

# New Public Management or Mismanagement? The Case of Public Service Agency of Indonesia

**JIN-WOOK CHOI**

Professor, Department of Public Administration, Korea University. Email: jinchoi@korea.ac.kr

---

## ABSTRACT

In line with the new public management (NPM), a public service agency (PSA) is considered as an alternative to replace the government-led public service delivery in a more efficient and effective way. At the same time, a PSA mechanism can deliver public service with better quality. To meet these ends, a PSA is granted with operational flexibility and autonomy particularly in managing finance and personnel. However, the PSA system has not yielded the expected benefits in Indonesia. On the contrary, PSAs have been regarded to cause financial burdens to the Government of Indonesia. This paper explores the current conditions of three key institutional bases of PSAs in Indonesia including PSA governance, financial management and performance management. The notable challenges related to the three dimensions in the Indonesia's PSAs include the weak PSA governance structure, and an inappropriate balance between flexibility and autonomy on the one hand and accountability and performance on the other in managing a PSA. Focusing on these challenges, this paper draws the following policy suggestions for Indonesia to improve the efficient operation of the PSA system: rebuild the PSA governance on a firm and clear legal base, absorb diverse stakeholders and outside experts in the PSA governance decision-making; monitor and evaluate the PSA's financial flexibility and autonomy through vigilant internal and external monitoring mechanisms; redesign performance appraisal to set up right appraisal structure, process, and performance criteria; and link the results of performance appraisal to relevant rewards and punishment.

Keywords: New Public Management, public service agency, autonomy, flexibility

## INTRODUCTION

In Indonesia, public services agencies (PSAs), which are called

“Badan Layanan Umum (BLU)” in Indonesian or “semi-autonomous agencies” in English, were introduced in 2005. Like other countries such as the U.K., Canada, Australia, and New Zealand among others, the primary reason of the adoption of PSAs in Indonesia is to improve the quality of public services through the efficient financial and performance management (Ministry of Finance, 2014a). In other words, PSAs were regarded as a new type of organizational form that would improve the productivity, efficiency and effectiveness.

The creation of PSAs whose organization form and the *modus operandi* differ from the traditional government organizations was much influenced by the New Public Management (NPM) in the 1980s and 1990s (Laking, 2005). As witnessed around that time, governments, whether developed or underdeveloped, were under severe criticism of inefficiency and ineffectiveness which were not properly checked by the accountability mechanism inside as well as outside of government. These problems mattered particularly when a government delivered public services to citizens. Not only did the government waste resources in the public service delivery process, but also the quality of public service was lower than citizens desired.

Under this circumstance, a PSA was considered as an alternative to deal with these problems. By receiving autonomy and flexibility in managing its finance and personnel affairs, a PSA is required to be more accountable to the government and citizens in terms of performance and results. It is obvious that autonomous financial management does not mean irresponsible spending by a PSA. Within its institutional framework, a PSA needs to consider the value for money in producing better services (U.K. Independent Commission on Good Governance in Public Services, 2004). This implies that both financial management and performance of PSA should be monitored and evaluated by a relevant government ministry.

Similar to other NPM-style public sector reforms in Indonesia (Harun et. al., 2014; Prabowo et. al., 2013; Rajiani and Jumbri, 2011; Tjiptoherijanto, 2007), the PSA system has been mismanaged instead of generating its intended goals. There are several factors that prevent PSAs from being run and operated effectively in Indonesia. The governance of PSA is not firmly structured. There is no clear division of roles and responsibilities between the Ministry of Finance (MoF), which takes the top position in PSA governance, and line ministries, which are the immediate principals of PSAs. Nor are these roles and responsibilities properly carried out. In particular, neither the MoF and line ministries administer properly performance management of PSAs, which is one of key factors to warrant the success of PSAs. Moreover, those in the Government of Indonesia (hereafter “GoI”) who are responsible for monitor and evaluate PSAs do not possess the necessary capacity.

What happens in Indonesia surrounding the PSA system is exactly echoed by a warning of Schick (1998) who pinpointed the risk of using PSAs in developing countries where rule-based government operations and a well-functioning market mechanism are hardly to be found. Under these circumstances, PSAs cause a problem of inefficacy more than gains to the government and the society.

Focusing on the three key PSA-related institutional arrangements such as governance structure, financial management, and performance management, this paper aims at identifying the factors that weaken the current PSA system in Indonesia and drawing policy suggestions for the GoI to improve the efficient operation of PSAs in general and to make PSAs accountable in light of financial and performance management in specific. The reason why these three institutional arrangements are explored is because governance structure of PSA is the most important framework within which key PSA polices are formulated and implemented. Financial and performance managements consist of the core operational principles of PSAs. At

the same time, they are complementary, representing the notions of autonomy and flexibility on the one hand and accountability and performance on the other.

This paper is structured as follows. Section II describes the brief background of the adoption of the PSA system in Indonesia. It also examines how the PSA governance structure is framed and how financial and performance managements of PSA are administered in Indonesia. In so doing, the key challenges faced by the GoI in running the PSA system are identified. Section III attempts to make policy recommendations for the GoI to improve the efficiency, effectiveness, and accountability of PSAs. Concluding remarks follow in the last section.

## **CURRENT CONDITIONS AND KEY CHALLENGES OF PSAS IN INDONESIA**

Badan Layanan Umum (BLU) in Indonesian language means literally a “public service agency” which other governments call differently, such as the “Next Steps Agencies” or the “Executive Agencies (EOs)” in the U.K., the “Crown entities” in New Zealand, and the “Special Operating Agencies (SOAs)” that renamed the “Legislative Agencies” in Canada (Armstrong, 2001: 8-13). As these terms indicate, a PSA is an agency through which the government delivers public services to citizens, although every public service organization is not a PSA.

The background of the adoption of PSAs in Indonesia can be traced back to the public sector reform that was initiated by the GoI in 2003. Public sector reform of 2003 was rooted in “Law 17/2003 on Public Finance,” “Law 1/2004 on State Treasury” and “Law 15/2004 on Public Audit.” One of the key agendas of the public sector reform is a reform of public finance. In doing this, a core reform program is how to reshape the relationship between the MoF, as an ultimate body that is responsible for government financing, and

line ministries and agencies that spend the budget. In this context, one of the most serious problems the GoI faced was that line ministries and agencies were not able to obtain the intended goals of many programs and projects and, accordingly, not to improve the quality of public services. The GoI recognized the stringent control by the MoF over spending of line ministries and agencies as a primary cause of this problem. PSAs were considered as an alternative to solve the problem (Ministry of Finance, 2014b). Under this circumstance, as the public complaints on government services increased, the GoI decided to introduce PSAs in 2005.<sup>1</sup>

PSAs of Indonesia are based on “Regulation 23/2005 on BLU Financial Management” which is in line with Law 1/2004 on State Treasury, especially Chapter XII of the Law.<sup>2</sup> In 2005, the GoI designated 9 agencies as PSAs, most of which were national hospitals. Since then, because more public entities wished to transform into a PSA, there are 134 PSA under the responsibility of 17 line ministries in 2014.<sup>3</sup> Among these, 49 PSAs are medical service institutions and 63 PSAs are related to education services. Other PSAs carry out a free economic zone function and a credit guarantee service.

In Indonesia, PSAs are granted with a high level of autonomy and flexibility, which is congruent with the principles of the PSA system. By contrast, PSAs are criticized because their service quality has not improved in so much as increased privileges (Damhuri, 2011). In other words, PSAs have exercised their financial and personnel management authority imprudently that cause managerial and operational inefficiencies. Despite the fact that the success of PSAs is determined by the mechanism with which the performance of PSA should be linked to rewards and punishment, the performance appraisal system in Indonesia is not yet firmly structured. Accordingly, the current system does not provide sufficient motivation for PSAs to improve their performance. As Schick (1998) predicted, if a coun-

try, particularly a developing country, does not have arrangements that make PSAs hold accountable and performance-oriented, the PSA system is not likely to succeed. Indonesia, in some aspects, faces this circumstance. Put it differently, Indonesia has not been able to meet the following basic requirements for the success of PSAs suggested by Laking (2005).

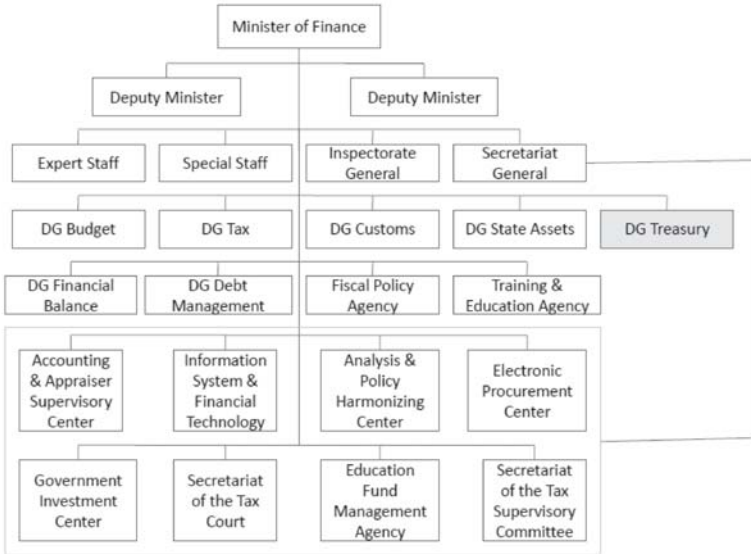
- \* Establish a PSA with a clear justification.
- \* Place external oversight and control over a PSA based on right rules and systems.
- \* Design a system that enables a PSA to manage itself properly

The following sub-sections provide the detailed explanations on these issues.

#### Issue 1: Governance Structure

When adopting the PSA system, the GoI did not take a specific PSA model of other countries into consideration. Nonetheless, it is known that the GoI referred to the experience of Canada at the early stage of designing its PSA system.<sup>4</sup> When institutionalizing the PSA system, the GoI designated the MoF as the ultimate responsible entity to govern the government-wide PSA system. In particular, the Directorate of BLU (PPK BLU) in the MoF takes the de facto responsibility concerning PSAs in Indonesia.

To capture the PSA governance, it is necessary to know the key participants, and their roles and responsibilities in governing PSAs. As Figure 1 displays, there are seven directorate generals (DGs) in the MoF. Among these DGs, the Directorate of BLU is located in the DG Treasury as shown in Figure 2. As of August, 2014, the total size of personnel of the Directorate of BLU was about 70.<sup>5</sup>



[FIGURE 1] ORGANIZATION CHART OF THE MINISTRY OF FINANCE  
 Source: Drawn by the Ministry of Finance, Government of Indonesia



[FIGURE 2] ORGANIZATION CHART OF THE DG TREASURY OF THE MINISTRY OF FINANCE  
 Source: Drawn by the Ministry of Finance, Government of Indonesia

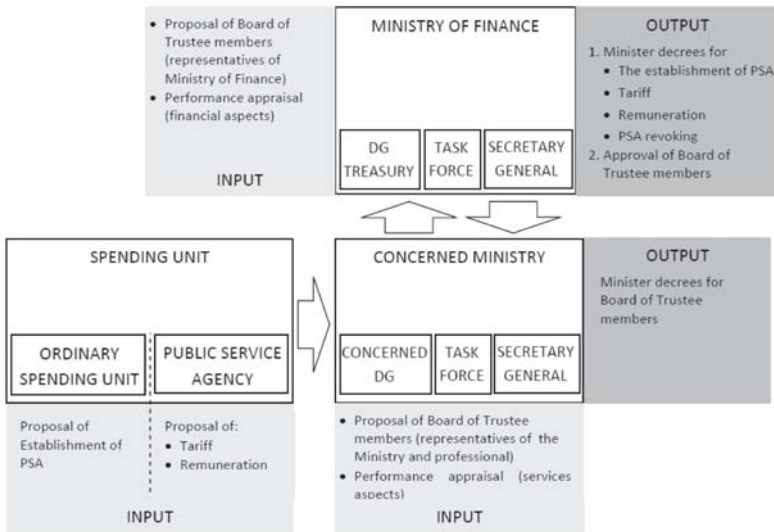
Along with the MoF, line ministries are one of core pillars in the PSA governance. As briefly mentioned above, many government organizations that provide public services to citizens wish to get a PSA status because PSAs are privileged to enjoy a wide range of autonomy with a low degree of requirements for accountability and

performance (Ministry of Finance, 2014b). The approval process of PSA takes two steps as follows. A request for transformation into a PSA is first reviewed and approved by a line ministry to which a requesting agency belongs. For example, if a national university requests to become a PSA-type agency, it must be approved by the Ministry of Education. After the approval process by a line ministry, the request is submitted to the MoF for a final approval.

The performance appraisal of PSAs that began since 2012 is undertaken in two steps—performance appraisal by a line ministry for technical aspects and one by the MoF for financial aspects. The line ministry's appraisal for technical aspects and the MoF's appraisal for financial aspects account for 70% and 30%, respectively. Before two-step performance appraisal, PSAs conduct their own performance review internally. PSA's internal performance review and results are submitted to the minister of line ministry concerned for the first formal review. The ministry's review results are reported to the MoF for the final review and appraisal. Although the two-step review and appraisal process, if undertaken properly, can strengthen the performance monitoring of PSAs, the performance appraisal is not effective in Indonesia because both line ministries and the MoF do not possess adequate capacity to review and assess the performance of PSAs. On the contrary, the current dual controlling mechanism prevents medical services PSAs from administering effective budget spending because directions on budget execution from the MoF and line ministries are neither consistent nor coherent.<sup>6</sup> Inadequate financial autonomy of medical services PSAs reflects the desire of the Ministry of Health to keep controlling power over its PSAs. This is also supported by Damhuri (2011) who claims that the line ministry's control limits PSAs to maximize their performance. Yet education services PSAs, which are under the same dual control, enjoy a high degree of autonomy with regard to budget spending.<sup>7</sup>



In summary, the PSA governance in Indonesia is structured by the linkage of “the MoF” line ministries (“Concerned ministries”) PSAs” as illustrated in Figure 3.



[FIGURE 3] PSA GOVERNANCE IN INDONESIA

Source: Drawn by the Ministry of Finance, Government of Indonesia

There are three problems stemming from the current PSA governance structure in Indonesia. First, although the current regulations on PSAs—Regulation 23/2005 and Regulation 74/2012, both of which are on financial management of PSAs—do not define the detailed roles and responsibilities of participating entities including the MoF, line ministries and PSAs. Nor do they specify the governance system to operate and manage PSAs effectively.

Second, while there is a shortage of manpower and capacity, the Directorate of BLU in the MoF alone carries out all PSA-related duties. When the dedicated PSA management unit like the Directorate of BLU suffers resource constraints, it needs to actively explore a chance to absorb external expertise.

Third, PSAs can be managed and treated differently depending on the type of services they deal with. Yet the governance of PSA

should be based on consistent and coherent managerial principles at a national level regardless of types of PSA. Nonetheless, as signified by the difference in financial autonomy between medical services and education services PSAs, the GoI lacks a unified governance structure to manage PSAs, which lowers the effectiveness of the PSA system.

## ISSUE 2: FINANCIAL MANAGEMENT

PSAs in Indonesia are highly autonomous in terms of financial management. This is one of the most significant characteristics that make PSAs different from ordinary government organizations whose financial management is usually under stringent control by the ministry of finance. There are several features of financial autonomy of PSAs in Indonesia.

First, when an ordinary government organization collects non-tax revenue from service fees, this non-tax revenue should be transferred to the government general account which is controlled by the Bank of Indonesia, the central bank in the country. If that specific government organization wants to use the non-tax revenue, it is possible only after it receives an approval from the MoF and the Parliament. By contrast, PSAs are exempt from this approval process and flexible to spend the non-tax revenue. When this is the case, the Minister of Finance Regulation 30/2011 mandates that PSAs report the spending and revenue to the treasury office of the DG Treasury in the MoF at least once within trimester. This reporting requirement serves for the purpose of managing the national financial information rather than other purposes.<sup>8</sup>

Second, while the expenditure of government organizations are bounded by the budget ceiling as indicated in the national budget statement, this binding of budget ceiling works differently to PSAs. For example, PSAs are given flexibility to exceed spending up to a certain portion of the total non-tax revenue target, which is called

“threshold,” if the received revenue is over the target. If they want to exceed the spending beyond the threshold, they need approval from MoF as stipulated in Regulation 23/2005.

Third, whilst government organizations have to set out their budget planning based on inputs, PSAs set out their budget based on a strategic business plan. In doing this, they formulate the budget based on cost accounting of services they provide to customers. In addition, unlike other government organizations, PSAs should also apply the accrual basis accounting using financial accounting system in addition to the cash basis government accounting system (Ministry of Finance, 2014b).

Fourth, PSAs are flexible to set their own pay scale with which they pay the salaries and performance-based bonuses for employees. By contrast, government organizations should apply a strict pay scale set out by the GoI (Ministry of Finance, 2014b).

These financial autonomy and flexibility can be summarized in Table 1.

TABLE 1 FINANCIAL FLEXIBILITY AND AUTONOMY OF PSAS

	PSAs	Government Organizations
Type of spending	Non-PNS Salaries, Remuneration, Operational Expenditure, Capital Expenditure.	PNS (civil servants) salaries, Operational expenditure, Capital Expenditure
Spending Mechanism	Could spend it directly and report the spending (and revenue) to the treasury office once in each trimester.	Every spending must be verified, get approval from and paid by the treasury.
Spending Limit	Could exceed the budget ceiling as long as the Non-Taxation revenue exceeds the budget estimate.	Not allowed to exceed the budget ceiling
Budget Formulation	Performance based Based on cost accounting calculation Accrual basis	Input based Cash basis

Source: Modified by author from the Ministry of Finance, Government of Indonesia (2014b: 5)

This financial autonomy and flexibility for PSAs cause several problems. The first problem is ambiguity of budget composition. For example, the sources of revenue for civil servants' salary, opera-

tional expenditure and capital expenditure of PSA come from the national budget.<sup>9</sup> However, salaries of those who are not civil servants in PSAs are covered by PSA's self-generating revenue. This indicates that PSAs use the mixture of government accounting and business-like accounting (Ministry of Finance, 2014b).

The second problem arises from the disconnection between budget spending and performance results of PSAs. In other words, the MoF is not able to control inefficient spending of PSAs because there is no well-structured performance appraisal system. Moreover, a lack of the MoF's capacity to manage and control PSAs accelerates this problem. For example, although the budget formulation in principle should be made on the basis of cost accounting of services that PSAs provide, PSAs tend to formulate their budget in an incremental manner, reflecting input factors such as manpower (Ministry of Finance, 2014b). If PSAs formulate the budget statement, they have to forecast the size of expenditure based on estimates of quantity and per unit cost of services they produce. Yet there are not many PSAs that use this budget formulation process. Rather, they formulate the budget of, for example, personnel expenses based on several percentage increase from last year's payroll. This practice is not much different from budget planning of other government organization.

The third problem, related to the second, is that while the budget of PSAs has increased over time, performance of PSAs has not been improved much. In particular, increasing expenditure of PSAs that is not parallel to performance becomes a problem. The primary reason is because PSAs can increase their budget when there are more inputs in the service production process. Causing inefficiency in budget spending, PSAs tend to amplify unnecessary and redundant inputs (Ministry of Finance, 2014b). A typical example is one national hospital whose operational costs increased three-fold after it transformed into a PSA. This increase happened be-

cause the hospital purchased very expensive medical equipment which could not be procured in non-PSA hospitals under strict government control over spending. The increase in expenditure of PSAs can be justified if it is necessary for PSAs to attain their goals. That is, if purchase of expensive medical equipment is to provide better quality of medical service, it cannot be blamed. However, the responsible line ministry, i.e., the Ministry of Health, and the MoF were not sure whether increasing operational costs helped the hospital provide better services to patients because of the ill-structured performance appraisal process in Indonesia.

### ISSUE 3: PERFORMANCE MANAGEMENT

The most important criteria to judge the success of PSA is performance improvement. This is in line with the *raison d'être* of PSAs. In other words, a PSA is expected to achieve the organizational goals in a most efficient and effective manner at the expense of a high degree of flexibility and autonomy in personnel and financial management. If a PSA is not able to meet this expectation and, thus, fails to improve performance, an agency problem arises. As the principal-agency theory explains, a moral hazard problem occurs if the MoF and line ministries are not able to supervise and monitor performance of PSAs.

The GoI started fairly comprehensive performance appraisal in 2012, indicating that performance of PSAs had not been systematically assessed during 2005-2011. Current performance appraisal is conducted by the MoF in collaboration with line ministries. They assess performance of PSAs in two aspects—financial aspect and technical (or services) aspect which account for 30 and 70, respectively, of a full score of 100. When the performance appraisal was first introduced in 2011, only the financial aspect of PSAs was assessed. This assessment scheme was changed to measure service-related aspects, which the MoF calls “services aspect,” in 2012. The current

scheme of performance appraisal has 8 grades such as AAA (the highest grade), AA, A, BBB, BB, B, CC, and C (the lowest grade). A PSA receives one of these 8 grades depending on the assessment scores of financial and services aspects. Table 2 shows this assessment scheme.

TABLE 2 PERFORMANCE ASSESSMENT SCHEME OF PSAS IN INDONESIA

2011				2012							
TOTAL SCORE (TS)		Grade		TOTAL SCORE (TS)		Grade					
Financial Aspect Score (Max = 100)				Financial Aspect Score (Max=30) + Services Aspect Score (Max=70)							
	TS	>	90	AAA		TS	>	95	AAA		
80	<	TS	≤	90	AA	80	<	TS	≤	95	AA
70	<	TS	≤	80	A	65	<	TS	≤	80	A
60	<	TS	≤	70	BBB	50	<	TS	≤	65	BBB
50	<	TS	≤	60	BB	40	<	TS	≤	50	BB
40	<	TS	≤	50	B	30	<	TS	≤	40	B
30	<	TS	≤	40	CCC	15	≤	TS	≤	30	CC
20	<	TS	≤	30	CC	Financial aspect score < 15		C			
	TS	≤	20	C							

Source: Internal document of the Ministry of Finance

The results of performance appraisal of PSAs in Table 3, overall performance of PSA improved from an average performance score of 64.65 in 2011 to 74.34 in 2012. Since the performance appraisal schemes of 2011 and 2012 are different each other as explained above, these two-year results cannot be compared equally. Nonetheless, there is a slight improvement in 2012 from 2011. For example, if the results of financial aspect were compared on a same standard, the 2011 result of 64.64 could be converted to 19.39 with applying a 30% weight as in a 2012 assessment. This result is lower than the 2012 result of financial aspect. When the average scores of 2011 and 2012 are judged in the performance assessment scheme in Table 2, the 2011 result falls into Grade BBB, whereas the 2012 result is classified into Grade A. When the 2012 result is compared across

the types of PSAs, health services PSAs show the best performance in both financial and services aspects. PSAs of education services and PSAs of zone and area management services received the lowest scores in financial aspect and services aspect, respectively. Finally, if the same weight is applied to financial and services instead of using a 30:70 weight scale, average scores of financial and services aspects are 72.1 and 75.28, respectively, on a 100-point scale indicating that PSAs managed service-related activities better than financial affairs.

TABLE 3 SUMMARY OF THE RESULTS OF 2011 AND 2012 PERFORMANCE APPRAISAL

Type of PSAs	Total Number of PSAs	2011	2012	Avg. of Services Aspect	Total Scores
		Avg. of Financial Aspect	Avg. of Financial Aspect		
Health Services					
General Hospital	13	70.20	22.09	56.37	78.47
Special Hospital	18	67.09	21.15	56.86	78.01
Clinic	4	54.40	22.48	57.1	79.58
Large Clinic of Health Laboratory	4	66	21.2	55.25	76.45
Police Hospital	10	73.6	25.67	52.50	78.17
Education Services					
Universities (Ministry of Education and Culture)	34	64.49	19.13	53.33	72.46
Universities (Ministry of Religious Affairs)	15	60.63	19.37	51.56	70.94
Others	22	60.94	21.04	54.14	75.18
Zone and Area Management Authority	4	59.07	19.25	42.88	62.12
Financing Management	7	66.31	23.87	48.57	72.44
Other Goods and Services Providers	11	68.40	22.72	51.18	73.90
<b>Grand Total</b>	<b>142</b>	<b>64.65</b>	<b>21.63</b>	<b>52.70</b>	<b>74.34</b>

Source: Author's calculation based on the internal data of the Ministry of Finance

In spite of this practice, performance appraisal in current form and practice has some problems.

First, performance appraisal is effective if it is linked to financial rewards and punishment. Put it differently, high performing PSAs should be rewarded with increasing budget allocation, whereas low performing PSAs should bear budget reduction as punishment. However, performance appraisal is not tightly linked to such financial implications in Indonesia. For example, the MoF does not use the results of performance appraisal in Table 1 to increase or decrease the budget of a PSA. Accordingly, PSAs do not have strong incentive or motivation to improve performance.<sup>10</sup>

Second, the structure of performance appraisal is neither complete nor comprehensive in Indonesia. In Korea, for example, performance of PSAs is assessed in several operational and managerial dimensions such as vision and strategy, operational efficiency, performance, and feedback. This appraisal framework is more comprehensive than that of Indonesia where performance appraisal is not well structured in terms of composition of criteria. Currently, the GoI engages in a performance contract with PSAs in which there are 10 key performance indicators (KPIs). For example, the medical service PSAs set up KPIs including a mortality rate in emergency installation, a net death ratio, a maternity mortality rate, infection of operating area, operating revenues to operating expenditure ratio, and patient satisfaction.<sup>11</sup> This composition of KPIs can be classified into the quality of service, financial management, and clients' satisfaction. Nonetheless, these KPIs do not represent all the dimensions of operation and management of medical service PSAs. This problem is even more serious in education service PSAs. Although the Ministry of Education conducts the first stage of performance appraisal, it does not assess the quality of education service, only assessing part of financial aspect.<sup>12</sup>

Third, the GoI with an incomplete performance appraisal sys-



tem does not possess sufficient manpower and capacity to monitor and evaluate performance of PSAs. The Directorate of BLU in the MoF and line ministries are ultimate entities responsible for conducting performance appraisal. As of 2014, 70 staff at the Directorate of BLU is not enough to monitor and evaluate more than 130 PSAs. Moreover, they are not specialized in conducting performance appraisal, lacking necessary capacity.<sup>13</sup> Being aware of these problems, the GoI revised the performance appraisal system in June, 2014.

## **CONCLUSION AND IMPLICATIONS**

Since adopting the PSA system, the GoI has allowed PSAs with a wide range of flexibility and autonomy in managing personnel and financial affairs, while the accountability mechanism is weak because the performance management system has not been placed strongly in Indonesia. Under these circumstances, there are more government agencies which want to transform into a PSA in Indonesia owing to a greater managerial flexibility with low accountability.

The PSA system, if properly operated, is beneficial to improve the efficiency and productivity of public service providers. For this, the most important operational principle of PSA is the balance of flexibility and autonomy on the one hand, and accountability and performance on the other. Judging from this principle, Indonesia has not implemented the PSA system successfully. In other words, whereas the PSA system is one of practices of the NPM, it is mismanaged in Indonesia.

As highlighted throughout this paper, a critical factor that makes the PSA system successful is performance appraisal based on good governance. If a government is not able to build good governance and implement performance appraisal, the PSA system may tend to cause more administrative and financial costs than gains. This hap-

pens in Indonesia. In particular, mismanagement of financial resources by PSAs matters in Indonesia.

Examining the current conditions surrounding the PSA system of Indonesia, this paper provides the GoI with several recommendations in three aspects.

First, the PSA governance needs to be grounded on a solid legal base rather than current regulations. Moreover, more diverse stakeholders and outside experts have to participate in the PSA governance decision-making.

Second, flexibility and autonomy of PSA's financial management should be monitored and controlled. A PSA needs to place an effective internal monitoring mechanism. At the same time, an external monitoring mechanism led by an oversight entity in the PSA governance must be installed.

Third, current performance appraisal should be redesigned. Performance criteria need to be expanded to measure the inputs, throughputs, outputs, and outcomes. In addition, the performance appraisal process should be reframed so that the MoF can conduct a meta-assessment. The results of performance appraisal should be utilized to provide useful feedbacks for a PSA. In a feedback process, rewards and punishment should be applied.

## IMPLICATIONS

Although PSAs are intended to improve the quality of public service, they do not render positive results at all time. To expect PSAs to achieve the objectives, there must be enabling environments within which PSAs are operated. Among others, essential is good governance structure which suggests clear principles and guidelines in the entire processes of managing and operating PSAs. If a government introduces PSAs without good PSA governance structure, PSAs are more likely to cause inefficiencies. Therefore, PSAs cannot be adopted as an unconditional alternative to a traditional pub-

lic service delivery mechanism. This is particularly true to developing countries where good governance in the public sector is not commonly found.

Indonesia has more than 10 years of history of PSAs. During that time period, the number of PSAs has increased sharply. There are more agencies that desire to gain a PSA status in Indonesia. However, the GoI needs to slow down the approval process because the PSA governance and other prerequisites are not properly placed. What is urgent in Indonesia is not more PSAs, but better structure and system to govern PSAs properly. In this regard, this chapter suggests the policy recommendations with respect to the PSA governance structure and the managerial schemes.

When governance of PSA implies the structure with which the national PSA system can be better managed and operated, good governance is important for PSAs to achieve the goals and to provide better service to citizens. PSAs of Indonesia have not served for those purposes because they are operated on weak governance at a national level. Concerning the PSA governance structure, two recommendations can be made.

**Recommendation 1: Form a national-level PSA committee in which diverse stakeholders and outside experts participate.**

Although each country in operating PSAs has its own governance structure, a committee structure usually takes the top position in PSA governance. In forming a committee dedicated to PSA governance, diverse stakeholders and experts are appointed as a committee member. By contrast, the GoI runs PSAs primarily relying on the Directorate of BLU in the MoF. Considering the practices of other countries, the GoI needs to expand the boundary of governance beyond the Directorate of BLU. For example, establishing a so-called PSA committee is a possible option. A PSA committee, if established, can be located in the MoF as a ministry in charge of the

national PSA system. What is important is the composition of committee members and the function of committee. It can be recommended that (vice) ministers of line ministry of PSA together with outside experts participate in a PSA committee as a member. In addition, a PSA committee should be given relevant authority with which it can oversee and manage efficiency and accountability of PSAs.

**Recommendation 2: Rebuild the PSA governance on a firm and clear legal base.**

PSAs should be operated on a solid legal base. The current legal base of PSA is a government regulation (Peraturan Pemerintah) which has a lower legal status than a law (Undang-undang). Because a government regulation is relatively easier to be replaced with or changed to a new one, the current regulation on PSA cannot ensure the stability of PSA system in Indonesia. In this regard, the GoI needs to consider enactment of so-called PSA law to make PSA governance more predictable and stable. If the GoI wishes to make a PSA legislation, a new law should include a sound PSA governance structure which provides clear roles and responsibilities of key stakeholders including the MoF, line ministries, and PSAs.

The GoI does not exercise the financial controls over PSAs even if there is serious financial mismanagement. Although the PSA system intends to allow a PSA financial autonomy, it does not necessarily mean that the government should not engage financial management of PSA at all cases. A PSA, albeit separated and different from the traditional government, is still part of government, dealing with administrative affairs for a line ministry. Therefore, financial autonomy for PSA, if a PSA misuses budget in the absence of financial control, may impose burdens to the government as well as citizens. In this respect, the following recommendation can be made.

**Recommendation 3: Monitor and evaluate the PSA's financial flexibility and autonomy through vigilant internal and external monitoring mechanisms.**

Financial autonomy of PSA should be grounded on financial accountability that must be held by a PSA. In this aspect, the GoI has to rebuild the internal controlling mechanism through which each PSA can audit and monitor the soundness of its financial management internally. At the same time, internal control should be aligned with external control. In other words, because there is a possibility of malfunctioning of internal controlling mechanism, the GoI needs to utilize external controlling mechanisms led by either the MoF or other governmental audit agency.

The most important reason to introduce PSAs is to improve performance of government organizations that deliver public services to citizens. Higher levels of autonomy and privileges that PSAs enjoy in managing and operating their organization can be justified only if performance improvement is warranted. However, the 10-year practice of PSA system has not yielded such expected outcomes in Indonesia partly because performance appraisal has not been placed well. Concerning performance management of PSA, three recommendations can be made.

**Recommendation 4: Redesign performance appraisal to set up right appraisal structure and performance criteria.**

The performance management system for PSAs needs to be re-structured and fine-tuned in Indonesia. This is because the current performance appraisal system is not designed to evaluate the key aspects pertinent to performance of PSA. In this regard, the GoI should consider redesigning the performance appraisal system from the current partial result-oriented evaluation to an all-inclusive one. For example, performance appraisal that measures partial outputs of PSA does not reflect crucial goals of PSA. Moreover, when per-

formance appraisal is skewed towards results too much, it is uncertain whether results can be sustainable. In this sense, performance appraisal should be based on a balanced evaluation of an “input-throughput-output-outcome” cycle. On an input side, leadership of CEO, organizational vision and mission, and organizational culture should be included in performance appraisal. On a throughput side, the efficiency and effectiveness of financial and personnel management and strategic planning should be taken into account. On an output side, the immediate results of PSA’s activities should be evaluated. Finally, on an outcome side, the impacts of output need to be incorporated into performance appraisal.

**Recommendation 5: Adopt a systemic performance appraisal processes and utilize outside experts.**

Concerning performance management, another recommendation for the GoI is that the current performance appraisal process should be reframed. As described in a previous section, the evaluation of PSA is undertaken first by line ministries. The MoF accepts the results of performance appraisal by line ministries without critical review or a meta-evaluation. Although the current process apparently takes a two-step evaluation process, it does not allow the MoF to detect the shortcomings in the evaluation process by a line ministry. Therefore, it is hard to provide PSAs with positive feedbacks from current performance appraisal. In this regard, the GoI has to restructure the evaluation process, sticking to the principles of performance appraisal. For this, the GoI needs to actively utilize outside experts in PSAs and performance appraisal because there is an inadequacy of current manpower and competency of those in the MoF and line ministries who are responsible for PSA affairs.

**Recommendation 6: Link the results of performance appraisal to relevant rewards and punishment.**

The final recommendation is that the GoI has to align the results of performance appraisal to relevant rewards and punishment. If a PSA is not rewarded or punished, it lessens the motivation to improve managerial efficiency and enhance performance. To expect the functional linkage of performance appraisal with motivation for efficiency and accountability, the GoI may consider adopting a relative evaluation scheme for performance appraisal. A relative evaluation scheme means that the distribution of PSA's performance results is fixed in each performance category. For example, no more than 20 percent of PSAs cannot be evaluated in the first place category. Likewise, more than 30 percent of PSAs should be allocated to the lowest place category. This recommendation of compulsory distribution is because the culture of performance appraisal is not embedded in the public sector in Indonesia. In the absence of culture of performance, if performance appraisal is conducted within a framework of absolute evaluation scheme, it is probable that performance appraisal can be generous, which prevents PSAs from being efficient and productive competitively.

**ENDNOTES**

- <sup>1</sup> Interview with a MoF official on August 19, 2014.
- <sup>2</sup> Regulation 23/2005 was replaced by Regulation 74/2012 to reflect the PSA-related regulation of the Ministry of Health. Interview with a MoF official on October, 23, 2014.
- <sup>3</sup> Interview with a MoF official on August 19, 2014.
- <sup>4</sup> Interview with a MoF official on August 19, 2014.
- <sup>5</sup> Interview with a MoF official on August 19, 2014.
- <sup>6</sup> For example, medical service PSAs are subject to the ceiling of personnel expenditure which cannot exceed more than 40 percent of total expenditure. There is no such restriction to education service PSAs. Interviews with a medical service PSA staff on August 20, 2014 and a MoF official on October 23, 2014.
- <sup>7</sup> Interviews with a MoF official on October 23, 2014.
- <sup>8</sup> Interview with a MoF official on October 23, 2014.

- <sup>9</sup> For example, one medical service PSA pay 70 percent of employees' salaries from self-generating revenues and 30 percent from the government budget. Interview with a medical service PSA staff on August 20, 2014
- <sup>10</sup> Interview with a MoF official on August 19, 2014.
- <sup>11</sup> Interview with a medical service PSA staff on August 19, 2014.
- <sup>12</sup> Interview with an education service PSA staff on August 19, 2014.
- <sup>13</sup> Interviews with a MoF official and a medical service PSA staff on August 19, 2014.

## REFERENCES

- Armstrong, J. (2001). "Executive Agencies and Good Governance," May 7, Discussion Paper, Governance Network.
- Damhuri, T. (2011). "The Performance of Newly Autonomous State Agencies in Indonesia: A Case Study on 12 Central Government Hospitals," MA Thesis of the KDI School of Public Policy Management.
- Harun, H., Mir, M., Ali, M., and An, Y. (2014). "Public Sector Reform and Its Paradox Outcomes: The Case of Indonesia," mimeo.
- Laking, R. (2005). "Agencies: Their Benefits and Risks," *OECD Journal on Budgeting* 4(4): 7-25.
- Ministry of Finance, Government of Indonesia (2014a). Republic of Indonesia, "Public Service Agency (BLU) in Indonesia," mimeo.
- Ministry of Finance, Government of Indonesia (2014b). "An Analysis towards Agencification Policy in Indonesia: Financial Management System on Badan Layanan Umum (Public Service Agency) and the Constraints in Its Implementation," available at <http://www.ppkblu.depkeu.go.id/>.
- Prabowo, T. J. W., Leung, P., and Guthrie, J. (2013). "New Public Management in Indonesia (1999-2012): Confusion in Implementation," A proceeding for the Seventh Asia Pacific Interdisciplinary Research in Accounting Conference (APIRA).
- Rajiani, I. and Jumbri, I. A. (2011). "A Cultural Ecology of New Public Management in Indonesia," *Journal of Administrative Science* 8(1): 17-31.
- Schick, A. (1998). "Why Most Developing Countries Should Not Try New Zealand's Reforms," *World Bank Research Observer* 13(1): 123-131.
- Tjiptoherijanto, P. (2007). "Civil Service Reform in Indonesia," *International Public Management Review* 8(2): 31-43.
- U.K. Independent Commission on Good Governance in Public Services (2004). *The Good Governance Standard for Public Services*. London: Independent Commission on Good Governance in Public Services.