Abstract of Dissertation

(Ph.D. in Public Management)

Performance-Based Grants in Indonesian Decentralization:
Incorporating Incentives to Improve Public Service Delivery

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Indonesia became a decentralized country on January 1, 2001. With the decentralization, public service delivery is devolved to local governments. To support local government in exercising public service functions, the central government provides financial support in the form of intergovernmental grants. The grants are major revenues for most local governments. In 2010, intergovernmental grants accounted for more than 80% of local governments’ revenues (Indonesian Central Bureau of Statistics, 2011).

In 2010, Indonesian central government started to implement Performance-Based Grants (PBG) on several national priority sectors, e.g. education, sanitation, and drinking water. In PBG, the funds can only be accessed if certain performance is achieved, thus incentivize local governments to comply with the required standards. Advocates of PBG argued that linking incentives, funding, and performance can benefit public service delivery performance through improved accountability and efficiency (see UNCDF 2010, Shah 2010, Steffensen 2007, 2010).

The research evaluates the impact of PBG implementation on public service delivery in Indonesia, proposing this hypothesis: PBG improves public service in Indonesia by strengthening local governments’ accountability in the service delivery. To verify the hypothesis, this research poses three research questions: (1) Does PBG in Indonesia strengthen the accountability of local governments in public service delivery?, (2) If so, how does PBG strengthen the accountability?, and (3) Is PBG generally applicable to local governments in Indonesia?. To answer the research question, this research uses a case study of PBG for drinking water, one of the PBG pilot projects in Indonesia.

In the case of drinking water service in Indonesia, there’s a worsening condition of water service coverage post decentralization, despite the national policy that put drinking water as national priority since 2005. A cause of the decreasing coverage is the lack of investments in this sector. This research finds that generally, most local governments have the capacity to increase their investments in drinking water, but for some reasons, chose not to do so. When PBG for drinking water is implemented, investments in this sector increased.
Based on the findings, this research argues that PBG improve public service delivery by strengthening local governments’ accountability in public services delivery. Related to the research questions, the research finds that:

1. **PBG in Indonesia strengthen the accountability of local governments in public service delivery.** This improved accountability can be observed in the attainment of quality standard in public service delivery, availability of information, improved coordination between local governments and service providers, and higher local budget allocation for public service investments. Providing financial resources for public service delivery is an important way to communicate accountability (Glynn 1993).

2. **PBG strengthens the accountability by providing incentives for accountable behavior.** There’s no one-to-one link between increase in spending and improvement in public service delivery (Huther et al 1997). Instead, outcome of the spending, whether it is good or bad, depends on the incentives embedded in it (Bird 2002). Related to this, the research argues that the incentive feature in PBG can influence local governments’ decision toward improved accountability. An indication of a more accountable decision, as far as public service in concerned, is local governments’ increasing investments level in critical sector like drinking water after a long period of low investments.

3. **Local government can adapt relatively well to PBG.** To investigate local governments’ response to PBG implementation, this research conducted a survey with local government officials as respondents. Based on the survey, the respondents show no different perception between PBG and the existing intergovernmental grants in term of administrative procedures and waiting time for funds transfer, however, PBG is perceived to require less workload. In general, survey results indicate that local government officials can adapt relatively well to PBG system.
As a conclusion, the research suggests that, in addition to citizens’ demand, PBG can serve as an alternative to trigger local governments’ action in improving public service delivery. Conceptually, as suggested by the World Bank (2004), the trigger comes from citizens’ demand for improved service, which will trigger local governments to respond. This argument still holds given citizens’ demand is politically strong enough to put pressure on local government. However, when the demand is not strong enough, another form of incentives is necessary to make a change. Based on the findings, the research argues that the incentives can also originate from decentralization by strategically incorporating incentives in intergovernmental grants, as in the case of PBG.

Keywords: performance-based grants, incentives, accountability, decentralization, intergovernmental grants, developing countries, performance.