

Research Frontiers Bearing on the Indonesian Village Law  
Erik Wibbels  
Duke University

Two factors combine to make this law an important opportunity for learning about local public finance and public accountability: First, with more than 73,000 villages, there is a great deal of statistical “power” to distinguish the effects of different interventions; and second, the law leaves a large number of very important details undefined, which raises the potential to introduce variation across village into the rollout of the law.

The goal of this brief report is to offer some initial ideas for research opportunities that emerge from the law and seem broadly consistent with the World Bank’s programming goals. These ideas are not borne of detailed knowledge of Indonesian villages and public finance; they are borne of a broad knowledge of decentralized public finance and local government interventions and research around the world. In developing the ideas, I have organized them around five areas:

- Financing and village transfers
- Village-level elections, participation and planning
- Construction and maintenance of infrastructure projects
- Motivation and oversight of public employees
- Public accountability

Ultimately, each of these areas will have important bearing on the quality of village governance and the efficiency of village PFM.

The analytical focus below emerges from a political economy framework that emphasizes the importance of principal-agent relationships. The key relationships bear on those between village citizens and village elected officials, between village officials and front-line service providers (or contractors in the event of capital projects), between those service providers and village citizens, and between village governments and higher-level governments that provide resources and oversight. The potential projects outlined below aim mostly at minimizing the information asymmetries inherent in these principal-agent relationships so as to limit corruption, increase efficiency and maximize the accountability agents to their principals.

The methodological orientation driving these ideas is the field experiment, which have become the gold standard in development programming. Field experiments will be possible to the extent there is flexibility with regards to the deployment of the village law. That flexibility could exist either in the actual content of its implementation (i.e., there could be variation in the nature of transfers, the extent of involvement of village councils, etc. across villages) or in the timed phasing in of the law (i.e., elements of the laws implementation could be phased in over time in order to learn how different elements impact village outcomes).

### ***Financing and Transfers***

The precise nature of the transfer system whereby villages will receive funds is unclear. There is extensive work in fiscal federalism suggesting that the composition of transfers have important effects on the incentives of the recipient government. The lack of precision in the law raises the possibility of investigating if and how grant composition impacts village behavior. Two possibilities:

- Experiment with the transfer formula between districts and villages. Transfer formulas typically try to balance two competing goals—efficiency and equity. Efficiency is often understood in terms of balanced budgets in the aggregate or with respect to some more rigorous assessment of PFM.<sup>1</sup> Equity is understood either in terms of equalizing resources across individuals/villages/districts or targeting resources where needs are greatest. One possibility would be to experiment with the balance between efficiency and equity in district allocations across villages. In a simple example, one group of districts might provide 75% of transfers on the basis of efficiency considerations and 25% on equity considerations; a second set of districts might reverse the weights. It would be useful to know, for instance, if poor villages are better served by a more redistributive transfer system (a greater weight on need) or incentives to manage their resources well (a greater weight on efficiency/PFM). Obviously, this kind of field experiment would need to be carried about at the district level, although it would presumably have important effects at the village level.
  - There seems to be some debate as to the quality of village-level statistics that might guide the equity portion of any formula. One possibility is to experiment with the transfer in ways that *promote better data collection* by the villages themselves. The VRRRI data, for instance, suggests that there are several pro-poor programs that villagers might qualify for. I imagine the quality of that data might improve, if village-level transfers were tied to villages providing better data on the number of recipients. This might both provide better data on village-level poverty and do a better job of targeting transfers to the neediest villages.
- Experiment with the composition of the grants between districts and villages. The most important distinctions among types of transfer are: automatic (i.e. unencumbered) transfers, conditional transfers (i.e. those that are tied to specific expenditures), matching transfers (i.e. those that match village expenditures via some formula), and discretionary transfers (i.e. those that higher level governments deliver at their discretion). Matching transfers should motivate village own-source revenue collection. Conditional transfers motivate village expenditures perceived to be particularly important. Automatic transfers provide maximal liberty to village government to decide how to tax and spend as it sees fit. Discretionary transfers provide maximal liberty to district governments to target those villages they see fit. Experimenting with the share of transfers that are matching would, for instance, provide insight into the extent of untapped village revenue streams. Experimenting with the share that is conditional would provide insight into the age-old flypaper effect, albeit in the specific context of Indonesian villages. Experimenting with the share of transfers that are discretionary would provide insight into the political economy considerations of district governments.

### ***Elections, Participation and Planning***

The law seems to be vague on the nature of village elections and how representatives to village councils will be chosen. It also leaves a great deal open with regards to the relationship between village heads and village councils. Both of these—who is represented on councils and how village government decisions will be made—have important

---

<sup>1</sup> For one example of a more detailed approach, see the AFD, CIDA, DANIDA and KFW-funded District Development Facility in Ghana, which ties transfers to PFM. The formula is way too complicated to predictably impact incentives, but the basic idea is sound.

implication for how villages will plan the conduct of their budgets. Several opportunities for learning include focusing on:

- Experiment with reserve seats in the village council. There is now extensive evidence on the role of reserved seats for women and members of lower castes in India's panchayats, and it would be straightforward to extend this to ethnic minorities. These interventions often (Pande 2003; Beaman et al. 2010), but not always (i.e. Bardhan et al. 2010), find significant effects of representation on policies and citizen attitudes toward under-represented groups. Given that the villages are expected to invest considerably in infrastructure, it seems very likely, for instance, that there are important gender differences with regard to priorities—women, who are oft-responsible for carrying water from distant sources, might very well favor water projects at higher rates than men, who might be more likely to prioritize road projects that facilitate getting goods to market. It would be useful to know, for instance, if varying the share of reserve seats impacted outcomes and citizen perceptions. The law is unclear on how many representatives each village council will have, but if they are even moderately large (say, five members), it would allow for experimenting with the share of reserved seats in an informative way.
- Experiment with different means of promoting voting. The VRRRI data suggests that participation in village elections is high, albeit variable—ranging from 76 to 97 percent. More importantly, 19 percent of the villages seem not to have had a village election in the past. If that pattern holds for all Indonesian villages, nearly 14,000 villages will be holding their first elections. If they are unfamiliar with the mechanics of voting, turnout may well disappoint. This allows for the potential to test alternative models for promoting electoral participation. The tried and true, albeit expensive method, involves information campaigns about the importance of elections. An alternative relies on growing evidence that electoral participation is strongly conditioned by social networks. That the case, it might be possible to mobilize a small number of socially central village citizens around the election and thereby provide a substantial effect at lower cost.
- Experiment with alternative means of ensuring the perception and reality of ballot secrecy. Clientelism—i.e. the exchange of votes for private benefits—is a common problem in rural settings. If citizens are unable to freely express their views at the ballot box, it may deter participation and will certainly impact the message that village officials extract from electoral results. Given the social proximity of village residents, ballot secrecy can be particularly hard to establish. Interventions could aim at varying electoral procedures that discourage tampering (i.e. vary the publicness of the voting act) or encourage tighter oversight of electoral procedures with the goal of promoting ballot secrecy.
- Experiment with the extent of the responsibilities of village councils. This represents a real opportunity to learn how the participation of elected bodies influences the behavior of government. The law seems ambiguous about the relationship between village councils and village heads. One could randomize these rules, varying from:
  - Highly participatory councils, whose approval is required for all local budgetary, service and regulatory acts.
  - Councils whose approval is required for all village-level infrastructure investment (much of the impetus for the law seems to be to fill a whole in public sector infrastructure).
  - Council whose approval is required to approve the village budget.

- Council is nothing more than a consultative body, and the village head is free to decide the budget and manage the village government as they see fit.
- Finally, one could experiment with the extent of participation by village citizens in much the same way. Evidence on citizen participation is very mixed. The most encouraging findings on the value of citizen participation come from the health sector in Uganda (Bjorkman and Svensson 2009), though those results have not been replicated. Khwaja (2012) reports encouraging findings on the effect of community participation on infrastructure projects in Pakistan, but there the benefits declined as projects became more complex. Banerjee et al. (2010) in contrast, find that concerted campaigns aimed at informing citizens about their rights to participate in consultative school committees has no impact on community involvement, teacher effort, or learning outcomes in Uttar Pradesh, India. There have, of course, been extensive evaluations of participatory budgeting, but participatory budgeting has never been randomly assigned, so evaluating its effect has been problematic. With sufficient geographic scope, it may be possible to craft different participatory institutions in different villages. For instance, it would be useful to experiment with the selection mechanism for who is called to participate, as well as the institutional procedures through which decisions are made. Again, there is a tremendous opportunity here, since villages will need to develop budget procedures afresh as a result of the law.

A small aside: The law seems to be silent on the electoral institutions that will guide village council elections, beyond a mention of “geographic” representation. This seems to suggest that villages will be sub-divided into districts. Given that most of them are likely to be quite small, this seems incredibly inefficient. Nevertheless, the ambiguity might allow for varying electoral institutions across villages in ways that would allow the World Bank to learn important lessons about how political geography impacts government behavior. In the big picture though, it would seem most appropriate to discourage this “geographic” representation.

### ***Construction and Maintenance of Infrastructure Projects***

Since one of the primary goals of the law is to address a perceived shortcoming in village infrastructure, it seems likely that villages will engage in considerable capital spending. Above and beyond the important issue of which projects will be budgeted (see above, where the composition of village government seems likely to influence priorities), this raises the question of what kind of oversight village government and/or village citizens will provide over the construction of infrastructure projects. Given the substantial increase in budgets, it seems plausible that the new law will introduce village governments to private contractors for the first time, although some villages might aspire to maintain traditions of village self-help in the construction of new projects. Whichever model pertains, villages will be challenged to develop procedures at the interface of the public budget and outlays for capital projects (i.e. contracting and payments) and a means of overseeing construction to ensure quality and timely completion while limiting corruption. The traditional public sector solution to these challenges is to develop a system of auditing, but villages are too small to warrant village-specific audit teams. Several alternatives present themselves:

- Experiment with capacity building and incentivizing internal auditors. Internal auditors will be the interface between village projects and contractors (village citizens or private firms). Where they are capable and properly incentivized, corruption will be lower and more/better projects will be built. One traditional approach is to do trainings so that internal auditors understand procurement laws

and the principles of PFM. Such trainings might be compared with incentives that reward internal auditors who uncover the most irregularities or manage contracts such that projects are completed on time.

- Experiment with direct citizen oversight of capital projects. There is considerable interest in social accountability (for more details, see below). Khwaja provides evidence that the principles of social accountability can be applied to local infrastructure projects. One could imagine experimenting with the frequency and scope of such citizen oversight of infrastructure projects.
- Experiment with different modes of publicizing and overseeing infrastructure projects, including both their nature and progress. This might include providing a running public record of projects with requests for citizen oversight; training of entire villages in oversight; and/or training rural NGOs to do randomized oversight.
- Experiment with the means through which projects themselves are built. This might involve randomizing across districts that will build projects through private contractors and those who pay their own citizens for the work. This will allow a comparison along important dimensions of capital projects—the professionalization of the contractor, the leakage of resources/corruption, time to completion, and quality of the finished infrastructure projects.
- Experiment with competitions that reward villages for good PFM. The idea would be to encourage competition among them for any number of objectives: balancing the budget, preventing the accumulation of unspent balances, building infrastructure projects in a timely manner, etc. Validating village performance could prove costly, but it should be possible to design the competitions to maximize the amount of information villages themselves provide.

### ***Motivation and Oversight of Public Employees***

Greatly expanded budgets will likely require the professionalization of village public sectors. At the very least, it seems they will need something akin to an internal auditor to maintain the village fiscal accounts, but it might be necessary to hire a village contract officer. The laws mention of “services”, moreover, suggests that villages might initiative public services themselves, above and beyond any infrastructure projects they build. Thus, villages will be faced with challenge of motivating and overseeing public employees in ways they have not in the past. This will be particularly challenging in the village setting because these will be very small public sectors and some typical tools will not scale to such a small level.

- Probably the easiest approach would be to experiment with broad approaches to motivating employees. One very popular approach involves capacity building, where the idea is that better trained employees perform better, and good performance is motivating. I do not think the evidence on capacity building is very strong, but it has not been subject to experimentation.
- The impact of capacity building could be compared with experiments on incentivizing workers. Bonus pay, for instance, could be tied to measures of performance. The performance measures could range from very simple (say, attendance) to more complicated (the share of work completed) to very complicated (efficiency of work and/or the satisfaction of villagers with their performance). One could even imagine experimenting with the pay of village employees, and how performance responds to it, though this may well run awry if public sector unions become active in villages.

### ***Accountability***

As village's governments expand, it will be important to provide citizens with information on the behavior of village government and means of holding village officials accountable. For ideas on how to experiment with elections—probably the most important tool for accountability—see the section “Elections, Participation and Planning” above. Below I focus on mechanisms that might provide village citizens with better information on the performance of village government so that officials can be held accountable. In addition, since nearly all of village expenditures will be funded via expanded transfers, the new law underscores the importance of hierarchical accountability of village governments to higher-level governments.

- Experiment with audits. The traditional approach to promoting hierarchical accountability is through audits, and we have fairly solid evidence that it works when audits are widespread. Given the sheer number of villages, however, a very extensive system of audits seems unlikely. One possibility is, instead, to vary the probability of audits across districts. This would be important because we currently know very little about how the probability impacts behavior. Another possibility is to experiment with financial audits vs. performance audits. The latter are more expensive, but they do a better job of evaluating infrastructure projects, which the law focuses on. It would be useful to know if a cheaper system of financial audits does as well as performance audits in shaping the incentives of village officials. Whatever the nature of the auditing experiment it is crucial that the information from the audit be made available in easily consumable format for village citizens. Indeed, one might very well experiment with different means of getting different types of such information into the hands of villagers.
- Experiment with social accountability mechanisms. While social accountability initiatives are popular, the details of the programming vary considerable from setting to setting. The key dimensions of these programs are: a) who does the evaluation/data collection on village governance (i.e. all villagers, an NGO, or...)? b) What is the information that is collected (is it on fiscal performance or the quality of constructed infrastructure or the performance of front-line service providers or something else)? C) How is the information provided to the public? And D) Who are citizens expected to hold accountable—the village council or the village head or service providers? Knowing what works along these dimensions is important for improving social accountability programming, and given the large number of villages, the role out of the decentralization law offers the potential to vary programming along many dimensions.
- Obviously, it would desirable to compare the effect of top-down, audit-based accountability efforts with social accountability efforts.