

# **Donor proliferation and coordination in Indonesia: the case of SME promotion**

Lienda Loebis, MOI – Jakarta  
Hubert Schmitz, IDS – Sussex

Centre for the Future State  
Institute of Development Studies

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## **1. Introduction**

The question of whether foreign aid works continues to occupy centre stage in the development debate. There is a lot of controversy in this debate but there is agreement that the key issue is whether aid helps the recipients to help themselves. This calls for a focus on state capacity. A good deal of recent discussion has centred on how the ‘aid architecture’ affects this state capacity, paying particular attention to donor proliferation and its effects on state capacity. There are two views on this connection: one says that more donors means more choices for recipients and coordination amongst donors risks reducing such choices. The alternative view is that donor proliferation fragments state capacity and greater coordination offers the hope of reducing this fragmentation. Donor agencies themselves have recognised that the proliferation of foreign agencies and projects can undermine the capacities they are expected to support. This recognition is enshrined in the Paris Declaration on Aid Effectiveness which commits donor agencies to greater coordination amongst themselves and subordination of their projects and programmes to the recipient governments priorities and systems.

While the policy debate on this issue has moved fast, evidence-based research has progressed only slowly. There is little systematic in-depth research on how donor proliferation and donor coordination affect state capacity. This is why the Centre for the Future has included this issue on its agenda for research. The question driving this line of research is *not whether but under what conditions* donor proliferation fragments state capacity and donor coordination augments state capacity.

The research is now underway, starting with the cases of Kenya and Indonesia and focussing in both countries on donor activities in two ‘sectors’: industrial development and governance reform. The project has two stages: Phase 1 seeks to establish the *extent and form* of donor proliferation/co-ordination in the two selected sectors and countries. Phase 2 is concerned with studying the *effects* on state capacity. While Phase 1 is the unavoidable stepping stone for Phase 2, it is also important in its own right: it provides an empirical basis for judging whether donor agencies are moving towards their declared objectives of reducing proliferation and increasing coordination. This paper summarises the findings from Phase 1 of the research carried out in one of the Indonesian sectors.

## **2. Proliferation of projects and agencies**

This case study focuses on donor activities in the field of promoting inclusive industrial development. By ‘inclusive’ we mean industrial development that includes local enterprises of micro, small and medium size. For reasons of convenience, the remainder of the paper often uses the term ‘SME promotion’ or ‘SME sector’ (SME = small and medium enterprises).

There are four reasons for choosing the SME sector: First, for many years, small and medium enterprises have been the darlings of donor agencies because of their expected contribution to economic growth, employment generation and poverty reduction; the resources involved are substantial. Second, recent thinking on economic reform suggests that a strategic approach to industrial policy, which builds on local enterprises, is possible, but requires considerable state capacity. Third, there is little if any research on donor proliferation and the effects on state capacity in this ‘sector’. Finally, we have worked on industrial development in general, and small and medium enterprises in particular, for many years in our academic, advisory and operational work. This gave us an outside and inside view of how donor support works.

In spite of this familiarity, assembling the information turned out to be difficult. Even the seemingly simple task of listing the donor projects turned out to be time consuming. This was so for two reasons: first because no single source could provide the required data. In principle, BAPPENAS (National Planning Agency) approves all donor projects and keeps a central registry but the practice is different. Donors often by-pass BAPPENAS and its data base (managed jointly with UNDP) is incomplete and out of date. It had to be complemented and updated with data obtained from various Ministries and donor agencies. Second, different donors use different language in their project documents – making it difficult to figure out which projects should be included in a particular sector. Some projects clearly specify the aim of promoting small and medium enterprise development. In others, it is hard to tell because the project documents stress poverty reduction, income generation, sustainable development, regional decentralisation or other objectives, making it necessary to dig into archives or interview personnel in the relevant donor agencies or national counterparts. We developed a set of criteria for including projects, but realised that in the end some decisions were arbitrary. Nevertheless, we believe that our final list of 83 projects is a reasonable approximation of donor activity in this sector over the period 2000-06. Since these 83 projects were not active throughout this period, Table 1 gives a year-by-year account.

**Table 1: Proliferation of Projects, Foreign Donors,  
National Counterparts and Implementing Agencies**

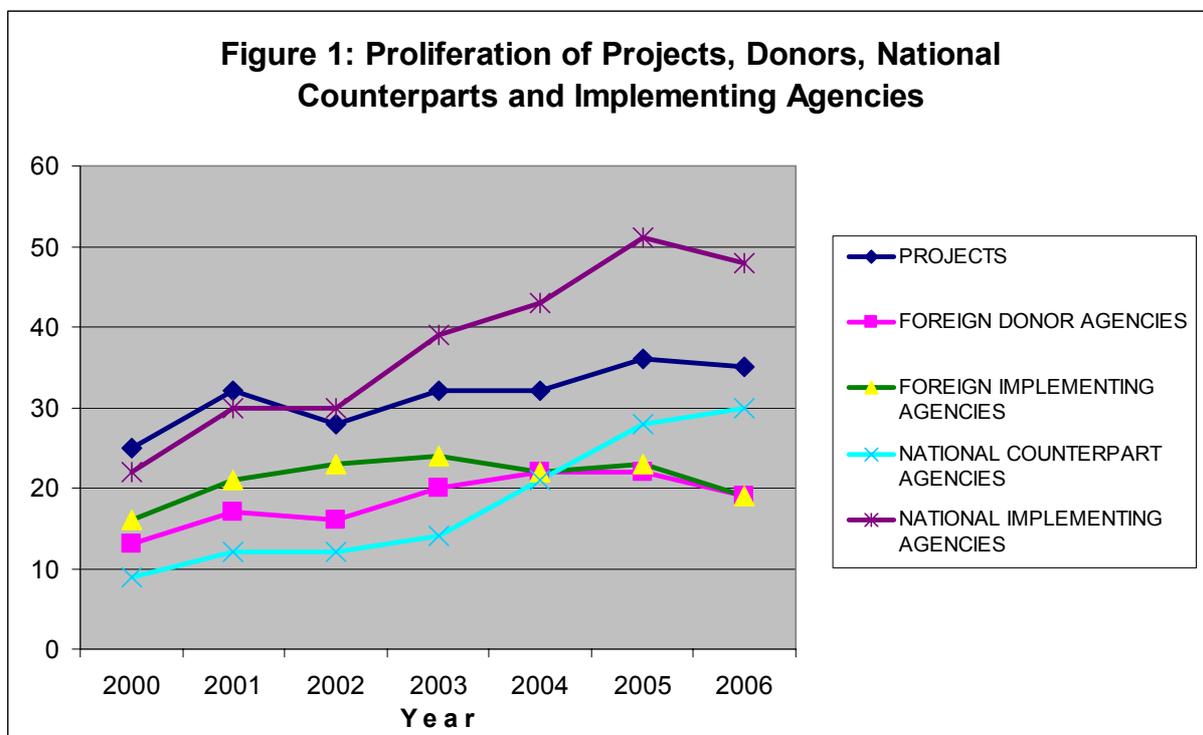
YEAR	PROJECTS	FOREIGN DONOR AGENCIES	FOREIGN IMPLEMENTING AGENCIES	NATIONAL COUNTERPART AGENCIES	NATIONAL IMPLEMENTING AGENCIES
2000	25	13	16	9	22
2001	32	17	21	12	30
2002	28	16	23	12	30
2003	32	20	24	14	39
2004	32	22	22	21	43
2005	36	22	23	28	51
2006	35	19	19	30	48
<b>2000-2006</b>	<b>83</b>	<b>32</b>	<b>45</b>	<b>35</b>	<b>75</b>

The following key messages can be derived from this Summary Table:

- In 2000, there were 25 projects, carried out by 13 different donor agencies. Their number increased further over the period 2000-5: projects increased by 44% and donor agencies by 69%. The slight decrease after 2005 is probably due the Tsunami which hit Indonesia in late 2004; contributing to reconstruction of the affected areas became a priority of most donor agencies.
- The international proliferation debate suggests that in many countries, a high and rising number of foreign donor agencies inter-acts – in a given sector - with a small number of national government agencies. In the case of Indonesia, this is different. These donor agencies have considerable number of different counterparts, reflecting the fact that Indonesia has a big state. Big does not necessarily mean strong. In the SME field alone, a number of different Ministries are counterparts: the Ministry of Industry (MOI), the State Ministry of Cooperatives and Small and Medium Enterprises (SMOCSME), BAPPENAS, Ministry of Manpower and Transmigration, Ministry of Forestry, Ministry of Finance, Ministry of Home Affairs, and others. It is widely recognised, both within and outside the Indonesian government that the inter-ministerial division of responsibilities is not clear, giving donors many choices of who to work with. The table shows that they use these choices: roughly speaking, for every foreign donor agency in the SME field, there is national counterpart. A more detailed analysis shows that MOI and SMOCSME are the main counterparts in donor-funded projects. However, both are big Ministries and donor-funded projects do not account for a large part of their activities.
- In order to understand the proliferation of foreign and national agencies it is essential to go deeper into the aid chain. Many donor agencies do not carry out the projects themselves: they contract foreign implementing agencies (for example other multilateral and bilateral agencies or specialised consultancy companies). In turn the counterpart agencies often pass on the implementation to other organisations, predominantly

governmental organisations. In some cases, more than one organisation is entrusted with the implementation, which is why in some years the number of such agencies exceeds the number of projects. As can be seen, from the table, the number of foreign and national implementing agencies increased over the period; this is most pronounced in the case of national implementing agencies which increased by 118% over 2000-6, partly because of the big size of Indonesia and the trend towards decentralisation.

There are two overall conclusions: first, there has been *considerable proliferation* of projects, donors, counterparts and implementing agencies in the field of SME promotion. Second, the impact on state capacity would be very hard to trace because the state is big and foreign donors work with a multitude of national agencies. *The number of national counterpart and implementing agencies increased faster than the number of foreign donor and implementing agencies* (see Table 1 and Figure 1).



This is the overall picture. Further insights can be gained by examining the composition of the totals given in Table 1 and reflected in Figure 1. This composition changes over time. The most interesting insight is that the donors responsible for the proliferation of projects change over time. Table 2 shows the main donors active in the SME sector in Indonesia and their relative importance in terms of the percentage of their projects in the total number of projects active in the year concerned. While ADB and the World Bank were the main proliferators in 2000, by 2006 IFC and JICA occupied this role. GTZ and AUSAID were major contributors throughout.

**Table 2: Relative Importance (%) of Main Donor Agencies 2000-2006**  
Percentage of all Projects Active in Respective Year

Agency	2000	2001	2002	2003	2004	2005	2006
Asian Development Bank (ADB)	20	19	21	19	13	8	3
World Bank	16	13	7	3	3	3	0
JICA	12	16	14	19	22	17	23
AUSAID	12	6	18	19	13	11	9
GTZ	8	9	7	6	9	6	9
UNDP	8	3	4	6	0	0	0
BMZ	4	3	0	3	3	3	3
IFC - PENZA	0	0	0	0	16	31	36
CIDA / CANADA	0	6	7	9	9	11	11
Japan Special Funds (JSF)	0	3	4	9	3	3	0
KFW	0	3	4	3	3	3	3
Others	20	19	14	3	6	6	3
<b>Total</b>	<b>100</b>						

### **3. Donor Coordination**

The problems arising from project and donor proliferation are well recognised, internationally and in Indonesia. The call for more and better coordination among donors is common, both internationally and in Indonesia. This section reviews how much progress has been in coordinating donor activities that seek to strengthen small and medium enterprise development. It is based on interviews and email exchanges with donor and government representatives, and on participation observation by Lienda Loebis in a number of meetings which brought donor and/or government officials together and which are specified in the course of this section.

*The CGI:* the experience of the CGI (Consultative Group Indonesia) provides important context for investigating donor coordination in a specific sector. The CGI was active throughout the period covered in this paper, namely 2000-06. Its key activities were meetings taking place twice a year, bringing together the main multilateral and bilateral donors (plus the latter's ambassadors). On the government side, these meetings were attended by the Ministers of Economic Coordination, Planning, Finance, Industry, and Agriculture (plus top civil servants from these Ministries). These were long meetings at which the donors would review the performance of the Indonesian economy and government. The reverse did not happen, there was rarely, if ever, a review of the donors performance by the Indonesian ministers. The atmosphere was typically post-colonial with foreign donor agencies sitting in judgement of their hosts (based on interviews with both sides; and participant observation in three of these meetings during 2003-2005). President Yudhoyono put an end to this spectacle in early 2007. The CGI was dissolved.

*The SME Working Group of the CGI:* this group met on separate occasions depending on when the main donors felt such meetings should take place. The Asian Development Bank (ADB) and the Japan International Cooperation Agency (JICA) took the lead as the most active foreign agencies in SME promotion, especially in the early 2000s. There was a two stage procedure, first senior officials of the relevant Ministries met to prepare for the Working Group meetings, with the State Ministry for Cooperatives and Small and Medium Enterprise (SMOCSME) coordinating the national input. Then the donor agencies met with the government officials to review the performance of the Ministries concerned. As in the main CGI meetings, there was no review of the performance of the donor agencies. At some meetings there was however a summary comment – usually made by the government official chairing the meeting – that greater coordination amongst the donors would be welcome (based on participant observation of Lienda Loebis at meetings during 2002-2004). After 2004, this SME working group was absorbed in the Investment Climate Working Group which produced little change with regard to relationships between donor agencies or treatment of government agencies.

*Attempts to coordinate donor action:* even though some agencies such as UNIDO, ADB, JICA, and GTZ have been active in Indonesia for several decades, there has been little coordination between these or other agencies. This is confirmed by all respondents, some of them with a long history of involvement in SME promotion. This is not to say, that no efforts were made by the donors. By way of example, two such efforts are recorded here, one at national level and one at provincial level. The observations are again based on participation observation, followed up in interviews and email exchanges.

In 2005, the Asia Foundation tried to bring together all the donors active in SME promotion in Indonesia. The representatives of 15 donor agencies, including all the key players, attended the first meeting in Jakarta. Some of the participants presented their portfolio of work. This was considered a useful start and there was agreement that others would present their work at subsequent meetings. No subsequent meetings took place.

In 2006, USAID-SENADA took the lead in a sub-national attempt at donor coordination, concentrating on East Java Province. Six donors came together for a first meeting in Surabaya in August 2006 presenting their projects. This exchange of information and experiences continued at a subsequent meeting in September. Again this was considered useful by the participating agencies and there was talk about supporting provincial and district-level government in a more coordinated way but there was little follow up. Further meetings were planned but did not take place.

*Reasons for the lack of donor coordination:* the experience of attempted co-ordination with little effective follow up is very common internationally. The main reasons are well-known:

- Coordination is costly in that it requires considerable amount of time of senior staff of donor agencies and recipient agencies. These costs are certain but the benefits are very uncertain.
- Donor staffs are under pressure to disburse funds against deadlines. Coordinating activities with those of other agencies is feared to slow down the speed at which programmes and projects can be introduced and executed.

- Closely related to the previous point, donor staff gain recognition and promotion by carrying out programmes and projects which apply (or develop) approaches agreed with headquarters. There is little reward for coordinating with other donors (or subordinating projects and programmes to recipient priorities).
- While often denied, donor agencies are competing with each other – or their staff feel they are competing with each other. As a result the exchange of information and experiences is shallow and developing joint initiatives makes it more difficult to develop an own profile.

These reasons apply in varying degrees also to the agencies and to the sector examined in this paper. The respondents interviewed for this project, however, stressed that there was another reason which had particular relevance to Indonesia. The argument – put forward by almost all respondents – centred on the size and diversity of the Indonesian economy and state. It was felt that, given this enormous size and diversity, donor coordination was both more difficult and less important. The overriding sentiment was that there was space for all donor agencies to do useful things in specific sectors and regions – without interfering with each other and or harming recipient agencies.

Clearly there is some truth in this, especially if one compares Indonesia with small aid-dependent countries. At the same time it is the case that duplication occurs, that the donor programmes and projects rarely build on each other, that considerable transaction costs arise from project and donor proliferation, that defunct national organisations can keep going with donor funding, and that donors interfere with recipient organisation and learning (in negative or positive ways). Whether one can trace and document these effects is another matter. As mentioned earlier, the donor agencies work with many national agencies and this makes the attribution problem almost insurmountable.

*Lack of coordination amongst government agencies:* the coordination problem arises not just on the donor aside. Proliferation of agencies and lack of coordination also exist on the government side. Indonesia has no less than 34 Ministries at central level, leading to duplication and overlap. While this can be productive if it leads to competition for providing good services, this is not what has happened in Indonesia. The duplication and resulting confusion is particularly pronounced in the SME field. Two Ministries have direct and strategic responsibility for SMEs: the Ministry of Industry (MOI) and the State Ministry for Cooperatives and Small and Medium Enterprise (SMOCSME). To confound matters, also BAPPENAS (Planning Ministry), the Ministry for Economic Coordination and even the Cabinet Secretariat have SME programmes, often funded by foreign donor agencies. It seems that internal and external (donor) proliferation reinforce each other. While the origin of the multitude of Ministries is not due the donors, the inefficient structures seem to survive partly due to access to donor resources. And donor agencies, desperate to disburse their funds, always find a willing recipient. This dynamic would be hard to document in detail, but our observations and informal discussions suggest that it is real.

Ironically, a donor agency was asked by President Megawati to improve the coordination between government agencies in the SME field. In 2002, she asked ADB to take a lead role in coordinating policies and programmes. ADB then developed, jointly with SMOCSME,

the Mid Term Action Plan. This plan however remained ineffective, partly because SMOCSME was a weak partner for ADB. Since then, there has been only marginal improvement in coordination amongst the government agencies active in the SME field. In the words of an insider, ‘we agree to coordinate better when we meet, but afterwards we continue with our own projects’.

#### **4. Conclusion**

The main findings arising from this phase of the research are clear:

- Over the period 2000-06, the number of donor-funded projects increased substantially.
- The number of donor agencies also increased over this period.
- The league of main proliferators changed over time.
- Donor coordination was attempted but failed.
- Lack of coordination amongst government agencies facilitated donor and project proliferation.
- Both the donor agencies and the government are responsible for the lack of progress towards the aims set out in the Paris declaration on aid effectiveness.
- The number of national agencies involved in the aid chain increased faster than the number of foreign agencies.
- The size of the Indonesian state and the high number of national agencies interacting with the foreign agencies make it very difficult to trace and document the effect of donor proliferation on state capacity.

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