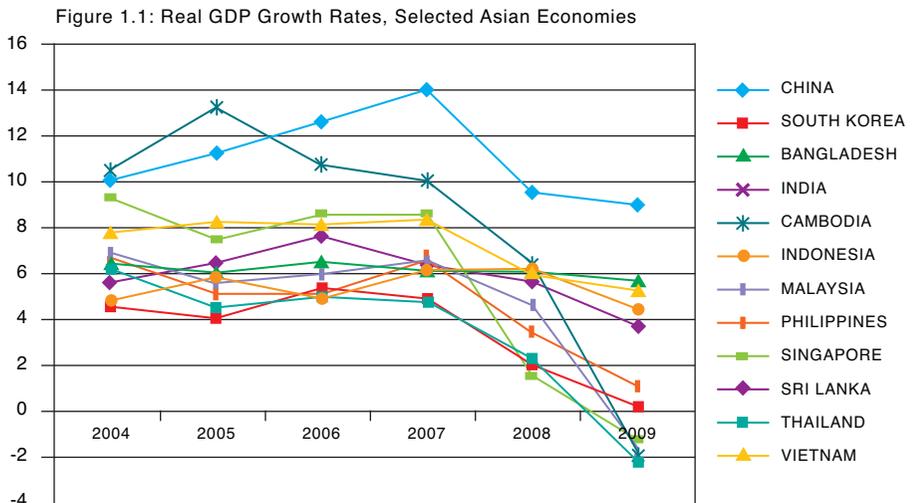


THE ASIA FOUNDATION: STRENGTHENING LOCAL ECONOMIC GOVERNANCE ACROSS ASIA

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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:

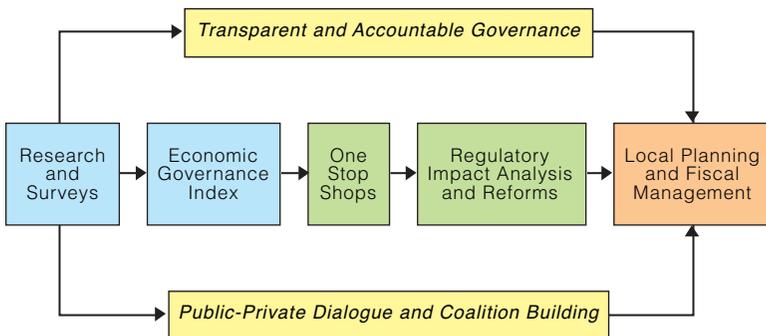
- enable investment and enterprise (especially for small and medium-scale businesses) through pro-market regulatory reforms at the local and national levels; and
- strengthen the responsiveness of local economic governance to the requirements of enterprise and the needs of the poor by supporting a culture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