The Impact of Fiscal Decentralization on Regional Economic Development in Indonesia For the Periods 2005-2008

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ABSTRACT

The debate that surfaced among the economic practitioners relates to the positive contribution of fiscal decentralization in regional economic development that has been discussed extensively in the last decade. One of the reasons is that fiscal decentralization is believed as an effective tool to increase the efficiency of public expenditures. This study examines the impact of fiscal decentralization on regional economic indicators such as economic growth, unemployment, poverty and Human Development Index. The relationship between intergovernmental fiscal transfer policy and regional economic development in Indonesia is to be examined over periods 2005-2008. This paper is presented in a "quantitative descriptive" approach by using Data Display Cross-case Analysis. Quantitative analysis is using the statistic tools such as trend analysis that compare statistic trends from 33 provinces and summary descriptive statistic. The research found that, from the years 2005-2008 fiscal decentralization in Indonesia, is still difficult to conclude whether there is a direct impact of fiscal decentralization on regional economic indicators. One of the reasons is that, during the period, economic recovery is likely due to the national macroeconomic stability improvement. Along with the bigger on fiscal decentralization fund, there is also improvement on regional economic indicators. The reason is the increase on sub national government funding resources. The research also provides that on average, the national economic indicators always increasing, but not in all provinces. In some provinces, the regional economic indicators are worse. One of the possible causes of low economic growth in sub national government is because of intergovernmental fiscal transfer funds cannot be absorbed in their spending budget. This condition reflects inadequate budget management in sub national government both in the planning and budgeting processes. The research also recommends that in its implementation, the principles of efficiency, transparency and accountability in the management of Intergovernmental Fiscal Transfer should be developed, and then followed by policy improvement. Thus, an increase in the allocation of transfers from year to year will improve the equitable distribution of financial capability among central and sub national governments, as well as supporting regional development in order to alleviate poverty (pro-poor), to extend employment opportunities (pro-job creation), and to increase economic growth (pro-growth). Furthermore, the sub national governments should be strong in implementing the application of the principles of good governance in order to stipulate budgets on time, and on target that will have a significant impact on the regional economic development and public welfare.

Keywords: Fiscal decentralization, intergovernmental fiscal transfer, regional economic development, regional economic indicator, Indonesia.

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INTRODUCTION

1.1   The Research Problem

The intense discussion on the fiscal decentralization has been continued for long time among the economist and administrations of Indonesia. The main issue of their interest is the impact of fiscal decentralization on public welfare indicators such as economic growth, unemployment, poverty and Human Development Index. One of the reasons is that fiscal decentralization is believed as an effective tool for local autonomy of economic management and the efficiency of public expenditures.

Since 2001, Indonesia allocated almost a third of national revenues to sub national governments in implementing fiscal decentralization policy that is very crucial in Indonesia. Intergovernmental Fiscal Transfer is allocated from National Budget (APBN) to finance sub national governments need. The objectives of Intergovernmental Fiscal Policy are to reduce fiscal gap between central and sub national government (vertical fiscal imbalance) and among sub national governments (horizontal fiscal imbalance). Intergovernmental fiscal transfer, consist of Revenue Sharing (DBH) from taxes and natural resources, General Purpose Fund (DAU), Specific Purpose Fund (DAK), and Special Autonomy Fund and Adjustment Fund. The total amount of the Intergovernmental Fiscal Transfer is always increasing from year to year in implementation of fiscal decentralization.

Transfer Fund To Sub National Government 2001-2008
(Billion Rupiah)

	REALIZATION OF NATIONAL BUDGET							
	2001	2002	2003	2004	2005	2006	2007	2008
I. Balancing Fund	81,054.4	94,656.6	111,070.4	122,867.6	222,130.6	222,130.6	243,967.2	278,714.7
a. Revenue Sharing	20,007.7	24,884.1	31,369.5	36,700.3	49,692.3	64,900.3	62,942.0	78,420.2
b. General Purpose Fund	60,345.8	69,159.4	76,977.9	82,130.9	88,765.4	145,664.2	164,787.4	179,507.1
c. Specific Purpose Fund	700.9	613.1	2,723.0	4,036.4	4,763.6	11,566.1	16,237.8	20,787.3
II. Special Autonomi Fund and Adjustment Fund	0.0	3,547.5	9,243.9	6,855.3	7,242.6	4,049.4	9,296.0	13,718.8
a. Special Autonomi Fund	0.0	1,175.5	1,539.6	1,642.6	1,775.3	3,488.3	4,045.7	7,510.3
b. Adjustment Fund	0.0	2,372.5	7,704.3	5,212.7	5,467.3	561.1	5,250.3	6,208.5
TOTAL	81,054.4	98,204.1	120,314.3	129,722.9	229,373.2	226,180.0	253,263.2	292,433.5

Source : Ministry of Finance RI

In addition, the relation between fiscal decentralization and regional economic development, seem to be an important topic especially when author try to analysts it through fiscal decentralization policy in Indonesian. Indonesia consisted of 33 provinces that have diverse in cultures and socials. Those characteristics contribute to the diversity of economic condition in Indonesia. The condition was reflected by economic indicators (such as economic growth, unemployment, poverty and Human Development Index), which is very crucial topic to be research and especially to find out the impact of fiscal decentralization to regional economic development in Indonesia.

Finally, along with the increasing of Intergovernmental Fiscal Transfer from Central Government to Sub National Government, it is a need to be studied further whether such transfers have a positive impact on the regional economic development and improving public welfare. Author want to research, by evaluating the eight years of the fiscal decentralization in Indonesia, how effective of fiscal decentralization regulation to increase regional economic development and social welfare in Indonesia. Of course, the government transfer fund may not be able to resolve the all problems of disparities of regional economic position and

equalization of economics. This research, does not attempt to measure how far the effect of Intergovernmental transfer on the regional economy and the public welfare, but try to see the picture of the pattern of inter-regional tendencies on several variables: Intergovernmental Transfer Fund, economic growth, unemployment and poverty levels.

1.2   Research Questions

Based on fact and condition that have been mentioned above, the main question is how to evaluate the impact of fiscal decentralization to regional economic development? There is some another research question that could help to clarify the main question:

1) How does the implementation of Intergovernmental Fiscal Transfer to sub National Government during the fiscal decentralization era? What are problems in the implementation of fiscal decentralization policy in Indonesia?

2) Does the sub National Government run on the right track in implementing fiscal decentralization in Indonesia?

3) What is the relationship between intergovernmental Fiscal Transfer and regional economic growth, regional Percentage of Population below the Poverty Line, regional percentage of unemployment, and Regional Human Development Index?

1.3   Research Objectives

The main purposes of this paper are (i) to convey an understanding about the importance of fiscal decentralization policy in Indonesia in order to create

regional economic development; (ii) to know the impact of fiscal decentralization policy to the regional economy in Indonesia, in regard to the economic development objectives; (iii) to know the impact of Intergovernmental Fiscal Policy to regional economic development in Indonesia; (iv) to know whether sub National Government is run on the right track in implementing fiscal decentralization, and (v) to propose any recommendations on fiscal decentralization policies that might be appropriate in Indonesia.

1.4 Scope of the Research

On this research, author makes identification on how the implementation is performed, and problems on the implementation of intergovernmental Fiscal Transfer policy. Furthermore, author makes an analysis on the impact of intergovernmental fiscal transfer to regional economic growth by using several variables such as regional economic growth, percentage of unemployment and percentage of poverty in every province. Author makes analysis on this topic by using primary data and secondary data. Primary data of sub national government from 33 provinces in Indonesia is obtained from the summary of sub national Government Budget (APBD) that is collected by Directorate General of Fiscal balance, Ministry of Finance Republic of Indonesia.

Secondary data are collected from Directorate General of Fiscal Balance that provides all regional financial data that cover all regions in Indonesia and Indonesian Statistic Board (BPS) that provides data indicator of regional economic development, such as regional economic growth, percentage of unemployment and percentage of poverty in every province. Secondary data are quantitative data that

important to answer the research question about how the impact of intergovernmental fiscal transfer to regional economic development.

1.5 Significance of the Research

This research will give the readers: First, an understanding of effectiveness in implementation of fiscal decentralization policy that can support economic development and regional economic development in Indonesia. Second, an understanding that a better fiscal decentralization policy will have multiplier effects on regional economic development in Indonesia.

In addition, this research will give Directorate General of Fiscal Balance, Ministry of Finance RI, a comprehensive evaluation about fiscal decentralization policy and its effectiveness related to regional economic development in Indonesian. Finally, any recommendation from this research hopefully will help Directorate General of Fiscal Balance, Ministry of Finance RI, to decide the best way to reach its goals.

1.6 Structure of the Paper

Chapter 1 Introduction, provide a brief explanation to the background of the study and its overall content. It includes main issues in the research and justification why the author has selected the subject as an academic paper. More over, in this chapter also discuss the research questions as guidelines. The main objectives of the study are stated in this chapter in order to provide background information for the readers. This chapter also explains the significance of the research and Structure of the paper.

Chapter 2 Literature Review, discuss the theories and concepts used by the research as references, tools or models to explain the main issues in the next chapters such as the Theories of Fiscal Decentralization, Fiscal Decentralization and Economic Growth, Intergovernmental Transfer Fund and Theories of Regional Economic Development.

Chapter 3 Methodology and Research Design, this chapter explains the research's methodology, research paradigm, research approach, research focus, which is shown and described by figure and explanation, in order to give the logical framework of the research. In the end, this chapter also includes data collection and data analysis techniques and research design.

Chapter 4 Fiscal Decentralization in Indonesia, gives an overview and description of the Indonesian Fiscal decentralization policy in Indonesia. How is the implementation of Intergovernmental Fiscal Transfer to sub National Government including General Purpose Fund, Revenue Sharing Fund and Specific Purpose Fund during the fiscal decentralization era and problems in the fiscal decentralization policy implementation.

Chapter 5 International Comparative Policy on Fiscal Decentralization, gives the overview and comparative analysis of Fiscal decentralization in Japan, India, China and Vietnam.

Chapter 6 Analysis of the Impact of Fiscal decentralization to Regional Economic Development in Indonesia period 2005-2008, includes a detailed discussion and analysis of the impact of fiscal decentralization to regional economic development in Indonesia which implemented since 2001. This chapter will also analyze the impact of Intergovernmental Fiscal Transfer, General Purpose

Fund, Revenue Sharing Fund, and Specific Purpose Fund to Regional Economic Development.

Chapter 7 Conclusion and recommendation, provides a summary as conclusion of the main arguments taken in the research and also the recommendation for fiscal decentralization policy decisions.

CHAPTER 2

LITERATURE REVIEW

2.1   The Theories of Fiscal Decentralization

Fiscal decentralization is a process of budget distribution from the higher levels of government to lower levels of government to support the functions or duties of delegated administration. Fiscal decentralization is a logical consequence of the implemented policy of regional autonomy. The basic principles that must be considered is the money follow functions, transfer or delegation of authority means the government take the necessary budgetary consequences to exercise these powers. Fiscal balance is done through the mechanism of equalization funds, namely the division of revenue between levels of government in order to perform the functions of government within the framework of decentralization. Fiscal balance problem becomes a serious problem because many of the central government does not allow local governments to conduct public debt.

Implementation of fiscal decentralization and regional autonomy will lead sub National government an obligation to provide public services and improve the regional economy. Roy Bahl (2008) states that in general, the benefits and the weakness of fiscal decentralization can be specified as follows:

1. The Benefits of Fiscal Decentralization

a. An economic efficiency - the budget for public services could be more easily adapted to local preferences with the level of accountability and a high willingness to pay.

b. Opportunities to increase tax revenue from local taxes - the local government can levy taxes on the basis of consumption and assets that can not be withdrawn by the Central Government.

2. The weakness of fiscal decentralization

    a. Low central government control to the macro economy;

    b. The difficulty of implementing policies of economic stabilization;

    c. The difficulty of implementing policies of economic development with equity;

    d. The amount of costs to local government rather than a benefit.

So the success of fiscal decentralization is strongly influenced by the existence of a trade-off between the benefits and drawbacks. In implementing decentralization fiscal principles, Money Follow Function is one of the principles that must be considered and implemented (Bahl, 1999). That is any submission or devolution of government authority has consequences on the budget required to implement the authority. Granting local autonomy through fiscal decentralization contained three main missions (Barzelay, 1991):

    a. Create efficiency and effectiveness resource management areas;

    b. Improving the quality of public services and welfare of the community; and

    c. Empowering and creating space for the community to participate (participate) in the development process.

Fiscal decentralization will provide optimum benefits if followed by adequate financial capability by autonomous regions. Based on Law. 33 Years 2004 revenue sources that are used for funding local government in implementation of fiscal decentralization are Own Local Revenue (PAD), General Purpose Fund (DAU), Specific Purpose Fund (DAK), Revenue Sharing, Sub National Government Loans, and

other legitimate revenue.

Fiscal decentralization is needed for improvement of economic efficiency, cost efficiency, improving accountability and increasing mobilization of funds. Fiscal decentralization is can not be only adopted, but in should be adapted with historical and cultural background, institutional conditions, political and economies inherent in the country. Also, implementation on each sub national governments is encouraged to be more independent in managing fiscal policy. Fiscal policy could be made through the allocation of funding resources on programs and activities that are oriented to the needs of society, so hopefully it can encourage job creation and reducing poverty.

2.2 Fiscal Decentralization and Economic Growth

Many researches on fiscal decentralization policy have been conducted in Indonesia and other countries in the world. In Indonesia, researches try to examine the high dependence of local government to central government. World Bank (1994), reported that the Indonesian financial system is the most centralized countries compare to China, Korea, India, Brazil, Argentina and Colombia. The ratio of local government revenue to expenditure is only 30%. This number show that the level of financial independence in local government is only 30% compare to other countries between 48%-76%. This reflects of high vertical fiscal imbalance.

Lewis (2001), conducted a study on the General Purpose Fund model and its impact on equality. Study was done to analyst the impact of equality on (1) variation between local government on potential revenue relative to expenditure before and after General Purpose Grant, and (2) the impact on increasing fiscal expenditure per capita. The first results show that variation is getting smaller, or there is increasing in

equalization on the impact of General Purpose Fund. While the latter shows the opposite, increasing in fiscal per capita needs, as expected, followed by the increasing in transfer per capita. This means that allocation will increase inequality.

Nowadays, research on the role of decentralization fund to economic growth has become an important policy issue in developing countries and transitional countries. Research of Aschauer (1989) and Barro (1990) quoted from Martines and Mc Nab (2001), find that increase in the part of central government consumption on GDP has a negative correlation with growth in income per capita. This McNab finding (2001) is in line with the study of Ram (1986), that there is a positive correlation between central government consumption on GDP with growth in income per capita. Meanwhile, Devarajan, Swaroop, and Zou (1996) study the impact of the composition of public expenditure on economic growth and found that increasing of central government expenditure has a positive significant to economic growth, but the capital component of public spending has a negative correlation in the growth per capita. Developing countries may allocate too many resources in capital investment on their expenditure.

Research by Aschauer (1989), Easterly and Rebelo (1993) found that spending on public infrastructure have been proven has significant positive correlation on economic growth, whereas Gupta, Honjo and Verhoeven (1997), which examines the efficiency of government spending in education and health in 38 African countries, found that on average, countries in Africa are less efficient compare to the countries in Asia and the Western Hemisphere. Inefficiency might be the result of relatively high salary of civil servant and intra-sector allocation of Government resources.

The research by Lin and Liu (2000), find that fiscal decentralization has a positive and significant impact on the economy growth in China. However in contrast

with the general findings that fiscal decentralization associated with lower growth for China case by Zhang and Zou (1998), in the U.S. by Davoodi, Xie, and Zou (1995), and for the entire sample of developing countries and developed countries by Davoodi and Zou (1998). Furthermore, Tai Sung Kim (1997) conducted a research in Korea to examine the role of local governments on economic growth. The results of research indicate that the role of local government in the regional economic growth is very real.

Further research by Davoodi and Zou (1998), Philips and Woller (1997), found that there is a negative impact of fiscal decentralization on economic growth for cases in the developing countries, whereas in developed countries shows positive impact. Fiscal decentralization policy has been proven a positive impact on economic growth in the United States. Zhang and Zou (2001) examined the impact of fiscal decentralization on economic growth at the provincial level in China and India. The results show that there is a negative impact of fiscal decentralization on economic growth in China, while the experience in India, fiscal decentralization had a positive impact on economic growth.

Research by Martinez and McNab (2001), shows that qualitatively, fiscal decentralization affect economic growth indirectly, through a balanced distribution of resources among regions and macroeconomic stability. Furthermore, Martinez and McNab (2005), explained that the fiscal decentralization not directly affect the economic growth, but have an indirect effect and positive impact on economic growth through macroeconomic stability.

From the above explanation, the debate of the impact of fiscal decentralization on economic development is still on going. Most of the studies are still looking for the effects of decentralization on the administration and public services site.

Brojonegoro (2005), states that in the first five years of fiscal decentralization in Indonesia, is still difficult to conclude whether there is a direct impact of decentralization on economic growth. One of the reasons was that during that period, economic recovery is likely due to the national macro economic stability improvement. A stronger indication is that the western part of Indonesia (IBB) is growing faster than the Eastern Indonesian (IBT), although Sulawesi economy experiencing the fastest economic growth. Another reason is that there is an indication that fiscal disparities across regions become worsened, as described above on the experiences of other countries. In Indonesia, that condition is try to be neutralize by giving the General Allocation Fund in the next following years.

Research of Simanjuntak (2007) quoted from Juanda (2008), states that, with bigger fiscal decentralization fund, there is also improvement on social welfare, one of the reasons is the increasing on local government fund resources. However, if we look deeper on this case, there are some phenomena appear: on average the national welfare indicators always increasing, although not in all regions. According to Ministry of Finance, The Republic of Indonesia data in 2009, stated that out of 33 provinces in Indonesia, there are 15 provinces, which decreased in the number of poor people, on the other hand, in 8 provinces the condition was worsened.

The above conditions can be explained by the phenomenon of the provincial and districts/municipalities budget structure in Indonesia today. If we brake down the budget, is consisted of employee expenditure, goods expenditure, capital expenditures and other expenditure (see table 1 below). With the assumption that the expenditure that related directly to the improvement of economic indicators is capital expenditure, it can be seen that the average capital expenditure rate never reached a third of total local

government expenditure. The number is still far behind compared to employees expenditure who remain in the first rank since prior to implementation of decentralization and regional autonomy.

Table 2.1
Composition of Budget Expenditure all Sub National Government in Indonesia 2005-2008 (Trillion Rupiahs)

Type of Expenditure	2005	2006	2007	2008
Employee Expenditure	85.62 (41.8%)	81.86 (32.3%)	130.48 (38.5%)	153.39 (39.4%)
Goods Expenditure	45.22 (22.2%)	79.05 (31.2%)	61.20 (18.0%)	72.30 (18.6%)
Capital Expenditure	**45.48 (22.2%)**	**54.79 (21.6%)**	**104.74 (30.9%)**	**111.85 (28.7%)**
Other expenditure	28.69 (14.0%)	37.85 (14.9%)	42.90 (12.6%)	51.82 (13.3%)
Total	205.02 (100%)	253.56 (100%)	339.34 (100%)	389.37 (100%)

Source: Ministry of Finance, RI

The unclear relationship between expenditure budgets with some indicators of Indonesian regional economy could also be noticed from the process of preparation of budget and the performance budget expenditures. The delay in the preparation of the budget is one of the factors that affect the improvement of the regional economy.

In addition, these conditions are worsened by a local government that has a surplus budget, especially in the last five years (see table 2). This indication is not good, because it reflects inadequate budget management.

Table 2.2
The Number of Sub National Government with a Surplus/Deficit Budget, and its Nominal

(Trillion rupiahs)	2004		2005		2006		2007	
	surplus	deficit	surplus	deficit	surplus	deficit	surplus	deficit
Number of distric/municipalities	206 (4.49)	112 (1.24)	282 (11.25)	49 (0.42)	341 (21.99)	34 (0.93)	373 (34.04)	44 (1.00)
Number of Province	24 (2.83)	3 (0.15)	29 (7.70)	2 (0.01)	21 (5.03)	5 (1.33)	26 (8.96)	5 (1.69)
Total	230 (7.32)	115 (1.39)	311 (18.96)	51 (0.43)	362 (27.02)	39 (2.26)	399 (43.00)	49 (2.70)
National Budget (APBN)		(23.80)		(17.78)		(30.44)		(61.93)

Source: Ministry of Finance, RI

2.3 Intergovernmental Fiscal Transfer

According to Widhiyanto (2008), Intergovernmental transfer can take two general forms. Intergovernmental Transfer can be conditional grants and unconditional grants. Conditional grants place any various kinds of restrictions on their use by the recipient, on the other hand unconditional grants are the lump sum transfers to be used in any way the recipient wants.

Intergovernmental Fiscal Transfers are intended to maintain consistency and continuity on implementation of regional autonomy and fiscal decentralization. Intergovernmental fiscal transfers consist of Balancing Fund and Special Autonomy and Adjustment Fund. Balancing Fund consists of Revenue Sharing (DBH), the General Purpose Fund (DAU) and Specific Purpose Fund (DAK). Balancing Fund should be viewed as a whole unified because three components complement each other.

Revenue Sharing (DBH), is one component of Balancing Funds sourced from the revenue budget allocated to the regions with a certain percentage based on the producing region (by origin) to fund local needs in the context of decentralization. Type of government revenue that has been distributed in the state budget includes several types of tax and natural resources which are managed by the central government. The characteristic of the transfer is a block grant and reflect the widest possible autonomy in their use in accordance with the potentials and needs of the region to promote economic growth and prosperity. The main purpose of the allocation of Revenue Sharing is to reduce the vertical fiscal imbalance between central and local government.

Due to differences in regional fiscal capacities, General Purpose Fund (or DAU) is aimed to address the problem of horizontal imbalances among sub-national governments. Differences in fiscal capacities arise from differences in local own-source

revenue and shared-revenue. So that, DAU has been used as an instrument of equalization grant, and the characteristic of the transfer is a block grant (Murniasih, 2007).

According to Law 33/2004, the specific purpose fund (DAK) is allocated to a particular sub national government to funding specific activities that are regional affairs and a program that became a national priority and became sub national government program. According to Murniasih, 2007, Specific Purpose Fund (DAK) is allocated to specific regions and certain sector programs. Specific Purpose Fund (DAK) intends to promote the attainment of minimum standards and compensate for benefit/cost spill-over related to priority capital investment.

2.4   Theories of Regional Economic Development

2.4.1 Regional Economic Growth

Development is a multidimensional process which includes a variety of the fundamental changes in social structure, community attitudes, and national institutions, in addition, to pursue accelerated economic growth, handling income inequality, and poverty. Development should reflect total change in a society or adjustment of the overall social system, without ignoring the diversity of needs base and the desire of individual and social groups that exist in it, to move forward toward more versatile living conditions both materially and spiritually (Todaro, 2003).

According to the Kuznets theory in Todaro (2003) economic growth is the increase on long-term capacity of the country concerned to provide economic goods to its population. The increase in capacity is determined by

progress or adjustment of technological, institutional, and ideological demands states. Todaro (2003), stated that there are three main factors or components in the economic growth of each country. These three factors are:

a. Accumulation of capital, which includes all form or type of new investment: invested in land, physical equipment, and capital or human resources.

b. Population growth, which in will eventually increase the number of workforce.

c. Technological advances, such as a new way or improvements in old ways handling jobs.

A good distribution of income is increasingly prevalent. However without economic growth, something that will happen is equal of poverty distribution. Economic growth will result in improved income distribution when meet at least two terms, expand employment opportunities and increase productivity. With the spread of employment opportunities, people's access to obtain income is bigger.

In this study, Economic growth is the change Gross Regional Domestic Product (GDP) per annum by the year 2000 constant prices, expressed in units of percent. This research used economic growth data issued by the Indonesian Central Bureau of Statistics for 33 provinces.

2.4.2 Percentage of Population below the Poverty Line

Poverty is a limitation that carried by someone, a family, a community, or even a country which causes discomfort in life, endangerment law enforcement and justice, endangerment bargaining power in the association world, the loss and the bleak future generations of the nation and state. This is a

broad definition of poverty. The poverty is related with discomfort in life, meaning that poor people's lives almost always and often uncomfortable. In all areas, they are always excluded, because they could not equating them with conditions surrounding community.

Many measurements could determine the number of poverty, one of them is the poverty line. Poverty line in terms of is a measure of general stating the amount of expenditure (in rupiah) to meet basic needs food and non-minimum diet (BPS, 2001), or standards states limit someone say poor, it considers the consumption point. The poverty line is used to determine the limit of poor people or the poverty line can be used to measure and determine the amount of absolute poverty. Poverty line based on consumption (consumption-based poverty line) consists of two elements (Kuncoro, 1997):

a. Expenditure that required to provide minimum nutrition standards and other basic needs, and

b. Amount of other varied needs, reflecting the cost of participation in everyday life.

Percentage of Population below the Poverty Line in this research is data issued by the Indonesian Central Bureau of Statistics (BPS) for 33 provinces.

2.4.3 Percentage of Unemployment

Standard definition for the Unemployed is those who do not have work, willing to work, and looking for a job. According to Central Statistic Bureau (BPS), the definition of Unemployed are (i) those who are seeking employment, or (ii) those who preparing the business, or (iii) those not seeking work because

they feel not possible to get a job (previously categorized as not labor force), and (iv) those who already have jobs but have not started work (Formerly categorized as unemployed), and at the same time they not working (jobless). Unemployed with this definition is usually called as unemployment (open unemployment). Specifically, the open unemployment according to BPS, consist of:

a. they are not working and seeking employment,

b. they are not working and preparing for business,

c. they are not working and not looking for work, because they felt not possible to get a job, and

d. they are not working and not seeking work because accepted to work, but not yet started working.

In this study, variables proxy for the percentage of Unemployment is data issued by the Indonesian Central Bureau of Statistics (BPS).

2.4.4 Human Development Index (HDI)

United Nations Development Programme (UNDP) since 1990 has established an indicator of human welfare that can show human progress based on factors such as average life expectancy, average education level, literacy rates, and overall social welfare. This report assumes that human development is essentially process of enlarging human choices. People welfare indicators that are prepared by UNDP is known as Human Development Index (HDI).

Human Development Index (HDI) is a very useful tool to measure the level of welfare between countries or regions (Todaro, 2003). HDI indicators

exceed the usage of the conventional growth. Economic growth is necessary to maintain welfare, but growth is not the end goal of human development. Growth is just tool, the most important are how economic growth used to improve human capabilities and how people using these capabilities. One of the advantage of using HDI is this index reveals that a country/region can do much better at low income levels and that large increasing in income only play a relatively small role in the humans development (Todaro, 2003).

Social welfare is the level of a decent life that indicated by economic conditions and social community circumstances. In this study, variables proxy for the public welfare Data/Human Development Index (HDI) is data issued by the Indonesian Statistic Board (BPS).

CHAPTER 3

METHODOLOGY AND RESEARCH DESIGN

3.1. Research Paradigm

This topic will be presented in a "quantitative descriptive" approach by using Data Display Cross-case Analysis. This research is a combination between qualitative analysis and quantitative analysis. The use of quantitative analysis helps increase the reliability of the data by reducing the possible bias from the researcher's opinion as well as establishing a commonly accepted basis for drawing conclusion (Taggart, 1997).

Quantitative analysis is used by using statistic tools such as trend analysis that compare statistic trend among province and summary descriptive statistic. Quantitative analysis is use to know the impact of intergovernmental transfer policy to regional economic development. Quantitative Analysis to answer this question use secondary data that are national data, by doing analytical statistic on many indicators such as regional economic growth, percentage of unemployment and percentage of poverty in every province. This analysis using trend analysis on average between years 2004-2008 on every province (aggregate data City/Municipalities in the same province).

Finally, to answer the question of relationship between Intergovernmental Fiscal Transfer and regional economic development indicator, author do statistical analysis using SPSS Software to know their each correlation.

3.2. Research Approach

This research uses a "quantitative descriptive" approach to address the research problems, and to bridge the cause and effect way of thinking. As Creswell (2003) point out, a quantitative approach is one in which the investigator primarily uses post-positivist claims for developing knowledge (i.e. cause and effect thinking, reduction to specific variables and hypotheses and questions, use of measurement and observation, and the test of theories), employs strategies of inquiry such as experiments and surveys, and collects data on predetermined instruments that yield statistical data (Creswell, 2003). Using the "quantitative descriptive" approach, the study seeks objectivity in its analyses of reality based on the empirical evidence and tested theories. In this study, the subjects are views as detached from the researcher in order to establish the objective explanation.

3.3. Research Focus

The research aims to analyze the performance of a government program. In this context, the government program is fiscal decentralization. (i) To convey the importance of fiscal decentralization policy in Indonesia in order to create regional economic development. (ii) To know the impact of fiscal decentralization policy to regional economic development in Indonesia, in regard to the economic development objectives. (iii) To know the impact of Intergovernmental Fiscal Policy to regional economic development in Indonesia. (iv) To know whether sub National Government is run on the right track in implementing fiscal decentralization.

3.4 Data Collection

Data Collection **Schedule:**

Period	Activity
April 2010-Juli 2010	• Data Collection and observation • Proposal Thesis, Literature Review.
August 2010-February 2011	• Data collection and In depth observation in national level (Jakarta) • Analyst data and finding writing.
April 2011- July 2011	Write a Thesis or Research Report as Master Candidacy requirement.
October 2011-April 2012	• Submit a Thesis or Research Report as Master Candidacy requirement • Thesis/report review; check and re-check with the supervisor. • Research finalizing; with the drafting of conclusion and recommendation. • Submit a Master Thesis/research report.

Selected Respondent and Secondary Data:

Information and data collection required for the analysis are obtained by direct source as follows:

1. Primary Data

Primary data are the data, and information obtained directly from the source who act directly as an actor by conducting an interviews and make a questioner. Primary data are collected by making an interview with senior staff in the ministry of Finance The Republic of Indonesia. With a qualitative interview, there is a possibility to get deeper information about the topic, what happening, how a policy happen and how a policy could be better.

The main goal of an interview with senior staff in directorate general of fiscal balance, Ministry of Finance are to gain all the information about the implementation of intergovernmental fiscal transfer and the obstacle that happen during the implementation of fiscal decentralization in Indonesia.

2. Secondary Data

Secondary data are collected from Regional Financial Information System (Sistem Informasi Keuangan Daerah), Directorate General of Fiscal Balance, MoF. Directorate General of Fiscal Balance provides all regional financial data that cover all province in Indonesia and from Indonesian Statistic Board (Badan Pusat Statistik) that provides data indicator of regional economic development in every province in Indonesia.

The secondary data are:

• Transfer Fund to Sub National Government data series 2001-2008 (Ministry of Finance)

• Revenue Sharing Fund data series 2005-2008 (Ministry of Finance)

• General Purpose Fund data series 2005-2008 (Ministry of Finance)

• Specific Purpose Fund data series 2005-2008 (Ministry of Finance)

• Special Autonomy Fund and Adjustment Fund data series 2004-2008 (Ministry of Finance)

• Gross Product Domestic Regional Growth base on constant price 2000, Year 2004 – 2008 by province (Regional Economic Growth) (Indonesian Statistic Board/BPS)

• Percentage of Population Below the Poverty Line by Province data series 2005-2008 (BPS)

- Percentage of Unemployment by Province data series 2005-2008 (BPS)

- Human Development Index (HDI) data series 1996 – 2008 (BPS)

- Percentage of Unemployment by Province data series 2005-2008 (BPS)

- Williamson Index for PDRB Year data series 2002 – 2008 (BPS)

- Population by Province, data series 2007 – 2009 (BPS)

- Theoretical data obtained from relevant text books that will be used as the theoretical frameworks in analyzing

- Other related data from journals and media such as newspaper (local, national and international) and internet.

3.5. Research Design

The research design is provided in figure 3.1 below:

Figure 3.1.: Research Design

Research Problem

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Research Methodology

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Data Collection

↓

Data Analysis

↓

Research Report
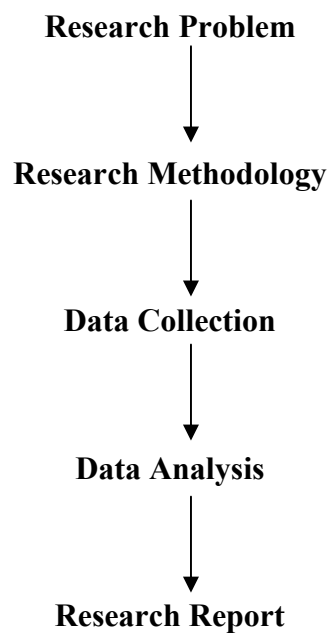
CHAPTER 4

FISCAL DECENTRALIZATION IN INDONESIA

4.1 Fiscal decentralization in Indonesia

Law No. 32 of 2004 on Regional Governance and Law No. 33 of 2004 concerning on Fiscal Balance between Central Government and Local Government, giving greater authority to local governments in managing government and local finance. Thus, regional development is expecting to run in accordance with the aspirations, needs and priority areas, so as to provide a positive impact on regional economic development, which in turn will improve the welfare of the community.

Fiscal decentralization as one of the instruments of government policy have principles and purposes to: (i) reduce fiscal disparities between the Government and the local (vertical fiscal imbalance) and inter-regional (horizontal fiscal imbalance), (ii) improve the quality of public services area and reduce inequalities in public services between regions, (iii) improving the efficiency of utilization of national resources, (iv) good governance, transparency, and accountability in the implementation of the allocation of transfers to regions targeted, timely, efficient, and fair; (v) support to fiscal sustainability in macro-economic policy. In addition, to increase the accountability of financial management area, the area is giving the authority to collect taxes (taxing power).

The main instrument of fiscal decentralization policy is through a policy of intergovernmental fiscal transfer, whose components are Balancing Fund, the Special Autonomy Fund, and Adjustment Fund. Balance Fund, consist of Revenue Sharing

(DBH), General Purpose Fund (DAU) and Specific Purpose Fund (DAK), is the largest component of the intergovernmental fiscal transfer. The amount of intergovernmental fiscal transfers continued to increase in line with the implementation of regional autonomy and fiscal decentralization, from Rp81.1 in 2001 to Rp226.2 trillion in 2006 or increased by an average of 22.8 percent per year. Later in the year 2007 intergovernmental fiscal transfer amounted to Rp254.2 trillion and in 2008 rose by 15 percent to Rp292.4 trillion.

Figure 4.1

Scope of Transfer to Region
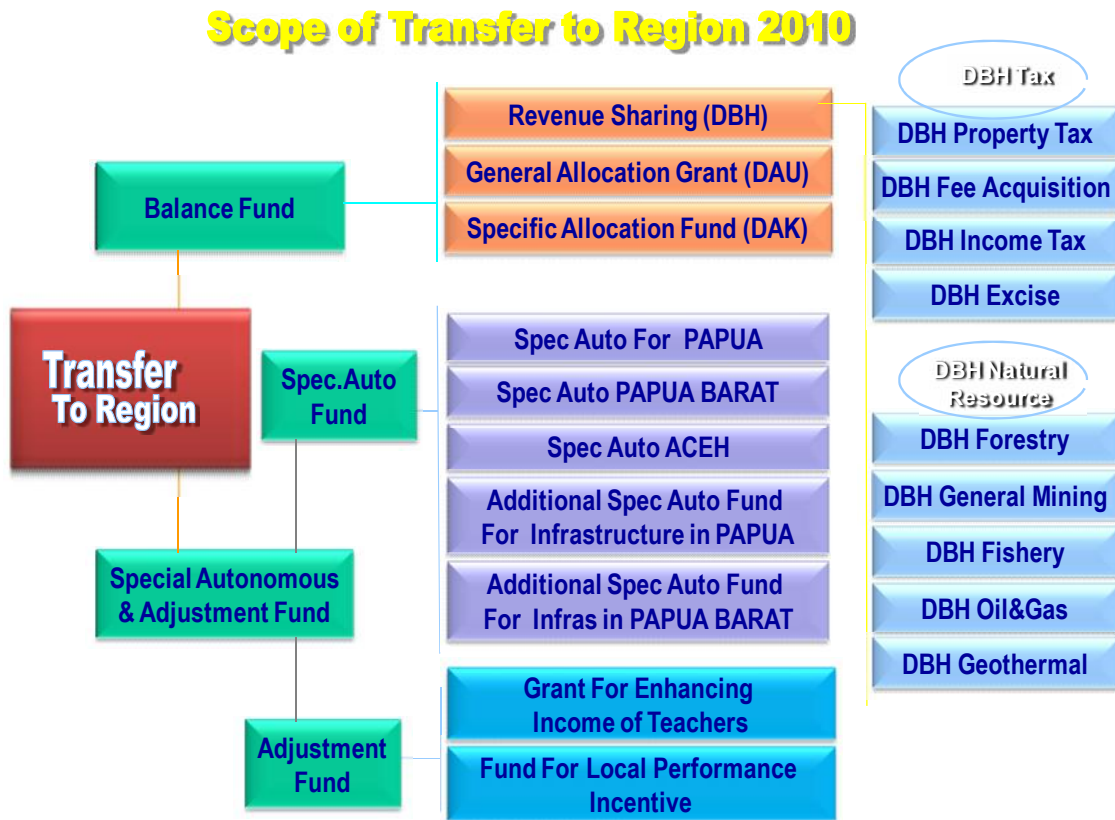
Source: Ministry of Finance RI

In addition to decentralization of funds, the Government also allocates funds to finance programs and activities that are the authority of the Government in the local

area, namely deconcentration funds, fund assistance duties (TP), and funds to implement programs and activities of Government agencies in the region. Although, these funds are not included in the sub national Government Budget (APBD), significantly, the funds spent in the local government, either physical or non physical expenditures. The amount of funds is quite significant, and the proportion of the expenditure of State Revenues and Expenditures Budget (APBN) is quite high. In 2008, the total funds spent in the region reached Rp408.9 trillion or 41.3 percent of total state budget expenditure.

Thus, approximately 65 percent of the total expenditure budget will be spent in the local government (see Figure 4.2, 4.3 and 4.4).

Figure 4.2

Proportion of Government Expenditure Budget FY 2008

(In Trillion Rupiahs)
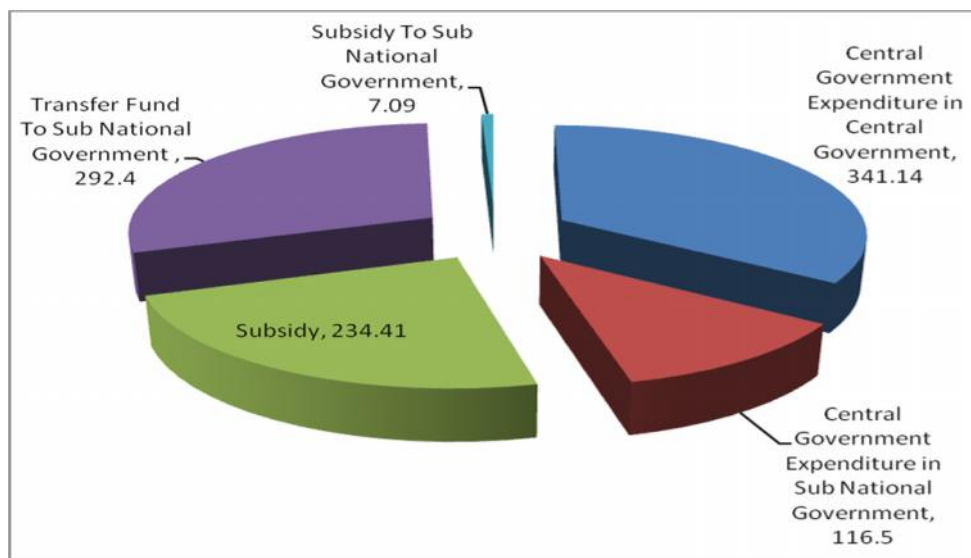
Source: Ministry of Finance RI

Figure 4.3

Proportion of Intergovernmental Fiscal Transfer FY 2008

(In Trillion Rupiahs)
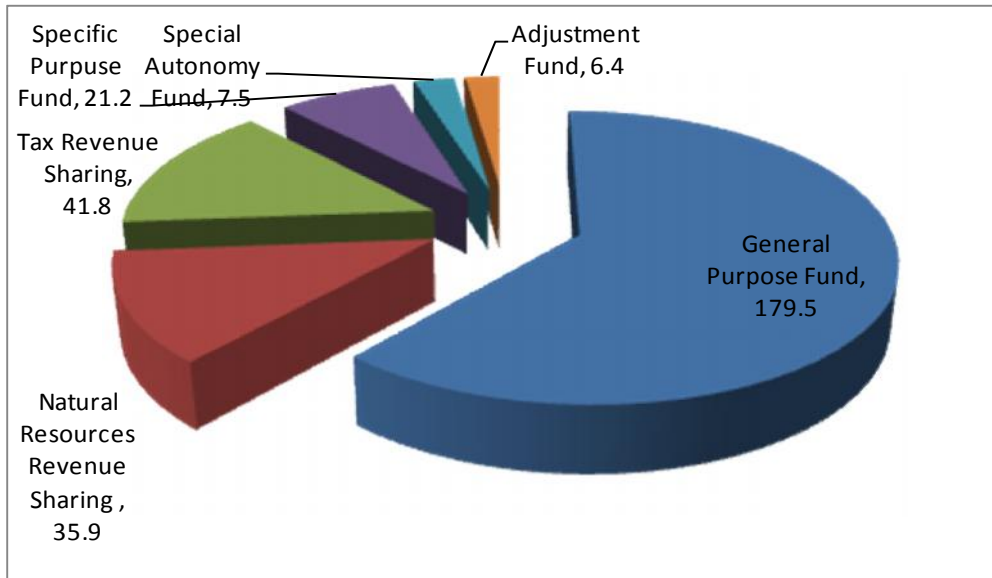
Source: Ministry of Finance RI

Figure 4.4

Proportion of Central Government Expenditure in Sub National Government

FY 2008 (In Trillion Rupiahs)
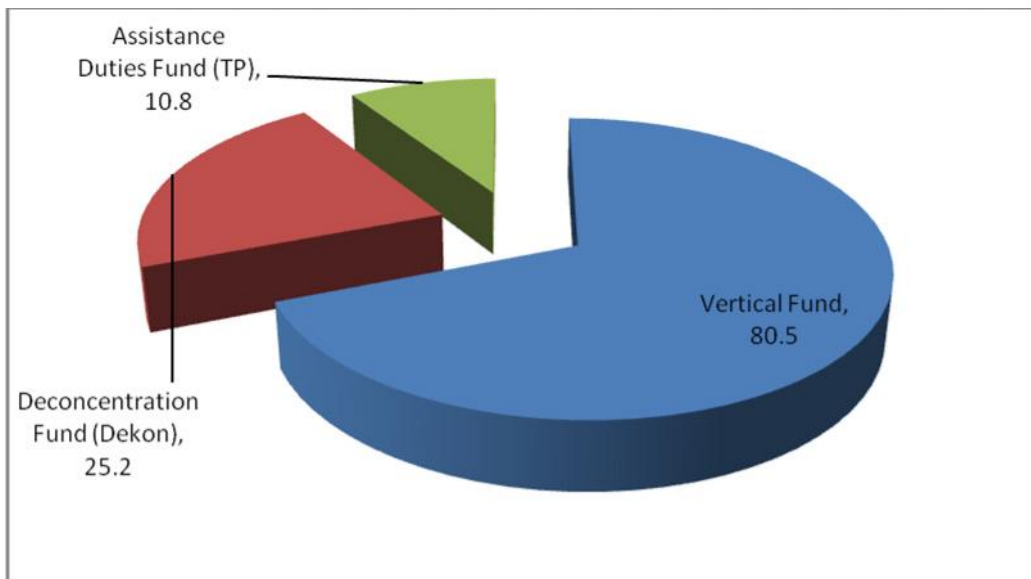
Source: Ministry of Finance RI

In addition to these funds, the Sub National Governments also has its own funding sources of revenue (PAD), which in 2008 total for the province and district Rp54 trillion. The total number of these funds, either from the state budget, as well as those derived from Own Revenue (PAD), will be very useful and a fiscal stimulus to the economy in the region in order to realize the welfare of society. The success of a region in realizing the welfare of society depends on the policy of each local government. The policy can be done through the allocation of funding resources to programs and activities that are oriented towards the needs of society (public interest), so it can create jobs and reduce the number of poor people.

Allocation of funding sources will be reflected in the allocation of spending expenditures. If the allocation of expenditures is divided by type of spending, then during 2005-2008, the share of personnel expenditure is the highest ranked an average of 38 percent of total spending. Meanwhile, the share of goods expenditures reached 25.9 percent, 25.8 percent of capital expenditures and other spending 10.3 percent. Meanwhile, when divided by function, in 2007 the Sub national government Expenditures that are used to perform the functions of public service is top ranked 35 percent of total regional expenditure. While local government expenditures that used to fund the education functions reached 23 percent, the housing function and public facilities by 19 percent, health functions only 8 percent, and allocation for the economic function are 10 percent.

Governments have an important role in improving the regional economy and welfare of the community through efforts to accelerate the disbursement of intergovernmental fiscal transfer and to encourage the implementation or realization of local government expenditure. To that end, the Government continues to push for the

establishment of Regional Regulation (Perda) Budgets can be done in a timely manner in order to accelerate the realization of regional expenditures. This needs to be done because of delays in setting local budget law is feared will lead to the accumulation of idle funds, which tend to be placed into the form of short-term investments, such as Bank Indonesia Certificates (SBI) through the Regional Development Banks.

Acceleration setting budgets and actual expenditures should be coupled with a quality of Local government expenditures. Efforts to improve the quality of local government spending can be done through the pattern of performance-based budgeting, budgeting in the medium term development framework, and accountable reporting systems. It is already started to set in various laws, such as guidelines for financial management and government accounting standards.

Acceleration intergovernmental fiscal transfer distribution, acceleration of the realization of regional spending, and improving the quality of government spending is expected to improve the quality of public services and local economic development. However, improving the quality of public services and local economic development must be balanced also with equality, and the level of inter-regional social welfare.

To measure the prevalence rate mentioned above, according to figures Williamson index that measures the level of inter-provincial distribution of GDP (excluding DKI Jakarta), in 2002 the gap level of economic activity in Indonesia is in the index amounted to 0.722 and decreased to 0.589 in 2006. Decreasing in number of Williamson Index indicates that the development of inter-provincial economic activity in Indonesia has decreased the level of the gap, although the index is still relatively high. Furthermore, to measure the level of social welfare, can be used Human Development Index (HDI). Based on survey results of the United Nations Development

Program (UNDP), Indonesia HDI value in 2001 amounted to 0.682 and in 2005 increased to 0.728. This indicates that an increasing in social welfare during this period. Based on the HDI data measured by the Central Statistics Agency (BPS), in 2007 Jakarta Provincial HDI ranks highest with an index value of 76.33, while Papua Province HDI ranked lowest with an index value of 59.91.

The aggregates size showed increased levels of economic conditions and welfare of the community mentioned above, an indication of the impact of increasing the amount of funds spent in the region, both through the mechanism of decentralization funds and other funds in the region. However, when viewed in partial, economic development and social welfare of each area were still different. Although the national average percentage of poor people has decreased, but still there are some provinces that have increased the percentage of poor population.

The regions that have a per capita allocation of funds, either through funding mechanisms decentralization, deconcentration, and funding assistance duties, as well as vertical agency funds, should also have an exciting achievement in terms of increased economic growth, poverty reduction, and unemployment reduction. However, based on the evaluation results on the last few years indicate that some areas that received great funding per capita was still to have indicators that have not been satisfactory level of prosperity and the economic growth rate is relatively slow. This indicates that the pattern of expenditures in some regions are still not optimal in order to increase people's income and regional economic development.

4.2. Implementation of Fiscal Decentralization in Indonesia

Along with the development of local autonomy and fiscal decentralization, decentralization of funding in the budget nomenclature is also changing. Since the year 2001-2007, nomenclature for the financing of decentralization has been amended several times in the posture adjustment budget which was originally known as the localized expenditure, and last up to 2007 are adjusted to local expenditure. Starting in 2008 the nomenclature was changed to Transfer to region settings specified in Standard Account.

After the implementation of fiscal decentralization policy, the allocation of transfers to the regional development can be seen in Figure 4.5. In the graph we can see that from the years 2001-2008 in nominal allocation of transfers to regions continues to increase on average by 20.7 percent per year.

Figure 4.5

Transfer Fund to Sub National Government 2001-2008

(In Billion Rupiahs)
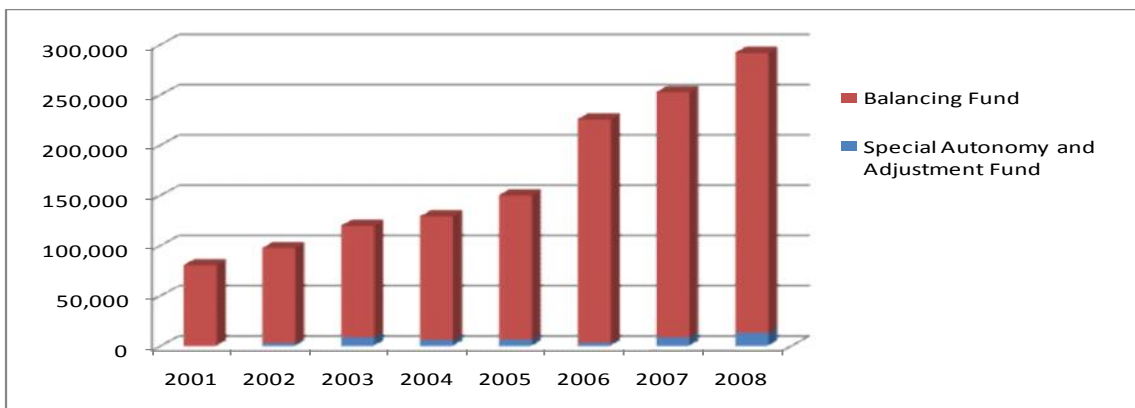
Source: Ministry of Finance RI

Development of the realization of transfers to the regional that allocated in the budget over seven years of fiscal decentralization, from the year 2001 - 2008 are presented in Table 4.1. In 2001, the allocation of transfers to a sub national government

includes a balancing fund. Since 2002, the allocation of transfers to the sub national government also includes a Special Autonomy Fund for Papua Province as the implementation of Law No. 21 of 2001 on Special Autonomy for Papua Province, and Fund Balance or Adjustment Fund allocated to sub national government that receive General Purpose Fund (DAU) smaller than the previous year. Beginning in 2008, the Government also allocates special autonomy fund at 2 % of national General Purpose Fund (DAU) ceiling for 15 years, and starting in the years 16th until the 20th of 1% of national General Purpose Fund (DAU) ceiling for the Province of Nangroe Aceh Darussalam in accordance with Law Number 11 Year 2006 on the Governing of Aceh.

Table 4.1

Transfer Fund to Sub National Government 2001-2008

(In Billion Rupiahs)

	REALIZATION OF NATIONAL BUDGET							
	2001	2002	2003	2004	2005	2006	2007	2008
I. Balancing Fund	81,054.4	94,656.6	111,070.4	122,867.6	143,221.3	222,130.6	243,967.2	278,714.7
a. Revenue Sharing	20,007.7	24,884.1	31,369.5	36,700.3	49,692.3	64,900.3	62,942.0	78,420.2
b. General Purpose Fund	60,345.8	69,159.4	76,977.9	82,130.9	88,765.4	145,664.2	164,787.4	179,507.1
c. Specific Purpuse Fund	700.9	613.1	2,723.0	4,036.4	4,763.6	11,566.1	16,237.8	20,787.3
II. Special Autonomi Fund and Adjustment Fund	0.0	3,547.5	9,243.9	6,855.3	7,242.6	4,049.4	9,296.0	13,718.8
a. Special Autonomi Fund	0.0	1,175.5	1,539.6	1,642.6	1,775.3	3,488.3	4,045.7	7,510.3
b. Adjustment Fund	0.0	2,372.5	7,704.3	5,212.7	5,467.3	561.1	5,250.3	6,208.5
TOTAL	81,054.4	98,204.1	120,314.3	129,722.9	150,463.9	226,180.0	253,263.2	292,433.5
Source : Ministry of Finance RI								

Judging from the amount of funds that are located to the regions, the actual transfer to the Regions in 2001 was Rp81.1 trillion (4.8 percent of GDP), in the year 2006 reached Rp226. 2 trillion (6.8 percent of GDP), an increase average of 22.8 per year. In the state budget of 2007, Transfers to the Regions was Rp254.2 trillion (6.8 percent of GDP) or an increase of 12.4 percent compared to 2006. Furthermore, in the 2008 transfers to the Regions was Rp292.4 trillion (6.5 percent of GDP).

Balancing Fund as the largest component of transfers to regions showed an increase from year to year. In 2001, the realization of Balancing funds amounting to Rp81.1 trillion (4.8 percent of GDP), then in 2007 reached Rp244.6 trillion or increased by an average of 22.3 percent per year. Furthermore, in the year 2008 Revised Budget allocation of equalization funds amounting to Rp278.4 trillion, or 13.8 percent higher than the realization in 2007. Allocation of Balancing consists of General Purpose Fund (DAU), Revenue Sharing (DBH) and Specific Purpose Fund (DAK). Development of the allocation of Balancing Fund from the year 2001-2008 can be seen in Figure IV.6.

Figure IV.6

Trend Balancing Fund DAU, DBH, and DAK FY 2001-2008

(In Billion Rupiahs)
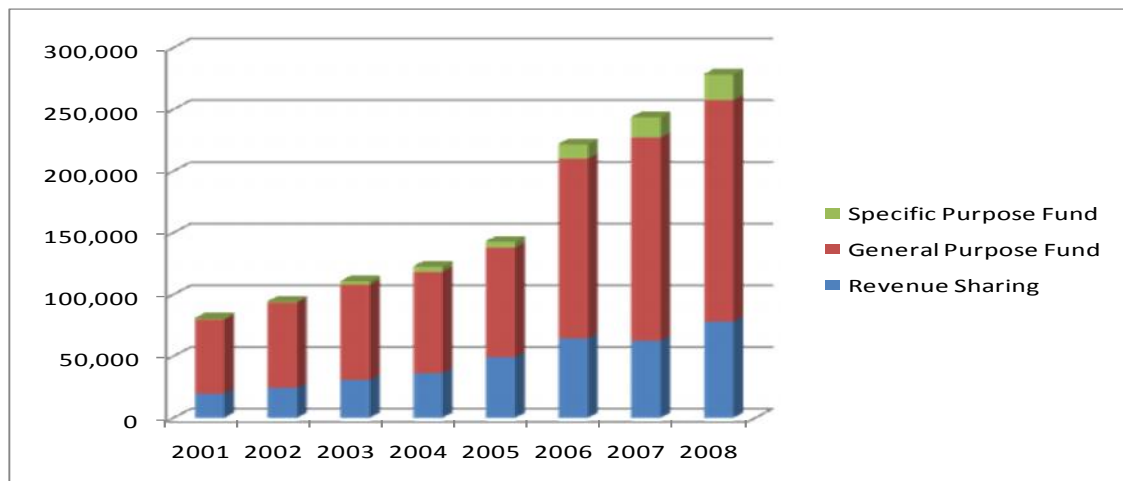
Source: Ministry of Finance RI

4.2.1 Implementation of Revenue Sharing (DBH)

Revenue Sharing (DBH) is one component of Balance Funds sourced from the revenue budget allocated to the regions with a certain percentage figure is based on producing regions (by origin) to fund the needs of the region in implementation of decentralization. Allocation policies, calculation, and the DBH distribution confirm that

the source comes from the state budget by a certain percentage with more attention to the potential for producing region. This type of state revenue that has been distributed in the state budget includes several types of tax potential and natural resources are managed by the center. DBH transfers are block grants to reflect the widest possible autonomy in their use, in accordance with the potentials and needs of the region in promoting economic growth and prosperity in the region. The main purpose of the allocation of revenue-sharing is to reduce the vertical fiscal imbalance between central and local governments.

Revenue Sharing (DBH) is calculated based on a certain percentage of each source of domestic revenues, both taxes and revenues from natural resources. Revenue Sharing (DBH) Tax and Natural Resources distribution as stipulated in Law No. 33 of 2004. State revenue derived from tax revenues distributed to the regions covering Income Tax, the Income Tax Article 21 and Article 25/29 individual Domestic taxpayer (WPOPDN), Land and Building Tax (PBB), and Customs and the Land Rights Acquisition Buildings (BPHTB). Meanwhile, state revenues from natural resources distributed to the regions include, among other natural resources: petroleum, natural gas, general mining, forestry resources, fisheries and natural resources. Since 2006, Revenue Sharing (DBH) natural resources also includes forestry reforestation fund, which is a diversion from the Specific Purpose Fund Reforestation Funds (DAK DR).

Realization of Revenue Sharing (DBH) including the transfer of Specific Purpose Fund Reforestation Funds (DAK DR) into the Revenue Sharing (DBH) Forest, in line with the increase in state revenue that has been distributed realization, showing a tendency to increase, from Rp27.07 trillion in 2005 to Rp33.47 trillion in 2006. Furthermore, in the Revised Budget of 2007, the realization of DBH is estimated at

Rp60.87 trillion. Moreover in 2008, the realization of DBH is estimated at Rp78.136 trillion.

Figure 4.7

Revenue Sharing Fund (DBH) FY 2008

(In Rupiahs)
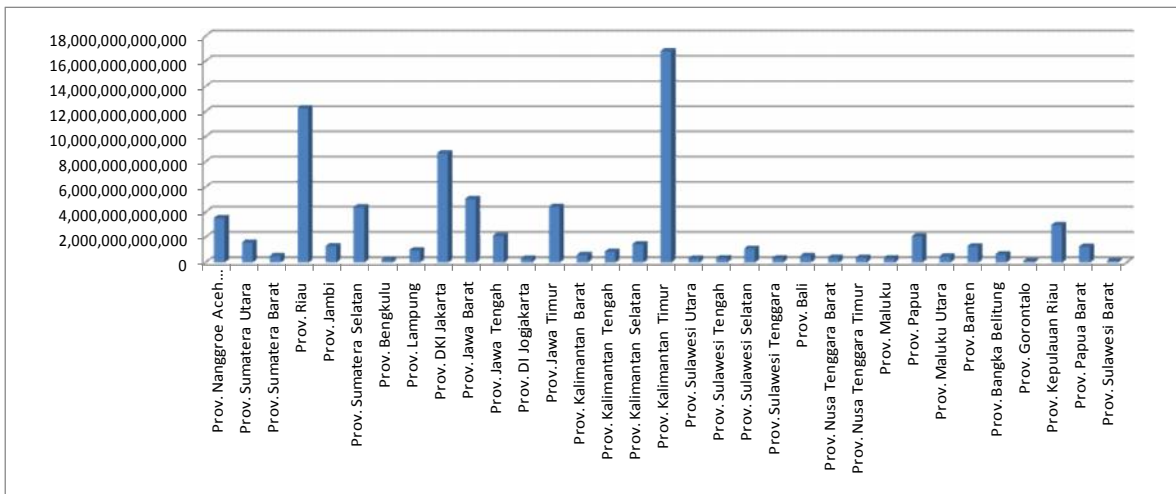
Source: Ministry of Finance RI

4.2.2 Implementation of General Purpose Fund (DAU)

General Purpose Fund (DAU) is a fund sourced from the revenue budget allocated for the purpose of inter-regional equalization of financial ability to fund the needs of the region in implementation of decentralization. DAU aims to interregional equity finance capabilities that are intended to reduce the financial imbalance between the regions through the application of a formula that considers the needs and potential areas. DAU determined on a region the size of the fiscal gap of a region which is the difference between fiscal needs and fiscal capacity.

In addition to Revenue Sharing (DBH), a significant increase from year to year also occurred in the General Purpose Fund (DAU). This is reflected, among others, of increasing the ratio of General Purpose Fund (DAU) allocation of net Domestic

Revenue (PDN), from 25 percent in the period 2001-2003, to 25.5 percent in the period 2004-2005, and later became 26.0 percent in the period 2006-2007. In line with the increasing ratio of General Purpose Fund (DAU) to the net Domestic Revenue, then in the same time frame, the realization of the General Purpose Fund (DAU) increased from Rp60,345.8 billion in 2001 to Rp145,664.2 billion in the year 2006 or increased by an average of 19.3 percent per year. During this period, the General Purpose Fund (DAU) is allocated to the Provincial and District increased by an average of 19.3 percent per year. Furthermore, in the state budget, in 2008, the General Purpose Fund (DAU) allocation increased by 8.9 percent from the realization of General Purpose Fund (DAU) in 2007.

DAU Map a province (including districts) is presented in Figure 4.8. From the graph, it can be seen that in 2008, the province that received the highest General Purpose Fund (DAU) East Java with an allocation of approximately 11.44 percent of the total General Purpose Fund (DAU).

Figure 4.8

General Purpose Fund (DAU) FY 2008

(In Billion Rupiahs)
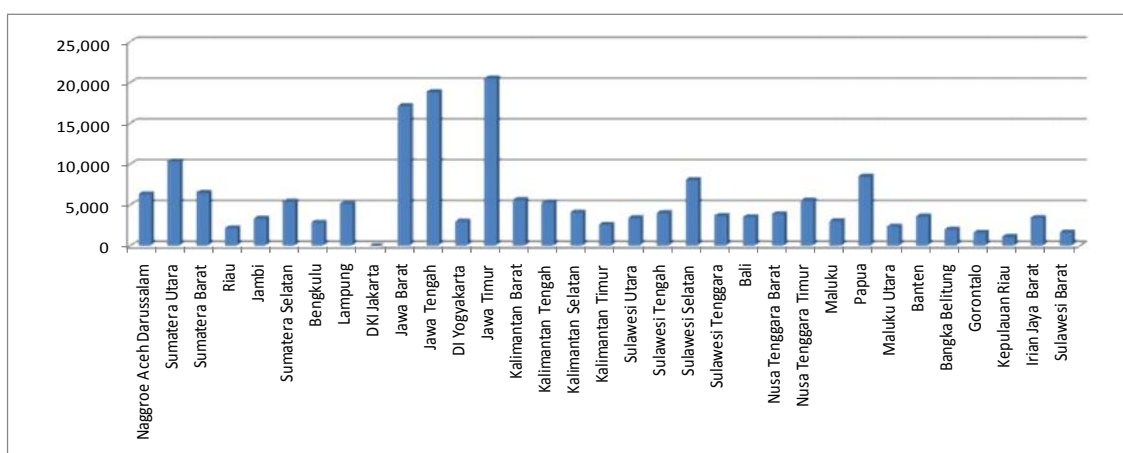
Source: Ministry of Finance RI

Next in Table 4.2, can be seen a trend of General Purpose Fund (DAU) allocation and the proportion of each provincial government in the period 2005-2008. Also, from Table 4.2 can be seen that based on the consolidation General Purpose Fund (DAU) districts throughout Indonesia are grouped by province, an area that receives the highest General Purpose Fund (DAU) in 2008 was the districts/cities in East Java province. This is because the amount of County/City of East Java province is the highest as compared to most other provinces, so the total accumulation of General Purpose Fund (DAU) is the highest nationally.

Table 4.2

Trend General Purpose Fund Allocation FY 2005-2008

(In Billion Rupiahs)

No	Province	2005			2006			2007			2008		
		Province	Kab/Kota	Total	Province	Kab/Kota	Total	Province	Kab/Kota	Total	Province	Kab/Kota	Total
1	Naggroe Aceh Darussalam	271.1	2,830.7	3,101.8	460.9	4,560.0	5,020.9	487.9	5,178.4	5,666.3	557.3	5,791.4	6,348.7
2	Sumatera Utara	313.7	4,509.2	4,822.9	539.7	7,793.9	8,333.6	657.4	8,854.6	9,512.0	727.9	9,676.5	10,404.4
3	Sumatera Barat	247.5	2,590.1	2,837.6	477.0	4,651.7	5,128.7	546.3	5,233.0	5,779.3	631.3	5,880.1	6,511.4
4	Riau	92.2	1,542.5	1,634.7	92.2	1,784.7	1,876.9	277.7	2,352.3	2,630.0	198.4	2,012.1	2,210.5
5	Jambi	243.6	1,561.6	1,805.2	374.4	2,425.0	2,799.4	415.0	2,718.5	3,133.5	468.8	2,912.1	3,380.9
6	Sumatera Selatan	242.7	2,271.4	2,514.1	421.4	3,829.0	4,250.4	510.2	4,437.7	4,947.9	545.8	4,906.2	5,452.0
7	Bengkulu	230.7	879.7	1,110.4	378.0	1,922.9	2,300.9	405.9	2,144.4	2,550.3	482.5	2,385.5	2,868.0
8	Lampung	300.9	2,393.2	2,694.1	460.9	3,800.6	4,261.5	509.7	4,209.1	4,718.8	570.5	4,630.3	5,200.8
9	DKI Jakarta	768.1	0.0	768.1	768.1	0.0	768.1	119.9	0.0	119.9	0.0	0.0	0.0
10	Jawa Barat	495.6	8,475.5	8,971.1	565.8	12,696.1	13,261.9	933.4	14,800.4	15,733.8	904.2	16,240.9	17,145.1
11	Jawa Tengah	550.0	9,904.7	10,454.7	890.4	14,960.0	15,850.4	1,050.7	16,406.3	17,457.0	1,053.5	17,789.1	18,842.6
12	DI Yogyakarta	238.7	1,327.2	1,565.9	402.5	2,050.0	2,452.5	437.4	2,267.0	2,704.4	511.3	2,495.1	3,006.4
13	Jawa Timur	454.6	10,494.0	10,948.6	820.8	15,796.0	16,616.8	1,091.2	17,669.6	18,760.8	1,022.9	19,508.4	20,531.3
14	Kalimantan Barat	312.6	2,148.0	2,460.6	586.0	4,068.6	4,654.6	610.9	4,468.9	5,079.8	728.1	4,919.3	5,647.4
15	Kalimantan Tengah	287.6	2,072.4	2,360.0	552.0	3,821.8	4,373.8	571.3	4,280.1	4,851.4	670.2	4,681.3	5,351.5
16	Kalimantan Selatan	230.7	1,741.1	1,971.8	378.7	2,981.7	3,360.4	428.0	3,316.1	3,744.1	465.5	3,647.2	4,112.7
17	Kalimantan Timur	72.5	1,624.1	1,696.6	72.5	2,135.0	2,207.5	235.7	2,759.0	2,994.7	126.2	2,502.8	2,629.0
18	Sulawesi Utara	247.9	1,289.8	1,537.7	404.3	2,355.0	2,759.3	447.0	2,624.6	3,071.6	532.9	2,894.9	3,427.8
19	Sulawesi Tengah	271.8	1,567.8	1,839.6	477.7	2,785.1	3,262.8	502.1	3,106.1	3,608.2	606.5	3,443.5	4,050.0
20	Sulawesi Selatan	332.7	4,443.7	4,776.4	509.5	6,076.8	6,586.3	599.5	6,752.3	7,351.8	656.7	7,439.4	8,096.1
21	Sulawesi Tenggara	254.2	1,216.2	1,470.4	426.4	2,466.4	2,892.8	461.8	2,781.6	3,243.4	566.4	3,139.3	3,705.7
22	Bali	199.9	1,624.6	1,824.5	353.3	2,500.8	2,854.1	436.5	2,856.2	3,292.7	448.2	3,107.0	3,555.2
23	Nusa Tenggara Barat	249.9	1,662.2	1,912.1	404.1	2,594.7	2,998.8	447.7	3,031.2	3,478.9	511.3	3,407.8	3,919.1
24	Nusa Tenggara Timur	300.0	2,605.6	2,905.6	479.4	4,050.0	4,529.4	553.6	4,505.8	5,059.4	616.6	4,960.0	5,576.6
25	Maluku	272.8	1,028.4	1,301.2	425.1	2,037.3	2,462.4	476.0	2,306.0	2,782.0	556.2	2,510.2	3,066.4
26	Papua	418.9	2,894.6	3,313.5	810.2	6,441.7	7,251.9	876.3	6,987.2	7,863.5	1,002.4	7,504.2	8,506.6
27	Maluku Utara	226.8	664.7	891.5	338.6	1,525.6	1,864.2	370.7	1,778.4	2,149.1	451.5	1,927.4	2,378.9
28	Banten	198.0	1,729.8	1,927.8	245.3	2,459.7	2,705.0	330.6	2,930.9	3,261.5	342.7	3,281.7	3,624.4
29	Bangka Belitung	187.4	517.8	705.2	275.7	1,192.7	1,468.4	319.4	1,417.5	1,736.9	391.0	1,650.9	2,041.9
30	Gorontalo	209.4	556.8	766.2	391.4	1,015.0	1,406.4	291.4	1,129.3	1,420.7	368.6	1,274.2	1,642.8
31	Kepulauan Riau	26.0	628.2	654.2	178.3	854.0	1,032.3	333.3	1,123.2	1,456.5	288.9	835.4	1,124.3
32	Irian Jaya Barat	128.2	1,093.4	1,221.6	350.5	2,395.8	2,746.3	464.9	2,694.3	3,159.2	578.1	2,880.5	3,458.6
33	Sulawesi Barat	0.0	0.0	0.0	255.2	1,070.4	1,325.6	279.3	1,188.5	1,467.8	366.7	1,321.5	1,688.2
	Total	8,876.7	79,889.0	88,765.7	14,566.3	131,098.2	145,664.5	16,478.7	148,308.5	164,787.2	17,950.7	161,556.4	179,507.1

Source : Ministry of Finance RI

General Purpose Fund (DAU) allocation to the regions is done by using a formula based on the data basis for calculating the General Purpose Fund (DAU). Historically from 2001 until 2005, the DAU formula is divided into two main components, namely the Minimum Allocation and DAU allocation based on the Fiscal Gap. Minimum Allocation is calculated based on the proportional and lumpsum component personnel expenditure. Since the enactment of Law number 33 of 2004 in 2006, Minimum Allocation and Fiscal Gap components are refined into Basic Allocation and the Fiscal Gap. General Purpose Fund (DAU) allocation based on equalization Fiscal Gap is a component of inter-regional financial capability, taking into account the difference between fiscal needs and fiscal capacity of each region.

4.2.3 Implementation of Specific Purpose Fund (DAK)

Specific Purpose Fund (DAK) is a fund sourced from the revenue budget allocated to a particular area in order to help funding special activities that are regional affairs and in accordance with national priorities. Specific Purpose Fund is intended to fund special activities into regional affairs and is a national priority, according to the function that embodies the task of governance in certain fields, particularly in the effort to fulfill the needs of the community facilities and infrastructure.

Within two years of fiscal decentralization, Specific Purpose Fund (DAK) is only allocated for Reforestation Funds (DAK DR) which is part of 40 percent of total revenue Reforestation Funds. In line with Law No. 33 of 2004, DAK DR, which was part of the DAK, grouped into DBH SDA DR-Forestry since 2006. Thus in writing no longer use the term DAK Non DR or DR, but only used the term Specific Purpose Fund (DAK).

In 2004, Specific Purpose Fund (DAK) Non Reforestation Funds allocated also for clean water infrastructure as well as the field of maritime affairs and fisheries, while in 2005, there is the addition of agriculture. Later in the year 2006 are the addition of the environmental field. Year 2008 increased two areas, namely the field of forestry. To demonstrate local commitment in the implementation of DAK, the district is required to budget funds in the budget balanced at least 10 percent of the amount received by the Specific Purpose Fund (DAK) allocation.

In line with the addition of fields that can be financed with Specific Purpose Fund (DAK), DAK realization tends to increase from year to year. In 2007 realization DAK Rp17,094.1 billion, while the state budget in 2008, Specific Purpose Fund (DAK) realization, is estimated at Rp21,202.14 billion. Sub national governments that receive Specific Purpose Fund (DAK) also tended to increase from year to year. When in 2003, the new Specific Purpose Fund (DAK) receiver covers 416 districts in 29 provinces, then in the year 2008 the number of recipients Specific Purpose Fund (DAK) covers 434 districts in 33 provinces.

Figure 4.9
Specific Purpose Fund (DAK) FY 2008
(In Rupiahs)
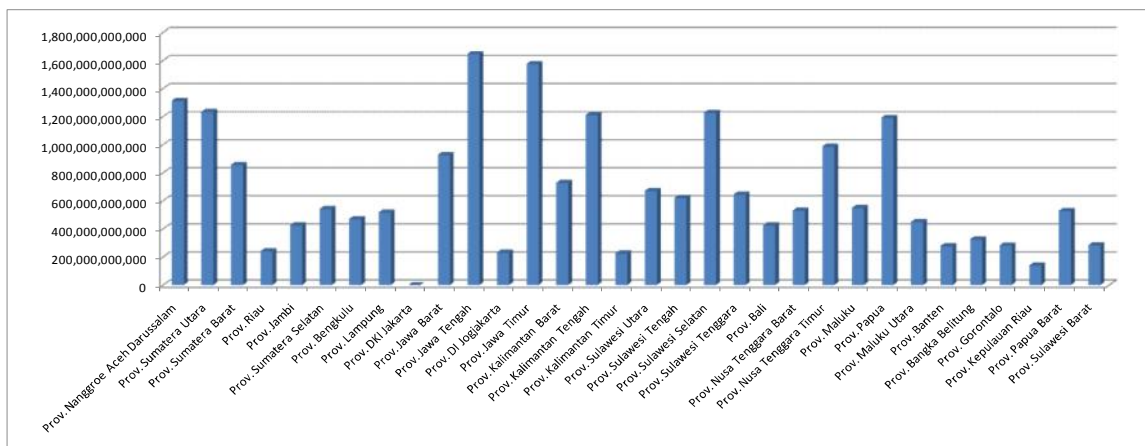
Source: Ministry of Finance RI

Distribution Specific Purpose Fund (DAK) districts/cities in provinces, in Indonesia, is presented in Figure 4.9. In the graph can be seen that for the years 2008, the area that received the highest DAK is East Java with the same proportion of each of 7.97 percent of total revenue DAK entire region.

4.2.4 Implementation of Special Autonomy Fund and Adjustment Fund

In addition to balancing fund, since 2002 it is also allocated the Special Autonomy Fund and Adjustment Fund at the regional expenditure budget heading. For Papua province is given special revenue in the framework of the implementation of special autonomy, amounting to 2% of national DAU ceiling for 20 years preferred to fund education and health. In addition, it is also provided additional funds for infrastructure development that amount to be determined between the Government and the Parliament as proposed by the province every year. Meanwhile, since 2008 to NAD is also given special autonomy funds allocated 2% of national DAU ceiling for 15 years, and for years 16th until 20th of 1% of national DAU ceiling.

Figure 4.10

Special Autonomy and Adjustment Fund FY 2001-2008

(In Billion Rupiahs)
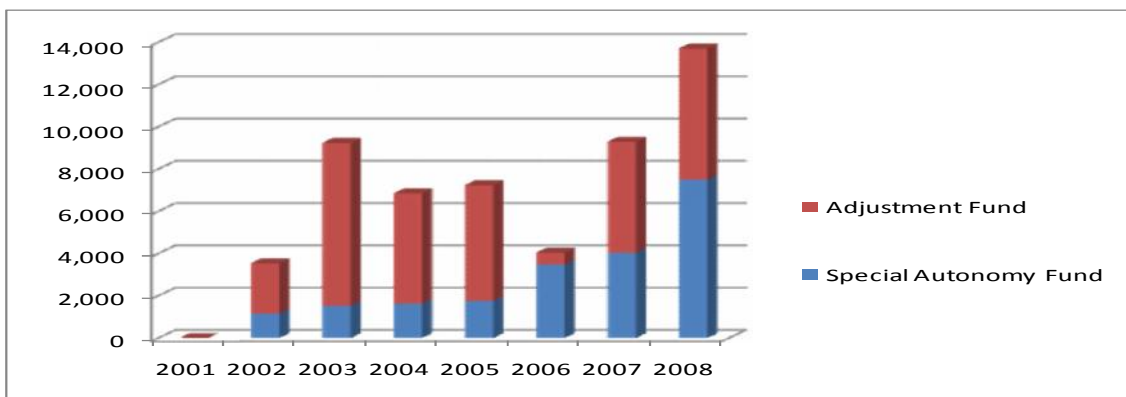
Source: Ministry of Finance RI

Figure 4.11

Special Autonomy and Adjustment Fund FY 2008

(In Rupiahs)
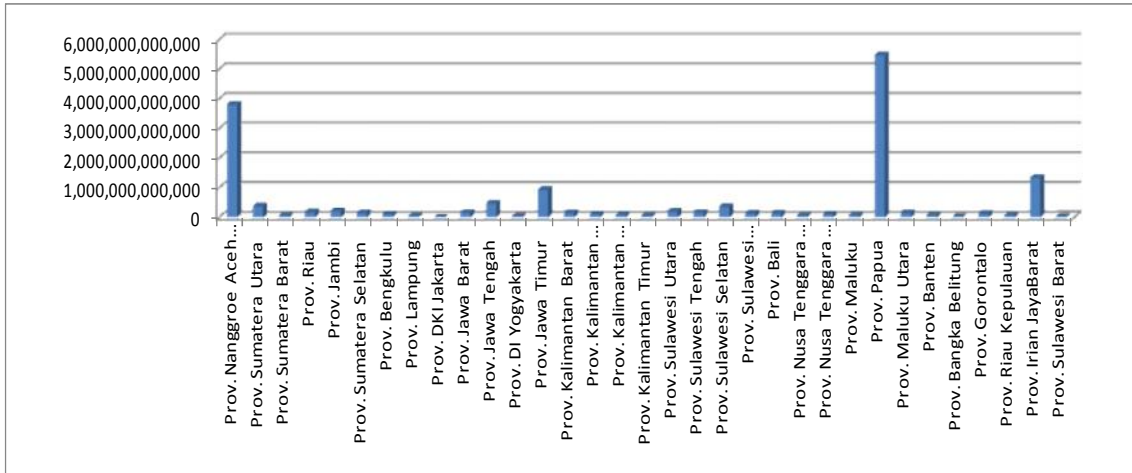
Source: Ministry of Finance RI

As shown in Figure 4.10, realization Autonomy & Adjustment Fund is always increasing from year to year. In 2002, the realization of Autonomy & Adjustment Fund has just reached for Rp3,600 billion, in 2007, the realization of Autonomy & Adjustment Fund reaches Rp9,600 billion, up an average of 45.8 percent per year. Furthermore, in the state budget in 2008, the realization of the Special Autonomy Fund and the Adjustment of Rp13,900 billion, an increase of 44.8 percent from the realization of the Special Autonomy Fund in 2007.

From the Figure 4.11, it can be seen that for the years 2008, regions that received the two highest Special Autonomy Fund and Adjustment fund are Papua Province and Nangroe Aceh Darussalam Province.

CHAPTER 5

INTERNATIONAL COMPARATIVE POLICY ON FISCAL DECENTRALIZATION

Problems on the implementation of fiscal decentralization are not only occurred in Indonesia. Other countries which implementing decentralization policies is also experiencing similar challenges, such as a problem of highly public sector growth, the relatively limited acceptance response of autonomy, lack of fiscal discipline and budget constraints in the mechanism of the transfer system.

From the balancing fund system in Indonesia, the policy associated with improvements of General Purpose Fund (DAU) formula associated with the principle of allocation based on the fiscal gap and identification of more measurable indicators for the calculation of fiscal capacity. Application of the fiscal gap in the DAU formula has not been fully applied because of each contains a historical component of the minimum allocation which consists of salaries expenditure component. Minimum Allocation also provides disincentives for local governments to efficiency of personnel expenditure. Problem on transfer formula is also one of the constraints faced by developing countries such as in India.

In the case of local taxes, the establishment of design taxes and local taxes is varied between countries. Some countries set broad autonomy for the province level, and setting local taxes tend to a policy formulated and determined by the level of provincial levels government. Therefore, acceptance of autonomy precisely at the provincial level, and one of the characteristics of management discretion over the tax is not all provinces have the type and the same tax structure. Local tax, on determining the

rates or coverage tax base is determined by the local government. Meanwhile, the gradual change to mobilize more revenue, as well as stimulation for the local government to improve human resources in local tax administration, and the authority to setting tax rates can be initiated through accelerated transfer of the property tax. Property tax in many countries, like Indonesia, is not central government tax. However, the application from many developing countries in terms of property tax administration is relatively non-uniform. Some countries, like China and India, set the property tax as part from provincial taxes, while there are some countries set the property tax as a local tax to the level sub national government.

In the case of special autonomy, the implementation of the Decentralization applied more asymmetric on historical factors. There is no linkage between autonomy reception with implementation of special autonomy. Special autonomy funds for Papua and Aceh are ad hoc lump-sum grants that not based on management discretion local taxes and the need for public service or expenditure need. It seems for the moment, not a government priority in determining the amount of the funds of special autonomy per se, but rather on the effectiveness of the use of these funds currently submitted in the form of block grants.

Therefore, in addition to special autonomy funds, the government also channeled funds in a lump-sum infrastructure in the two regions as one of the sectors of national priority. Improved design of the decentralization policy is expected to ensure consistency in the process of decentralization policy.

This chapter review on other countries experiences of fiscal decentralization, with a focus on four countries: Japan, Vietnam, China, and India. Selection of these four countries, in general, is due to these countries are already implementing minimum

service standards for both national level and sub national government level, moreover financing of local governments in these countries still depends on inter-governmental fiscal transfers in the form of block grants.

Fiscal decentralization in China provides uniqueness for comparison with Indonesia in the case of the two countries began the planning approach of centralized economy. The implementation of decentralization in China also faced with the problem of tax effectiveness is relatively less developed mainly due to the problems of extra-budgetary accounts. While India, is an example of a democratic state that involves the transfer system policies with an emphasis on state or provincial level. Of the four countries, except India, all countries are unitary states, which may be examples of transitions, that are relatively close to the characteristics of the Indonesian state. Fiscal decentralization in Vietnam is showing more slowly transformation from centralization administrative stages to deconsentration than Indonesia and China. Japan also describes a case of gradual approach to the implementation of fiscal decentralization policy.

5.1 Fiscal Decentralization in Japan

Since the last decade, Japan has made progress in fiscal decentralization policy. In April 2000, the Decentralization Law's Package aims to increase local autonomy in terms of expenditure and revenue area came into effect.

5.1.1 Distribution Authority

Public spending, including spending on education and infrastructure mostly the authority of the local governments, while the central government withdraws taxes to get revenue. This asymmetric distribution function caused the vertical fiscal gap is solved with the fiscal transfer. With the large parts of fiscal

transfer comes with discretion of central government, so that local governments have little authority.

Japan's fiscal condition is still marked by the dominant policy designed by the central government. GDP expenditure (FY2001) amounts to approximately 502 trillion yen. Total government expenditure accounted for 121 trillion yen (24.2%). The central government contributes 23 T yen (4.6%) and local governments contributed 67 T yen (13.5%). The difference is the social security fund.

As shown in the picture below, local government spending is especially in sectors relating to daily life. The highest is in the health sector and public sanitation. Local governments also control 70% of the total public works. While the highest national expenditure is in the defense sector, the international relationship, and pension funds.

Figure 5.1 GDP and Public Financing in Japan
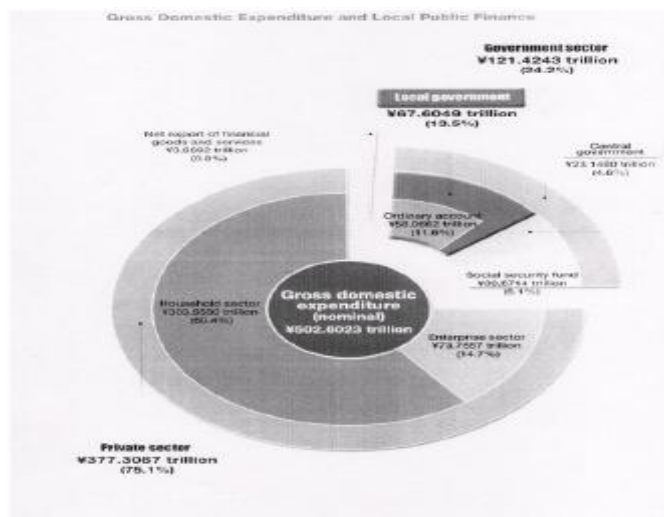
Sources: "White Paper on Local Public Finance, 2003"

5.1.2 Fiscal Balance

Since the early 70s, when Japan's economy slowed and entered a stable period, central government provides a very large fiscal transfer funds to poor areas with the aim of income redistribution. Public investment increased rapidly intended to redistribute income and create jobs, so that consequently poor areas become dependent on government investment and fiscal transfer.

Similar with other countries, there are two kinds of equalization funds to the regions which is general purpose funds (block grants) and specific purpose funds (matching grant). Matching grant called "national reimbursement", which is determined by the technical ministry, while the block grant called the "Local Tax Allocation", which under the authority of the Ministry of Public Administration.

Local Tax Allocation is determined by the ratio as follows: 32% individual income tax, 35.8% corporate income tax, 29.5% for consumption taxes and 25% for cigarette tax. 94% of Local Tax Allocation to local governments are allocated based on the fiscal gap, namely the fiscal needs minus the estimated total revenue per area.

Although formally Local Tax Allocation determined by a formula, but there are interventions to this formula. Bailout could be included in the Local Tax Allocation, so that local governments tend not to solve their problems fiscal itself. Bailout schemes included in the calculation of the fiscal needs standards that are based on a complicated formulation. In contrast improvement on local fiscal capacity led to decrease the amount of Local Tax Allocation transferred to sub national government. So that, poor regions have an incentive to remain poor, while wealthy areas have an incentive to increase fiscal capacity while not receiving

Local Tax Allocation. As a result, it will worsen the horizontal gap fiscal and the higher dependence of the poorer regions.

5.2 Fiscal Decentralization in India

India is a developing country with a tradition of carried on a federal structure democratically. In fact, the system of federalism in India is very centralized that the central government can controls the significant sources of tax revenue and secure with the power to revoke decisions created by local governments. While the form of federation was adopted for respect the diversity of national interests, after applying the centralization during the 1960s, India then moved to stages of fiscal decentralization. The adopted form is to increase the share of state tax base that has been distributed to the individual income tax and excise. Moreover in the 1980s, India began to be decentralized to the districts. When the decentralization process is underway, the government is increased public sector spending significantly so that India had experienced high budget deficits at both the central government and states government.

5.2.1 Allocation Authority

In accordance with the constitution of India, the division of revenue and expenditure authority is based on the principle of division of authority between the government levels. National public affairs such as defense and foreign trade are central government authority, while local affairs such as agriculture and primary education are the responsibility of local government.

On the revenue side, most of the tax base, such as corporate income tax, is owned by the central government, while local governments tax base including

local tax and land and buildings tax, agricultural income tax, motor tax and sales tax. There is an attempt to separate the tax base between the two levels of government depends on the mobility level of the tax base. The separation is done legally but did not meet the rules of economics.

5.2.2 Fiscal Transfer

Due to the significant tax base controlled by the central government, there is vertical fiscal gap that needed to be covered with fiscal transfers from central government. In 1990, revenues from the State Own Revenue accounts for about 45% of total local budgets, while the rest financed through the Fiscal balance fund and loan. The central government is strict controlling the loans made by states.

In addition, horizontal fiscal disparities that caused by inequality of development between regions, makes the importance of fiscal transfers to achieve a minimum level of public services and equitable distribution of tax. Transfer from the central government takes place through three channels: 1) Finance Committee, 2) Planning Commission, and 3) Ministry. Finance Commission proposed the division of 1) income tax, and 2) duty excise, between the central and state (to reduce the vertical fiscal gap) and between the States (to reduce horizontal fiscal disparities).

The division is based on assessment and the estimated expenditure and income between the central government and state. These transfers are block grants. Planning Commission provide grants and loans to state that intended to finance regional development. Financial support is necessary because the state is responsible for developing the economy but not have sufficient revenue sources to finance these functions.

The significance of this fiscal transfer is relatively increased, but its distribution is still discretion. Planning Commission and other ministries also joined the state to interfere with the decision part in their development schemes and as a result, local needs and local conditions may not be involved in planning decision. In addition, mismanagement in the construction scheme that has been financed by debt makes some states get into the bondage of debt also increase seeking credit limitations on local fiscal autonomy.

5.3 Fiscal Decentralization in China

Despite the phenomenal success of China in developing its economy, this country is less so successful in expanding the tax base. Both the central government and local tax base have not been able to reach out the rapidly growing private sector since the 1980s, so the tax burden more depend on the prospect of SOEs.

During the 1980s, the relations between central and local governments in China based on the fiscal contract system. Generally, the fiscal contract system allows the provincial government took a portion of tax revenues collected in their regions. The portion taken varied across the province until the maximum margin is 100%. Excess on this system is the formation of a strong positive relationship between local revenue and local economic development.

In line with the principle of "market preserving federalism", this will motivate local governments to enhance regional economic development because they have the policy tools and the ability to fulfill this function. In fact, China is successful in develop its economy during the 1980s. In the mid-80s, the central government implementing tax reforms that aimed at increasing portion of central

government tax revenue, but these efforts were failed due to strong rejection from local government, so that eventually this fiscal contract system runs until 1994.

In 1994, China was started the taxation reform. The goals were first increase government revenue to GDP ratio, and second increase the ratio of central government revenue. Different with the contract system, differentiated among the fiscal areas, tax-sharing scheme is formal. The division of taxation powers takes in place, also formation of national tax collector board. Value Added Tax is also divided between central and sub national government with a ratio of 75:25. Individual income tax is fully owned by local governments while authority to levy corporate income tax is allocated according to ownership of SOE.

Fiscal decentralization in China after the year 1970 gives more authority on local governments that help boost the regional economy. However, this also brings conflict of interest regarding the acceptance of revenue between central and local governments. In addition, in the development process, the gap between provinces in the coastal areas with the provinces in the western region is increasing. The central government now faces the problem on equalization fiscal capacity between regions that have not been considered by the reforms of 1994.

5.4 Fiscal Decentralization in Vietnam

Decentralization system in Vietnam is characterized by deconcentration and decentralization administration, whereby local governments are responsible for implementing policies decided by the central government. Budget allocation including investments held by the central approach to the region, so that less

attention to the uniqueness of the area and not flexible. This causes inefficiencies in public spending.

The allocation by the central government to local discretion depends on the negotiations between the ministries also between central and local. Consequently inter-regional allocation may be distorting. There is a tendency rich region would only receive the allocation of greater public spending, resulting in horizontal fiscal disparities widened.

Although autonomy in public spending has increased since the 1990s, in reality local authorities conduct very limited autonomy due to lack of local fiscal resources. There is a tax agreement between the central and sub national government, which is somewhat similar to the case of China before the reforms of 1994. Sub national government entitled to take advantage of targeted tax revenue. Incentive is intended to empower motivated local resources for local development. Despite these incentives results, the rich province is got higher profits. Poor Local governments in the end forced to rely on ad-hoc fund to finance local expenditures.

CHAPTER 6

ANALYSIS OF THE IMPACT OF FISCAL DECENTRALIZATION

ON REGIONAL ECONOMIC DEVELOPMENT IN INDONESIA

(PERIOD 2005-2008)

6.1   Analysis of Impact Intergovernmental Fiscal Transfer on Regional Economic Development

The implementation of fiscal decentralization has a main objective to support the funding of affairs that has been given to the province/regent to improve efficiency and effectiveness of governance and public service. With governance and better public services, it is expected to provide an opportunity for regions to improve the people welfare, so that, in turn will promote economic development through regional economic development.

However, efforts to improve the regional economy and improving people's welfare can not be simply depend on the fiscal decentralization policy alone. Regional development is an integral part of national development that adjusted with the potential, aspirations, and regional problems. A good implementation of regional development can only be done if there is a balancing role of the three pillars, namely: government, private sector, and society. Each of them has the functions and roles in charge of development. Government (executive and legislative) plays to run and create conducive political and legal environment to the other elements. There for synchronization and coordination between different levels of government must be realized. The role of the private sector is to provide job creation and income. Society plays a role in the creation of social

interaction, economic and political. The three pillars are to play a role in accordance with the values and principles embodied in the good governance.

To assess the success of the implementation of regional economic development, there are some indicators that can be used. One indicator of regional economic development is economic growth, which is reflected by the growth in GDP at constant prices. Factors that affect regional economic growth are consumption rate, investment, employment, the multiplier effect from government spending, and trade activities. As shown in Table 6.1 and Figure 6.1, regional economic growth vary widely, which is influenced by investment, employment, a multiplier effect from government spending and regional trade activities. Between the period of 2005-2008, the average regional economic growth is 5.17 percent. At Figure 6.1, shows that there are 24 provinces are above average and the 9 provinces are below average. Fluctuations in a relatively high on economic growth, in the province of Aceh and Papua, are caused by fluctuations in export mining results.

Tabel 6.1

Regional Economic Growth by Province 2004-2008 (percent)

No	Province	Year					Average 2005-2008
		2004	2005	2006	2007	2008	
1	Nanggroe Aceh Darussalam	(9.63)	(10.12)	1.56	(2.36)	(5.27)	(5.14)
2	Sumatera Utara	5.74	5.48	6.20	6.90	6.39	6.08
3	Sumatera Barat	5.47	5.73	6.14	6.34	6.37	5.92
4	Riau	2.93	5.41	5.15	3.41	5.65	4.22
5	Jambi	5.38	5.57	5.89	6.82	7.16	5.92
6	Sumatera Selatan	4.63	4.84	5.20	5.84	5.10	5.13
7	Bengkulu	5.38	5.82	5.95	6.03	4.93	5.79
8	Lampung	5.07	4.02	4.98	5.94	5.26	5.00
9	Kepulauan Bangka Belitung	3.28	3.47	3.98	4.54	4.44	3.82
10	Kepulauan Riau	6.47	6.57	6.78	7.01	6.65	6.71
	Sumatera	**2.93**	**3.57**	**5.26**	**4.95**	**4.92**	**4.18**
11	DKI Jakarta	5.65	6.01	5.95	6.44	6.18	6.01
12	Jawa Barat	4.77	5.60	6.02	6.48	5.83	5.72
13	Jawa Tengah	5.13	5.35	5.33	5.59	5.46	5.35
14	DI. Yogyakarta	5.12	4.73	3.70	4.31	5.02	4.46
15	Jawa Timur	5.83	5.87	5.77	6.11	5.90	5.89
16	Banten	5.63	5.88	5.57	6.04	5.82	5.78
	Jawa	**5.40**	**5.75**	**5.77**	**6.19**	**5.88**	**5.78**
17	Bali	4.62	5.56	5.28	5.92	5.97	5.34
	Jawa & Bali	**5.38**	**5.75**	**5.76**	**6.18**	**5.89**	**5.77**
18	Kalimantan Barat	4.79	4.69	5.23	6.02	5.42	5.18
19	Kalimantan Tengah	5.56	5.90	5.84	6.06	6.16	5.84
20	Kalimantan Selatan	5.03	5.06	4.98	6.01	6.23	5.27
21	Kalimantan Timur	1.75	3.17	2.85	1.88	4.82	2.41
	Kalimantan	**3.01**	**3.92**	**3.80**	**3.53**	**5.26**	**3.57**
22	Sulawesi Utara	4.26	4.90	5.72	6.47	7.56	5.34
23	Sulawesi Tengah	7.15	7.57	7.82	7.99	7.76	7.63
24	Sulawesi Selatan	5.26	6.05	6.72	6.34	7.78	6.09
25	Sulawesi Tenggara	7.51	7.31	7.68	7.96	7.27	7.62
26	Gorontalo	6.93	7.19	7.30	7.51	7.76	7.23
27	Sulawesi Barat	0.00	6.78	6.42	7.43	8.54	5.16
	Sulawesi	**10.30**	**6.28**	**6.83**	**6.88**	**7.72**	**7.57**
28	Nusa Tenggara Barat	6.07	1.71	2.77	4.91	2.63	3.86
29	Nusa Tenggara Timur	5.34	3.46	5.08	5.15	4.81	4.76
30	Maluku	4.43	5.07	5.55	5.62	4.23	5.17
31	Maluku Utara	4.71	5.10	5.48	6.01	5.98	5.32
32	Papua Barat	7.39	6.80	4.55	6.95	7.33	6.42
33	Papua	(22.53)	36.40	(17.14)	4.34	(1.49)	0.26
	Tenggara, Maluku & Papua	**(5.26)**	**13.97**	**(4.03)**	**5.06**	**2.40**	**2.43**
	Kawasan Barat	**4.72**	**5.17**	**5.63**	**5.86**	**5.63**	**5.34**
	Kawasan Timur	**3.07**	**6.43**	**3.00**	**4.72**	**5.39**	**4.30**
	Jumlah 33 Provinsi	**4.44**	**5.38**	**5.18**	**5.67**	**5.59**	**5.17**

Source :Indonesian Statistic Board

Figure 6.1

Average Regional Economic Growth Period 2005-2008
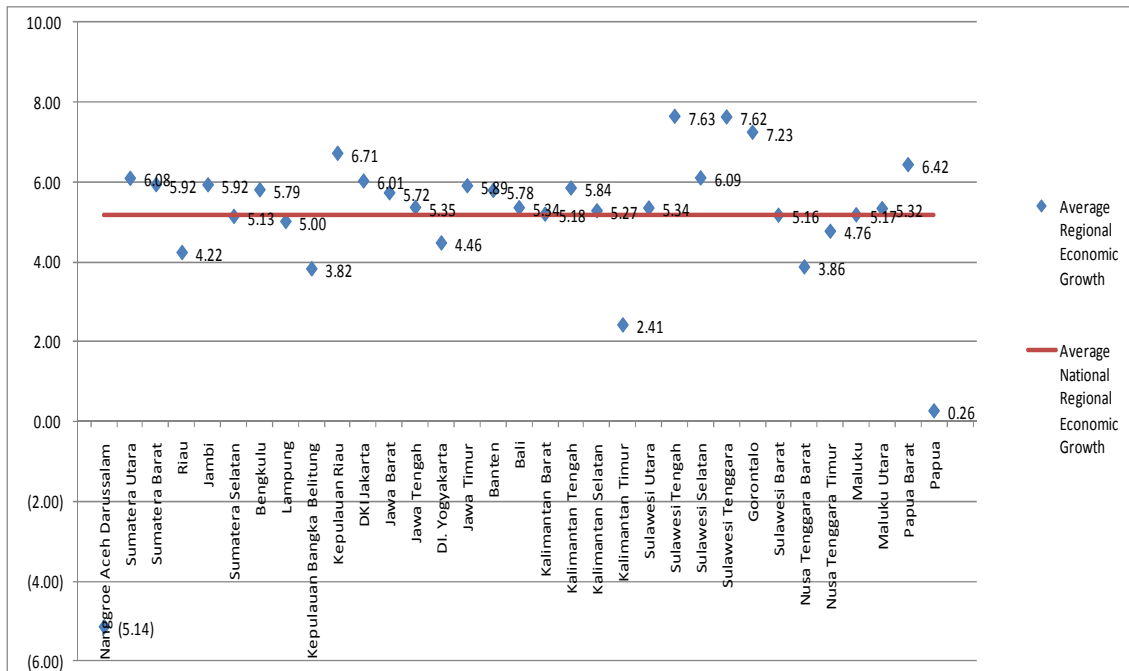
Source: Indonesian Statistic Board

Increased economic growth as indicated by increasing on GDRP, on one hand give the opportunity to increased social welfare, on the other hand, has the potential to increase the rate of regional inflation. In recent years, movements in the inflation rate can be maintained below the level 2 (two) digits. The average inflation rate in all regions experienced a significant increase due to fuel price hike policy in 2005. The highest inflation rate in 2005 occurred in the province of Aceh, particularly in Banda Aceh, reached 41.11 percent. The high rate of inflation is caused by the limited circulation of goods in the post-tsunami rehabilitation process that occurred in Aceh Province and parts of North Sumatra Province. In 2006 and 2007, high inflation rate on these regions can be significantly reduced through a variety of policies that give priority to the development of physical infrastructure. Meanwhile in 2008, inflationary pressures is reoccur in line with the policy of fuel price increases and the impact of turbulence in

international food prices which occurred in late 2007. The development of the inflation rate in 33 cities can be seen in Table 6.2.

Table 6.2

Yearly Inflation in 33 Cities/Provinces

No	Kota	2005	2006	2007	2008	No	Kota	2005	2006	2007	2008
1	Banda Aceh	41.1	9.5	11	12	18	Mataram	17.7	4.2	8.8	12.4
2	Medan	22.9	6	6.4	9.9	19	Kupang	15.2	9.7	8.4	10.5
3	Padang	20.1	8	6.9	13.1	20	Pontianak	14.4	6.3	8.6	11.6
4	Pekanbaru	17.1	6.3	7.5	10.5	21	Palangkaraya	12.1	7.7	8	12.2
5	Batam	14.8	4.6	4.8	8.6	22	Banjarmasin	12.9	11	7.8	11
6	Jambi	16.5	10.7	7.4	11.1	23	Samarinda	16.6	6.5	9.2	12.8
7	Palembang	19.9	8.4	8.2	13.3	24	Manado	18.7	5.1	10.1	9
8	Bengkulu	25.2	6.5	5	14.5	25	Palu	16.3	8.7	8.1	10.7
9	Bandar Lampung	21.2	6	6.6	14.4	26	Makasar	15.2	7.2	5.7	12.2
10	Pangkal Pinang	17.4	6.4	2.6	18.4	27	Kendari	21.5	10.6	7.5	16
11	DKI Jakarta	16.1	6	6	11.1	28	Gorontalo	18.6	7.5	7	7.9
12	Bandung	19.6	5.3	5.3	9.9	29	Ambon	16.7	4.8	5.8	10.1
13	Semarang	16.5	6.1	6.7	11.2	30	Ternate	19.4	5.1	10.4	12.2
14	Yogyakarta	15	10.4	8	10	31	Manokwari	n.a	n.a	n.a	14.5
15	Surabaya	14.1	6.7	6.3	10.4	32	Jayapura	14.1	9.5	10.3	15.5
16	Serang	16.1	7.7	6.3	13.7	33	Mamuju	n.a	n.a	n.a	8.5
17	Denpasar	11.3	4.3	5.9	10.5						

Source: Indonesian Statistic Board

In the context of regional development, one of the factors that could affect regional economic growth is the high competitiveness of the region, particularly with regard to the ability to create investment in each region. In order to increase investment, the region can make efforts in improving services and conveniences for investors to create conducive conditions to the business development. At Table 6.3 can be seen that Investment growth in some regions tends to show improvement.

Based on data from the Investment Coordinating Board (BKPM), in 2008, the realization of foreign investment (FDI) reached U.S. $ 14,871.4 million and Domestic Investment (PMDN) of Rp20.363,4 billion. This figure shows a slight decrease compared to 2005. However, overall investment activity still concentrated in Java and

Sumatra. Although this BKPM data do not include the overall types of investments such as oil and gas sector, banking, insurance portfolio, but at least it shows that investment activity outside of Java and Sumatra is relatively not optimal mainly because it is still inadequate infrastructure in that region.

Table 6.3

Foreign Direct Investment and Domestic Investment in Indonesia 2005-2008

	FDI (million US $)				Domestic Investment (Billion Rp.)			
Province	2005	2006	2007	2008	2005	2006	2007	2008
Sumatera	1,232.4	898.2	1,398.5	1,009.9	13,501.7	4,505.9	10,754.5	4,840.1
Jawa	7,245.7	4,416.4	8,503.5	13,566.8	14,796.6	13,030.8	18,668.9	12,230.7
Bali and Nusa Tenggara	102.6	106.2	56.7	95.5	66.1	104.9	15.7	29.0
Kalimantan	181.8	534.8	300.6	115.2	1,747.6	2,536.1	1,558.0	1,821.4
Sulawesi	145.3	15.5	79.6	654.0	509.0	68.6	3,881.6	1,147.5
Maluku	9.1	200.0	0.0	0.0	0.9	0.2	0.0	0.0
Papua	0.0	0.6	2.5	18.7	43.1	403.5	0.0	294.7
	8,916.9	5,991.7	10,341.4	14,871.4	30,665.0	20,649.0	34,878.7	20,363.4

Source: Indonesian Statistic Board

Investment activity both Foreign Direct Investment (FDI) and Domestic Investment (PMDN), indirectly have a positive impact on decreasing the unemployment rate in the region. The average unemployment rate in the island of Sumatra and Java in 2008 was relatively lower than in 2005. However, the average unemployment rate of each province in Java Island is relatively higher than the Sumatra island. This happens as a result of population density in Java is not supported by an adequate increase in employment. Meanwhile, for the region of Nusa Tenggara and Kalimantan, although in the year 2008 has been a decline in the average unemployment rate, but the unemployment rate increased slightly in 2006 compared with 2005. Growth rate of unemployment per province can be seen in Table 6.4. Between the period of 2005-2008, the average unemployment rate is 9.5 percent. At Figure 6.2 shows that there are 10 provinces are above average, and the 23 provinces are below average.

Tabel 6.4

Percentage of Unemployment by Province Period 2005-2008

Province	2005	2006	2007	2008
Naggroe Aceh Darussalam	12.5	10.4	9.8	9.6
Sumatera Utara	11.0	11.5	10.1	9.1
Sumatera Barat	11.5	11.9	10.3	8.0
Riau	13.9	10.2	9.8	8.2
Jambi	8.6	6.6	6.2	5.1
Sumatera Selatan	8.6	9.3	9.3	8.1
Bengkulu	6.2	6.0	4.7	4.9
Lampung	6.9	9.1	7.6	7.2
Bangka Belitung	8.1	9.0	6.5	6.0
Kepulauan Riau	n.a	n.a	9.0	8.0
DKI Jakarta	14.7	11.4	12.6	12.2
Jawa Barat	14.7	14.6	13.1	12.1
Jawa Tengah	8.5	8.0	7.7	7.4
DI Yogyakarta	5.3	6.3	6.1	5.4
Jawa Timur	8.5	8.2	6.8	6.4
Banten	14.2	18.9	15.8	15.2
Bali	4.0	6.3	3.8	3.3
Nusa Tenggara Barat	8.9	8.9	6.5	6.1
Nusa Tenggara Timur	5.5	3.7	3.7	3.7
Kalimantan Barat	8.6	8.5	6.5	5.4
Kalimantan Tengah	4.9	8.7	5.1	4.6
Kalimantan Selatan	6.2	8.9	7.6	6.2
Kalimantan Timur	9.0	13.4	12.1	11.1
Sulawesi Utara	14.4	14.6	12.3	10.7
Sulawesi Tengah	7.6	10.3	8.4	5.5
Sulawesi Selatan	13.6	12.8	11.3	9.0
Sulawesi Tenggara	8.9	9.7	6.4	5.7
Gorontalo	9.8	6.2	7.2	5.7
Sulawesi Barat	n.a	n.a	5.5	4.6
Maluku	12.3	16.7	12.2	10.7
Maluku Utara	8.9	6.9	6.1	6.5
Irian Jaya Barat	n.a	n.a	9.5	7.7
Papua	7.1	5.8	5.0	4.4
INDONESIA	**11.2**	**10.3**	**9.1**	**7.4**

Source: Indonesian Statistic Board

Figure 6.2

Percentage of Unemployment by Province Average 2005-2008
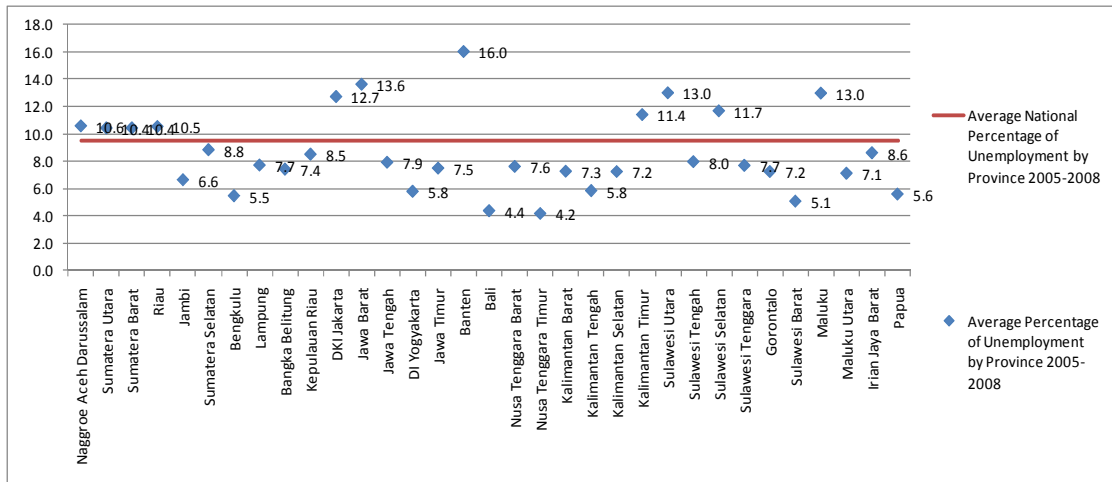
Source: Indonesian Statistic Board

In addition, other indicator that can be used to measure the success of economic development is equitable development. Based on Williamson Index figures, in 2002-2008, showed that the level of economic activity, reflected on the distribution of the value of inter-provincial GDRP is still relatively low, but its development shows better conditions. As can be seen in Table 6.5, in 2002, Williamson index for economic activities of 0.723, fell to 0.533 in 2008. Improvement on Williamson Index showed that the development of inter-provincial economic activities is become more balanced than before. When viewed by region, local provinces in Java Island (excluding DKI Jakarta) have the most equitable economic activity, followed by the province located on the Sulawesi Island. However, the provinces that located in Sumatra, Kalimantan, Maluku Islands and Papua have relatively high inequality.

Table 6.5

Williamson Index for GDRP Period 2002 – 2008

	2002	2003	2004	2005	2006	2007	2008
Indonesia	0.723	0.691	0.677	0.613	0.589	0.561	0.533
Sumatera	0.933	0.931	0.932	0.914	0.914	0.520	0.520
Jawa	0.176	0.168	0.171	0.175	0.169	0.170	0.172
Kalimantan	0.984	0.919	0.899	0.886	0.856	0.418	0.433
Sulawesi	0.198	0.183	0.178	0.204	0.193	0.516	0.498
Maluku and Papua	0.659	0.623	0.625	0.611	0.568	0.823	0.816
Bali, NTB and NTT	0.394	0.381	0.380	0.395	0.416	0.197	0.192

Source: Indonesian Statistic Board

Various indicators have been developed to measure the success of economic development, one of them is HDI, developed by UNDP through a survey of most of the countries in the world. Based on the survey, as can be seen in Table 6.6, HDI Indonesia tends to increase which indicates that there is an improvement in the welfare of society.

Table 6.6

Human Development Index by Province Period 2002-2008

Province	2002	2004	2005	2006	2007	2008
Nanggroe Aceh Darussalam	66.0	68.7	69.1	69.4	70.4	70.8
Sumatera Utara	68.8	71.4	72.0	72.5	72.8	73.3
Sumatera Barat	67.5	70.5	71.2	71.7	72.2	73.0
Riau	69.1	72.2	73.6	73.8	74.6	75.1
Jambi	67.1	70.1	71.0	71.3	71.5	72.0
Sumatera Selatan	66.0	69.6	70.2	71.1	71.4	72.1
Bengkulu	66.2	69.9	71.1	71.3	71.6	72.1
Lampung	65.8	68.4	68.9	69.4	69.8	70.3
Bangka Belitung	65.4	69.6	70.7	71.2	71.6	72.2
Kepulauan Riau	-	70.8	72.2	72.8	73.7	74.2
DKI Jakarta	75.6	75.8	76.1	76.3	76.6	77.0
Jawa Barat	65.8	69.1	69.9	70.3	70.7	71.1
Jawa Tengah	66.3	68.9	69.8	70.3	70.9	71.6
Yogyakarta	70.8	72.9	73.5	73.7	74.2	74.9
Jawa Timur	64.1	66.8	68.4	69.2	69.8	70.4
Banten	66.6	67.9	68.8	69.1	69.3	69.7
Bali	67.5	69.1	69.8	70.1	70.5	71.0
Nusa Tenggara Barat	57.8	60.6	62.4	63.0	63.7	64.1
Nusa Tenggara Timur	60.3	62.7	63.6	64.8	65.4	66.2
Kalimantan Barat	62.9	65.4	66.2	67.1	67.5	68.2
Kalimantan Tengah	69.1	71.7	73.2	73.4	73.5	73.9
Kalimantan Selatan	64.3	66.7	67.4	67.8	68.0	68.7
Kalimantan Timur	70.0	72.2	72.9	73.3	73.8	74.5
Sulawesi Utara	71.3	73.4	74.2	74.4	74.7	75.2
Sulawesi Tengah	64.4	67.3	68.5	68.9	69.3	70.1
Sulawesi Selatan	65.3	67.8	68.1	68.8	69.6	70.2
Sulawesi Tenggara	64.1	66.7	67.5	67.8	68.3	69.0
Gorontalo	64.1	65.4	67.5	68.0	68.8	69.3
Sulawesi Barat	-	64.4	65.7	67.1	67.7	68.6
Maluku	66.5	69.0	69.2	69.7	70.0	70.4
Maluku Utara	65.8	66.4	67.0	67.5	67.8	68.2
Irian Jaya Barat	-	63.7	64.8	66.1	67.3	68.0
Papua	60.1	60.9	62.1	62.8	63.4	64.0
Indonesia (BPS)	**65.8**	**68.7**	**69.6**	**70.1**	**70.6**	**71.2**

Source: Indonesian Statistic Board

At Table 6.6, can be seen the level of regional social welfare. In general, there is no change in regional welfare ranking of the years 2002-2008, except for Bangka Belitung province that experienced a significant increase in ratings. Region with the highest HDI is DKI Jakarta Province while the lowest is the province of Papua.

Welfare indicator can also be seen from the level of poverty is inversely related to HDI values prevailing in each region. In Figure 6.3, seen that picture of the poverty level is not much different with a picture of the achievements of HDI. The regions with high HDI such as DKI Jakarta and Bali province also has a relatively low percentage of poverty, by contrast areas with low HDI such as Papua and Maluku province tend to have a high percentage of poor people. Between the period of 2005-2008, the average poverty level is 16 percent. Moreover in Figure 6.4, shows that out of 33 provinces, there are 16 provinces, which percentage of poor people, above average and 17 provinces percentage of poor people below the average.

Figure 6.3

Map of Indonesia HDI by Province Average 2005-2008
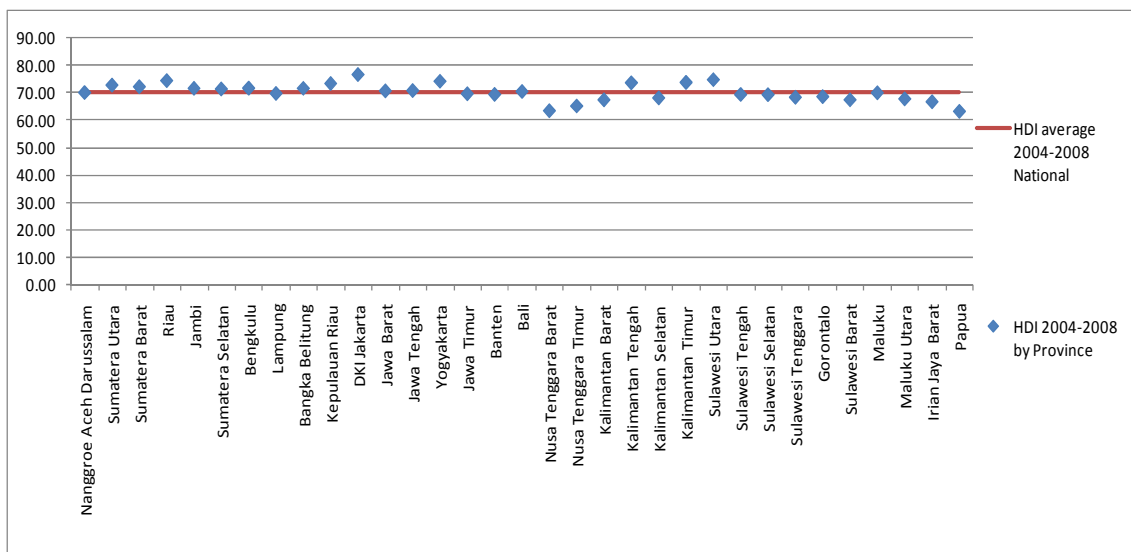
Source: Indonesian Statistic Board

Figure 6.4

Percentage of Population below Poverty Line Average 2005-2008
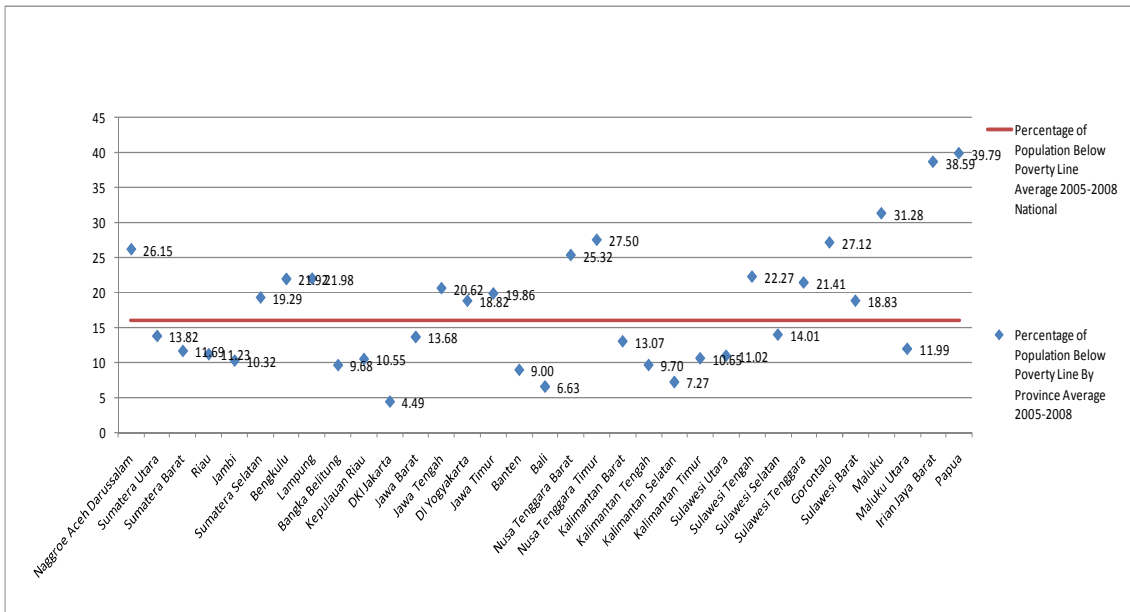
Source: Indonesian Statistic Board

Portraits of the national economy and the level of social welfare, which have increased from year to year, are in line with the increase in local funding sources through implementation of fiscal decentralization. Despite the increase in transfers from government to the regions, there was also accompanied by improved level of social welfare indicators. However, when we see the conditions in each region and correlation between the level of social welfare and increase on transfers, there are some things that need to get serious attention from Government and local government. The indicators level of social welfare nationally showed improvement, but not in all sub national governments had improved.

This study, did not attempt to measure how far the influence of Intergovernmental Fiscal Transfer on the regional economy and the welfare of society, but try to see the picture of the pattern of inter-regional trends in some variables:

Intergovernmental Fiscal Transfer, economic growth, unemployment, poverty and Human Development Index. In general, there is no direct relationship between transfer of Intergovernmental Fiscal Transfer with the regional economy and the people welfare. In theory that could affect the regional economy, is the multiplier effect created by government spending. Therefore, the assumption to be used is that a region, which has a high Intergovernmental Fiscal Transfer, will have a total high income also, then with high incomes will increase local spending that will push the regional economy.

Intergovernmental Fiscal Transfer variables will use numbers per capita, because it will be far more meaningful than the total nominal figures. For example, two of the sub national government, region "A" and region "B" has exactly the same income that is equal to 100 billion, but the Region "A" has a population of one million people while Region "B" of two million inhabitants. With the approach of total nominal rate, then the two regions considered having the same earning capacity. Meanwhile, when using per capita approach would appear that the Region "A" turns out to have the "real" earning capacity higher than the Region "B". Revenue per capita will become more meaningful because it has accounted for one aspect of the main requirements of governance, such as population.

In this study, Intergovernmental Fiscal Transfer per capita will be compared directly with the four other variables, namely Poverty Level, GDRP Growth Rate, Unemployment Rate and Human Development Index. Comparisons performed on average data period 2005-2008 for the whole of the provinces in Indonesia, which consists of 33 provinces. Provincial financial data are aggregated data from provincial data and all municipal and city within the province concerned.

Figure 6.5

Income per capita and Intergovernmental Fiscal Transfer per capita

Average 2005-2008 Compare
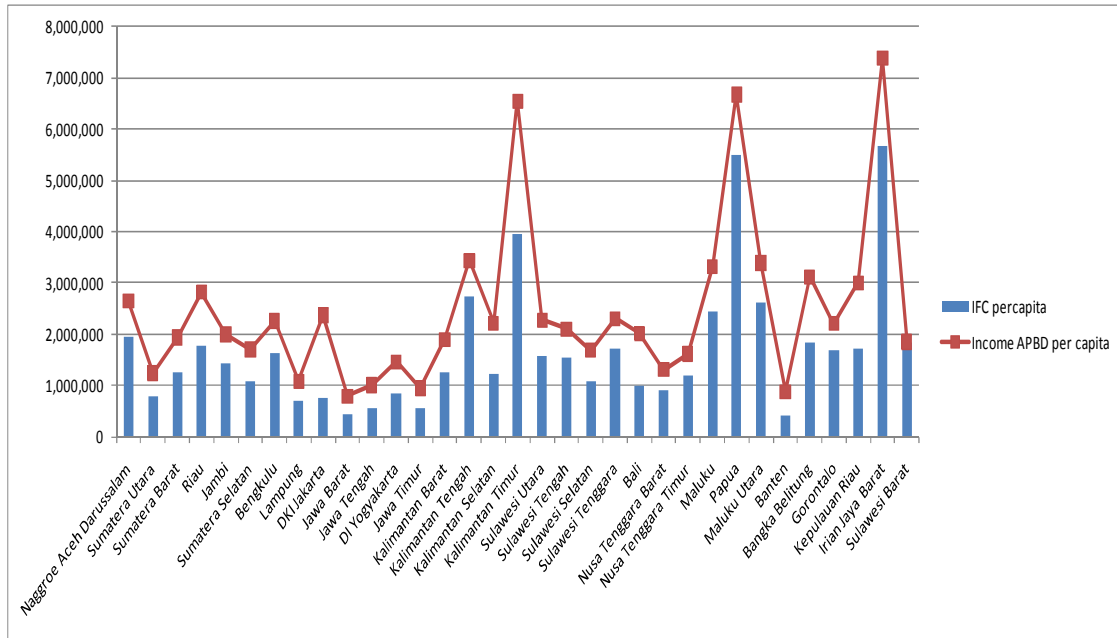
Source : Ministry of Finance Republic of Indonesia

The first analysis is to test the assumption that regions with high Intergovernmental Fiscal Transfer will have higher total budget revenue than the other. By using an average of 2005-2008, data from 33 provinces (aggregate provincial, municipal and city), data Intergovernmental Fiscal Transfer per capita compared with the total budget per capita income. As seen in Figure 6.5, it turns out that sub national governments with high Intergovernmental Fiscal Transfer per capita tend to have high total income per capita as well. It is also shown with a fairly high correlation of both variables that are equal to 0.97. Based on test results assuming the relationship between Intergovernmental Fiscal Transfer per capita with total income per capita, then further testing can be done on the next assumption, namely that regions with high

Intergovernmental Fiscal Transfer income will be able to encourage better economic growth than the other.

Figure 6.6

Correlations between Income per capita and

Intergovernmental Fiscal Transfer per capita Average 2005-2008

Correlations

		VAR00003	VAR00004
VAR00003	Pearson Correlation	1	.969[**]
	Sig. (2-tailed)		.000
	N	33	33
VAR00004	Pearson Correlation	.969[**]	1
	Sig. (2-tailed)	.000	
	N	33	33

**. Correlation is significant at the 0.01 level (2-tailed).

Further analysis is to compare between the variables Intergovernmental Fiscal Transfer per capita with the level of poverty. The general assumption to be used is that high-income province will be smaller poverty level in the regions concerned. Once again, it is still associated with the assumption that high-income provinces could stimulate economic growth significantly, and further could reduce the level of poverty. In Figure 6.7, shows that regions with high Intergovernmental Fiscal Transfer per capita like East Kalimantan, Riau, Kepulauan Riau and DKI have a relatively low percentage of poor people, or at least below average at 16.58%. On the other hand, regions such as Central Java, Yogyakarta, East Java and NTT, which has a low per capita Intergovernmental Fiscal Transfer also has a high percentage of poor people. However, West Papua and Papua regions that have high per capita income of Intergovernmental Fiscal Transfer per capita have proved to be the highest percentage of poor people.

Increased on transfer is coupled with improved levels of welfare, but the correlation was very low. The correlation between per capita transfers to the percentage of poor people in 33 provinces during the period of 2005-2008 showed a correlation rate of less than 0.5 even close to 0 (zero). This indicates that the increase in transfers to the regions not directly affect the improvement of public welfare.

Figure 6.7

Intergovernmental Fiscal Transfer per capita and Level of Poverty

Average 2005-2008 Compare
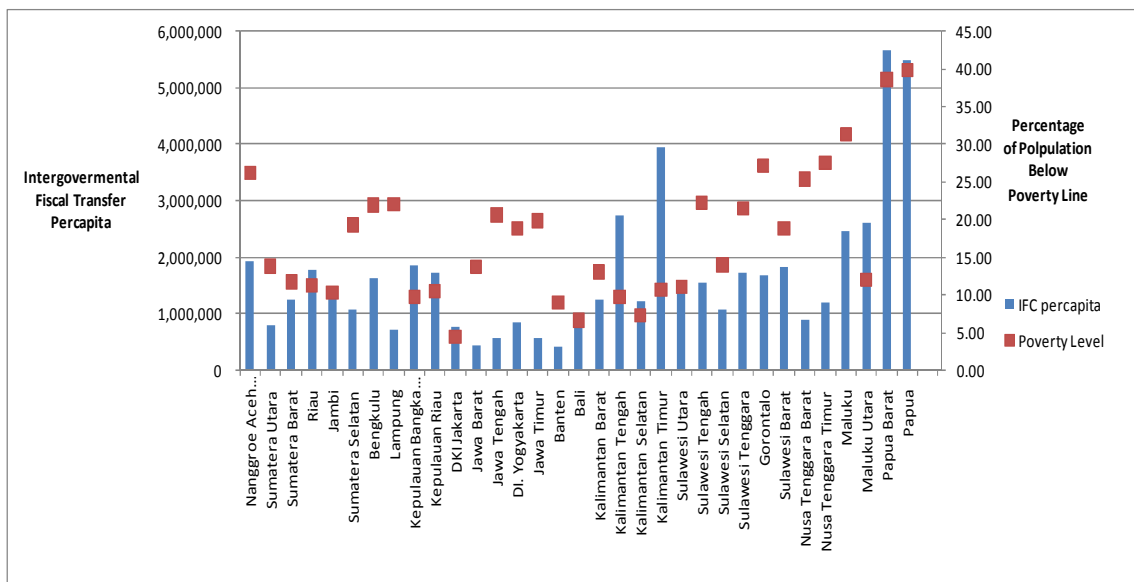
Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

In the above figure, shows that some regions that have high average Intergovernmental Fiscal Transfer per capita was precisely shows higher average percentage of poor people than the others. This indicates that Intergovernmental Fiscal Transfer to Region has been concentrated on regions that have low welfare level. So that, Government and the sub national government need to strive for better utilize of decentralization funds, to improve the welfare of the society. It is expected that the

relationship will look clearer and stronger link between the implementation of decentralization and improving the welfare of society.

Further testing can be done to the next assumption, that sub national governments with high Intergovernmental Fiscal Transfer income will be able to encourage better economic growth than the others. To see the pictures on the assumption that the paired 2 (two) variables in one graph, namely between the variables Intergovernmental Fiscal Transfer per capita income and economic growth variables. In this analysis, I will carry out a description of average data for 4 years (2005-2008), which is a regional aggregate data in 33 provincial areas. In Figure 6.8, shows that on average, from 2005 until 2008, the sub national government that has the highest Intergovernmental Fiscal Transfer per capita income is West Papua, followed by Papua, and East Kalimantan. While in the lowest position are Banten, West Java, Central Java, and East Java. In nominal terms, Central Java, East Java and West Java get a high enough Intergovernmental Fiscal Transfer income. However, because of the population in Java is relatively high compared to West Papua, Papua, and East Kalimantan, the Intergovernmental Fiscal Transfer per capita income is very much different.

Interesting things that can be seen in Figure 6.8 is the fact that sub national governments with high Intergovernmental Fiscal Transfer per capita would have relatively low regional economic growth, even for Aceh, Papua and East Kalimantan are regions with low economic growth. Average economic growth in the period of four years 2005-2008 is 5.17%. In Figure 6.8, shows that there are provinces with high Intergovernmental Fiscal Transfer income per capita proved to be its economic growth is below average. Meanwhile, regions with low Intergovernmental Fiscal Transfer income, such as Central Java, East Java and West Java, in fact, have the economic

growth above average. As such, it is contrary to the assumptions presented earlier.

In Figure 6.8, shows that within seven years of fiscal decentralization, sub national governments that receive higher per capita transfers are areas experiencing low economic growth rates than others. This reality needs a more serious attention from the Government and local government spending patterns for more effective in boosting the regional economy. Thus, sub national governments that get a higher transfer should be able to promote regional economic growth in a more optimal.

Increased on transfer is coupled with improved levels of welfare, but the correlation was very low. The correlation between per capita transfers to regional economic growth in 33 provinces during the period of 2005-2008 showed a correlation rate of less than 0.5 even close to 0 (zero). This indicates that the increase in transfers to the sub national governments not directly affect the improvement of public welfare.

Figure 6.8

Intergovernmental Fiscal Transfer per capita and Economic Growth
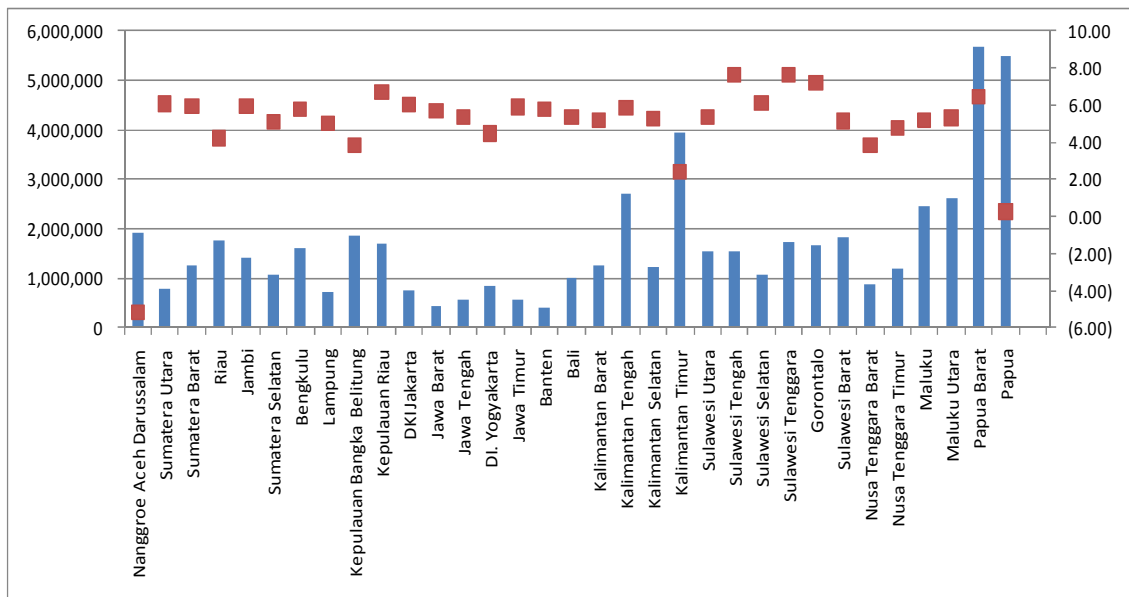
Average 2005-2008 Compare

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Other economic indicator that will be analyze is the level of unemployment. As the previous analysis, general assumption is that high-income sub national government will have smaller unemployment level in the regions concerned. It is still associated with the previous assumptions related to economic growth. If high-income sub national governments could stimulate economic growth significantly, the unemployment rate will decrease. As seen in Figure 6.9, it turns out that sub national governments with high Intergovernmental Fiscal Transfer per capita income has high levels of unemployment. Sub national governments of East Kalimantan, Riau, West Papua, Aceh and Jakarta which is the highest per capita recipient of Intergovernmental Fiscal Transfer, in fact, have unemployment rates above the average. The average unemployment rate in the period 2005-2008 is 9.5%. On the other hand, sub national governments with low per capita income of Intergovernmental Fiscal Transfer per capita, such as Central Java, Yogyakarta, East Java, NTT and West Java would have a low unemployment rate. It is consistent with the results of previous analysis, that turned out to regions with high Intergovernmental Fiscal Transfer per capita tended to lower its economic growth.

Increased on transfer is coupled with improved levels of welfare, but the correlation was very low. The correlation between per capita transfers to unemployment in 33 provinces during the period of 2005-2008 showed a correlation rate of less than 0.5 even close to 0 (zero). This indicates that the increase in transfers to the sub national governments not directly affect the improvement of public welfare.

Figure 6.9

Intergovernmental Fiscal Transfer per capita and Percentage of Unemployment
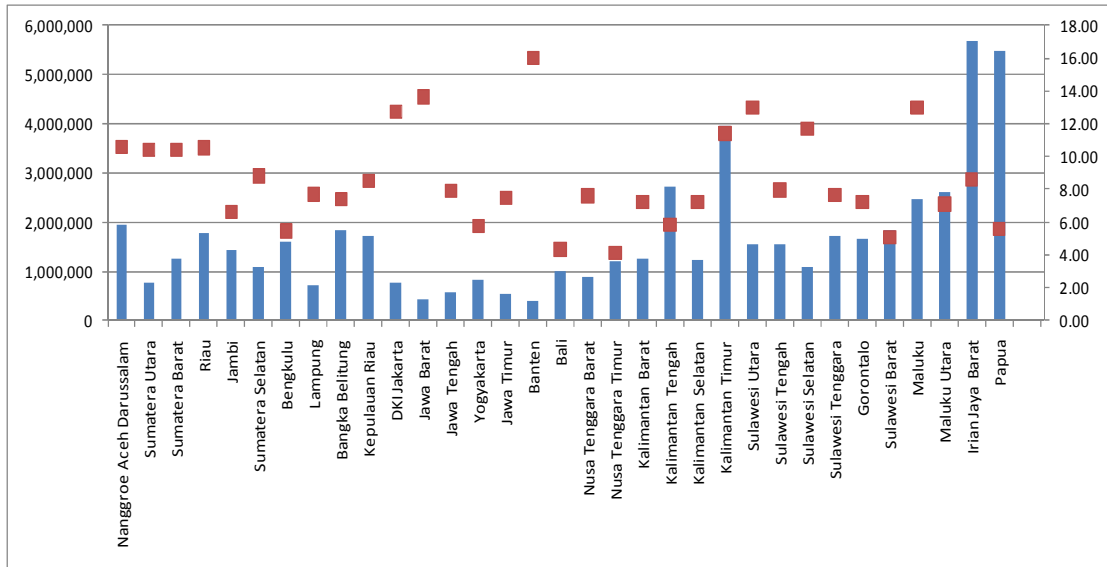
Average 2005-2008 Compare

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Further economic indicators to be analyzed, is the level of Human Development Index. General assumption is that high-income province will have higher HDI level in the regions concerned. It is still associated with the previous assumptions related to economic growth. If high-income sub national governments could stimulate the economic growth significantly, the HDI will increase. As seen in Figure 6.10, it turns out sub national governments with high Intergovernmental Fiscal Transfer income per capita have low levels of HDI. Provinces of Papua and West Papua which is the highest per capita recipient of Intergovernmental Fiscal Transfer, in fact, have HDI below the average. The average HDI in the period 2005-2008 is 70.6. On the other hand, sub national governments with low income of Intergovernmental Fiscal Transfer per capita, such as Central Java, Yogyakarta, East Java, and West Java would have HDI above

average. It is consistent with the results of previous analysis that turned out to provinces with high Intergovernmental Fiscal Transfer per capita tended to lower its economic growth.

Increased on transfer is coupled with improved levels of welfare, but the correlation was very low. The correlation between per capita transfers to Human Development Index in 33 provinces during the period of 2005-2008 showed a correlation rate of less than 0.5 even close to 0 (zero). This indicates that the increase in transfers to the regions is not directly to affect the improvement of public welfare.

Figure 6.10

Intergovernmental Fiscal Transfer per capita and Human Development Index

Average 2005-2008 Compare

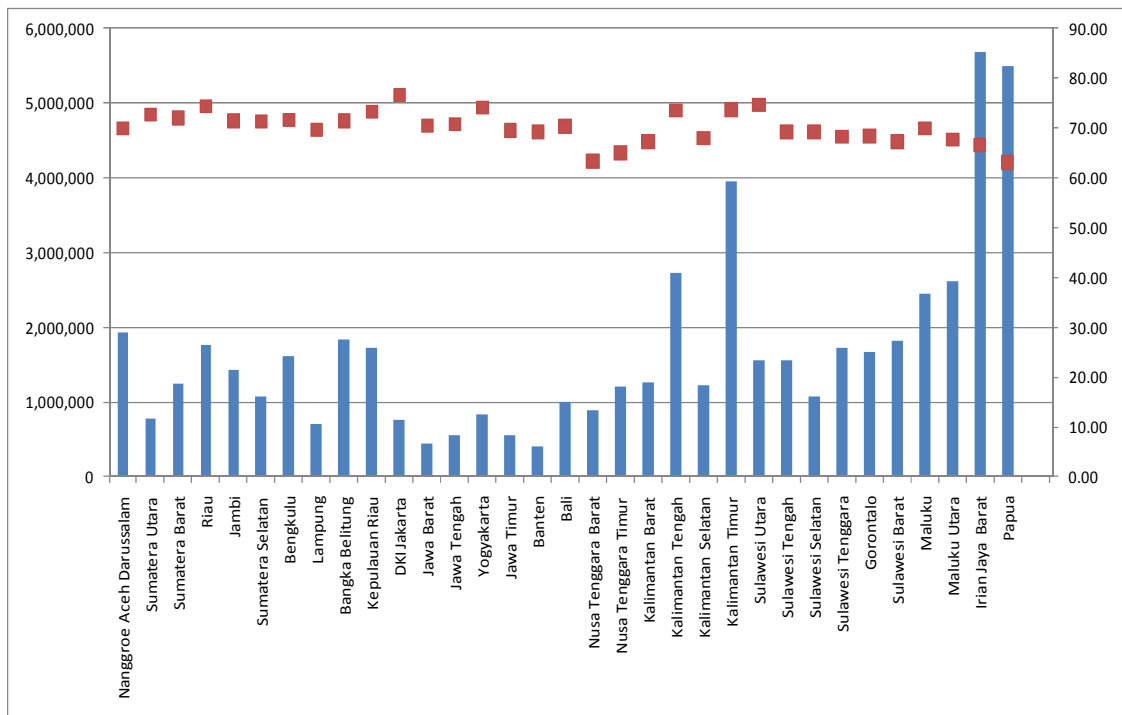Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

In addition to decentralization funding, government also allocates funds to finance activities in the sub national government, namely through the mechanism of the

vertical allocation of funds to institutions in the region, deconcentration fund allocation and the allocation of Tasks Fund. While the various funds are not a source of decentralization funding, but due to be spent in the regions then indirectly also have a role in the regional economy.

Table 6.7

Comparasion between Income percapita, Economic Growth, Poverty Level, Unemployment and HDI Average 2005-2008

Province	Income APBD percapita Average 2005-2008	Economic GrowthAverage 2005-2008	Poverty Level Average 2005-2008	Unemployment Average 2005-2008	HDI Average 2005-2008
Naggroe Aceh Darussalam	2,643,525	(5.14)	26.15	10.58	69.89
Sumatera Utara	1,232,438	6.08	13.82	10.43	72.64
Sumatera Barat	1,930,492	5.92	11.69	10.43	72.01
Riau	2,815,833	4.22	11.23	10.53	74.29
Jambi	1,987,810	5.92	10.32	6.63	71.42
Sumatera Selatan	1,701,113	5.13	19.29	8.83	71.19
Bengkulu	2,255,038	5.79	21.92	5.45	71.52
Lampung	1,077,896	5.00	21.98	7.70	69.58
DKI Jakarta	2,368,684	6.01	4.49	12.73	76.51
Jawa Barat	787,518	5.72	13.68	13.63	70.52
Jawa Tengah	1,005,280	5.35	20.62	7.90	70.64
DI Yogyakarta	1,461,715	4.46	18.82	5.78	74.06
Jawa Timur	946,797	5.89	19.86	7.48	69.44
Kalimantan Barat	1,896,860	5.18	13.07	7.25	67.25
Kalimantan Tengah	3,435,992	5.84	9.70	5.83	73.50
Kalimantan Selatan	2,219,019	5.27	7.27	7.23	67.98
Kalimantan Timur	6,546,995	2.41	10.65	11.40	73.62
Sulawesi Utara	2,275,085	5.34	11.02	13.00	74.61
Sulawesi Tengah	2,101,245	7.63	22.27	7.95	69.19
Sulawesi Selatan	1,682,740	6.09	14.01	11.68	69.18
Sulawesi Tenggara	2,305,796	7.62	21.41	7.68	68.16
Bali	2,016,113	5.34	6.63	4.35	70.34
Nusa Tenggara Barat	1,304,571	3.86	25.32	7.60	63.32
Nusa Tenggara Timur	1,618,793	4.76	27.50	4.15	64.98
Maluku	3,321,107	5.17	31.28	12.98	69.82
Papua	6,670,854	0.26	39.79	5.58	63.06
Maluku Utara	3,386,826	5.32	11.99	7.10	67.62
Banten	880,377	5.78	9.00	16.03	69.23
Bangka Belitung	3,113,817	3.82	9.68	7.40	71.42
Gorontalo	2,200,515	7.23	27.12	7.23	68.40
Kepulauan Riau	3,001,763	6.71	10.55	8.50	73.22
Irian Jaya Barat	7,376,463	6.42	38.59	8.60	66.54
Sulawesi Barat	1,850,244	5.16	18.83	5.05	67.26

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Of the four aforementioned analysis, when we combined in a single table will look like in Table 6.7. From this table, it can be seen that the sub national governments with high per capita Intergovernmental Fiscal Transfer are West Papua, Aceh, Papua, East Kalimantan, Riau, and Jakarta. However, the average of all local economic indicators of sub national governments with high Intergovernmental Fiscal Transfer per capita was worsening than a sub national government with a low per capita Intergovernmental Fiscal Transfer.

It must be realized that the analytical work mentioned above is only a rough picture of the relationship between Intergovernmental Fiscal Transfer with the regional economy development. A lot of external factors outside the financial are affecting economic indicators. This is evident from the low statistical correlation between the parameters of Intergovernmental Fiscal Transfer with four economic parameters, which are all below 0.5. Therefore, this study is not intended to examine the factors to be decisive in affecting the regional economy development, but to see whether the sub national governments, especially the relatively "rich", has been on the right track on local economic development. Descriptions in this study could at least be an early warning for Central and sub national government, particularly to assess whether public money that has been transferred to such a large region has yielded results that benefit to the local community.

The question then arises is why the facts show that the sub national government, which is relatively "rich" from Intergovernmental Fiscal Transfer, indicate poor economic performance. A Lot of possible answers can be obtained from various perspectives, such as the readiness of infrastructure, human resources, quality of measures taken by the district, nor the quality of regional spending. In this study, one

factor that we want to see is of the quality of budget implementation, particularly related to the absorption of local budget. If high income is not well absorbed in the spending budget, it will reduce the ability of spending multiplier effect in stimulating the regional economy.

Figure 6.11

Saving on APBD and Economic Growth for Year 2007
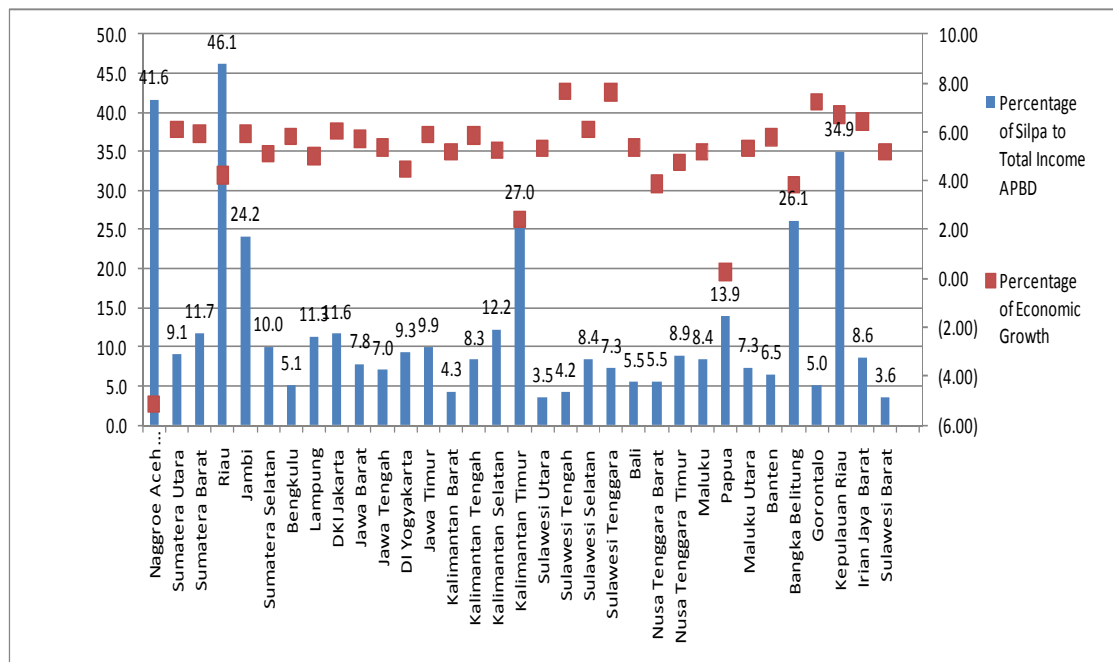
Source: Ministry of Finance Republic of Indonesia

To answer the question, one of the indicators that can be seen is the spending of the Budget. Silpa/saving is completely idle money that can not be absorbed in the Spending. In Figure 6.11, it can be seen that variable Silpa and economic growth variables show the opposite trends. Statistically, it was also evidenced by the relatively big statistical correlation between two variables that reached (-0.53), which means higher Silpa/saving will tend to lower its economic growth. Sub national governments with high Silpa/saving (at the highest extreme) are Riau, East Kalimantan and Aceh who also happened to be high income per capita Intergovernmental Fiscal Transfer and

low economic growth. Thus, it can be concluded that one possible cause of low economic growth in regions with high Intergovernmental Fiscal Transfer is because the funds are not absorbed in the spending (indicated by large Silpa/saving).

Figure 6.12

Correlation between Saving on APBD and Economic Growth for Year 2007

Correlations

		VAR00005	VAR00007
VAR00005	Pearson Correlation	1	-.530[**]
	Sig. (2-tailed)		.002
	N	33	33
VAR00007	Pearson Correlation	-.530[**]	1
	Sig. (2-tailed)	.002	
	N	33	33

**. Correlation is significant at the 0.01 level (2-tailed).

Expenditure budgets also have a very important role in the implementation of local government administration. The effectiveness of budget expenditure will directly influence the effectiveness of public services and in turn will determine the success of regional development. The effectiveness of budget expenditure is strongly influenced by internal and external factors of governance, such as the budget process, the role of community participation, political support from the parliament, the sustainability of the budget, and synergy with government programs.

The biggest challenge for the sub national government is to establish the budget in a timely manner, to expedite the process of budget implementation and further provide a positive impact on public service. There are some problems in the budget process. One of the problems is the difficulty of achieving agreement in discussion with

the parliament. In addition, technical barriers also occur frequently in the budget process, related to the complexity of performance-based budgeting process. Other problem in budget preparation and adoption process is the synergy between the Government and sub national governments, that the Sub National budget is highly dependent on the state budget. The challenge for Government is to be as early as possible determine the allocation of funds to be transferred to the region and then immediately inform the Sub National Government.

To keep pace with development, in certain sub national governments such as Papua and Maluku, requires substantial funds, primarily to fund the initial investment in infrastructure. The important thing to get attention from the Government and Sub National Government is an attempt to align the pattern of allocation of funds to Sub national Government with economic growth target and the target of public welfare.

6.2 Analysis of Impact General Purpose Fund (DAU) on Regional Economic Development

Balancing Fund consists of three main components, namely the General Purpose Fund (DAU), Revenue Sharing (DBH) and Specific Purpose Fund (DAK). The allocation of these three types of Balancing Fund has a different purpose but collectively complement and supplement the inadequate of local funding needs. General Purpose Fund (DAU) is intended to reduce the problem of inter-regional disparities (horizontal fiscal imbalance). Revenue Sharing (DBH) is intended to reduce the disparity between central and local government (vertical fiscal imbalance), and Specific Purpose Fund(DAK) is intended to assist the regions in the affairs of government

funding which has become regional affairs in the field of basic services and become a national priority.

Allocation of General Purpose Fund (DAU), is calculated using a formula that considers local needs and local fiscal capacity. According to regulations, the General Purpose Fund (DAU) is allocated a minimum of 26% of Total Domestic Revenue. Because of regions that have a high fiscal capacity are very limited in number, the DAU is very dominated in number of local budgets in most sub national governments.

In accordance with the essence of regional autonomy, the large amount of General Purpose Fund (DAU) is allocated by block grants that can be used by sub national government with full discretion. The sub national government can spend DAU in accordance with the needs and priorities of each region. With the assumption that local governments know better the needs of their communities and will allocate the budget in accordance with these requirements, it is expected that public service functions can be implemented better.

In the existing legislation, states that the amount of General Purpose Fund (DAU) for each region are calculated based on comparison of proxy of the needs and fiscal capacities of the salaries of civil servants. Fulfilling the requirement of salary expenditure is paid by the Local Government through General Purpose Fund (DAU), the distribution mechanism of General Purpose Fund (DAU) is also considering that is routinely paid 1/12 each month. However, with the inclusion of salary expenditures as a determining factor in the allocation of DAU creates an impression of guaranteeing regional salaries by the central government. These conditions are feared to lead to problems of inefficiency of civil servants because of the possibility of sub national government recruiting civil servants who exceeded the real needs of the region.

General Purpose Fund (DAU) is a block grant that can be used freely by the sub national government. Besides that, historically, most sub national government have been considered as a replacement of DAU Subsidy of Autonomous Regions, which is a component of local personnel expenditure payments. This is strengthened by the fact that up to now the DAU formula still takes employees expenditures as one of the crucial variables. The combination of these things has made the understanding to the DAU, which is considered by the Regional DAU as a guarantee for payment of personnel expenses of each sub national government.

However, such an assumption is not entirely wrong, proven that the General Purpose Fund (DAU) is very dominant for most of Regency/Municipality. Nationally, the total DAU of sub national government accounted for more than 61% of total sub national government revenues (based on Budget 2008). Therefore, there is no doubt that in the existing system of fiscal balance, dependency of sub national government on the DAU is still very high. With a very high dominance of DAU, it is very easy to understand if the sub national government expects that the DAU can at least fulfill their mandatory spending. It can be concluded that in general the DAU for Regent/City indeed has to provide for funding of sub national government personnel expenditure.

General Purpose Fund (DAU) contribution in the budget picture is slightly different in provincial regions. Nationally, the total DAU Province contributes only 21% of total Provincial revenue (APBD 2008). Provincial revenues are dominated by the Own Revenue (PAD), which reached 44% of total Provincial revenue. It can be concluded that for the Province of personnel expenditure required was not met from the DAU, so that the province must rely on other funding sources outside the DAU, particularly Own Revenue (PAD).

The other main role of the DAU is to reduce inter-regional disparities. With the tax-sharing, as well as natural resources, in the system of fiscal balance, the role of the DAU become crucial because the outcome will tend to widen the existing gap. This is mainly because only a small sub national government that receives revenue sharing in adequate amounts. Own Revenue (PAD) also have the potential to widen the gap between regions. Once again, this is because only a small sub national government that has big potential for Own Revenue (PAD), such as the Province of DKI Jakarta and Surabaya.

This study did not attempt to measure how far the influence of General Purpose Fund (DAU) on the regional economy and the welfare of society, but try to see the picture of the pattern of inter-regional trends in some variables: General Purpose Fund (DAU), economic growth, unemployment and poverty. Moreover, there is no direct relationship between acceptance of General Purpose Fund (DAU) with the regional economy and the welfare of the community. In theory, that could affect the regional economy is the multiplier effect created by government spending. Therefore, the assumption can be used is that a region, which has a high General Purpose Fund (DAU), will have a total high income also, then with high incomes will increase local spending that will push the regional economy. General Purpose Fund (DAU) variables will use numbers per capita because it will be far more meaningful than the total nominal figures. Revenue per capita will become more meaningful because it has accounted for one aspect of the main requirements of governance, such as population.

In this study, General Purpose Fund (DAU) per capita will be compared directly with the three other variables, namely GDP Growth Rate, Unemployment Rate and Poverty Level. Comparisons performed on average data 2005-2008 for the whole of the

provinces in Indonesia, which consists of 33 provinces. Provincial financial data are aggregated data from provincial data and all district and city within the province concerned.

Based on the assumption, namely that regions with high General Purpose Fund (DAU) income will be able to encourage better economic growth. To see the pictures, I use the paired two variables in one graph, namely between the variables General Purpose Fund (DAU) per capita income and economic growth variables. In this analysis, I carried out a description of the average data for four years (2005-2008), which is a regional aggregate data in 33 provincial areas. In Figure 6.13, shows that on average, from 2005 until 2008, the sub national government that has the highest DAU per capita income is West Papua, followed by Papua, Central Kalimantan, and Maluku. While in the lowest position is DKI Jakarta, followed by Banten, North Sumatera, Riau and West Java.

Interesting things that can be seen in Graph is the fact that sub national government with high per capita DAU would have regional economic growth is relatively low, even for Papua, Central Kalimantan, and Maluku are sub national government with low economic growth. Average economic growth in the period of four years is 5.17%. In Graph shows that there are areas with high DAU income proved to be its economic growth is below average. Meanwhile, sub national governments with low DAU income, such as DKI Jakarta, North Sumatra and West Java, in fact, have the economic growth above average. As such, it is contrary to the assumptions presented earlier.

Figure 6.13

General Purpose Grant (DAU) per capita and Economic Growth
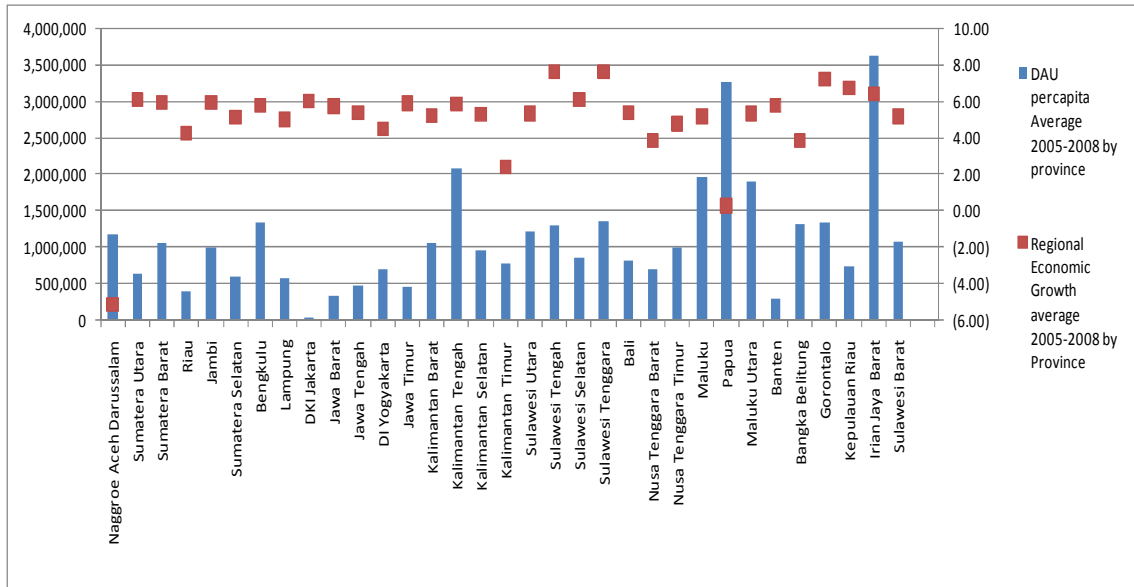
Average 2005-2008 Compare

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Other economic indicator that will be analyze is the level of unemployment. As the previous analysis, general assumption is that high-income province will have smaller unemployment level in the regions concerned. It is still associated with the previous assumptions related to economic growth. If high-income sub national government could stimulate economic growth significantly, the unemployment rate will decrease. As seen in Figure 6.14, it turns out that sub national governments with high General Purpose Fund (DAU) per capita income has low levels of unemployment. Sub national government of West Papua, Papua, Central Kalimantan, except Maluku which is the highest per capita recipient of General Purpose Fund (DAU), in fact, have unemployment rates below the average. The average unemployment rate in the period 2005-2008 is 9.5%. On the other hand, sub national government with low per capita

income of Intergovernmental Fiscal Transfer per capita, such as Central Java, Yogyakarta, and East Java would have a low unemployment rate.

Figure 6.14

General Purpose Grant (DAU) per capita and Percentage of Unemployment

Average 2005-2008 Compare

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Further analysis is to compare between the variables General Purpose Fund (DAU) per capita with the level of poverty, the general assumption to be used is that high-income province will be smaller poverty level in the regions concerned. Once again it is still associated with the assumption that high-income provinces could stimulate economic growth significantly, and further could reduce the level of poverty.

Interesting things that can be seen in Figure 6.15 shows that sub national government with highest General Purpose Fund (DAU) per capita such as West Papua and Papua have proved to be the highest percentage of poor people, or at least above

average at 16.58%. In Graph shows that there are sub national governments with high DAU income proved to be its level of poverty is below average. Meanwhile, sub national governments with low DAU income, such as DKI Jakarta, North Sumatra and West Java, in fact, have the level of poverty below average. As such, it is contrary to the assumptions presented earlier.

Figure 6.15

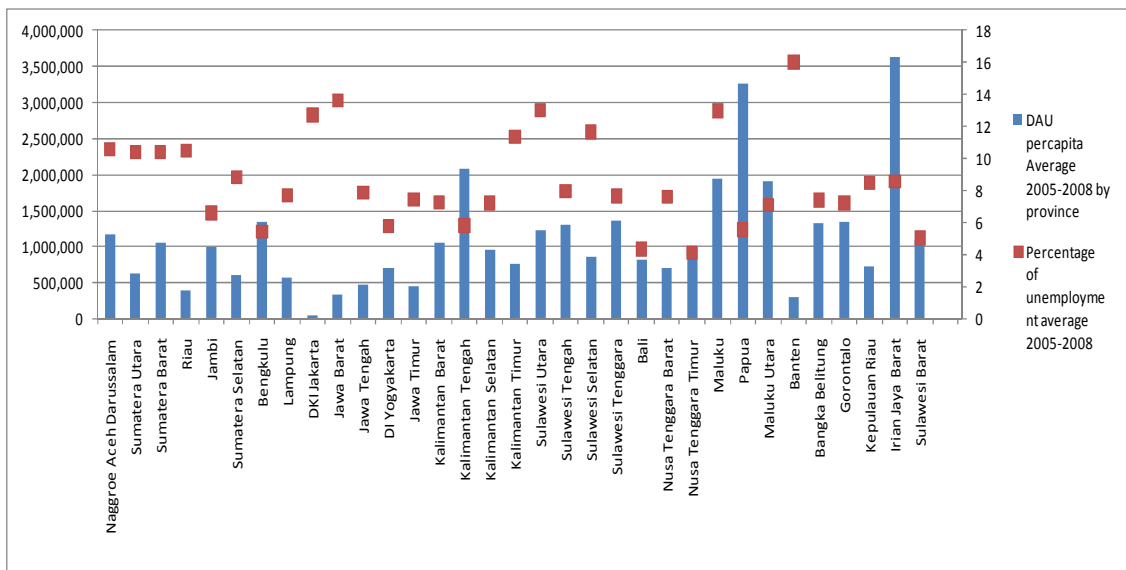**General Purpose Grant (DAU) per capita and Poverty Level**

Average 2005-2008 Compare
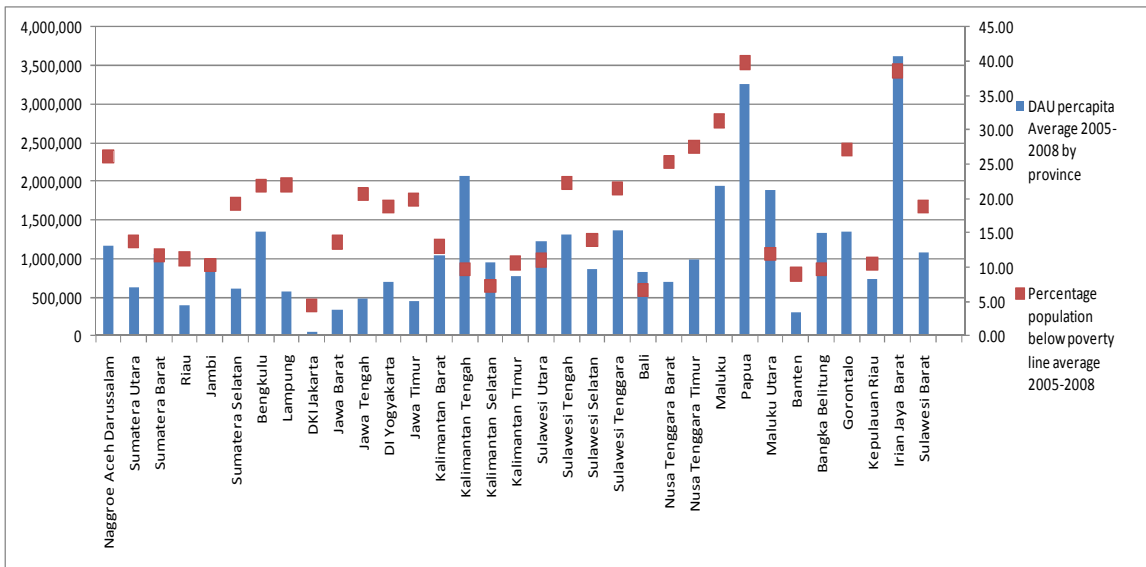
Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Table 6.8

Comparasion between DAU percapita, Economic Growth, Poverty Level,

Unemployment and HDI Average 2005-2008

Province	DAU percapita Average 2005-2008	Economic Growth Average 2005-2008	Poverty Level Average 2005-2008	Unemployment Average 2005-2008	HDI Average 2005-2008
Naggroe Aceh Darussalam	1,172,505	(5.14)	26.15	10.58	69.89
Sumatera Utara	633,984	6.08	13.82	10.43	72.64
Sumatera Barat	1,063,255	5.92	11.69	10.43	72.01
Riau	402,402	4.22	11.23	10.53	74.29
Jambi	996,957	5.92	10.32	6.63	71.42
Sumatera Selatan	602,558	5.13	19.29	8.83	71.19
Bengkulu	1,344,473	5.79	21.92	5.45	71.52
Lampung	570,805	5.00	21.98	7.70	69.58
DKI Jakarta	45,275	6.01	4.49	12.73	76.51
Jawa Barat	336,735	5.72	13.68	13.63	70.52
Jawa Tengah	479,748	5.35	20.62	7.90	70.64
DI Yogyakarta	701,295	4.46	18.82	5.78	74.06
Jawa Timur	450,617	5.89	19.86	7.48	69.44
Kalimantan Barat	1,049,825	5.18	13.07	7.25	67.25
Kalimantan Tengah	2,075,101	5.84	9.70	5.83	73.50
Kalimantan Selatan	956,704	5.27	7.27	7.23	67.98
Kalimantan Timur	769,670	2.41	10.65	11.40	73.62
Sulawesi Utara	1,222,474	5.34	11.02	13.00	74.61
Sulawesi Tengah	1,308,350	7.63	22.27	7.95	69.19
Sulawesi Selatan	858,808	6.09	14.01	11.68	69.18
Sulawesi Tenggara	1,362,972	7.62	21.41	7.68	68.16
Bali	819,668	5.34	6.63	4.35	70.34
Nusa Tenggara Barat	705,225	3.86	25.32	7.60	63.32
Nusa Tenggara Timur	996,350	4.76	27.50	4.15	64.98
Maluku	1,952,494	5.17	31.28	12.98	69.82
Papua	3,254,337	0.26	39.79	5.58	63.06
Maluku Utara	1,897,522	5.32	11.99	7.10	67.62
Banten	299,877	5.78	9.00	16.03	69.23
Bangka Belitung	1,325,780	3.82	9.68	7.40	71.42
Gorontalo	1,346,503	7.23	27.12	7.23	68.40
Kepulauan Riau	733,835	6.71	10.55	8.50	73.22
Irian Jaya Barat	3,625,405	6.42	38.59	8.60	66.54
Sulawesi Barat	1,085,414	5.16	18.83	5.05	67.26

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Of the three aforementioned analysis, when combined in a single table will look like in Table 6.8. From this table, we can see that the sub national governments with high per capita General Purpose Fund (DAU) are West Papua, Papua, and Aceh. However, the average of all local economic indicators of sub national governments with high General Purpose Fund (DAU) per capita was worse than a sub national government with a low per capita Intergovernmental Fiscal Transfer.

It must be realized that the analytical work mentioned above is only a rough picture of the relationship between Intergovernmental Fiscal Transfer with the regional economy development. A lot of external factors outside the financial are affecting economic indicators. This is evident from the low statistical correlation between the

parameters of Intergovernmental Fiscal Transfer with four economic parameters, which are all below 0.5. Therefore, this study is not intended to examine the factors to be decisive in affecting the regional economy development, but to see whether the sub national governments, especially the relatively "rich", has been on the good track on local economic development. Descriptions in this study could at least be an early warning for Central and sub national government. Particularly to assess whether public money that has been transferred to such a large region has yielded results benefit to the local community.

However, DAU is improving inter-regional disparities. This is shown by Williamson Index Based on Williamson Index figures in 2002-2008 showed that the level of economic activity, reflected the distribution of the value of inter-provincial GDRP is still relatively low, but its development shows better conditions. As can be seen in Table 6.9, in 2005, Williamson index for economic activities of 0.613 in 2005 fell to 0.533 in 2008. Improvement on Williamson Index showed that the development of inter-provincial economic activities is become more balanced than before. When viewed by region, local provinces in Java Island (excluding DKI Jakarta) have the most equitable economic activity, followed by the province located on the Sulawesi Island. However, the provinces that located in Sumatra, Kalimantan, Maluku Islands and Papua are had relatively high inequality.

Table 6.9

Williamson Index for GDRP Period 2005 – 2008

	2005	2006	2007	2008
Indonesia	0.613	0.589	0.561	0.533
Sumatera	0.914	0.914	0.520	0.520
Jawa	0.175	0.169	0.170	0.172
Kalimantan	0.886	0.856	0.418	0.433
Sulawesi	0.204	0.193	0.516	0.498
Maluku and Papua	0.611	0.568	0.823	0.816
Bali, NTB and NTT	0.395	0.416	0.197	0.192

Source: Indonesian Statistic Board

6.3   Analysis of Impact Revenue Sharing (DBH) on Regional Economic Development

Under Law No. 33 of 2004, concerning Fiscal Balance between Central Government and Local Government, there is allocation to the regional budget that transfers from the state budget. Such transfer is done through Revenue Sharing (DBH), the General Purpose Fund (DAU), the Specific Purpose Fund (DAK) and other transfers funds, such as Special Autonomy Fund and Adjustment Fund.

Each transfer has a different purpose, therefore, allocation mechanisms are also vary. Revenue Sharing (DBH) aims to overcome the problem of vertical imbalance between central and sub national government. Allocation is done by a relatively simple way of dividing the percentage between central and sub national government (the producing region). Formulation percentage of Revenue Sharing in detail is regulated by Law 33/2004 and PP. 55 Year 2005 on the Balancing Fund, as well as several other laws. Revenue Sharing (DBH) consists of DBH from taxes and DBH from non-tax revenue (Natural Resources). Before regional autonomy in 2001, Revenue Sharing (DBH) to the sub national government was conducted only on revenue from the Land and Building Tax, BPHTB, and Income from Forestry Resources. Since 2001, revenue sharing transfer was expanded to:

a. Tax Sharing of Land and Building Tax (PBB), Tax on Acquisition of Rights to Land and Buildings (BPHTB) and Income Tax Article 21 and Article 25/29 Domestic individual tax payer (WPOPDN);

b. Sharing of Natural Resources of Oil, Natural Gas, Geothermal, General Mining, Forestry and Fisheries.

Through this diversification, sub national government potential revenue is expected to be increased. For certain sub national governments, the portion of Revenue Sharing (DBH) in their budgets can be very dominant and since 2001 has an increasing trend from year to year. In addition, most of Revenue Sharing (DBH) allocation was provided in the form of block grants, so it can be used freely by the sub national government according to their priorities and needs.

This study did not attempt to measure how far the influence of Revenue Sharing (DBH) on the regional economic development and the public welfare, but try to see the picture of the pattern of inter-regional trends in some variables: Revenue Sharing (DBH), economic growth, unemployment and poverty. There is no direct relationship between acceptance of Revenue Sharing (DBH) with the regional economic development and welfare of the community. In theory, that could affect the regional economy is the multiplier effect created by government spending. Therefore, the assumption to be used is that a region, which has a high Revenue Sharing, will have a total high income also, then with high incomes will increase local spending that will push the regional economy. Revenue Sharing (DBH) variables will use numbers per capita because it will be far more meaningful than the total nominal figures.

In this study, Revenue Sharing (DBH) per capita will be compared directly with the three other variables, namely GDRP Growth Rate, Unemployment Rate and Poverty Level. Comparisons performed on average data period 2005-2008 for the whole of the provinces in Indonesia, which consists of 33 provinces. Provincial financial data are aggregated data from provincial data and all Regent and city within the province concerned.

The first analysis is to test the assumption that regions with high Revenue Sharing (DBH) income will be able to encourage better economic growth. To see the pictures on the assumption, we will use the two paired variables in one graph, namely between the variables Revenue Sharing (DBH) per capita income and economic growth variables. In this analysis, I carried out a description of the average data for four years (2005-2008), which is a regional aggregate data in 33 provincial regions.

In Figure 6.16 shows that on average, from 2005 until 2008, sub national government that has the highest per capita income in Revenue Sharing (DBH) is East Kalimantan, followed by Riau, West Papua, Riau, Aceh and Jakarta. While in the lowest position are Central Java, Yogyakarta, East Java, Nusa Tenggara and West Java. In nominal terms, East Kalimantan and Riau are getting the highest DBH (mainly from Natural Resources Revenue Sharing), while Central Java, East Java and West Java DBH also get a high enough income on average (from Tax Revenue Sharing). However, because the population in Java is relatively high compared to East Kalimantan and Riau, the Revenue Sharing income per capita is much lower.

Interesting things that can be seen in Figure 6.16 is the fact that sub national governments with high per capita Revenue Sharing would have relatively low on regional economic growth. Even for Aceh, Papua and East Kalimantan are regions with low economic growth. Average economic growth in the period of four years is 5.17%. In Figure 6.16, shows that there are sub national governments with high Revenue Sharing income proved to be its economic growth is below average. Meanwhile, sub national governments with low Revenue Sharing income, such as Central Java, East Java and West Java, in fact, have the economic growth above average. As such, it is contrary to the assumptions presented earlier.

Figure 6.16

Revenue Sharing per capita and Economic Growth
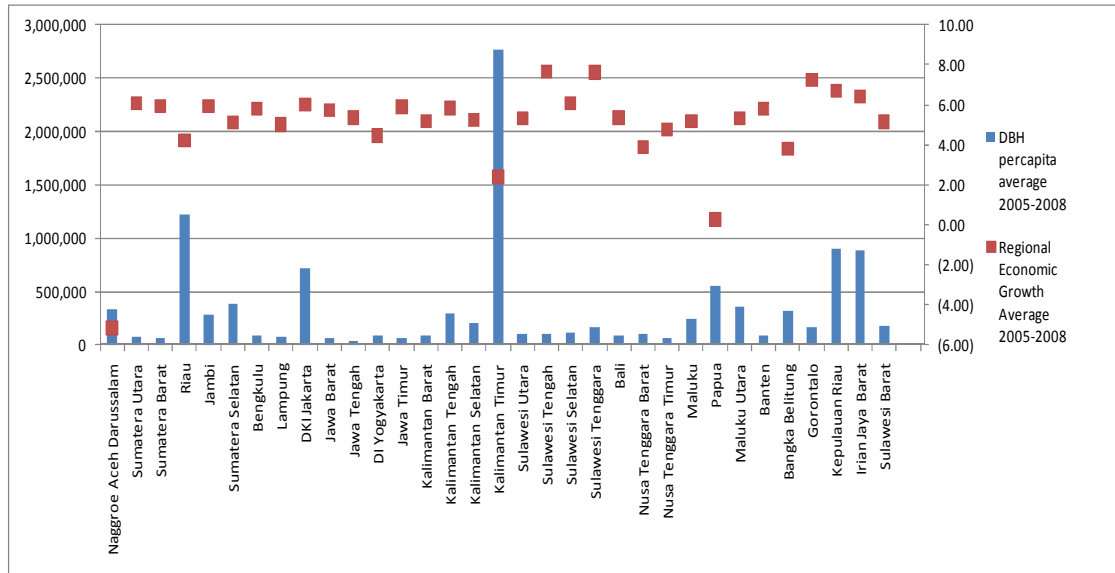
Average 2005-2008 Compare

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Other economic indicators will be analyze is the level of unemployment. General assumption is that high-income regions will have smaller unemployment level in the regions concerned. It is still associated with the previous assumptions related to economic growth. If high-income sub national governments could stimulate economic growth significantly, the unemployment rate will decrease.

As seen in Figure 6.17, it turns out that sub national governments with high per capita Revenue Sharing (DBH) have high levels of unemployment. Sub national governments such as East Kalimantan, Riau, West Papua, Aceh and Jakarta, which is the highest per capita recipient of Revenue Sharing (DBH), in fact, have unemployment rates above the average. The average unemployment rate in the period 2005-2008 is 9.5%. On the other hand, regions with low per capita income of Revenue Sharing

(DBH), such as Central Java, Yogyakarta, East Java, NTT and West Java would have a low unemployment rate. It is consistent with the results of previous analysis that turned out to: sub national governments with high Revenue Sharing (DBH) tended to lower its economic growth.

Figure 6.17

Revenue Sharing per capita and Percentage of Unemployment
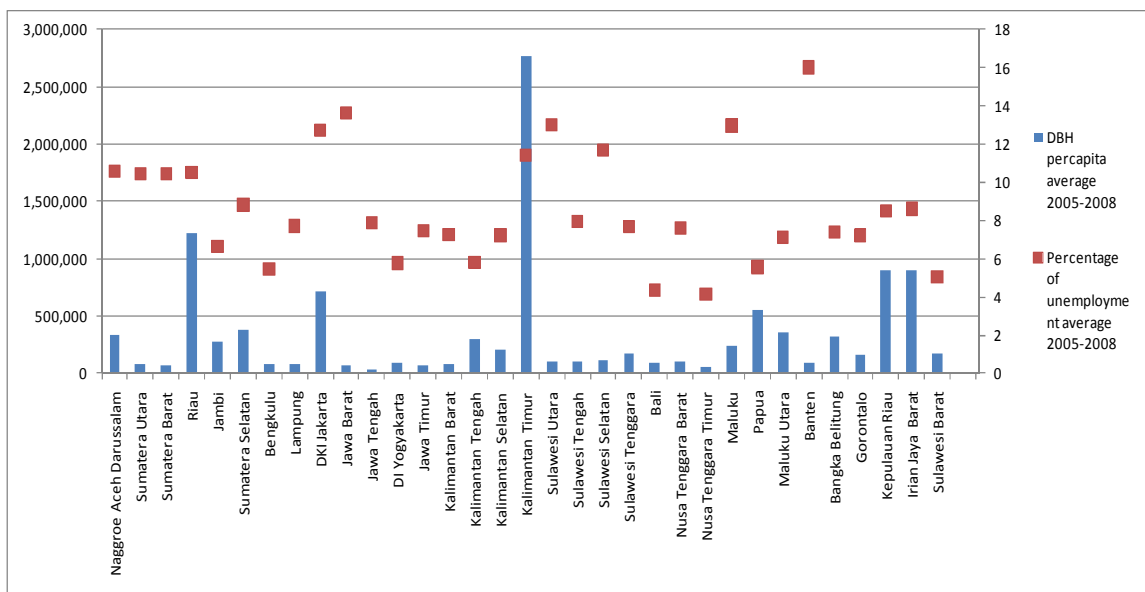
Average 2005-2008 Compare

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Further analysis is to compare between the variables of Revenue Sharing (DBH) per capita with the level of poverty. As the previous analysis, the general assumption to be used is that high-income sub national governments will have smaller poverty level in the regions concerned. Once again it is still associated with the assumption that high-income sub national governments could stimulate economic growth significantly, and further reduce the level of poverty. In Figure 6.18 looks rather different thing from the previous analysis. In Figure shows that sub national governments with high per capita

Revenue Sharing (DBH) such as East Kalimantan, Riau, Kepulauan Riau and DKI have a relatively low percentage of poor people, or at least below average at 16%. On the other hand, the sub national government such as Central Java, Yogyakarta, East Java and NTT, which has a low per capita Revenue Sharing (DBH) has a high percentage of poor people. However, West Papua and Papua regions that have high per capita income of DBH have proved to be the highest percentage of poor people.

Figure 6.18

Revenue Sharing per capita and Poverty Level

Average 2005-2008 Compare

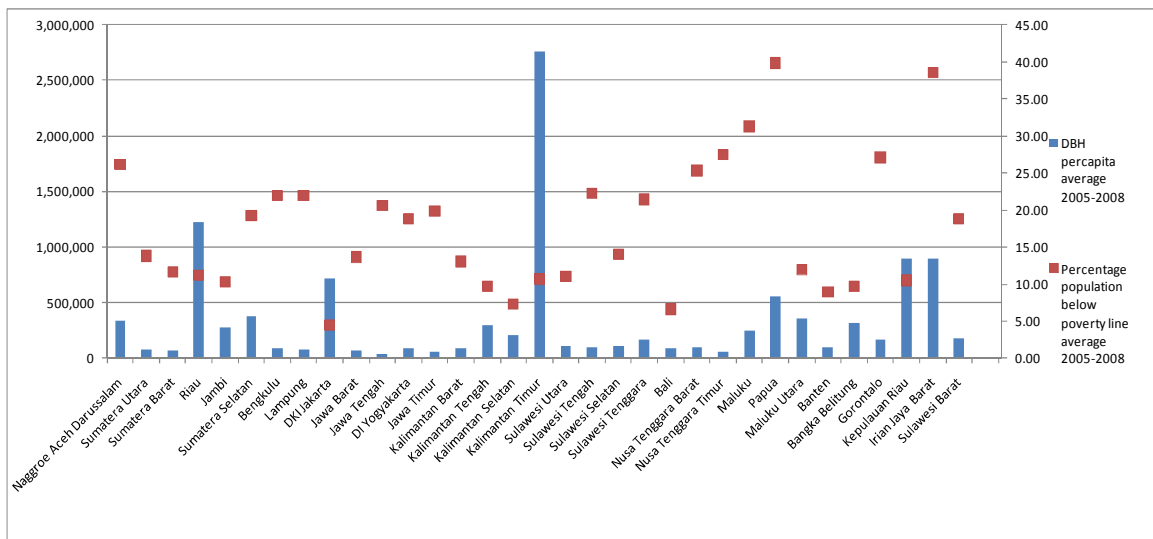Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Table 6.10

Comparasion between Revenue Sharing percapita, Economic Growth, Poverty Level, Unemployment and HDI Average 2005-2008

Province	DBH percapita Average 2005-2008	Economic Growth Average 2005-2008	Poverty Level Average 2005-2008	Unemployment Average 2005-2008	HDI Average 2005-2008
Naggroe Aceh Darussalam	336,869	(5.14)	26.15	10.58	69.89
Sumatera Utara	74,997	6.08	13.82	10.43	72.64
Sumatera Barat	67,012	5.92	11.69	10.43	72.01
Riau	1,220,503	4.22	11.23	10.53	74.29
Jambi	278,073	5.92	10.32	6.63	71.42
Sumatera Selatan	379,622	5.13	19.29	8.83	71.19
Bengkulu	84,664	5.79	21.92	5.45	71.52
Lampung	80,128	5.00	21.98	7.70	69.58
DKI Jakarta	717,643	6.01	4.49	12.73	76.51
Jawa Barat	69,072	5.72	13.68	13.63	70.52
Jawa Tengah	36,464	5.35	20.62	7.90	70.64
DI Yogyakarta	90,395	4.46	18.82	5.78	74.06
Jawa Timur	62,976	5.89	19.86	7.48	69.44
Kalimantan Barat	84,578	5.18	13.07	7.25	67.25
Kalimantan Tengah	298,842	5.84	9.70	5.83	73.50
Kalimantan Selatan	210,202	5.27	7.27	7.23	67.98
Kalimantan Timur	2,763,704	2.41	10.65	11.40	73.62
Sulawesi Utara	106,292	5.34	11.02	13.00	74.61
Sulawesi Tengah	102,537	7.63	22.27	7.95	69.19
Sulawesi Selatan	109,538	6.09	14.01	11.68	69.18
Sulawesi Tenggara	168,716	7.62	21.41	7.68	68.16
Bali	91,541	5.34	6.63	4.35	70.34
Nusa Tenggara Barat	103,927	3.86	25.32	7.60	63.32
Nusa Tenggara Timur	61,420	4.76	27.50	4.15	64.98
Maluku	247,180	5.17	31.28	12.98	69.82
Papua	553,753	0.26	39.79	5.58	63.06
Maluku Utara	354,100	5.32	11.99	7.10	67.62
Banten	94,820	5.78	9.00	16.03	69.23
Bangka Belitung	317,508	3.82	9.68	7.40	71.42
Gorontalo	164,285	7.23	27.12	7.23	68.40
Kepulauan Riau	897,016	6.71	10.55	8.50	73.22
Irian Jaya Barat	893,365	6.42	38.59	8.60	66.54
Sulawesi Barat	174,913	5.16	18.83	5.05	67.26

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Of the three aforementioned analysis, when we combined in a single table will look like in Table 6.10. From this table can be seen that the sub national governments with high per capita Revenue Sharing (DBH) covering East Kalimantan, Riau, West Papua, Aceh, Papua, Jakarta. However, Regions which high Revenue Sharing (DBH) per capita income, in fact, average of all local economic indicators was worse than a region with a low per capita Revenue Sharing (DBH).

It must be realized that the analytical work mentioned above is only a rough picture of the relationship between Revenue Sharing (DBH) with the regional economic development. A lot of external factors outside the financial condition are also affecting economic indicators. This is proven from the low statistical correlation between the parameters of Revenue Sharing (DBH) with three economic parameters, which are all below 0.5. Therefore, this study is not intended to examine the factors affecting the regional economy, but to see whether the regions, especially the relatively "rich regions", has been on the right track on regional economic development. Descriptions in this study could at least be an early warning for Central and Local Government, particularly to assess whether public money that has been transferred to such a large area has yielded results that could be benefited to the local community.

The question then arises is why the facts show that region, which is relatively "rich" from Revenue Sharing (DBH), indicate poor on economic performance. Lots of possible answers can be obtained from various perspectives, such as the readiness of infrastructure, human resources availability, quality of the policy taken by the sub national government, nor the quality of sub national government spending.

In general, a term known as "the curse of natural resources", which means that regions which is rich in natural resources experiencing low economic growth (Jeffrey Sachs & Andrew Warner, 2001 and E Papyrakis & R Gerlagh, 2003). The theory is particularly true in some countries, but there is also the fact that there are resource-rich countries whose economies are growing well (A Cabrales & E Hauk, 2008).

It is recognized that factors that affect the regional economy and the welfare of society are enormous, and not everything can be identified by either being related to external factors. However, the prevailing logic is that the sub national government,

which is relatively "rich" because it has high potential revenue should be able to improve local economic conditions better than in the low-income sub national governments. Therefore, one possible cause of low economic performance of rich sub national governments is the low absorption of funds into the Revenue Sharing expenditure budget. This is based on the fact that sub national governments with high Revenue Sharing (DBH) have a fairly large of idle funds, which reflected the high Saving/Silpa. The problems that occur in many regions are how to optimize the funds in sub national government for public purposes.

6.4 Analysis of Impact Specific Purpose Fund (DAK) on Regional Economic Development

Since the implementation of regional autonomy and fiscal decentralization in 2001, the Government continues to refine the policy foundation for the implementation of decentralization in order to keep staying on the right track. Main goal of decentralization is to accelerate the realization of public welfare through the improvement of service, empowerment and community participation while maintaining harmonious relationships within the system of government of the Republic of Indonesia. Completion of the foundation of the policy is linked to reforms in the areas of governance and finance.

Balancing Fund aims to achieve fiscal balance between central and sub national governments and among sub national governments. Balancing Fund is the largest component in the allocation of Intergovernmental Fiscal Transfer that have a very important role in supporting the implementation of fiscal decentralization and regional

autonomy. Balancing Fund consists of General Purpose Fund (DAU), Revenue Sharing (DBH) on Taxation and Natural Resources and Specific Purpose Fund (DAK).

In the implementation of fiscal decentralization in Indonesia, the Specific Purpose Fund (DAK) is one type of transfer from central government to sub national government involved in specific grant or conditional grant. Other types of transfers are general purpose grand or unconditional grant is in Indonesia called the General Purpose Fund (DAU) and Revenue Sharing (DBH) of its use in accordance with local needs. In accordance with Government Regulation No.55 year 2005, the Specific Purpose Fund (DAK) is a source of funding for the sub national government in the implementation of decentralization. The allocation can not be separated with another balancing fund, considering the objectives of each type of balancing fund that co-exist and complement. Specific Purpose Fund (DAK) is intended to fund special activities into regional affairs and is a national priority in order to meet the needs of minimum standards of facilities and infrastructure for basic community services. As a Specific Purpose Fund (DAK), the use of specific grants is determined by the central government to meet the targets of development on the national priority. Activities funded by Specific Purpose Fund (DAK) must comply with the technical guidelines set by Technical Department.

Specific Purpose Fund (DAK) was allocated to help funding the physical needs of facilities and basic infrastructure, which is a national priority in education, health, road infrastructure, irrigation infrastructure, drinking water and sanitation infrastructure, government infrastructure, marine and fisheries, agriculture, environment, family planning, forestry, rural infrastructure, and trade.

Specific Purpose Fund (DAK) allocation amount for each sub national government is based on three criteria: namely general criteria, specific criteria and technical criteria.

1) General Criteria

   The general criteria established by considering the ability of local finance in financing regional development needs to reflect the general revenue budget minus personnel expenditures.

2) Specific Criteria

   Specific criteria established by taking into account legislation and regional characteristics: formulated on the basis of legislation governing of the implementation of special autonomy, and regional characteristics.

3) Technical Criteria

   Technical criteria are formulated and established by the relevant technical minister. Technical Criteria have been prepared based on indicators that can describe the condition of facilities/infrastructure in their respective sub national government to be funded by Specific Purpose Fund (DAK).

The objectives of Specific Purpose Fund (DAK) funding is to maintain basic services in sub national governments that have become regional affairs that is a national priority, and related to the implementation of Specific Purpose Fund (DAK), of course not free from shortcomings, both in the stage of allocation, distribution, execution and reporting. One fact that emerged in the implementation of Specific Purpose Fund (DAK) in Year 2008 was a low absorption on Budgets in some regions.

This study did not attempt to measure how far the influence of Specific Purpose Fund (DAK) on the regional economic development and the welfare of society, but try to see the picture of the pattern of inter-regional trends in some variables: Specific Purpose Fund (DAK), economic growth, unemployment and poverty. There is no direct relationship between acceptance of Specific Purpose Fund (DAK) with the regional economic development and welfare of the community. In theory, that could affect the regional economy is the multiplier effect created by government spending. Therefore, the assumption to be used is that a region, which has a high Specific Purpose Fund (DAK), will have a total high income also. Furthermore, with high incomes from transfer, will increase local spending that will push the regional economy. Specific Purpose Fund (DAK) variables will use numbers per capita because it will be far more meaningful than the total nominal figures.

In this study, Specific Purpose Fund (DAK) per capita will be compared directly with the three other variables, namely GDRP Growth Rate, Unemployment Rate and Poverty Level. Comparisons performed on average data period 2005-2008 for the whole of the provinces in Indonesia, which consists of 33 provinces. Provincial financial data are aggregated data from provincial data and all Regent and city within the province concerned.

The first analysis performed was to test the assumption that regions with high Specific Purpose Fund (DAK) income will be able to encourage better economic growth than other. To see the pictures on the assumption, I will use the two paired variables in one graph, namely between the variables Specific Purpose Fund (DAK) per capita income and economic growth variables. In this analysis, I carried out a description of the average data for four years (2005-2008), which is a regional aggregate data in 33

provincial regions.

In Figure 6.19 shows that on average, from 2005 until 2008, region that has the highest per capita income in Specific Purpose Fund (DAK) is Papua, followed by West Papua, Central Kalimantan, North Maluku and Maluku. While in the lowest position are Central Java, Yogyakarta, East Java, Nusa Tenggara and West Java. In nominal terms, East Kalimantan and Riau are getting the highest DBH (mainly from Natural Resources Revenue Sharing), while DKI Jakarta, Banten, Central Java, East Java and West Java also get a high enough income on average from Specific Purpose Fund (DAK). However, because the population in Java is relatively high compared to Papua, Maluku and Central Kalimantan, the Specific Purpose Fund (DAK) income per capita is very much different.

Interesting things that can be seen in Figure 6.19 is the fact that regions with high per capita Specific Purpose Fund (DAK) would have relatively low on regional economic growth, especially for Papua, Bangka Belitung and East Kalimantan are regions with low economic growth. Average economic growth in the period of four years is 5.17%. In Figure 6.19, shows that there are regions with high Specific Purpose Fund (DAK) income but proved to be its economic growth below average. Meanwhile, regions with low Revenue Sharing income, such as Central Java, East Java and West Java, in fact, have the economic growth above average. As such, it is contrary to the assumptions presented earlier.

Figure 6.19

Specific Purpose Fund per capita and Economic Growth
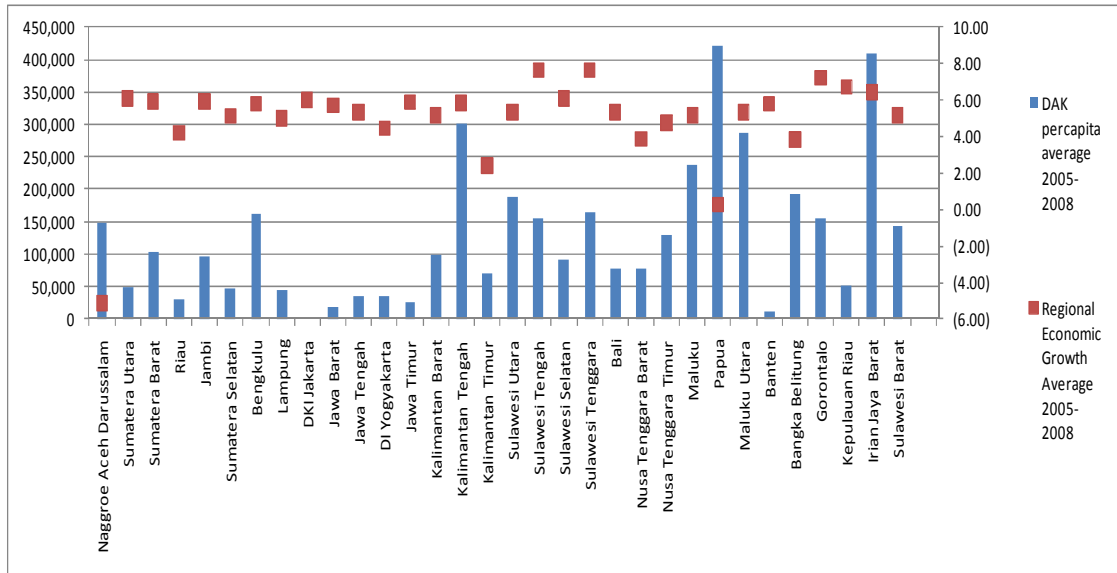
Average 2005-2008 Compare

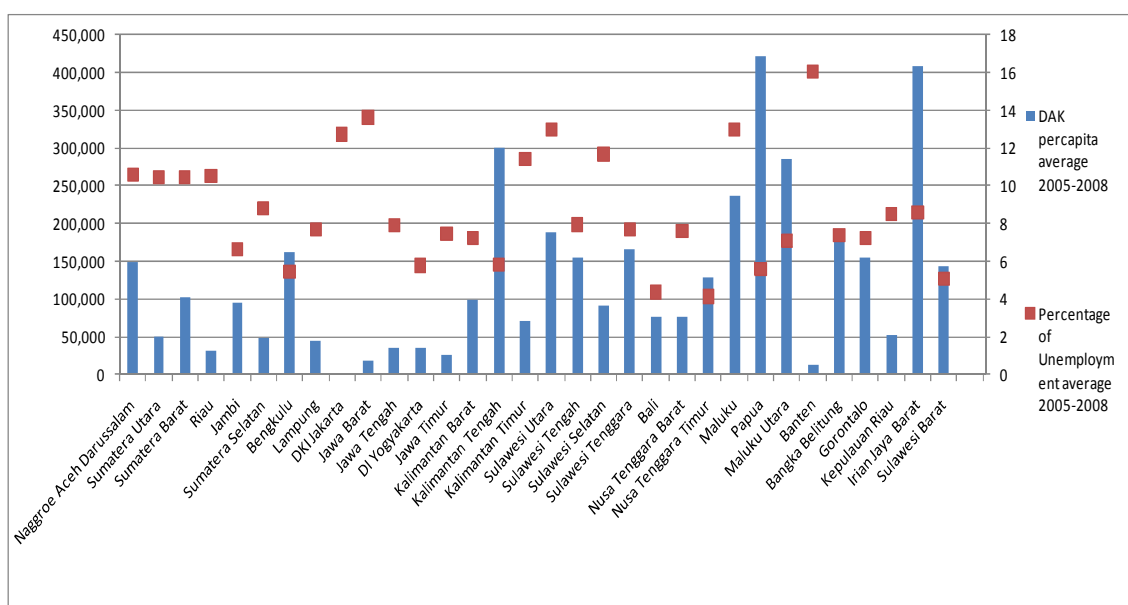Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Furthermore, other economic indicators that will be analyze is the level of unemployment. The general assumption is that high-income regions will have smaller unemployment level in the regions concerned. It is still associated with the previous assumptions related to economic growth. If high-income regions could stimulate economic growth significantly, the unemployment rate will decrease.

In Figure 6.20, looks rather different thing from the previous analysis. In Figure 6.20, it turns out that region with high per capita Specific Purpose Fund (DAK) actually also have low levels of unemployment. Regions such as Papua, West Papua, Bangka Belitung, Central Kalimantan and East Kalimantan which is the highest per capita recipient of Specific Purpose Fund (DAK), in fact, have unemployment rates below the average. The average unemployment rate in the period 2005-2008 is 9.5%. On the other

hand, regions with low per capita income of Specific Purpose Fund (DAK), such as Central Java, Yogyakarta, East Java, NTT and West Java would have also a low unemployment rate. It is not really consistent with the results of previous analysis, namely, that regions with high Specific Purpose Fund (DAK) tended to lower its economic growth.

Figure 6.20

Specific Purpose Fund per capita and Percentage of Unemployment

Average 2005-2008 Compare

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Further analysis is to compare between the variables Specific Purpose Fund (DAK) per capita with the level of poverty. As the previous analysis, the general assumption to be used is that high-income regions will have smaller poverty level in the regions concerned. Once again it is still associated with the assumption that high-income regions could stimulate economic growth significantly, and further reduce the level of poverty. In Figure 6.21, looks interesting from the previous analysis. In Figure

6.21 shows that regions with high per capita Specific Purpose Fund (DAK) such as Papua, West Papua, Bangka Belitung, Central Kalimantan and East Kalimantan have a relatively high percentage of poor people, or at least below average at 16%. On the other hand, the region such as DKI Jakarta, Central Java, Yogyakarta, East Java and West Java, which has a low per capita Specific Purpose Fund (DAK) has a low percentage of poor people. However, West Papua and Papua regions that have high per capita income of DBH have proved to be the highest percentage of poor people.

Figure 6.21

Specific Purpose Fund per capita and Poverty Level Average 2005-2008 Compare
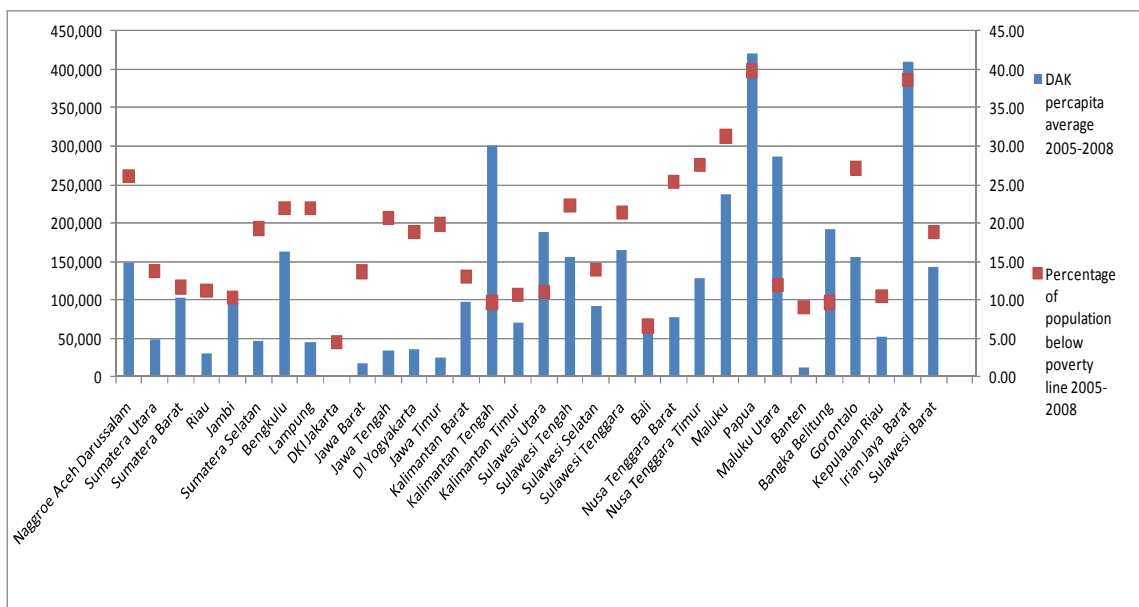
Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Table 6.11

Comparasion between Specific Purpose Fund percapita, Economic Growth,

Poverty Level, Unemployment and HDI Average 2005-2008

Province	DAK percapita Average 2005-2008	Economic Growth Average 2005-2008	Poverty Level Average 2005-2008	Unemployment Average 2005-2008	HDI Average 2005-2008
Naggroe Aceh Darussalam	148,874	(5.14)	26.15	10.58	69.89
Sumatera Utara	49,649	6.08	13.82	10.43	72.64
Sumatera Barat	103,253	5.92	11.69	10.43	72.01
Riau	31,239	4.22	11.23	10.53	74.29
Jambi	95,836	5.92	10.32	6.63	71.42
Sumatera Selatan	47,664	5.13	19.29	8.83	71.19
Bengkulu	162,299	5.79	21.92	5.45	71.52
Lampung	45,196	5.00	21.98	7.70	69.58
DKI Jakarta	0	6.01	4.49	12.73	76.51
Jawa Barat	18,226	5.72	13.68	13.63	70.52
Jawa Tengah	35,126	5.35	20.62	7.90	70.64
DI Yogyakarta	36,155	4.46	18.82	5.78	74.06
Jawa Timur	25,156	5.89	19.86	7.48	69.44
Kalimantan Barat	98,282	5.18	13.07	7.25	67.25
Kalimantan Tengah	301,226	5.84	9.70	5.83	73.50
Kalimantan Timur	69,901	2.41	10.65	11.40	73.62
Sulawesi Utara	188,658	5.34	11.02	13.00	74.61
Sulawesi Tengah	155,120	7.63	22.27	7.95	69.19
Sulawesi Selatan	91,560	6.09	14.01	11.68	69.18
Sulawesi Tenggara	165,321	7.62	21.41	7.68	68.16
Bali	76,388	5.34	6.63	4.35	70.34
Nusa Tenggara Barat	77,223	3.86	25.32	7.60	63.32
Nusa Tenggara Timur	129,012	4.76	27.50	4.15	64.98
Maluku	237,552	5.17	31.28	12.98	69.82
Papua	421,358	0.26	39.79	5.58	63.06
Maluku Utara	286,252	5.32	11.99	7.10	67.62
Banten	12,247	5.78	9.00	16.03	69.23
Bangka Belitung	192,184	3.82	9.68	7.40	71.42
Gorontalo	154,979	7.23	27.12	7.23	68.40
Kepulauan Riau	52,072	6.71	10.55	8.50	73.22
Irian Jaya Barat	408,897	6.42	38.59	8.60	66.54
Sulawesi Barat	143,607	5.16	18.83	5.05	67.26

Source: Ministry of Finance Republic of Indonesia and Indonesian Statistic Board

Of the three aforementioned analysis, when we combined in a single table will look like in Table 6.11. From this table, can be seen that the regions with high per capita Specific Purpose Fund (DAK) covering Papua, West Papua, Bangka Belitung, Central Kalimantan and East Kalimantan. However, Regions which low Specific Purpose Fund (DAK) per capita income, such as DKI Jakarta, Central Java, Yogyakarta, East Java and West Java, in fact, average of all local economic indicators was better than a region with a high per capita Specific Purpose Fund (DAK) income.

It must be realized that the analytical work mentioned above is only a rough picture of the relationship between Specific Purpose Fund (DAK) with the regional economic development. A lot of external factors outside the financial condition are also affecting economic indicators. This is proven from the low statistical correlation between the parameters of Specific Purpose Fund (DAK) with three economic parameters, which are all below 0.5. Therefore, this study is not intended to examine the factors affecting the regional economy, but to see whether the regions, especially the relatively "rich regions", has been on the track on local economic development. Descriptions in this study could at least be an early warning for Central Government and Sub National Government, particularly to assess whether public money that has been transferred to such a large area has yielded results that could be benefited to the local community.

The question then arises is why the facts show that region, which is relatively "rich" from Specific Purpose Fund (DAK), indicate poor on economic performance. A Lot of possible answers can be obtained from various perspectives, such as the infrastructure availability, human resources availability, quality of policy taken by the local government, nor the quality of local government spending.

One fact that emerged in the implementation between the years 2005-2008, is the low absorption of Specific Purpose Fund (DAK) in budgets spending in some regions. The cause of the problems is occurred at the time of allocation of Specific Purpose Fund (DAK), also on disbursement and implementation of Specific Purpose Fund (DAK) by sub national government.

Specific Purpose Fund (DAK) allocation mechanism still has weaknesses, mainly related to technical data accuracy and application of three criteria in determining

the receiving regions. As a result, there are few cases of mismatch between the needs of the regions with the allocation of Specific Purpose Fund (DAK).

In general, fundamental problems in the distribution mechanism are slow absorption (Budget spending accumulate at the end of the year). It is caused more by local factors, such as the understanding of the mechanisms of distribution, poor management in internal coordination, technical implementation of the tender, also because of delays in technical guidelines. However, given that Specific Purpose Fund (DAK) is one of the regional funding sources, which for some regions is a source of financing of infrastructure development. It is very crucial then to solve some of the problems associated with the distribution, including through simplification of the distribution mechanism.

Problems in the implementation of Specific Purpose Fund (DAK) in the local government, caused either by a factor of the central government as well as specific factors in the sub national government. In central government, problem is on Specific Purpose Fund (DAK) technical guidelines, namely delays in technical guidelines. Meanwhile, factor in sub national government is due to lack of understanding of sub national government officers on Specific Purpose Fund (DAK) mechanism.

CHAPTER VII

CONCLUSIONS AND RECOMMENDATIONS

7.1 CONCLUSIONS

By using qualitative and quantitative descriptive analysis, some conclusions that can be drawn from this research are:

1. Intergovernmental Fiscal Transfer is the main instrument for implementing fiscal decentralization policy through the balancing funds and the Special Autonomy Fund & Adjustment Fund. Balancing Fund represents the largest component in the Intergovernmental Fiscal Transfer. Intergovernmental Fiscal Transfer Policy is expected to maintain fiscal neutrality, which are an integral part of the state budget in fiscal consolidation and budget. The average allocation of Intergovernmental Fiscal Transfer in 2005-2008 has reached about 33 percent of total expenditure in the National Budget (APBN). However, in line with the increase in total state budget, the allocation amount of Intergovernmental Fiscal Transfer can be directed to support national fiscal sustainability in the framework of macroeconomic policy.

2. Allocation of Intergovernmental Fiscal Transfer experienced a significant improvement trend (from Rp150 trillion in 2005 to Rp292 trillion in 2008). Nationally, Intergovernmental Fiscal Transfer gave the role of 60%-80% of Sub National Government budget revenues. So that, many sub national governments are very depending on Intergovernmental Fiscal Transfer on their Budget Revenues.

3. The purpose of allocation General Purpose Fund (DAU) is to reduce fiscal disparities among regions, also to stimulate regional economic development. An evaluation of General Purpose Fund (DAU) continues to be sustainable from year to year to obtain the best equalization results using Williamson Index (WI) indicators. General Purpose Fund (DAU) is obviously improving inter-regional disparities. This is shown by Williamson Index for economic activities of 0.613 in 2005 fell to 0.533 in 2008 that the level of economic activity, reflected the distribution of the value of inter-provincial GDRP is still relatively low, but its development shows the better conditions. Although for Provincial Region, General Purpose Fund (DAU) only gave the role of 21% of budget revenues, but for majority regions such as Regent and Cities, the portion of DAU gave the role of 61% of their budget revenues.

4. Revenue Sharing (DBH) allocation policy, is directed to be more optimal to reduce the vertical fiscal gap among central government and sub national government, due to most of tax revenue sources is still managed by the Central Government. Although nationally, Revenue Sharing (DBH) only gave the role of 18%-20% of budget revenues, but for certain areas such as Aceh, Riau, Riau Islands, Jakarta, and East Kalimantan, the portion of DBH in their budgets revenues reach the range of 40% - 70%.

5. Specific Purpose Fund (DAK) policy is expected to encourage improvement quality of local public services and to reduce inequalities in public services among regions. For that reasons, the allocation of Specific Purpose Fund (DAK) will be directed to refine the indicators required in the preparation of criteria and the utilization of Specific Purpose Fund (DAK). Specific Purpose Fund (DAK)

allocation is directed to fund regions to support basic public services, such as infrastructure, education, and health. Some certain regions such as all regents/cities in the province of Papua and West Papua and all under developed regions will receive priority on the allocation of Specific Purpose Fund (DAK).

6. In general, regions with high Intergovernmental Fiscal Transfer are not able to show an encouraging performance associated with increased on welfare and economy. On average, compare to regions with low Intergovernmental Fiscal Transfer/capita, the regions with high Intergovernmental Fiscal Transfer income per capita such as Papua, West Papua, Central Kalimantan, Riau, East Kalimantan, and Aceh, show that the indicators of welfare and economic indicators are worsening.

7. It is recognized that factors that affect the regional economy and the welfare of society are enormous. Also, not everything factors that affect the regional economy could be identified by either being related to external factors. However, the prevailing logic is that the region which is relatively "rich" because it has high potential revenues should be able to improve local economic conditions better than in the low-income regions. Therefore, one possible cause of low economic performance of rich regions is the low absorption of Intergovernmental Fiscal Transfer into their expenditure budget. This is based on the fact that regions with high Intergovernmental Fiscal Transfer have a fairly large idle funds, which reflected the high Saving/Silpa.

8. Assuming that the expenditure budget to provide a multiplier effect on the economy, the region with a low absorption of realized expenditures will be hampered its economic growth rate. This is proven by the fact that regions with

high Saving/Silpa on their budget were likely to have low economic growth. The relationship between % Silpa against the budget revenues with the economic growth was negative and relatively strong, namely -0.53. The problems that occur in many regions are how to optimize their fund for public purposes.

7.2 RECOMMENDATIONS

Based on some of the conclusions mentioned above, some points that can be recommended are:

1. In its implementation, the principles of efficiency, transparency and accountability in the management of Intergovernmental Fiscal Transfer should be developed, then followed by policy improvement. Thus increasing in the allocation of transfers from year to year will improve the equitable distribution of financial capability among central and sub national government, as well as supporting regional development in order to poverty alleviation (pro-poor), to extend employment opportunities (pro-job creation), and to increase economic growth (pro-growth).

2. Expenditure budgets have a very important role in the implementation of local government administration. The effectiveness of budget expenditure will directly influence the effectiveness of public services and in turn will determine the success of regional economic development. The effectiveness of budget expenditure is strongly influenced by factors in internal and external governance, namely, the budget process, role of community participation, political support from the parliament, the sustainability of the budget before and after the budget year concerned, and synergy with government programs.

3. One of possible cause of low economic growth in sub national government is because of funds not absorbed in their spending (indicated by large Silpa/saving). The biggest challenge for the region is to establish the budget in a timely manner, so as to expedite the process of budget implementation and further provide a positive impact on service delivery to the public.

4. The more dominant of Intergovernmental Fiscal Transfer in the structure of the budget is not expected to reduce motivation of sub national government to explore and raise the potential for other funding sources, especially coming from local taxes and levies. It should also be followed by good governance and central government supervision as well as public supervision.

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