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Staying the Course: AusAID's Governance Performance in Indonesia

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Table of Contents

ADB	Asian Development Bank
AFP	Australian Federal Police
APS	Australian Public Service
AusAID	Australian Agency for International Development
AUSTRAC	Australia's Anti-Money Laundering Agency
BPK	Indonesian Audit Board
CJC	Queensland's Criminal Justice Commission
BPKP	Agency for the Supervision of Finance and Development
DGT	Directorate-General of Tax, Ministry of Finance
DPR	Indonesian Parliament
FATF	Financial Action Task Force
GDP	Gross Domestic Product
GNI	Gross National Income
IBRA	Indonesian Bank Reconstruction Agency
ICAC	New South Wales Independent Commission Against Corruption
IMF	International Monetary Fund
JCLEC	Jakarta Centre for Law Enforcement Cooperation (JCLEC)
JI	Jema'ah Islamiyah
KPK	Anti-Corruption Commission
LAKIP	Public Sector Agency Accountability Reporting
LRP	Legal Reform Program
MGU	State Banks Monitoring and Governance Unit, Ministry of Finance
MOF	Ministry of Finance
NGO	Non-Government Organisation
OECD	Organisation for Economic Cooperation and Development
PENSA	Program for Eastern Indonesia SME Assistance
PKI	Indonesian Communist Party
PPATK	Centre for Reporting and Analysis of Financial Transactions
SBI	Bank Indonesia Certificate
TAMF	Technical Assistance Management Facility

This paper examines the effectiveness of Australian aid in serving Australia's national interests in Indonesia, at a time when Australia's regional environment is less favourable than it has been for 30 years. Events over the past three years have starkly demonstrated that the most direct threats to Australia's security come through or derive from an Indonesia weakened by economic crisis and poor governance since 1998.

In 1999, Australia was involved in military action against Indonesia in East Timor. In 2001, a wave of boats departed Indonesia carrying illegal immigrants that the Australian Government did not want to accept. One hundred and eighty died in the sinking of the SIEV-X. The Jema'ah Islamiyah network, while relatively small in numbers, operates in Indonesia and has linked up to networks outside Indonesia. It was responsible for the death of 88 Australians in the Bali bombings of October 2002.On 9 September last year, terrorists detonated a massive truck bomb outside the Australian embassy in central Jakarta.

These emerging threats to both Australian and Indonesian interests are best met by a more effective Indonesian Government that is able both to deliver growing economic opportunity to its people and combat terrorism and transnational crime.

On Boxing Day, last year, Indonesia's restive Aceh province was devastated by a tsunami. Australia's aid program to Indonesia now is much larger and more central to the bilateral relationship, yet many of its structural problems still need to be addressed. The tsunami that hit Aceh on 26 December 2004 boosted Australia's aid commitment to Indonesia putting new strains on AusAID and its operations in Indonesia. The problems identified in this report, written before the tsunami tragedy, are now even more pressing.

Australian Government and AusAID policy statements show that aid policy is being reshaped to face these new realities. Good governance is now the primary goal of Australian aid policy. Support for strengthening the capacity of the security services of the region has become a high priority. Funding is beginning to match these priorities. AusAID has developed good guidelines for its own governance assistance.

While Australian Government and AusAID policy statements appear to respond to these new threats and challenges, AusAID itself is not delivering governance aid of a quality that meets the challenges. The successes and failures of Australian governance interventions in

Indonesia analysed in the case studies in Section 3 indicate that three ingredients are critical to success:

- Commitment of adequate time and resources to achieve a sustainable result
- The right people with the right knowledge in AusAID and among its contractors and sub-contractors
- Proper diagnosis of development problems and their causes, so that aid is not wasted.

AusAID is not solely responsible for the weaknesses and problems identified in this paper. A number result from Government neglect of AusAID. AusAID's own operational funding base needs to increase as the aid program expands, not decrease as it does at the moment. With its inadequate funding from Government, AusAID cannot be the professional effective body it should be.

Government too is responsible for the proliferation of aid programs to meet political imperatives and to satisfy Australian domestic interests.

The successes identified in the case studies reflect commitment from Australian Government agencies other than AusAID which have a clear mission based in the national interest and which use their own staff in aid delivery. AusAID needs to develop the same sense of commitment and mission in delivering AusAID programs.

Five recommendations for improving the delivery of Australian assistance, based on the case studies, emerge from this paper. They are:

1. Refocus AusAID's Indonesia program for greater impact for both countries
2. Allocate adequate time and resources to AusAID governance interventions
3. Expand and deepen AusAID's knowledge base
4. Improve AusAID design, delivery and evaluation of aid
5. Strengthen AusAID's funding base.

Nothing could be more positive for Australia's national interests than a stable, democratic Indonesia; an Indonesia able to ensure peace and safety for its citizens, deliver growth and prosperity, control its own borders, and play its proper role in building regional security.

These economic and strategic objectives can only be built on strong, sustained, long-term improvement in the quality of government in Indonesia itself. As the case studies show, Australian aid can make a difference in achieving these objectives.

Before the Asian financial crisis, Indonesia was considered an economic miracle. A combination of good policies and strong political direction transformed Indonesia over 30 years. Per capita incomes rose strongly and poverty fell sharply in this period – fundamental goals of effective development:

> "The Indonesia of the mid-1990s is almost unrecognizable in comparison with that of the 1960s. From the despair of the earlier period, the new regime was able to engineer an amazingly rapid recovery…
>
> By the late 1980s Indonesia was being classified among the select group of developing countries destined shortly to become newly industrialized economies, following the successful path of Asia's outward-looking industrial economies."[1]

Progress was achieved not only in the economy. All social indicators showed dramatic improvement in this period. Poverty fell sharply. The one blight was the authoritarianism of the regime and its abuse of human rights, which ultimately contributed to Soeharto's downfall on 21 May 1998. The following crisis derailed Indonesia's economic and social progress of thirty years to the status of a newly industrialised economy. The outlook now for the economy, welfare, poverty reduction and human security is at best mixed.

Good macroeconomic data and fiscal management

The main macroeconomic indicators show positive trends. Bank Indonesia interest rates were still trending well in early 2005 – in February the one month SBI rate remained at 7.56% despite growing inflationary pressures. The $US/Rupiah exchange rate has been relatively stable, except for the election period. Foreign exchange reserves are strong at around $US 35 billion.

The budgeted deficit for 2004 is 1.2% of projected GDP, maintaining a downward trend since 2000 under the stewardship of the President Megawati Soekarnoputri's Minister for Finance, Boediono. His replacement, Jusuf Anwar, has promised to maintain Indonesia's impressive fiscal consolidation program. Recently, the new Indonesian government took the politically fraught decision to slash fuel subsidies causing a 29% spike in fuel prices. Government debt

[1] p.3 Hal Hill, "The Indonesian Economy Since 1966", Cambridge University Press, 1996

continues to trend downwards. In 2004, it will reach 60% of GDP, down from 77% in 2002 and over 100% in 1998/1999 at the beginning of the crisis.

But debt servicing will be a major cost to the Government for the whole of this decade. Domestic debt servicing takes up 12% of the 2004 Budget, external debt servicing 7%. With the end of the IMF Agreement with the Government, repayment of IMF lending will be a significant call on the Budget until 2009. But these demands, with continued good Government control of the deficit, are manageable.

The contrary signs…

The outlook is not uniformly positive. Banks are not able to play an effective role in promoting domestic investment. Depositors, still uncertain of the banking system, prefer to deposit their money for one month only. While most banks are quite liquid, their on-lending is well below loan to deposit ratios in the rest of Asia. Investment interest rates are still in the 14 to 16% range.

A messy democracy and decentralisation of power to over 400 regional governments have replaced the authoritarianism of the Soeharto era. Corruption, as a result, has proliferated at all levels of government. The legal system is profoundly weak. As a result, Indonesia remains one of the poorest performing economies in Asia in terms of attracting foreign direct investment. In 2004, there was a net investment outflow from Indonesia.

Weak investment and the absence of strong fiscal stimulus will leave consumption as the main driver of growth this year. In 2004, consumption was particularly strong as political parties and candidates spend on all the accoutrements of political campaigns in Indonesia from t-shirts, to radio and TV advertising, to rent-a-crowds. Growth was stuck at around 4-5% in 2004.

In the words of economist Faisal Basri, Indonesia suffered a "serious stroke" in 1997/1998[2]. This stroke victim is now dressing well – the well-pressed macroeconomic dark suit and strong red tie. But he shuffles as he moves, revealing an array of problems:

- Weak, unresponsive Government institutions
- Corruption
- Low tax take

[2] Presentation on the political and economic outlook for Indonesia 2004, Puri Consulting, J W Marriott Hotel, 20 January 2004

- Inadequate infrastructure development
- A weak legal system creating investor uncertainty.

The result is that Indonesia's output has still not returned to pre-crisis levels and it is beginning to lag behind competitors in the Asian region. In the 2003-2005 period, East Asia is predicted to grow 6.5%, South Asia 5.4%, both outperforming Indonesia.

Governance in Indonesia

Indonesia is one of most corrupt countries in the world. In Transparency International's Corruption Perceptions Index 2003, Indonesia ranked 122, tied with Kenya, out of 133 countries surveyed (the lower the ranking, the more corrupt the country). Corruption permeates the civilian, Police and military arms of Government and severely weakens their capacity to deliver security, justice and a satisfactory livelihood to Indonesians.

The Government's capacity to deliver better services to its citizens is severely circumscribed by its own funding base. Revenue from non-oil and -gas taxes is a low 13% of GDP as against up to 17% in comparable regional developing countries. Collusion between tax officers and taxpayers and the failure of an unfocused and corrupt tax bureaucracy to expand the tax base are the reasons.

The funds that the Government does allocate to health, education and public security are siphoned off throughout the bureaucracy as they trickle out to their intended destinations. The external auditor of the Indonesian Government, the BPK, estimates that up to 30% of the Government's Budget is regularly misused or mismanaged each year[3]. 74% of the Government's own rice distribution program for the most disadvantaged in 2003 went to those classified as not poor[4]. With its present quality of governance, Indonesia cannot provide adequate essential services to its citizens.

Long-term question marks

While poor governance constrains the quality and volume of services that can be delivered to citizens, the projected annual growth of 4-5% for this year is itself insufficient to absorb all new entrants into the workforce. Open unemployment is now at 10% of the workforce and will continue to grow slowly over the decade while growth is stuck in the 4-5% range. Formal employment, which guarantees at least the provincial minimum wage and basic

[3] Interview with the Chairman, BPK
[4] p.62, World Bank CGI Brief, December 2003

employment and severance conditions, is shrinking as previous staples of industry such as electronics and clothing, textiles and footwear close in the face of increasingly stiff competition from China in particular. The unemployed and those forced out of the formal sector are compelled to find whatever employment they can for whatever payment they can secure.

The inevitable result will be a steady rise over the decade in the number of Indonesians below the official poverty line, which is set very low. The greatest rise will occur in the cities. At present, 18% are counted as being below the poverty line. Another 30% of the population lives close to the poverty line. They will be increasingly vulnerable to the longer-term consequences of the predicted sustained stagnation in economic growth.

If growth in the Indonesian economy remains flat over the rest of this decade, if Government services cannot be improved through better governance, the declining economic opportunity for increasing numbers of Indonesians could become fertile ground for a future resurgence in radical politics. With the ruthless destruction of the Indonesian Communist Party (PKI) in 1966 and the continued ban on it since then, communism and radicalism from the Left are unlikely to re-emerge. Islamic radicalism, never totally eliminated by Soeharto as was communism, is a much more likely vehicle for future economic discontent.

Human security

After the fall of Soeharto, Indonesia's security forces lacked the will to tackle the Muslim terrorist threat out of a fear of being condemned for human rights abuse. Intelligence networks withered. Some elements in the military supported Muslim extremist groups like *Laskar Jihad*. Soldiers sometimes supported co-religionists on both sides of the Maluku religious war. Muslim extremists, including Abubakar Ba'asyir, who had fled Soeharto's Indonesia, returned and melted back into society. The chaotic Gus Dur Government, itself at loggerheads with the Armed Forces leadership, could not provide the required political will and direction to the Police and Armed Forces.

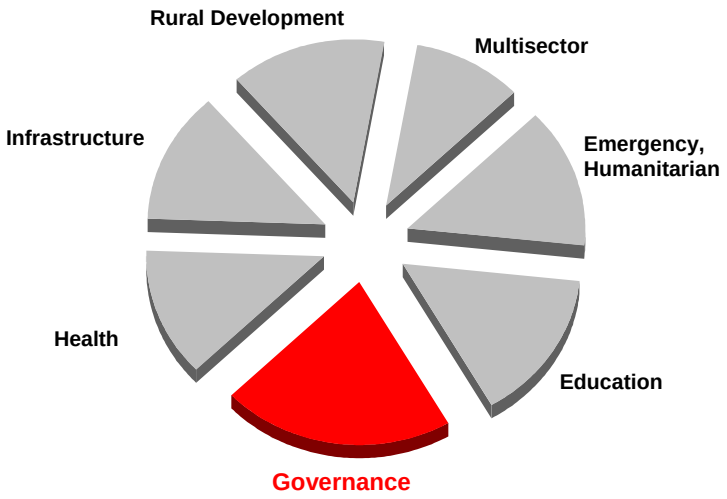
By 2000, the state of governance in Indonesia's security apparatus had reached a dangerous low point. Many of the same individuals involved in the 2002 Bali bombings were involved in the church bombings on Christmas Eve 2000, which killed 36 Indonesians. These bombings, however, were not pursued effectively. Only after the Bali bombings were this history and detailed evidence uncovered and acted on.

Four years after the Christmas Eve bombings of 2000, major security challenges still lie ahead of the Indonesian Government. In addition to the continuing threat of terrorism and recurring violence in Maluku, Central Sulawesi and Papua, armed conflict continues in tsunami-affected Aceh. To achieve sustainable, democratically based solutions to these challenges, the Government must continue developing civilian control and direction of the Armed Forces and Police, modernising the security and intelligence apparatuses and their systems, improving intelligence gathering, developing modern management skills, and creating a culture of serving rather than dictating to the people.

All this adds up to enormous governance challenges in the economic, political and security fields. Indonesia's return to a high growth path that can help its escape from the growing poverty trap in which it finds itself is highly dependent on overcoming the governance weaknesses that have opened up and proliferated since the fall of Soeharto. Growing concerns with Indonesia's governance problems in Australia and beyond are reflected in strategic changes to Australian development assistance that prioritise governance aid and the international relief welcoming the election of Susilo Bambang Yudhoyono as Indonesian President. The ability to follow through on these strategic changes is one of AusAID's greatest challenges, with Indonesia the most important recipient country.

Australia's planned development assistance in 2003-2004 totalled $A 1.894 billion. Governance comprises the largest proportion of this aid – 21% in 2003-2004.

Estimated sectoral breakdown of Australian aid 2003-04[5]



AusAID Note: 'Multisector' includes direct expenditure on areas such as gender, environment and food security

The Australian Government's 2004-2005 Budget proposes an aid budget of $A 2.133 billion. In 2004-2005, aid for improving governance is projected to rise to a new high of 33% of Australian aid, by far the largest component of the aid budget.

That governance receives the largest – and still growing – share of non-tsunami related Australian aid reflects the thrust of the Government's September 2002 statement on aid policy, "Investing in Growth, Stability and Prosperity" and the emphasis this Statement places on the role of governance in achieving the aims of Australia's aid:

[5] p.3 Australia's Overseas Aid Program 2003-04,Budget Statement by The Honourable Alexander Downer MP, 13 May 2003
AusAID Note: 'Multisector' includes direct expenditure on areas such as gender, environment and food security

> "The single objective established for the Australian aid program in *Better Aid for a Better Future* will remain: To advance Australia's national interest by assisting developing countries to reduce poverty and achieve sustainable development.
>
> The Statement reinforces the aid program's focus on assisting developing countries in the Asia Pacific, for both developmental and national interest reasons. It also emphasises the critical importance of good governance as the basis for successful poverty reduction.
>
> Governance cuts across all elements of the international development agenda, and underpins all of our aid investments."

AusAID's governance assistance to Indonesia

At Attachment A is a complete list of the components of Australian aid to Indonesia in the 2003-2004 financial year. This list is extensive. There was a total of 44 individual activities in the 2003-2004 financial year.

Of the $A120 million in bilateral Australian aid to be provided to Indonesia in 2003-2004, AusAID estimated that 18% would be spent on improving governance. This share was dispersed among a large number of medium-sized and small activities:

economic reform

- Indonesian debt (bond) management project
- Technical advisory management facility (TAMF)
- Program for Eastern Indonesia SME assistance (PENSA)
- Government sector linkages program

civil and legal governance

- Legal Reform Program
- Australian community development & civil society strengthening scheme (ACCESS)
- Civil society organizations – interim fund
- 2004 electoral reform support
- Partnership for governance reform

- Australian Volunteers International
- Australian Youth Ambassadors development program
- SMERU research institute[6]

Forty-four separate activities in Indonesia, twelve of them governance-related, represent too wide a dispersal of AusAID funding and effort among too many activities. It imposes an impossible administrative and intellectual burden on AusAID staff. It is doubtful that sufficient Australian contractor expertise of the necessary quality exists to properly service this extensive range of activities. The $1 billion tsunami package will test these stretched resources even more.

A questionable diversion into Islamic education

AusAID's scattergun allocation of the available funds to an excessive number of activities for the most part does not reflect Indonesian needs but rather the accommodation of aid fads and the Government's political and other interests in Australia. There may be a well-meaning attempt by AusAID to 'try out' ideas and options that present themselves. The result is an overall aid program in Indonesia lacking in coherence, credibility and impact.

Political intervention is a factor. In a knee-jerk reaction to the discovery that the core of the Bali bombers were led by the head of Ngruki pesantren (Islamic boarding school) in Central Java and that some of them had been educated there, the Minister for Foreign Affairs, Alexander Downer, has driven a plan for aid to be spent on madrasah (Islamic) schools. Shadow Foreign Affairs Minister Kevin Rudd indicated that if the Labor Party had won the 9 October election, helping reform the Indonesian education system would have been one of his top priorities. How such an intervention in Islamic schools can make a difference is unclear. There may be tens of thousands of religious schools across the country and yet only a handful at present may be fomenting extremist ideology that leads students into terrorism. The terminology was initially confused. In Indonesia, religious schools include pesantren and madrasah. Many madrasah are State run. Pesantren are invariably run by a private individual of religious stature. The pesantren are predominantly boarding schools, like Ba'asyir's Ngruki school, while madrasah are largely day schools.

[6] http://www.indo.ausaid.gov.au/index.html

During 2004, the focus of this activity has begun to transform to a more general one on assistance to Islamic education, to balance the exclusive focus of Australian aid so far on the Government education system. But it still not clear that this is an appropriate activity for Australia. How would Australians feel about the Saudi Embassy in Australia attempting to intervene in the Catholic Church school system? Or Islamic schools in Australia?

A small amount of Australian aid money spent on Islamic education cannot have any impact. Sound analysis of the issues in any case points to an entirely different priority. The greatest danger Indonesia faces now and into the future is low growth which increases the number of unemployed by 1.5 million every year. Until their Government can offer these people work and a decent future *after* school, the danger is that they will drift into crime, drug use and, worse, terrorism. Strong growth is the rational response to the problems of Indonesia's youth.

There is a clear and pressing case for radically reducing the overall number of aid programs in Indonesia and refocusing governance work in Indonesia. The focus should be on a small number of sustained, well funded and better co-ordinated activities in legal, economic and security governance reform where Australia has demonstrated competence.

Indonesia's need for governance reform is considerable. The Australian Government is committing increasing amounts to supporting governance reform in Indonesia. How effective is this Australian aid? What lessons can be learnt from Australia's experience so far? The following eight case studies of Australian Government assistance to Indonesia help to demonstrate what works and does not work in Australia's support for governance reform in Indonesia. The case studies cover:

1. Monitoring of Indonesia's four state banks
2. Anti-money laundering
3. Tax administration reform
4. Capacity building in economic modelling
5. Combating corruption
6. Australian development scholarships (ADS)
7. Ministry of Finance restructuring, 2003
8. AFP/Indonesian police cooperation

Case Study 1: Monitoring of Indonesia's four state banks

In 2001, AusAID began assisting the Ministry of Finance in improving the performance of Indonesia's four state banks. Three full-time Australian banking experts were assigned to create capacity in the State Banks Monitoring and Governance Unit of the Ministry of Finance to monitor their compliance with the performance agreements which they concluded with the MOF as part of the price for their refinancing with Government bonds in 1999 after the financial crisis.

From its beginnings, AusAID's involvement was principally for the purpose of helping the Ministry of Finance to prevent a repetition of the events of 1997/1998 when, in the midst of the financial crisis, the Government had to guarantee deposits in the banking system as banks collapsed under the weight of bad debt and fraud. As a consequence, the Government issued 420 trillion Rupiah ($A65 billion) in bonds to recapitalise its own failed state banks and other failed banks. The state banks suffered the biggest losses and received most of the bonds because they had been the ATM of the Soeharto regime and its cronies. The interest that the Government pays from the Budget on these bonds is money that should otherwise be spent on education, health and other services for Indonesians.

This project achieved substantial success in its first three years. Although the banks bridled initially at perceived interference from the Ministry of Finance and "foreigners", the AusAID team developed positive relations with the banks and helped achieve substantial modernisation and reform of the banks' policies and systems. From the ruins of the bank collapses of 1997/1998, three of the state banks have now been partly privatised as a result of this sustained focus on reform.

It is far too soon, however, to declare the task of reforming all Indonesia's banks completed. Most banks have failed to perform effectively their role in intermediating between borrowers and lenders. While Bank Indonesia's SBI one month rate is now at 7.56%, banks are charging 14-16% to borrowers. Banks prefer to enjoy the interest they earn on the bonds given by the Government in 1999 to recapitalise them and the small margin they earn from their SBI deposits rather than lend to the real sector.

The Ministry of Finance is still highly exposed to a repetition of the events of 1997/1998. This year, the Central Bank has had to close two banks; the bill to cover depositors in these banks has again fallen to the Ministry of Finance. While deposits in failed banks remained fully guaranteed by the Government, the Government's finances will remain hostage to delinquent banks and their owners and the critical goal of fiscal sustainability for the Government cannot be guaranteed.

The priority now is to move away from overseeing the reform of the state banks, now partly privatised, to better managing and minimising systemic weaknesses in the banking system as a whole and minimising the risk to Government of further bank collapses. In conjunction with Bank Indonesia, the AusAID supported State Banks Monitoring and Governance Unit (MGU) in the Ministry of Finance developed in 2003 a draft "safety net" framework for the banking system, which includes several measures to protect the Government in the future. The "safety net" package of measures includes early warning procedures for identifying problem banks, which included ending the blanket guarantee of deposits and replacing it with a deposit insurance scheme. The Ministry received substantial help from the AusAID advisors in the MGU in drafting the safety net proposals. During an AusAID funded visit, Ministry staff from the MGU introduced the framework to Australian audiences in 2003.

By the end of 2004, there will be no further AusAID support for monitoring of the state banks. This makes sense given that, since 2003, three of the four banks have been partly privatised and further privatisation is in train. Intense Ministry of Finance scrutiny is no

longer appropriate given that the Ministry of Finance is no longer the sole shareholder in the partly privatised banks.

More importantly, however, there is no expectation of AusAID support for the new directions that the Indonesian Government must take to consolidate the banking sector as a whole and protect itself from future banking sector crises. Expert external assistance is still needed to refine the safety net package and guide and encourage its implementation but these new Ministry of Finance needs are not being considered.

Throughout the four years that this project has run, AusAID has from time to time pushed to end it. It was argued early on, for example, that the project under which it was operated – AusAID's Technical Assistance Management Facility (TAMF) – was for short-term assistance only, but this particular intervention was becoming 'long-term' and had to stop. Or it had to be developed as a separate project with its own management structure (it never was). It was later argued that two years were enough, regardless of need. Reviews were organised to end the project but, each time, recognition of its success and continuing criticality to the stability and reform of Indonesia's financial sector led to extensions.

This lack of appreciation in AusAID of the long timeframes for achieving lasting reform, which is a common theme of the case studies that relate to AusAID governance work, is the result of several influences. First, as the financial crisis took hold in Indonesia from 1997, donors initially thought that small reform interventions would be enough to restart the Indonesian economy. This approach ignored the deep weaknesses in the Indonesian bureaucracy and the profound influences of both the economic crash of 1997/98 and the political upheavals it precipitated in slowing reform and recovery. Indonesia did not begin to stabilise politically and economically until 2002. To expect small, brief interventions to work in these circumstances was foolhardy and yet AusAID has proceeded with governance interventions as short as a few weeks to address profound problems.

A second factor driving this short-term mentality relates to the constant changes of AusAID staff in Canberra and overseas. Seven different AusAID personnel in Jakarta and Canberra have handled the MGU project during its life, which over time produced erosion of interest in and commitment to activities that require long-term commitment to have any chance of succeeding. With this level of changeover of staff, it is not surprising that the original clear but still pressing rationale for this intervention is being lost.

Several years' more work is required to put in place and consolidate the safety net framework which will give more assurance than the Indonesian Government has now that it can manage future bank failures without enormous costs to Government revenue. External assistance is still required. AusAID's involvement, however, is likely to end this year, even though a key part of a stronger Indonesian economy is incomplete.

Case Study 2: Anti-money laundering

From December 2001, AusAID gave intermittent support to strengthening Indonesia's anti-money laundering system. A first round of AusAID assistance in late 2001 and early 2002 led to the adoption of Indonesia's first anti-money laundering legislation on 2002.

Once the Indonesian Parliament (DPR) passed this first law in 2002, AusAID interest ceased. Several requests for assistance were dismissed, even though this first law had serious deficiencies, which still left Indonesia open to threatened international (FATF) sanctions on its still weak financial sector. There was, moreover, no conception in the Indonesian Government of the processes for establishing a sophisticated anti-money laundering system.

This indifference to the importance of anti-money laundering in strengthening governance in the finance sector was swept aside with the Bali bombings of October 2002. AusAID quickly moved to assist in establishing PPATK, an anti-money laundering agency, by the end of 2002, reforming Indonesia's first law on anti-money laundering, and examining Suspicious Transaction Reports which had already begun to accumulate from early 2002 in Bank Indonesia.

In 2004, it was Australia's anti-money laundering agency, AUSTRAC, which continued to develop capacity and systems inside PPATK using AusAID funding. AUSTRAC has in effect assumed decision making on the content and direction of assistance to Indonesia and PPATK, giving it a professional agency-to-agency rationale for this assistance that AusAID itself could not provide.

Effective anti-money laundering efforts require good country-to-country co-operation and the sharing between agencies of sensitive information on financial transactions. For Australia, Indonesia, through PPTAK, is an important player in the web of the world's anti-money laundering agencies. Australia has not been the sole beneficiary of this co-operation. In April 2004, funds traced and then seized by the Australian Government from the estate of Hendra Rahardja, the owner of a failed Indonesian bank found guilty of fraud, were returned to

Indonesia as a result of joint co-operation between Indonesian and Australian ministries, Police and the anti-money laundering agencies in both countries.

Australia's more focused commitment through AUSTRAC is a reflection of a clear perception by the Government and AUSTRAC of Australia's own national interest being served by Indonesia's having an effective anti-money laundering system respected by and linked to fellow agencies around the world. The agency-to-agency support for PPATK from AUSTRAC, using AUSTRAC staff, enables a level of commitment and professional expertise that AusAID itself cannot provide.

Case Study 3: Tax administration reform

In 2002, AusAID began contributing advisors to an IMF program to improve tax collections and probity in Indonesia's Directorate-General of Tax (DGT). The nature of the assistance was determined by IMF staff and their consultants flying in from time to time to assess progress and to set new tasks and priorities. The IMF was itself unable to fund assistance and therefore sought advisors from donors like AusAID. For the first two years, two AusAID advisors worked principally in the new IMF-created Large Taxpayer Office.

This program had some early and important wins. For example, the IMF and AusAID advisors in the DGT, combined with the efforts of DGT staff in the Large Taxpayer Office, contributed through their work in 2002 and 2003 to the collection of an estimated $A1 billion in taxes that would not otherwise have been collected.

The DGT agreed to an AusAID proposal to 'sell' the DGT's messages to the public, an approach which the IMF later endorsed. The proposal was aimed at developing essential bureaucratic and community support for the IMF tax reform program. This was a risky strategy for the DGT. In talkback radio sessions with DGT officials, the public let loose on the corruption they faced in their day-to-day dealings with tax officials. DGT responded by arguing that the Large Taxpayer Office initiative and projected reforms to the Tax Laws were aimed at solving these very problems. Major Indonesian businessmen agreed, and told the public and DGT on radio that they wanted the Large Taxpayer Office reforms extended to all Indonesians.

Tax reform is critical to improving Indonesia's investment climate. Corruption and the fickle administration of tax law are a major disincentive to investors. Tax reform is critical to Indonesia's fiscal sustainability. Indonesia is not collecting as much tax as comparable developing countries – 12 percent of GDP in 2001 compared with 14 to 17 percent in other

comparable developing countries. According to the World Bank, the deficit could be eliminated with better tax collection. Even with a 50 percent increase in collection of uncollected taxes, the deficit could have been cut by half in 2001 and nearly eliminated in 2002.[7]

Despite the pressing need, AusAID involvement in tax administration reform shrank in 2004 to one advisor. The possibility of further AusAID assistance in 2004 in improving taxpayer/DGT communication was not taken up. The IMF involvement itself had run out of steam by the end of 2003 and the World Bank was contemplating taking up the IMF reform program from 2004 as part of its comprehensive plans for Ministry of Finance reform (see Case Study 7). The DGT became increasingly inaccessible to external advice and assistance. The draft tax laws which were to be the DGT's own vehicle for tax reform still remain to be tabled in the DPR.

Several factors contributed to this premature end to the chances of any further significant external assistance to tax reform. One is the innate difficulty of tax reform and the resistance of those who benefit financially from the current system. Another factor was the style of the IMF, which rankled with the Indonesians from the beginning. In the case of AusAID's own involvement, there is a repeat of the familiar pattern of early enthusiasm followed by a premature waning of commitment, even though tax reform can only be addressed through long-term sustained effort. One AusAID advisor remained in the DGT in 2004.

Case Study 4: Capacity building in econometric modelling

In 2001, AusAID began developing capacity in econometric modelling using Indonesia's INDORANI general equilibrium model. In 2002, building on this early work, AusAID conducted a public relations campaign for the Indonesian Government based on econometric work using INDORANI that indicated a minimal impact on inflation of the Government's proposed reduction of fuel price subsidies and the consequent rise in the price of fuel. The campaign also emphasised that fuel subsidies benefited the rich. It addressed the major concern that the marketplace, in particular public transport operators, would use the fuel price increase to raise their own prices unreasonably. The campaign also urged fuel economy. The fuel price increases of 2002 passed without controversy.

It was different with the fuel price increase of 1 January 2003. There had been no prior campaign to re-explain the increases. The DPR demanded their withdrawal although they had

[7] February 2003 Report "Selected Fiscal Issues in a New Era" by the World Bank's East Asia and Pacific Poverty Reduction and Economic Management Unit

been part of the 2003 Budget passed by the DPR in November 2002. The Government bowed to public and political pressure and rescinded the reduction in fuel subsidies. The beneficiaries: the well-to-do.

Wishing to build on the initial 2002 success, senior staff of the Ministry of Finance sought further Australian assistance with econometric modelling as part of its strategy to professionalise budget planning and improve revenue estimation. AusAID refused further assistance without proper consultation with those in the Ministry making the request. AusAID also involved the World Bank in the issue, to the annoyance of the Ministry of Finance, but without properly explaining the request to the World Bank. AusAID staff themselves did not properly understand the issues. The World Bank advised against providing assistance. When later on it was clear what had been sought, the World Bank supported the request but it was too late.

In this case, despite the initial successes, it was both poor AusAID understanding of Indonesia's needs combined with the AusAID urge, noted in other case studies, not to commit too much time to any one governance activity which closed off an opportunity to play a role in modernising Indonesia's budget planning and analysis. Once again, AusAID could not take a decision without consulting one of the big donors.

Case Study 5: Combating Corruption

Corruption is a growing problem for Indonesia. AusAID support in combating corruption has been intermittent, inconsistent and in some cases misdirected.

Audit is a critical means of exercising independent scrutiny of Government and in identifying and bringing to public attention weaknesses and misappropriation of public funds. An early target for TAMF I governance support was Indonesia's Audit Board (BPK), the external auditor of Government. For AusAID, however, there was the issue that AusAID was already assisting another audit body, the BPKP (Agency for the Supervision of Finance and Development), in support of an ADB loan to the BPKP. The question was raised by AusAID: why support the BPK? It became evident that the role of the BPKP had not been properly understood by AusAID. The BPKP is one of several Government *internal* audit agencies. It was created by President Soeharto as a means of undermining the BPK, the constitutionally mandated, independent *external* auditor of Government. The BPKP was given generous funding in the Soeharto years, and today remains much better staffed than the BPK.

In the first six years of the post-Soeharto era, it has been the BPK, not the BPKP, which has taken the lead in professional auditing of Government and delivered honest professional audits to Parliament. It is the BPK which revealed in its 2002 audits the US$15 billion loss of Bank Indonesia Liquidity Assistance funds paid to banks suffering runs in the financial crisis of 1997/1998. The BPK has been driven by the reformist zeal and strategic management concepts of its Chairman, S B Joedono.

In 1999 the BPK began to receive TAMF assistance, while AusAID assistance to the BPKP continued for a time through different channels. In late 2001, however, assistance to the BPK was ended. The BPK was seen by AusAID to have already received enough assistance.

After a review of the BPK's needs and the effectiveness of AusAID support from 1999 to 2001, AusAID assistance resumed in late 2002. AusAID assistance supported the development of BPK capacity in defence auditing and complex financial auditing, the latter a priority as the BPK audited the Indonesia Banks Reconstruction Agency (IBRA) and other major financial sector issues arising from the 1997/1998 financial crisis. Assistance for defence auditing continued on a small scale into early 2004, but support for the BPK has otherwise once again retreated to nothing, even though external auditing was identified in 2003 as a priority for TAMF III. In a repeat of the pattern evident in case studies 3, 4 and 7, whereby AusAID gives way to other donors, the ADB has now assumed the dominant donor role in the BPK, even though it was the ADB that providing ill-conceived support to the BPKP at the end of the Soeharto era. The BPK itself is wondering where AusAID has gone.

External audit of government is still weak and compromised by overlapping audit structures throughout the central and regional governments. The issue of the competing role of the BPKP still remains unresolved seven years after the fall of Soeharto. The BPK does not have the resources to implement its constitutionally mandated role to become the external auditor of all regional governments. Effective *external* audit of Government, an essential tool for good governance, remains seriously weakened. Indonesians themselves must solve these structural problems, but external support and advice, including from Australia, helped professionalise the BPK over five years from 1999. There remains a role for Australia in continuing support for this key instrument in governance reform.

AusAID played a central role in the early stages of drafting legislation to create Indonesia's new Anti-Corruption Commission (KPK) through the work in 2001 of Mr Justice O'Keefe. Justice O'Keefe brought his experience with New South Wales' ICAC to Indonesia. His ideas were embraced by the then Minister for Justice, the late Baharuddin Lopa. This early

work in 2001 had no immediate outcome. The Government of Indonesia took another two years to get a draft law into the Parliament. Only in late 2003 was the law creating the KPK eventually passed and members of the KPK appointed.

Despite the delays from the Indonesian side, there was scope for continuing Australian assistance in developing a strong anti-corruption agency in this intervening period. Even after the death of Baharuddin Lopa, the Indonesian side sought assistance. The problem from the Australian side was that the AusAID governance program that had worked on the anti-corruption law was split in June 2001, and a new legal program was created. This new program was notionally responsible for anti-corruption work but appears not to have responded to the requests for assistance. In addition, different AusAID staff worked on the legal program, creating another break with the past. The early Australian focus on helping to combat corruption through an effective anti-corruption agency was lost as a consequence.

This is surprising given that most members of the KPK have had direct involvement with Australian governance assistance through the initial drafting in 2001 of the KPK law by Mr Justice O'Keefe, through their own work with Australian NGOs, through TAMF work from 2002 to 2003 on anti-money laundering, or through the development in 2002 of public sector accountability reporting (LAKIP) with the internal auditors of government, the BPKP. Between 2001 and 2003, the members of the KPK visited ICAC, Queensland's Criminal Justice Commission (CJC), police agencies and Australia's anti-money laundering agency, AUSTRAC. Two members of staff of the Ministry of Justice and Human Rights trained in 2001 at the CJC and the St James Ethics Centre in Sydney.

With this depth of interchange with Australia on governance issues, Australia could have continued to contribute ideas and advice in the course of the difficult two year process of finally forming the KPK in late 2003. The lack of follow-up over two years on the work of Justice O'Keefe meant that when the Commission was established in late 2003, there was no in-house memory inside AusAID of that past work. Another important opportunity to help Indonesia in a key governance area had evaporated over two years of neglect and the initial investment had been wasted.

Case Study 6: Australian Development Scholarships (ADS)

At $31 million in 2003/2004, AusAID's scholarships program (ADS) is the largest single component of Australia's aid to Indonesia. In early 2005, the Australian government committed another $58 million dollars over two years to a new scholarship program as part of its tsunami response. The current ADS scheme is seeking to link student selection more

closely to other elements of the aid program, including governance programs. Some students are being selected from agencies identified through AusAID governance work as championing reform, such as the State Banks' Monitoring and Governance Unit (case study 1). On the whole, however, the ADS scheme is not driven by a primary focus on supporting Indonesia's public sector reform agenda. Its focus is getting students to Australia without regard to their potential future impact on good governance, growth and welfare. As a consequence, AusAID regards the large numbers of students who have been educated in Australia as a good outcome in itself, without any indication of proven impact on Indonesia's development[8].

Despite the very substantial amount of money spent over many years on providing postgraduate education to Indonesia's civil servants, the effectiveness of Indonesia's civil service is today at a low point and still declining. Training has not made a difference. Any impact that it could have had is greatly reduced by the antiquated structures and personnel policies of Indonesia's civil service, including lack of mobility across the service and the crucial role of seniority in determining promotion. Returning, relatively young students are therefore unlikely to be able to make full use of what they have learnt in Australia. They can return to the same unreformed ministries to do the same work they were doing before they left.

Until there is comprehensive civil service reform, the value of overseas training will be severely limited. Indeed, if ADS for policy reasons is to continue at its present high rate of expenditure, civil service reform must become a main focus of AusAID governance work in Indonesia to give value and impact to ADS. Comprehensive, sustainable civil service reform, including the introduction of modern administrative systems and practices and the elimination of corruption, is the key to the sustainable reform in Indonesia. It is a far higher priority for Indonesia than still more postgraduate education for civil servants.

One option for linking the scholarships program to civil service reform would be to divert some ADS funds to establishing *in Indonesia* an institute of public administration that offers short- and long-term courses and training in public sector reform focused on the Indonesian experience. Such an institute could draw on eminent Indonesians, experienced in and champions of reform, as staff, lecturers and moral support. It could draw on the experience of Indonesia's private sector, and on the best available international experts in public sector

[8] See Australian National Audit Office (ANAO) 1999 audit of the ADS scheme, "Management of the Australian Development Scholarships Scheme", which can be accessed at http://www.anao.gov.au. In this audit, the ANAO concludes at para 4.2 that "AusAID does not have performance indicators to measure the outcomes of ADS in terms of students contributing to their country's development."

reform. A key role of such an institute in Indonesia would be advocacy for the comprehensive civil service reform that Indonesia requires if it is to achieve better governance. Indonesian staff and supporters could use the resources of such an institute to promote the idea of reform, develop strategies and plans for reform and sell them to Government and society.

Some of the benefit that ADS provides, students of generous foreign income and time out of Indonesia. would disappear, probably generating opposition to change. But this idea offers a better chance of aid money for training and education having some direct impact on the reform agenda. Ultimately it could also contribute to creating a more favourable environment for re-integrating overseas graduates into a reformed civil service better able to use their new skills and knowledge.

Case Study 7: Ministry of Finance restructuring, 2003

In 2003, the Minister for Finance, Boediono, asked McKinsey & Co to review the functions and structures of the Ministry of Finance and to recommend change. The Ministry turned at an early stage to AusAID and the Canadian Aid Agency CIDA to support the first steps in implementing the McKinsey recommendations. By the end of 2003, AusAID was providing effective assistance to the initial stages of the restructuring of the highly antiquated and inefficient structures of the Ministry of Finance.

AusAID assistance included planning for the movement of staff to new accommodation for the three new Directorates-General, the identification of operating procedures that would need to be revised in the light of the new structures, and the development of IT plans for the new Directorates-General. By December 2003, as TAMF II came to an end, answers to the questions of who would move and to where and how they could be serviced had been largely defined and agreed. AusAID also mapped out the issues of co-ordination and integration that would need to be addressed by the new Directorate-General of Treasury.

The TAMF II strategy of moving as fast as possible to implement the physical moves required to implement the new reformed structures was driven by the vision of the Minister of Finance, Boediono, to make the restructure, in Boediono's own words, *"irreversible"* before Indonesia entered the Presidential campaign period in mid-2004, when the Government's and Ministers' power to act would be much more circumscribed. Against this imperative, AusAID was negotiating in December 2003 to bring back in 2004 the consultant who had driven the detailing of the moves to cement the restructure, so that the momentum was maintained through 2004. At this point, the World Bank intervened. The World Bank had been

designated by Minister Boediono to be the principal lender to the MOF restructure and its accompanying modernisation.

The restructure was approved by the President in early May 2004, but the momentum the AusAID consultant had created had been lost. Only on 17 September 2004, the last working day before the second round of Presidential Elections, did the Minister for Finance formally install two senior officials to head the two new Directorates-General which are key to the restructure. The new President, Susilo Bambang Yudoyono did not retain Boediono as Minister of Finance. Even if the restructuring and reform of the Ministry of Finance can resume in 2005 where it was left in late 2003, a whole year will have been lost while the champion of this reform is no longer in office. Internal opposition to change has been allowed to consolidate. An even less happy scenario is that Indonesia's MOF will find itself with different but still very inefficient structures in 2005 and beyond.

Case Study 8: AFP/Indonesian police cooperation

The Indonesian Police are essential to an effective anti-money laundering system. They attended all the Government of Indonesia working group meetings through 2001 and 2002 on the development of Indonesia's anti-money laundering legislation. Along with other parts of the Government, the police were visited by the teams of foreign experts who came to check Indonesia's progress or assess Indonesia's needs over these two years. But the Police were said to lie outside AusAID's normal scope, so that the Police could not be included in AusAID's work in 2002 and 2003 to build an effective anti-money laundering system in Indonesia. The Police could be looked after by the United States, which had programs that could cover the Police.

This indifference to the multiple needs of the Indonesian Police disappeared after the Bali bombings of October 2002. Australia, through the Australian Federal Police (AFP), has developed outstanding co-operation with the Indonesian Police that has both short-term and longer-term objectives. In the short term, AFP assistance has helped the Indonesian Police find the necessary evidence and track down and arrest members of the Jema'ah Islamiyah (JI) terrorist network responsible for the Bali bombing. Key members of JI involved in the Bali bombings still remain at large, so that continuing support is needed here. In the longer term, AFP assistance is directed at developing the capacity of the Indonesian Police and other regional Police forces to handle more effectively, and to co-operate with fellow agencies in doing so, all forms of transnational crime – terrorism, the narcotics trade, people smuggling, human trafficking for sex and money laundering.

The Indonesian Police were separated from the military only in 2000. They have not had a good reputation in Indonesia for effective, honest law enforcement. The Police are a principal source of the petty day-to-day corruption which polling shows most affects and angers ordinary Indonesians. Subsequent investigation has shown that several of the JI bombers were involved in the Christmas Eve church bombings of 2000, in which 36 died. Poor policing and lack of commitment led to no action being taken until after the Bali bombings galvanised the Indonesian Police. To build their capacity to fight complex internationally linked crime is a major challenge and cannot happen just through short-term, ad hoc assistance.

In 2004, Australian Government support for the Indonesian Police has moved into a longer-term phase. Like AUSTRAC assistance to Indonesia's PPATK, AFP assistance uses AFP personnel and seeks to build the professional skills of police and link Indonesia more effectively into global networks combating transnational crime. The AFP has developed a Trans National Crime Centre in Jakarta, to which other countries are also contributing. It is developing a Centre for Law Enforcement Cooperation (JCLEC) in Semarang, Central Java, for use as a training centre for Indonesian and regional police forces to develop capacity in fighting all forms of transnational crime. JCLEC too is able to receive support from other donors, which will bolster the Australian inputs.

Since 2002, the short- and longer-term phases of the AFP's co-operation with Indonesia have had some important early wins. Several factors help to explain this success. Out of the shock of the Bali bombings, Australia has acknowledged the need for substantial, sustained commitments. Australia has committed $A38.5 million to JCLEC alone over five years. This is understandable given the potential for direct and potentially fatal impacts for Australia itself of the crimes these institutions will be combating.

Strong police commitment on both sides is another key ingredient of the AFP success. Serving AFP personnel skilled in the issues worked on the Bali bombing investigation. Serving AFP are now being assigned to TNCC and JCLEC, a number on a long-term basis. This means that up-to-date professional advice and training is always being imparted and the work is being done by serving police, which eases communications between the co-operating regional police forces.

An important advantage of using serving AFP and other agency staff is that JCLEC and TNCC are not captive to AusAID tendering processes. Those processes are unlikely to deliver serving professionals. AusAID tendering leaves the staffing of projects subject to the

vagaries of the offerings of contractors. The result is that AusAID programs can be staffed by contractors, sub-contractors and experts of mixed skills and abilities.

In using serving agency staff, it is important that they are skilled and experienced enough to win the respect of often very senior foreign counterparts. If those assigned are too young and inexperienced, the value of using serving staff is diminished or lost.

Plenty of time is the third key ingredient for AFP success. The problems from which the Indonesian Police are trying to emerge are generational in nature and need to be addressed by Indonesians themselves over a long timeframe. A premature end to external support and advice, which is the pattern of AusAID governance assistance emerging from these case studies, would lead to the failure of the work being done now and demand fresh investments in the future in the wake of future crises. It is still early days for the AFP's involvement in Indonesia. If it and other donors can maintain a long-term commitment to institutions like JCLEC and the TNCC, there is a chance for external assistance to play a role in achieving long-term progress in building the quality and effectiveness of the Indonesian Police in tackling serious crime.

From the preceding eight case studies, several ingredients for successful aid interventions emerge:

- Commitment of adequate time and resources to achieve sustainable results
- The importance of having the right people with the right knowledge in AusAID and among its contractors and sub-contractors
- Proper diagnosis of development problems and their causes, so that aid is not wasted.

Ample time and resources

In the preceding case studies, it frequently emerges that, after a good beginning, AusAID commitment to a governance activity ends prematurely. This goes against AusAID's own guiding principles for governance assistance. The first principle set out in AusAID's 2000 governance publication "Good governance: Guiding principles for implementation" states that:

> "Governance reform should be seen as a lengthy process of continuous improvement, which goes beyond introducing new systems, but requires new skills, attitudes and organisational cultures. Sustainable institutional change requires careful selection of desired interventions, a gradualist approach to implementation and long-term support."

Phase I of AusAID's TAMF in Indonesia ran for two years. Phase II ran for two and a half years. Phase III is scheduled to run for five years. While AusAID is inching up the life of this governance program, it is still well short of the five to ten year timeframe for achieving sustainable reform.

Even within a program like TAMF, no one activity can expect to run the full life of the program. AusAID support for the State Banks Monitoring and Governance Unit covered in case study 1 is the only activity to have lasted the life of TAMF II, and it began under TAMF I. As noted in case study 1, this was considered highly irregular. Efforts were made to end the intervention on policy and procedural grounds at various points. This did not happen because various reviews endorsed its value and the time required for sustainable change in the critical area of bank reform to take root. One review quoted the view of the TAMF I Program Manager that this intervention "couldn't achieve full capability development unless they were

in there for ten years. What is sustainable depends on the country's capacity to address those issues. There has been a significant amount of technical skills transfer but it would take many years to fully change culture."[9]

There are two points in the life of an activity where AusAID governance work is denied adequate time and resources. First, at the planning, design and approval stage there is constant pressure to cut back on both the time and resources to be allocated. Project designs, which are a key to a successful project, are put together on the basis of very short in-country visits by contractors and AusAID staff. Design teams usually call on agencies and reform champions once only. There is no time to gain a wider view of the planned project in the current and potential political and bureaucratic context. Advisors who may be expert in their particular field can lack essential knowledge of the Indonesian context. This gap can lead to fundamental mistakes in designing the means of applying new knowledge and skills to the Indonesian environment because designs are insufficiently informed by local needs and realities. At the approval stage, on one occasion, a TAMF job assessed as requiring several months was initially agreed to by AusAID for two weeks. Six weeks was eventually accepted when the recipient Ministry objected, but even after this period ended, TAMF and the contractor worked on the activity in an ultimately unsuccessful attempt to achieve some worthwhile outcomes[10].

Second, as the case studies show, the commitment of AusAID resources and time to an activity can also be brought to a premature end even as co-operation is showing promise. This can happen as a result of changes in AusAID staff, unexplained changes in priorities, or the expectation that a large donor will do the work.

In Australia itself, federal public sector reform has been a continuous and sometimes intense process since the mid-1980s. How then can an Indonesian agency be expected to undertake far more profound reform in much shorter periods of three years and less? In Indonesia, there is no public sector wide framework for reform as there was under the Hawke Government which began the reform of the Australian Public Service in the 1980s. Corruption is a far more profound problem than it was in Australia. The concept of 'public service' as service *to the public* as the generally accepted ethos and motivation of civil servants does not yet exist in Indonesia, undermining the bureaucratic will for reform.

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[9] "Review of Institutional Strengthening and Technical Facilities", AusAID, November 2002.
[10] See TAMF II Completion Report, Attachment 31

The right people with the right knowledge

There are many causes for the short timeframes AusAID allows for governance work in Indonesia. Some AusAID staff do not regard governance work as genuine aid. Many lack experience and training in governance work and its complexities. The complexity is compounded by the fact that there is no global template for governance reform. Governance reform has to be pursued with different strategies for each country depending on local circumstances. That the issues are complex and often highly technical may explain the tendency among AusAID staff to pass the buck too readily to other donors like the World Bank, ADB, IMF and the United States.

A factor in this lack of knowledge of, and even curiosity about, what is governance reform is the lack of experience of most AusAID staff in actual governance reform either in developing countries or, more importantly, in their own countries. The wave of reform begun in Australia by the Hawke Government and in the States during the 1980s has largely run its course. Younger AusAID staff being posted overseas or working on country desks where governance reform is a priority are unlikely to have had any direct personal experience in their own society of the challenges posed by public sector reform. They may not even understand their own system of Government. One AusAID officer explained to a surprised Indonesian audience that Australia did not have local government[11]. When face to face with senior bureaucrats and Ministers trying to achieve reform in circumstances even more difficult than anything ever faced in Australia, what can younger AusAID staff say?

AusAID staffing policies contribute to this poor understanding of and capacity to manage governance work. As noted in case study 1, seven different AusAID staff in Canberra and Indonesia dealt with the project in the State Banks Monitoring and Governance Unit over four years. AusAID's overseas postings are for two to a maximum of three years. This is too short a period for any person to understand Indonesia, its governance reform priorities and the means of supporting the champions of reform and navigating its opponents.

Although AusAID has now taken the important step of posting an SES head of the Aid Section to the Embassy in Jakarta, many of the AusAID Australian staff working on Indonesia are young and relatively inexperienced. No effort is made to give in-depth language training to all staff posted to Indonesia so that they can communicate fluently with Indonesians on a professional basis. Most are on a steep two to three year learning curve about Indonesia and will not fully understand the issues. The question therefore arises of how

[11] Comment to the author by a foreign expert working in Indonesia

a person can, without adequate language and prior knowledge of Indonesia, and without relevant professional background and experience, even begin to relate to Indonesia and its governance needs in a posting of just two or three years? How in these circumstances can AusAID and the Australian taxpayer be confident that aid is properly targeted and delivered?

In contrast to the model which the AFP is using in Indonesia (case study 8), contracting out has taken AusAID staff away from the coalface of actual aid delivery. Project implementation has been overwhelmingly outsourced to contractors. Private contractors are primarily responsible for the design, implementation and evaluation of AusAID projects. Contractors even advise on the selection of contractors. AusAID staff have become managers of contractors. In one way only does this division of labour make sense: contracting out is the only answer to the steady growth in Australia's aid program while AusAID's budget, Australian staff numbers and in-house specialist country and sector skills have been in decline. Contractors, like AusAID's overseas local staff, are paid out of the aid program, not the AusAID Budget.

Contracting out delivers a mixed bag of contractors and advisors. The tender process for contractors forces AusAID to accept whomever the winning tender offers. Experience in Indonesia suggests that many contractors and advisors do not have sufficient experience in or knowledge of the country to give sound, workable advice. Even where knowledgeable and experienced contractors are employed, the time that AusAID allocates to a task is invariably inadequate. AusAID also tends to discount expert opinion and to rework ideas and designs once the experts are finished. Without a sound knowledge base of its own on the issues, this adds no value and invites failure. Project designs as a consequence can be poor guides to what needs to be done.

At the same time, among some of AusAID's contractors and advisors there is valuable knowledge and information about the country of operation and aid that works and doesn't work, which AusAID is not tapping. Relations with contractors in the field focus on contract management issues and set up confrontational positions on both sides. The result can be that AusAID mistrusts both the good and the poor expert. AusAID needs to develop its own in-house country and sectoral skills to equip it better to select contractors and advisors, formulate with them country strategies, and undertake project design and the evaluation of work done. More time, money and in-house effort directed at the initial selection of quality contractors and advisors will deliver a better targeted and better delivered aid program.

Fees are a source of antipathy between AusAID and its contractors and advisors. AusAID's 2000 publication "Good governance: Guiding principles for implementation" recognises that "in an area as sensitive and important as governance, it is important to use high level, very experienced senior advisers who are the best in their field." The problem is that "the best in their field" invariably require a fee higher than AusAID experiences in other aid work. The issue of the fees required to recruit the best, most experienced experts for TAMF I and II work proved the most contentious.

AusAID staff with insufficient background and experience in governance do not fully understand the issues and cannot therefore judge the requirements and who is best to meet them. They do not understand fee structures for financial and legal sector professionals. Some AusAID staff, assured a fortnightly salary with generous pension rights, apply their own salary levels to the situation, unaware of the very different circumstances and the uncertainties facing contractors and consultants. AusAID should take its own stated principles to heart and accept that governance work as a rule comes with higher fees than might otherwise be required for aid work in other fields.

Australian aid risks losing its Australian identity and character following AusAID's opening up delivery of its aid programs in 2003 to individuals of any nationality. Only the main contractor for a project or activity must be an Australian company. The identification of Australia as the source of aid is particularly important in the field of governance, where AusAID and its contractors and advisors are dealing with Ministers and senior bureaucrats. This policy change will result in a dilution of the Australian face of aid delivery, which will in turn dilute the impact of successful aid on Australia's national interest. A Canadian or Malaysian advisor will convey no sense of Australia as the source of the aid they are delivering and will not signal Australian commitment to better governance in Indonesia.

To meet the problem of the decline in its own knowledge and skills base and help it supervise its contractors, AusAID has begun to add to programs expensive Technical Support Groups in the hope that those who staff them understand the countries and sectors in which AusAID operates, can give sound guidance to AusAID, and will improve contractor performance when necessary. One danger is that more opinions bring only less clarity. Another danger is that AusAID staff will rely too much on these mechanisms and feel even less need to try to understand the countries and sectors in which they operate.

AusAID has begun a questionable search for concrete, objective performance indicators for all its programs in Indonesia, including governance programs. Performance measurement is

essential to contractor and AusAID accountability to the taxpayer, but the measures have to be appropriate and useful and properly assign cause and effect. The World Bank is now concluding that subjective data on governance is the only data that is potentially informative in the field of governance. In their work over several years, Kaufmann, Kraay and Mastruzzi have constructed six measures of governance as a means of assessing the state of, and tracking changes in, governance. The sources they use are subjective, based on perceptions of corruption and other issues relating to governance. In their most recent study they come to the following conclusions on "subjective" data:

> "We have argued that, for the purposes of measuring governance, there are few alternatives to the subjective, experiential data on which we rely.
>
> Moreover, in cases where objective indicators of governance are available…these too have implicit margins of error…on the same order of magnitude as those associated with our subjective aggregates."[12]

AusAID needs to be careful that its search for concrete, objective measures of governance programs does not become another managerialist end in itself, diverting AusAID resources and focus even further away from the coalface of actual aid delivery and into increasingly complex, pseudo-scientific dead-ends.

Case studies 8 and 2 offer AusAID a more effective approach to governance assistance. The success of the AFP in Indonesia shows the value of long-term *agency-to-agency* commitment of money and resources to a task and of using its own serving police with the required skills and experience for the work. Not all Government agencies, however, can afford this level of investment of its own people in overseas governance work. TAMF I and II experience was that no Australian Government agency, when approached to provide advisors for governance work in Indonesia, could afford the long-term investment of appropriately senior experienced staff. The Australian Office of Funds Management could not, for example, provide long-term staff to support Indonesia's new Debt Management Office when AusAID began assistance to it in 2000.

In these circumstances, the onus of delivering professional quality governance assistance falls back on AusAID, but AusAID is not meeting the challenge. AusAID's contracting out of aid work delivers a mixed bag of skills that cannot match the skills and experience that the AFP is

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[12] p.39 Kaufmann D., Kraay A., Mastruzzi M., Governance Matters III: Governance Indicators for 1996-2002, WP #3106, revised version 5 April 2004

delivering in Indonesia at the moment. AusAID commitment to the job is consistently eroded by excessive staff mobility, inexperience in governance and poor country and sectoral knowledge, which combine to encourage a culture of timidity, a preference for short-term timeframes and an over-reliance on other donors to see projects through.

AusAID should instead be developing in AusAID itself strategic focus in its governance programs for key countries like Indonesia based on deep in-house country knowledge and demonstrated experience in successful governance reform. AusAID needs to recruit adequately skilled full-time staff, slow down internal staff movements, lengthen strategically important internal placements and overseas postings to five years, and engage part- or full-time genuine professionals to support country and sector analysis, program design and implementation, and evaluation. The search for concrete, objective performance measures is not the answer.

Getting the diagnosis right

The lack of understanding inside AusAID of governance can lead to serious gaps in governance program design. While AusAID's "Good governance: Guiding principles for implementation" states that "the elements of governance are interdependent", governance reform in Indonesia remains broken up into legal, economic, debt management and other compartments. Co-ordination between them is poor. Synergies have been lost. As case study 5 demonstrates, the creation of the separate legal reform program in 2001 contributed to the premature end of AusAID involvement in the creation of an anti-corruption commission and the waste of the work already done by AusAID on the legislation to create the commission.

Most importantly, in this dispersal of effort and focus, critical cross-sectoral preconditions for governance reform are overlooked because they do not fit into pre-ordained boxes of legal, economic, debt management and security reform. An important lesson of TAMF work is that economic and legal governance reform cannot focus solely on the technical aspects of the task at hand. Technical, economic or legal inputs invariably constitute less than 50% of needed inputs. Reforming the work environment so that civil servants can make effective use of the technical inputs is more important. Without such reform, individual interventions cannot work in the long term. Comprehensive public sector reform, which includes the Police and military, is the only long-term solution.

AusAID and other donors nevertheless persist with piecemeal programs and partial solutions. For example, as case study 3 demonstrates, the IMF prescription in 2002 to pay higher allowances to Tax Office staff in the new Large Taxpayer Office (LTO) will not bring reform

to other tax offices unless the same principles of fair remuneration and full accountability are applied to all Tax Office staff – and indeed to all of Indonesia's civil servants. Tax reform cannot work when it is locked away in one part of the Tax Office. As AusAID and IMF interest wanes, the LTO experiment could well wither and the areas where reform began to take root could revert to old patterns of taxpayer/tax officer accommodation.

AusAID does not actively recognise comprehensive civil service reform as the key to sustainable governance reform. And yet the absence of sustainable reform could mean that, in five years' time, the conclusion is drawn that much of Australia's aid was largely wasted in Indonesia. If this is the conclusion, it will be because of its weak civil service. The challenge is to get AusAID staff and the economists, environmentalists, health experts and lawyers who work on the ground for the World Bank and other donors to understand the role of public service systems and the people in them in either blocking or facilitating change. The problem is that too few have ever actually had sustained, 'hands on' experience in reforming a public service.

Case study 6 demonstrates a costly consequence of this failure to identify the main impediment to governance reform. Australia invests a substantial amount each year on scholarships for civil servants and has done so for fifty years. While AusAID can point to the several Australian graduates in the Indonesian Cabinet, the present poor state of the Indonesian civil service as a whole does not justify the size of this investment.

A corollary of the need to focus on comprehensive civil service reform is the need in Indonesia's new decentralised environment to build components for improving governance into AusAID health, environment and education programs to give those programs a better chance of sustainability after the AusAID interventions end. AusAID support directed at the poorest regions is particularly vulnerable, e.g. the Nusa Tenggara Timur Primary Education Partnership. If aid inputs which support the delivery of basic services to the poorest regions are to survive in the long term, there has to be a proper long-term share of local government budgets for such services. Local government revenue needs to be generated and dispersed transparently to basic services. Local corruption needs to be progressively eliminated. Poor regional governments have to become advocates in ministries in Jakarta and in the DPR for the reversal of the present trends in funding which favour the rich regions.

Effective advocacy in the right places, better budget planning, open debate in local assemblies on the allocation of funds, effective accountability of elected officials and local assembly members to voters, transparency and probity in financial management and effective audit can

all ensure better prospects for the survival of worthy AusAID initiatives supplying basic needs to the poorest regions of Indonesia. This concept has been built into the new ANTARA program for East and West Nusa Tenggara, but it needs to be built into all other existing and new AusAID activities.

The eight case studies indicate three factors in successful interventions:

- Commitment of adequate time and resources to achieve sustainable results
- Having the right people with the right knowledge working on governance
- Proper diagnosis of development problems and their causes, so that aid is not wasted.

It is telling that the driving force behind the successes among the case studies is not AusAID but two other Australian Government agencies, the AFP and AUSTRAC. Where there are failures in programs, the case studies suggest they are due to:

- AusAID's allowing inadequate time and resources for its interventions, its tendency to give way to large donors, and its 'stop start' approach
- Inadequate diagnosis of underlying governance issues such as the profound weakness of the civil service
- Lack of commitment from AusAID, which wanes under the combined weight of changing personnel, inexperience, lack of knowledge, and an Indonesian program that is far too unfocused and weighed down by new fads and enthusiasms.

This lack of commitment is hard to understand. How can AusAID not be as stirred as the AFP by the long-term challenges it can address of civil service reform, combating corruption, bolstering the banking system, reforming the tax system, and strengthening external audit? With adequate time and strong commitment, Australia can make a strategically important difference to improving the quality and effectiveness of government in Indonesia.

Government and AusAID policy statements and guidelines show that aid policy is being reshaped to face new realities in the Asia/Pacific region. Good governance is now the primary goal of aid policy. Support for strengthening the capacity of the security services of the region has become a high priority. Funding is beginning to match these priorities. AusAID has developed good guidelines for its governance assistance.

While Government and AusAID policy statements are responding to these new threats and challenges, AusAID itself is not delivering governance aid of a quality that meets the challenges. Five recommendations emerge from this paper.

Refocus aid to Indonesia for greater impact for both countries

AusAID must narrow the number of activities in the overall aid program in Indonesia, including in the governance field. Far fewer, better funded and managed activities should focus on the inter-related priorities of economic, legal and security governance reform.

The Government's and the Opposition's planned Islamic schools program in Indonesia is an ill-conceived diversion of effort and resources.

Allocate adequate time and resources to governance interventions

Governance programs should be given adequate time and resources to achieve sustainable results – up to 10 years in profoundly corrupt countries like Indonesia. Agency commitment and agency-to-agency engagement is a key to successful interventions. Where this is not possible, AusAID staff need to be as motivated about and qualified for AusAID governance work as the AFP has been in its work in Indonesia.

Expand and deepen AusAID's knowledge base

AusAID is shrinking into a purely contracting agency, lacking the skills to make judgements about the issues of substance covered by the contracts it is managing. A number of 'knowledge' weaknesses inside AusAID limit its capacity to deliver effective governance assistance.

AusAID needs to reverse this trend and return to the coalface of aid delivery. It should build its own capacity to direct the design and delivery of effective aid based on its own strong country and sectoral knowledge. AusAID needs to be smarter in the way it manages and delivers the aid program to advance its own long-term institutional interests.

Improve aid design, delivery and evaluation

AusAID should spend more time and resources on identifying and recruiting contractors with genuine knowledge of and expertise in recipient countries and with up to date knowledge of and proven experience in the governance sector in which they operate. To strengthen its own strategic focus, AusAID should be capturing contractor knowledge and insights which currently go to waste.

AusAID should pay the required fee for the required expertise in the governance field. Young, inexperienced Australian public servants are not a source of effective governance

assistance. AusAID should not allow the Australian face of its assistance to Indonesia to disappear.

Strengthen AusAID's funding base

The main reason for the weaknesses pointed out so far is the quite inadequate funding allocated to AusAID to manage aid professionally. For 2004-2005, AusAID is to receive $14.5 million and $58.2 million for its policy and program management "outputs" respectively. This is an increase of 4.3% and 3% respectively for AusAID management while the aid budget itself is projected to increase by 12.6% in 2004-2005.

AusAID's Australian staff alone are responsible to Government and the Parliament for the aid program. Steadily decreasing the amount of funds allocated to AusAID to manage an already large and increasing amount of aid money is irresponsible and asking for trouble. Funding should be increased to enable AusAID to acquire the specialist skills that will give the Australian public the confidence that the substantial amount of aid that Australia gives is well managed and wisely targeted. AusAID must have the in-house skills and experience to play a direct role in the design, implementation and review of all its work.

The problem is not just AusAID

In achieving a more effective aid program, the focus should not be on AusAID alone. The shrinking of AusAID into a contracting agency is not the result of decisions made within AusAID. The weakening of AusAID capacity through the constant shrinking of AusAID's own operational budget while aid funds grow is a choice that the Government itself makes each year in its Budget. The scattergun approach of providing a little bit of aid to every cause, sensible or not, enables the Australian Government to satisfy political needs and competing interest groups in Australia, but it does not meet Indonesia's needs. The result is an aid program in Indonesia lacking in coherence and credibility and too dispersed to be properly managed.

This suggests that what the Government regards as most important is the appearance of commitment, not actual delivery of quality aid. AusAID and the Government have produced competent guidelines and principles on providing governance assistance, but the standards are not being met and neither is being held accountable. Does this matter? Australian aid to Indonesia is only $A120 million per annum. This gives the appearance of commitment. Diverse domestic Australian interests are accommodated. Isn't this enough?

Such a narrowly Australia-centric view of aid pays no attention to the benefits Indonesians and Australia's own long-term security interests could gain from effective Australian aid to Indonesia. For forty years from the mid 1960s, Australia's external security environment changed fundamentally for the better with the rise to power of Soeharto. Indonesia itself entered a period of sustained growth, which rescued it from economic chaos and brought sustained improvement in the living conditions of its people. Australia's security interests remain inextricably linked with Indonesia.

Australia's long-term national interests are served by a well governed, democratic Indonesia that can return to the strong growth that Indonesia enjoyed from the 1970s through to the 1990s. Australian aid alone obviously cannot achieve this aim. What is clear, however, is that Australia's current aid program is overall not clever enough to help Indonesia towards achieving this goal. The Government must give priority to adequately funding and professionalising AusAID. With new resources, AusAID needs above all to build its own strong country and sectoral knowledge and expertise as the basis for delivering effective governance assistance.

The Government must also give AusAID the scope to operate professionally according to development priorities and beyond the dictate of short-term political priorities. Rather than overload its aid program in Indonesia with myriad priorities, Australia should be aiming at long-term commitments to assist in a small number of security, legal and economic areas where Australia has demonstrated capacity and where Indonesia and Australia can clearly benefit.

In the full range of policy instruments available to the Government to rebuild strong confident relations with a newly democratic but still profoundly weak Indonesia, aid is neglected and priorities are distorted. It is good for producing symbols – a burns unit in a hospital in Bali opened in July 2004. Islamic education is suddenly a new priority in 2004. But commitment to tough but truly important challenges is being avoided – promoting civil service reform, strengthening fiscal sustainability by stabilising the banking sector, building a strong Anti-Corruption Commission, restructuring the Ministry of Finance and reforming the tax system. The new focus on tsunami recovery and its benefits for the bilateral relationship risks diverting attention away further from these structural and politically painful reforms.

Nothing could be more positive for Australia's national interests than a stable, democratic Indonesia able to ensure peace and safety for its citizens, deliver growth and prosperity, control its own borders, and play its proper role in building regional security. Talking –

ASEAN Summits and Consultative Group on Indonesia meetings – will not achieve these economic and strategic objectives. They can only be built on strong, sustained, long-term improvement in the quality of government in Indonesia itself. As the eight case studies show, good Australian aid backed by strong commitment can make a difference in helping Indonesia towards these objectives. With a professional, better funded and more committed AusAID, Australia could do much more in the future. As Australia's aid relationship with Indonesia deepens, it needs to be strengthened or risk delivering disappointment.

APPENDIX A

Estimated Total Aid Flows to Indonesia 2003-04 Financial Year

BILATERAL ACTIVITIES	AUD EXPENDITURE
Australian Community & Civil Society Strengthening Scheme (ACCESS)	5,171,604
Australian Development Scholarship Off-shore Management - Phase 1	965,055
Australian Development Scholarship Off-Shore Management - Phase II	4,636,658
Australian National University Indonesia Project	342,102
Area Focused Approach	367,576
Bali Memorial Package	3,636,435
BAPEDAL East Java Institutional Strengthening	1,965,519
BAPEDAL Regional Denpasar Project	1,475,653
Civil Governance	169,883
Coral Reef Rehabilitation and Management	1,125,693
Creating Learning Communities for Child	500,000
Debt Management Project	1,111,190
Decentralisation Activities	39,367
Education Sector Program Development	405,590
Electoral Assistance 2004	12,552,405
Emergency and Humanitarian Program	1,418,741
English Language Training Activities	929,447
Environment: Technical Assessment Group	137,045
Financial & Economic Reform Expert Team	124,163
Government Sector Linkages Program	993,132
Medical Research Initiative	16,538
Decentralised Health Services (ADB Technical Assistance)	1,000,000
Healthy Mothers Healthy Babies	2,417,604
HIV/AIDS Prevention & Care Ph 2	6,321,627
Improving Maternal Health in Eastern Indonesia	1,000,000
Australian Development Scholarship	31,882,389
Indonesia Education: Technical Assessment Group	134,333
Program Support Unit (PSU)	1,212,000
Learning Assistance Program for Islamic Schools (LAPIS)	585,224
Legal Development Facility	357,679
Legal Reform Program Facility	453,314
Madrasah Education Preparatory Design	3,653
Managing Basic Education	422,641
NTT Primary Education Partnership	4,961,775
Partnership for Governance Reform	400,000
Partnership in Skills Development	3,160,745
Program for Eastern Indonesia Small to Medium Enterprises Assistance (PENSA)	500,000
Police Counter Terrorism Capacity Building Project	695,500
Program Management & Travel	204,532
Social Monitoring & Early Response Unit (SMERU)	609,274
Specialised Training Project - Phase II	8,964,091
Specialised Training Project - Phase III	306,002
Strengthening Microfinance Institutions	9,125
Technical Assistance Management Facility (Phase II)	2,960,994
Technical Assistance Management Facility (Phase III)	1,838,829
Technical Advisory Facility – Health	520,096
UNICEF Safe Motherhood Programme	2,854,505

Water Supply & Sanitation Policy Formulation & Action Planning (WASPOLA Phase 1&2)	1,876,806
Sanitation by Neighbourhoods Project (SANIMAS)	457,344
Water Supply & Sanitation for Low Income Communities Ph II	1,701,932
Women's Health and Family Welfare	5,804,190
TOTAL BILATERAL PROGRAMS	**121,700,000**
GLOBAL PROGRAMS	
Humanitarian Assistance	10,000,000
Regional Activities (NGOs, IDSS, Other Government Departments)	20,000,000
TOTAL GLOBAL PROGRAMS	**30,000,000**
GRAND TOTAL	**151,700,000**

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About the Author

Geoff Forrester has been writing on Indonesian politics and Indonesia's economy since 1996 when he left the Department of Foreign Affairs and Trade. He is the editor of two books on recent developments in Indonesia. *The Fall of Soeharto* was first published in 1988 and later translated into Bahasa Indonesia. *Post-Soeharto Indonesia: Renewal or Chaos?* was published in 1998. He writes regularly for clients on business and politics in Indonesia.

Geoff lives in Jakarta. Since 2002, he has been Commissioner of a 100% owned foreign investment company in Indonesia, PT GFI. Since 1996, he has been Director of Geoff Forrester Asia & Associates Pty Ltd, which provides analysis of and advice on economic and political developments in Indonesia. From 1999 to 2003, he was Program Manager of AusAID's Technical Assistance Management Facility, an Australian Government funded aid program supporting the economic and legal reform objectives of the Indonesian Government. His contract was not renewed in 2003.

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