



INNOVATIONS IN STRENGTHENING LOCAL ECONOMIC GOVERNANCE IN ASIA



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The Asia Foundation

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First Edition

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The Asia Foundation

465 California Street 9th Floor
San Francisco CA 94104

ISBN 1-892325-10-1

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FOREWORD

Since its founding in 1954, The Asia Foundation has focused attention and emphasis on initiatives that intensify the engagement and capabilities of community leaders and civil society in effective economic governance.

We are most pleased to share with you this compendium—“Innovations in Strengthening Local Economic Governance in Asia.” This volume provides information and insights on the Foundation’s long-running experience in programs and projects that strengthen the development efficiency and effectiveness of local-level leaders and institutions in various Asian countries.

This book features chapters written by various staff members—many from the field offices of the Foundation. They describe the varied efforts and approaches deployed in their on-the-ground programs and projects—including the use of the Economic Governance Index (EGI), Public-Private Dialogue (PPD), Regulatory Impact Assessment (RIA), political economy approaches to economic reform, and assistance to local governments on economic development planning and economic governance. All these efforts are aimed at expanding public participation in governance and decision-making, broadening the benefits of economic and social development, and providing citizens with the tools they need to advance their interests, particularly in investment and enterprise.

Premier Deng Xiaoping is said to have described the leadership of China’s dizzyingly rapid development journey of the past two decades as a process of “... crossing the river by feeling for stones.” Indeed, The Asia Foundation has formulated, developed, and refined its approaches to the strengthening of local economic

governance through repeated cycles of trial, implementation, and learning. This evolutionary process is an important feature of the Foundation's overall approach to development work, anchored as it is on an in-depth understanding of the local context, informed by empirical analysis of development challenges, and structured for optimum flexibility in response to changing circumstances.

The Asia Foundation has earned a reputation for integrity and performance at the highest level through its continued long-term, on-the-ground presence in Asia, now operating in more than 20 countries from 18 offices. This continuing, proactive presence has resulted in detailed knowledge, continuity, and an unparalleled network of contacts and Asian partners. The importance of that experience base for relevant and substantive programming cannot be over-emphasized.

David D. Arnold

President, The Asia Foundation

PREFACE

Asia's amazing economic performance over the past 40 years strengthens the lesson that economic liberalization and good governance are crucial for rapid, continuing economic growth and political progress. Indeed, the democratization of opportunities for productive investment and entry into profitable enterprise enable the majority an equitable opportunity to enhance their livelihoods and welfare—not only as entrepreneurs but as employees.

More rapid economic growth directly reduces poverty through job creation. In tandem with enlightened governance, economic growth bolsters increased investment in crucial public goods and services—primary education, public health, rational management of natural resources, infrastructure, peace and order, and access to justice.

The Asia Foundation's programs in Economic Reform and Development (ERD) promote investment and private enterprise, especially small and medium-scale businesses, through pro-market reforms of the regulatory environment at the local, provincial, and national levels. The Foundation also strives to advance domestic and international trade and financial sector reforms, and to strengthen the responsiveness of local governance to the requirements of the business sector and the needs of the poor.

Over the past decade, the ERD portfolio of The Asia Foundation has steadily expanded and now comprises significant multi-year programs in a number of Asian countries. As these programs have taken root and achieved significant visibility and impact, the Foundation is increasingly recognized in the development community for its ability to use empirical analysis to guide reform, and particularly its expertise in surveys and the deployment of rigorous

indices of the business climate in different countries—exemplified by the Foundation’s signature “economic governance index.”

The Foundation has also generated useful field experience in programs featuring One Stop Shops, which help to streamline business operations, reduce corruption, improve regulatory reform processes, and promote private enterprise. The political economy of reform has also become an important aspect of the Foundation’s work, helping to ensure that its programs aimed at inducing economic reforms are informed by careful, locally grounded correct analysis of the political structures, dynamics, and incentives that shape the reform process.

This book summarizes The Asia Foundation’s experience in designing and implementing programs aimed at strengthening economic governance in Asia. Most of this work has been formulated and executed by Foundation staff in close collaboration with partners on the ground—national and local governments, Chambers of Commerce and other business associations, and civil society groups and NGOs. In general, the experience covered in this book unfolded from the mid-1990s to 2010.

We hope this book will make a useful contribution to our shared understanding of local economic governance in Asia and its critical role in the broader reform and development process.

Gordon Hein

Vice President, Programs, The Asia Foundation

ACKNOWLEDGEMENTS

The Asia Foundation thanks the many donors, public and private, that have over the past decade funded the various programs and projects implemented across Asia by the Foundation. The learning, innovations, and experiences documented and reported in this book arose from these programs and projects, supported by donors, including:

Asian Development Bank

Australian Agency for International Development

British High Commission – Indonesia

Canadian International Development Agency

Danish International Development Agency

Department for International Development, United Kingdom

International Finance Corporation

Give2Asia

Decentralization Support (Multi-donor) Fund, Indonesia

Mekong Project Development (Multi-donor) Facility, Cambodia

Swiss Foundation for Technical Cooperation (SwissContact)

United States Agency for International Development

United States Office for Transition Initiatives

The World Bank

Finally, many staff members of The Asia Foundation contributed in many ways, large and small, to produce this compendium of innovations and field experiences in local economic governance, including:

- V. Bruce J. Tolentino (Chief Economist and Director of Economic Reform and Development Programs), who organized the process of book writing and production, incessantly pushing authors, contributors, and editors toward completion;
- Carolyn Iyoya Irving (Consultant) and Johan Kharabi (Junior Fellow, Winter 2010-11) served as editors. They interacted with and interviewed the authors and contributors, and prepared up to a dozen drafts of the manuscript;
- Robbie Paras (Program Assistant, Economic Reform and Development Unit), who handled logistical support and issues with calm and care; and
- Nancy Kelly (Associate Director, Design and Production), who managed the book's production process, shepherding the manuscript through institutional clearances, copyediting, layout, proofs, and printing.

LIST OF ABBREVIATIONS

ARMM	Autonomous Region of Muslim Mindanao
BOSS	Bukidnon One Stop Shop
BRRC	Bangladesh Regulatory Reform Commission
CBO	Community-based organization
CCTAGs	City Coalitions for Transparent and Accountable Governance (Philippines)
CIDS	The Cambodian Institute of Development Study
CLG	Commissioner of Local Government (Sri Lanka)
CRC	Center for Research and Communications (Philippines)
DANIDA	Danish International Development Agency
DFID	UK Department for International Development
DPPD	District Public-Private Dialogu
DPRD	Devan Perwakilan Rakyat Daerah, an Indonesian Municipal Council
EGI	Economic Governance Index
EPC	Eastern Provincial Council (Sri Lanka)
ERD	The Asia Foundation's Economic Reform and Development theme
IFC	International Finance Corporation
IRA	Internal revenue allotment
KPPOD	Local Economy Watch (Indonesia)
LA	Local authority
LEG	The Asia Foundation's Local Economic Governance program
LG	Local government
LGU	Local government authority
LPPD	Local Public-Private Dialogue

MLGPC	Ministry of Local Government and Provincial Councils (Sri Lanka)
MOU	Memorandum of Understanding
MSME	Micro, small, and medium-scale enterprise
OECD	Organization for Economic Cooperation and Development
OSS	One Stop Shop
PAD	Local generated revenue (Indonesia)
PBES	Provincial Business Environment Scorecard (Cambodia)
PBPB	Participatory Barangay Planning and Budgeting module (Philippines)
PCC	Participatory Community Consultation
PC	Provincial council
PCI	Provincial Competitiveness Index (Vietnam)
PPD	Public-Private Dialogue
PPPD	Provincial Public-Private Dialogue
PROMIS	Reducing Barriers to Market Entry and Business Operation program
PSEEAP	Public Service Excellence, Ethics, and Accountability Program
RIA	Regulatory Impact Assessment
RIAS	RIA statement
RDRS	Ranjur-Dinajur Rural Services
RO-RO	Roll-on and roll-off program
SME	Small and medium enterprise
SWS	Social Weather Station
TAG	Transparent Accountable Governance program (Sri Lanka)
TALG	Transparent Accountable Local Governance program (Indonesia)
ToP	Technology of Participation

TWG	Technical Working Group
USAID	United States Agency for International Development
VNCI	Vietnam Competitiveness Initiative
VCCI	Vietnam Chamber of Commerce and Industry

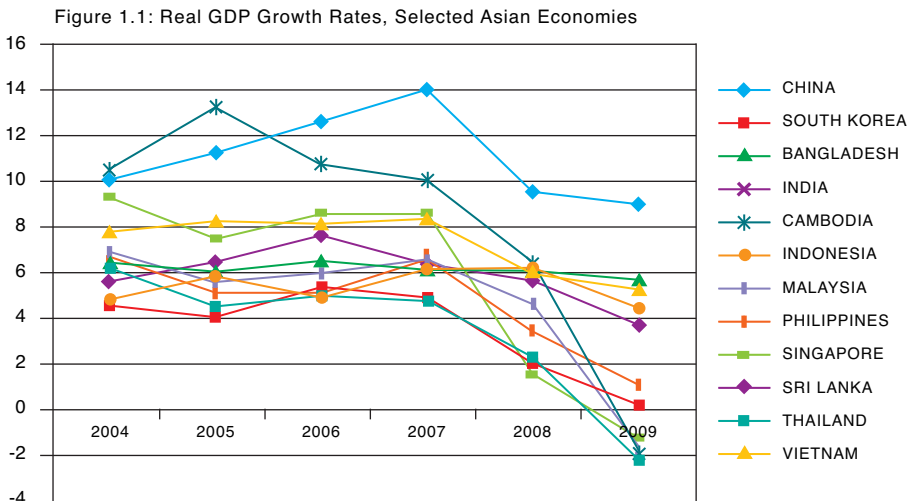


THE ASIA FOUNDATION: STRENGTHENING LOCAL ECONOMIC GOVERNANCE ACROSS ASIA

V. Bruce J. Tolentino

Asia at a Crossroads: Challenges and Opportunities

In the wake of the global financial crisis that has shocked both East and West, the sense of economic hubris that enshrouded the West—particularly the United States—over the decades of the 1990s and early 2000s of seemingly invulnerable economic strength and growth has fallen away, leaving most of the world’s economic managers and political leaders distressed and fearful for the first time since the Great Depression of the early 1930s. The current era is one of great international economic uncertainty. Global economic performance since mid-2007 has been abysmal, especially in the U.S. and other more developed countries. Even across Asia, which has been the world’s fastest-growing region over the past several decades, growth sharply decelerated (Figure 1.1).



Source: Asian Development Bank. "Key Indicators for Asia and the Pacific," August 2010

For a while, Asia seemed unaffected by the financial turmoil that broke out in the United States in late 2007. However, most of Asia's economies were swept up in the global downward spiral by mid-2008 due to the collapse in Western demand for Asia's exports.

While growth rates in the European Union and United States rebounded slightly throughout recovery in 2010, Asia exhibited unique resilience. In 2010, East Asia as a whole grew at 8.9 percent,¹ driven by 10 percent growth in China. Developments in Southeast Asia were likewise encouraging. The economies of Indonesia, Thailand, Malaysia, and Vietnam grew at 6.0, 7.5, 7.4, and 6.5 percent respectively.² In South Asia, growth was also strong; India's economy saw 8.5 percent growth; Bangladesh grew at 7.0 percent.³

Although Asia has been the fastest-growing region in the world since the 1980s, economic performance has been mixed across the region. Some nations—Cambodia, China, Vietnam, and India in particular—have posted strong overall growth, while others have lagged—notably the Philippines, Pakistan, and Timor Leste. Moreover, for many Asian economies, strong national productivity numbers conceal underperformance at the local level—often in those communities where poverty is most severe. In these countries, many provincial or district economies are failing to live up to their potential as engines of growth.

1 Estimates for January 2011 provided by The World Bank, "Robust Recovery, Rising Risks," East Asia and Pacific Economic Update 2010, vol. 2, October 2010.

2 Estimates for January 2011 provided by The World Bank, "Quarterly Update," November 2010.

3 Estimates for January 2011 provided by The World Bank, "Moving Up, Looking East," South Asia Economic Update, 2010, June 2010.

Many Asian nations are at crucial crossroads in their economic development processes. In the relatively short span of time since the 1990s, these nations have established stable governments (many democratic), strengthened their national institutions, and have undertaken important initiatives to improve their respective business environments. Asian governments have worked to simplify investment rules and stabilize macro-economic policies; and have made slow but steady progress in eradicating corruption.

Decentralization

Several Asian countries—notably the Philippines, Indonesia, and Vietnam—have embarked on wide-ranging decentralization programs with the idea that subnational governments are best positioned to connect with and respond to the needs of constituents. However, these initiatives have generated unexpected complications—including uncertainty around the pace, timing, and intensity of transfers of responsibility as well as resources to local authorities. Also, the decentralization of political power to the regions has created new challenges for driving business growth, in many cases leading to greater uncertainty and a proliferation of new regulations.

For example, Indonesia today comprises more than 480 districts, up from 292 in 1998, and the number is still growing. While central government remains a key part of the overall Indonesia story, local governments now have a major role in allocating public spending and establishing the regulatory environment. The rules and procedures governing business licensing, registration, permits, user charges, and some taxes have largely been devolved to local governments.

Decentralization has brought many benefits to Asian countries, as decision-making processes are now closer to citizens and more

relevant to local communities. Direct local elections have also enabled greater accountability in the exercise of the powers of local government. Greater access to local program budgets has been granted to local executives, allowing citizens more direct involvement in local fiscal oversight and management.

While some local governments have used this new freedom to create dynamic business climates, others continue to struggle with fiscal management, legal uncertainty, and weak governance. The shift of authority and resources from national to local jurisdictions has also led to concerns about distorted economic governance and alleged corruption among some local “kings”—the mayors and leaders of cities and districts.

As Asian governments attempt to address these challenges and global businesses seek creative solutions amidst financial flux, interest in local economic governance—which includes local government and governance, public administration, fiscal management, and the promotion of local economic growth—has steadily grown. This attention has been spurred by observations of uneven progress across localities despite strong national-level economic growth; and the adoption of decentralization/devolution/de-concentration programs across many countries—not only in Asia but also Latin America. Moreover, along with interest in local governance, a focus on local/national linkages and inter-governmental relations has also burgeoned.

The Asia Foundation and Local Economic Governance

As a private, international development organization deeply engaged with development processes across the region, The Asia Foundation is uniquely positioned to help Asia’s governments, businesses, and civil society organizations address these pressing

economic development challenges and respond to the myriad opportunities presented by the ever-changing global economic climate. With nearly 60 years of experience in Asia, and a network of 18 offices throughout Asia, Washington, DC, and San Francisco, The Asia Foundation is recognized internationally for its innovative work on economic governance and a political economy approach to reform. Across Asia, the Foundation implements programs in the areas of regulatory reform, strengthening of local economic governance, private sector development, anticorruption, trade liberalization, and promotion of private investment.

The Foundation has developed a one-of-a-kind Economic Reform and Development (ERD) package of strategies, projects, interventions and activities designed to enhance and sustain economic growth.⁴ Tailored to specific country contexts, specific elements of the ERD package are deployed to strengthen local governance (including civil society) in ways that contribute to overall, national economic growth. The ERD package includes the following components:

- strategic analysis, surveys, and research;
- the Economic Governance Index (EGI);
- PublicPrivate Dialogue (PPD) and coalition-building;
- One Stop Shops (OSS);
- Regulatory Impact Assessment (RIA) and reform; and
- local development planning and fiscal management.

These programs (a) identify and delineate crucial issues for reform; (b) enable investment and enterprise through pro-market reforms;

⁴ These programs are organized under the Economic Reform and Development (ERD) Program of The Asia Foundation.

(c) advance trade and financial sector reforms; and (d) strengthen the responsiveness of economic governance to the needs of enterprise and the poor. The Foundation works with a broad variety of partners, including chambers of commerce and business associations, civil society organizations, research institutions, donors, and government agencies.

The Asia Foundation's ERD portfolio has expanded rapidly over the past decade and now comprises multi-year programs in Bangladesh, Cambodia, Indonesia, the Philippines, and Sri Lanka, with an annual programming investment of more than US\$9 million, or about 14 percent of the Foundation's total annual program budget. Financing for ERD projects comes from diverse sources, including the United States Agency for International Development (USAID), the Australian Agency for International Development (AusAID), the U.K. Department for International Development (DFID), the Danish International Development Authority (DANIDA), the Canadian International Development Agency (CIDA), The World Bank (WB), the International Finance Corporation (IFC), and private donors.

The Economic Reform and Development Toolkit

While many of the impediments to economic reform and poverty alleviation are governance-related, the solutions are not primarily sectoral or technical. Rather, Foundation experience suggests that successful reform requires addressing the political and social interests that benefit from existing exclusionary and uncompetitive arrangements. Initiatives to spur growth and reduce poverty cannot be implemented on the basis of canned and formulaic approaches. Country-specific diagnostics that consider cross-sectoral, political, and socio-cultural factors are essential, in tandem with country-dedicated programming owned and largely implemented by citizens.

The Foundation focuses on identifying the competing interests and amplifying the voices of those who would benefit from greater transparency and accountability; and on creating and promoting initiatives that shape the incentives of stakeholders toward policies that create economic opportunities for all. Moreover, the Foundation works to enable the participation of those primary economic actors who are often excluded from policy debate such as small businesses, reform-minded officials, and marginalized subsectors such as female and minority entrepreneurs.

Resources generated from donors by the Foundation are channeled to implementing groups to undertake tasks based on agreed project objectives and designs, which are consistent with the guiding principles of the partners. The Foundation is strengthening its ERD programming not only in size, but also in program quality and innovativeness. Priority is being placed on economic analysis and impact evaluation of interventions, particularly since there are major conceptual as well as methodological challenges that must be overcome in order to appropriately assess program impact.

Over years of refinement and experience, the Foundation has developed and deployed ERD tools to:

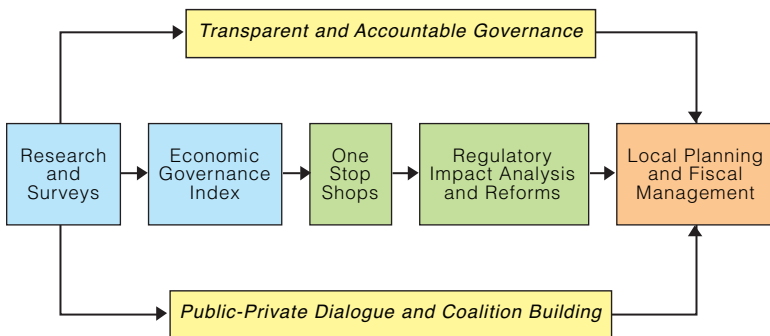
- enable investment and enterprise (especially for small and medium-scale businesses) through pro-market regulatory reforms at the local and national levels; and
- strengthen the responsiveness of local economic governance to the requirements of enterprise and the needs of the poor by supporting a culture of dialogue and consultation among the different stakeholders.

These tools are scalable from the local level up to the national level, and are employed at strategic points to improve the policy

environment for investment and enterprise. They are calibrated to suit the particular conditions of target countries or local jurisdictions. The tools are not fully separable nor are they deployed in fixed sequence, but there is some overlap among tools in order to facilitate transitions between stages and phases. The strength of each program lies in the attention given to the unique characteristics of each country and to ensuring the participation of all key players in the process.

In effect, the tools form a continuum of programming, as illustrated by Figure 1.2. Public-Private Dialogue facilitates joint action and collaboration toward reforms. Research and surveys—particularly the Economic Governance Index—identify competitive or less competitive localities, and also the key constraints to private investment and enterprise. Regulatory Impact Assessment focuses on regulatory constraints and applies economic analysis to transparent and participatory processes toward reforms. Ultimately, the application of these tools improves the capacities of governments, especially at the local level, to keep their fiscal houses in order.

Figure 1.2: The Asia Foundation's ERD Programming Tools



Each of these ERD tools is briefly described below. The remaining chapters of this book document their implementation across various countries in Asia.

Strategic Analysis, Surveys, and Research

The Asia Foundation's economic programming begins with surveys, polls, and research, conducted to identify impediments to business growth in defined geographical areas and to enhance the relevance, quality, and impact of programs and projects. This research-based approach is a "best-practice" in developing effective approaches to important governance challenges by generating and utilizing policy-relevant information useful to all stakeholders.

The Foundation undertakes survey research to improve the quality and impact of its work. Empirical analysis informs project design and establishes clear baselines against which to measure progress. Research informs project design by determining the most effective interventions to bring about the desired change. Empirical studies are also important as a reality check to ensure that starting assumptions about an issue or problem are correct at the outset. Without empirical validation, there is greater danger that donor investments will be wasted. This is a particularly serious problem for governance-related projects, where the issues involved are abstract and may not lend themselves to clear methodological approaches.

The research process itself is empowering. Asking people their perceptions of government performance underscores their fundamental rights as citizens to express their views. Furthermore, surveys reinforce the idea that government must be transparent, accessible, accountable, and responsive; and that citizens have the responsibility and the right to engage with government in constructive ways. With a focus on shared responsibility, this approach can also

be important for securing the necessary buy-in from government officials who have the power to change policies or adjust budget allocations, on the premise that it is in their own interest to understand existing problems and citizen perceptions of government performance.

Surveys—particularly those that lend themselves to indices, scorecards, and rankings—can serve as powerful tools for advocacy. People generally like comparisons and are fascinated by lists and rankings, so these kinds of projects tend to generate a great deal of public and media attention, which in turn puts pressure on government to improve performance.

The Asia Foundation invests heavily in surveys to help build the capacity of local research organizations. Over the Foundation's nearly 60 years of operation, a premium has always been placed on strengthening the capacity of Asia's governmental, non-governmental, and academic institutions. Each survey project involves local organizations that understand the local political landscape and are able to capture local nuances in a way that would be impossible for any international organization acting on its own.

The Economic Governance Index

The Economic Governance Index (EGI) is one of the diagnostic surveys developed by The Asia Foundation as a response to emerging development governance needs and realities in Asia. One consequence of decentralization is that elected local officials are eager to be seen as successfully promoting investment and job-creation in their localities, while voters and investors are keen to measure the success or failure of their local officials. However, measuring performance is often difficult because standards must be relevant and comparable while also within the actual influence

of local officials—at least in the short run. Most existing methods focus on outcomes not under the local government’s direct control, such as the percentage of the labor force that is employed, the Human Development Index (HDI), and the economic growth rate. The challenge is to find an effective and reliable tool for measuring the quality of economic governance among districts.

The EGI provides part of the solution, as its survey and indicators are specifically tailored to country contexts, and focus on aspects of governance that local governments can influence. Typically, investment climate surveys measure key infrastructure endowments (such as road and sea logistics) that are not easily altered by local government. The EGI survey controls for these factors and focuses instead on how well local leaders manage the delivery of business services and undertake initiatives to improve their business climates. The survey enables the calculation of the index, which measures the quality of economic governance and enables comparisons across local jurisdictions. It is based on actual practice and business perceptions, rather than official legal frameworks.

The large non-governmental organization KPPOD (the Indonesian acronym of “local economy watch”) has been implementing a survey and ranking of economic governance and business climates in Indonesia since 2001. The first of its kind in Indonesia, the ranking gradually increased its coverage from 90 districts in its first year to 243 in 2007. The original KPPOD survey helped to spur competition between districts and highlight the importance of local economic governance in the era of Indonesia’s remarkable and swift decentralization. KPPOD data has shown that regional performance is mixed. In 2007, the Foundation worked with KPPOD to develop a comprehensive new survey and index methodology. The survey covered all 243 cities and regencies with-

in 15 provinces, making it the largest of its kind in Indonesia (and one of the largest in the world).⁵

In partnership with relevant government ministries and the national and local Chambers of Commerce and Industry in Bangladesh, Cambodia, Indonesia, Sri Lanka, and Vietnam, The Asia Foundation has established the EGI as a powerful tool to identify those aspects of governance that determine the competitiveness of given localities in terms of investment and enterprise. The results of the EGI then feed into a collaborative identification of regulatory issues that constrain investment and enterprise, leading to dialogue between stakeholders (government, business, and community) that facilitates and sustains policy reform.

By focusing on economic governance, the EGI emphasizes policies, initiatives, and performance of the local authorities, thus setting the stage for needed adjustments and reforms.

In short, EGIs:

- inform the key stakeholders (private sector, business, government, and citizens) about the business environment in their area relative to other areas, thus creating a demand for an improved business environment;

⁵ The Asia Foundation support for KPPOD was provided under the PROMIS program, initiated in April 2005 with the generous support of the United States Agency for International Development (USAID). In 2007, the survey was redesigned and implemented as the “Local Economic Governance Survey.” Respondents included 729 business associations and 12,187 firms. For more information, see The Asia Foundation, “Reducing Barriers to Market Entry and Business Operation (Program untuk Memperbaiki Iklim Investasi-PROMIS),” Quarterly Reports (2006-07).

- provide provincial leaders with a frame of reference for best-local practices as they seek to improve policies within their own borders; and
- create a proactive and competitive process aimed at improving the local business environment.

The EGI uses results from surveys of local enterprises and data collected from published sources and statistics to develop indicators against which municipalities, districts, or provinces are measured and ranked. The administrative units ranked vary among countries to reflect local realities of decision-making and/or structural elements such as decentralization.

Dedicated EGIs are developed for each country, with country-specific indicators on state sector bias, the abundance and quality of labor, cost of business and business infrastructure. The indices measure performance in economic governance using similar criteria, including: entry costs; transparency and access to information; participation; time costs of regulatory compliance; informal charges; crime prevention; taxes; and dispute resolution.

Public-Private Dialogue and Coalition-Building

Information and analysis in isolation do not lead to change. The promotion of reforms requires building the constituencies for change. Thus, an essential aspect of The Asia Foundation's strategy involves working with independent local business groups to enhance their role and effectiveness in policy reforms. These include farmers' groups, Chambers of Commerce, associations of women entrepreneurs, guilds and crafts associations, NGOs, community groups, and other civil society organizations.

Efforts to improve governance also involve strengthening key reformers. To do so, the Foundation helps facilitate Public-Private Dialogues (PPDs) that enable the private sector to press for legislation or improvements to the business environment that will support business growth. This dialogue sets the stage for technical assistance to enact reform measures through revised legislation or the sharing of best practices in implementation.

The Foundation devotes substantial attention to the links between poverty and the delivery of core public services. The growth process in Asia has excluded many poor people and in some cases has made them worse-off. Much of current decision-making on public expenditures—including the determination of priorities and the actual implementation process—fails to incorporate diverse views, like those of the emerging middle class and local business groups. There is a need for governance that accounts for the interests of the poor—creating opportunities to accelerate growth and generating better outcomes for the poor without risking the benefits of broad-based growth.

The strengthening and engagement of local coalitions in public expenditure programming is crucial to establish this type of governance. Co-equal dialogue cognizant of political processes thus underpins the Foundation's approach to improved governance.

The Foundation's strategy is not solely focused on increasing expenditures, but rather encourages a broad assessment of resources and allocation processes. The Foundation works with the poor and their representatives. Programs are aimed at expanding the set of partners working with government on public service issues to include small business owners, academics, professional associations, and other civil society organizations. This broader array of interest groups—varied in provenance yet focused on common issues—

enables more constructive dialogue with public officials. In solidarity with other groups, the representatives of the poor are able to present their interests within an array of community concerns on commonly held objectives—all held together by a shared interest in effective and transparent governance.

The Asia Foundation focuses on amplifying the voices of those who would benefit from greater transparency and accountability, and on creating policies that generate economic opportunity. As the primary economic actors excluded from policy debate, small and medium-scale enterprises (SMEs) make a natural constituency for reform; as do women and reform-minded officials. Existing chambers of commerce and sectoral business associations have long failed to reflect the needs of members (particularly SMEs) and have traditionally functioned more as brokers of government largesse.

One Stop Shops

Micro, small, and medium-scale enterprises (MSMEs) account for the vast majority of all enterprises in Asia. Most exist in the informal sector—unregistered and without required permits and licenses. This poses a serious obstacle for the growth of these firms, as they are often unable to access bank finance, sell to large buyers, or export. Since the costs of registering a new business are very high, business owners must consciously weigh the value of being registered against the time and expense of undergoing the process. There are two formidable barriers to entry into the formal sector in many Asian countries: (1) the quantity of licenses required by law, which is much higher than in most regions, and (2) the poor quality of public services, high levels of corruption, and inefficiency, which makes obtaining these licenses slow and costly. Often, these impediments are exacerbated by decentralization processes that

have shifted authority over business licenses from national to local governments.

The Asia Foundation works to address these issues through developing and strengthening One Stop Shops (OSS)—new government offices that consolidate and simplify licensing processes to better serve the business community. The OSS development process involves two basic steps:

- *Baseline Business License Surveys*: The Foundation conducts surveys to provide information for the implementation of the technical assistance program, as well as to set a benchmark for later monitoring and evaluation. The baseline survey includes responses from the business community reporting actual business experiences with government regulatory and licensing agencies.
- *Mapping*: The Foundation then utilizes mapping in order to fully document how licenses are processed across government agencies; and gather information on the existing local regulations and decrees that stipulate permits and licenses requirements, procedures, time, and cost.

Together, baseline surveys and mapping inform the development of strategies for local governments to simplify processes and consolidate licensing authority. OSS centers then streamline licensing procedures by establishing clear and straightforward procedures and consolidating them under one roof. The process is streamlined and requires only one point of contact between the business owner and the government. Positive impacts for local businesses include less paperwork, faster processing times, and smaller informal payments. By lowering barriers in this manner, more informal businesses are encouraged to enter the formal sector.

Regulatory Impact Assessment and Reforms

In many parts of Asia, the biggest obstacles to business activity and expansion stem from government regulation and governance—specifically heavy regulation or rent extraction. These impediments are manifested in burdensome licensing and opaque registration requirements; poor law-and-order conditions; endemic rent-seeking behavior and corruption; and insecurity in the legal enforcement of contracts. Within this environment, small businesses with limited access to capital and fewer political connections tend to carry a disproportionately heavy burden.

Regulatory Impact Assessment (RIA) helps ensure that the impact of regulations is clear and helps governments and their citizens pursue a more transparent regulatory process. RIA is a systematic process of defining problems, objectives, and weighing alternatives. It improves on current practices by introducing greater rigor in the form of cost/benefit analysis and stakeholder consultation. These steps make the cost of regulation clear and help to prevent the implementation of poor regulations.

The Asia Foundation has implemented RIA processes in various countries at the national and local government levels. The Foundation works closely with partners and experts to develop each RIA site—beginning with an inventory of all economic regulations, followed by public consultations to determine relevance and concern. Key regulations are then selected by the RIA team for economic impact analysis and examination through the consultative RIA process. The RIA program not only finds regulatory solutions to problems, but also promotes the drafting of more appropriate legal issuances that facilitate the implementation of reforms. Government officials, business owners, and NGO leaders receive specialized RIA training and related analytical tools, helping

community leaders and stakeholders to take a more informed and critical view of policies and the policymaking process. Chapter 4 of this compendium details The Asia Foundation's experience in the deployment of RIA processes across Asia – particularly in Indonesia, Sri Lanka, and Cambodia. These examples show that reform-oriented programs that utilize RIA processes have enabled the Foundation to focus its efforts at local-level regulatory reforms while ensuring that any advances achieved at the local level subsequently serve as platforms for national-level change.

Local Development Planning and Fiscal Management

Amidst volatile economic trends and a groundswell of decentralization, The Asia Foundation's ERD programs enable local communities and private entrepreneurs to pursue opportunities for enhanced growth and incomes. Fiscal management is the concrete expression of government policy, where resource mobilization and expenditure strategies reveal which sectors of the community are taxed and which are supported. The development aspirations of citizens, and the vision and strategy of community leaders, are summarized in local development plans. The Foundation supports transparent, accountable, and participatory governance, where representatives of civil society—especially those from traditionally isolated and disenfranchised groups—are enabled to engage in local governance, particularly in planning and budgeting processes. Research, analysis, and diagnostic exercises such as the EGI, give citizens the tools to develop and voice their opinions regarding governance, as well as to monitor implementation and assess results.

The Asia Foundation: Supporting Asian Initiatives Toward Sustained Growth

The Asia Foundation's approach to economic reform and development is unique—it lies at the crossroads of economics, political science, and public administration; between research and direct program implementation; and astride the development views of large multilaterals and local reformers and coalitions. Accumulated experience and learning indicates that success in economic growth and development requires not only policies that “get prices right,” but also the appropriate institutions that ensure the protection of property rights; enforce contracts; stimulate entrepreneurship; nurture international integration; maintain macroeconomic stability; manage financial risk; supply social safety nets; and enhance transparency, voice, and accountability.

The Asia Foundation's ERD programs support Asian initiatives to enhance economic governance to accelerate and sustain economic growth. The Foundation's long experience has led to its focus on the mitigation of regulatory and structural constraints to investment and enterprise, and other reforms necessary to build Asia's economic resilience in the face of challenges and enable all to gain from the benefits of global integration.



THE ECONOMIC GOVERNANCE INDEX: MEASURING GOOD GOVERNANCE FOR ECONOMIC GROWTH AND DEVELOPMENT IN BANGLADESH, CAMBODIA, INDONESIA, SRI LANKA, AND VIETNAM

Nina Merchant-Vega

Across Asia, economic dynamism is providing new jobs and new opportunities for hundreds of millions of people. It is altering the global economic system and transforming the lives of Asia's citizens. However, performance across the region has been mixed. For some Asian nations, strong national productivity numbers conceal underperformance at the local level. In these countries, many provincial or district economies are failing to live up to their potential as engines of growth. What challenges are holding these underperformers back, and what can they do to enhance their competitiveness? To help answer these questions and respond to concerns of entrepreneurs, The Asia Foundation's Economic Governance Index (EGI) focuses on the impact of local governance on private sector development.

In recent years, there has been a growing consensus among academics that good governance promotes sustainable and equitable economic growth.¹ As a result, bilateral and multilateral aid agencies have made promoting good governance a cornerstone of their

1 These papers include Stephen Knack and Philip Keefer, "Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures," *Economics & Politics*, vol. 7, p. 207; Daron Acemoglu, Simon Johnson and James A. Robinson, "The Colonial Origins of Comparative Development: An Empirical Investigation," *The American Economic Review* (2001), p. 1369; Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, "Measuring Governance Using Perceptions Data" in Susan Rose-Ackerman, ed., *Handbook of Economic Corruption*, 2006; Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, "Governance Matters VI: Governance Indicators for 1996-2006," World Bank Institute (2007).

programs across the world. Recognizing the vital link between governance and growth, The Asia Foundation has developed the EGI as a powerful tool to identify governance factors that influence local competitiveness.²

EGIs are country-specific diagnostic tools used to assess and rank the performance of localities (e.g. provinces, states, districts) in specific areas of their regulatory environments. The indices are constructed from data gathered from surveying businesses on their perceptions of the local business environment. One of the most comprehensive economic indices of its kind, the EGI represents the aggregate voice of the private sector. EGIs identify the best performing local governments, and allow entire communities to see how they measure up against neighboring provinces or districts. In short, EGIs are snapshots of government performance with an emphasis on implementation.

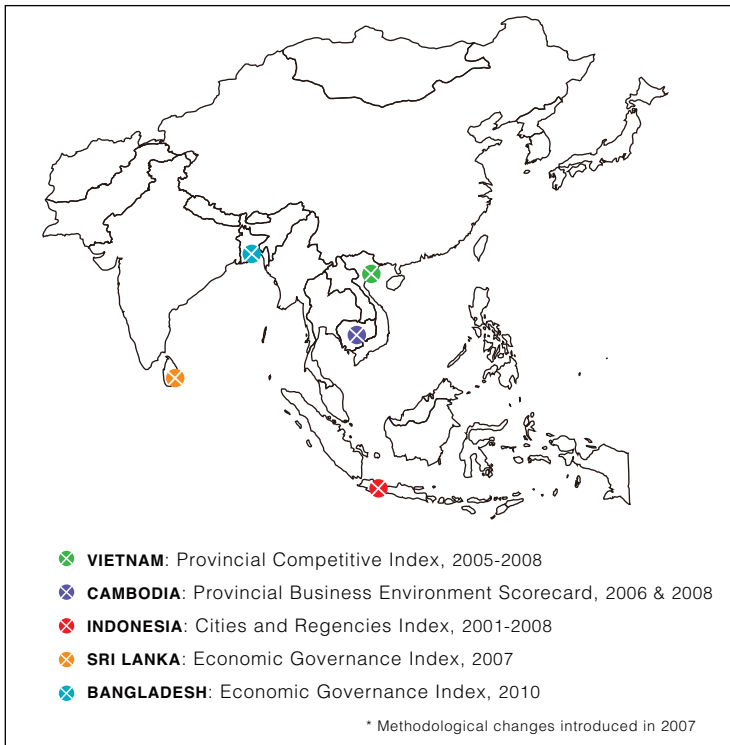
In partnership with government ministries, and national and local chambers of commerce and industry, the Foundation has developed EGIs in countries throughout South and Southeast Asia (Figure 2.1), including Cambodia, Indonesia, the Philippines, Sri Lanka, Vietnam, and Bangladesh.³ The overall rationale for creating this tool stems from the idea that economic governance impacts private sector development—independent of structural endowments such as location, infrastructure, and human capital—

2 The EGI methodology was originally developed in partnership with Dr. Edmund Malesky of the University of California, San Diego for use in Vietnam in 2005.

3 Specifically, the Vietnamese Provincial Competitiveness Index (PCI, 2005-2008); the Cambodian Provincial Business Environment Scorecard (PBES, 2006 & 2008); the Sri Lankan Economic Governance Index (EGI 2007); the Indonesia Cities & Regencies Index (2001-2007); and the Bangladesh Economic Governance Index (2009). All of these indices were created with the close collaboration and funding of The Asia Foundation.

<http://asiafoundation.org/publications/>

Figure 2.1: The Asia Foundation's ERD Programming Tools



and, in turn, that private sector development generates economic growth. By focusing on economic governance, the EGI emphasizes policies, initiatives, and performance of local authorities, thereby setting the stage for needed adjustments and reforms.

THE ECONOMIC GOVERNANCE INDEX

EGIs are composite indexes—based on a 100-point scale—that score the economic governance of each locality in a country. Each index comprises 10 sub-indices—developed from academic literature on economic transition and growth—which capture the key elements of the local business environment that can be influenced

by provincial laws and public service delivery. While specifics vary from country to county, some common sub-indices include:

1. *Entry Costs*: a measure of the time it takes for firms to register and receive necessary permits to start a business, as well as the number of licenses required and the official costs of obtaining all licenses/permits.
2. *Land Access and Property Rights*: a measure combining two dimensions of the land problems confronting entrepreneurs, as well as the ease of access to land and the security of land tenure.
3. *Transparency and Access to Information*: a measure of various aspects of transparency such as a firm's access to information, equity of information, and whether information is shared predictably and openly.
4. *Participation*: a measure of whether firms are consulted in the creation of local policy and whether their interests are represented by business associations or interest groups.
5. *Time Costs of Regulatory Compliance*: a measure of the time spent by firms on bureaucratic compliance and the regularity with which they must suspend operations for inspections by local regulatory agencies.
6. *Informal Charges*: a measure of the amount firms pay in informal charges; the degree to which these charges pose as an obstacle for business operations; and whether or not informal charges deliver expected "results" to firms.
7. *Crime Prevention and Security*: a measure of the explicit costs incurred by firms as a result of crime, as well as the implicit costs firms pay to prevent crime through security or protection money.
8. *Taxes*: a measure of the administrative fiscal burden imposed by tax laws at the local level.
9. *Dispute Resolution and Legal Environment*: a measure of the level of satisfaction among firms with the outcome of informal and formal modes of dispute resolution and legal institutions.

10. *Proactivity and Openness Toward Business*: a measure of the creativity local authorities use in helping businesses solve their problems in the context of opaque central government policy.

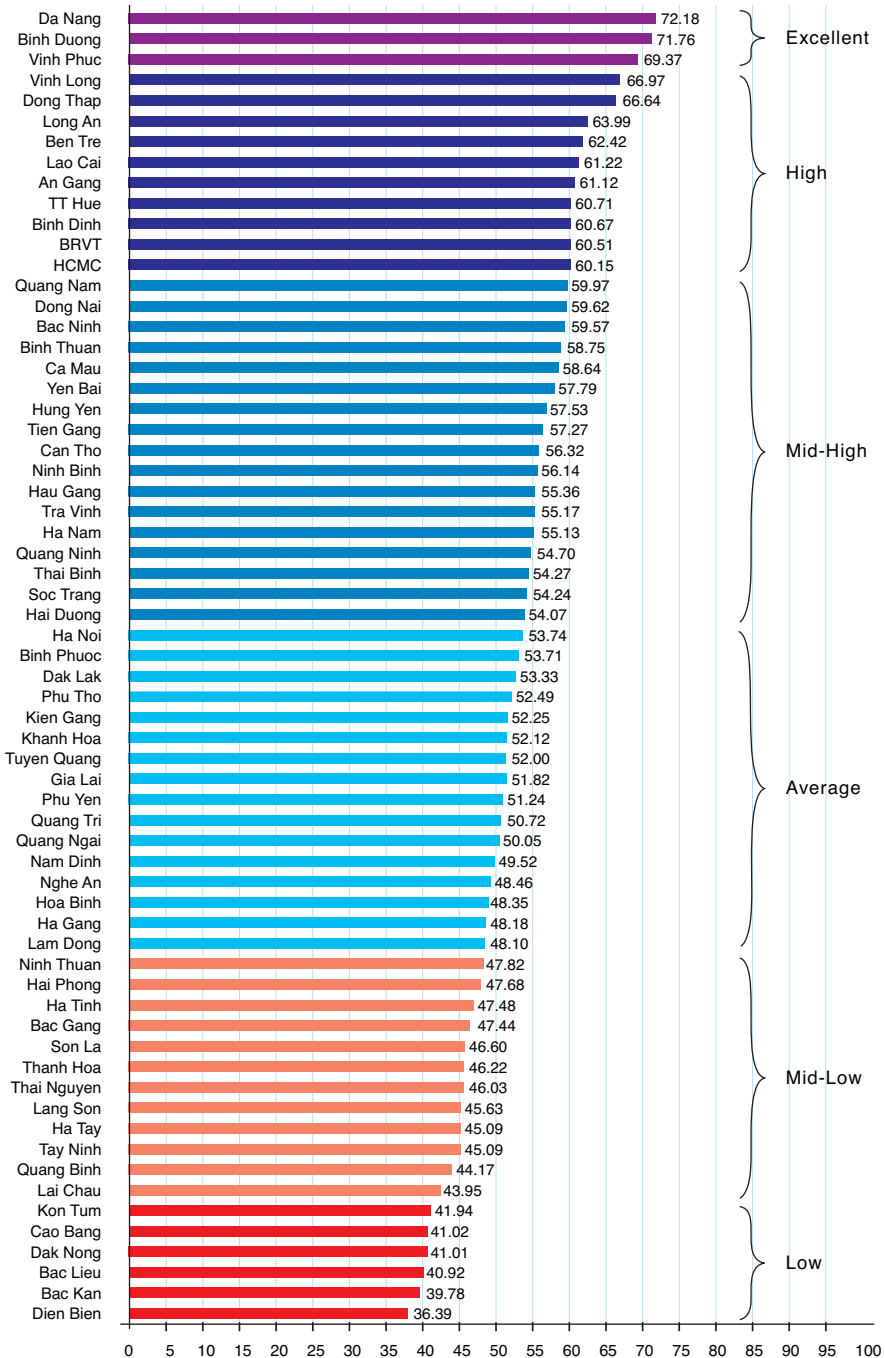
Each of these sub-indices is broken down into a series of operationalized indicators. The data required to capture these indicators is derived from a comprehensive, firm-level perceptions survey; and “hard data” from various published sources. The indicators are then scored, scaled, and aggregated to create composite scores for each subnational unit. For most EGIs, each of the sub-indices are given weights from a weighting regression in which structural factors such as infrastructure, human resources, and GDP are held constant.⁴ The composite scores are then ranked to create a full composite index.

The methodological rigor needed to construct an EGI requires not only international experts in survey research and statistics, but intense local knowledge to understand the economic governance context. For this reason, the Foundation establishes both technical and advocacy partnerships with the relevant government ministries, non-government organizations, research institutes, chambers of commerce, and industry in all EGI countries. Such partnerships are crucial to the design, implementation, creation, and dissemination of EGIs; and vital in creating local ownership over the product.

Lastly, as the example from Figure 2.2 (taken from the 2008 Vietnam Provincial Competitiveness Index) demonstrates, although EGIs are methodologically rigorous, their visual format is easy for laypersons to understand. This feature makes them excellent tools for understanding and diagnosing economic governance issues.

⁴ The Vietnam, Indonesia, and Bangladesh EGIs are weighted. The Cambodia and Sri Lanka EGIs are not weighted due to sample and data limitations.

Figure 2.2: 2008 Vietnam Provincial Competitiveness Index



Features of the EGI Program

EGIs provide relevant economic governance information to policymakers, businesses, citizens, and development professionals. The aim of the EGI is to link policymakers and development practitioners to valid evidence in order to better diagnose problems, target prescriptions, and isolate the impact of policies and programs. Such evidence is crucial for implementing policies and programs that improve the business environment.

The EGI exposes poor performance transparently, encouraging stakeholders to engage in dialogues around business environment issues. Further, because comparisons are drawn between neighboring localities, the EGI frames policy locally and places reform in a competitive but achievable context. This creates a proactive and competitive process aimed at improving the local business environment.

A Policy Analysis Tool for Government

Undoubtedly, one of the most important functions of the EGI is as a policy analysis tool for national and subnational governments for use in diagnosing and addressing economic governance issues. For many years, policymakers and researchers have inhabited almost parallel universes. Policymakers protest that research is disconnected from reality and difficult to put into action, while researchers lament the primacy of “political considerations” in the policymaking process.⁵ This conflict reflects both the failure of researchers to

⁵ Overseas Development Institute, “Bridging Research and Policy in International Development: An Analytical and Practical Framework,” Policy Briefing, October 2004.

take into account political and economic factors when designing policy, and policymakers' resistance to change to reform efforts that directly conflict with political incentives.

EGIs seek to overcome this conflict by being highly relevant and transparent. They aim to arm reform-minded policymakers with understandable data on the business environment—including which policies and problems are most detrimental to the business environment—to help them craft effective reforms. Such objective data is also crucial to helping push through reforms that are politically sensitive or face high opposition by providing political cover for reformers. Moreover, while index rankings are meant to inspire the desire for improvement, EGIs are not designed to place particular blame on individual provincial-level policymakers or institutions.

In Vietnam and Cambodia the results have become so important that the national governments of these countries are using the index as a benchmarking instrument to monitor economic reform progress at the provincial level. In many countries, local officials request customized diagnostic workshops from researchers to learn more about their scores and how they can improve them. For example, following the release of the 2008 Vietnam Provincial Competitiveness Index (PCI), the People's Committee of Kien Giang province requested a provincial diagnostic workshop. Following the workshop, the committee created a report with an analysis of each of its sub-index rankings as well as a detailed action plan outlining reforms that needed to be undertaken by specific provincial departments. Kien Giang's efforts highlight its interest in and commitment to using the PCI as a tool to develop a roadmap for reform.

A Monitoring and Dialogue Tool for Businesses and Citizens

EGIs also provide a useful way for businesses and citizens to monitor and create dialogue with local and national governments. Public-private sector dialogue is vital to economic development, as it provides government with a better understanding of the micro-foundations for growth from the perspective of the private sector. EGIs are an obvious starting point for such dialogue because they provide a clear, empirical basis for discussion. In this way, they bolster the legitimacy of private sector concerns and are difficult for even normally unresponsive public sector organizations to ignore.

The release of the 2006 Provincial Business Environment Scorecard (PBES) in Cambodia drew attention to governance constraints that directly affect the performance of enterprises. As a follow-up to these results, The Asia Foundation sought to empower the business community—particularly micro, small, and medium-sized enterprises (MSMEs)—to discuss these constraints with local authorities and improve the business environment through policy advocacy. To establish a collective voice for MSMEs, the Foundation supported the creation of Cambodia's first provincial cross-sector business associations in Kampong Cham, Kampong Chhnang, and Kampot. Together, these associations represent more than 200 enterprises from a variety of sectors, including rice milling, retail, agro-business, and fisheries. The Foundation strengthened the voice of these associations by providing them with networking opportunities, training, and technical assistance.

Provincial Public-Private Dialogues (PPPDs), initiated by these provincial business associations and facilitated by the Foundation, brought MSME owners and local authorities together to formulate proposals for change. Business owners raised concerns regarding

informal fees, the need for clearer information on licensing procedures, and greater taxation transparency. The clear articulation of issues requiring attention resulted in the simplification of administrative paperwork and the reduction of taxes and informal fees. Workshops organized by the Foundation in cooperation with the Cambodian Senate also provided opportunities for local enterprises to raise provincial business concerns.

Dialogues have also taken place throughout localities in Sri Lanka and Bangladesh. Such regular interactions with local and national authorities help position business associations as legitimate partners for the public sector.

A Program Analysis Tool for NGOs and Multilaterals

EGIs are also an important tool for development practitioners, including NGOs and multilateral aid organizations. Like policymakers, development practitioners have often been apathetic or even hostile toward using research to inform their programs.⁶ Institutional inertia and a lack of understanding of the importance of solid research are partly responsible for this stance.⁷ Another contributing factor is that institutions often do not have incentives to use good research to drive programs.⁸

EGIs help breach this divide by objectively presenting data in a clear and simple format. With straightforward tables and graphics,

6 Lant Prichett, "It Pays to be Ignorant: The Simple Political Economy of Rigorous Program Evaluation," *The Journal of Policy Reform*, vol. 5, no. 4 (2002), p. 251.

7 Abhijit Vinayak Banerjee, *Making Aid Work*, 2007, p.7.

8 Prichett, op. cit., p. 251

development practitioners can clearly and easily discern where certain provinces are falling short in the sub-indices or in the composite index as a whole. While this doesn't fully overcome the structural incentive problems that development practitioners face, it can help better target and focus programs aimed at improving the subnational business environment. Anecdotal evidence suggests that development practitioners are using EGIs to inform and evaluate their programming. For example, both the Danish International Development Agency's (DANIDA) Business Sector Program Support Program and the Deutsche Gesellschaft für Zusammenarbeit GmbH (GTZ) have incorporated the Vietnam PCI into their work plans and monitoring and evaluation systems.

A Baseline Tool for Development Research

Finally, EGIs are a powerful tool for development research; they generate high-quality, annual datasets for multipurpose use, creating an invaluable source of information for researchers. Researchers can use the raw dataset to find out more about particular cross-province variations—answers to such questions as, “Do informal charges affect the level of long-term investment across provinces?” or “Does the level of transparency in a province have a significant impact on average profits?” The data thus helps to explain why some provinces underperform, rather than simply identifying which provinces underperform.

Researchers may also use the raw data to understand variations across different dimensions, adding nuance and insight to their overall understanding of economic governance. For instance, researchers may want to know if certain types of businesses or industries are particularly unhappy with certain aspects of economic governance. Some may want to know if there are particular regional or cultural variations that are correlated with economic gover-

nance. The composite index can also help researchers to monitor the implementation of national-level policies.

Two EGI datasets—the Vietnam Provincial Competitiveness Index and the Cambodia Provincial Business Environment Scorecard—have subsets of data that are collected as a longitudinal panel. A longitudinal panel collects data from the same respondents over time, allowing researchers to identify short and long-term changes in firm-level responses. This is particularly important in impact assessments of provincial-level policies and programs.

Researchers have already begun to use the data to inform their research. Dr. Edmund Malesky of the University of California, San Diego, who serves as a senior consultant on each of the EGIs, has incorporated EGI data in several papers that have been published in leading political economy journals. Using EGI data, he has written extensively on the impact of institutions on business formalization in Vietnam; credit and investment growth in Vietnam; and corruption and investment strategy in Cambodia. In addition, Dr. Neil McCulloch of the Institute of Development Studies used the data from the 2007 Indonesia EGI to study the extent to which the quality of economic governance at the district level enhances the economic performance of Indonesia's decentralized districts.

Program Highlights

Measuring Provincial Competitiveness in Vietnam

In 2002, The Asia Foundation partnered with the Vietnamese Chamber of Commerce and Industry (VCCI) to explore why some provinces in that country have business environments that are more conducive than others to private sector dynamism, job creation, and economic growth. This groundbreaking research

provided the basis for the development of the PCI as part of the larger Vietnam Competitiveness Initiative (VNCI).⁹

First implemented by the Foundation in 2005 in partnership with VCCI, the inaugural PCI covered 42 provinces that accounted for approximately 90 percent of economic activity in Vietnam. It provided the first-ever ranking and assessment of provinces based on their regulatory environments. Subsequent annual PCIs continued to refine the methodology and expanded it to all 64 provinces in Vietnam.

The annual releases of the PCI from 2005-2008 attracted tremendous attention from the media, the business community, national and provincial governments, and the donor community. Vietnamese national TV news (VTV1) named the PCI one of the “Top Ten Economic Events in 2005.” Between 2006 and 2008, the PCI was featured prominently in more than 500 media publications.

In response to the success of the PCI, provincial authorities invited the Foundation, in partnership with VCCI, to present customized diagnostic analyses of their respective province’s PCI performance each year. These diagnostic workshops resulted in important commitments and initiatives by provincial governments—including new measures to promote business participation in the policy and planning process; greater efforts to streamline and rationalize business licensing, and land access procedures; and improved institutional responsiveness to the needs of private sector entrepreneurs and investors.

⁹ The VNCI project was implemented by The Asia Foundation with the generous support of the United States Agency for International Development (USAID).

Enabling Policy Advocacy in Cambodia

In 2006, The Asia Foundation and the International Finance Corporation's (IFC) Mekong Private Sector Development Facility created the Provincial Business Environment Scorecard (PBES) in Cambodia. The PBES helped to promote private sector development and job creation by supporting and strengthening private sector policy advocacy for an improved business environment at the national and subnational levels. It was the first-ever comparative analysis of the business environment across 10 of Cambodia's 24 provinces and municipalities and was subsequently extended to cover all 24 provinces in 2009.¹⁰

Each iteration of the PBES was a great success, and its rollout through a series of national and provincial workshops provided opportunities for local governments and business associations to take practical steps to identify priorities and discuss possible reforms. The publicity helped increase awareness in the policy community and highlighted the importance of subnational business environments when considering long-term prospects for economic growth and private sector development.

Going forward, the Foundation's Economic Reform and Development team will continue working with community-based governments, and line ministry representatives to use the PBES

10 The PBES was implemented under The Asia Foundation's, "Strengthening the Private Sector in Rural Cambodia: Association-Building and Policy Advocacy" program, with the generous support of the Australian Agency for International Development (AusAID), and in partnership with the International Finance Corporation's Mekong Private Sector Development Facility (IFC-MPDF).

findings as a platform for identifying the key constraints to improving business opportunities for poor, natural resource-dependent communities. The hope is that the PBES will become not just a successful publication, but also the basis for multi-sectoral advocacy and regulatory reform at various levels—commune, district, provincial, and national.

Improving the Environment for Private Enterprise in Sri Lanka

In 2007, The Asia Foundation constructed an EGI for local authorities in Sri Lanka. The index was launched at a symposium organized jointly by the Foundation, the Ministry for Local Government, and provincial councils during “Local Governance Week” in July 2007.

EGI analysis showed that even though structural conditions—such as quality of infrastructure in a locality—tend to dominate the business environment, improvement in economic governance can substantially alter the business environment from one area to another. The data demonstrated that improvement in certain areas of economic governance—such as reduction of informal charges, transparency, and participation—can have an important impact on the overall business climate in the country.

The EGI helped identify and facilitate understanding of government-influenced constraints to economic growth, and demonstrated the influence of economic governance on business behavior. EGI activities have also improved communication and relationships between business leaders and local government officials in Sri Lanka. As a follow-on, the Foundation supported provincial-level working group meetings, where issues such as infrastructure needs were solved through joint action of the private sector and the provincial government.

Fueling Local Competitiveness in Indonesia

Since 2001, the Indonesian non-governmental organization Regional Autonomy Watch (KPPOD) has conducted the Competitiveness of Regencies/Cities survey with The Asia Foundation's support. This annual survey of business people assesses the business environment in regencies and municipalities (the two types of localities within provinces) and rates the investment competitiveness of various regions in Indonesia. In the latest 2007 survey, the KPPOD surveyed 243 out of the country's 483 regencies and municipalities.

In Indonesia, regional autonomy has created mixed results in economic growth. While some local governments have become more transparent and have reduced burdensome regulations for businesses, others have lagged behind. KPPOD concluded that, "Decentralization has created new challenges for business growth, often leading to greater uncertainty for investors." Survey results indicated that licensing and regulatory factors had the lowest ratings in Indonesia.

These results have helped local governments target specific areas in need of improvement. By identifying and publicizing the factors that make the highest-ranking regions most successful in attracting investment, the survey fuels competition among regions to improve their investment climates.

Linking Local and National Level Economic Reforms in Bangladesh

In 2010, The Asia Foundation, with support from the IFC, released the first iteration of the Bangladesh EGI, which covered 19 of Bangladesh's 64 districts and municipalities. The first index

of its kind in Bangladesh, the EGI launch in Dhaka was attended by important stakeholders from the public and private sectors including the commerce minister, members of parliament, mayors, chambers of commerce, and the media.

During the launch, the commerce minister made several high-level reform announcements based on the findings of the EGI including new transparency rules for businesses to access information as well as a “guide to doing business in Bangladesh.”¹¹ He also outlined new initiatives to encourage the participation of women entrepreneurs, which were shown to be a very small percentage of business owners in Bangladesh. These initiatives were supported by private sector representatives who noted the need for increased transparency and responsiveness from local governments.

11 “Economic Governance Index Launched,” *The Financial Express*, August 2, 2010.



CREATING STRATEGIC PARTNERSHIPS BETWEEN THE PUBLIC AND THE PRIVATE SECTORS

Véronique Salze-Lozac'h

Micro, small, and medium-scale enterprises (MSMEs) comprise the vast majority of enterprises in Asia, and are mostly located outside of main cities. In many Asian countries, private sector development and employment in suburban and rural areas are closely linked to balanced economic growth, social development, and poverty reduction. For the private sector—especially for MSMEs—improved business environments and enhanced economic governance are needed at the local level to enable firms to gain from the opportunities offered by economic growth and national economic reforms.

However, in many Asian countries, there are significant knowledge and communication gaps between national-level economic development practitioners and policymakers, and the private sector at the subnational level. Studies on the subnational business environment¹ conducted by The Asia Foundation reveal that most enterprises—particularly very small ones—take economic governance constraints as a given and thus seek little assistance from local government officials or other actors. The capacity and political will of government officials to supply market-based reforms—and of business owners to demand them—is often weak at both the local and national levels.

Key challenges to successful public/private cooperation in these countries include insufficient information and consultation at the

¹ Refer to The Asia Foundation's Economic Governance Index, Chapter 2.

local level; poor communication between national and subnational stakeholders; absence of trust among stakeholders; and inadequate advocacy capacity and mechanisms.

In an effort to tackle these significant challenges, The Asia Foundation has developed a toolkit of integrated programs that aim to:

- build a culture of dialogue between the public and private sector to support economic growth and job creation by building the capacity of both sides to be proactive;
- create momentum for reform by promoting better diagnosis of investment climates, documenting business issues, and providing tools to better design policy reforms that support sustainable and responsible private sector development; and
- promote transparency and economic governance for enhanced economic development through improved dissemination of information and increased public scrutiny.

If larger enterprises are often organized in associations and have some lobbying power to influence their business environments, it is rarely the case for most micro or small enterprises, which have very little constructive interaction with the civil servants or government of their localities. These enterprises often have no venue to express their concerns and no power to influence the business environment. Increasing the voice of these smallest, and often informal, businesses; and creating venues for more interaction between them and their local authorities is part of The Asia Foundation's approach to obtaining more balanced and sustainable development.

Public-Private Dialogues

The Local Public-Private Dialogue (LPPD) is the cornerstone of The Asia Foundation's efforts in fostering more balanced economic development at the local level. LPPDs bring together business people, local and national authorities, local civil servants, and representatives of the civil society to analyze issues and formulate proposals for change. Concerns commonly raised by business owners include unknown regulations, informal fees, the lack of reliable information on licensing or control procedures, and the need for greater taxation equity and transparency.

The idea of exchanges and dialogues between the public sector and private enterprises is not new. What is new, however, is the recent surge of interest in Public-Private Dialogues (PPDs) as an essential component of the private sector reform process in many developing countries. There is a growing consensus that a culture of dialogue between the private and public sector is a useful tool for economic development and poverty reduction.²

Although the principle of dialogue seems straightforward, the implementation is far from simple. The difficulties involved in bringing local stakeholders together to discuss policies and reach a consensus—without adequate motivation, information, and preparation—is often underestimated by practitioners and development

² On Public-Private Dialogues, see the website <http://www.publicprivatedialogue.org/>, originally created with support from DFID, the World Bank Group and OECD Development Centre; and the Facebook PPD Club “to get fresh PPD news, interact with other PPD fans, and contribute to the PPD community.”

partners.³ When implementing a PPD, the country's social, political, and economic context must be taken into account. While there is no "one-size-fits-all" standard emerging, much has been learned in the last few years about establishing PPDs.

Since 2006, PPD practitioners have exchanged information regarding their experiences and have developed good practices in annual workshops organized by a cross-sectoral team from the World Bank Group, the UK Department for International Development (DFID), and the OECD Development Centre.⁴ General principles on how to develop PPDs at the national level have been collected in a "Charter of Good Practice in Using Public-Private Dialogue for Private Sector Development," with operational guidelines.⁵ As a complement to these guidelines and tools, The Asia Foundation has developed specific expertise working at the subnational level, where a tailored approach is needed.

The Asia Foundation: Working Together Across Asia

The Asia Foundation has been conducting PPDs at the local level in several countries for nearly a decade.

3 Nicholas Pinaud, "Public-Private Dialogue in Developing Countries: Opportunities and Risks," *OECD Emerging Economies* (September 2007), vol. 15, p. i-86, <http://www.publicprivatedialogue.com/papers/PPD%20in%20developing%20countries.pdf>.

4 PPD workshops have been held in Paris, France (February 2006); Douala, Cameroon (April 2007); Dakar, Senegal (April 2008), and Vienna, Austria (April 2009). For more information see <http://www.publicprivatedialogue.org>.

5 Benjamin Hertzberg and Andrew Wright, *The PPD Handbook: A toolkit for Business Environment Reformers*, 2006.

In Indonesia, the Foundation's approach over the last decade has been to support the development of local business associations (*forda*), and to build the capacity of the public sector to respond to the demand of the business community for a more transparent and simplified business environment. Focusing on streamlining administrative procedures, the Foundation has helped develop One Stop Shops (OSS) and worked on policy reforms to facilitate registration and licensing procedures.

In Cambodia for the past seven years, several types of dialogues have been tested. At the provincial level, Provincial Public-Private Dialogue (PPPD) pilots have been cross-sector and have concentrated on access to information, taxation, and informal fees issues for micro and small enterprises. At the grassroots level, working with farmers and very poor rural communities, dialogues with public officials have helped to create a voice for community-based organizations (CBOs). The CBOs are using their voice to demand better public service delivery to improve natural resource management and increase their livelihood within specific value chains such as honey, resin, fisheries, or forestry activities.

In Bangladesh, PPDs have become useful tools for small producers in addressing issues such as transportation, access to markets, and a better integration of the producers in the value chain. More recently, at the district level, dialogues with larger enterprises have been facilitated to identify areas where public/private coordination can help reduce production costs, lighten administrative burdens, and create a more transparent business environment.

In Sri Lanka, the Foundation has helped the already numerous and active business associations to coordinate their actions and develop the capacity to join forces for more effective policy advocacy. In working groups with representatives of the public and the private

sectors, LPPD participants have made significant progress in creating practical partnerships to address issues such as solid waste management and city planning.

In each of these countries, LPPDs have been tailored to fit a unique economic, social, and political context; and have adopted practical and realistic approaches aimed at addressing issues raised by the local business community. Nevertheless, all LPPD programs share the same basic principles:

- dialogue is an efficient way for enterprises to foster a business environment that will support their development;
- governments that bring the private sector into the policy-making process are more likely to design policy reforms that are both efficient and workable, and which will help job creation and improved livelihoods; and
- building mutual trust and increased understanding between the public and the private sector will enhance efficiency, as well as social and political acceptance of the reform process.

The Asia Foundation's Integrated Approach

Fostering dialogue between the public and private sector would not lead anywhere without adequate support to build the capacity of all stakeholders, provide reliable information on the issues raised, build ownership of the process, and ensure that tangible results are achieved.

While LPPDs are often the backbone of the Foundation's approach to creating strategic public/private partnerships, these dialogues are supported by a variety of tools (discussed throughout this book). The Foundation's integrated approach includes three clusters of activities:

- **Research, Information Gathering, and Dissemination:** aimed to build broader stakeholder support for policy reform and to provide empirical information on the business environment at the subnational level by measuring stakeholders' awareness and support for policy reforms (like a "Quarterly Local Business People Survey" in Bangladesh), and by evaluating and ranking economic governance at the local level through an Economic Governance Index (EGI). The results of the EGI work feed into the collaborative identification of regulatory issues that constrain investment and enterprise in local Public-Private Dialogue sessions. Survey activities can be complemented by more in-depth analysis of economic governance strengths and weaknesses in the selected provinces or districts (diagnostics), and by identifying and disseminating practical examples of best practices across the country.
- **Public-Private Dialogues:** concentrated on the establishment and capacity building of a platform through which constructive partnerships between the local private sector and public sector can be fostered. To ensure that dialogues also provide some tangible results and that changes in the business environment directly impact the development of the private sector, this dialogue process is accompanied by efforts in capacity building and by the introduction of tools to address issues raised.
- **Tools for Improved Business Environments:** to ensure that LPPD participants see tangible changes as the result of the process. The Foundation provides tools and incentive mechanisms to the key stakeholders involved in the Public-Private Dialogues to demonstrate the potential impact in improving the business climate. The Regulatory Impact Assessment (RIA) methodology, for example, may be introduced to LPPD participants as a tool to be applied in

measuring the impact of select regulations. Focused Action Research is also used to document some specific issues identified during the LPPD and answer practical questions raised in the dialogue sessions. A great deal of emphasis is placed on exchanges among the participants to the LPPD and inter-district or inter-province exchange visits. Regional study programs are organized to provide LPPD participants with opportunities to network, exchange experience, and learn from other districts or countries, enhancing motivation and capacity.

Another interesting tool is the small grants mechanism. Private and public sector stakeholders have access to some resources (in the form of grants, vouchers or technical assistance) to implement programs or activities decided during the LPPD and/or identified by the EGI.

Technical Assistance: Building the Capacity of the Demand and Supply Sides of Reform

Building the capacity of the private sector to demand reforms and the capacity of public officials to respond to this demand is essential to establishing effective public-private partnerships with reform-minded public officials and agencies.

The Foundation supports the goals and efforts of LPPD by:

- providing training in facilitation and policy advocacy skills;
- building the capacity of the members to strengthen their capacity in research, data analysis, or in writing policy recommendations; and
- providing technical assistance in specific areas (e.g. book-keeping, tourism, traffic management, city planning).

Fostering Horizontal and Vertical Linkages

LPPD actions have proved more efficient when strong networks are established across districts. To encourage such horizontal networking, inter-district or inter-province meetings are organized on a regular basis. In Cambodia, cross-provincial meetings have provided a forum to share common experiences on LPPDs, with particular attention paid to improving the organization of the dialogues, increasing participation of civil servants and local governments, and tracking and monitoring the commitments made by the public sector during these dialogues. These meetings contribute to the effectiveness of the LPPD, and help to develop local capacity and willingness to advocate for a better business environment.

While the bulk of the LPPD activities and discussions generally focus on issues that can be solved at the local level, some problems and recommendations may require the intervention of a higher-level actor. Similarly, the government or national level ministries and agencies may need the relay of LPPD to ensure the dissemination of information; and, more importantly, the actual implementation of national level reforms at the local level. To really empower LPPDs and ensure that they are fully connected to the national level, vertical linkages need to be established.

In countries, like Cambodia, where national-level public-private fora have been established and have become important actors in the policy process, local-level dialogues have the capacity to use these national-level platforms to raise local-level issues that need the government's attention.⁶ Vertical linkages may also include the participation of national officials in local dialogues.

⁶ For examples of Public-Private Dialogues at the national level, see "PPD Impact Assessment - Vietnam Cambodia Laos," supervised by Benjamin Herzberg & Lili Sisombat; IFC, SME Department and MPDF/PEP China, April 2007.

LPPDs can serve as a channel of communication between national private sector development agencies and individual business owners, business membership organizations, and government agencies and officials at the subnational level. These communication mechanisms facilitate the dissemination of information and a more homogenous implementation of national reforms at the local level.

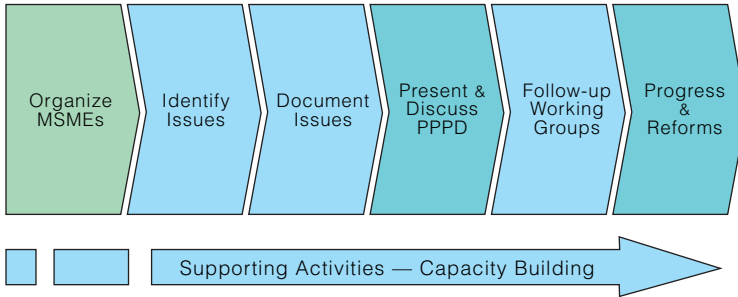
KEYS TO LPPD SUCCESS

Nurturing a culture of dialogue among different stakeholders where none has existed in the past, and affirming the steps that must be taken to establish efficient mechanisms for good faith dialogue in a reform-oriented environment are key elements of the LPPD program. As stated in a USAID report on lessons learned on policy reforms, “policy reform is an evolving, iterative, multistage process that requires patience, mutual respect, and enduring commitment.”⁷

In all countries, on various levels, this first phase of trust building has proven essential for the success of the LPPD process. It is an ongoing task that requires a careful selection of participants who are willing to collaborate; and facilitators who can conduct meetings that are structured enough to remain focused on a few collective issues raised, without allowing personal interests and political agendas to overcome the general interest. The process also requires tangible results to keep the participants motivated. Keeping this

⁷ “Policy Reform Lessons Learned: A Review of Economic Growth Related Policy Reform Activities in Developing Countries” (June 2007), EPIQ II, United States Agency for International Development and Chemonics International, International Resources Group, PA Consulting Group (2003–2009).

Figure 3.1: Engaging the Private & Public Sectors in the Policy Reform Process



objective in mind, many different tools can be used to ensure cohesion of the groups—policy advocacy or meeting facilitation trainings; the use of research to provide reliable and non-partisan data; as well as structured agendas and preparatory meetings to ensure that dialogue goes smoothly.

The core strategy of The Asia Foundation’s LPPD programs is fostering opportunities for participants to join forces and work in a collaborative way. Programs are aimed at improving two-way communication of business and regulatory information; increasing opportunities to identify problems and better understand the challenges on both sides; clarifying why problems exist and identifying bottlenecks; documenting the issue to generate workable ideas and recommendations; and applying solutions. To ensure that progress is made, it is important that participants prioritize issues, with a special focus on those that have quick solutions and will generate maximum impact. It is also important that programs allow both sectors to access additional support and resources that will help them to effectively address more complex or deeply rooted issues. A practical way to ensure progress is to organize smaller working groups with dedicated and experienced participants from both the public and the private sectors to work on selected issues. In

Sri Lanka, for example, the Foundation's Local Economic Governance program has facilitated the establishment of working groups comprised of business and government sector leaders. They meet monthly to discuss issues affecting local businesses, and work toward implementing solutions. Initially, the working groups have been focusing on "quick-win" projects that require cooperation but are not dependent on technical or financial support (i.e. street clean up, dissemination of existing information, improved communication, etc.). In Cambodia, an issue-driven approach has been developed to help CBOs improve their costs of production and facilitate income generation in specific value-chains. Ad-hoc working groups are created for specific issues or groups of issues such as transportation permits or access to markets. The working groups include local farmers or producers, civil servants, and/or members of civil society; and are tasked with investigating the issue, determining areas where reforms are needed, and suggesting solutions. Successes in one province are then duplicated in others to make a more significant contribution to the sector.

LPPDs: A Five-Step Process

In the LPPD, the Foundation has developed an efficient tool to improve business environments and generate more balanced development. In sum, the basic components of the Local Public-Private Dialogues are:

1. *Raising Awareness*: First-step programs focus on increasing understanding of the importance of effective public-private partnerships at the local level among key stakeholders and defining common operational processes.
2. *Creating a Culture of Dialogue*: LPPDs are organized at the national or subnational level with varying degrees of formality. They may focus on a specific sector or value-chain, or look at

cross-sector issues. Sessions might be limited to the public and the private sector or be enlarged to include other stakeholders. Gender-specific trainings and group activities may be developed to ensure active participation of women. The objective is to create a culture of dialogue among the main stakeholders for an improved business environment.

3. *Documenting the Dialogue:* The dialogues are informed by quantitative and qualitative data and analysis from research. At all steps of the program, two-way linkages are forged and facilitated with national PPDs where they exist (such as the Government Private Sector Forum in Cambodia, facilitated by the World Bank) and other local or national level private sector development agencies.

4. *Implementing Solutions and Communicating:* The Foundation and its partners provide technical assistance to the business community on issue identification and prioritization; assist the public sector to develop constructive policy alternatives; and build the capacity of both to improve information dissemination and to work with the media.

5. *Evaluating Progress:* Special attention is given to evaluate the impact of advocacy actions on the local business environment and measure progress in terms of number of issues raised, policies/regulations changed, and benefits to the private sector and/or the community.⁸

⁸ The Asia Foundation is currently working on adapting local level monitoring and evaluation tools in line with those used by other practitioners at the national level. For examples of tools, see http://www.publicprivatedialogue.org/monitoring_and_evaluation/.

PROGRAM HIGHLIGHTS

Association Building and Policy Advocacy in Cambodia

In 2004, The Asia Foundation initiated the first PPPDs in the three Cambodian provinces of Kampot, Kampong Cham, and Kampong Chhnang.⁹ The dialogues brought together provincial business associations and provincial and district level government officials, and provided an opportunity for members of newly created business associations to raise issues and discuss potential improvements to their business environment.

Top Three Changes Witnessed as a Result of PPPD

- Enforcement of regulations or rules of the government have been abided by the government officials
- Administrative paperwork simplified
- Reduced tax and informal fees

Taken from a survey of about 100 LPPD participants in Cambodia (2007)

⁹ In Cambodia, PPPD activities have been implemented by The Asia Foundation with support from the United States Agency for International Development (USAID) in 2004, then the Australian Agency for International Development (AUSAID) in 2007. The program is designed to foster the local economic dynamism that is necessary to create new jobs and raise the standard of living by removing or easing the burdens faced by micro, small, and medium enterprises (MSMEs) in rural Cambodia. For more information, see The Asia Foundation, "Final Report: Strengthening the Private Sector in Rural Cambodia: Association-Building and Policy Advocacy (Phase II) August 2007 – January 2008," (February 2008).

In addition to producing intangible results—such as a greater awareness of rights among business owners and improvements in the levels of respect accorded by officials to association members—the PPPDs and cross-provincial dialogues have had a concrete impact on the business environment. In Kampot, the governor ordered the garbage collection company to renegotiate the price of garbage collection. In Kampong Chhnang, the tax department representative provided MSMEs with documents related to taxation to help them distinguish legal and illegal fees. Also in Kampong Chhnang, as a result of the PPPDs, the annual fees of brick manufacturers were reduced from 120,000 Riels to 50,000 Riels. In Kampong Cham, the governor agreed to abolish the environmental fees charged to SMEs.

Another interesting outcome of the LPPDs was the coordinated design of large information boards posted in the provincial offices of the main ministries, providing information on the licenses required by type of business, the documents needed, as well as the official fee and the waiting time. For the first time, this basic information was made readily available to all, improving transparency and reducing the risk of informal charges for local MSMEs.

Bangladesh: Finding Simple Solutions to an Administrative Hassle

In Bangladesh, the District Public-Private Dialogue (DPPD) in Rajshahi played a crucial role in reducing the cost and the time required to get a new trade license for enterprises that had lost their original document. A trade license—mandatory for all businesses in Bangladesh—is normally provided by the City Corporation with a fee between Tk. 300-2,500, depending on the nature of the business. When a trade license was lost or damaged, the Rajshahi City Corporation did not have any

provision to replace it with a duplicate. They could either issue a new trade license subject to payment of the full fee or provide an attested photocopy of the trade license. Attested photocopies, however, are not accepted by banks and other financial institutions for opening business accounts or taking loans. Businesses also faced problems in exporting or importing, and making tax and VAT payments without a proper trade license. The attested photocopy is also often not accepted when applying for visas to attend international trade fairs.

The problem was raised in a thematic group meeting by the Bangladesh Silk Industry Owners' Association with support from the Rajshahi Chamber of Commerce and Industries and Rajshahi Shop Owners' Association. These associations were able to enhance their preparatory skills by participating in the policy advocacy training offered to private sector DPPD members by The Asia Foundation. Subsequently, they worked jointly to develop an action plan and hold meetings with relevant authorities. This joint action led to a quick response from the Rajshahi City Corporation (RCC). The decision of the RCC to issue duplicate trade licenses has been included in the resolution of the Financial Committee, as well as the RCC Budget and Development Plan 2009-10. A separate form for applying for a duplicate trade license has been developed, and the fee has been set at Tk.100 for a replacement license in Bengali and Tk.200 for an English version. Not only has the problem of the business community been solved, but the RCC believes it will also earn extra revenue by providing duplicate trade licenses instead of photocopies.

The Philippines: Tripartism as an Approach to Transparent Accountable Governance

In the Philippines, The Asia Foundation has helped to create City Coalitions for Transparent and Accountable Governance (CCTAGs), comprising representatives from business, local government, and civil society. The Foundation, in partnership with the Mindanao Business Council, facilitated the creation of 13 city-level coalitions as platforms for participative discussions and monitoring reforms in government. Through these tripartite dialogues, the private sector is able to raise awareness in the public sector of the needs and interests of local businesses, and influence policies. Civil society groups are able to advocate more effectively for pro-people policies, and influence the allocation of resources from both the public and the private sectors.

Finally, for the local government, the involvement of the private sector and civil society organizations means additional expertise and resources for policy development; thus ensuring the relevance and acceptability of new policies and programs. Through these coalitions, procedural handbooks and service manuals were published in the cities of General Santos and Surigao; and localized counter-corruption scorecards were developed. CCTAGs also helped city governments shorten processing time of payments to suppliers, and set up hotlines and One Stop Shops for business registration.

In 2005, with USAID support, similar tripartite dialogues were used in Bangladesh, Cambodia, and Sri Lanka to mitigate the risk of a crisis in the garment sector with the end of the Multi-Fiber Agreement and the quota system. These tripartite dialogues provided a venue for all actors to exchange information and concerns, and agree on common actions to improve competitiveness.

The experience of The Asia Foundation shows that Public-Private Dialogue is an important mechanism for the assembly and strengthening of coalitions for policy reform. The dialogues provide a structure and schedule for communities and stakeholders to engage with each other on issues of shared interest and concern. The PPD structure is very flexible in that participation can be designed to ensure the participation of all key stakeholders in specific issues. PPD structures are also scalable, allowing focus on very specific, very local-level concerns while remaining open to national and even international-level implications.

Local Public-Private Dialogues: Improving the Business Environment and Promoting Balanced Development

Local Public-Private Dialogues provide a platform for public-private partnerships to improve local business environments. They need to be inclusive yet manageable; identify actors of change without serving vested interests; foster discussion without becoming a “talking shop”; and, above all, achieve tangible results that will improve the climate for businesses in the localities. The LPPD process is paved with risks and opportunities, but the main factor of success is the commitment of all participants to establish a culture of dialogue and cooperation.

The Asia Foundation’s work with LPPDs complements the efforts of many other development partners, including the World Bank, to build strong public-private partnerships at the national level. Not only do local-level PPDs reinforce the work of national PPDs in the policy reform process, they can also serve as a useful counter-power to ensure that the position of provinces and remote areas are expressed or that the interests of less well-known and smaller enterprises are preserved.

The Asia Foundation and its partners are engaged in an ongoing learning process. The Foundation will continue to document experiences, develop tools for improved business environments, improve monitoring tools for tracking the progress and impact of LPPD, and participate in identifying best practices to be shared within and across countries.



REGULATORY IMPACT ASSESSMENT AND REFORM IN INDONESIA, SRI LANKA, AND CAMBODIA

*Frida Rustiani, Hari Kusdaryanto, A. Subakaran, and
Véronique Salze-Lozac'h*

Regulations¹ are essential to the efficient functioning of a modern society, and are a key instrument used by governments to execute public policy in many areas, including the economy. Entrepreneurship and business activities are shaped not only by markets, but also by regulatory and administrative climates established by governments. There is a risk, however, that regulations can impede innovation or create unnecessary barriers for businesses in terms of trade, investment, and opportunities in the global market. Some regulations may result in greater difficulty and cost for investors and entrepreneurs to enter into business, while others might confer undue advantage or disadvantage to selected subsets of society. Small and medium enterprises (SMEs), which have more limited access to capital and fewer political connections, tend to carry a disproportionately heavy burden. Regulations thus need to be carefully designed to avoid undesirable impacts or unnecessary distortions that ultimately reduce, not promote, public welfare.

¹ "Regulation" is best defined as "the diverse set of instruments by which governments set requirements on enterprises and citizens." They include "laws, formal and informal orders, and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to whom governments have delegated regulatory powers." See OECD, OECD Report on Regulatory Reform, (Paris: 1997).

Recent experiences—specifically the United States subprime mortgage crisis, which precipitated the global financial crisis—likewise illustrate the crucial role played by regulation in the economy. While recent economic literature has tended to promote open and liberal regulatory regimes, the subprime debacle underlines the dangers inherent in poor or weak regulation. A balance must be struck in order to guarantee “smart” regulation that promotes economic activity and growth, while maintaining basic prudential standards.

Good Regulatory Governance

In order to address the ineffective and inefficient aspects of regulations, many countries—particularly those of the Organization for Economic Cooperation and Development (OECD)—have adopted broad-based programs for regulatory reform aimed at improving the quality and reducing the costs of regulations needed to protect the public, while simultaneously eliminating unnecessary regulation.

In 1995, the OECD produced a checklist for regulatory decision-making (Figure 4.1). With these recommendations in mind, regulatory reform programs

Figure 4.1: OECD Checklist for Regulatory Decision-making

1. Is the problem correctly defined?
2. Is government action justified?
3. Is regulation the best form of government action?
4. Is there a legal basis for regulation?
5. What is the appropriate level (or levels) of government for this action?
6. Do the benefits of regulation justify the costs?
7. Is the distribution of effects across society transparent?
8. Is the regulation clear, consistent, comprehensible, and accessible to users?
9. Have all interested parties had the opportunity to present their views?
10. How will compliance be achieved?

Source: OECD (1995), *OECD Recommendation on Improving the Quality of Government Regulation*

are adopting the broad concept of “good regulatory governance,” based on the proactive role of government in establishing effective, market-oriented regulatory regimes, as well as high standards of social and environmental protection. These recommendations are based on the understanding that regulatory practices can substantially improve market performance, public sector effectiveness, and citizen satisfaction through a mix of deregulation, re-regulation, and better quality regulation, backed up by new or improved institutions. Earlier notions of deregulation and cutting “red tape” have been replaced by this wider concept of good regulatory governance.

Good regulatory governance, designed to maximize the efficiency and effectiveness of regulation, is based on an integrated approach to the following three mutually supportive elements:

- thorough adoption of regulatory policy at the political level;
- good quality regulatory tools; and
- sound institutional arrangements.

Regulatory Impact Assessment: A Tool for Good Governance

In an effort to achieve good regulatory governance, many Asian countries—such as Indonesia, Sri Lanka, Bangladesh, and Cambodia—are now employing, sometimes only occasionally, Regulatory Impact Assessment (RIA) to ensure that the costs and benefits of regulations are made clear to decision-makers, and that business communities and other relevant stakeholders are consulted throughout the policymaking process.

RIA is an analytical tool used to weigh the necessity and benefit of regulation against its potential negative impact through a series of structured consultations with stakeholders directly affected by the

regulation.² As an integral component of The Asia Foundation's operational methodology, the RIA method is most often introduced as a response to a regulatory problem previously identified through participatory processes like the Economic Governance Index (*see Chapter 2*) or Public-Private Dialogues (*see Chapter 3*). As will be described, once the problem has been acknowledged via initial research and/or consultations, RIA is initiated in order to: (a) systematically document and analyze the problem; and (b) provide well-informed recommendations on how to remedy it.

RIA provides an organized process of identifying and calibrating changes in regulations found to place unnecessary constraints on businesses. Adhering to its methodology ensures that key steps are taken in the review of regulations, and that crucial stakeholders are engaged in the reform process. RIA is intended to assist governments in determining whether a regulation is actually required, identifying the costs and benefits of proposed regulation, and determining whether there may be alternative solutions to regulation. The assessment—a process of defining problems, objectives, and weighing alternatives—provides a means by which governments and citizens can ensure that the impact of regulations is not harmful, and that the process of devising them is both transparent and responsive to citizens' needs. Ultimately, RIA ensures that political negotiations on the appropriate policies needed to resolve economic issues are based on facts, statistics, and data.

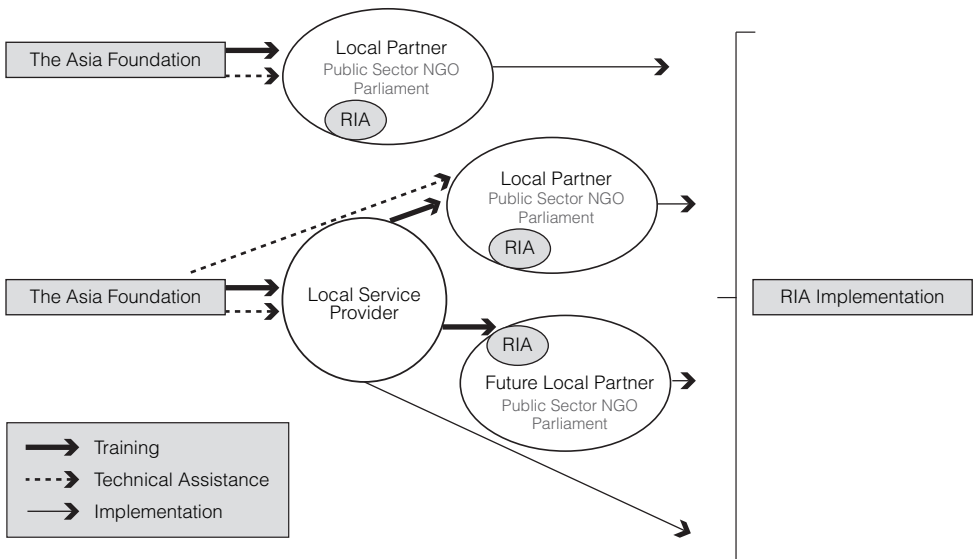
² The Asia Foundation, "Improving the Business Environment for SMEs and Gender Responsive Budget Initiative in Sulawesi," *Proposal to the Canadian International Development Agency (CIDA)*, May 2004.

The Asia Foundation’s Unique Approach to RIA

The Asia Foundation’s role in carrying out RIA can be divided into a set of dual processes (Figure 4.2):

1. Capacity building entails the training of a local actor in the basic tools and skills needed to assess the impact of a regulation or law on the private sector. This actor will then provide training in RIA methodology to the RIA technical team. The Foundation’s initial training can target one of two actors: 1) a local service provider or 2) a local partner.
2. Implementation involves carrying out RIA methodology in order to achieve a policy outcome. This is done through the six-step RIA process, facilitated primarily by a local partner, with technical assistance provided by the Foundation.

Figure 4.2: The Asia Foundation’s Dual Role Throughout RIA



Capacity Building

The Asia Foundation must first make certain that the partner has sufficient capacity to implement technical assistance throughout the process. The Foundation undertakes preliminary capacity building in one of two ways: (1) training a third-party local service provider—a research institute or university, for instance, or a consulting firm—so that it is able to assist the Foundation’s official partner in the private or public sector in implementing RIA; or alternatively (2) directly building up the capacity of the partner itself—an NGO, business association, or government body—so that the partner itself has the ability to evaluate the impact of a regulation and provide technical assistance.

Ultimately, the degree of Foundation involvement in the capacity-building process is determined by the level of existing capacity among the country’s relevant stakeholders. The Foundation’s role can entail anything from designing the regulatory assessment itself to maintaining quality control. However, it is the partner who is always in charge of actual implementation.

Initial partner/third-party service provider training and technical assistance may involve the establishment of a national RIA unit or task force (called a RIA technical team) comprising local government officials, as well as business owners and leaders of relevant NGOs. In this case, the Foundation works with the local government to establish the technical team, which then helps to strengthen government capacity to review regulations, as well as provide guidance on regulatory reform initiatives. The partner provides the initial training and guidance to the RIA technical team directly or through a contracted third-party local service provider.

Various approaches are employed to build the capacity of stakeholders to undertake RIA. Initial partner/service provider training includes a general tutorial in the promotion of supportive climates for business and investment, regulatory reform processes, basic economic analysis, and process facilitation. This involves an introductory training course (based on a published RIA manual) for officials in select areas with a focus on understanding the economic and political aspects of RIA implementation. Well-designed training typically includes case studies and theory overview. On occasion, local governments have learned directly from neighboring local governments well versed in RIA.

The Foundation leads a training session, usually facilitated by its national RIA consultant. During the week-long workshop, the local partner or service provider is trained in the technical aspects of the RIA methodology, as well as in advocacy, coalition-building, and the political work required to deliver the reform message to policymakers and garner local support. For those parties implementing RIA technical assistance at the local level, additional training on local regulatory mapping is provided. In order to assist government counterparts on addressing regulatory challenges, the Foundation will generally develop a RIA manual that customizes regulatory reform strategies to the country's context.

Once training of the partner and the RIA technical team is complete, both are ready to implement the regulatory assessment process, throughout which the Foundation continues to provide technical assistance.

Implementation

Throughout the process of RIA implementation, The Asia Foundation provides technical assistance through its local partners.

This approach ensures that both local governments and non-governmental stakeholders have the capacity to analyze regulations. RIA capacity thus remains accessible to local governments long after Foundation involvement ends, and partners continue to advocate for local governments to apply the method well into the future. With guidance and strategies provided by the Foundation, local partners work with government counterparts throughout the RIA process. This partnership is the key for successful program implementation; as it brings in together local knowledge, frequent field monitoring, and outside technical expertise.

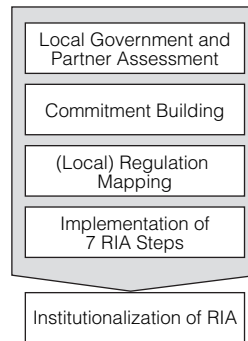
The Foundation's approach to RIA (Figure 4.3) can best be summed up by the following five phases below.

PHASES 1 and 2:

Local government and partner assessment/securing commitment

Before deciding on a partner and RIA site, or agreeing to any technical assistance program, the Foundation secures support from government leadership and a local partner. A comprehensive local government and partner assessment is completed in order to gauge the dedication of relevant government agencies and officials, as well as that of the partner organization.

Figure 4.3: Five Phases of RIA



This includes not only expressions of interest—typically through the issuance of a Memorandum of Understanding (MOU)—, but also through evidence of past reform initiatives and an agreement to contribute significant matching funds and staff towards realizing program goals.

Next, the Foundation may facilitate the drafting of a regent or mayoral decree that officially establishes a RIA technical team. Typically, the team contains 10-15 members from across stakeholder groups. As previously mentioned, the group will then be trained in regulatory policy, economic analysis, and policy advocacy by the Foundation's local partner or a local service provider.

PHASE 3: Regulatory mapping

The process of regulatory mapping—which runs parallel to the establishment of the RIA technical team—involves assisting a local government in mapping out regulations related to the business community. The partner, having received training in regulatory mapping by the Foundation, facilitates workshops and focus group discussions with various stakeholders, including the newly formed core RIA technical team, local business associations, and personnel from relevant government technical units. Several regulations are studied to identify those failing to promote a climate conducive to business.

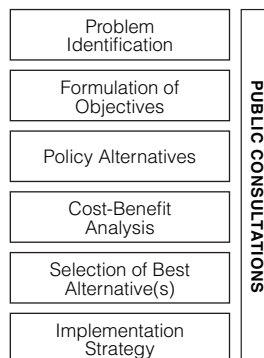
Results of regulatory mapping are then discussed with regional stakeholders, who pinpoint those regulations considered top priority for further review. The group then identifies the 10 most burdensome regulations for assessment by the RIA technical team. The RIA technical team maps out these 10 local regulations and narrows the list down to the two most problematic regulations affecting businesses. Once these regulations are chosen, the official RIA process can begin.

In addition to its obvious function in identifying regulations to be targeted, regulatory mapping also acts as a means of improving overall awareness among various stakeholders as to the nature and number of existing business regulations. Stakeholders are often surprised by the number of regulations, which they were previously unaware of, some of which may have been generated decades in the past.

PHASE 4: Implementation of RIA

The technical team then reviews each regulation using the RIA methodology. This involves six steps (Figure 4.4) that enable the team to (1) articulate the problem; (2) identify the objectives of policy action; (3) determine a range of policy alternatives; (4) analyze the costs and benefits of potential regulations; (5) identify alternative solutions to regulation, if any; and (6) implement the needed changes.

Figure 4.4: Six Step RIA Process



By using the RIA tool in consultation with stakeholders, policy-makers are eventually able to select the best policy alternative. “Consultation” comprises discussions, workshops, and field study, facilitated by the Foundation’s local partner, and is undertaken throughout the following six-step process.

1. Problem Identification: The assessment of problematic regulations begins with a review of the reasons why these regulations were initially issued. What problem was each regulation originally intended to overcome? What problems have the regulation generated?

2. Formulation of Objectives: As the problem highlights existing negative conditions, the objective will be to achieve a specific positive future condition. The technical team determines what aims the government would like to achieve and what behavior it seeks to change based on the initial problem.

3. Policy Alternatives: What alternatives are available for remedying the problem? Was the issuance of the regulation the best alternative? With the option to leave the regulation as is serving as the baseline, the group will then formulate anywhere from two to four alternatives that can work to meet the stated objective. Results are then discussed in consultations with stakeholders, particularly those business owners impacted by the regulation.

4. Cost-Benefit Analysis: Cost-benefit analysis of each identified alternative is then conducted. This involves extensive public consultation. Despite initial RIA training, the technical team may not be equipped with the quantitative skills or proficiency in economics needed to conduct cost benefit analysis, so the Foundation's local partners or consultants with relevant background may provide more direct assistance during this step. The nature of the cost-benefit analysis process largely depends on the nature of the regulations, the experience of the RIA technical team, and the availability of data. It can involve anything from in-depth field surveys to a calculation based on statistical data. Following cost-benefit analysis, the RIA technical team will have generated a list of alternatives arranged according to the highest net benefit relative to highest net cost.

5. Selection of Best Alternatives: The alternatives, ranked accordingly, are then presented via a RIA statement (RIAS), which documents the entire RIA process and its results. Because the RIA team is technocratic in nature, its role is simply to provide the recommendation based on data. Whether the political leadership follows the team's recommendations—that is, whether it selects the top-ranked alternative—will depend on the political process that follows.

The RIAS is disseminated publicly to guarantee that the community at large is informed of the team's calculations. This way, once the legislature makes a decision as to what alternative to go with, the public is well aware of where the choice stands in terms of net benefit. The partner can release the RIAS by way of a variety of media campaigns—via leaflets, for example, or through radio talk shows and local newspapers.

Generally, a new regulation is needed in order to fulfill the recommendations made in the RIAS. The technical team uses the RIAS as the basis with which to draft a revised local regulation. After the RIAS is submitted to the local government for consideration, the draft regulation moves through government, where it is reviewed and deliberated.

6. Implementation Strategy: Following further stakeholder consultation, a strategy is formulated to implement and institutionalize the alternative chosen. The Foundation and its partners collaborate with the technical team to formulate a plan implementing the desired changes. A political process to approve the regulation by the local legislature may also be supported.

PHASE 5: Institutionalization

For sustainability reasons, RIA should be institutionalized through a local formal decision such as a regulation or head of district's decree. In addition to institutionalization, success of the RIA program can be measured by:³

- scope and depth of draft regulations considered under RIA;
- number of local governments adopting RIA as a regular, integral, and accepted part of regulatory formulation;
- quality of public consultation and changes to regulation as a result of stakeholders input; and
- number of officials and stakeholders trained in RIA.

Whenever possible a posteriori evaluation of the impact of the changes can be conducted.

In Sum: The RIA Process

The RIA process can tackle regulations one at a time or in batches; by sector, by area or by agency. While it may be applied to regulations as they flow through the regulatory system of a country, in countries like Bangladesh there is often a large stock of regulations that need to be reviewed en masse, as the Bangladesh Regulatory Reform Commission (BRRC) is presently doing. In recent years there has been increased interest in a type of RIA process called the “regulatory guillotine,” which is designed to deal with the large stock of regulations on a sectoral or ministerial (agency), or jurisdictional (local government) basis.

³ The Asia Foundation, “Improving the Business Environment for SMEs and Gender Responsive Budget Initiative in Sulawesi,” *Proposal to the Canadian International Development Agency (CIDA)*, May 2004.

In the end, successful RIA ensures that:

- the need for government action is justified;
- regulation is proven to be the best alternative;
- regulation maximizes net social benefits with minimum cost;
- adequate consultation has been undertaken; and
- appropriate compliance and enforcement mechanisms are in place.

A Unique Three-Pronged Approach

The Asia Foundation has implemented the RIA process in several Asian countries at both the national and local government levels using a three-pronged approach:

1. The Foundation works at the local level and advocates for national-level reform based on local experiences. By creating local best practices, the Foundation demonstrates the results of reform with tangible evidence.
2. In reviewing existing regulations at the local level, the Foundation highlights the benefits, in terms of processes and outputs, of adopting RIA in the government regulatory-making process. This strategy aims to show government officials that having an effective tool will help to produce good regulations and increase government capacity.
3. Lastly, the Foundation works with both local government and civil society to improve stakeholder interaction, increase technical capacity, and ensure the sustainability of reforms.

RIA in Indonesia

Following decentralization in 2001 through the implementation of Laws No. 22/1999 and 25/1999, more than 500 local governments (*kabupaten* and *kota*) in Indonesia have been given greater authority to issue laws and regulations.⁴ This has resulted in an explosion of local lawmaking, with many policies creating onerous fees to generate short-term revenue without due consideration for the impact on economic growth. Many of these local regulations (*perda*) are drafted with no in-depth analysis of the need for regulation and with very limited public consultation. Some are even illegal and create significant distortions in the local economy. In Sulawesi, the government of Manado alone has passed nine local regulations charging user fees for market, route, and terminal use. Around 80 percent of the revenue raised in Manado is used to cover recurring costs in the local parliament budget (salaries and perks) rather than on service provision or development.

To help address this problem in Indonesia, the Foundation has worked with more than 38 local governments across 11 provinces—in addition to the Ministry of Trade (MOT), Ministry of Finance (MoF), the National Development Planning Agency, and the Ministry of Home Affairs (MoHA) at the national level—to introduce the RIA method. Today, RIA is regularly commissioned by governments interested in incorporating the method directly into its policymaking process.

⁴ The Asia Foundation, “Improving the Business Environment for SMEs and Gender Responsive Budget Initiative in Sulawesi,” *Proposal to the Canadian International Development Agency*, May 2004.

Program Highlights

Through the PROMIS program⁵ in 2005-08, The Asia Foundation partnered with seven local NGOs to work with 20 local governments (LGs) in five provinces (West Sumatra, West Java, Central Java, DI Yogyakarta, and East Java) to introduce RIA into local policymaking. To build local capacity, the Foundation and its partners conducted 39 training sessions on RIA. The initial training covered the first three steps of RIA—identification of problems, formulation of objectives, and identification of policy alternatives. The second session focused on cost-benefit analysis, public consultation, and formulation of an implementation strategy. In total, 284 local government officials, business owners, and NGO representatives received RIA training.⁶

Each LG established a team that was responsible for implementing RIA. A total of 41 regulations were reviewed by these RIA teams, who formulated the results into RIAs. Regulations covered nuisance permits in Solok, Kendal, and Kota Pekalongan; construction permits in Solok; advertisement permit taxes in Kota Pekalongan; and trading permits and street vendors in Kota Blitar.⁷ RIA teams across 19 districts used the results to draft 37 revised local regulations and one draft regent decree. As many as 19 revised laws were submitted to local parliaments (DPRD),⁸ and seven revised perda

5 The PROMIS Program is implemented by The Asia Foundation with the generous support of USAID.

6 The Asia Foundation, "Reducing Barriers to Market Entry: Program untuk Memperbaiki Iklim Investasi – PROMIS," *Final Report April 27, 2005 – October 26, 2008, February 2009*, pp. 38.

7 *Ibid.*, pp. 37-38.

8 DPRD refers to the Dewan Perwakilan Rakyat Daerah, an Indonesian municipal council.

were passed in five districts.⁹ Various changes proposed included simplifying procedures and requirements for construction permits, allowing smaller firms to obtain free trade permits, and enabling small firms to apply for multiple permits simultaneously.

From 2004-08, The Asia Foundation introduced the RIA process under the Canadian International Development Agency (CIDA) funded program, “Improving the Business Environment for SMEs in Sulawesi (IBESS).”¹⁰ Key local partners in the effort included the Institute of Rural Technology Development in North Sulawesi, the Gorontalo Institute of Development, as well as the Baray Bhakti Mandiri Foundation and the Adil Sejahtera Foundation, located in South Sulawesi. By June 2008, seven sites had completed RIA training and 18 local regulations had been reviewed. These sites included the cities of Parepare, Makasar, and Gorontalo; and the districts of Pinrang, South Minahasa, and Minahasa.¹¹

As the following highlights illustrate, the Foundation has worked to institutionalize the RIA process in a number of kota or kabupaten throughout Sulawesi, Sumatra and East Java.

9 The Asia Foundation, “Reducing Barriers to Market Entry: Program untuk Memperbaiki Iklim Investasi – PROMIS,” *Final Report April 27, 2005 – October 26, 2008*, February 2009, pp. 7.

10 IBESS is implemented by The Asia Foundation with the generous support of CIDA.

11 Michael Hatton, *End of Project Evaluations: The Asia Foundation Project: Improving the Business Environment for SMEs in Sulawesi (IBESS) and Gender Responsive Budget Initiative in Sulawesi (GRBI) and The International Finance Corporation Project: Program for Eastern Indonesia SME Assistance (PENSA)*, submitted to the Canadian International Development Agency (CIDA), October 2008.

Kota Parepare (South Sulawesi)

Through the IBESS program in 2005-08, The Asia Foundation worked with its local partner, BBM, a Universitas Hasanuddin-based NGO, to institute a RIA program in the city of Parepare.¹² The RIA process began in August 2005, when the Foundation and BBM worked with the Kota Parepare municipality to establish and begin training a local 15-person RIA technical team comprising lawyers, activists, private sector representatives, and local government officials. The Asia Foundation's technical assistance program was initiated in October 2005 following the signing of a MOU between BBM and the mayor's office.¹³

Throughout the upcoming months, the Foundation's technical support was provided by program officers based out of The Asia Foundation's Jakarta office as well as expert RIA consultants. Assistance was provided to BBM as it (1) facilitated regulatory assessment focus group discussions (FGDs) on problem/objective analysis and alternative identification, attended by stakeholders within the local government as well as relevant NGOs and associations; (2) selected two local regulatory ordinances to target—one on street vendor management and the other on local market management; and (3) oversaw public consultations through interviews and FGDs with a variety of business associations—including shop and market stall owners—to assess current management of the

12 Ibid, pp. 18.

13 From The Asia Foundation's Semi-Annual Reports, "Improving the Business Environment for SMEs in Sulawesi and Gender Responsive Budget Initiative in Sulawesi," submitted to the Canadian International Development Agency (CIDA), (April 1 – September 30, 2005), (October 1, 2006 – March 31, 2007), (April 1 – September 30, 2007).

market area. The RIA team then hosted FGDs on cost-benefit analysis. Among the stakeholders involved throughout the process was Forda UKM, a business association representing a range of SMEs, including street vendors.

The process culminated in September 2007, when the RIA team published its RIAS through local mechanisms. This entailed the distribution of leaflets in public venues, publication in the *Pare Post*, a local newspaper, and discussion on an interactive radio talk show at Radio Mesra FM in Parepare.

The RIAS recommended that the local government:

- determine classifications of stalls and selling venues in open spaces, and in market areas;
- set user charges based on the type of facility and classification of stall or selling venue;
- coordinate and increase supervision for law enforcement; and
- provide guidance for market administrators and conduct a public information campaign on market security, cleanliness, and order.

The RIA Statements provided a framework for the technical team and the legal bureau to prepare new draft regulations on market management and street vendor management, subsequently submitted to the local parliament. These were then deliberated and approved by the DPRD. A draft street vendor regulation was finally passed by the Parepare Local Parliament in April 2008 as *Local Regulation 6/2008 on Street Vendors*.

As a result of the institutionalization of RIA through a Mayoral Decree in 2006, the Parepare municipal government continues to use RIA to review all draft regulations impacting the business

community before they are proposed to the DPRD, independent of support from the Foundation.

Kota Blitar (East Java)

From April 2007 to September 2008, under the PROMIS program, The Asia Foundation, through its local NGO partner PUPUK Surabaya, worked with the municipal government of Blitar to implement RIA. The process began with a series of workshops to introduce the RIA methodology to local government officials, parliamentarians, and members of business associations. These introductory workshops provided an excellent opportunity for brainstorming and securing local government commitment.

Next, a RIA technical team was established and trained. PUPUK Surabaya facilitated a series of training sessions on legal drafting to equip team members with the skills needed to formulate local regulations. The RIA technical team in Kota Blitar then analyzed two local regulations— related to street vendors and local trading permits.

Throughout the process, public consultation workshops were conducted eight times. The workshops invited participation from members of street vendor associations and SME associations, Chamber of Commerce officials, and representatives from local banks. Local government agencies were also represented, including the Departments of Trade and Industry and Public Works, the local cooperatives agency and the local tax office. To close the public consultation series, a 60-minute interactive talk show was broadcast on a local radio station, Mayangkara FM.

The RIA team presented the results of their analysis and the draft of revised local regulations to the local parliament during a two-

day dissemination seminar. Having such a seminar was useful in getting buy-in from local legislators, and assisted them in better understanding the findings of the RIA analysis.

After an 11-month process, the RIA technical team in Kota Blitar was able to successfully revise the regulations. The local parliament approved the revised regulations within a few months. On July 28, 2008, the *Local Regulation on Street Vendors* and the *Local Regulation on Trade Permits* were officially passed by the local parliament:

- *Local Regulation on Street Vendors*: The permitting process for street vendors was simplified so that street vendors could formalize their business with a minimum of requirements and without paying any fees. Licensed vendors are allowed to do business in the designated public areas without any risk of eviction.
- *Local Regulation on Trade Permits*: Revisions to the trade permitting process included a reduction in the number of requirements (from nine to eight), reduction in processing time (from 12 days to three days), and an extension of the permit renewal period (from every two years to every five years). The permit fee of IDR 100,000 (roughly USD\$11) was abolished.

RIA at the National Level

From 2007-09, The Asia Foundation worked with Indonesia's ministries of trade and finance to review six national regulations on cacao; rattan; traditional markets; weights and measures; local budgeting deficits; and electronic road pricing. A different strategy from technical assistance at the local level, this involvement was initiated by lobbying high-ranking government officials to pilot

RIA implementation in their units. The Foundation began with a three-to-five-day RIA training for teams comprised of unit heads.

The second phase of technical assistance involved applying every RIA step to the regulation chosen by the head of each unit. The project developed expertise within the economic faculty at University of Indonesia in undertaking systematic RIA. It also introduced the importance of conducting regular public consultations among civil society and private sector organizations during the policymaking process.

From 2007-08, 15 local governments in Central Java—eight of whom were facilitated by the Foundation—reviewed local regulations on nuisance permits using the RIA method. Using their findings, they then requested that the Ministry of Home Affairs revise its decree on nuisance permits. In 2009, the MoHA issued a new decree on nuisance permits.

Finally, in 2009, through a series of Foundation-organized meetings, seminars, and lobbies, the National Development Planning Agency (*Bappenas*) became the institution in charge of RIA development. Trainings and workshops were provided to Bappenas to revise the existing RIA manual for national policy.

RIA in Sri Lanka

The end of the war in Sri Lanka has increased the potential for economic growth to accelerate and for its benefits to spread to neglected regions and marginalized groups. The Sri Lankan government has emphasized the need for lagging regions, particularly the post-conflict Northern and Eastern Provinces, to catch up to the rest of the country in terms of economic development and quality of life if future armed conflict is to be avoided.

To realize this potential, businesses of all sizes in the lagging regions must have a chance to operate in a supportive business environment, and be enabled to link with leading regions, as part of an overall strategy of economic development and community rehabilitation. However, there remains a weak enabling environment for local private enterprise to grow and flourish. Such growth is necessary to increase employment opportunities and improve the quality of life for citizens.

In Sri Lanka, decision-making at higher levels profoundly influences communities' ability to recover from conflict and prosper. The Asia Foundation recognizes that a narrow focus on location-specific interventions for community rehabilitation that ignores the dynamics of district, provincial, national, and international linkages and governance contexts can constrain impact and progress. Horizontal relationships and coordination mechanisms at each level must be improved, as well as the vertical relationships between these tiers of government. Moreover, reform efforts targeting constraining national-level policies and regulations can only succeed if the deleterious local impacts of these constraints are demonstrated—principally by coalitions and pressure built from the ground up.

Program Highlights

To support the growth of a dynamic local enterprise sector in Sri Lanka, the Foundation has implemented several initiatives to streamline regulations that directly affect local authorities and the business community. Since 2007, the Foundation has helped streamline regulations at the national and sub-national levels. Going forward, it will focus on the use of RIA in order to help the national and subnational governments understand the potential negative impacts of existing and proposed regulations.

Regulatory Mapping

One of the most time consuming frustrations facing local businesses in Sri Lanka—as identified through Public-Private Dialogues initiated by the Foundation—is the lack of information on what services local governments actually provide and how those services are meant to be delivered. To address this, the Foundation developed 10 Regulatory Mapping Guidebooks that illustrate the actual required services (i.e., licenses, permits, registrations, etc.) provided by provincial, municipal, and urban councils, as well as national agencies including the Board of Investment and the Urban Development Authority. These guides provide a map/outline of the regulations, eligibility, fees, application process, timeline, accountability, and recourse available for a broad range of council services.

The guidebooks have been circulated to all national and regional business associations and local authorities (LAs)¹⁴ to increase awareness among service recipients and providers. They not only have helped the LAs to better regulate their services but have also generated awareness among staff who were new to the local government sector. In addition, the guidebooks have been used by LAs to develop citizen charters.

Strengthening the By-law Process

The Asia Foundation has supported the Ministry of Local Government and Provincial Councils (MLGPC) and many LAs to strengthen the process of implementing of by-laws. Passing by-laws in Sri Lanka involves myriad steps, and the process has always

14 A local authority (LA) in Sri Lanka is defined as a pradeshiya sabha (PS), municipal council, or provincial council.

been bogged down by technical and administrative issues at each juncture. In 2009, the Foundation supported the commissioner of the local government (CLG) office in the Central Province of Sri Lanka, to set up a “by-law operation unit” at the provincial level. The objectives of the unit are to:

- conduct by-law training programs for LA officials and staff of CLG offices in order to improve technical capacity in preparing legally and socially acceptable by-laws;
- improve the efficiency and strengthen the capacity of provincial councils (PC) in handling by-laws by engaging a by-law review committee; and
- establish a resource unit to gather and store all required data—such as standard by-laws, approved by-laws, copies of all relevant laws, etc.—in order to support the by-law process in the province.

Within three months, the unit conducted a series of training programs and trained about 50 LA and PC officials. In addition, more than 40 by-laws from 18 LAs in the Central Province were reviewed by the reviewing committee, of which 30 were finalized.

Additionally, the Foundation has supported the Ambalangoda and Kinniya urban councils to review and update approximately 40 by-laws. The MLGPC and Southern Provincial Council conducted a series of consultations among stakeholders and a core group was trained to formulate by-laws in the provinces and national level. In the Southern Province, the core group trainers with the support of LAs drafted more than 100 standard by-laws for the province. These by-laws can help LAs to increase their revenues and regularize several regulatory mechanisms related to the business environment.

RIA in Cambodia

From August 2010 to June 2011, The Asia Foundation partnered with the Senate of the Kingdom of Cambodia and the Cambodia Institute of Development Study (CIDS), a local research institute, to introduce the RIA methodology and practice to core officials/staff of the Senate Research Department, concerned parliamentary commissions, and National Assembly research staff. With the aim of strengthening the capacity of parliament to engage in economic policy reform, the program worked to familiarize senators and other key decision makers with the RIA methodology so that they would be able to draw on the enhanced capacity of the research team after the program concluded.

The program's overall objective centered on developing the capacity of the Senate and Parliamentary staff to better understand the potential impact of regulations on private sector development through use of the RIA approach, with a special focus on regulations affecting business environments at the subnational level, using results from the 2009 Provincial Business Environment Scorecard (PBES). The program built on earlier efforts made from June 2007 to January 2009 to strengthen the partnership between The Asia Foundation and the Cambodian Senate through a project to "Strengthen the Capacity of Cambodian MPs in Policy Making Processes and Economic Development." This involved a series of workshops and discussions on business environment issues and economic policy reform. Linkages were promoted between the national and provincial levels, and efforts were supported by all stakeholders in the executive and legislative branches, the private sector, and the research community to build consensus in developing economic policy reforms.

Program Highlights

Before the process to introduce RIA was officially initiated in Cambodia, the Foundation worked to build the capacity of CIDS to deliver basic RIA training and provide ongoing tutorials using case studies. Next, a RIA committee was formed—comprising high level senators, as well as members of CIDS, and the Foundation—to generate a consensus on RIA and ensure the training was aligned with the needs of the Senate. The Foundation and CIDS were then ready to facilitate formal training on basic cost/benefit analysis and RIA analysis, tutoring, and group work on case studies. Case studies used as simulation exercises focused on three newly decentralized business registration procedures under the newly established One Window Service of the province of Battambang—registration of business under the department of Commerce, under the Department of Industry, and under the Department of Construction.

Step 1: Training

An international RIA expert from Indonesia provided a one-week intensive training on RIA methodology and tools to 20 key officials/staff of the Senate and National Assembly. Training introduced the concept and applicability of RIA to Cambodia and provided a tutorial on the techniques of basic cost/benefit analysis. CIDS participated in the training with the expert and acted as liaison to the trainees.

The official opening of the RIA one-week training session took place on September 27, 2010, in the Senate Conference Hall. There were roughly 80 attendees, including the chairmen of the Commissions of the Senate and National Assembly, senators, members of the National Assembly, officials from the General Secretariat of the Parliament, and 20 trainees.

Step 2: Fieldwork

Following the training, trainees conducted a RIA field research activities at the subnational level using information from the *Provincial Business Environment Scorecard* on provincial business environments, constraints, and the current parliamentary agenda. The field research consisted of focus group discussions with local authorities and the business community. CIDS provided guidelines to the trainees for their field research and acted as a mentor, helping to collect information and facilitate focus group discussions to ensure that trainees collected sufficient data to conduct the RIA. During the field research activity, CIDS helped facilitate the focus group discussions, demonstrated information collection techniques, and engaged participants in active discussion.

Step 3: Analysis and Development of Case Studies

Upon the conclusion of fieldwork, The Asia Foundation and CIDS provided mentoring sessions reviewing methods of gathering, checking and analyzing field data using the RIA framework. The trainees were also provided with advice and guidance on how to organize and present the findings to their audience of senators and parliamentarians in a clear and concise way.

Step 4: Dissemination and Development of Short Booklets

A dissemination workshop on RIA will be held at the Senate for a large audience including members of Parliament and Government, but also private sector representatives as well as donors and development partners. While trainees will present their case studies, this workshop will be another opportunity to raise awareness on how RIA can help the policy reform process and to stress the importance of consultation of concerned stakeholders in the process.

RIA Around the World

With the increased emphasis on good governance, the use of RIA is expanding internationally, with RIA programs being established within many national governments. In Australia, the United States, and many European countries, RIA is now a required step in the review of major regulatory reforms. As mentioned at the beginning of this chapter, the OECD has taken a leading role in advocating the use of RIA. Recently, the organization has begun to use this experience to support new RIA programs in developing countries.

RIA has proven an effective tool for developing countries struggling to manage rapid economic growth and shifting regulatory standards. The Asia Foundation continues to play a key role in integrating RIA into local economic governance programs throughout Asia. Foundation-supported RIA programs are not simply viewed as a way of tackling problematic regulations. They also help all stakeholders—governments, businesses, and NGOs—take a more informed and critical view of the government policymaking process. Such engagement has long-term benefits as the public plays an increasingly active role in improving the business climate.



A POLITICAL ECONOMY APPROACH TO NATIONAL-LEVEL REGULATORY REFORMS

Jaime Faustino and V. Bruce J. Tolentino

Political economy is not a new field of study or area of concern. What is new, however, is the application of political economy analysis to current conundrums in economic development. Of even more recent vintage is the deliberate implementation of political economy approaches to development programming.

Over the past two decades, the development community's attention to economic and political aspects of development has intensified, with many aid organizations formulating approaches to social and political analysis. Development analysts and donors are increasingly recognizing that reforms are shaped by the context of political decision-making and the way in which politics affects economic choice. Concerns over power and authority are particularly relevant since there are always conflicts of interests among economic actors. How does a society make collective policy decisions, given conflicting interests? How do individuals, classes, or groups gain power or authority; or attempt to influence societal decisions with their specific preferences?

Applied to regulatory issues, the solutions generated by standard economic analysis often exclude political and operational considerations. Due to this exclusion, the approach is often viewed as ignoring political incentives and motivations, and is thereby "exceedingly technical" and likely to fail. Indeed, it has become quite clear that academic or purely technical approaches to policy reforms, along with conditionalities and policy actions organized as structural adjustment programs, have not worked.

The Asia Foundation's accumulated experience and learning indicates that success in economic growth and development requires not only the correct policies that "get prices right," but also the appropriate institutions that ensure security of property rights; enforce contracts; stimulate entrepreneurship; nurture international integration; maintain macroeconomic stability; manage financial risk; supply social safety nets; and enhance transparency, voice, and accountability. The Foundation has thus developed a set of tools and approaches that enable flexible entry and engagement in Asia's volatile policy arenas.

The Asia Foundation's Political Economy Approach

The Asia Foundation's approach to economic reform and development is unique, lying at the crossroads of economics, political science, and public administration; between research and direct implementation; and amidst the development practices of the large multilateral and bilateral development institutions on the one hand, and national reformers and local coalitions on the other.

The political economy approach is embedded in The Asia Foundation's deployment of its economic reform and development toolkit—research and surveys—including the Economic Governance Index (EGI), Public-Private Dialogue (PPD), Regulatory Impact Analysis (RIA), One Stop Shop (OSS), and local fiscal management.

Operationally, the Foundation's political economy approach to reform begins with analysis (diagnosis and metrics); continues with project activities (flexible support for advocacy and engagement by selected partners and reform actors, and dialogue); followed by implementation assistance (activities far beyond policy reform analysis, including help for stakeholders to achieve and sustain reforms).

In the Foundation's approach, any reform effort must begin with a careful analysis and understanding of the prevailing "business model." This model depicts a status quo that benefits a defined subset of stakeholders with strong incentives to support and defend it, thereby thwarting reform. Indeed, the Foundation's approach is premised on an understanding that economic reform is inherently a political act because it changes the distribution of costs as well as benefits among groups in society. Some benefit while others are hurt.

Based on its understanding of the underlying business model, the Foundation and its partners then develop a strategy to influence the situation by changing the dynamics and information flows among stakeholders toward a desired post-reform state. This approach utilizes an explicit political economy framework, where activities take into consideration the ways in which political and economic actors, institutions, the political environment, and various aspects of the economic system interact with and influence each other.

Implementation: Constituencies for Reform

All of this is easier said than done. Policy reform efforts are difficult; and those significant enough to require political economy approaches are more demanding still. Successful, politically informed reform hinges on the work of on-the-ground, skilled individuals and organizations with a position and the requisite skills to intensely interact with stakeholders on both sides of the policy issue.

A key feature of The Asia Foundation's political economy approach is the identification and development of constituencies for reform. This is done by:

- building informed and engaged constituent groups (in many cases informal) of stakeholders and officials interested in pursuing reform;
- strengthening the capacity of those stakeholders to communicate the benefits of specific reforms; and,
- developing a deeper understanding of the interests, relationships, and leverage of those who seek to undermine the reform process.

In each reform effort there are often “tipping points” in which policy reform is more likely to succeed because the case for reform builds to an intensity that can overcome entrenched interests and existing barriers. Understanding and identifying those tipping points for specific reforms in key sectors; mobilizing and coordinating reform stakeholders; and channeling the case for reform to the right decision-makers at the right time can significantly increase the effectiveness and reduce the costs of policy reform efforts. Political and economic actors in the “coalition for reform” tend to be working in their own interests, and are often new to the game. Knowing how to increase the number of actors in the process is crucial to changing the outcome.

To implement its programs, the Foundation provides technical assistance to reformers while at the same time assisting local partners in informing and persuading stakeholders—thereby broadening support across various government agencies, the private sector, and civil society organizations. A key lesson learned through the experience of the Foundation is that it is insufficient to provide only technical assistance to policymakers or the bureaucracy and assume that implementation and reform will follow. Because reforms often run counter to the specific interests of policymakers and bureaucrats, they do not have the internal incentive to effectively implement the reforms. Reform is achieved when concerned

stakeholders and decision-makers have access to relevant technical information, and understand the issues; a strong coalition supports reform; and the government issues the appropriate policy instruments.

Based on Foundation experience, the key elements of successful economic policy reform projects are:

1. A result-oriented, flexible project structure.
2. A clear understanding of the political economy of the currently operating “business model.”¹
3. A clear and simple reform agenda that changes the business model and incentives.
4. A formal or informal coalition of informed and engaged partners in the public and private sector.
5. A group of “policy entrepreneurs” to manage the reform process and nurture relationships with key constituents.

Program Highlights

The Asia Foundation’s experiences in national-level policy reforms—particularly those that deploy political economy approaches—have been most extensive in the Philippines. However, the Foundation is also successfully applying its unique approach in Bangladesh, Cambodia, Indonesia, and Sri Lanka. Effective partnerships are key to the success of the Foundation’s programs. With its extensive background and longstanding network of relationships, The Asia Foundation is able to identify the

¹ This refers to the set of incentives and processes that lead actors to act in the way they do. Typically, powerful political interest groups—both public and private—are satisfied with the status quo, whereas “reformers” are trying to increase overall social welfare at the expense of “rents” being captured by the interests.

most appropriate partners, bring them together, and provide the resources to help them achieve their goals. Some highlights of country experiences are described below.

Establishing Rights in Accessing Financial Services in Bangladesh

In Bangladesh, the Foundation supports the Rangpur-Dinajpur Rural Services (RDRS), an NGO dedicated to empowering the rural poor in the country's northwest. In 1999, through the "Competency-based Economies through Formation of Entrepreneurs (CEFE) Entrepreneurship Development Program," the RDRS launched a business development program aimed at building confidence among local businesses and entrepreneurs, and establishing a local network of small and medium-scale enterprise (SME) service providers.

RDRS held a launch workshop in Lalmonirhat, where the organization solicited the participation and cooperation of important stakeholders, such as the Bangladesh Small and Cottage Industries Corporation, commercial banks, government line agencies, chambers of commerce, local elites, and NGOs. This initial consensus building with key players was successful both in terms of establishing connectivity and securing commitment of support.

A training program on new business creation was then organized in Lalmonirhat for a group of 25 interested participants, who were carefully selected from a larger group of 60. At the end of the training—conducted by an expatriate CEFE Trainer—the participants were asked to formulate business plans they intended to implement. The plans were evaluated by a panel of qualified practitioners representing local commercial banks, the Bangladesh Small and Cottage Industries Corporation (BSCIC), and the Rajshahi Krishi Unnayan Bank (RAKUB).

The panelists appreciated the initiatives of RDRS and the business plans prepared by the entrepreneurs; and the local bank managers assured participants of financial assistance, as some of the plans were very convincing and potentially deserving of investment support. At the end of the training, however, local commercial banks did not in fact provide investment support when the participants actually applied for enterprise loans.

Realizing this reluctance of bankers to process the loan applications of the new entrepreneurs, the RDRS Business Development Unit resorted to an advocacy approach to influence the local bankers in favor of the applicants. The applicants were organized into a group and advised to move collectively instead of approaching the local banks individually. They were also provided with all necessary information regarding loan eligibility, and processing and disbursement procedures.

The collective approach was a success. Applicants demonstrated confidence and assertiveness when negotiating on various conditions. Within a short period of time, their voice was augmented because of their collective approach and skills, as well as their access to information. At one stage, the aspiring applicants invited all local bank managers they had approached to visit their business sites, where they explained the potential they had to make their businesses profitable. This exposure to firsthand evidence of the potential of these SMEs finally prompted BSCIC to finance six off-farm SMEs, and RAKUB to finance at least one on-farm business plan.

The RDRS continued to monitor their progress until the businesses commenced operations and reached a position whereby they could profitably sustain their enterprises. The follow-up also indicated that loan repayment by CEFE entrepreneurs was done regularly and at the rate of nearly 95 percent.

Upgrading the Adi Sucipto Airport in Indonesia

Small and medium-scale businesses in Indonesia's Yogyakarta are dominated by handicraft producers. Until recently, these producers marketed their products mostly in Bali, both for consumption in Bali (a tourist destination) and for export. Following the Bali bombing tragedy in October 2002, exports through Bali virtually stopped; and there was a sudden drop in demand for products sold there, as foreign tourism numbers fell sharply.

Reeling from the impact on Yogyakarta, the district-level business association Forda UKM (SME Forum) Yogyakarta—supported by JNP-UKM (National Support Network for Small and Medium Enterprises) and The Asia Foundation—proposed that the local Adi Sucipto Airport be upgraded to become an international airport. With an international airport, they argued, Yogyakarta's dependence on tourists shopping in Bali would be reduced. Furthermore, it was hoped that security disturbances in other regions would not affect tourist visits to Yogyakarta, where things remained relatively stable.

To support their case, Forda UKM Yogyakarta used research study results that quantitatively showed the amount of losses suffered by Yogyakarta as a consequence of the Bali bombing. This quantitative data was presented to policymakers at the local and national levels by Forda UKM Yogyakarta together with other business associations. In addition, Forda UKM Yogyakarta cooperated with the media in airing talk shows on the issue, further strengthening the advocacy effort.

On 21 February 2004, the Indonesian government finally established Adi Sucipto as an international airport. Since then, both the volume and value of Yogyakarta's air cargo exports have risen

dramatically—from nine tons (USD 298K) in 2003 to 28 tons (USD 856K) in 2004 and 309 tons (USD 2.1 million) in 2005.

This is a good example of how The Asia Foundation works with partners and beneficiaries in a local situation to iteratively bring issues up through successively higher levels of decision-making. The Foundation continues to work in Indonesia to strengthen the capacity of local organizations so that they have the voice, presence, and ability to bring questions and issues up to national-level authorities.

Promoting Civil Aviation Policy Reform in the Philippines

The Philippines is highly dependent on air transport for the movement of people and goods. As an island country, 98 percent of its visitors arrive by air. Exports of high-value commodities (72 percent of total export earnings) are moved by air. Even domestic tourism and trade are increasingly taking advantage of airline options.

In 1993, the Ramos Administration implemented reforms aimed at liberalizing the domestic and international civil aviation industry, and new domestic carriers entered the market. Despite this progress, serious constraints to air access remained. From 1997-2007, the Philippines concluded only one air agreement per year; and bilateral agreements to key Philippine markets such as Singapore, Thailand, Malaysia, Hong Kong, and South Korea were severely constrained. New carriers could not enter the market and current carriers could not increase capacity. The lack of capacity served the interests of the dominant Philippine carrier, which benefited from the absence of effective competition.

In late 2006, both civil society partners and allies in government approached The Asia Foundation to develop an activity to further

promote liberalization and increase competition. In response, the Foundation provided a grant to the Center for Research and Communications (CRC).² Over a two-year period, with Foundation support, the CRC helped the airport authorities:

- identify the key markets that lacked entitlements in air agreements;
- prepare and deliver presentations—including several to the president and her cabinet—on the negative impact of low entitlements on Philippine economic development; and
- submit recommendations to accelerate negotiations on bilateral air services agreements.

In 2007, the airport authorities held two presentations for President Arroyo and her cabinet. The principal message focused on the analysis that air rights to key markets were “fully utilized” and therefore growth was hampered by the lack of additional entitlements. In January 2008, a presentation by the Diosdado Macapagal International Airport (DMIA, also known as Clark International Airport) to President Arroyo and her cabinet recommended that air talks with countries take place as soon as possible to provide capacity entitlements to secondary gateways like DMIA, Cebu, and Davao airports.

Based on the recommendations prepared by the Foundation’s partners, President Arroyo ordered that bilateral air talks be implemented at an accelerated pace. The impact of the order has been evident over the past two years. In 2007, only two air agreements were signed. Following the January 2008 cabinet meeting, 10 air

² The Asia Foundation activities were undertaken under the Policy Reform Program (PRP), with the generous support of the United States Agency for International Development (USAID). For more information, see The Asia Foundation, “Policy Reform Program (PRP),” *Annual Report FY2007*, November 2007.

agreements were concluded that year. Prior to each air talk, Foundation partners provided analysis of the current air service agreement and recommended positions for the upcoming negotiations. The Foundation's technical assistance enabled DMIA airport officials to pursue an accelerated air service agreement timetable. Increased air access enabled by these liberal air agreements has led to a more competitive market characterized by significantly more flights—at lower fares and fees—for tourists, business travelers, and Filipinos traveling to and from work overseas. Passenger arrivals to Clark Airport have increased tenfold since 2004, and the airport is emerging as a viable alternative to the congested airport in Manila.

This has had a significant impact on Philippine tourism and the local economy. In the Clark area, investments in room capacity doubled to nearly 5,000 rooms from 2006-08. Based on estimates from the Clark Investors and Locators Association, more than 1,000 new jobs were created by these investments. The new air agreements have also increased air access to secondary gateways such as Davao, Cebu, and Laoag. These represent opportunities to promote increased tourism, investment, and employment.

Connecting the Philippine Islands through Efficient Sea Transport

As an archipelago of thousands of islands, sea connectivity is critical for Philippine economic development. To increase connectivity among the myriad “island economies,” The Asia Foundation and its local partners provided analysis³ and recommended the introduction of a policy to shift away from a “container box”

³ The Asia Foundation activities were undertaken under the Policy Reform Program (PRP), with the generous support of the United States Agency for International Development (USAID). For more information, see The Asia Foundation, “Policy Reform Program (PRP),” *Annual Report FY2007*, November 2007.

shipping system to a system that allows trucks, buses, and cars to “roll-on and roll-off” (RO-RO) shipping vessels.

To pursue the RO-RO policy reform, the Foundation and its local partners worked with those affected by the high cost of sea transport: the Department of Agriculture, the Development Bank of the Philippines, the National Economic Development Authority, the Mindanao Business Council, the Philippine Chamber of Commerce and Industry, and the Supply Chain Management Association of the Philippines.

Since the RO-RO policy was signed and initiated in 2003, inter-island transport logistics costs decreased. Among five different product categories (fish, live cattle, liquid CO₂, dry goods, and beer) transport costs were reduced by 20 to 60 percent. The RO-RO network also changed business and logistics practices, and has had a tremendous impact on many companies that used to ship the traditional way.

Since the introduction of the RO-RO policy, the annual increase in cargo handling charges has ceased (except in 2006, when there was a sharp increase in oil prices). RO-RO shipping has brought competition in the way goods are shipped, thereby discouraging the increase in cargo handling rates.

Many shippers themselves attest to the fact that RO-RO has greatly reduced their transport cost. A study done by the Foundation’s partner, the CRC, in 2006 determined that the cost savings due to RO-RO amounts to approximately 40 percent.

In 2008, The Asia Foundation and the CRC helped the Philippines inaugurate a third major North-South link between Luzon and Mindanao called the Central Nautical Highway. The three North-South links, collectively known as the Strong Republic

Nautical Highway (SRNH), have been critical in connecting the country's thousands of island to trade and investment. The Foundation and the CRC provided assistance to both agencies and business associations through studies, analysis, primers, presentations, and briefings.

The SRNH has increased the options on how to best ship goods at the lowest possible cost and in the shortest possible time. Prior to the opening of the highway, shippers were not given any choice. Cargo was usually transported via long haul (e.g. Manila-Cagayan de Oro; Manila-Davao; Manila-Cebu) utilizing the traditional way of cargo handling (lift-on/lift-off or LOLO). This lack of options often resulted in shippers having to ship inefficiently at higher costs.

One example of the impact these reforms have had is the case of Nestle Philippines, a leading food conglomerate. According to Nestle officials, the expansion of RO-RO complemented its expansion to further markets. Because of Nestle's extensive use of the Nautical Highway and the reliability of RO-RO service, the company has been able to do direct deliveries to customers and clients in the most practical manner, thus ensuring product safety and shorter lead-times. Because of the RO-RO system, inventories have been minimized and Nestle has reduced its distribution centers from 36 prior to the policy to three. Using the extensive RO-RO network, Nestle delivery trucks can now act as rolling "distribution centers."

Moreover, the RO-RO has helped their distribution by providing a solution to the lack of food-grade container vans, and an alternative to the congestion experienced when shipping via long haul. Finally, RO-RO has also enabled Nestle to reduce its operational costs dramatically. Due to these savings, the company was able to keep milk prices stable despite the 400 percent increase in the global price of milk, passing on the savings to consumers.



STREAMLINING BUSINESS LICENSING AND TRANSPARENCY MECHANISMS IN INDONESIA AND THE PHILIPPINES

Frida Rustiani and Maria Belen Bonoan

Economic growth and investment in Asia are constrained by a host of factors. The difficulty of obtaining required business permits and licenses, in particular, looms large as an impediment for firms throughout the region. Especially at the level of local economies, excessively complex licensing procedures discourage the establishment, formalization, and expansion of companies. Without the influx and growth of formal businesses within local economies, job growth is weak and local government revenues are insufficient to support needed social and infrastructure projects. Although many business climate factors, such as transportation and education, can only be addressed in the long term, licensing reform is an area in which quick results can be achieved to catalyze business development.

In Asia, four of the leading problem areas within the business licensing system are:

1. **Regulatory overlap:** Different types of business permits have overlapping functions, posing a significant regulatory problem.
2. **Bureaucratic challenges:** The actual implementation of business licensing often suffers from a lack of government capacity and resources. This can prevent governments from providing the social protection, market control, or information collection that business license revenue is intended to afford.

3. **Division of licensing responsibility:** Responsibilities are often scattered across different levels of government, resulting in a lack of efficiency and accountability.
4. **Economics of licensing:** Many local governments issue licenses with the sole aim of raising revenue.

Streamlining and Increasing Transparency

Micro, small, and medium-scale enterprises (MSMEs) account for the vast majority of enterprises in Asia. Most operate in the informal sector—unregistered and without legal status—largely because of the barriers to entry into the formal sector. The two most formidable of these obstacles are: (1) the large quantity of licenses required by law; and (2) the poor quality of public services, high levels of corruption, and chronic inefficiency—which make obtaining these licenses slow and costly.

Informal status impedes the expansion of MSMEs, since they are unable to access bank finance, sell to large buyers, or even export. As a result, they often operate at low levels of productivity. The difficulties these firms face in the informal sector constitute a serious obstacle to economic and employment growth throughout the region.

The Asia Foundation is working to address these issues through its Economic Reform and Development (ERD) programs, including the One Stop Shop (OSS) program in Indonesia and the Transparent Accountable Governance (TAG) program in the Philippines. The OSS program, initiated in 1999, focuses on streamlining business licensing through the establishment of one stop licensing centers throughout Indonesia. Permit and license issuance is consolidated in these local government departments and offices, simplifying processes, and reducing the number of contact

points between applicants and officials. The TAG program, initiated in 2002, provides local Philippine governments with the technical assistance needed to restructure services in order to increase efficiency, decrease the cost of doing business, and encourage investment.

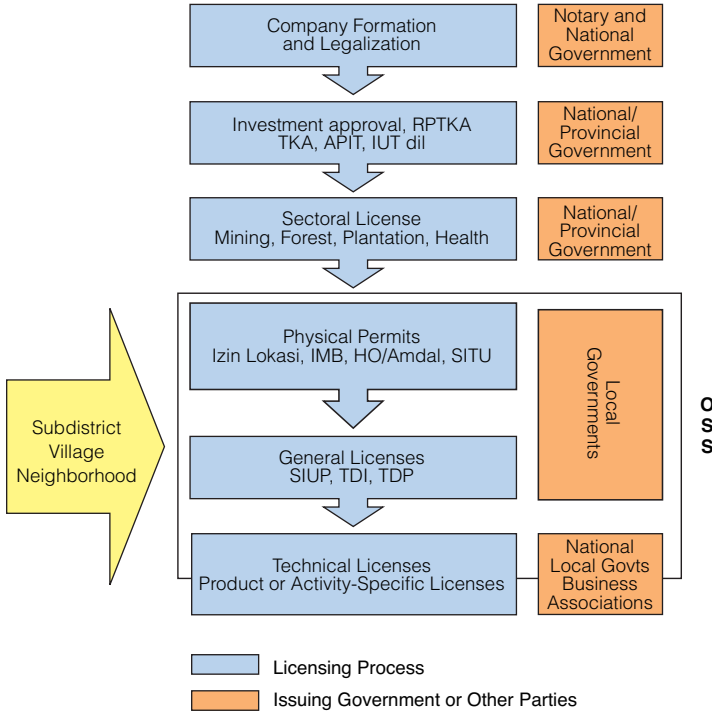
One Stop Shops in Indonesia

Indonesia has one of the most cumbersome, time-consuming, and corrupt licensing processes in Asia (Figure 6.1). Since the costs of registering a new business are so high, business owners must consciously decide whether the value of being registered offsets the time and expense of going through the process. The process is so difficult, however, that nearly 80 percent of the country's domestic private sector remains informal and unregistered.¹ MSMEs account for approximately 95 percent of all enterprises in Indonesia—the vast majority of which is unregistered and without required permits and licenses.

These barriers to entry—the large quantity of licenses required and the poor quality of public services—have been made all the more disruptive by a decentralization process that has placed authority over business license issuance into the hands of more than 500 local governments. Indeed, local governments have an increasingly important role in encouraging economic growth and prosperity in Indonesia. Regional autonomy has granted them the power and resources to significantly influence the business climate by establishing regulatory and licensing rules, determining expenditure allocations for economic development, and setting the quality of public services.

¹ According to the Indonesian Central Bureau of Statistics (BPS) data, approximately 90 percent of Indonesian firms are in the informal sector. (See The Asia Foundation, "Streamlining Business Licensing: An Evaluation of the Impact of One Stop Centers," 2005.)

Figure 6.1: Business Registration and Licensing Process in Indonesia



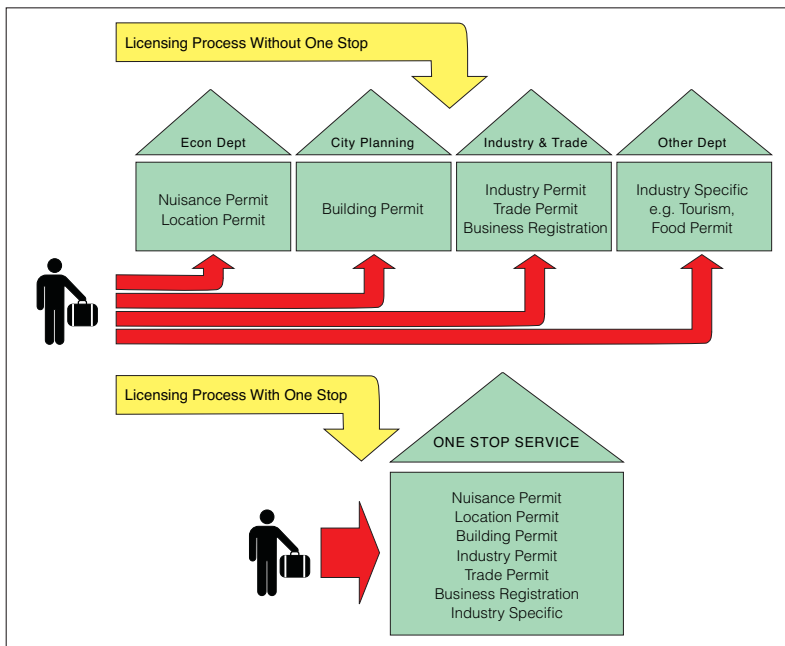
While such a high degree of autonomy has created the potential for greater political freedom and government innovation, it has also increased variability in the quality of economic governance. There are two issues, in particular, that continue to impede investment at the district-province level. First, the central government remains a key determinant of local economic policy. Second, many local governments are ill prepared to implement these new functions and, as a result, collectively issue thousands of local regulations imposing taxes, levies, and other fees without clear justifications as to the benefit for businesses or the community. A short-term focus on revenue generation has a detrimental effect on long-term economic development.

An additional constraint to the development of a business-friendly regulatory environment is the poor quality of legal drafting for regulations in many regions. The public is rarely consulted during the drafting process, and cost-benefit analysis is seldom conducted to assess the impact of new legislation.

One Stop Shops (OSS)

OSS centers are physical offices where permit and license issuance is consolidated, simplifying processes and reducing the number of contact points between applicants and officials (Figure 6.2). The Asia Foundation has provided technical assistance to more than 65 local governments throughout Indonesia to establish OSS centers that accept, process, and approve licenses so that business owners no longer have to approach each technical department directly.

Figure 6.2: Licensing Process and OSS



The program has incorporated improvements in information technology to allow for better management, performance monitoring, and customer service for businesses. The Foundation has focused largely on general licenses required by all businesses (e.g. trade licenses, building permits, etc.) rather than sectoral licenses that require specific approvals (e.g. food safety and environmental clearances). As will be described, the choice of which licenses to streamline is made via a consultative and participatory process with each local government.

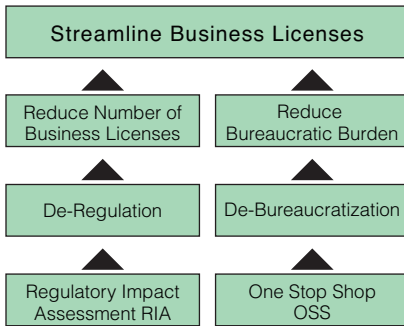
An Integrated and Bottom-Up Approach

The Foundation's approach combines technical assistance for government with support for advocacy by the private sector. The Foundation takes an integrated approach toward implementing its OSS activities, operating at three levels—district, provincial, and national—and prioritizing support from local government leadership.

By 2002, three years after the OSS program's initiation, only an estimated 20 percent of districts nationwide had opened an OSS, and many of these did little to streamline licensing. This led the Foundation to a new phase of business licensing reform: the "all-Indonesia" approach. Rather than focusing only on Indonesia's major centers of economic activity, the Foundation's ERD unit shifted its work to a number of areas throughout the country. This not only provided the program with an excellent understanding of economic reform at the local level, but also a good perspective on how national and provincial policies actually impact districts in practice.

To address myriad complex issues, the Foundation's advocacy program in Indonesia focuses on two major areas: (1) the excessive

Figure 6.3: Dual Initiative for Improving Business Licensing



number of licenses that business must obtain, and (2) the large number of institutions involved in the licensing process. In order to address these licensing and regulatory issues, the Foundation has undertaken Regulatory Impact Assessment (RIA) and the establishment of OSS licensing centers (Figure 6.3).

The OSS program in Indonesia is conducted in conjunction with local non-government organizations, business associations, and academics. These partners conduct studies, provide recommendations, and hold workshops for local government staff, with technical support provided by Foundation staff. As is the case with RIA, The Asia Foundation has an explicit strategy of building local expertise among NGOs that can then provide sustainable technical assistance to local government. Capacity-building activities ensure that local NGO partners have gained a degree of expertise that will prove valuable to local and provincial governments.²

² The Asia Foundation, "Reducing Barriers to Market Entry and Business Operation: Program untuk Memperbaiki Iklim Investasi – PROMIS Final Report," February 2009.

When implementing the OSS program, technical assistance provided by the Foundation involves five key steps (Figure 6.4), with media advocacy employed throughout:³

- 1. Assessment:** The Foundation and its partner support an assessment of the current political and economic context as well as the level of commitment within local government.⁴ This step includes a review of all existing bureaucratic structure and procedures through interviews with MSME owners and government officials.
- 2. Design of Licensing Reform:** The partner facilitates the process of mapping current business licensing practices and costs, and formulates strategic recommendations. Recommendations typically entail a restructuring of the bureaucratic process and a reorganization of authority over licenses.
- 3. Building Political Commitment:** The third step involves building political commitment through the formulation of a legal basis for improved licensing practices. Once the local government has decided which licenses will be moved under the authority of the OSS, a decree or regulation is passed recognizing the new authority. This leads to the development of a Memorandum of Understanding (MOU) between the local partner and local mayor's office. The MOU binds the local government to genuine participation in the project, which entails support provided through its staff

3 The Asia Foundation, "Improving the Business Environment for SMEs and Gender Responsive Budget Initiative in Sulawesi," *Proposal to the Canadian International Development Agency*, 31 May 2004.

4 The Asia Foundation, "Reducing Barriers to Market Entry and Business Operation: Program untuk Memperbaiki Iklim Investasi – PROMIS Final Report," February 2009, pp. 10.

and facilities. Determination of local government financial contribution is included in the MOU as well.

4. Implementation of Reform: At this stage, OSS personnel are trained and service provision infrastructure is established.

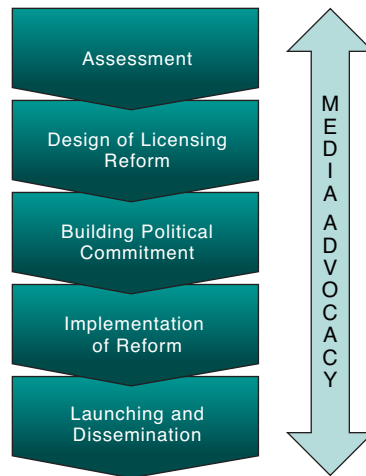
Workshops are held for officials and OSS staff on standards and procedures for efficient licensing based on

Foundation-developed methodology, with examples provided from well-run OSS centers in other cities.

Technical assistance is provided to government officials to implement the reforms agreed upon during the workshop. This assistance includes the development of cost-effective reforms that address deficiencies identified in the needs assessment, training on OSS operations, and the establishment of customer feedback mechanisms. In most

cases, bureaucratic restructuring requires capital improvements, information technology enhancements, office renovation, and personnel upgrading on the part of the local government. Minimum service standards, standard operating procedures, and service inno-

Figure 6.4: Five Steps of OSS Implementation



ventions (such as e-government and staff incentives schemes) are also installed.

5. Launching and Dissemination: The Foundation supports launching and dissemination activities to promote OSS services to the community through events, leaflets, billboards, and other channels. A series of public education campaign activities—including regular radio and television talk shows and public service announcements—are organized to encourage businesses to register.

Media Advocacy, Public Education, and Dialogue

Throughout the process, activities to engage the public and encourage dialogue are undertaken, including:

- Public seminars to generate public awareness and political pressure for sustained reform. Seminars are aimed at publicizing the OSS and ensuring that the government follows through on commitments made in private meetings. They provide officials and members of the public with an outline of how an OSS can improve local economic performance, enhance business and employment opportunities, and even increase tax revenues.
- Inter-agency dialogues between OSS authorities and relevant local departments are held in order to improve inter-departmental coordination. The Foundation develops technical agendas for sessions to improve coordination between local government departments and agencies.
- Private-public dialogues (PPDs) are held for local MSME owners, government officials, and parliament members. Attendees discuss corruption and reforms of current practices that can make licensing regulations more business-friendly.

National Decree and Guidelines on OSS

Presidential Instruction No. 3/2006 on Improving the Investment Climate called for a number of initiatives to accelerate economic investment in Indonesia. The country's Ministry of Home Affairs (MOHA) was appointed to draft guidelines for establishing OSS sites. Due to the Foundation's expertise in business licensing, MOHA requested technical support to develop the guidelines and to draft a decree on OSS. The Foundation provided assistance to MOHA in partnership with its long-established NGO partner, Bandung Trust Advisory Group (B-Trust).

The Asia Foundation facilitated a series of interdepartmental consultations at the national level, followed by consultations with provincial and district governments in Makassar, Solo, and Bali. A national seminar to gather final stakeholder inputs was held on May 3, 2006, in Jakarta and the decree was completed in July 2006. The Foundation then worked with the International Finance Corporation (IFC) and MOHA to produce OSS guidelines to clarify the procedures for establishing OSS at the district level. The drafting team included academics and provincial government officials, and was vetted through consultations held in Yogyakarta, Bali, Makassar, and Banjarmasin. The final draft was finished in April 2007.

Additionally, the Foundation facilitated public consultations related to a draft presidential decree on OSS for investment licenses. The new investment law, No. 25/2007, was issued in early 2007, specifically addressing the role of OSS in attracting investment by simplifying business licensing procedures. An inter-ministerial team, including the National Investment Coordination Board, the Ministry of Trade, and the Coordinating Ministry for the Economy, was established to discuss this role in more detail.

The Asia Foundation facilitated consultations between the team and local and provincial governments.

Following this national decree, the *Guidelines on the Establishment and Improvement of One Stop Shops* document was launched in 2007. The guidelines provide information for district governments on developing OSS policy, technical steps required to improve the quality of services by OSS, and templates for commonly used forms and paperwork. More than 400 participants, including local government officials from across Indonesia, attended the launch. In 2008, the State Ministry for the Empowerment of State Apparatus reported that 293 districts had established OSS to comply with the MOHA decree.

Program Highlights

As part of its USAID-funded PROMIS program in 2005-08, The Asia Foundation provided OSS technical assistance to local governments within 32 districts across nine provinces throughout Indonesia. In partnership with 14 local NGOs, the program successfully upgraded or established 29 OSS centers.⁵ Among the 10 districts that established a new OSS was Kota Cimahi, described in more detail below. Among the 19 districts receiving OSS upgrades was Kota Yogyakarta, also discussed further in this chapter.

Licensing practices in Indonesia have long been plagued by a sequential standard process whereby one license must be obtained before applying for the next. Throughout the PROMIS program,

⁵ The Asia Foundation, "Reducing Barriers to Market Entry and Business Operation: Program untuk Memperbaiki Iklim Investasi – PROMIS Final Report," February 2009.

the Foundation assisted local governments in passing a decree allowing for parallelization, enabling multiple basic permits to be processed simultaneously. Under PROMIS, governments in Kota Banda Aceh, Serdang Bedagai, Probolinggo, Pasuruan, Sidoarjo, Blitar, Cimahi, and Pekalongan all issued decrees allowing licenses to be issued in parallel without a duplication of common requirements.⁶

Because of this reform, the maximum time for obtaining three of the five main licenses across these local governments fell to approximately nine days. The average time needed to obtain major licenses for starting a business was reduced from 44 to 23 days. In total, technical assistance helped to reduce the average time for obtaining major licenses from 68 days to 23 days (a 34-35 percent decrease).

Furthermore, most PROMIS sites successfully adopted new regulations that exempt and/or reduce the number of licensing requirements. Overall, the number of supporting documents required to obtain licenses and permits decreased by 24 percent as a result of the reform. On average, 10 less requirements are now needed to obtain key business licenses.⁷ At the same time, the volume of licenses issued increased significantly. In six OSS surveyed (Indramayu, Kota Cimahi, Kota Pekalongan, Sidoarjo, Kota Blitar, Serdang Bedagai) the volume of licenses increased 20 percent on average.⁸

These improvements were further supported by the introduction of information technology (IT) systems in various locations. A total

6 Ibid, pp. 19.

7 Idem.

8 Ibid, pp. 15.

of 14 OSS developed websites to provide customers with licensing information. Finally, the Foundation introduced standard operating procedures in all OSS that require clear information on the costs and time to process licenses to be available on signboards. Transparency was further ensured through the distribution of leaflets and brochures containing information about costs and processing times.

Kota Cimahi

In 2007, The Asia Foundation and B-Trust assisted Kota Cimahi in the establishment of an OSS authorized to cover 60 types of licenses. The reduction in the time and cost required to secure permits in Kota Cimahi led to a significant increase in the number of basic permits issued—nearly two and a half times as many within two years after the OSS was established. In 2007-2008, the number of licenses in Kota Cimahi increased by 50 percent.⁹ Furthermore, there was a robust increase in Locally Generated Revenue (PAD) without raising the rates for licensing and investment.

Most notably, during a mass-licensing event held on April 1, 2008, Kota Cimahi processed and issued 1,116 documents in one day. Most licenses issued were business registrations, trading permits, and nuisance permits. As many as 154 small businesses—60 percent of which were small women-owned enterprises—obtained their first business formalization free of charge. The mass-licensing event also helped businesses access direct credit through leading banks in Cimahi. More than 25 eligible small businesses were able to sign their credit contract agreements on the day of the event.¹⁰

9 The Asia Foundation, “Reducing Barriers to Market Entry and Business Operation: Program untuk Memperbaiki Iklim Investasi – PROMIS Final Report,” February 2009, pp. 15.

10 Ibid, pp. 29.

Kota Yogyakarta

The Asia Foundation and its local partner, Daya Prosumen Mandiri (DPM), had originally initiated OSS in Kota Yogyakarta in 2003. At the time the PROMIS program for upgrading the OSS was launched in January 2006, the existing OSS was capable of processing 38 different licenses. Over the following three years, this number increased to 75 and included a number of key licenses important for investment, including business registration licenses, construction permits, and trading permits.

Additionally, the government introduced parallel licensing procedures, and created an information and communications center for all local government services. The new Kota Yogyakarta website allows customers to download their licensing applications, check their application status, and file complaints via SMS.

During the 2007 Investment Awards held in December 2007, Indonesian President Susilo Bambang Yudhoyono awarded Kota Yogyakarta the title of “Best One Stop Shop,” due to the efficiency of its licensing center. The OSS has since become a model for other licensing centers throughout Indonesia.

Transparent and Accountable Governance in the Philippines

The *Local Government Code of 1991* substantially decentralized national power, devolving services to local governments in the Philippines and authorizing local revenue collection.¹¹ In many ways, decentralization has had a positive impact on the quality of

11 “TAG3: Local Governance in Mindanao: Results Evaluation Report,” Report submitted to The Asia Foundation, August 2009, pp. 6.

local governance throughout the country. Many local governments have taken the lead in e-governance; some are effectively raising local revenues; others are preparing for the challenges of rapid urbanization, migration, and climate change.¹² Business and civil society organizations are working hard to improve the quality of their engagement with local governments to ensure that policy better incorporates the interests of local businesses and citizens.

Nevertheless, many local governments in the Philippines still fail to address the most basic needs of their citizens, and service delivery continues to be overwrought with corruption and inefficiency. Some local governments lack mechanisms for transparency and accountability, and many have yet to exercise genuine autonomy from the national government—as is reflected by an overreliance on national government revenue and an inability to effectively leverage existing local resources. This is particularly true in conflict-affected areas of Mindanao, where local governments are overwhelmed due to a lack of service delivery capacity, poor planning processes, and limited resources.¹³

Local governments in the Philippines can derive revenue from a variety of local sources, including: (1) local business tax; (2) real property tax; (3) fees; and (4) charges and income from economic enterprises. The potential of these sources has yet to be fully maximized in the country, however. Low tax rates, an absence of a uniform basis for tax assessment, outdated records of business

12 The Asia Foundation, “Synopsis of Findings: Eleventh Rapid Field Appraisal (RFA) of Decentralization in the Philippines,” 2010.

13 The Asia Foundation, “Transparent Accountable Governance (TAG) 4: Local Governance in Mindanao,” *Revised Program Proposal in Response to USAID-Philippines-492-09-004 Democracy and Governance FY2009 Annual Program Statement*, 16 September 2009.

establishments, and inefficient records management are major reasons why business permitting and registration processes in most local governments continue to be tedious and burdensome for local businesses. Moreover, due to a lack of local revenue, the majority of Philippine local governments continue to be dependent on the internal revenue allotment (IRA)—their share of the national government’s internal revenue tax collection.

Local business permits and licensing account for 40 percent of local revenue collection and nearly 8 percent of total revenues for Philippine local governments. Typically, a municipal government’s share of IRA accounts for 86 percent of its total revenues. For cities this figure is 70 percent and for provinces 90 percent.¹⁴ Even more urbanized cities with many sources for revenue—generally, the most economically dynamic areas of the country—still rely on IRA for 50 to 60 percent of their total resources. Because conflict-affected areas are normally the least developed ones, citizens there pay fewer taxes and have a lower tax base. As a result, in these localities the ratio of internal revenue allotment to total revenue for the local government can reach up to 99 percent.

Consecutive years of budget deficits and shortfalls in internal revenue collections have hit local government budgets hard, and an over-dependence on IRA is beginning to affect the delivery of vital services by local governments. In Mindanao, local governments not only face the constraints of limited resources and lack of service delivery capacity, but are also confronted with separatist activities, communist insurgency, and clan conflicts that further challenge

14 The Asia Foundation, “Synopsis of Findings: Rapid Field Appraisal (RFA) of Decentralization in the Philippines, 2010.

local government service delivery.¹⁵ Despite its autonomous nature, the Autonomous Region of Muslim Mindanao (ARMM)¹⁶ still receives approximately 98 percent of its operating budget from the national government. Per capita spending on education and infrastructure in the ARMM is among the lowest in the country.¹⁷

To address this problem, The Asia Foundation is working with local governments in the Philippines to develop and leverage their existing resource base more effectively as a potential source of revenue. Doing so improves service delivery and makes governments more accountable to the citizens they serve. At the same time, improving these services benefits local SMEs whose business license registration and renewal costs are cut.

The Transparent Accountable Governance Program

Since 1999, The Asia Foundation's Transparent Accountable Governance (TAG) program¹⁸ has worked to address major local economic governance problems in the Philippines by empowering

15 The Asia Foundation, "Transparent Accountable Governance (TAG) 4: Local Governance in Mindanao," *Revised Program Proposal in Response to USAID-Philippines-492-09-004 Democracy and Governance FY2009 Annual Program Statement*, 16 September 2009, pp. 3.

16 The Autonomous Region in Muslim Mindanao (ARMM) comprises Basilan, Lanao del Sur, Maguindanao, Sulu, and Tawi-Tawi—some of the country's predominantly Muslim provinces. Established in 1989, it is the country's only region ruled by its own government, the ARMM Regional Government, led by the regional governor.

17 "TAG3: Local Governance in Mindanao: Results Evaluation Report," Report submitted to The Asia Foundation, August 2009.

18 The Transparent Accountable Governance (TAG) project is implemented by The Asia Foundation with generous support from the United States Agency for International Development (USAID).

local governments financially and operationally, improving bureaucratic efficiency and transparency, and promoting multi-sectoral participation in governance in order to ensure that policy takes crucial stakeholders into account. The Foundation's technical assistance under TAG is aimed at reforming specific governance processes, such as real property tax administration, business permits and licensing, management of economic enterprises, and city services and procurement. The reforms are geared toward simplifying procedures, reducing monopolies of power, limiting the discretion of city employees, increasing transparency in the process, and improving citizen access to information. This chapter will focus specifically on TAG's business permit and license streamlining component.

Using a demand-driven and assisted self-reliance approach, TAG works solely with local governments who have demonstrated an interest in the reform process, and a firm commitment to partner with and involve civil society groups in undertaking the reform process in a participatory fashion.¹⁹ The Foundation currently works with dozens of Philippine partner organizations throughout the country, including business chambers, non-government organizations, and other civil society groups, to strengthen local government and private sector collaboration for reforms. Training on TAG processes has been provided to local resource partners and institutions in order to ensure that local expertise is readily available to local governments interested in undertaking reform processes on their own.²⁰

19 The Asia Foundation, "Transparent Accountable Governance (TAG) 4: Local Governance in Mindanao," *Revised Program Proposal in Response to USAID-Philippines-492-09-004 Democracy and Governance FY2009 Annual Program Statement*, 16 September 2009, pp. 4.

20 "TAG3: Local Governance in Mindanao: Results Evaluation Report," Report submitted to The Asia Foundation, August 2009, pp. 9.

Organization of TAG

Different levels of government require varying types of intervention to further the development of local autonomy. Cities and urbanizing localities, for instance, are typically confronted with problems of service delivery associated with rapid urbanization. Particularly in Mindanao, cities and urbanizing localities lack the technical and managerial expertise required to manage urban growth and facilitate integration between government departments in the delivery of services.²¹ Municipalities face the problem of limited resources—many are extremely dependent on IRA—so the inadequate technical capacity of local government staff seriously affects service delivery provision. TAG is thus best understood according to distinctive types of work done on the *barangay*,²² city, and municipality levels.

Technical Assistance for TAG

Under the TAG program, The Asia Foundation's technical assistance to local governments involves five major activity areas:²³

21 The Asia Foundation, "Transparent Accountable Governance (TAG) 4: Local Governance in Mindanao," *Revised Program Proposal in Response to USAID-Philippines-492-09-004 Democracy and Governance FY2009 Annual Program Statement*, 16 September 2009, pp. 5.

22 Barangays are the smallest administrative unit of government in the Philippines, best described as villages. In all, there are about 42,000 barangays throughout the country, each with its own set of elected officials and appointed staff. Under the Local Government Code of 1991, every barangay directly receives an Internal Revenue Allocation from the national government, which it is authorized to plan and budget under specific guidelines from the Department of Budget and Management. Barangays are also allowed to generate their own local taxes under the Code.

23 The following steps are taken from the *Transparent Accountable Governance (TAG) Tools Manual*.

1. Participatory diagnosis and consultations

This first area of activity involves initial consultations with local officials to identify the focus for reform, usually by way of meetings with various stakeholders to build consensus and solicit support. Once a mayor has decided to undertake procedural reform under the TAG program, identified the area of focus, and expressed the reform agenda, the office will issue an executive order establishing a technical working group (TWG) comprising staff members of various offices within the local government and, on occasion, members of the business community. The TWG works with closely with a focal person, chosen by the mayor, to spearhead the reform process, perform data gathering, and conduct project assessment. Support is also required of the *Sanguinang Bayan* (SB)/*Panlungsod* (the City/Municipal Council), which authorizes the re-alignment of funds for the procedural reform initiative, and eventually passes the resolutions/ordinances required to institutionalize the reform initiatives.

This first step also involves the gathering and analysis of data through interviews, group discussions, perception surveys, tracking studies, consensus building workshops, and diagnostic studies. Various tools like time-and-motion study and process mapping are employed at this stage.

Time-and-motion study

Time-and-motion study—also called a process-tracking study—is used to analyze the way in which a specific task is carried out in order to determine how the process might be conducted more efficiently and quickly. A researcher accompanies a client from the very first step (e.g., obtaining an application form for business renewal) until the end of the process. At each step, the researcher records waiting and transaction time. Other factors recorded include the number of service providers, requirements and docu-

ments needed, the physical situation within the office, and the attitude of service providers. The times logged at each step are summed up to get the total time to complete the service. Time-and-motion study is helpful in identifying the steps or parts of the process that take too long to complete—referred to as “bottle-necks.” In sum, the study monitors the following:

- number of steps from start to finish;
- number of minutes, hours or days devoted to each step;
- number of forms, clearances, and signatories required for each step;
- frequency of a particular document going back to receive signatures;
- absence or presence of information, flow charts, referral systems, and schedule of fees disseminated to public;
- accessibility of required forms;
- transparency in the computation of fees for payments; and
- positions of personnel involved in the renewal process.

The results of the study are discussed with city officials and used to design improvements on the registration process. The results will later serve as a benchmark for monitoring the improvements and actions implemented.

Process mapping: Process mapping is a method of illustrating the sequence of steps that constitute a complete transaction carried out through the random observation and process documentation of a select sample of customers. Mapping provides a visual representation of the workflow within a process or an image of the entire operation. A good map ultimately reveals the level of effectiveness of a system or process.

Surveys: With the Foundation's local partner, Social Weather Stations (SWS), the TAG program has conducted surveys on good local governance to measure citizens' perception of local governance effectiveness. SWS activity has provided invaluable time series data on business attitudes toward corruption and related issues.

Dialogues: TAG also involves a series of dialogues and focus group discussions. Campaigns are undertaken to increase public awareness, enunciated in specialized annual polls that probe attitudes and knowledge of the business community on transparency, accountability and corruption, as well as media coverage and reportage of corruption-related issues.

2. Strategy formulation and action planning

During the second activity area, a course of action is chosen to address the issues and challenges present in the selected reform area. Through a consultative process, stakeholders determine the practical measures and options needed to address identified issues and challenges, and set benchmarks and indicators. The plan is then presented to the mayor and the legislative council.

3. Testing of the enhanced system

The newly redesigned system undergoes a test run, during which stakeholders evaluate its efficiency and effectiveness. This phase also includes the strengthening of organizational links—working relationships among the TWG, the concerned departments, and other agencies of government—through coordination meetings and observation of the process during the testing.

4. Evaluation and fine-tuning of the system

The fourth activity area entails further process monitoring and documentation. This includes surveys of employee and customer

satisfaction, an evaluation of effectiveness and efficiency, and an agreement regarding system adjustments and benchmarks. Any adjustments made to the system are based on the results of these activities. Process mapping is conducted, engaging representatives of business organizations and non-governmental/civic organizations as independent observers. The perception survey is also re-administered.

5. Adoption of the system

The enhanced system is then presented to the mayor, SB members, office heads, and other concerned agencies of government, stakeholders, and media organizations. It then awaits final adoption by the local government. Administrative and legal mechanisms are initialized to institutionalize the proposed systems and procedures. At a minimum, SB resolutions must be passed, but appropriate ordinances are usually also needed to ensure the continuity and sustainability of reform initiatives.

Program Highlights

TAG in Mindanao

Since 2002, the TAG project in Mindanao has engaged representatives from the private sector and civil society organizations in undertaking activities on regulatory reform, the reduction of compliance costs, and anticorruption. As of 2010, The Asia Foundation has worked with 16 cities, more than 70 municipal governments, and 767 barangays in Mindanao, implementing reforms in business licensing, real property administration, investment promotion, economic enterprise management, and human resource management and policy reforms.²⁴

24 "TAG3: Local Governance in Mindanao: Results Evaluation Report," Report submitted to The Asia Foundation, August 2009.

Throughout the early portion of the TAG project (TAG2, 2002-07), the project expanded from the national to local level, and the process for business registration and real property tax administration was simplified in 10 cities. Processing time was reduced on average from seven days to 30 minutes. Furthermore, increases in local revenue collections reached up to 300 percent.²⁵ TAG partners—including the League of Cities (LCP), the Mindanao Coalition of Development NGOs (MINCODE), and MINDANEWS²⁶—have provided cities with technical assistance in the form of training, TAG manuals,²⁷ and information-sharing sessions.²⁸

Under the TAG3: 2007-2009 portion of the project, reform was undertaken throughout nine Mindanao cities and 30 municipalities.²⁹ The TAG3 program succeeded in reducing the time required for business permit and licensing transactions from two to three

25 “Transparent Accountable Governance (TAG) 4: Local Governance in Mindanao,” *Revised Program Proposal in Response to USAID-Philippines-492-09-004 Democracy and Governance FY2009 Annual Program Statement*, Submitted by The Asia Foundation, 16 September 2009,

26 Management Systems International (MSI), “The Transparent Accountable Governance Program (TAG): An Evaluation,” March-April 2004.

27 In providing models of good governance tools and practices for local governments, the project has published the *Manual on TAG Tools and Processes*, a sourcebook outlining the steps of the reform process, offers tools tested by TAG-assisted local government, provides practical tips in implementing the reforms, and presents good governance practices. A Service Standard Guidebook has likewise been published to cover processing time, requirements, and costs of service for business registration.

28 Management Systems International (MSI), “The Transparent Accountable Governance Program (TAG): An Evaluation,” March-April 2004, pp.13.

29 “TAG3: Local Governance in Mindanao: Results Evaluation Report,” Submitted to The Asia Foundation, August 2009, pp. 8.

days or longer to 30 minutes, and increasing the collection of business taxes in six selected cities by 40 percent over its 2008 level.³⁰ Moreover, the number of registered businesses across targeted municipalities increased by 25 percent from 2008-09.³¹ A total of 13 Mindanao local governments have been assisted in implementing governmental reforms in their public economic enterprises to turn these into revenue-generating assets. Business registration processes in 11 municipalities have been streamlined, resulting in increased business tax and regulatory fees collection upwards of 300 percent.³²

Malaybalay City³³

Under the TAG2 program in 2006-07, The Asia Foundation partnered with the Ateneo de Manila School of Government to provide technical assistance to the government of Malaybalay City, in Mindanao, to improve the city's business license renewal process.

In 2005, the school conducted a survey of Malaybalay City's business atmosphere. It confirmed bottleneck areas previously identified by the city licensing office and recommended the improvement of the business permit and licensing system. Of particular focus was the processing of requirements with the local and national agencies whose branch offices were located in nearby Valencia City. Issues were raised regarding the array of require-

30 Ibid, pp. 6.

31 *Transparent Accountable Governance (TAG) Tools Manual*.

32 The Asia Foundation, "Transparent Accountable Governance (TAG) 4: Local Governance in Mindanao," 16 September 2009.

33 The Asia Foundation, "The Issuance of Revocable Business Permit," Study conducted by the Ateneo Resource Center for Local Governance (ACRLG), Ateneo de Davao University, 2008.

ments that could often not be met in time for the three-week window in January allotted for business permit and license issuance. Unmet requirements ranged from pending laboratory tests required for health certificates, to an inspection clearance from the Bureau of Fire Protection or from city engineers for building and safety integrity. With a strong mandate from the city mayor, the city licensing office conferred with representatives from national government agencies and agreed on ways to expedite processing.

The office first requested that the agencies provide satellite teams in Malaybalay City during the renewal period. To do so, the city developed the Bukidnon One Stop Shop (BOSS) for permit and licensing. BOSS was housed on the first floor of City Hall, with representatives from various offices, including the Bureau of Internal Revenue, occupying tables arranged according to the sequence of the streamlining process. Two huge billboards featuring a breakdown of the licensing process were placed outside the BOSS area.

When it implemented these plans in 2006, the city also began to issue revocable business permits—temporary permits for applicants who fall short of the necessary requirements upon application. During the January 2007 renewal of business permits, applicants formed the first lines around the BOSS. Within an hour, they received “conditional” business permits that would expire after 30 days if requirements remained unmet. As a result of the changes, processing time decreased from nearly three days to one hour and six minutes. In many cases, renewing a business license in Malaybalay City took less than an hour. More than 2,600 permits were processed in 2007, compared with approximately 1,900 in 2006.

Zamboanga City³⁴

In 2005, The Asia Foundation began working with the Ateneo Resource Center for Local Governance to improve the process of business permit renewal in Zamboanga City. Reforms focused specifically on the issuance of locational clearance from the City Planning and Development Office. The renewal process for business permits in Zamboanga had long been subject to chronic delays due to its application-dependent nature—offices could only begin processing applications and conducting needed inspections once applications were completed. Laws stipulated that registrants comply with both building code and zoning and land use requirements, and demanded proof of ownership or lease for the land where the business was located. Necessary inspection of all business establishments often could not be done in enough time before January’s 20-day renewal period. Without a building permit or land title, many applicants could not receive business permits.

Under TAG, the technical working group began working with consultants to document the way the city government issued new and renewal permits. The TWG analyzed these processes, looking for areas of improvement and, based on this analysis, designed a new system for the issuance of business permits. Among the initial activities undertaken were: (1) the updating of business establishments’ classification; (2) mapping of business establishments; and (3) the conduct of advance inspections. Other activities included an advance assessment and payment scheme of business taxes, a

34 The Asia Foundation, “Addressing Conflicts Between Regulatory Requirements and Revenue Generation,” Study conducted by the Ateneo Resource Center for Local Governance (ACRLG), Ateneo de Davao University, 2008.

monitoring of the completion of the renewal process, the design of flow charts, and the issuance of closure orders for erring businesses.

The leadership of the Zamboanga City government decided the most effective way to speed up the processing of business permits would be through conducting advance inspections. In accordance with this, the following actions were pursued:

- Departments involved in the TAG program were mandated to conduct early inspections on all business establishments from February to November of the year prior to the renewal period.
- The local chief executive instructed the business permits and licensing office to give out application forms to any applicant without demanding the fulfillment of requirements.
- Applicants were allowed to pay their business permit taxes and fees first, before compliance with regulatory requirements.
- Policies and implementing rules were drawn up to allow businesses located in a government-owned lot to sign a waiver temporarily for six months. This allowed the owner of the business establishment ample time to secure the legal requirements or improve the property in accordance with the building code.
- A waiver was provided to be signed by applicants having problems with the requirements of right over property stating that the business permits issued were limited to the appropriateness of conducting a business in their respective places and could not be used as a defense for any illegal activity such as squatting.

Additionally, the process of business permit licensing and renewal was computerized, thereby reducing processing time, and the procedure was made more transparent and better understood by way of signs and flowcharts posted throughout the processing area.

Media assistance was secured to facilitate the dissemination of information on the importance of meeting requirements prior to the licensing and renewal period. Information materials were posted in shopping centers and department stores. These improvements greatly simplified the process in a number of ways:³⁵

- Processing and waiting time was reduced from an average of 11 days in 2006 to an average of 2.89 days in 2007.
- Over 1,000 business permits were issued to the more than 2,000 squatters who were not able to acquire business licenses in 2005.
- Approximately P29,000,000 in revenue was generated during the licensing period from in January of 2006, compared with only P9,000,000 in 2005.

Additional Experiences in Mindanao

As of 2010, the TAG project had worked with more than 17 municipal and city governments throughout Mindanao to establish OSS sites and reduce the number of steps needed to complete business registration transactions. The results of reforms undertaken in a number of Mindanao's cities and municipalities are summarized in Figure 6.6. Innovations introduced include:

- rationalization and simplification of the process and the requirements for business registration;
- setting up higher levels of coordination among concerned agencies;
- information dissemination through radio and television broadcasts;

35 *Transparent Accountable Governance (TAG) Tools Manual*, pp. 54.

- posting of requirements in conspicuous places;
- coordinated inspection by regulatory agencies involved in the issuance of business registration to avoid inconsistency and contradictory assessments;
- designation of an alternate signatory in the absence of the mayor to speed up the approval and release of business permits;
- use of a “presumptive income level” in the determination of gross sales of business establishments to lessen the discretion of assessment officers;
- organizing mobile renewal teams to issue permits in the remote areas;
- installation of collection performance boards to ensure transparency; and
- weekly performance evaluation of tax collectors to encourage accountability of collectors.

Specific developments throughout Mindanao have included:

- In Alicia, the municipal government installed information boards in 20 barangays where business permit registration guidelines were posted. At the municipal hall, a television and air conditioning unit were installed to provide comfort to customers waiting for transactions at the municipal hall.
- The Mayor of Labason submitted a budget proposal to the SB for the purchase of additional computers to be used for business permit processing and database. The government also hired a municipal service information officer to help provide instructions and directions to the public.
- In Bongao, the Business Permits and Licensing Office, in coordination with the municipal treasurers office, made business registration forms available in advance to business owners in order to help speed up the processing.

Figure 6.6: Results of OSS, Mindanao Cities and Municipalities

Cities	Results/Impact
Koronadal	<p>Decreased processing hours for business permit processing from 3 days to an average of only 1 day</p> <p>Increased number of business permits from 954 in January 2005 to 1,505 in January 2006</p> <p>Decreased number of processing stations from 10-15 sites to 1 site (the City Hall, utilizing 2 floors)</p> <p>Decreased the number of forms from 4 to 2</p> <p>Reduced number of signatories from 13 to 7</p>
Malaybalay	<p>Reduced processing time from 2 hrs and 10 minutes to 1 hr and 30 minutes</p> <p>Increased number of registration of new business establishments from 200 to 300</p> <p>Increased percentage of business permit renewal from 45% to 54%</p>
Oroquieta	<p>Increased collections during the January 1 – February 9 period from PhP 2,454,805.19 in 2005 to PhP 2,499,817.17 of the same period in 2006 (increase of PhP 45,011.98)</p> <p>Reduced processing time from 1.6 days in 2005 to 2 hours, 1 minute and 40 seconds in 2006</p>
Ozamiz	<p>Increased collection from PhP 19,179,518.00 in 2005 to PhP 22,046,606.35 in 2006 a 14% increase</p> <p>Simplified application forms</p> <p>Reduced processing time from 3 days to half day</p> <p>Displayed flowchart and signs</p>
Tacurong	<p>Increased collection from PhP 3,357,237.37 in January 2-20, 2005 to PhP 5,489,345.89 for the same period in 2006 or an increase of PhP 2,132,108.52 (63.5%)</p> <p>Increased number of business permits issued from 311 in January 2-20, 2005 to 565 for the same period in 2006 or an increase of 254 business permits issued (81.6%)</p> <p>Reduced processing time from 2.58 days to about 2 hours</p> <p>Reduced the number of forms from 2 to 1 and the number of signatories from 11 to 4</p>
Zamboanga	<p>Increased collection for Business Tax from PhP 9,995,053 in 2005 to PhP 29,488,651 in 2006 (295.03% increase)</p> <p>Introduced a waiver for businesses who have deficiencies in locational clearance which resulted to the increase in collection</p> <p>Assessed payment prior to completion of all requirements, resulting in the increase in collection</p>

Municipalities	Business Tax Collection ³⁶ (PhP) (January)		Regulatory Fee Collection ³⁷ (PhP) (January)		Number of Business Registrants (January)		Processing Time to issue the permit (January)	
	2008	2009	2008	2009	2008	2009	2008	2009
Alicia	493,379.22	520,690.75 (5.5%)	45,900.00	29,100.00 (-36%)	81	113 (39%)	4 hours	1 hour
Baroy	155,273.22	250,511.96 (61%)	43,270.00	98,289.64 (127%)	38	60 (57%)	45 min.	2-30 min.
Leon Postego	77,950.85	118,894.49 (52%)	72,417.93	124,403.07 (71.78%)	171	92 (-46%)	2-3 days	3 hours
Siay	261,584.57	368,531.75 (40%)	121,390.35	152,476.27 (26%)	97	132 (36%)	1-2 days	25 min.
Tungawan	52,883.45	213,600.77 (304%)	54,573.00	229,883.50 (321%)	75 (67%)	280 (273%)	3 hours	30 min.

36 Total business tax collection for whole year of 2008.

37 Total regulatory fee collection for whole year of 2008.



STRENGTHENING LOCAL GOVERNMENT MANAGEMENT IN SRI LANKA AND THE PHILIPPINES

A. Subakaran and Maria Belen Bonoan

“Economic governance consists of the processes that support economic activity and economic transactions by protecting property rights, enforcing contracts, and taking collective action to provide appropriate physical and organizational infrastructure. These processes are carried out within institutions, formal and informal.”¹

– Avinash Dixit, 2008

The establishment and nurture of a policy and institutional setting that attracts investment and encourages enterprise and job creation is a key responsibility of government. This responsibility is a partnership between national and local-level government bodies, and is executed mainly through the instruments of administrative fiat and regulatory power, and fiscal authority and allocation, specifically taxation and public expenditure. The skill and efficacy with which these instruments are wielded by governments largely determine the attractiveness of countries and localities to investment and enterprise growth. Regimes that are overly tight and interventionist often drive investors and entrepreneurs away, or prevent them from entry in the first place. Predatory tax structures sap the energy and profitability of enterprises and entrepreneurs. Public revenues expended on goods and services that do not install both the

¹ Avinash Dixit, “Economic Governance” Intertic Lecture, Conference on Endogenous Market Structures and Industrial Policy, , Bicocca Department of Economics - University of Milan, 5 June 2008.

hard and soft infrastructure that enables private enterprise to grow and thus generates jobs are wasted.

Across many Asian countries, the citizenry's aspirations for growth and development, community agreements on how growth and development is to be achieved, and the vision and strategy of public leaders is documented in development plans. Technical analysis of development issues and challenges, whether sectoral or general, is a feature of most development plans of Asian countries. Such technical analysis is brought to bear in the consultation and formulation of these plans.

In its work on local economic governance, The Asia Foundation has also paid attention to the strengthening of local development planning and management. This is because the local development plan summarizes the local government's vision and strategy for economic growth, and that the management capacity of local executives determines the effectiveness and efficiency with which the shared objectives of the local development plan are achieved.

Decentralization

Over the last two decades, support for “decentralization,”—the devolution of authority and resources from central to local government—has become widespread throughout the developing world. Indeed, decentralization is now one of the most popular policy experiments among many governments, donors, and civil society organizations (CSOs), which view it as a means to reduce inefficiencies inherent in concentrated, overly bureaucratic government. Since the 1990s, decentralization has been increasingly seen as complementary to democratization, based on the assumption that it is easier to bring about positive and meaningful citizen engagement with government at the local level rather than the

national level, where powerful, long-established elites tend to tightly control political and fiscal processes.

Policies for decentralization have been instituted to some degree in most countries throughout Asia under the theory that subnational governments are best positioned to connect with and respond to constituents. National-level policies, strategies, and resources ultimately impact citizens through the actions of local government. Moreover, the experiences of citizens in dealing with their respective local governments ultimately shapes their impressions of government as a whole. As a result, the success or failure of local government can define the performance of government in general.

An informed and organized citizenry is critical to achieving responsive and responsible local governance; and the facilitation of community participation in local decision-making can improve government performance. Other factors conducive to good and effective governance include:

- willingness of the Center to share political, economic, and administrative authority, as well as to commit a share of national financial resources to the local level;
- local-level capacity to use authority and resources responsibly;
- a well-developed bureaucracy at all operational levels;
- a multilevel local institutional framework that permits local politicians, leaders, officials, community representatives, and ordinary people to work harmoniously.

The Asia Foundation's Approach: Starting Local

Programmatically, reform efforts are more likely to be sustainable if they can be demonstrated to be beneficial at the local level before

being implemented across the nation. Thus, reforms intended for national-level implementation can first be attempted locally and, if successful, can then be advocated nationally based on a record of local success—local implementation for national impact. Because of the central role played by local governments, the Foundation has focused much of its efforts on strengthening these governments' institutions and processes. Foundation programs support transparent, accountable, and participatory governance, where representatives of civil society—particularly those from traditionally isolated and disenfranchised groups—are enabled to engage its various components.

Through its Economic Reform and Development (ERD) programs, The Asia Foundation aims to reduce poverty and foster peace and justice in Asia by enhancing growth, investment, enterprise, and employment. To this end, the Foundation works with private and public partners at the local level to achieve three goals: (1) market and business-friendly regulation; (2) effective fiscal management; and (3) successful provision of adequate public goods and services. Two of the Foundation's leading programs in the area of economic governance are the Local Economic Governance program in Sri Lanka and the Transparent Accountable Governance (TAG) program in the Philippines.

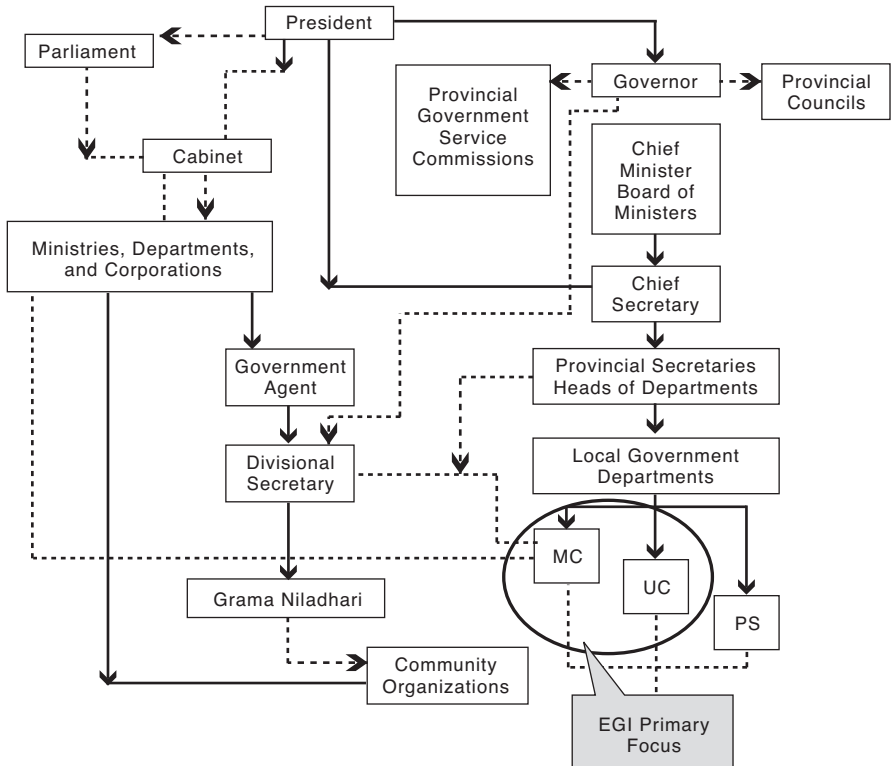
Local Economic Governance (LEG) in Sri Lanka

In Sri Lanka, where decentralization has been underway since 1987, local leaders are subject to democratic elections. Although in theory citizens can use their ballots to extract greater transparency and effectiveness from local authorities, most pressures on local politicians continue to originate from the opposition or national party leaders, rather than voters. The situation can be attributed on one hand to the country's proportional representation system in

which people vote for a party rather than particular representatives, and on the other hand to a lack of organized community participation in local governance.

The Asia Foundation pursues a range of activities and strategies aimed at enhancing the capacity and effectiveness of Sri Lanka's local governments (Figure 7.1). This includes providing support

Figure 7.1: Government Structure, Sri Lanka



for local development planning among local authorities (LAs) and stakeholders, as well as streamlining the fiscal transfer process within national and provincial governments. Foundation programs provide training and technical assistance to LAs in order to enable staff members to more effectively manage their finances, increase revenue, improve services for citizens, and facilitate meaningful dialogues and consultations with citizens.

In sum, Foundation activities seek to: (1) develop sustainable mechanisms to ensure continuous dialogue between local authorities and citizens; (2) establish lasting relationships between local authorities and stakeholders for participatory and consultative planning; and (3) ensure effective and equitable fulfillment of citizen rights and obligations to participate in decision-making at the local level.

Local Development Planning: The TALG Program

In 2005, The Asia Foundation initiated the Transparent Accountable Local Governance (TALG) program to work with Sri Lankan LAs to develop and implement medium-term (three to five years) planning processes. Through the program, which concluded in 2008, the Foundation successfully trained staff in 35 LAs across six provinces on planning and implementation processes, and established a number of planning support cells at the district and provincial level.

The ultimate goal of TALG was to ensure a participatory and consultative process that identifies development and service delivery priorities of the local authority area, and facilitates generation and effective use of financial and other resources at the local level. In view of the limited resources of LAs and the abundant needs of constituents, it makes sense to seek convergence among local stake-

holders on the directions of the local authority and the ways in which to spend taxpayer money. Strategic and participatory local development planning initiatives have helped partner LAs to:

- rationally diagnose internal and external realities;
- determine the interests and needs of key stakeholders and constituent groups;
- clarify organizational vision and mission;
- encourage elected officials and staff to agree on priority problems, issues, and solutions;
- help LA-elected officials and staff focus on a concrete set of interventions that can help them achieve their goals and objectives;
- speed up the implementation of priority plans and projects.

Facilitation and coaching provided under the TALG program have equipped LAs with the skills needed to implement participatory local development planning processes. As of 2008, the Foundation had trained more than 300 local authority staff and council members in the Technology of Participation (ToP)² and created a group of 40 ToP master trainers equipped with the facilitation skills to conduct public consultations, promote discussion, and solicit citizen involvement. LA staff members were then able to utilize public consultations to incorporate community input into the planning process.

² Technology of Participation (ToP) is a method of facilitating public consultations. ToP workshops aim to increase the ability of staff and council members to engage with citizens. The workshops give participants a clear understanding of the theory of citizen participation and demonstrate the ways in which to use basic facilitation tools to promote participation. For more information, see “Technology of Participation (ToP): Basic Group Facilitation Techniques,” by the Ministry of Local Government and Provincial Councils (MLGPC) and the Sri Lanka Institute of Local Governance (SLILG), Sri Lanka, 2008.

Under the TALG program, The Asia Foundation has assisted LAs in undergoing a complete change in decision-making and service provision, while also improving relationships with the public and increasing innovative thinking. Fresh approaches to community consultation in decision-making and community participation in program planning, implementation, and monitoring have helped to increase community input to and investment in LA-managed programs. Not only has citizen participation in LA activities increased, but trainings have helped citizens to reach other government and non-government institutions and donor agencies in order to obtain services and facilities such as schools, hospitals, bus transportation, and electricity. A participatory approach ultimately enhances the responsiveness of all types of development and service delivery agencies to citizen needs.

Local Development Planning in Sri Lanka

In practice, the planning processes used by Sri Lankan LAs to identify problems, set priorities, and design budgets have by and large been non-participatory. As a result, plans are often implemented in ways the political authority thinks appropriate, with little attention paid to the needs of the people. Citizen participation in local planning can lead to lasting relationships between citizens and local authorities, and joint exercises can provide a valuable opportunity to prepare participatory plans to generate and manage resources at the local level. Furthermore, by helping to develop solid participatory structures, such exercises can ensure more effective service delivery in the future.

With the support of the Ministry of Local Government and Provincial Councils (MLGPC), the Foundation has introduced local development planning concepts in Sri Lanka and worked to institutionalize a functioning participatory planning process. The

Foundation has partnered with various LAs (pradeshiya sabhas, urban councils, and municipal councils) on several local government-led relief, rehabilitation, and development programs connected to tsunami recovery, local government capacity development, disaster management, and the provision of basic services such as water, sanitation, and livelihood support to local communities. Under the TALG program, training modules and publications have been developed and subsequently used by local partner NGOs to train officials in LAs across Southern, Eastern, Central, North Western, North Central, and Uva provinces.³

Streamlining the Fiscal Transfer Mechanism

Under the country's current fiscal transfer mechanism, Sri Lanka's central government is responsible for the allocation of funding grants to provincial councils (PCs), which then utilize the grants to fund local development projects managed by LAs. The MPCLG assists in the distribution and monitoring of grants and the PCs will then disburse the grants to select LAs. The portion of the transfer process from PC to LA is riddled with problems, however. Most notably, there is little scientific basis to the often-opaque allocation process of capital grants, and lengthy and rigid procedures for fund delivery can result in chronic reimbursement delays. As a result, when funding LAs and PCs, donors have regularly made efforts to avoid the government system altogether.⁴

3 Ministry of Local Government and Provincial Councils (MLGPC) and the Sri Lanka Institute of Local Governance (SLILG), "Building Partnerships Between Local Authorities and Citizens: A Training Module to Mobilize and Empower Citizen Groups," Sri Lanka, 2008.

4 "Fiscal Transfer Mechanism: RIWASH Experience," Presentation by The Asia Foundation, Sri Lanka.

As will be described, with the support of the national, provincial, and local levels of the Sri Lankan government, The Asia Foundation successfully tested a pilot project in the country's Eastern Province to facilitate a more efficient fiscal transfer process for funding specific projects previously identified through TALG-supported participatory planning processes.

The Eight-Step Development Planning Process

The Foundation's TALG participatory local development planning process consists of two key components—capacity development, and planning facilitation and coaching—and involves eight steps, as illustrated in Figure 7.2.

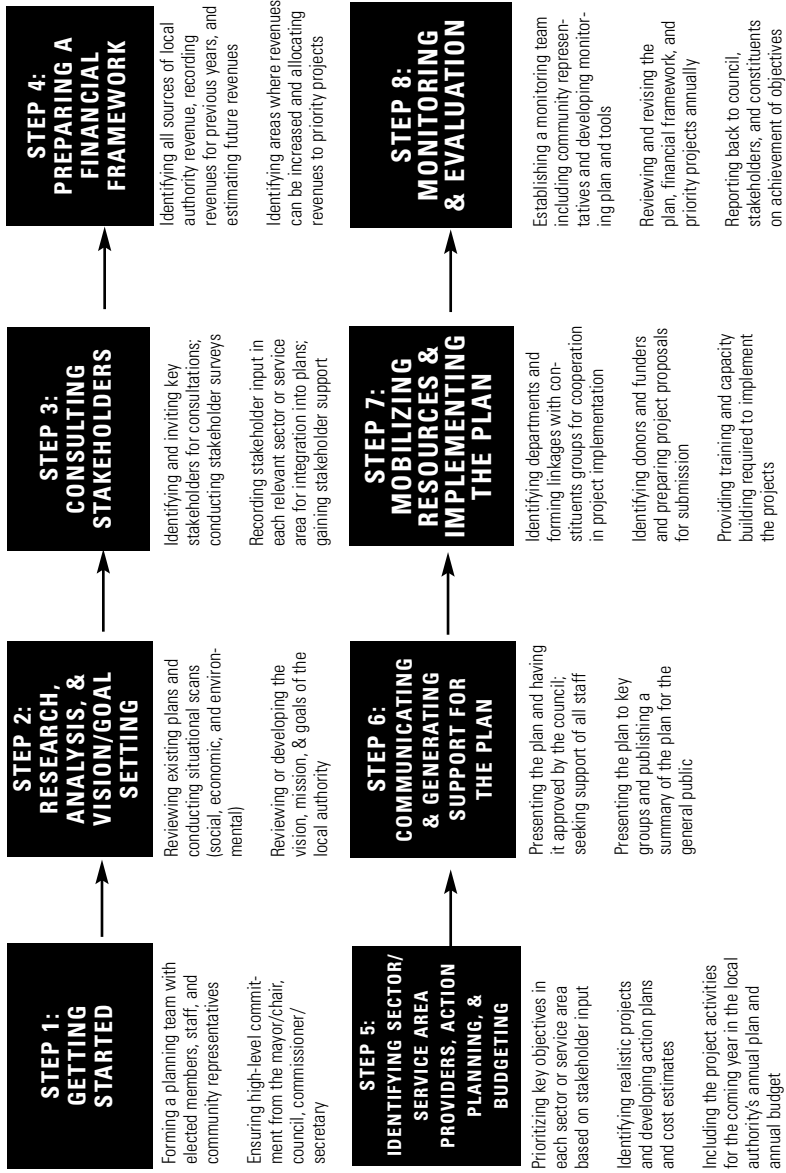
Program Highlights

Tsunami recovery

Following the December 2004 Indian Ocean Tsunami, various Sri Lankan NGOs and institutions were provided with massive assistance packages to undertake recovery and reconstruction efforts. In most cases, unfortunately, Sri Lankan LAs—mandated to coordinate disaster relief and responsible for many basic services and infrastructure disrupted and destroyed by the tsunami—were left out of the recovery process.

Under the TALG program from 2005-07, the Foundation assisted 22 LAs located in various tsunami-affected areas to become more effectively involved in post-tsunami recovery activities, and to consult and involve affected citizens in the planning and implementation of recovery initiatives. Through ToP training, Participatory Community Consultations, the strengthening of citizen committees, and assistance in mobilizing resources, LAs in Sri Lanka's

Figure 7.2: The Participatory Planning Process



Southern and Eastern provinces were able to increase their capacity while working with citizens to develop and implement tsunami recovery plans and projects.

Local authority “staff enhancement grants” allowed LAs to hire the additional supervisors, technical officers, and laborers necessary to implement tsunami recovery projects. With workers paid for TALG grants, LAs were able to restore damaged office files and records, bring final accounts up to date for past years, and prepare and submit proposals to donors for additional funds. Other projects implemented by LAs with TALG guidance or support entailed delivering livelihood assistance for families, assisting citizens in restarting businesses, and providing basic services (drinking water, electricity, toilets, and garbage collection). The program helped LAs to strengthen the infrastructure of camps and temporary settlements, provide scholarships, tuitions and school kits for children’s education, facilitate vocational training for youth, social welfare and psycho-social programs, develop health and sanitation programs, and execute small infrastructure projects.

Finally, as many as 20 LAs successfully mobilized grants of approximately Rs. 1 million each from Give2Asia (a charitable organization initiated by The Asia Foundation) for community-based projects to be implemented in partnership with citizen committees. Hundreds of families were assisted through these projects.

Interaction between tsunami-affected citizens and LAs was improved through continual meetings between citizen committees with LAs during the process of implementing recovery projects. Throughout the program, LAs came to better understand the advantages of working in collaboration with citizens to successfully implement disaster management, mitigation, and recovery projects. As a result, most TALG LAs took on a more active role in coordinating donor,

NGO, and government-assisted tsunami-recovery programs, producing better results with minimal duplication and frustration. All 22 LAs under the TALG program were successful in mobilizing funds or resources from other donors or NGOs as well.

Participatory Budgeting and Planning – Chilaw PS

The PS (Pradeshiya Sabha - village level local government) of Chilaw—a rural local government with 17 elected council members and 63 staff members—is responsible for preparing an annual budget on the basis of the previous year’s financial estimates. The PS had long lacked an adequate planning process, as well as sufficient mechanisms for priority setting, citizen participation, or budgeting based on accurate financial forecasting.

Because of past budgetary failures to give serious attention to generating accurate cost estimates for activities to be implemented, however, there had long been an unequal distribution of resources, with little attention given to the actual priorities of the citizens. This had resulted in widespread dissatisfaction and suspicion among constituents, as well as discontent among elected council members with what they considered to be unequal and non-systematic resource allocation via an opaque decision-making process.

The Asia Foundation invited council members and key staff to a series of awareness programs and training sessions on citizen participation and participatory planning. The Foundation supported the work of focal point officers and planning committees, incorporating staff, members, elected members, and citizen representatives. As the details below illustrate, the program largely adhered to the steps and guidelines of the participatory development planning process (outlined in Figure 7.2).

Through its initial consultations, the Foundation succeeded in securing support for the planning process on behalf of the chairman, elected council members, and PS staff. A planning committee was then formed, comprising members that represented a fair cross-section of the local population. The Foundation provided assistance to the committee's "Facilitator/Process Champion" to help produce the plan within a given time period.

During village-level consultations, the planning committee was flooded with local stakeholders' issues and requests. Although providing solutions to all problems and meeting each request was unfeasible, the committee was able to present all submitted issues to the community to prioritize as needed. Community proposals, specific requests, and discussions of objections and criticisms eventually helped to generate a healthy four-year plan. Importantly, the process of designing the plan provided an opportunity for the Chilaw PS to collaborate closely with other agencies and relevant stakeholders.

Discussions were organized in the PS office with staff, council members, and selected citizen groups. During planning and budgeting discussions with citizens, the PS identified the major public complaint to be the absence of an equitable distribution of resources. A decision was thus made to allocate resources based on the Grama Niladhari Division (GND) system⁵. The annual income of the Chilaw PS was equally distributed among the 99 GNDs at the rate of RS.50,000 for each. Additional funds required to respond to priorities came from contributions in the form of cash, goods and services, transportation, food supplies, and labor.

5 The Grama Niladhari Division (GND) is the smallest administrative unit in Sri Lanka.

Activities prioritized at the village level were incorporated into the PS budget. One council member was responsible for each GND. The member was included into the village planning and implementation committee, without taking political affiliations into account. Prioritized activities were incorporated into the PS four-year plan in a sequence proposed by stakeholders. Community groups decided on the priorities to be met for each of four consecutive years.

The participatory process in Chilaw produced a number of additional results, including:

- The council changed their traditional seating arrangements to reflect a more harmonious situation based on the seniority and duration in office, and not on political party affiliation.
- Citizens were given more opportunities to participate in planning and budgeting. Village priorities were given greater attention through fairer resource allocation.
- In addition to long-established budget allocations for roads and street lamps, now 20 percent of the budget could be allocated to community development and social programs—such as sports, pre-schools, social activities, and subsidies for the poor.

Streamlining the Fiscal Transfer Mechanisms for Eastern Province Local Authorities

In 2007-08, the Foundation worked with the MLGPC and the Eastern Provincial Council (EPC) to facilitate an improved fiscal transfer process to fund local solid waste management projects for its LAs. The pilot project, titled the Rural Integrated Water Sanitation and Health (RIWASH) program, was intended to

produce a successful model for enhanced capital project fiscal transfer. The RIWASH fiscal transfer mechanism—an improvement upon the government’s existing structure for fund transfer—introduced a more participatory approach that better incorporated important stakeholders, including the PC, LAs, and the community at large.

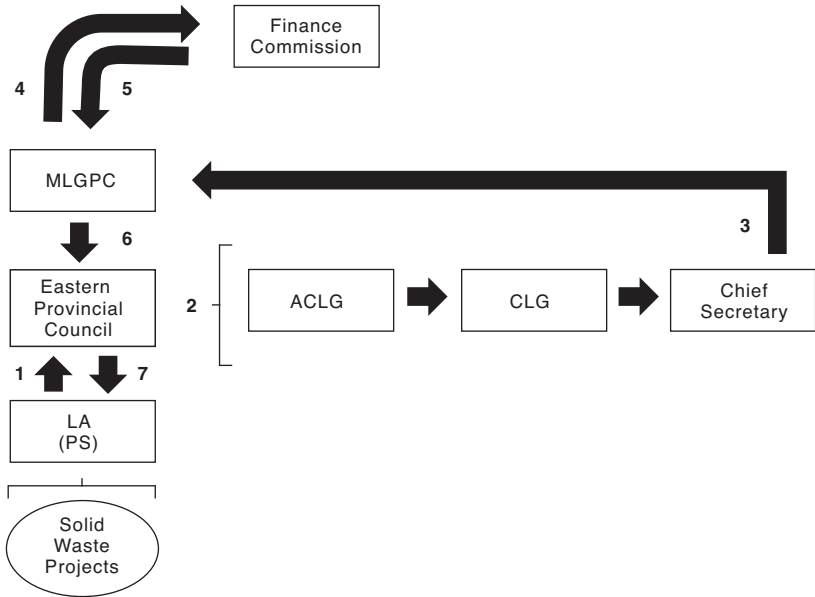
The Foundation provided support to officials through training sessions, exposure tours, and tutorials on new procedures. Stakeholders were engaged in the funding and implementation of RIWASH project activities and teamwork was encouraged at the national, provincial, and local levels. An approach was coordinated at the national and provincial levels to successfully release funds without delay.

The first stage entailed determining the responsibilities of each stakeholder involved in the fiscal transfer process. The arrangement is outlined in Figure 7.3.

Technical assistance was then implemented across the above steps of the fiscal transfer process. Through its capacity building program, the Foundation helped to improve existing communication mechanisms and procedures. In fact, no new procedures needed to be introduced; rather, the current structure was improved upon to produce better results.

In order to enhance communication between agencies, the Foundation introduced a mechanism to monitor each stakeholder at each level and ensure meetings more regularly. The Foundation also conducted periodic meetings, discussions, and follow-up with stakeholders regarding their respective roles.

Figure 7.3: RIWASH Fiscal Transfer Process



In sum, the RIWASH Facilitation of Fiscal Transfer Mechanism entailed:

- the adoption of close coordination between the Assistant Commissioner of Local Government (ACLG) and national and provincial agencies;
- assistance in drafting an MOU on fiscal transfer between the MLGPC and World Vision Canada (WVC), the funding source;
- awareness meetings held with all stakeholders; and
- coordination and liaising with the MLGPC and EPC—

mainly the chief secretary, the Commissioner of Local Government (CLG), and the ACLG—to facilitate the release of funds.

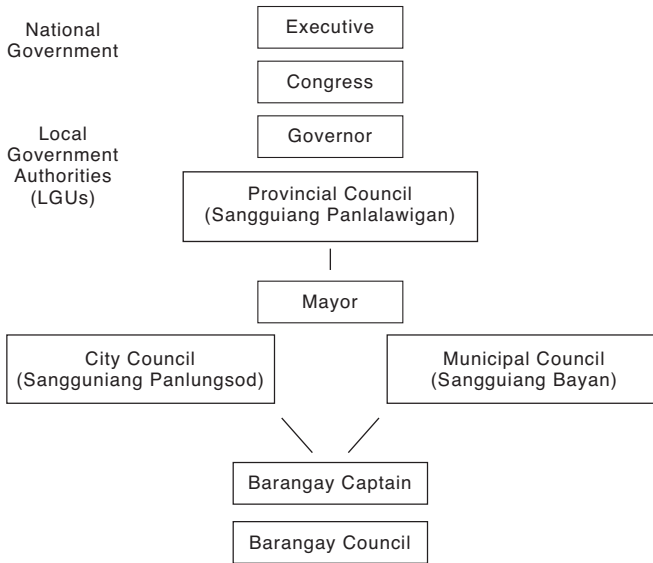
The RIWASH pilot project effectively demonstrated the benefits of utilizing an available government mechanism for fund transfer while improving upon it through closer coordination among stakeholders and enhancement of government-donor relations. In general, the project succeeded in identifying the strengths and weaknesses of the current fiscal transfer mechanism, allowing the process to be shortened and increasingly transparent.

Promoting Transparent and Accountable Governance in the Philippines

In the early 1990s, the Philippines initiated a historic process that resulted in the devolution of significant authority, responsibility, and government personnel to the local level. This resulted in significant gains in Philippine development, and continues to represent one of the bright spots in the country's current affairs.

Under the *Local Government Code of 1991*, local governments have become crucial for economic development. Local governments can help restore economic livelihood by working with citizens to protect or rehabilitate their natural resource base, for instance, and can provide an enabling environment for business through more coherent development and land use plans. In Mindanao and elsewhere, local governments are at the forefront of restoring peace and order as well as addressing poverty reduction. As they are often at the frontlines in terms of business development, conflict management, and resource decision-making, local governments can have a significant impact on growth and stability by reducing resource waste from corruption and increasing the efficiency of local administration. Better local governance is

Figure 7.4: Government Structure, the Philippines



thus a key component for sustainable peace and genuine economic development in the Philippines.⁶

While popular consensus has generally supported the move toward increased local government autonomy, there remains much confusion among local citizens, civil servants, and elected officials on matters surrounding basic service delivery, revenue generation, financial management, and internal control. Maintaining and consolidating the achievements of decentralization will require a sustained focus on transparency and accountability issues at the local level—possibly the most important element in the success of any decentralization effort.⁷ Local government units (LGUs)⁸

6 Steven Rood, “Decentralization, Democracy, and Development,” in David G. Timberman (ed.), *The Philippines at the Crossroads* (New York: The Asia Society, 1998).

7 This argument is forcefully stated in James Manor’s, *The Political Economy of Democratic Decentralization* (Washington, D.C.: The World Bank, 1999).

8 Local government units (LGUs) include city, municipal, and barangay councils.

must ensure that limited financial resources are well budgeted and managed, and are directed toward development programs and projects that reflect the priorities of the citizenry. Unclear development priorities, poor organization, and inadequate and ill-equipped staffing have long prevented local Philippine governments from maximizing the use of already limited budgetary resources.

The Asia Foundation's TAG Program

In addition to the Foundation's *Transparent Accountable Governance* focus on regulatory reforms (*see Chapter 6*), planning and budgeting are also part of TAG. Since 2002, the program has been providing technical assistance in planning and budgeting to local government units in the Philippines using a methodology that emphasizes community participation. Technical assistance for barangay and municipal development planning and budgeting is just one of the various interventions and technical assistance areas that the TAG program offers local governments.

In implementing TAG, the Foundation adopts a “demand-driven and assisted self-reliance approach,” in its conduct of activities and the selection of local governments where technical assistance will be provided. In order for these governments to participate in the program they must demonstrate:

- an interest in the reform process;
- the presence of political leaders who are willing to work with the project;
- a commitment to partner with and involve civil society groups and the business sector in undertaking the reform process;
- a commitment to implement and institute reforms by way of an executive order issued by the mayor, a local council

resolution, or a local ordinance passed by the local council;
and

- willingness to provide counterpart contributions for project activities in the form of workshop/training meals and local transportation for staff.

Different levels of local government call for varying kinds of interventions. Cities are relatively complex, for instance, so their needs are more sophisticated than municipalities and barangays. By contrast, municipalities and barangays—where governance is often poor and public participation, transparency, accountability, and responsiveness are woefully lacking—often have more basic technical assistance needs. Many barangays, especially in rural areas, still need to build their basic financial management system and strengthen public participation and accountability. Their knowledge of barangay mandates and sources of revenues need to be strengthened. Only a few barangay officials are aware of how much IRA they are supposed to receive, and what services barangays are expected to deliver. In some barangays only the chairman and treasurer have knowledge of the IRA, and funds by law reserved for development activities are in fact used in any manner the chairman decides. As a result, barangays often find it necessary to offer “gifts” to municipal financial officers, in order to get information about their IRA or to ensure funds are released.⁹

The Barangay and Municipal Development Planning and Budgeting Module

The Foundation’s participatory local planning and budgeting module has several innovative features. First, it integrates local

⁹ Management Systems International (MSI), “The Transparent Accountable Governance (TAG) Program: An Evaluation,” March-April 2004, pp. 21.

planning and budgeting activities—previously treated in other modules as distinct activities—into a single, continuous process. Second, the module promotes a process characterized by increased participation as a way of ensuring transparency, accountability, and responsiveness to citizen needs and priorities. The module comprises planning and budgeting activities on both the barangay and municipal level.

In all cases, preparatory activities include: (1) coordination with key barangay and municipal stakeholders to ensure their active participation in the planning activities; (2) project orientation for municipal and barangay officials; (3) formation of the municipal-level technical working group (TWG) to oversee planning and budgeting activities; and (4) preparation of local stakeholders to serve as facilitators for major activities.

Barangay Planning and Budgeting Activities

The TAG project utilizes a three-step approach in providing assistance for planning and budgeting exercises at the barangay level.

1. Through a sub-grant agreement, the Foundation engages a local resource institution (LRI) to help organize the municipal TWG and build its capacity to manage and facilitate workshops in the barangays. Each TWG has 10 members comprising municipal technical staff, a representative from a local people's organization, and at least two barangay chairmen. TWG members undergo a five-day training on data gathering and meeting facilitation that equips them to conduct activities in the different barangays.
2. The LRI conducts a pilot program on data gathering and workshop facilitation in one barangay. The workshop serves to expose TWG members to the actual workshop process. Following this

exercise, an assessment of the process is conducted to prepare group members to undertake planning and budgeting activities in their assigned barangays.

3. Finally, with guidance and coaching from the LRI, TWG members conduct on-site participatory planning and budgeting exercises in identified barangays.

Data Gathering and the Development and Planning Workshop

In order to facilitate the planning and budgeting activities, barangay data/information must be up to date. The TWG updates information with the assistance of barangay officials and the participation of community leaders and residents in a workshop. Data gathering is usually conducted two weeks before the Barangay Development Planning and Budgeting Workshop.

The three-day workshop features the following major sessions/activities:

- orientation on local governance and the local government code
- current reality dialogue
- practical visioning for the barangay
- strategic direction workshop
- annual investment planning and prioritization for five sectors: economic, social, infrastructure, environment and development administration
- barangay planning and budgeting system
- consolidation of plan and budget
- formation of a monitoring and evaluation team
- post workshop planning and budgeting

Throughout this phase, the barangay plan and budget is presented to the members of the community through the Barangay Assembly. Members of the community who may have not been able to participate in the planning and budgeting workshop are given the opportunity to provide their feedback and suggestions. Following community approval, the Barangay Development Council (BDC), with assistance from the TWG, finalizes the plan and submits it to the Sangguniang Barangay (SB or Barangay Council) for approval and appropriation. Barangay officials then submit the approved plan and the budget to the municipal government, with the endorsement of the Barangay Development Council.

The Foundation's technical assistance for participatory barangay development planning and budgeting has resulted in the following:

- enhanced participation of citizens in substantive discussions, allowing them to gain significant new knowledge about barangay budgets and procedures;
- establishment of clearer development priorities;
- increased transparency in the allocation of resources and strengthened commitment from local executives to allocate funds for projects identified through the participatory process.

Municipal Planning and Budgeting Activities

This municipal planning and budgeting component of the program seeks to (1) generate broad consensus on the practical vision of the municipality; (2) formulate a relevant and responsive municipal development plan and investment program; and (3) design a municipal budget that is closely linked to the development plan using a participatory approach that engenders transparency and accountability.

These objectives are pursued in a two-day municipal planning and budgeting workshop attended by municipal elected and appointed officials; members of the Municipal Development Council (which includes all barangay chairmen in the municipality); representatives of national government agencies; representatives of non-government organizations, business organizations, and people's organizations; and chairpersons of the different sectoral committees and local special bodies. The workshop features the following sessions/activities:

- discussion of the current municipal situation
- development of practical visions for the municipality
- project and program identification and prioritization
- discussion of the municipality's budgeting system; and sources of, and projected income for the budget year
- allocation of the 20 percent development fund to identified and prioritized programs and projects
- drafting of a municipal plan and budget consolidation
- final adoption of the municipal plan and budget by the municipal council

Program Highlights

During the early phase of TAG (TAG2, 2002-2007) in the Philippines, The Asia Foundation conducted planning and budgeting exercises in more than 700 barangays, enabling more than 20,000 citizens to participate in local planning and budgeting processes.¹⁰ Later, as part of the TAG3 program (2007-2009), technical assistance was additionally provided to conflict-affected municipalities in Mindanao—specifically Patikul and Panamao—for participatory barangay development planning and budgeting.¹¹

10 "Transparent Accountable Governance (TAG) 4: Local Governance in Mindanao: Revised Program Proposal," Report submitted to USAID by The Asia Foundation, 16 September 2009, pp. 4. See also, "TAG3: Local Governance in Mindanao: Results Evaluation Report," Report submitted to The Asia Foundation, August 2009, pp. 31.

11 "Transparent Accountable Governance (TAG3): Local Governance in Mindanao, Final Report," Submitted to The Asia Foundation, 5 April 2010.

The Participatory Barangay Planning and Budgeting module (PBPB) has enabled many barangays to produce a written development plan for the first time in their history. Technical assistance has improved local government operations, planning and budgeting, resource mobilization, and organizational development. With plans and budgets crafted through a participatory process, local officials in municipalities that have undergone the assistance are now better guided on the development direction of their locality; have better knowledge on what priority programs and projects to focus on in order to achieve their desired development, have increased the budget allocation for project and programs identified through consultative and participatory processes; and have improved the quality, efficiency, and effectiveness of their services.¹²

Barangay Planning and Budgeting in the ARMM

The Autonomous Region in Muslim Mindanao (ARMM) comprises Basilan, Lanao del Sur, Maguindanao, Sulu, and Tawi-Tawi—some of the country’s predominantly Muslim provinces. Established in 1989, it is the country’s only region ruled by its own government, the ARMM Regional Government, led by the regional governor.

In the ARMM Regional Government, roughly 82 percent of total budgetary allocation is spent on employee salaries and benefits.¹³ Accordingly, performance of ARMM local government units—in terms of transparency, accountability and governance—has long

12 “TAG3: Local Governance in Mindanao: Results Evaluation Report,” Report submitted to The Asia Foundation, August 2009, pp. 31.

13 Management Systems International (MSI), “The Transparent Accountable Governance (TAG) Program: An Evaluation,” March-April 2004, pp. 21.

been unsatisfactory. Many barangays lack a formal development process. In Lanao del Sur, for example, it has been estimated that 50 percent of ARMM barangays do not have a development plan or budget. Where formal development planning processes have been undertaken, the emphasis is generally on project identification, with no attention given to locally available resources as significant resources for undertaking them. The result is often a “wish list” of infrastructure projects that need to be funded from elsewhere.

The Asia Foundation has introduced TAG programming throughout the ARMM, promoting participatory planning and budgeting at the barangay level in Basilan, Lanao del Sur, Maguindanao, and Tawi-Tawi by providing grants to a number of NGO partners which were then given training in ToP and the PBPB module. By April 2004, 219 PBPBs had been issued throughout the provinces of Basilan, Lanao del Norte, and Maguindanao. In total the program served 3,444 participants—an average of 17 participants per barangay.¹⁴ Attendees included barangay officials, civil society organizations, barangay residents, and members of other government agencies.

Asia Foundation partners for ARMM activities include 12 locally based CSOs, two Davao-based groups, one Zamboanga City-based CSO, and two national-level organizations. One notable example was the Alternative Center for Organizational Reforms and Development Foundation (ACORD), which worked to organize PBPB exercises in Tawi-Tawi. ACORD informed barangay residents about upcoming workshops, invited barangay chairmen to present detailed budget information, and persuaded the chairmen and councilors to submit themselves to a performance evaluation

¹⁴ Ibid, Annex 9.

by local citizens. PBPB and the ToP have brought new levels of participation and citizen knowledge of community governance to the ARMM. Citizens have been increasingly informed of the actual levels of funding available for barangay operations and programs, and have taken part in lively discussions about future directions. With significant knowledge about barangay budgets and processes and communities, citizens have developed standards against which their leaders can be judged.

Participatory Barangay Planning and Budgeting in Balongisan

Barangay Balongisan is one of 29 rural barangays in the Municipality of Payao that received barangay development planning and budgeting assistance under the TAG. The activity was the first of its kind in Balongisan, and people's organizations—particularly farmers and women's groups—actively participated in the process. Representatives of the Department of Education were also active in the barangay's community development processes.

Having a local development plan developed in a participatory way gave Balongisan's local government a better foundation for prioritizing programs and projects. The government gained an appreciation of what activities to focus resources on, and how much to allocate accordingly. Barangay officials, NGO representatives, and private sector participants in the training sessions crafted a development agenda for their community that reflected widespread community priorities and concerns.¹⁵

15 "Barangay Development Planning and Budgeting in Barangay Balongisan, Payao, Zamboanga Sibuguey: Transparent Accountable Governance (TAG) Project," Office of the Municipal Mayor, Municipal Hall, Payao, Zamboanga Sibuguey, 2005.



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V. Bruce J. Tolentino

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