or ‘human development’ as the UNDP prefers to call it. The primary role of the central government is to provide an enabling environment for local governments to reach their full potential as the custodian of poverty alleviation and human development programs. In this framework, the central government also plays a fundamental role by working with its regional partners to enunciate minimum human development standards to which all regional communities are entitled. The financing needs of regions and the critical policy interventions can then be derived once these key ideas are in place.

It should be emphasized that in promulgating the idea of regional entitlements in human development do not constrain the more dynamic regions to move ahead. The mandated national human development standards only set a floor below which regional communities should not fall. There is evidence that at least some provinces are thinking along these lines – at least that is the impression that UNSFIR has in its discussion with Bappeda Tk1 in South Sulawesi.

Another advantage of such a mission statement is that it enables policy-makers to de-link decentralization from becoming a perceived instrument for the ‘downsizing’ of government through civil service reform. Such an interpretation should be avoided as it is then cast in negative terms and it will unleash attempts to stall the process of decentralization. Civil service reform should proceed with or without decentralization. One should not ‘piggyback’ on the other. In any case, decentralization will directly affect the composition of the civil service, so that its overall size should be determined as a residual.

#### Shared vision of allocation of functions: towards a greater role for provinces in the decentralization package

What principle – or principles – should one use in assigning functions across different layers of government?<sup>15</sup> Critics of the current decentralization package argue that there is considerable confusion over this issue. One possible mechanism for engendering clarity is to focus on the transboundary dimension of activities and weigh this against the benefits that can be extracted from tailoring the delivery of public services to variations in local needs and preferences. Some functions/activities have large spillover effects that cut across local jurisdictions – others are more location-specific. A classic example is

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<sup>15</sup> In highlighting the economic principles for expenditure assignment to different layers of government, Gandhi (1995:45-46), draws attention to three points: the universal nature of the public service provided, economies of scale embedded in the activity being provided, and spillover effects that cut across local jurisdictions. In all such cases, the expenditure assignment belongs to the central government. See Gandhi, V (1995), ‘Intergovernmental Fiscal Relations and Economic Performance’ in Roy, J (ed) *Macroeconomic Management and Fiscal Decentralization*, Economic Development Institute Seminar Series, Washington D.C.: World Bank. In the discussion here, the three points raised by Gandhi are subsumed under the transboundary dimension of the functions of governments.

macroeconomic management whose benefits – and costs – flow to all Indonesians rather than a Kabupaten. Other examples include national standards and norms pertaining to, say, the protection and management of the environment that affect all Kabupatens throughout the archipelago rather a particular one. At the other extreme could be the services provided by a public health centre located in a Kabupaten in Irian Jaya. The benefits of such a centre are usually location-specific and are unlikely to flow in any significant scale to a Kabupaten in another province or even within the same province.

The point of emphasizing these examples is that greater the degree of the transboundary component of a function/activity, the more persuasive the case for coordinating this activity across local jurisdictions. This implies that such an activity ought to belong to higher, rather than lower, levels of government. Any strategy that devolves a lot of authority to Kabupatens, but pays insufficient attention to the transboundary component of different functions, is likely to cause coordination problems at a later stage.<sup>16</sup> In practice, perhaps the best strategy is to ‘unbundle’ the delivery of public services, such as basic health and education, in order to identify activities that exhibit high cross-border externalities and activities that are much more localized in terms of their potential benefits. This yields a much more complex ‘principal-agent relations’ between the centre

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<sup>16</sup> The analytical literature that explores the pros and cons of centralization and decentralization focus on the trade-off between transboundary externalities and heterogeneity of local preferences. Oates, in his well-known decentralization theorem, argued that in the absence of spillovers or cross-border externalities, decentralization is preferable. When spillovers are present, the appropriate level of government depends on weighing the benefits of harnessing cross-border externalities against the cost of a ‘one-size-fits’-all’ approach entailed in a centralized system that ignores local tastes and needs. See Oates, W (1972) *Fiscal Federalism*, New York: Harcourt Brace. Besley and Coates revisit these issues and show that a benevolent government even in a fully centralized state can resolve this trade-off. The argument is that a benevolent government would respect the diversity of local preferences and needs and at the same time optimally account for cross-border externalities. The case for decentralization would then have to rest on imperfections in the political institutions of the centralized state that inevitably emerge once the strong assumption of a benevolent government is relaxed. See Besley, T and Coate, S (1999) ‘Centralized vs Decentralized Provision of Local Public Goods’, *Working Paper no 7084*, Cambridge, MA: National Bureau of Economic Research. Those who have worked on a comparison of fiscal decentralization between developed and developing countries as well as transitional economies are not convinced that the efficiency case for decentralization is particularly relevant for the latter group of economies. As Bahl (1995: 75) observes: ‘... (T)he efficiency case for fiscal decentralization is much stronger in industrial than in developing or transition countries’. See Bahl, R (1995) ‘Comparative Federalism: Trends and Issues in the United States, Russia and China’ in Roy, J (ed) (1995) *Macroeconomic Management and Fiscal Decentralization*, Economic Development Institute Seminar Series, Washington D.C.: World Bank.

and the regions, where local governments are simultaneously ‘agents’ of the central government and principals in the provision of public services.<sup>17</sup>

The issue of coordination mechanisms also has a direct bearing on the concern that Kabupaten-level autonomy may cause fragmentation and intensify localized rivalry. This will in turn sour relations between the provincial layer and the Kabupatens because of insufficiently specified coordination mechanisms between the two levels of government. Under current legislation, Bupatis are accountable to both the central government and the DPRD II – leaving little, if any, room for the provincial-level administration to intervene. The central government could then be dragged into resolving these issues and inadvertently open the route for ‘back-door’ re-centralization.

In sum, interpreting the functions of government in terms of their transboundary dimension has the merit of clarifying the assignment of functions across different levels of government. It also means that the government will have to reconsider its strategy of making Kabupaten-level autonomy as its core focus. The alternative is a decentralization package that entails a much more significant coordinating role for the provincial government for dealing with cross-border issues within its domain.

There are, of course, uncomfortable political ramifications that stem from the above discussion. Given Indonesia’s constitutional specification of a unitary state, any attempt at strengthening the provincial government is seen as the thin end of the wedge towards federalism. Such a move is usually perceived as a move that could threaten national unity by formalizing the political power of restive provinces. These may be valid concerns, but a decentralization package driven by Kabupten-level autonomy is not the most effective vehicle for containing the assertiveness of provinces because it may be seen as a denial, or at least dilution, of their identities. Indeed, one could argue that the greater recognition of the role that provinces can play in mediating conflicts among Kabupatens may be more

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<sup>17</sup> This point is made forcefully in Burki et al (1999) and illustrated by using Latin American experience. See Burki, S.J., Perry, G.E. and Dillinger, W (1999) *Beyond the Center: Decentralizing the State*, World Bank Latin American and Carribean Studies, Washington D.C: World Bank

effective in maintaining national cohesion by formally recognizing the distinctive status of provinces in a regionally diverse country.

In sum, it is possible for a decentralization package to be federalist in spirit rather than in substance. More importantly, the notion of constitutional amendments in Indonesia that revisits the issue of the unitary state is now no longer taboo. If, over time, such a momentum for revisiting the constitution builds up, a decentralization package that recognizes the coordinating role that provinces can play in dealing with cross-border issues can provide very useful preparation for such a fundamental exercise. The role of the donor community is to anticipate this debate on the future of the unitary state in Indonesia and nurture an enabling environment in which public discourse can take place on the basis of knowledge and information rather than prejudice and ignorance.

The ‘multiple instruments-multiple objectives’ framework and its application to decentralized governance

There are two well-known rules that should be observed in designing policies. First, the number of objectives should be matched by a corresponding number of instruments. Second, the instruments selected should be appropriate to the objectives targeted. This in essence is the ‘multiple instruments-multiple objectives’ framework. It is very useful in understanding how to deal with policy trade-offs. Perhaps the most widely acknowledged application of this framework is the standard example of using monetary policy in an open economy. If a single instrument, in this case monetary policy, is used to simultaneously target exchange rate stability, price stability and full employment, it will not be able to accomplish this task: one will have to be forsaken to achieve the others. The solution is to find additional instruments that are appropriate to the objectives being pursued.

This logic can be fruitfully applied to the design of decentralized governance. Consider the issue of regional disparities.

The most appropriate instrument for dealing with regional disparities is an equalization grant scheme and, more generally, a viable conflict resolution mechanism. Decentralization of fiscal resources and administrative authority to local government per se and ‘leaving them alone’ cannot resolve the issue of regional disparities. Indeed, the problem will intensify as more dynamic local governments forge ahead of their weaker counterparts. The consequent movement of people and resources to the more dynamic regions may perpetuate the initial disparities. Such a problem can be addressed by an equalization scheme, but this scheme can also be applied under a centralized system. Indeed, one could argue that the reason why the highly centralized state under Suharto managed to contain regional cohesion can at least partly be explained by the fact that it did operate an equalization scheme – although not always successfully.

It is not surprising therefore, to realize that all well-designed decentralization initiatives need an equalization scheme as a core feature. Certainly, the decentralization laws in Indonesia have provisions for an equalization scheme, but it is defined in the broadest of terms. The design of an equalization scheme is also a fundamental political act and ought to be viewed in the context of a conflict resolution mechanism that is seen to be credible and the product of a consultation process with pertinent stakeholders. This is certainly a huge task and will take time to accomplish.

Another advantage of the ‘multiple objectives-multiple instruments framework’ is that it engenders realistic expectations on what decentralization can achieve. Ultimately, decentralization is only one of a range of instruments that can be used to engender sustained improvements in societal welfare. It thus requires complementary strategies in place before the potential benefits of decentralization can be fully achieved. Most importantly, it must not be regarded as a magic solution to regenerating sustainable growth in Indonesia. Indeed, there is evidence that decentralization has, at best, a mild impact on economic growth.<sup>18</sup>

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<sup>18</sup> Manor (1999:117) considers the impact of decentralization on rural development and asks: ‘Does decentralization facilitate growth in the agrarian economy?’ The answer: ‘On present evidence, we would expect it to have only a relatively modest role in either impeding or promoting growth’. This view is consistent with cross-country studies that estimate the sources of growth. Decentralization does not feature

The relevance of the ‘multiple objectives-multiple instruments’ framework can be replicated for a whole range of issues that impinge on the design of decentralized governance. Rather than going through a case-by-case illustration of the arguments, a summary in Table 1 captures the essence of the message being conveyed here.

Table 1: An application of the ‘multiple objectives-multiple instruments framework’ to decentralized governance

Objective	Instrument
Containing regional disparities	Equalization grants scheme within the context of conflict resolution mechanism
Accountability of local government	Democratic accountability at local level; financial reporting and management supervised by central govt
Capacity building at local level	Education, training and awareness program
Reduced barriers to domestic trade and competitive business environment	Non-distortionary local tax base; domestic competition policy/trade liberalization
Fiscal sustainability	Well-specified regional borrowing framework; well-specified spending responsibilities and revenue assignments

Engaging regional communities in the decentralization process: developing a regional network

Based on UNSFIR’s field mission, the overwhelming impression that one gets is of a lack of engagement of regional communities in the decentralization process, both at the pre-approval and post-approval stage of the new laws. The local media has generally been rather dormant in stimulating public awareness and debate. Attempts have been made by

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in any of these studies. See, for example, ADB (1997) *Emerging Asia: Changes and Challenges*, Manila. It is also worth going back to Manor (1999: 119) who ‘...seeks to lower the unrealistically high expectations of decentralization which have developed in certain quarters, lest they lead to unjustified disenchantment that could scuttle promising experiments’. See Manor, J (1999) *The Political Economy of Democratic Decentralization*, Directions in Development Series, Washington D.C.: World Bank

some local activists to influence the process at the pre-approval stage, but they have not been successful. Observers closely associated with the team that crafted the legislation and the team currently designing the implementation legislation acknowledge that the decentralization initiatives have taken place in a context of insufficient consultation with, and participation of, regional communities.

The evidence is persuasive that without active engagement of regional communities, the commitment to make decentralization work may be missing as a combination of ignorance, cynicism and deflated expectations take over. One way of responding to this emerging problem is to nurture and sustain a regional network of professional communities anchored in selected regional universities. They seem to have good links with the local bureaucracy, civil society and the local media. Some groups within these universities have taken initiatives to forge links with DPRD as well as to assist them in capacity building. The idea is to tap the collective intellectual energy that resides in the provinces to the point where a regional network of professional communities can provide leadership in pushing the decentralization agenda forward. This can happen in number of ways: through peer review of the current design from the perspective of region-specific concerns; recommendations for improvements; assisting in capacity building of local bureaucracy and the DPRD; stimulating public debate on, and awareness of, decentralized governance and generally engaging in advocacy role for good governance.<sup>19</sup>

#### Legitimizing the ‘new’ paradigm of decentralized governance: towards a national convention

The idea of a national convention was apparently raised within the team responsible for guiding the decentralization, but was subsequently shelved. The symbolic value of a highly visible national event that ‘showcases’ the benefits of well-designed decentralized

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<sup>19</sup> Blair (1998) offers a cogent account of how democratic accountability of local government depends on a variety of local actors working together, not just the locally elected representatives. See Blair, H (1998) *Spreading Power to the Periphery: An Assessment of Democratic Local Governance*, USAID Program and Operations, Assessment Report No.21

governance cannot be dismissed. It will represent a crystallization of low-key, behind-the-scenes initiatives in moving a major reform agenda forward. It will provide a credible forum for sharing province-specific concerns and international experiences pertaining to the reform of centre-region relations. It is an event that deserves support by the donor community, but ultimately it ought to be staged by Indonesians for Indonesians. The donor community then acts as a cheerleader on the sidelines. The key central ministries (MOHA, MOF, Bappenas) should lead the proposed national convention in partnership with representatives of regional communities. It could be staged soon after the formation of a new government and repeated as a mid-term review. Table 2 identifies the salient features of the proposed national convention.

Table 2 : Salient features of a proposed national convention on decentralization

- The proposed convention could be held twice – at the start of a new government followed by a mid-term review
  - Government produces a ‘state of the provinces’ survey of key issues and challenges facing the implementation of decentralized governance in partnership with provinces and *kabutpatens*
  - Deliberations proceed on the basis of the ‘information blueprint’ generated above
  - Development of statement of entitlements of regional communities based on nationally mandated human development standards
  - Standards guide identification of financing needs of local government, identification of critical policy interventions and strategic framework for implementation
  - Revisiting standards and strategies during mid-term review
  - Convention also a forum for sharing international experiences on decentralization
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## **6. Concluding comments**

Indonesia is moving with some speed towards a major transformation of centre-region relations. This appears to be a significant break with a historically entrenched centralized state. The new form of decentralized governance that is scheduled to emerge in 2001 has

not inspired as much excitement as one would have expected – at least among some quarters.

There are wide ranging concerns among some external stakeholders and representatives of regional communities about the design of the decentralization package, the process in which it has been conceived and the manner of its implementation. It appears that the team that crafted the administrative decentralization law primarily conducted it as an in-house exercise with insufficient engagement of regional communities. Concerns have been expressed that the schedule of transition to the new system is too hasty. There is a perceived lack of legitimacy about the process. This is because a government that is regarded by some Indonesians as a transitional government lacking credibility and popularity has crafted the laws. There appear to be coordination problems among ministries. There are unresolved questions about the relationship between Kabupatens and provinces and the view that Kabupaten-level autonomy could trigger fragmentation and localized rivalry. There is a predicted increase in regional disparities, concerns about the fiscal sustainability of the program, fears about a resurgence of barriers to domestic trade and the suspicion that Indonesia has paid insufficient attention to lessons of international experience in regional decentralization.

Evidence from a field mission to four provincial capitals indicates low public awareness of the initiatives in decentralization. Representatives of regional communities have expressed concern that province-specific concerns have been overlooked. This in turn has bred cynicism and deflated expectations that could prove counterproductive in making decentralization work.

This paper takes the view that the apprehensions pertaining to the evaluation of the design of decentralization are broad enough to be taken seriously. From the perspective of the donor community, support for the decentralization movement should adopt a ‘first principles’ approach rather than an ‘implementation’ approach. The former sees the need to revisit the design of regional decentralization; the latter seeks to make improvements at the margin by focusing on implementation details. The risks of adopting a ‘first

principles' approach are that it could be seen as disruptive and as political interference with the mandate of the current government. Under such circumstances, the concerns raised here could be abused by vested interests in reversing the decentralization process. The pay-offs of adopting such an approach are that they can avoid costly mistakes and consolidate potential gains that follow from a well-designed, well-executed decentralization program.

As a means of encouraging the government to revisit the design of decentralized governance, the paper has suggested the dissemination of a 'new' paradigm of decentralized governance that shifts attention away from a preoccupation with fiscal and short-term political issues. This paradigm – entitled as the social accord – conceptualizes decentralization as a creative partnership of central and local government in order to attain a poverty-free Indonesia in the new millenium. This paradigm urges the adoption of minimum human development standards to which regional communities are entitled. It argues for a shared vision of allocation of functions across different layers of government. It encourages a focus on a 'multiple objectives-multiple instruments' framework in order to deal with policy-trade offs under decentralization and to engender realistic expectations on what decentralization can deliver. It promotes the cause of an active engagement of regional communities in the decentralization process and highlights the symbolic value of a national convention that will crystallize a wide range of initiatives in improving the current design of decentralized governance.

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