

IRSA Book Series on Regional Development No. 10

Regional Development and Finances

Challenges for Expanding and Financing Public Services



Edited by

Hefrizal Handra
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Foreword by

Armida S. Alisjahbana



Indonesia
Regional
Science
Association



*Regional Development and Finances:
Challenges for Expanding and Financing Public Services*

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I welcome the publication of this book by the International Institute held in Bandung, 2012. It was "Regional Development and Financing Public Services in the Economic Integration Era"

Recent democratization has been used to promote local development. Some regulations that try to bridge the gap between central and regional governments, in fact, tend to be conflicting regulations and policies. Other regional governments. Other factors such as natural disasters, and other factors tend to shift public budget for regional development. On the other hand, people's needs and expectations for the growth of infrastructure and services are increasing.

Many factors contribute to the development of a region, nevertheless, limited resources are the main factor. Various alternative strategies for regional development such as public-private partnership, and municipal government tend to highly relies on the central government. If the resources are worsened by population growth, the development of a region will be limited.

This IRSA Book Series provides a platform for the mentioned issues. It is expected that this book will also provide regional development from academic basis. As IRSA members have related background, ideas and researches are the result of researches and studies. We are to congratulate and express our appreciation to those involved in the publication of this book.

Jakarta, June 2012

Prof. Dr. Armida S. Alisjahbana
President of Indonesian Regional Science Association
State Minister for National Development

CONTENTS

Foreword	i
Contents	iii
List of Tables	v
List of Figures	ix
List of Contributors	xi

INTRODUCTION	1
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PART 1. REGIONAL DEVELOPMENT IN THE ERA OF DECENTRALIZATION

1. Current Social and Economic Issues of Regional Development in Indonesia Sjafrizal	7
2. Creating Knowledge Regions: Indonesia's Challenge and Future Galuh Syahbana Indraprahasta	29
3. Analysis of Regional Growth and Volatility Using A Spatial Econometric Approach: A Case of Indonesia Agus Salim and Yulismi	47

PART 2: DISPARITIES AND POVERTY ISSUES OF REGIONAL DEVELOPMENT

4. Impact Analysis on Infrastructure Development Program to Reduce Poverty in Indonesia's Underdeveloped Regions Perwita Sari, Nunung Nuryartono, and Lukytawati Anggraeni	67
5. A Study on Income Disparity in Indonesia Using CGE Model Hiroshi Sakamoto	81
6. Urban Inequality in Indonesia Akita Takahiro and Alit Pirmansah	103

PART 3. FINANCING THE REGIONAL DEVELOPMENT: CHALLENGES FOR IMPROVEMENT AND EXPANSION OF SERVICES

7. An Evaluation on Institution of Public Private Partnership (PPP) in Indonesia Arief Ramayandi and Arief Bustaman	119
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8. The Impact of Semarang Airport Expansion on the Regional Economy of Central Java D. S. Priyarsono	129
9. Forward Estimates for Intergovernmental Transfers in Indonesia: Is It Possible? Hefrizal Handra	141
10. Specific Grant in Indonesian: Is It Really Specific? Kodrat Wibowo, Astia Dendi, and Zulhanif	163

PART 4. ENVIRONMENTAL, HUMAN RESOURCES, AND GOVERNANCE ISSUES IN REGIONAL DEVELOPMENT

11. Peat Swamp Forest Management Scenarios Based on Total Economic Value Syafrol Yunardy and Nur Arifatul Ulya	183
12. Wage and Labor Union in Manufacturing Sector Pipit Pitriyan and Adiatma Siregar.....	195
13. IT Value Creation in Indonesian Local Government: A Service Model Herry Irawan, Suhardi, and Alfira Sofia	213
14. Improving Local Government Financial Reporting Fauzan Misra	226

Table 1.1	Trends of Regional Growth
Table 1.2	Regional Development
Table 1.3	The Trend of Indonesia 19
Table 1.4	Variations of 2010
Table 1.5	Number of Indonesia 19
Table 2.1	Primary Product Regency
Table 2.2	Three Aspects
Table 2.3	Supporting S
Tabel 3.1	Regression without Oil a
Table 4.1.	Table of Descri
Table 4.2.	Estimation Res Static and Dyn
Table 4.3.	Estimation Res Reduction by Instrumental V
Table 5.1	Average per Household G
Table 5.2	Average Wage Disparity by W
Table 5.3	Classification e
Table 5.4	Classification b
Table 5.5	Classification c
Table 5.6	Simulation Des
Table 5.7	Simulation Res (trillion)
Table 5.8	Simulation Res (IDR10 trillion)
Table 5.9	Change in Dist
Table 5.10	Change in Dom
Table 5.11	Simulation Res (trillion)
Table 5.12	Simulation Res

Chapter 9
**FORWARD ESTIMATES FOR INTERGOVERNMENTAL
TRANSFERS IN INDONESIA: IS IT POSSIBLE?**³⁰

Hefrizal Handra

INTRODUCTION

Forward estimates for intergovernmental transfers will be an important tool for Indonesia to reduce uncertainties in relation to future transfers and shared revenues and to facilitate the introduction of Medium-Term Expenditure Framework (MTEF) approaches at Sub-National Government (SNG) levels. Realistic forward estimates will strengthen the reliability and predictability of funds for the SNGs since the transfers accounted for about 87% of municipality/regency revenues and 55% of provincial revenues in the period 2008-2010. It will be almost impossible for the SNGs, especially local governments (Municipalities/Regencies) to better estimate their revenues as well as to undertake any form of MTEF without the provision of forward estimates of intergovernmental transfers from the centre.

International practice shows that the majority of industrialized countries prepare multi-year budgets. Experience of budget reform in OECD and developing countries suggests that MTEFs can help to improve budget processes and outcomes through greater clarity of policy objectives, better predictability in budget allocations, comprehensiveness of coverage; and transparency in the use of resources (OPM review 2000). But experience also illustrates that the MTEF is not always the solution for all budget problems. Improving budget outcomes requires a focus on where the real problems lie. If, for example, the release of budget funds is unpredictable, it will be difficult to instill confidence in medium term projections.

In Indonesia, the Medium Term Expenditure Framework (MTEF) has already been prescribed to be implemented since enactment of the Public Finance Law (No. 17 Year 2003). The subsequent **Government Regulation (GR) No. 20 Year 2004 and the GR No. 21 Year 2004 indicate** that the programs and activities of each Ministry/Agency should be based on a medium term perspectives (more than one year). However, until now, there is no presentation of such medium estimates for intergovernmental transfers in Indonesia's budget system. Three years projections for the aggregate estimates of State's revenues and expenditures have been stated in the financial notes of the budget proposal since 2008, but the details of the budget have never been accompanied by forward estimates.

³⁰This paper is reproduced (extracted) from my final report as a consultant for the ADB Technical Assistance Project (TA7184: Local Government Finance and Governance Reform) at the Ministry of Finance Republic Indonesia from January 2010 to March 2011.

The challenge comes with the new manual in the planning and budgeting reform issued by the MoF and Bappenas in 2009. The manual requires the central government to provide three years projections (forward estimates) for the budget 2011 including for intergovernmental transfers. This paper assesses the feasibility of implementing forward estimates for intergovernmental transfers in Indonesia. This is a descriptive study which assesses the system of intergovernmental transfers in Indonesia and the possibility to implement forward estimates.

REVIEW OF INTERNATIONAL EXPERIENCES ON FORWARD ESTIMATES

A majority of industrialized countries prepare multi-year budgets, named depending on the approach taken, such as multi-year budget, forward budget, expenditure review, multi-year estimates, forward estimates, etc. Meanwhile, in the developing and transition countries, the expression "Medium-Term Expenditure Framework" (MTEF) is frequently used to describe some form of multi-year budget or more aggregated estimates. The definition of MTEF given by experts varies from one to another. A broad definition given by Grewal (2005), explains the MTEF as "a multiyear system for managing public expenditure so that the goals of fiscal policy can be achieved". A more straightforward definition given by Pearson (2002) is "an MTEF is a multi-year public expenditure planning exercise which is used to set out the future resource requirements for existing services, and assess the resource implications of future policy changes and any new programs".

Various literature articles describe that the process of building a MTEF begins with preparing top-down estimate of aggregate resources available for public expenditure consistent with macro-economic stability. The World Bank's *Public Expenditure Management Handbook* (1998) called it "a top-down resource envelope" which is fundamentally a macroeconomic model that indicates fiscal targets and estimates revenues and expenditures, including government financial obligations and high cost government-wide programs. This is then followed by preparation of bottom-up estimates of the current and medium-term costs of existing policy. The term "existing policy" could also apply in the context of a medium term. For example, if the decision has been made to increase the coverage of certain services in year $n+3$, the implication of such policy to the cost estimations should be included. Finally, the process includes a framework to reconcile the costs with aggregate resources. In other words, it matches the costs with available resources in the context of the annual budget process.

The MTEF is a rolling process repeated every year and aims to reduce the gap between what is affordable and what is demanded by public institutions/Ministries. The forward estimates of expenditures for a particular year could change for a number of reasons. First, the estimates are based on a continuation of the Government's current policies and programs. These will change over time as new programs

are introduced or existing changes may or may not. Agency/Ministry level reordering of priorities, expenditure growth or demand variables. For each particular year will require demographic sensitive series of parameters, such as with changes in forecast expenditure estimates being produced.

Intergovernmental transfers not be included in the MTEF. Some countries are very cautious about transfers in the MTEF. Some countries have different types of CG expenditure. Some countries provide transfers to SNGs based on a level or the growth of relevant to from forward estimates to medium-term policies.

Coverage and Timeframe

The Medium-Term Expenditure Framework in various countries show different comprehensive coverage of transfers. Uganda. It covers not only CG but also intergovernmental transfers. In Malawi, the MTEF covers CG and Expenditure. In the UK and other countries, particular types of CG expenditure are included in the estimates for intergovernmental transfers. (1) The amount of transfers to SNGs based on the projected amount of transfers to SNGs based on the growth of relevant central government transfers, if the policy is to increase transfers.

The forward estimates of expenditures for five years. In Australia, the forward estimates are for five years. The projection figures are for five years. In the UK, the projections are for five years. The types of expenditures are different.

Legal Status of MTEF

The legal status of MTEF varies. The highest legal status is in South Africa.

are introduced or existing programs are enlarged or reduced. Such changes may or may not impact on the financial aggregates at the Agency/Ministry level as the changes may be offset through a reordering of priorities. Second, existing policies may result in real expenditure growth or contraction where the policies are driven by demand variables. For example, changes in demographic forecasts for a particular year will require a refinement in the forecast payments for demographic sensitive services. Lastly, changes over time in the forecasts of parameters, such as wages growth and interest rates, will result in changes in forecast expenditures between the time of the forward estimates being produced for a year and the budget for that year.

Intergovernmental transfers, as part of CG's finances, may or may not be included in the MTEF, depending on the country concerned. Some countries are very comprehensive and cover intergovernmental transfers in the MTEF. Some only include the CG Ministry expenditures. In some countries the MTEF is only relevant for particular types of CG expenditure. Forward estimates for intergovernmental transfers basically provides information about the projected amount of transfers to SNGs based on the current policies adjusted with the price level or the growth of relevant central revenues. Additions/reductions to from forward estimates of transfers should be based on costing of the medium-term policies.

Coverage and Timeframe of Medium-Term Expenditure Framework

The Medium-Term Expenditure Framework (MTEF) experiences in various countries show variation in the coverage. The most comprehensive coverage of the MTEF is in South Africa, Australia and Uganda. It covers not only the Central Government Expenditure but also intergovernmental transfers. In some countries like Ghana, Kenya and Malawi, the MTEF only applies for the Central Government Expenditure. In the UK and Japan, the MTEF is even only relevant for particular types of Central Government Expenditure. Forward estimates for intergovernmental transfers provide information about: (1) The amount of transfers to SNGs if the policy is not changed; (2) The projected amount of transfers to SNGs (adjusted with the price level or the growth of relevant central revenues); and, (3) Additions/reductions to transfers, if the policy is to be changed over the medium-term.

The forward estimates practices in many countries vary from two to five years. In Australia, Kenya, Uganda and Ghana, for example, the forward estimates are for three years, while in South Africa, the projection figures are for four years (including the next years' budget). In the UK, the projections vary from two to five years depending on types of expenditures.

Legal Status of MTEF

The legal status of MTEF varies from one country to another. The highest legal status is in South Africa, Australia and Uganda where the

MTEF is a part of the budget process and subject to approval/endorsement of the Cabinet/Parliament. The next strong legal process is in Ghana where the MTEF is part of budget process but not subject to formal approval by either Cabinet/Parliament. Vice versa, in Kenya, the MTEF process is separated from the budget, but it should be approved by Cabinet/Parliament. The lowest legal status is in Malawi where the MTEF is neither a part of the budget process nor submitted to Cabinet/Parliament for approval. For the best results, continuing political commitment for MTEF is important. Therefore, the best system of MTEF is where it becomes part of the formal budget processes and a formal legal document.

Advantages of MTEF

Learning from the MTEF system in countries like South Africa and Australia, the advantages of applying the MTEF are observed from the role of it on: (i) assisting macroeconomic stability; (ii) in maintaining the level of public services; and (iii) in providing predictable resources for SNGs. However, the success of the MTEF will depend upon flexible fiscal rules and realistic targets.

There are several reasons why an MTEF is desirable. Pearson (2002), for example, argues that a MTEF helps to build the needed link between policy and budgetary spending by extending the perspective of the budget beyond only the following year. Under an MTEF, the focus of budgetary authorities is extended to the same medium term (3-5 years) over which the key targets of fiscal consolidation such as reductions in fiscal deficits and debt are achievable. Wildavsky (1993) argued some 17 years ago that isolated annual budgeting leads to short-sightedness because only the next year's expenditures are reviewed. He emphasized that annual budgets can hide overspending and lead to huge disbursements in future years.

Besides the above arguments, the MTEF provides the first step to developing medium term estimates for individual spending agencies, so that it gives some degree of budget predictability to the agencies while ensuring overall fiscal discipline (OPM Review 2000). This would be a significant gain for many developing countries where a large gap between stated policies and actual resources leads to ad hoc spending cuts in budget implementation. Budget reforms are only sustainable if they demonstrate early benefits to key players in the process. Therefore, it is particularly important that the introduction of any form of medium term framework brings improvements in the predictability of organizational funding. This appears to have been achieved in South Africa (OPM Review 2000). Meanwhile in Uganda the designation of protected sectors (health, education, roads) has restricted unpredictability to lower priority areas. In contrast, little predictability seems to have been achieved in Ghana or Malawi and there are indications that this is impeding progress (OPM Review 2000).

Experience of budget reform in OECD and developing countries

suggests that MTEFs through greater clarity in allocations, comprehensive resources (OPM Review 2000). MTEF is not always the best outcome requires a framework of budget funds is used in medium term projections. Difficulties for low macroeconomic indicators are impossible. Moreover, budget holders are not held responsible. Attempts to link budget outcomes to achieve transparency is futile where over budgeting is unrealistic.

In brief, the best practice in budget making, planning, and adjustments taking place in the Government's budget should be better off managing it. The Year Budget should be based on additional expenditure with the price level of expenditure, if the series of experiences suggest the implementation of an MTEF.

- * It should be re-examined in macroeconomic context.
- * It is a rolling process on a 3-year basis. If the annual budget is a "constraint", the budget entitlements should be reviewed.
- * It should be coordinated with all public expenditure and participation in the sector allocation is important.
- * It should be based on realistic estimates. This should cover changes in inflation rates and other factors.
- * It should provide clear responsibilities and be published (rather than secret) to enhance its credibility.

suggests that MTEFs can help improve budget processes and outcomes through greater clarity of policy objectives, predictability in budget allocations, comprehensiveness of coverage, transparency in the use of resources (OPM Review 2000). But experience also illustrates that the MTEF is not always the solution to budget problems. Improving budget outcomes requires a focus on where the real problems lie. If the release of budget funds is unpredictable, it will be difficult to instill confidence in medium term projections. Pearson (2002), points out one of the difficulties for low income countries to implement MTEFs is the **macroeconomic instability** that can render forward planning impossible. Moreover, if Ministers, Parliamentarians and budget holders are not held to account, then no gains can be made from attempts to link budget outcomes to policy objectives. Also, trying to achieve transparency in the allocation of resources to specific activities is futile where overall sector policies are unclear, inconsistent or unrealistic.

In brief, the best process of a MTEF should bring together policy-making, planning, and budgeting early in the budgeting cycle, with adjustments taking place through policy changes. Even if the whole of the Government's budgeting system is not working well, each sector is better off managing itself with a medium-term perspective. A Multi-Year Budget should show: (1) the present level of expenditures, (2) additional expenditures to provide the same service in future adjusted with the price level and demographic changes; and, (3) additional expenditure, if the service is to be changed or expanded. International experiences suggest that the key characteristics of a successful implementation of an MTEF are:

- * It should be realistic and should be set within a well prepared macroeconomic framework;
- * It is a rolling program and thus needs to be updated on an annual basis. If the annual budget is fixed and subject to a "hard budget constraint", the figures projected for later years are not seen as entitlements but as best estimates for planning purposes;
- * It should be comprehensive and sufficiently detailed in covering all public expenditures and revenues from all sources. Broad participation in decisions related to sector allocations, intra-sector allocations and on sector policy discussions are important;
- * It should be based on realistic (conservative) cost and revenue estimates. This could involve the provision of contingencies to cover changes in economic circumstances such as changes in the inflation rates and new policy commitments; and
- * It should provide clarity in terms of accountability and responsibilities. It should be approved by Cabinet and published (rather than just adopted as a working document) to enhance its credibility.

Nevertheless, a number of factors make it difficult for developing countries to implement MTEFs. Schiavo-Campo (2008) points out the weaknesses in macroeconomic planning and external shocks that have made annual budgets unrealistic in developing countries. Typically when a country faces a large trade adjustment, the annual budget is quickly overtaken and with it the MTEF. Other than macroeconomic conditions, there are various factors that should be addressed in developing countries before a full scale MTEF can be implemented, such as institutional weaknesses, lack of budgetary discipline, lack of realism (overestimates), etc. Moreover, the MTEF which is aimed at developing a fully output-oriented budget requires an extraordinarily heavy information load and thousands cost centers which is a very challenging proposition for any developing country.

Importantly, many (indeed most) papers discussing the MTEF or forward estimates do not give much attention to intergovernmental systems. Most papers only discuss expenditure of Central Ministries. It seems that many writers consider that CG expenditures for Ministries automatically cover intergovernmental transfers. However, such transfers are different from Ministry expenditures and are uniquely determined in the central budget of many countries. Nevertheless, similar to the definition of forward estimates for CG expenditures, forward estimates for intergovernmental transfers can be developed based on the principles that:

- Forward estimates of transfers to SNGs provide for the projected amount to be technically adjusted with the price level or the growth of relevant central revenue; and
- Apart from technical adjustments any additions to or reductions from transfers occur only if the intergovernmental policies are changed over the medium-term

INTERGOVERNMENTAL TRANSFERS IN INDONESIA

Indonesia is a unitary state by proclamation of independence on 17 August 1945. Following proclamation, the Basic Constitution of 1945 has been used to establish a unitary country, which is clearly stated in article 1 of the Constitution. With regard to decentralization, the Basic Constitution 1945 does not regulate in detail how decentralization should be organized in Indonesia. More specifically for SNGs and their powers, the Constitution mentions that arrangements will be established by Laws.

There have been six Laws and one Presidential Decree about political and administrative aspects of SNGs since independence. Each of them gives a different approach to the system. Those laws currently are Law 1/1945, Law 22 /1948, Law 1 /1957, Presidential Edict 6/1959, Law 18/1965, Law 5/1974, Law 22/1999 and Law 32/2004. At the end of 2009, Indonesia comprised 33 Provinces and 491 Municipalities / Regencies. Each level of SNG is assigned particular responsibilities. The Provinces in Indonesia are assigned limited functions, which are mainly

concerned with the multi the Province and local f are not able to perform l may include regional m and research, the mar protection, trade and tou spatial planning. With functions are handled by

Municipal/Regency at least fourteen govern public works, primary educational services ar cooperatives and manpo such as planning, fir evaluation; and mainten assigned separate tax ba formalized by a Law. Th taxes and charges. Tho 28/2009. In addition to th Government, there are relations. Central Govern are subject to transfers to to the regions aim to ful met by the region's own close the vertical imbalan

Three forms of transf three decades. The first central taxes and non-ta shared revenues (Dana Income Taxes administer the source regions. The grant from Central Gov general purpose gran various types of specific regions and various spec

There are some other in Indonesia, includin administration funds. C part of transfers to SNGs. A grant from CG to LG is from a loan or grant from other words, the CG is j counted as a part of tra unique administrative pr

² Domestic revenue means the rev

³ Another translation of grant into as a translation of grants from (regency/municipal government).

concerned with the multi-jurisdiction of regional affairs and services in the Province and local functions which the Regencies / Municipalities are not able to perform because of limited resource capabilities. These may include regional macro planning, human resource development and research, the management of regional ports, environmental protection, trade and tourism promotion, pest control / quarantine; and spatial planning. With regard to local public services, almost all functions are handled by Municipalities/Regencies.

Municipal/Regency Governments have financial responsibility for at least fourteen government affairs and local services such as local public works, primary health services, primary and secondary educational services and culture, local environment, land matters, cooperatives and manpower, etc. Such responsibilities involve activities such as planning, financing, implementation, monitoring and evaluation; and maintenance. From the revenue point of view SNGs are assigned separate tax bases. Tax assignments to sub-national level are formalized by a Law. There have been three Laws about sub-national taxes and charges. Those are Law 18 /1997, Law 34 /2000; and Law 28/2009. In addition to the assignment of taxing powers to each level of Government, there are also other forms of central-regional financial relations. Central Government's domestic revenues² (state revenues) are subject to transfers to sub-national governments. Transfers from CG to the regions aim to fulfill the fiscal needs of SNGs, which cannot be met by the region's own revenues. In other words, the transfers are to close the vertical imbalance between the CG and SNGs.

Three forms of transfers have been practiced in Indonesia in the last three decades. The first is by transferring revenues from particular central taxes and non-taxes to the source regions. This is usually called shared revenues (*Dana Bagi Hasil/DBH*). For example, Individual Income Taxes administered by Central Tax Office are to be transferred to the source regions. The second form of transfer is the general purpose grant from Central Government to the regions. Which is called the general purpose grant (*Dana Alokasi Umum/DAU*). The third is various types of specific grants including grants for special autonomous regions and various specific types which are called adjustment funds.

There are some other forms of intergovernmental financial relations in Indonesia, including *Hibah*, de-concentrated funds and co-administration funds. Currently, they are not technically considered as part of transfers to SNGs. *Hibah* is a translation of 'grant' into Indonesia.³ A grant from CG to LG is categorized into *Hibah* if the source of funds is from a loan or grant from other countries or international institutions. In other words, the CG is just channeling the fund to SNGs. *Hibah* is not counted as a part of transfers due to the irregularity of funds and its unique administrative procedures. Meanwhile the de-concentrated and

² Domestic revenue means the revenue from taxes and non-taxes collected in Indonesia.

³ Another translation of grant into Indonesia is *bantuan*. The term *bantuan keuangan* is currently used as a translation of grants from Provincial Governments to Kabupaten / Kota Government (regency/municipal government).

co-administration fund basically aim to finance CG functions assisted by the SNGs. Those funds are not counted as revenues for SNGs but rather as CG expenditure executed by or through the SNGs.

Since decentralization, there have been two Laws about central transfers to SNGs in Indonesia. The first is Law 25/1999, which was applied from the beginning of fiscal year 2001 until fiscal year 2005. Then at the end of 2004, Law 25/1999 was replaced by the Law 33/2004 which was implemented from fiscal year 2006 until now. Transfers to SNGs accounted on average for about 33.7% of state revenues or about 5.8% of GDP during the period 2002-2010 as seen in Table 9.1. The total amount of transfers varied from 4.9% to 6.8% of GDP. Transfers achieved the highest ratio to GDP at 6.8% in FY 2006.

Table 9.1 Ratio Transfers to State Revenue and GDP During 2001-2010

Fiscal Year	GDP	State Revenues (SR)	Transfers to SNG	Ratio Transfers to SR	Ratio Transfers to GDP
		In Trillion Rupiah			
2001	1646,3	300,6	81,1	27,0%	4,9%
2002	1821,8	298,5	98,2	32,9%	5,4%
2003	2013,7	340,9	120,3	35,3%	6,0%
2004	2295,8	403,1	129,7	32,2%	5,6%
2005	2774,3	493,9	150,5	30,5%	5,4%
2006	3339,2	636,2	226,2	35,6%	6,8%
2007	3950,9	706,1	253,3	35,9%	6,4%
2008	4951,6	979,3	292,4	29,9%	5,9%
2009	5613,4	847,1	309,3	36,5%	5,5%
2010	6253,8	990,5	344,6	34,8%	5,5%
Average 2002-2010				33,7%	5,8%

Sources : Writer's calculation based on the data provided by the DJ Budget, MOF

Note : data for FY 2001-2009 is the realization, data for FY 2010 is the Revised Budget

Shared Revenue

According to Law 25/1999 which was replaced by Law 33/2004 SNGs (Provinces and Local) have rights over a portion of certain CG revenues. In other words, particular kinds of CG revenues, taxes and non-taxes, should be shared to the autonomous regions, mainly those in which the revenues are raised. SNGs are not normally involved in the administration of these types of revenue. They just receive them in the form of transfers from the CG.

The amount of shared revenue received by each region per year is only known exactly after the real national revenue is collected and calculated. However, every year, the Ministry of Finance (MOF) issues the decree about the estimation of shared revenue for each region based on the budget. Then MOF transfers the funds quarterly to regions. The

amount of funds transfer based on the budget es third and fourth quarter related state revenue. S available is not recogn final adjustment is usua

As part of intergove revenue is significant. I transfers in the period DAU but higher than th changed greatly during 2009 to a high of 33.6% i

Table 9.2. Composition

Fiscal Year	General Purpose Grant
2003	64,0%
2004	63,3%
2005	59,0%
2006	64,4%
2007	65,1%
2008	61,4%
2009	60,4%
2010	59,1%
Average	62,1%

Source: writer's calculation

Note: The 2003-2009 data is re

The shared revenues fr revenues. On average they during the period of 2001- and building tax (PBB), an Generally, each kind of sha of relevant State revenues revenues from oil and gas c

⁴ In practice, it is called the fifth qu SNGs has exceeded the actual a revenues.

⁵ Only Dana Alokasi Khusus (DAB

amount of funds transferred for the first and second quarters is usually based on the budget estimation, while the amount of transfers for the third and fourth quarter are adjusted with the estimated realization of related state revenue. Since the actual amount of shared revenue finally available is not recognized until the first quarter of the next year, the final adjustment is usually done at the first quarter next year.⁴

As part of intergovernmental transfers, the total amount of shared revenue is significant. It accounted on average for about 27.5% of total transfers in the period 2003-2010 (see Table 9.2). It is smaller than the DAU but higher than the DAK. As a portion of total transfers it has not changed greatly during such period, ranging from a low of 24.7% in FY 2009 to a high of 33.6% in FY 2005.

Table 9.2. Composition of Intergovernmental Transfers 2003-2010

Fiscal Year	General Purpose Grant	Specific grants ⁵	Shared Revenue	Special Autonomy and Adjustment Fund
2003	64,0%	2,3%	26,1%	7,7%
2004	63,3%	2,2%	29,2%	5,3%
2005	59,0%	2,6%	33,6%	4,8%
2006	64,4%	5,1%	28,7%	1,8%
2007	65,1%	6,4%	24,9%	3,7%
2008	61,4%	7,1%	26,8%	4,7%
2009	60,4%	8,0%	24,7%	6,9%
2010	59,1%	6,1%	26,0%	8,8%
Average	62,1%	5,0%	27,5%	5,5%

Source: writer's calculation from data provided by DJA of MOF.

Note: The 2003-2009 data is realization, the 2010 data is the revised budget.

The shared revenues from oil and gas were dominant among other shared revenues. On average they accounted for about 42% of total shared revenues during the period of 2001-2010. Then followed shared revenues from the land and building tax (PBB), and fees for property ownership transfers (BPHTB). Generally, each kind of shared revenue tends to increase following the growth of relevant State revenues. Marked fluctuation is experienced with shared revenues from oil and gas due to the volatility of oil and gas prices.

⁴ In practice, it is called the fifth quarter if the CG has to provide additional funds. If the payment to SNGs has exceeded the actual amount, the CG will adjust the estimation of next years shared revenues.

⁵ Only Dana Alokasi Khusus (DAK), not included *Hibah*

General Purposes Grant (Dana Alokasi Umum)

Dana Alokasi Umum (DAU) is a general purpose grant from CG to Provincial and Municipal/Regency Governments. It was introduced by Law 25/1999 and implemented for the first time in FY 2001. During the New Order Era, Indonesia had various kinds of grants for development. Most of them were specific grants such as the grant for regional recurrent expenditure (especially for salaries of local civil servants), grants for development of provincial and local roads, grants for development of primary schools, etc.

Significant changes were promoted by Law 25/1999. It simplified the grants system and introduced a more reliable system of grants. The Law secured the revenues of SNGs by determining the amount of DAU to be at least 25% of net state domestic revenue⁶ (Law 25/1999, Article 7.1). This was completely different from the previous approach in which the value of the grant was determined by the actual expenditure on wages of regional civil servants. This arrangement secured for the SNGs reliable sources of funds to finance their responsibilities in line with the State's fiscal capacity. It also aimed to force the regions to be more responsible in financing their recurrent expenditures.

Based on Law 25/1999, the DAU is declared to be an equalization grant which attempts to address fiscal disparities of regions, not only in fiscal capacities but also in expenditure needs. The fund is intended to balance fiscal capacities among the regions in financing the expenditure needs of their decentralised functions. The DAU allocation is supposed to follow the fiscal gap equalisation (FGE) model. It is allocated on a formula basis not as a discretionary system. However, in practice, only about 60% of the DAU is distributed in relation to the fiscal gap, while the remaining 40% is based on the basic/staffing allocation. Therefore, the equalization effect of the DAU has been decreased.

After Law 25/1999 was replaced by Law 33/2004 the reliability and predictability of the DAU was maintained. The new Law even increased the minimum amount of the DAU to 25.5% of net state revenues for FY 2006 and 2007 and then 26% from FY 2008. However, the reliability of the total amount of the DAU has been undermined by the budget Laws for FYs 2009 and 2010 with the calculation of net state revenue no longer based on Law 33/2004. Rather it has been amended through the Budget Law every year so that the total amount of DAU has become lower than it should be under Law 33/2004. Data in table 3.4 confirms that the total amount of DAU was only 19% of State revenue in FY 2009 and 20% in FY 2010. Meanwhile, it has averagely 23% of net state revenue during the period, 2001-2008.

⁶ Government Regulation (GR) 104/2000 stated that the minimum amount of total DAU is 25% of the budgeted state revenue minus the total amounts of state revenue distributed to regions through the shared revenues. State revenue is the revenue from State taxes and non-taxes raised domestically (not from foreign debt and international grants).

Table 9.3. Ratio of Eac
2001-2010

Fiscal Year	Ratio DAU t SR
2001	23,0
2002	22,9
2003	22,9
2004	23,5
2005	23,4
2006	23,4
2007	22,9
2008	23,0
2009	18,9
2010	20,3

Source : writer's calculation f

Specific Grants (Dana

The role of the Spe
25/1999 article 8, was
particular local needs v
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However, the total
compared to the total
DAK was only IDR0.7
In FY 2009, the DAK
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37.5%, the total amoun

Table 9.3. Ratio of Each Type of Transfers to State Revenues During 2001-2010

Fiscal Year	Ratio DAU to SR	Ratio DBH to SR	Ratio DAK to SR	Ratio SA&AF to SR
2001	23,0%	7,7%	0,3%	0,0%
2002	22,9%	8,1%	0,3%	1,1%
2003	22,9%	8,3%	0,8%	2,8%
2004	23,5%	7,7%	0,9%	2,0%
2005	23,4%	8,2%	1,1%	1,9%
2006	23,4%	9,5%	1,9%	0,6%
2007	22,9%	9,5%	2,4%	1,2%
2008	23,0%	8,5%	2,7%	1,9%
2009	18,9%	8,7%	2,5%	2,4%
2010	20,3%	8,6%	2,2%	1,7%

Source : writer's calculation from several years budget Law (UU APBN)

Specific Grants (Dana Alokasi Khusus)

The role of the Specific Allocation Fund (DAK), according to Law 25/1999 article 8, was to provide financial assistance to SNGs for: (1) particular local needs which could not be accommodated by the DAU; and (2) for particular local services which have been set as national priorities. Law 25/1999 mentioned that the DAK was intended to make the equalization mechanism more comprehensible. The Law implicitly recognizes the difficulty in accommodating regional diversity through the DAU and thus provided mechanisms to address national priorities through the DAK.

Law 33/2004 slightly changed the DAK definition to a fund allocated to SNGs in order to help financing particular activities which have been decentralized to SNGs but in line with national priorities. The law emphasizes that the DAK should only be provided to finance local affairs which are also set as national priorities. A similarity of both Laws is that the amount of the DAK was not set as a percentage of national revenues as per the DAU. The amount of the DAK is determined every year according to national fiscal capacities. In short, the amount of DAK is not certain. Besides, it can and has fluctuated.

In FY 2001 and 2002, the DAK was only a reforestation fund. Other sectors of DAK funding introduced in FY 2003 consisted of grants for local infrastructure, education; and for health services. The type of DAK has expanded from only 5 types in FY 2003 to 13 types in FY 2010. However, the total amount of DAK has remained insignificant compared to the total amount of DAU. In FY 2001, the total amount of DAK was only IDR0.7 trillion while the total DAU was IDR60.5 trillion. In FY 2009, the DAK was IDR24.8 trillion while DAU was IDR186.4 trillion. Although annual average growth of DAK during 2003-2010 was 37.5%, the total amount of DAK remained much lower than the DAU.

Table 9.4. Specific Grants (DAK) in Indonesia from 2003-2010
(in IDR billion)

No	Sector	2003	2004	2005	2006	2007	2008	2009	2010	Annual Growth
1	Education	625	653	1.221	2.920	5.195	7.015	9.335	9.335	47,1%
2	Health	375	456	620	2.407	3.381	3.817	4.017	2.830	33,5%
3	Road Infrastructure	843	839	945	2.576	3.113	4.045	4.501	2.810	18,8%
4	Irrigation Infrastructure	339	357	385	628	859	1.497	1.549	968	16,2%
5	Water and Sanitation			204	608	1.062	1.142	1.142	714	28,6%
6	Government Infrastructure	88	228	148	449	539	362	562	386	23,5%
7	Fishery		305	322	776	1.100	1.100	1.100	1.208	25,7%
8	Agriculture			170	1.095	1.492	1.492	1.492	1.544	55,5%
9	Environment				113	352	352	352	352	32,8%
10	Family Planning						279	329	329	8,6%
11	Forestry						100	100	250	58,1%
12	Village Infrastructure							190	300	145,9%
13	Trade							150	107	-12,0%
	Total	2.269	2.839	4.014	11.570	17.094	21.202	24.820	21.133	49,0%

Source: Data from Ministry of Finance.

Although the total amount of DAK is not certain, three DAK components: education, health and road, have always been dominant. However, in line with increasing number of DAK sectors, the share of DAK health and roads decreased, but this has not been the case for education. Although the amount of DAK health and roads remains next important after education, their share has decreased with annual growth below annual growth of total DAK.

Special Autonomy and Adjustment Fund

Special autonomy funds were introduced in FY 2002 for Papua Province. The Special Autonomy Law for Papua requires the CG to provide the special fund for 20 years. The amount of funds is set at 2% of the DAU with the main purpose being to finance education and health services (Law 21/2001, Article 34). Moreover, the CG is compelled to provide additional funds for infrastructure with amounts to be determined by the Government and DPR, based on proposals of the Provincial Government. Special Autonomy Funds should also be provided for Aceh following implementation of Law 11/2006 on Aceh Government autonomy. The amount of funding for Aceh is the same as for Papua which is 2% of the DAU for the first 15 years. But the amount is to be reduced to 1% of DAU beginning from the 16th to 20th year (Law 11/2006 Article 183). Another difference is that there is no additional infrastructure fund for Aceh.

Adjustment funds are not mentioned in any Law. The funds are legalized by the Budget Law every year. They were firstly introduced in the Budget Law 2002 to compensate those SNGs that became worse off (DAU reduction) due to the implementation of the new DAU formula.

The Government and I the same amount of the adjustment fund continuing and not only for DAU but also for the main types of adjustment funds: (1) teachers with civil servant salaries; (2) DAK 2008; and, (4) Unpa

While the special autonomy funds for special autonomy provinces, the adjustment funds as justified by the Budget Law are predictable since the amount seen from Table 9.5 that exactly 2% during the period 2002-2007 and 4% since FY 2008 due to the special autonomy for Aceh and for the special autonomy provinces. Meanwhile, the amount of adjustment funds processes. It is a highly variable

Table 9.5 Special Autonomy Funds

Fiscal Year	Special Autonomy (SA)
2001	0,0
2002	1,3
2003	1,5
2004	1,6
2005	1,7
2006	2,9
2007	4,0
2008	7,5
2009	8,8
2010	9,1

Source: writer's calculation from

ASSESSMENT OF THE NEED FOR INTERGOVERNMENTAL

Realistic and accurate assessment will strengthen the reliability of the transfers since the transfers to Municipalities/Regencies revenues during the period 2002-2007 took about 34% of the state budget (part). Providing forward estimates to implement their own MTE will enable the LGs to realistically estimate their better estimated from the C

The Government and DPR agreed to guarantee the DAU minimum at the same amount of the 2001 DAU for all SNGs. Following this, the adjustment fund continued to be provided every year in various forms and not only for DAU hold harmless provisions. In FY 2010, there are four main types of adjustment funds, those are: (1) Additional benefits for teachers with civil servant status; (2) Regional Incentives Fund; (3) Unpaid DAK 2008; and, (4) Unpaid Infrastructure adjustment fund 2008.

While the special autonomy funds are only for Aceh and Papua Provinces, the adjustment fund is provided for every particular region as justified by the Budget Law every year. The minimum amount of funds for special autonomous regions is determined by the Law and it is predictable since the amount is set to be at least 2% of DAU. It can be seen from Table 9.5 that the ratio of special autonomy funds to DAU was exactly 2% during the period of 2002-2006. It has increased to more than 4% since FY 2008 due to the implementation of special autonomy funds for Aceh and for the additional funding for Papua infrastructure. Meanwhile, the amount of adjustment funds is determined by political processes. It is a highly volatile and unreliable source for RGs.

Table 9.5 Special Autonomy and Adjustment Fund 2001-2010 (in IDR trillion)

Fiscal Year	Special Autonomy (SA)	Adjustment Fund	Total	Ratio SA to DAU
2001	0,00	0,00	0,00	0,0%
2002	1,38	2,05	3,44	2,0%
2003	1,54	7,85	9,39	2,0%
2004	1,64	5,21	6,86	2,0%
2005	1,78	5,47	7,24	2,0%
2006	2,91	0,56	3,48	2,0%
2007	4,05	4,41	8,45	2,5%
2008	7,51	6,94	14,45	4,2%
2009	8,86	14,88	23,74	4,8%
2010	9,10	7,30	16,40	4,7%

Source: writer's calculation from several years budget Law (UU APBN)

ASSESSMENT OF THE POSSIBILITY OF FORWARD ESTIMATES FOR INTERGOVERNMENTAL TRANSFERS IN INDONESIA

Realistic and accurate forward estimates for intergovernmental transfers will strengthen the reliability and predictability of funds for SNGs in Indonesia since the transfers are large accounting for about 87% of Municipalities/Regencies revenues; and 55% of Provincial Government revenues during the period 2008-2010 (see Table 9.6). In total, transfers to SNG took about 34% of the state revenues during the period 2001-2010 (see previous part). Providing forward estimates of transfers will also assist SNGs to implement their own MTEFs. It will be almost impossible for SNGs, especially the LGs to realistically estimate their revenues in a MTEF framework without better estimated from the CG.

Table 9.6. Composition of SNG Revenues in the Period of 2008-2010

	Provinces	Municipalities/ Regencies	SNGs
Local Own Revenues	43,8%	7,3%	16,0%
Transfers from Central Government	55,0%	86,8%	79,3%
Shared Revenue (DBH)	22,9%	16,4%	18,0%
General Purposes Grant (DAU)	22,7%	59,8%	51,0%
Specific Grants (DAK)	1,6%	8,0%	6,5%
Dana Otsus and Adjustment	7,8%	2,5%	3,8%
Other Revenues	1,2%	5,9%	4,7%
Total Revenues	100,0%	100,0%	100,0%

Sources: writer's calculation from the data of local government budgets provided by the MOF

Possibility of Forward Estimates for Shared Revenue (Dana Bagi Hasil)

As explained in the previous section, the formula of shared revenue (Dana Bagi Hasil/DBH) has been determined by Law 33/2004. Forward estimates of each component of DBH which comprise shared non-taxes (SNT) and shared taxes (ST) can be prepared once the aggregate forward estimate of relevant state revenues are produced. In this case, the accuracy of state revenues estimation becomes very important. If they are over estimated, the estimation of shared revenues will also be overestimated and vice versa for under estimation. The preparation of forward estimates for DBH is clearly possible based on the regulations and forward estimates of relevant state revenues.

Tables 9.7 and 9.8 show the estimation of ST and SNT in the state budget. Table 9.8 shows that the percentage shares of individual income tax (Pajak Penghasilan/PPH) and of excise on tobacco are very similar to what the regulation requires. The shared IIT has always been 20% of the estimated state revenue from individual income taxes (Article 21, 25 and 29) during 2002-2010, except for FY 2004 which was only 19%. Moreover, the share of tobacco excise was exactly 2% of the related state revenues since introduction in FY 2009 and 2010. But the percentage share of land and building tax (Pajak Bumi dan Bangunan/PBB) and of fees on property transfer of ownership (Biaya Pengalihan Hak atas Tanah dan Bangunan/BPHTB) have been higher than what is actually mentioned in Law 33/2004. According to regulations, the share of PBB is only 90% and the share of BPHTB is 80%. For PBB, the difference is due to CG policy of reallocating the 10% central share to SNGs equally and to provide incentives for particular LGs which achieve the revenue target. Moreover, for BPHTB, the CG also redistributes the central share to all SNGs.

Table 9.7. Percentage Share

State Tax Revenues and Share to SNGs (in Trillion Rupiah)	2002	
	Budget	
Individual Income Taxes (Art. 21, 25&29)	20,36	
Property Tax	5,92	
Property Transfer Fees	2,21	
Excise on Tobacco		
Share to SNGs (Total)	11,95	
Individual Income Tax	4,07	
Percentage Shares	20%	
Land and Building Tax	5,67	
Percentage Shares	96%	
Property Transfer Fee	2,21	
Percentage Shares	100%	
Excise on Tobacco		
Percentage Shares		

Source : writer's calculation from

Table 9.8 shows that the share is also close to what revenue after the implementation to 16%. It was initially higher than the requirement for Aceh and Papua. More always been just above shared oil, the shared le explained by higher share

Reductions were explained from an average of 80% 2006-2010 in the era of shifting the reforestation with the share for SNGs. Generally, it can be revenues closely follow. Therefore, it is quite possible of natural resource revenue aggregate revenues.

Table 9. 7. Percentage Share of Tax Revenue to SNGs from 2002 to 2010

State Tax Revenues and Share to SNGs (in Trillion Rupiah)	Era of Law 25/1999				Era of Law 33/2004					Average Annual Growth
	2002 Budget	2003 Budget	2004 Budget	2005 Budget	2006 Budget	2007 Budget	2008 Budget	2009 Budget	2010 Budget	
Individual Income Taxes (Art. 21, 25&29)	20,36	29,25	31,66	32,10	30,01	37,37	42,46	50,45	65,87	15,8%
Property Tax	5,92	7,52	8,03	10,27	15,73	21,27	24,16	28,92	26,51	20,6%
Property Transfer Fees	2,21	2,40	2,67	3,21	5,28	5,39	4,85	7,75	7,39	16,3%
Excise on Tobacco						41,93	43,57	48,24	55,93	10,1%
Share to SNGs (Total)	11,95	15,39	16,42	19,50	26,24	33,06	36,33	45,75	46,92	18,7%
Individual Income Tax	4,07	5,80	6,04	6,40	6,00	7,47	8,49	10,09	13,17	15,8%
Percentage Shares	20%	20%	19%	20%	20%	20%	20%	20%	20%	
Land and Building Tax	5,67	7,19	7,71	9,80	14,96	20,20	22,99	27,45	25,24	20,5%
Percentage Shares	96%	96%	96%	95%	95%	95%	95%	95%	95%	
Property Transfer Fee	2,21	2,40	2,67	3,20	5,28	5,39	4,85	7,25	7,39	16,3%
Percentage Shares	100%	100%	100%	100%	100%	100%	100%	94%	100%	
Excise on Tobacco								0,97	1,12	16,0%
Percentage Shares								2%	2%	

Source : writer's calculation from several years budget Law (UU APBN)

Table 9.8 shows that, for most non-tax revenues, the percentage share is also close to what regulation requires. The budgeted share of oil revenue after the implementation of Law 33 / 2004 has ranged from 15% to 16%. It was initially 15%, but then was increased to 15.5% from FY 2009. The budget of shared oil, which was 16% in FY 2009 and 2010 (0.5% higher than the requirement), can be explained by the higher share for Aceh and Papua. Moreover, the budgeted share of gas revenue has always been just above 30% (minimum percentage share). Similar to shared oil, the shared levels of gas which were higher than 30% can be explained by higher share for Aceh and Papua.

Reductions were experienced by the share of forestry revenues, from an average of 80% in the era of Law 25/1999 to around 60% during 2006-2010 in the era of Law 33/2004. This reduction was caused by shifting the reforestation fund from DAK to shared revenues in 2006 with the share for SNGs reducing to 40% of total reforestation revenues. Generally, it can be concluded that the share of natural resource revenues closely followed the regulation in terms of budgeted levels. Therefore, it is quite possible to prepare forward estimates for the share of natural resource revenues, based on forward budget estimates of the aggregate revenues.

Table 9.8 Percentage of Share of Non-Taxes Revenue to SNGs from 2002 to 2010

State Revenue from Natural Resources and the Share to SNGs (in Trillion Rp)	Era of Law 25/1999				Era of Law 33/2004					Average Annual Growth
	2002	2003	2004	2005	2006	2007	2008	2009	2010	
State Revenue from Natural Resources										
Oil	44,01	39,91	28,25	31,86	110,14	103,90	84,32	123,03	89,23	9,2%
Gas	14,52	16,28	15,75	15,27	36,10	35,99	33,61	39,09	31,30	10,1%
General Mining	1,34	1,48	1,63	2,02	2,99	3,56	5,31	8,72	8,23	25,5%
Forestry (IHPH & PSDA for 2002-2005)	0,98	0,40	0,29	0,33	2,00	2,55	2,78	2,50	2,87	14,4%
Fishery	0,29	0,45	0,60	0,70	0,41	0,25	0,20	0,15	0,15	-8,0%
Geothermal									0,24	
Shared Natural Resources	12,66	12,51	10,51	11,80	33,12	32,02	29,74	28,16	34,48	
Oil	5,79	5,53	3,84	4,70	16,74	15,83	12,85	19,15	14,08	
Percentage shares	13%	14%	14%	15%	15%	15%	16%	16%	16%	15,4%
Gas	4,78	5,12	4,66	4,80	12,50	11,62	10,77	12,21	9,94	
Percentage shares	33%	31%	30%	30%	35%	32%	32%	31%	32%	32%
General Mining	1,07	1,18	1,30	1,60	2,40	2,85	4,25	6,98	6,59	
Percentage shares	80%	80%	80%	79%	80%	80%	80%	80%	80%	80%
Forestry	0,786	0,32	0,228	0,3	1,16	1,52	1,71	1,51	1,57	
Percentage shares	80%	80%	80%	91%	58%	60%	62%	60%	55%	59%
Fishery	0,233	0,36	0,48	0,6	0,331	0,2	0,16	0,12	0,12	
Percentage shares	80%	80%	80%	86%	80%	80%	80%	80%	80%	80%
Geothermal									0,196	
Percentage shares									80%	80%

Source: writer's calculation from several years budget Law (UU APBN).

Some adjustments to the forward estimates are needed due to the amendment of the Law on Local Taxes and Charges that have shifted the DBH components, namely: (1) fee for transfer of property ownership by 2011; and (2) the land and building taxes to local taxes progressively between 2011 and 2014. Other adjustments to the regular shared revenue are due to different share formula applied for Papua and Aceh. Shared oil and gas for Papua and Aceh are much higher than the share for others.

Possibility of Forward Estimates for Dana Alokasi Umum

Judging from its realization, Dana Alokasi Umum (DAU) is the most reliable revenue for LGs. For the last nine years (2001-2009) the realization of DAU has been equal to the budget as stated by the Budget Law.⁷ Moreover, the DAU at least up until 2008 is also the most predictable transfer since the total DAU in the budget has always followed the Law of intergovernmental transfers which is 25% of NSR according to Law 25/99 and 26% of NSR based on Law 33/2004. The NSR is the domestic SR minus the revenue shared to regions. Based on such a rule, forward estimates for total DAU can be prepared easily once the forward estimates of state revenue and shared revenue are produced. Indeed, the Government has already produced forward estimates for the SR but not the shared revenues in the financial notes to the budget since FY 2008.

⁷ There was a small difference between the realization and the budget of DAU in FY 2010 due to a revision (an increase) of DAU for Kabupaten Indramayu in the revised budget 2010. According to the official of DJPK, the revision of such DAU was a correction to wrong data used in the calculation of DAU 2010.

However, for FY 2009 changed in the Budget Law minus shared revenues subsidies, etc. As a result, every year since the form produces uncertainty in the leads to difficulties in calculation.

Despite such uncertainty still technically possible scenarios are outlined by involves calculation based about 23% of total state calculation based on Law 20-21% of total state revenue while the first is the optimal define its policies on the DAU is a critical issue for broad

Possibility of Forward Estimates (Khusus)

Unlike the DAU and (DAK) is not guaranteed to be markedly. Table 9.4 confirms greatly reduced in FY 2010 2009. The annual average 49%, but then it decreased about 7.7% of total transfer the total amount of DAK based on uncertain policy positive from 2003-2009, confirmed its inconsistency

Nevertheless, forward Medium Term Development Menengah Nasional/RPJN the amount of fund provided Unfortunately, the RPJN programs/activities would needed in using (the current forward estimates. The resource allocation plans and

One possible technical statistical methods, such as In general, the trend of DAU period 2003-2010, the total DAK was contributed to the of the main types of DAK infrastructure (road and i

However, for FY 2009 and FY 2010, the calculation of the NSR was changed in the Budget Law. The NSR from 2009 became State revenues minus shared revenues, tax subsidies, fuel subsidies, electricity subsidies, etc. As a result, the calculation of NSR is volatile and difficult every year since the formula no longer accords to Law 33/2004. This produces uncertainty in the total amount of DAU every year. This also leads to difficulties in calculating the forward estimates for the total DAU.

Despite such uncertainty, forward estimates for the total DAU are still technically possible and development of two possible technical scenarios are outlined here (others are possible). The first scenario involves calculation based on Law 33/2004. Such amount has averaged about 23% of total state revenues. The second scenario involves calculation based on Law of APBN 2009 and 2010 which provides about 20-21% of total state revenues. The second scenario is a pessimistic one, while the first is the optimistic alternative. The capacity of CG to clearly define its policies on the DAU and to project these estimates accurately is a critical issue for broader success of the MTEF.

Possibility of Forward Estimates for Specific Grants (Dana Alokasi Khusus)

Unlike the DAU and DBH, the amount of Dana Alokasi khusus (DAK) is not guaranteed by Law 33/2004, so that the DAK can fluctuate markedly. Table 9.4 confirms the unpredictability of the DAK. The DAK greatly reduced in FY 2010 after strong continuous growth during 2003-2009. The annual average growth of DAK during 2003-2009 was about 49%, but then it decreased by 15% in 2010. In 2009, the DAK shared about 7.7% of total transfers. Clearly, one of the problems in estimating the total amount of DAK for the next three years is due to its volatility based on uncertain policy. Although the trend of all sectors of DAK was positive from 2003-2009, the decrease of seven types of DAK in 2010 confirmed its inconsistency.

Nevertheless, forward estimates for DAK could refer to the National Medium Term Development Planning (Rencana Pembangunan Jangka Menengah Nasional/RPJM) since the RPJM has already estimated the amount of fund provided for each program/activity for five years. Unfortunately, the RPJM has not explicitly clarified which programs/activities would be funded by the DAK. More clarification is needed in using (the current) RPJM as a basis to justify the DAK for forward estimates. The Government's medium term policy and resource allocation plans are not yet clear enough.

One possible technical way to estimate the DAK is by using statistical methods, such as trend analysis or other forecasting methods. In general, the trend of DAK to date has to been increase. During the period 2003-2010, the total DAK grow 49% annually. The growth of DAK was contributed to two main factors. The first is due to the growth of the main types of DAK especially the DAK for education, health and infrastructure (road and irrigation). The second is due to the expansion

of DAK types caused by shifting the Ministry/Agency Budget which funded the SNG's affairs (de-concentration funding) to the DAK.

Among 14 types of DAK, the DAK for Education has the biggest share and growth of 47% annually (see Table 9.4). The education DAK is likely to increase yearly due to the requirement from the Constitution to share at least 20% of CG expenditure for education. The technical specification for education DAK could change but the amount is likely to increase in line with the increase in Government expenditure. The second biggest share in 2010 was the DAK for health. Although this DAK experienced a reduction of about 30% in 2010, it grew annually by 33.5% during the period 2003-2010. The third biggest share in 2010 was the DAK for road infrastructure. In 2009, this DAK was higher than the DAK for health. It experienced a sharp decrease of 38% in 2010. Similar to DAK for health, the annual growth for road infrastructure was 19% during the period 2003-2010.

The historical data for the top three DAK sectors shows that the lowest average annual growth was at 19%. Such annual growth is higher than the estimated growth of DAK for 2011-2014 at 15% annually. Therefore, using trend analysis, forward estimates of DAK could be technically prepared for each type of DAK constrained by the total available funds. The use of technical statistical methods for estimating the total DAK will come up with an increase in DAK since the historical data shows a clear trend of growth. Therefore, analysis should be justified by an analysis of the availability of funds for transfers. In practice it would be better for the policy makers to determine medium term policies and levels for the size of the DAK, both in total and for key priority sectors. Such policy decisions could consider past trends but would also look forward and set out the medium term policy priorities and plans of Government.

Possibility of Forward Estimates for Special Autonomy Funds

The total amount of special autonomy fund (SAF) has been clearly stated in the Law as discussed in the previous chapter. Therefore, forward estimates for such funds can be easily prepared and based on the forward estimates of the DAU. For the next 15 years, the forward estimates for the SAF can be said to be a minimum estimate since the amount of funds for special autonomous regions, according to the Laws (special autonomy law for Papua and Aceh), is "at least" 2% of the DAU.⁸

Possibility of Forward Estimates for Adjustment Fund

Unlike the SAF, the adjustment fund is a very volatile and unreliable source of funding for regions. These transfers are not regulated by any Law other than the Budget Law. The amount of adjustment fund is usually determined through a process of annual budget assessment in

⁸Total DAU in the budget.

the Parliament. They are requests initiated either. Therefore, the possibility on the type of funds provided for additional could be reasonably estimated. But other adjustment funds (Insentif Daerah/DID), Decentralization (Dana Peningkatan Accelerating the Regional Daerah/PPD), will very much and the ability of the Government funding for such schemes in context.

Development of MTI setting of policies and predictable medium term successfully for the inter-discipline will be needed additional matters covering term policies and pro-costing—rather than covering over policies and funds.

CONCLUSION

Forward estimates are important tools for Indonesia future grants and share medium-term expenditure levels. Realistic forward predictability of funds for 87% of Municipality/Regency in the period 2008-2011, especially LGs to implement undertake a kind of MTI intergovernmental transfer.

The study concludes aggregate figures of possible, especially forward since they are clearly realistic possible by developing calculation based on LG based on the Budget Law total state revenues. Forward are also possible since

However, there are the DAK since the amount

the Parliament. They are mostly to accommodate various political requests initiated either by the Government or by the Parliament. Therefore, the possibility to estimate the adjustment fund will depend on the type of funds provided. For example, the adjustment funds provided for additional benefits for teachers with civil servant status could be reasonably estimated since the number of teachers is known. But other adjustment funds, such as the Regional Incentive Fund (Dana Insentif Daerah/DID) and Fund for Strengthening Fiscal Decentralization (Dana Penguatan Desentralisasi Fiskal/DPDF) and Accelerating the Regional Development (Percepatan Pembangunan Daerah/PPD), will very much depend on national resources availability and the ability of the Government and the DPR to set policies and funding for such schemes in a medium term planning and budget context.

Development of MTEF's requires considerable discipline in the setting of policies and funding levels for particular activities in a predictable medium term framework. If the MTEF is to work successfully for the intergovernmental transfer components then more discipline will be needed by DPR and the Government so that additional matters covered by the Adjustment Fund have clear medium term policies and procedures that allow their medium term costing—rather than current approaches based on annual haggling over policies and funds allocations.

CONCLUSION

Forward estimates for intergovernmental transfers are very important tools for Indonesia to reduce uncertainties in relation to future grants and shared revenues and to facilitate the introduction of medium-term expenditure framework (MTEF) approaches at SNG levels. Realistic forward estimates will improve the reliability and predictability of funds for the SNGs since the transfers accounted about 87% of Municipality/Regency revenues and 52% of Provincial revenues in the period 2008-2010. It will be almost impossible for the SNGs, especially LGs to improve medium term revenue estimates and to undertake a kind of MTEF without the provision forward estimates of intergovernmental transfers from the centre.

The study concludes that, generally, forward estimates for the aggregate figures of intergovernmental transfers in Indonesia are possible, especially for three types of transfers: DBH, DAU and SAF, since they are clearly regulated. Forward estimate for the total DAU is possible by developing two policy options. The first option is the calculation based on Law 33/2004. The second choice is the calculation based on the Budget Law of 2010 which is in practice about 20-21% of total state revenues. Forward estimate for the SAF for Papua and Aceh are also possible since the minimum amounts are set by the Law.

However, there are difficulties to estimate the aggregate figure of the DAK since the amount of this grant is not clearly regulated (not

guaranteed by any Law). Moreover, it is impossible to predict the Adjustment Funds since these are determined in the annual budget assessment. Nevertheless, the forward estimated for the total of both (DAK and Adjustment Fund) can be undertaken assuming that the total amount of transfers to SNGs is set at an agreed policy level (such as 35% of state revenues).⁹ Current uncertainties suggest that the Government should develop a clear medium term intergovernmental policy direction which will not only facilitate enhanced forward estimates for transfers, but also help in the preparation of medium term projections of available funds for all Central Ministries.

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⁹ The average annual ratio during the period 2002-2010 was 34% (Table 3.1). However, in FY 2001, the budget shows the ratio was 35.7%.

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SPECIFIC GRANT

Kodrat W.

INTRODUCTION

One of fundamental to improve efficiency and in accordance with the challenge, capacity building and efficient utilization standards is clearly a use of development funds of Indonesia continues the need to revise the central-local government No.55/2005 about equal dynamics of decentralization.

The development (Dana Alokasi Khusus/ equalization fund) perspectives during more consistent (coherent) regions, particularly spend their block grants and other routine expenses through DAK will be 33/2004 mentions that finance decentralized Article 51 of Government DAK is allocated to special parts of a national priority.

Furthermore, Article which is a national Work Plan (Rencana year. Based on the ministries will propose

We thank *Deutsche Gesellschaft für Internationale Zusammenarbeit* (GIZ) Development Planning Board framework of Indonesia-Germany BAPPENAS for providing BAPPENAS, the Ministry of during the process of this report Tim Auracher from GIZ for Technical Team of DAK from Affairs for inputs

About 100 papers have been presented and discussed at the 3rd IRSA International Institute. Finally, only 14 papers are presented to be part of this book. The conference, held on 19-21 July 2011 at Andalas University in Padang, was conducted by the IRSA in conjunction with the Centre for Finance and Development Studies (PSKP), Faculty of Economics-Andalas University. This book is organized into four parts. Part I discusses the regional development in the era of decentralization. Part II reviews the disparities and poverty issues of regional development. Part III explains the challenges for improvement and expansion of public services from financial point of view. Part IV explores the environmental, human resources and governance issues in regional development.

Hefrizal Handra, Budy P. Resosudarmo, Arief A. Yusuf, Elfindri & Efa Yonnedi

Editors

Recent democratization and decentralization, which were hoped to promote local development, in some cases, had the opposite effect. Some regulations that try to clarify the division of responsibilities between central and regional governments on investment policy and its implementation, in fact, to some extent result in overlapping and conflicting regulations and procedures issued by both the central and regional governments. Many factors contribute to lower provision of public services in the region, nevertheless, limited financial resources are always blamed as the main factor. Various alternatives of financial schemes other than regional government expenditure have been developed to foster regional development such as private sector initiatives, public-private partnership, and municipal bond. However, regional development still highly relies on the central government support. Ironically, inadequate resources are worsened by poor financial management and corruption.

This IRSA Book Series presents some articles addressing the above-mentioned issues. It is expected by substance to be a meaningful input and contribution to Indonesia's regional development. This book will also provide regional development stakeholders with insights drawn from academic basis. As IRSA members are mostly from university-related background, ideas and recommendations covered in this book are the result of researches and thorough analysis.

Armida S. Alisjahbana
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State Minister for National Development Planning

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