Case Study of Aid Fragmentation in Indonesia

IAFF 222: Development Policy and Practice

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[The author offers a brief overview of official development assistance to Indonesia 1960-2008 and offers an analysis of aid fragmentation based on the country-level aid fragmentation there based on country programmable assistance, portfolio size and Hirschman-Herfindahl Index for the same period.]
I. Introduction

In 1967, Indonesia was one of the poorest countries in the world. With a per capita income of $50, poverty consumed about 60% of the population. Moreover, high infant mortality, low life expectancy, high adult literacy rates and low primary and secondary enrollment rates compared worse than other low-income Asian countries at the time. Over the next three decades, from the position as one of Asia’s poorest nations, Indonesia has recorded rapid and sustained growth between the years of 1967 and 1997 at seven percent per year and closed the gap on social indicators as a result of intentional development policies that focused on health and education. Indonesia has also risen to the ranks of a middle-income country by World Bank standards (World Bank).

The role of foreign aid, foreign direct investment and other forms of capital transfer are major contributing factors in Indonesia’s successful development process. However, with foreign aid especially, closer examination of the effectiveness of these transfers is necessary before attributing causality for the role of aid in development. As the Millennium Development goals have created a newfound excitement for more aid to poor countries, scholars such as William Easterly have criticized the call for more aid by criticizing aid effectiveness (Easterly et al. 2003).

This paper will explore one aspect of the aid effectiveness picture in Indonesia: aid fragmentation. Using OECD DAC data for 1960-2008, I will explore the net disbursements of official development assistance (ODA) in terms of aid types, donor types as well as offer an analysis of the intensity of aid fragmentation by examining the following: country programmable aid, portfolio size and the Hirschman Herfindahl Index (HHI) of bilateral aid concentration in this period from the country-level dimension (i.e. Indonesia’s recipient-level fragmentation). Based on my analysis, I will provide recommendations for mitigate aid fragmentation in Indonesia based on current research on the topic. More broadly, findings from this paper should serve as policy guidance for improving aid harmonization and mitigating aid fragmentation in Indonesia from the perspective of Indonesia as a receiving country.
II. Literature Review

Aid fragmentation has been increasingly important given the Millenium Development Goals’ calls for increases in aid. However, as the delivery of aid becomes more fragmented—between many donor agencies each with their own country missions, reporting systems and schedules—more administrative demands are pressed against recipient governments in developing countries. The fear of recipient countries is that there will be less value of aid per dollar received.

Aid fragmentation can be viewed as concentration of aid in a certain sector or country. As the concentration of donors/donor projects increases, aid fragmentation decreases accordingly. For Kharas, a developing country receives aid from various donors that constitute a portfolio (Kharas 2008). Each asset in that portfolio (donor) pays a return that the recipient enjoys. The developing country decides how much money it requires and then decides how to finance it. Acharya et al. and Knack and Rahman assert that the administrative burden for the recipient is large (Archarya et al. 2006, Knack and Raman 2007). Because negotiating with each lender entails transaction costs (administrative resources, meetings, human capital), the country decides its sources of finance, taking these costs into account, the return of the assets, and their risks. From an investment point of view, portfolio expansion and de-concentration corresponds to a commitment to diversification. Finance investors diversify their portfolios in order to lower the overall risk they bear. Recipients follow a similar strategy. If an asset returns can dry out (a donor may choose unilaterally to stop a partnership), or at least decrease, the recipient should diversify its sources of income as a contingency strategy. However the finance investor perspective of fragmentation ignores the upfront costs that have to be paid in order to have access to these returns. These upfront costs are the main cause for the large administrative burden developing country governments with diversified portfolios face.
As mentioned, fragmentation can exist on the donor level as well as the recipient level. Existing literature expands fragmentation in aid effectiveness to three primary dimensions: donor, recipient and sector. Donor aid fragmentation refers to the division of labor of a given donor’s aid budget fragmented across different recipients (donor diversification). Recipient aid measures the degree to which a given country’s aid allocations are fragmented across many different donors (country-level diversification). Donor fragmentation is the source of the problems of aid fragmentation whereas recipient fragmentations are the symptoms of the problem. Sector-level fragmentation can be examined at either the donor level or at the country level. In principle, size and concentration of projects within a sector can be a function of donor characteristics, recipient characteristics, donor-recipient relations and the type of projects funded (Kilby 2010). Research has shown that when fragmentation cuts to the level of sectoral level, there are additional problems with donor coordination (Kilby 2010). The costs of fragmentation therefore are linked to the extent and depth of fragmentation; that is, whether it is merely donor- or country-level fragmentation or if it is also sector-level fragmentation (Kilby 2010).

Research also shows that aid fragmentation reduces aid effectiveness and reduces development impacts. Studies by Djankov et al. and Kimura et al. examine the link between fragmentation and the impact of aid on growth (Djankov and Kimura et al. 2009). Both use cross country growth regression and conclude that high levels of fragmentation reduces the development effectiveness of aid (Djankov and Kimura et al. 2009).

While the cost implications of aid fragmentation are increasingly known and reviled, it does not seem that this cost factor has played any role in limiting further fragmentation. There are many possible reasons donors fragment their aid. Prevailing answers come from geopolitics and domestic politics (Acharya et al. 2006, Frot and Santiso 2009). Donors, especially bilateral donors, usually use aid as a way to win favor with countries of geopolitical importance. Acharya et al. suggest that the “one country, one vote” system in the UN General Assembly makes it cheaper to buy direct influence in the form of small
amounts of aid to small countries, incentivizing small aid programs in a wide range of countries (Acharya et al. 2006). Froot suggests that ‘early aid partners’ such as former colonies continue to get a substantial share of donor’s funds while late aid partners receive a smaller share (Froot 2009). Domestic politics may direct foreign aid to certain darling causes and countries despite the relative need of other countries. As Knack and Rahman put it, “aid agencies additionally have the objective of maximizing aid budgets, which requires satisfying key domestic constituencies in parliament and among aid contractors and advocacy groups (Knack and Rahman 2007). This latter objective often requires making the results of aid programs visible, quantifiable, and directly attributable to the donor’s activities—even when doing so reduces the developmental impact of aid”. Seabright offers an explanation that views donor agencies as unrepresentative of the needs of recipient countries (Seabright 2002). For Seabright, in order to maximize their number of successes, they choose to diversify their portfolios but without taking into account the costs imposed on the recipients (Seabright 2002). Froot and Santiso have recently opened up new research that argues that donors treat the recipient’s scarce resources (budget, maintenance, skilled personnel) as a common pool and fail to internalize the social cost of establishing new partnerships, focusing instead on their private benefits (Frot and Santiso 2008). Kilby offers a yet unexplored reason that is consistent with the public choice: the pursuit of bureaucratic and personal interests (Kilby 2010). Donor agencies and their staff may benefit in terms of budget, status and professional perks from having a more global portfolio of projects (Kilby 2010).

As aid fragmentation is largely an international problem that requires an international solution, it has become necessary for donors and recipients to come to an internationally recognized agreement for mitigating aid fragmentation and for improving aid harmonization on all levels. Political will for achieving better aid effectiveness has started with the commitments made in the Paris Declaration on Aid Effectiveness (2005) and the Accra Agenda for Action (2008). These two documents are organized
around principles of aid ownership, alignment, harmonization, managing for results and mutual accountability. Follows are the Paris and Accra commitments pertaining to aid fragmentation:

Paris Declaration
Complimentarity: more effective division of labor
33. Excessive fragmentation of aid at global, country or sector level impairs aid effectiveness. A pragmatic approach to the division of labor and burden sharing increases complimentarity and can reduce transaction costs.
34. Partner countries commit to:
   Provide clear views on donors’ comparative advantage and on how to achieve donor complimentarity at country or sector level.
35. Donors commit to:
   - Make full use of their respective comparative advantage at sector or country level by delegating, where appropriate, authority to lead donors for the execution of programs, activities and tasks.
   - Work together to harmonize separate procedures.
Target for 2010: 66% of aid flows are provided in the context of program-based approaches; 40% of donor missions to the field are joint; 66% of country analytic work is joint.

Accra Agenda for Action
We will reduce costly fragmentation of aid
17. The effectiveness of aid is reduced when there are too many duplicating initiatives, especially at country and sector levels. We will reduce the fragmentation of aid by improving the complimentarity of donors’ efforts and the division of labor among donors, including through improved allocation of resources within sectors, within countries, and across the countries. To this end:
   a) Developing countries will lead in determining the optimal roles of donors in supporting their development efforts at national, regional and sectoral levels. Donors will respect developing countries’ priorities, ensuring that new arrangements on the division of labor will not result in individual developing countries receiving less aid.
   b) Donors and developing countries will work together with the Working Party on Aid Effectiveness to complete good practice principles on country-led division of labor. To that end, they will elaborate plans to ensure that maximum co-ordination of development co-operation. We will evaluate progress in implementation starting in 2009.
   c) We will start dialogue on international division of labor across countries by 2009.
   d) We will work to address the issue of countries that receive insufficient aid.

Methodology
Both the Paris and Accra commitments offer twelve indicators to measure progress against aid effectiveness commitments. The underlying assumption of these indicators is that the analysis of donor allocations needs to be based on actual cooperation between individual development agencies and the recipient country, “one relationship at a time”. One of these indicators, as it relates to aid fragmentation, is the extent of country programmable aid (CPA). Compared to ODA, CPA better captures better the amount of aid which is relevant for the aid effectiveness agenda in terms of ownership of aid. CPA
avoids aid fragmentation largely because the purpose of this aid is programmed by the recipient rather than the donor. The country is able to make a direct transfer into their national budgets to support their identified development plan and avoid the administrative costs that would have accompanied managing a large number of donors and the individual projects, standards and schedules of each donor. CPA is derived from gross ODA, by subtracting aid that:

- is unpredictable by nature (humanitarian aid and debt relief);

- entails no cross-border flows (administrative costs, imputed student costs, promotion of development awareness, and research and refugees in donor countries);

- does not form part of co-operation agreements between governments (food aid and aid from local governments); and

- is not country programmable by the donor (e.g. core funding of NGOs).

- CPA aid is measured in disbursement terms, i.e. the actual transfer of resources, rather than commitments which reflect an agreement between a donor and a recipient country to make transfers (over a number of years).

Other commonly used measures of country-level aid fragmentation are portfolio size (the number of donors or projects present at a given time) and the HHI index - a measure of market concentration taken from the industrial organization literature to measure a recipient’s donor flows from all its donors (Easterly and Pfutze, 2006). The formula used in this paper for HHI of aid concentration is

\[ H = \sum_{i=1}^{N} s_i^2 \]

where \( s_i \) is the share of country \( i \) in the total ODA, and \( N \) is the number of bilateral donors. Data is extracted from the OECD-DAC database.

Alternative definitions of aid fragmentation are the Theil Index (Archarya et al. 2006). Stenson and Ericsson of OECD investigated the fragmentation of aid using CPA data for 2005-2006 and measure...
aid fragmentation as when a large number of donors represent 10 per cent of the aid allocated to a recipient (OECD 2008). This latter definition considers that fragmentation is severe when a recipient deals with many recipients for small aid quantities. Some donors are considered significant in terms of their share of a recipient country’s total aid receipts while others are insignificant (OECD 2008).

This paper will offer measures of fragmentation in terms of Indonesia’s shares of CPA, bilateral assistance portfolio size and HHI of bilateral aid concentration to give a sense of the aid fragmentation issues that have faced Indonesia between 1960 and 2008.

There are limitations to this research as they relate to describing the full picture of the country-level aid fragmentation of Indonesia. The figures used to calculate the HHI Index were ODA for DAC bilateral countries only. Country programmable aid (CPA) figures were only available on the aggregate level and therefore showed no breakdown by individual bilateral donor. Moreover, the available data only provided a breakdown of donor allocations from bilateral donors. Therefore my HHI analysis of fragmentation excludes the effect of fragmentation from individual multilateral agencies and also does not analyze the extent that fragmentation exists on the project or sector level. The author recommends further research using a database that provides breakdown by multilateral agency as well as the PLAID1.9.1 data which donor flows by project from 22 bilateral donors, 1973-2008. Last, aid fragmentation is primarily donor-driven. While this paper does not purport to perform an analysis of donor-level fragmentation, it would be useful to complete an analysis all donor-level fragmentation that contributes to Indonesia’s country-level aid fragmentation effects.

II. Brief Overview of the Official Development Assistance in Indonesia

Indonesia’s history and development assistance after Independence can be viewed in three parts: the years under President Sukarno (1948-1966), the years under President Suharto (1967-1994) and the post-Suharto era which is defined by democratic rule (1995-present). This paper will focus
mainly on the Suharto period and the democratic ruler period, due to limitations in OECD DAC data
which is available for 1960-2008 and in some cases only 2002-2008.

**Indonesia - total net disbursed ODA (USD, millions, 1960-2008)**

![Graph showing total net disbursed ODA (USD, millions, 1960-2008)](image)

Source: OECD DAC

**Historical Context of Development Aid Flows to Indonesia**

**1960-1966**

The situation in 1960 when OECD first started collecting ODA information for Indonesia was not
conducive to national development as well as receiving development assistance through the creation
official development partnerships with multilateral and bilateral institutions. The national philosophy of
Pancasila (the five principles) became the center of the country’s philosophy which included
development policy. Starting in 1964, politics formed into two major groups—the communists and the
anti-communists (Ricklefs 2000: 334). In terms of economic progress, the economy grew quickly after
Independence, gradually lost momentum, declined in the final years under Sukarno. In 1966 inflation
rose about five times and the exchange rate for the increased by ten times (Ricklefs 2001: 338). Military
unrest and a series of riots caused General Suharto to rise to full authority to restore order and security
and to protect President Sukarno after President Sukarno—who was still in power—handed over power
in what is called the Supersemar letter (Ricklefs 2001: 346). Given the situation the new state had to
deal with in its early years, there was little opportunity for the state to develop a functional
administrative system. Much of it operated under the Dutch system until Suharto took power in what is known as the New Order era (1967-1998)

**1967-1998**

In July 1966, after Sukarno had forced the IMF out on grounds of the lender’s contradiction with Indonesia’s national values based in communist and self-reliance, Suharto asked the IMF to return to Indonesia and help the country with its financial problems. With the assistance of an elite team of ‘technocrats’ Suharto’s government made great strides in the economic recovery of Indonesia. More efforts were made to court the international community back to Indonesia in a conference in Tokyo in September 1966. There Indonesian officials met with Western trade leaders, and the IMF granted Indonesia an eighteen-month moratorium on the payments of its debts. In return, the government guaranteed that there would be no future nationalization of property and that companies could send their profits abroad. During this time, Suharto also attracted the likes of the World Bank, Chinese businessmen and other large bilateral donors such as Japan, the United States and Australia (Ricklefs 2001: 345).

Confidence of donors of the recipient country’s aid mechanism is an important contributing factor and can explain to a certain extent the general increase in ODA over time. During the New Economic Order era under Suharto’s rule (1967-1997), Indonesia was governed by bureaucratic and military elite in what was largely a centralized system. This elite is organized around strong presidential leadership and a corporatist strategy to ensure that policymaking lies outside of populist sentiments. Under Suharto an insulated team of ‘technocrats’ guided development policy. In this time, accounting systems and administrative procedures that helped to create the infrastructure for administrating large amounts of aid allocations to be absorbed in development programs were developed. It is interesting that remnants of the centralized structure exist today and only recently has the Indonesian government made a move to decentralize government, as well as decisions and administration of development
programs. Following their success under the Suharto regime, these technocrats have retained the confidence of the political leadership and continue to exert considerable influence. Moreover, between 1967 and 1992, and again between 2003 and 2007, there was an effective aid mechanism, which at least theoretically lessens the duplication of donor efforts. All aid Indonesia was disbursed through a consortium of bilateral and multilateral donors called the Intergovernmental Group on Indonesia (IGGA) or the Consultative Group on Indonesia (CGI). Originally a Dutch foreign assistance mechanism for the Dutch colony, the name-changing body evolved to become the main mechanism for aligning aid from donors with national budget priorities. In addition to the Western-educated ‘technocrats’, the New order government welcomed technical assistance from external development actors when designing its national development strategy.

Macroeconomic stability and economic growth also attracts aid. Between 1967 and until the Asian fiscal crisis in 1997 the economy saw sustained growth, aided in part by the oil boom of the 1970s and export-led growth in the 1990s.

Being able to align national priorities with donor agendas is often a contingency for a country to develop continuing development partnerships with bilateral and multilateral donors. These often take the form of the World Bank’s Country Partnership Strategy (World Bank). These documents are useful because they are written to align with the country’s own development plans. Thus the existence of development plans is crucial for receiving ODA. Under Suharto, the State Policy Guidelines (GBHN), the 25-Year Long-Term Development Plan (PJP) and the Five-Year Development Plan (REPELITA) were formulated as national development plans. The Five-Year Development Plan was set up based on the PJP and its yearly budgeting has been put into effect in accordance with the REPELITA. For example, in the 6th Five-Year Development Plan (REPELITA VI, 1994-1999), the Government of Indonesia advocated the "fairness and alleviation of poverty" as its central targets as well as "qualitative improvement of human resources" and "economic growth and economic structural adjustment," and declared that it
would tackle with the measures against poverty on a full-scale basis as a national project. At the time when Suharto stepped down, the economy was a disaster with inflation reaching 80%. Much ethnic violence ravaged Sulawesi and Aceh until 2005.

**1999-2008**

Since 1999, there has been significant reduction in Indonesia’s financial expenditure due to the Asian economic crisis. Aside from the compounding economic effects of capital outflow due to tighter global liquidity conditions, Indonesia has been feeling the effects principally through pressure on the value of the rupiah, a weakening stock market, and falling commodity prices (World Bank). It is also tackling a large debt repayment to ODA donors. In 2006 its debt to GDP still stood very high at 40.6% (World Bank). Moreover its expenditure on debt servicing has fallen in recent years but exceeded 38% at the peak of 1999, as a result of the economic crisis. If one compares the government debt to GDP ratios, one can see that Indonesia accrued much debt in 1999 when the crisis was worst, and as a result, is still paying off that debt in large amounts in the years following the disastrous event.

![Graph of Government Debt to GDP ratio, %](image)

Source: World Bank Staff

**Debt Expenditure as % of Total Expenditure**

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As one can see from the last chart, bilateral debt makes up a whopping 19% of debt, and behind domestic debt presents the largest share of external debt. What more debt plus less expenditure meant for Indonesia prior plans for development was that most of the development projects formulated in the REPELITA VI (1994-1999) were halted or considerably corrected except for several projects supported by donors, and more urgent economic reconstruction measures were launched. This may explain the plateauing effect of total ODA amounts in the late 1990s. Much of the government expenditure was directed to the reform of the financial sector implemented under the initiative of the IMF. During this time, poverty increased considerably and the REPELITA projects were abandoned for the

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2 World Bank Staff, “Indonesia’s Debt and World Bank Assistance”, World Bank
implementation of the Social Safety Net (SSN) Program intended to alleviate the socioeconomic impact on those hurt most by the crisis.

In January 2000, the National Development Plan (PROPENAS, 2000-2004) was formulated after the REPELITA. In contrast to the REPELITA, which is a largely centralized government approach because it plans by sector, the PROPENAS is a problem-solving type approach where specific development programs have been established in nine areas to solve problems with five cross-cutting issues (such as the building of a democratic political system and the maintenance of national unity).

Under the Megawati administration, Indonesia has moved towards greater democracy and decentralization with positive changes such as a direct vote for the president and the Kecamatan decentralized governance model (World Bank). Reform alone may account for the increase in the number of donors or increase in allocations by donors who tend to give aid in the form of policy-oriented aid such as U.K. Program-oriented aid may increase as overall democracy and governance improves, as we see from the increases in the 1999-2008 from traditionally program-oriented donors such as the United States, Germany and Switzerland (Aminajanov et al. 2009).

At the end of 2006, public expenditure (and thusly, development-related expenditure) is reaching pre-crisis levels. However, the economic crisis that started to hit Indonesia in late 2008 may suggest that these gains are not as significant today. In 2009, about half of the populations borders on the poverty line of $2 per day and work in agriculture or the informal sector (World Bank). Export growth and foreign direct investment are slowing. As a result, job losses and the ensuing need to create jobs are expected. While poverty rates have returned to pre-tsunami levels, it is again rising because the current global economic crisis is pulling more families into poverty. In a recent poll of Indonesians, only half of the adults in Indonesia preferred democracy over other forms of government, of which most were lower-income Indonesians³. In 2009 worsening economic conditions in Indonesia’s key export

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markets may lead to significant effects on the economy, such as large-scale job losses\(^4\). The government has developed a number of policy responses to that threat, including a package of fiscal stimulus\(^5\). What the increased need in public expenditures will do to aid flows (increase or decrease) is yet to be known. History would suggest, based on the years 1999 and 2004 when Indonesia was hit by first an economic crisis and then a disaster that killed over 250,000 people, that smaller DAC countries will step in to provide much need assistance. Earlier donors such as the IMF, Japan and the United States maintain previous levels of aid allocations. But Indonesia is forced between a rock and hard place because it continues to repay its debts even in times of hardship, resulting in lower shares of public expenditure to service development. In fact, Indonesia has disbursed no ODA from Japan 2005-2008 due to repayment requirements. Also, judging by what occurred in 1999 and 2004, one may expect to see non-traditional players, such as the non-DAC countries (mostly OPEC states, Brazil and China) to take on a new role as larger donors to Indonesia (Aminajanov et al. 2009).

**Bilateral DAC versus non-DAC, USD millions, Indonesia, 1960-2008**

<table>
<thead>
<tr>
<th></th>
<th>Bilateral DAC</th>
<th>Non-DAC</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>39579.57</td>
<td>418.72</td>
</tr>
</tbody>
</table>

Source: OECD DAC

**Share of Bilateral Aid, DAC versus Non-DAC, Indonesia, 1960-2008**

Source: OECD DAC

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Unlike most countries Indonesia also sees a large proportion of its ODA in the form of bilateral assistance as opposed to multilateral assistance from large donors that include World Bank, IMF, Asian Development Bank. 82% of all aid in the 1960-2008 period came from bilateral donors, 125 from multilaterals and only 2% from NGOs.

**Total aid by type, USD millions, Indonesia, 1960-2008**

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<thead>
<tr>
<th></th>
<th>USD millions</th>
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<tbody>
<tr>
<td>Multilateral Agencies Total</td>
<td>5564.07</td>
</tr>
<tr>
<td>Bilateral (Non-DAC and DAC)</td>
<td>39998.29</td>
</tr>
<tr>
<td>Private NGO</td>
<td>948.44</td>
</tr>
</tbody>
</table>

Source: OECD DAC

Beginning in 2005, multilateral and NGO assistance have taken on a larger share of all development assistance in Indonesia. This trend is similar to the role of non-DAC countries, as mentioned earlier and may be due to unpredictable events of need such as the 2004 tsunami crisis. As we can see from the chart below, the share of food and humanitarian assistance as a proportion of overall ODA increased beginning in 2004 (see charts below). We also see some of this effect of a larger share of unpredictable food and humanitarian aid in the economic crises of the late 1990s.

**Share of ODA by Type, Indonesia, 1960-2008**

Source: OECD DAC

**Share of technical assistance, humanitarian aid and food assistance 1960-2008**

Source: OECD DAC
Historically, 86% of all Indonesia’s bilateral assistance has been concentrated in the top ten donors. 96% is historically concentrated in the top five donors. Before 1999 Indonesia saw much sustained economic growth and engagement with the international donor community for Indonesia. Especially during the Cold War era, bilateral aid was used as a means to win favor on both political fronts. Moreover, in recent years the ‘wave of democracy’ that has overtaken Indonesia has attracted non-traditional forms of assistance from new donors and in new forms of aid, such as democracy and governance projects. Japan, a regional superpower and a former colonizer of Indonesia, is Indonesia’s largest bilateral donor with 53% of all development aid 1960-2008. The United States is the second largest historical donor with about 10% of all historical bilateral assistance to Indonesia (see figure below for average donor share of all DAC countries below). As recently as 2004, Japan’s bilateral assistance to Indonesia made up 79% of all bilateral assistance and in 2000-2008 made up 40% of all bilateral assistance to Indonesia. Japan’s strong ties to Indonesia and the region may explain its large share compared to the average trend found in all recipient countries (see figure below).

**Top ten bilateral donors, USD millions, Indonesia 1960-2008**

<table>
<thead>
<tr>
<th>Country</th>
<th>Amount</th>
</tr>
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<tbody>
<tr>
<td>Japan</td>
<td>37344.28</td>
</tr>
<tr>
<td>United States</td>
<td>7108.15</td>
</tr>
<tr>
<td>Australia</td>
<td>4807.44</td>
</tr>
<tr>
<td>Germany</td>
<td>5451.13</td>
</tr>
<tr>
<td>Netherlands</td>
<td>4377.54</td>
</tr>
<tr>
<td>France</td>
<td>3304.06</td>
</tr>
</tbody>
</table>

Source: OECD DAC
United Kingdom 1864.09
Canada 1839.71
Spain 766.49
Switzerland 573.01
Source: OECD DAC

Bilateral DAC Donor Average Share, Indonesia, 1960-2008

Source: OECD DAC

Bilateral donor average share, all DAC countries (1960-2006)

Source: OECD

Bilateral DAC Donor Share, Indonesia, 2000-2008

Source: OECD DAC
IV. Aid Fragmentation Analysis

Country Programmable Aid

Given access to more datasets, e.g. PLAID, one would be able to extract CPA net disbursements by country. As CPA is a more accurate measure of aid, one would ideally use CPA figures to calculate the HHI aid concentration of bilateral aid. I was, however, able to extract aggregate CPA from all net ODA disbursements. Below is a chart that illustrates the trend in CPA versus non-CPA allocations 1960-2008.

Indonesia - Shares of CPA and non-CPA ODA aid 1960-2008

![Chart showing CPA and non-CPA aid shares for Indonesia 1960-2008]

Source: OECD DAC

As one can see, CPA aid to Indonesia was the main form of foreign aid before 1966. This healthy share of fragmentation steadily decreased as non-CPA allocations steadily increased into the mid-1970s. The recent decrease in share of non-CPA suggests a new trend that is a positive move in more ownership over aid in Indonesia by the Indonesian government. However, it is still high compared to its early post-Independent history. This combined with Indonesia’s high HHI suggests that it should make efforts to urge future receipts of aid in the form of CPA, whenever possible.

Portfolio Size

A crude measurement of aid fragmentation is the number of technical cooperation (or bilateral country missions) that a recipient country receives. As one can see from the chart below, Indonesia has steadily increased the number of bilateral donors that it must cooperate with over the course of time.
The time trend is also steady and shows little sign of changing directions. Based on the measure of portfolio size alone, and excluding for the concentration and size of donors’ allocation, one could deduce that aid in Indonesia has seen an increase in fragmentation. From engaging only 13 donor countries in the 1969 decade to 26 donor countries it has come to engage twice that amount in 2008.

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<tr>
<td></td>
<td>5</td>
<td>13</td>
<td>16</td>
<td>19</td>
<td>22</td>
<td>26</td>
</tr>
</tbody>
</table>

**Number of bilateral donors (1969-2008)**

Indonesia’s aid portfolio situation is common. The increase in number of donors has more to do with increased engagement of all donors and their desire to support development to more countries as time passes. As a result developing countries receive aid from more countries. The following chart is the average increase in portfolio size (number of bilateral donors) of developing countries that receive ODA (1960-2006).
Aid fragmentation can be revealed using a measure of the concentration of donors’ shares of total ODA in a given time period. In this exercise, I computed the Hirschman-Herfindahl index (HHI) of market concentration of Indonesia’s bilateral ODA receipts from 26 bilateral donors, 1960-2008. The HHI is equal to the sum of squared donor shares of total ODA disbursed in each decade. A high index means that few donors represent a large share of aid disbursed in the country. The figure below shows the HHI for each decade starting in 1960.

<table>
<thead>
<tr>
<th>Decade</th>
<th>HHI Index</th>
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<tbody>
<tr>
<td>1960-1969</td>
<td>0.57</td>
</tr>
<tr>
<td>1970-1979</td>
<td>0.21</td>
</tr>
<tr>
<td>1980-1989</td>
<td>0.29</td>
</tr>
<tr>
<td>1990-1999</td>
<td>0.48</td>
</tr>
<tr>
<td>2000-2008</td>
<td>0.22</td>
</tr>
</tbody>
</table>

Regardless of whether or not Indonesia is receiving sufficient amounts of aid for its particular development agenda, the findings show that the nature of the aid is becoming increasingly fragmented.
Indonesia is receiving smaller amounts of aid from larger numbers of donors. In 2008, fragmentation is high at a low HHI of .21 (DAC OECD, author’s calculations). When one compares the most recent decade, 2000-2008, with an HHI of .22 to the 1990-1999 decade, when it reached an HHI of just over .48, one can see that fragmentation has increased. Moreover, some of the aid harmonization gains that were made in the 1990 decade were later lost. Some of this is contributed by the fact that Indonesia has had to pay off large amounts of debts to Japan in the past four years and has thus seen a small or even negative net ODA disbursement amount from its largest donor. The low HHI (i.e. high fragmentation) may also be caused by an increase in the number of new donors that consistently give in very small sums e.g. Poland and Italy.

V. Conclusion

At the end of 2008, while it is positive that Indonesia receives most of its aid in the form of country programmable aid, Indonesia’s portfolio size tells us that the country is receiving from more donors than it ever has in its history. The increasingly high fragmentation, as measured by HHI of bilateral aid concentration, also suggests that aid is fragmented across countries, mainly due to a large number of donors who give less than 10% of the total share of total ODA to Indonesia. At the same time, Indonesia is facing increased administrative burdens due to a slowdown in the economy and lasting effects from recent events that have increased its debt burden i.e. the economic crisis of the late 1990s and the 2004 Tsunami.

As this paper focuses on the country-level fragmentation that faces Indonesia, there are some recommendations that Indonesia can do to increase aid coordination and reduce the effect of aid fragmentation. Clearly, donor-level fragmentation that creates a situation of country-level should be reduced with greater division of labor. Aid fragmentation occurs mainly because bilateral donors decide unilaterally which country programs and which international organizations to assist and to what extent, and tend to do so outside of specific country contexts. Division of labor should apply both in terms of
which recipient countries and sectors/projects within those countries donors decide to assist. There are economies of scale that can be attained through rationalization of aid allocations, and some bilateral donors—for example—have already started to concentrate on fewer countries. However, Froot and Sanitiso suggest that there is not enough incentive in place for donors to adapt division of labor: “A simple game theoretical approach would prove the point. Assume there are two donors and two developing countries, and that the optimal allocation of resources implies having only one donor in each country. Donors may still end up in a socially non optimal equilibrium where both are present in each country, simply because none of them is willing to sever any partnership for fear of leaving all the benefits to the other donor” (Froot and Santiso 2008).

In the absence of being able to influence division of labor aspects, what can Indonesia do to lessen the costs of aid fragmentation on its government? As there is already international agreement that aid fragmentation must be reduced, Indonesia should be able to return to this agreement when it consults with its donors. Froot and Santiso offer one tool that can be used on the part of recipient countries: investing in monitoring and evaluation: “A systematic monitoring, on a yearly basis, both at donor and recipient levels, could also be also imagined and developed based on [measures of aid fragmentation]. It could help both donors and recipients to benchmark and monitor their respective performances and add an incentive to reduce aid fragmentation” (Froot and Santiso 2008).

Recipients themselves have taken more drastic measures against fragmentation. In 2003, India decided to progressively phase out aid from all but six large donors, arguing that the benefits were too small compared to the bureaucratic costs associated with small sums of money (Financial Times 2008). Another option that Tanzania has taken is introducing a “quiet time” that incentivizes a smaller amount of donors to allocate large amounts of country programmable aid (Roodman 2006). In 2003, Tanzania announced that from April to August of each year it would meet only the most urgent donor missions during these months (Roodman 2006).
Another solution often used by recipient countries is donor aid coordination forums. After Indonesia graduated from the IMF’s lending program in 2004, in early 2007 the Indonesian government decided to disband the Consultative Group on Indonesia, a donor forum of all the multilateral and bilateral donors for making decisions about aid coordination, preferring instead to focus on bilateral development assistance. This move can be viewed positively, as decreasing dependency on large lenders such as the IMF. At the same time, dealing with as many as 26 bilateral partners creates administrative burdensome. An assessment for creating a more effective aid coordination forum should be considered given Indonesia’s increasing aid fragmentation.

References


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