

Legal Review:

INDONESIAN DECENTRALIZATION: EVALUATION, RECENT MOVEMENT AND FUTURE PERSPECTIVES¹

B. Raksaka Mahi²

Department of Economics
University of Indonesia
(raksakamahi@yahoo.com)

INTRODUCTION

It is almost 15 years since Indonesia adopted the decentralization policy. Initially, there was pessimism regarding the future success of the policy, given the large transfer of functions from central to local governments with a lack of preparation and proper sequencing. Due to its scale and speed, Indonesian decentralization has been called *Big Bang* decentralization. These are highlights of the decentralization as it occurred in its initial stages:

- The policy involved significant devolution of the responsibilities from central to local governments. Only a few responsibilities were retained by Central Government, namely: defense, foreign affairs, security, religious affairs, fiscal and monetary affairs, and justice.
- A significant fiscal transfer was allocated from the central to local governments. Most of them were general purpose grants, and a only small portion was considered to be specific grants. This situation was different from how it was during the Soeharto era, when it was dominated by specific grants called *Inpres* (Presidential Instructions).
- Over 2 million civil servants, or almost two-thirds of the central government workforce,

mostly were teachers and health workers, were transferred to the regions.

Despite its *Big Bang* nature, the Indonesian decentralization process was praised for its implementation steps, as mentioned by Hofman and Kaiser (2002): “Surprisingly little went wrong in the logistics of this radical, hastily prepared move.” The initial steps of decentralization were the key for Indonesia to avoid failures when adopting the *Big Bang* decentralization. As pointed out by Koichi Mera (2004): “One reason for the country being able to avoid catastrophes was the incremental adjustments the Central Government adopted during the process, such as its decision to bear the cost of the transferred civil servants in the initial years.”

Law No.22/1999, which guided the process of devolution and the local autonomy, was endorsed by the Parliament in 1999. The first revision of the law took place in 2004, and the latest version was passed by the Parliament in 2014. The revised law, known as Law No.23/2014, came with attachments describing a clear division of the responsibilities between all government levels. This gives certainty to the local governments regarding their responsibilities.

Historically this law was accompanied by the Law on the Central-Local Fiscal Balance. At present, this law is still in the process of revision and the new version is expected to be issued by 2016. The Central-Local Balance Law regulates the fiscal decentralization process and regulation in Indonesia.

The co-existence of the two laws shows that, to some extent, Indonesia has adopted the principle of “money follows functions” by which the

¹ The earlier version of this paper was presented at the 4th Research Meeting on Asia Decentralization, GRIPS, Tokyo, Japan, in January 2015. The Author would like to thank Prof. Hiroshi Ikawa and the participants at the meeting for useful comments.

² B. Raksaka Mahi is a Senior Lecturer, Department of Economics, University of Indonesia.

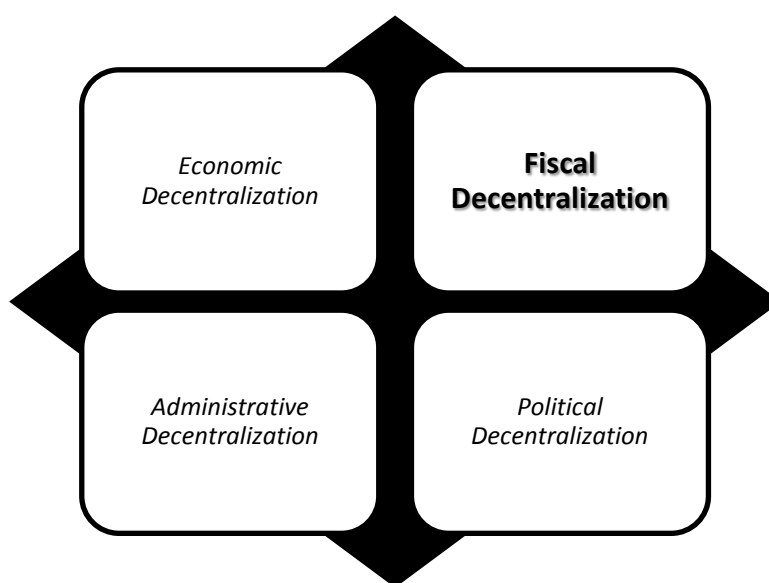
functions are first decentralized and then followed by the fiscal allocation to finance those decentralized functions. A good implementation of this principle requires the adoption of a standard spending assessment. In an advanced country, such as the United Kingdom, the central government assistance to local government has already been implemented through the Standard Spending Assessment (SSA) for a long time, which is intended to reflect the spending needs of each local authority. In the United Kingdom, the total SSA is calculated for each local authority and is built up from component parts for each service the authority provides, such as education or social services. The SSA calculation is broken down between the different services provided by those responsible locally, and this requires good information and measurement for each local government service as a base for allocating the transfer.

Since such data were not available to calculate the SSA, especially during the first year of implementation of the fiscal decentralization, the fiscal transfer to the local government in Indonesia was allocated based on the fiscal gap method which involves the difference between fiscal capacity and fiscal needs. Both fiscal needs and capacity were calculated based on indicators, such as population, area, poverty,

local GDP, and the actual total revenue from local owned revenue and local shared revenue.

The initial motivation of decentralization was highly affected by political reform and democracy, which led to the local direct elections. The early version of the law on local government stipulates the regulations regarding these elections. In 2014, the issues pertaining to local direct elections were separated from the law on local government and became a standalone law, namely Law No.1/ 2015.

The focus of local government law has gradually changed to improving local public services, hence the local welfare. Better local administration and management are important to meet this objective. Under the scheme of Indonesian decentralization, significant basic instruments, namely responsibilities, human resources (administrative officials, teachers and health workers) and financial transfer were already in the hands of the local government. The head of local government is responsible for managing all of these transfers to empower the local economy. This is to show that the economic authority is basically also decentralized. We can conclude that Indonesian decentralization basically relies on four main pillars (**Figure 1**): (1) Politics, (2) Fiscal Matters, (3) Administration and (4) Economic Decentralization.



Source: Grand Design of Fiscal Decentralization (Ministry of Finance, 2008)

Figure 1. Four Pillars of Indonesian Decentralization

The objective of this paper is to evaluate the implementation of Indonesian decentralization. The rest of this paper discusses the evaluation of decentralization policy in Indonesia, especially in the area of local leadership and direct elections, welfare and regional disparities, and budget quality.

This paper also provides highlights of recent movement in the decentralization laws, namely the revision of the law on local government and the issuance of the new village law. Finally, the paper ends with a discussion on the future challenge of decentralization in Indonesia.

EVALUATION OF CURRENT DECENTRALIZATION

Along with the transfer of responsibilities to the local government, there is an expectation that the decentralization policy could provide better local public services. Indicators related to the economic growth and welfare could be used to monitor the welfare improvement in the regions after decentralization. The ability of local leaders plays an important role in managing decentralization. Strong local leadership, a pro-business environment and good management of the public budget are essentials of the local leader.

Along with the implementation of decentralization, some issues have raised concerns, namely the asymmetric decentralization and regional disparities. These issues must be very carefully assessed as these may hamper the decentralization policy results.

1. Regional Economic Growth

Indonesia experienced a deep crisis in 1998. Not only did it affect the national economy, it also had a significant impact on regional economies. Regions also experienced a significant decrease in economic growth during the crisis, especially in Java. The weakening of the Indonesian Rupiah has made exported commodities cheaper, which benefited regions with these commodities. Their increasing exports abroad have driven positive economic growth rate during the crisis time.

Decentralization has given the local government stronger authority to manage and to im-

prove the performance of local economies. As seen in **Table 1**, some regions managed to recover from the crisis earlier than other regions, and some of them had higher growth than the national average.

Some provinces, particularly those located outside Java and Sumatra, have enjoyed high economic growth rates since decentralization, namely: Gorontalo, Jambi, Southeast Sulawesi, West Sulawesi and West Papua. Unfortunately, natural resource provinces tend to experience lower growth compared to the national average, such as East Kalimantan and Riau.

2. Local Welfare and Local Budgets

Another measurement to reflect welfare is the Human Development Index (HDI) which, according to the definition of the UNDP, is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and having a decent standard of living. The HDI is the geometric mean of normalized indices for each of the three dimensions. There are many factors affecting changes in the HDI, among others is the local government achievement in providing good public facilities, such as education and health.

An observation of the HDI's changes between 1999 (before decentralization) and 2011 (after eleven years of implementing decentralization) shows that almost 50% of all districts and municipalities have an increase in the HDI by five to ten percent (**Table 2**). Only a few of them have seen the HDI increase by less than five percent. Another forty percent of districts and municipalities have their HDI increased by twenty percent or more. Increases in the HDI may indicate that some positive progress has been made in managing education and health services. As we know, the measurement of the HDI depends particularly on 3 (three) indicating variables, namely income per capita, educational participation and reduction on infant mortality rate (as measurement of the health index in HDI).

Table 1. Provincial Economic Growth (Various Years)

Province	Annual Growth Rates						Province	Annual Growth Rates					
	1993-1996	1997-2000	2001-2004	2005-2008	2009-2011	2012-2014		1993-1996	1997-2000	2001-2004	2005-2008	2009-2011	2012-2014
NAD	1.74	-7.26	6.79	-4.04	0.77	2.77	E.kal	8	2.68	1.79	3.19	3.75	0.07
N.Sumatra	9.18	1.43	5.04	6.24	6	5.92	N.Sulawesi	8.1	3.21	3.43	6.99	7.47	6.52
W.Sumatra	8.08	-0.54	5.13	6.27	5.48	6.06	C.Sulawesi	8.51	0.95	6.31	8.34	8.54	8.06
Riau	4.76	1.91	3.12	4.91	4.05	2.95	S.Sulawesi	7.94	5.42	4.84	4.63	7.36	8.02
Jambi	8.49	0.86	5.12	6.36	7.43	7.29	SE.Sulawesi	6.59	0.57	7.29	7.56	8.15	8.47
S.Sumatra	8.26	-0.97	4.07	5.24	5.41	5.64	Bali	7.86	-0.15	3.74	6.76	5.88	6.79
Bangka-Belitung	-	1.46	4.71	4.15	5.36	5.13	W.NT	7.8	9.17	4.53	3.05	5.10	2.89
Bengkulu	6.66	0.07	5.1	6	6.03	6.13	E.NT	8.57	1.34	5	4.63	5.05	5.31
Lampung	8.51	-0.13	5.39	5.07	5.83	5.77	Moluccas	6.82	-22.15	3.86	5.12	5.98	6.37
Jakarta	8.99	-4.97	5.4	6.16	6.08	6.20	Papua	14.19	6.2	1.05	5.55	4.46	4.3
W.Java	8.15	-8.04	4.51	6.08	5.62	5.97	Banten	-	-	7.2	10.02	5.74	6.48
C.Java	7.19	-1.73	4.55	5.47	5.66	5.3	Gorontalo	-	-	6.73	7.44	7.62	7.63
Yogya	7.91	-2.29	4.73	4.44	4.82	5.35	N.Moluccas	5.23	-8.59	3.64	10.37	-6.25	6.28
E.Java	8.26	-2.46	4.78	5.98	6.30	6.19	Riau Islands	-	-	-	6.75	5.79	7.35
W.Kal	9.25	0.25	4.12	5.11	5.37	5.66	W.Sulawesi	-	-	-	8.18	9.45	8.30
C.Kal	9.58	-1.56	5.08	5.99	6.27	6.82	W.Papua	-	-	-	6.54	23.21	5.47
S.Kal	9.25	0.99	4.41	5.63	5.66	5.39	Rata-rata	7.92	-0.87	4.72	5.76	6.04	5.70

Source: Calculated from the Bureau of Central Statistical Data

Table 2. Number of Municipalities and Districts with HDI Changes (From 1999 to 2011)

Changes of the HDI	Number of Regions	% of Total
Decrease	0	0
Increase less than 5%	4	0.88 %
Increase between 5 – 10%	226	49.89 %
Increase between 10 – 15%	37	8.17%
Increase between 15 - 20%	8	1.77%
Increase above 20 %	178	39.29%
TOTAL	453	100

Source: Calculated from the HDI data.

The increased focus of the local government on these sectors can be seen from the budget allocation, which increased consistently and significantly for these sectors after decentralization (**Table 3**).

However, we need to understand that, for the education sector, the increased portion of its budget does not solely result from the decisions of the local government; it is also influenced by the education law, which mandated every government to have at least twenty percent allocation for education.

Table 3. Basic Sectors in Local Budget

Sector	Year	
	1999/2000	2013
Provinces		
Agriculture	2.12	2.58
Transportation	8.09	2.94
Education	3.8	8.75
Health	3.11	8.22
Districts/Municipalities		
Agriculture	1.47	2.16
Transportation	7.64	1.30
Education	3.25	33.31
Health	1.53	9.74

Source: Calculated from the data of Ministry of Finance

3. Local Leadership and Business Environment

The policy of decentralization forces the local government to improve the local business environment. Everywhere, local government has created a “pro-business” environment in its

region; such as simplifying the process of starting a business. This action has benefited the local economy, as the “pro-business” action attracts Foreign Direct Investment (FDI).

There are, however, some local leaders who failed to manage their local economy. Instead of working on simplifying the regulations, these leaders created cumbersome local regulations, which hamper the local business climate. Investors have moved away from such regions, and this is slowing the economic growth rate in those regions.

A simple regression analysis on provincial investment data has proven that “pro-business” regions could attract more investment. Provinces with less nuisance regulations are generally more attractive for investment.

As summarized in **Table 4**, there are some positive factors affecting the investment flow to a province, such as the size of the economy, population size and local taxes. On the other hand, there are also negative factors affecting investment flow, such as the availability of the infrastructures (road and electricity) and the number of nuisance regulations. Negative signs about infrastructure showing that its quality is not good is an impediment to investment. The existence of the nuisance regulations, derived mainly from bad local tax and user charges, also has a negative impact on investment.

Understanding the negative impact of the nuisance local tax regulations, the old law on local tax and user charges has been revoked, and replaced by Law No.28/20009. The new revised law adopts the positive list method; meaning that local governments are permitted to collect taxes and user charges, only if those are stipulated in the Law.

4. Asymmetric Decentralization

Asymmetric decentralization is found in which different constituent sub-nationals given different powers: one or more sub-national has considerably more autonomy than the others, although they have the same constitutional status. This is in contrast to symmetric decentralization, where the policy does not make a distinction between constituent regions.

Table 4. The Summary of Factors Affecting Provincial Investment (2006)

Variable	Coefficient	t-stat	significance
ln y	0.888	5.9	**
ln N	0.362	2.41	**
ln tax	0.693	5.39	**
lninf_road	-1.23	-1.62	
lninf_elec	-0.0013	-0.99	
ln Nr	-0.704	-1.82	*
Const	-0.736	-0.49	

Notes:

** = Significance at the level of 5 %

* = Significance at the level of 10 %

A short description of the Model to estimate factors affecting **Provincial Investment:**

Y = Provincial GDP (**)

N = Provincial Population (**)

Tax = Percentages of local owned revenue (PAD) to GRDP (**)

Inf_Road = Road Infrastructure (Not Significant)

Inf_Elec = Electricity (Not significant)

Nr = Number of nuisance local taxes regulation (*)

The model using Provincial Data of 2006

The asymmetric decentralization approach is frequently proposed as a solution to the dissatisfactions that arise when one or two constituent units feel significantly different needs from the others as a result of an ethnic, linguistic or cultural difference.

In Indonesia, although the form of state is Unitary, four provinces were given the special autonomy status; namely Aceh, Jakarta, Yogyakarta, and Papua. Each province has its own special status law which stipulates its degree of special autonomy. Each province has been given special autonomy funding, in line with its uniqueness.

To avoid giving each province special status, the asymmetric decentralization policy needs to be implemented differently. The uniqueness of a region is acknowledged not as an individual treatment, rather as a clustered treatment. The cluster could be used as additional criteria for allocating general purpose grant. For example, regions could be distinguished based on the urban and rural needs. This implies the general purpose grant can be different between urban and rural regions.

5. Regional Disparity

The phenomenon of a regional inequality is not new for Indonesia. As shown in **Table 5**, the distribution of GRDP (Gross Regional Domestic

Product) has not changed much since 1970, whereby the largest portion of the GRDP is enjoyed by the Java region. This is because of differences in production location for industries in Indonesia. Most of production base, which usually creates more added value, is still located in Java and Sumatra.

To reduce the regional disparities, there should be a change in the economic structure of regions outside Java and Sumatra. The government should take affirmative action to develop more industries outside Java, as these are more value-added. There should be a “catch-up” strategy for regions outside Java and Sumatra. The availability of the infrastructure, such as railroads, ports and electricity, outside Java and Sumatra, could stimulate the regional economic dynamic. Fiscal decentralization policy could help the establishment of better infrastructure outside Java and Sumatra, formulated through the specific grant of DAK (*Dana Alokasi Khusus*). A recent study by Mahi and Riatu (2015) shows that, among the types of transfers, the DAK is an effective one to stimulate capital expenditure in districts and municipalities. By increasing the specific DAK grant, the central government could stimulate outer island regions to allocate more capital spending for infrastructure, hence minimizing regional disparity in the future.

Table 5. Regional GDP Distribution

	Regional GDP Distribution (%)		
	1971	1990	2010
Sumatera	29.1	25.3	23.0
Jakarta	8.7	12.1	16.3
Java (w/o Jakarta) & Bali	47.7	46.2	43.1
Nusa Tenggara	1.7	1.3	1.5
Kalimantan	5.2	9.1	9.1
Sulawesi	5.8	4.1	4.6
Maluku dan Papua	1.8	1.9	2.4

Source: Mahi and Nazara (2012)

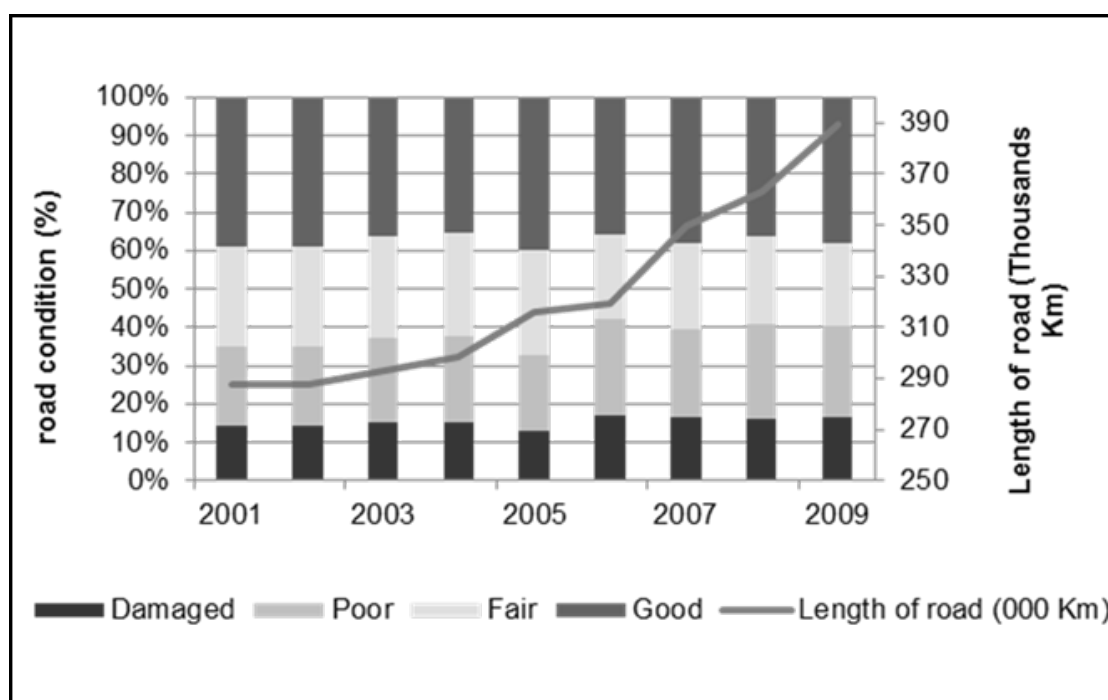
6. Public Facilities and Their Quality

The amount of public facilities has increased during 1999-2011. However, there is still a question about the quality of the facilities. The doubts are because the quality of the facilities tends to be stagnant or even deteriorated.

For example, evaluating the condition of roads across the regions, despite increases in the length of the roads (2001-2009), we could find that the quality of roads has hardly changed

much. The evidence seen in **Figure 2** shows that good roads still comprise around 30-40% of all roads, while the damaged and the poor roads (combined) remains at 30-40% of all roads.

These indicate that decentralization does not have an effect on the quality improvement of road across Indonesia. The length of roads keeps increasing, but on the other hand, there is a lack of ability to maintain the roads.



Source: The World Bank

Figure 2. Road Quality

RECENT MOVEMENT ON DECENTRALIZATION

Recently, there have been some changes to decentralization law and regulations. Several factors motivated the changes in regulations, such as the increasing role of decentralization to support national priorities, improvement in the bottom-up process and local democracy.

a) Decentralization as an Instrument to Support the Achievement of National Priorities

Infrastructure availability and poverty alleviation programs are the most important national priorities of Indonesia. For infrastructure development, the availability of land has become the main impediment. A clear responsibility of the central and local governments is the land management that is needed to solve the land availability problem for infrastructure development.

Under Indonesian decentralization law, basically, provincial governments have dual roles as an autonomous regional government as well as representative of central government in the region. The role as the autonomous province is mainly to coordinate and to intervene in matters that straddle districts and municipalities.

Its function as the representative of the central government are mainly to supervise local government to work effectively. Such a function is important to support the central government in accomplishing national priorities. Recently, understanding the important position of the province as the representative of the national government, under the new law on local government (Law No.23/2014), the role of the governor is strengthened to support the achievement of the national priorities.

b) Decentralization and the Bottom-up Process

Decentralization basically places importance on the role of the local voice in deciding about local development; this is the essence of the bottom-up planning process. The closest institution to the local people is the village. Through the village, the local community's needs are identified and are compiled. From the village, those needs are submitted to the districts and municipalities to be discussed at the provincial

level. This shows the important role of the village in the bottom-up planning process. Understanding the important role of the village, in 2014 the Parliament agreed to issue the Village Law.

c) Decentralization, Democracy and the Local Direct Elections

The local direct election has placed importance on supporting local democracy in Indonesia. There are typically two types of cost in the process of election. The first cost is related to the administration of the election. Bringing as many voters as possible to the poll centers usually involves high administration costs. The second type of cost is related to the acceptance of the winner. When many voters come to the ballot, this can increase the public acceptance rate on the results of the election, hence reducing the social cost. It is clear that the costs move in the opposite direction. Economically, there should be a situation where there is optimizing of both costs of the elections that could lead to the minimum number of voters.

The debate over the cost of local elections intensified which lead to their elimination. The system was replaced by indirect local elections through which the selection of the head of the local government was in the hands of the members of the local parliament. This new system was rejected by the public, and following this public response, the local indirect election policy was terminated by using the government regulation replacing the law. At present, Law No.1 of 2015 which maintains the local direct elections has been issued by the parliament. This new law gives guidance to improve the process of local direct elections.

These three factors have motivated the revision of the Law on Local Government and also the Law on Local Elections. In addition to those two laws, the acknowledgement of the village's role in decentralization was supported by the Parliament through the issuance of the Village Law. This law stipulates the role and the strategic position of the village in the local development in Indonesia. In addition to that, the law also establishes a village fund; this is a source of

funding for the village which is an integral part of the fiscal decentralization policy. Highlights of these current changes in law and regulation are described in the next sections.

7. A Revised Local Government Law

The revised law on the local government (Law No.23/2014) addresses the following issues:

- 1) A more comprehensive description about the division of responsibilities between the central, province and district/municipal governments.
- 2) The role of the Governor as the representative of the central government is strengthened.
- 3) The improvement on the proliferation process. Under the new regulation, it does not give automatic status to a new local government; instead the candidate should make better preparations first, and undergo an evaluation, before finally being accepted as a new local government.

7.1. Division of the Government Affairs

The Division of Responsibilities is addressed based on the principles of accountability, efficiency, externalities and national strategic issues. Government responsibilities/affairs are divided

into 3 (three) major types: the absolute central government affairs, the concurrent affairs, and the general affairs.

It is important to balance the concurrent affairs between the central and the local government functions in the region in delivering public services to the local people. The absolute central government affairs, on the other hand, are the ultimate authority and the responsibility of the central government, including foreign affairs, justice, religion, defense, security, and monetary and fiscal policy. Finally, the general affairs are the sole responsibility of the central government, and it relates to the building of national integrity.

The issues of central-local governmental relations are addressed in the concurrent affairs, of which the responsibilities are divided between the three levels of government. These affairs consist of two types: (a) obligatory affairs, (b) non-obligatory (competitive) affairs. The obligatory affairs include: education, health, general construction and spatial management, public housing, social affairs and local security. The non-obligatory affairs are activities chosen by each local government, based on the local competence. The summary of the division of the government affairs can be seen in **Figure 3**.

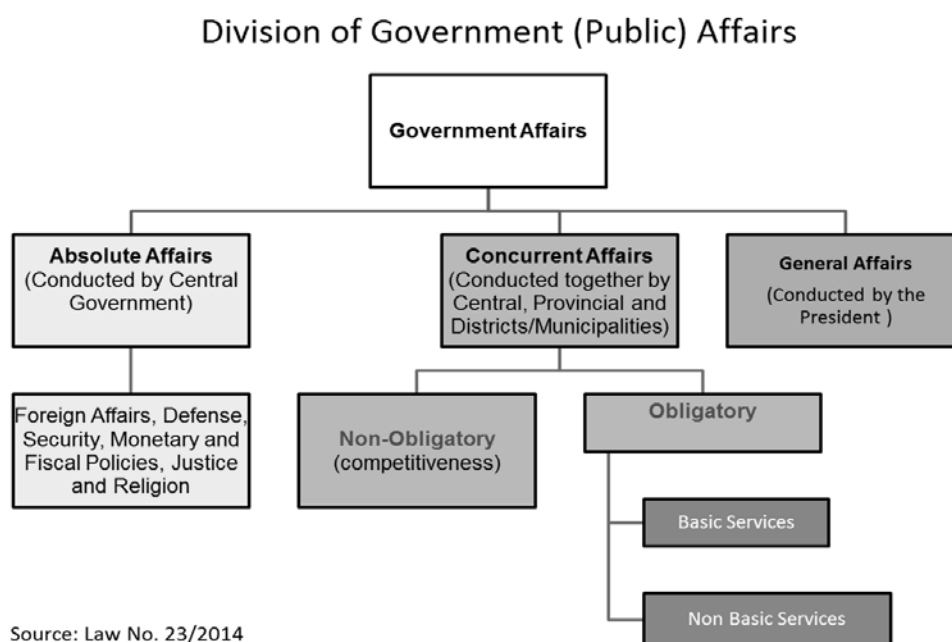


Figure 3. Division of Government Affairs

The revised law on local government includes an attachment which comprehensively shows the division of responsibilities (for each obligatory and non-obligatory affair) between the three levels of the government. The previous Law No.32/2004 did not have such an attachment; however, the division of responsibilities was stipulated in a separate government regulation (Government Regulation No.38/2007).

7.2. Role of the Governor

The increased role of the Governor has become an issue in decentralized Indonesia. The Governor has a dual role; with autonomous power as well as a representation of the central government in the region. In the past, the role of the governor as the representation of the central government was not clearly addressed. The new law addresses significantly that, to act on the behalf of the central government, the Governor carries out monitoring and evaluation of the performance of district/municipality.

To carry out the above function, the Governor has some instruments, such as: ability to cancel (to abolish) the district/municipal regulation, giving rewards and penalties, acting as a mediator between conflicting districts, approval of local budgets, recommending the specific grant (DAK) for a certain activity in the region, and some ceremonial activities on behalf of the central government (for example; inaugurating the new head of district and also the new head of central government unit at the region). In addition to these, the governor can also propose the termination of the head of a district/municipality in a case where its parliament does not carry out its function.

7.3. Local Government Proliferation

Local government proliferation has become a very important issue during the fourteen years of Indonesian decentralization. Compared to other countries, the number of local governments in Indonesia is considered small, given the large size of the country. The problem with the creation of new local governments (proliferation) is not with their size, but rather with their performance.

According to the report of the MoHA (Ministry of Home Affairs), around 78% of the

new local government failed to grow independently (2013 MoHA report). Because of this bad performance, the new law addresses some tighter steps before allowing the creation of a new local government. A tighter regulation is implemented in relation to the creation of the new local government. Those points include the following:

1. To create a new local government, there are two basic criteria: a) basic regional criteria, and b) basic capacity criteria. The basic regional criteria consist of minimum size of the area and the population, local border, the scope of region and the age of the local government. The capacity criteria are derived based on some indicators, which basically to prove that the new local government could survive and stays independently in the future.
2. The proliferation could happen only if the region has fulfilled the following requirements:
 - a. The candidate of the new Province should have at least 5 Districts
 - b. The candidate of the new District should have at least 5 Sub-districts (“kecamatan”)
 - c. The candidate of the new municipality should have at least 4 Sub-districts (“kecamatan”)
 - d. In addition to that, the minimum age of the Province is 10 years to be proliferated, while the minimum age of the district/municipality is 7 years; all are calculated from the year of the establishment of the local government.
3. The local capacity of the new local government needs to be assessed based on indicators such as geography, demography, security, socio-politic, economic potential, local finance and bureaucratic ability.
4. The new law also addresses a significant change regarding the preparation steps of a new local government. Based on this, before obtaining a new local government status, the candidate should obtain first its status as a “prepared” region to allow a better preparation of the candidate to become the new local government. At the end, after a few years with this “prepared” status, this local government should pass the survival criteria,

which determined and evaluated by the central government, in order to obtain its final status as a new local government.

With the recent changes in regulation for proliferation, it is expected that the creation of the new local government can benefit local people to obtain better access and good quality of public services. Cases of bankrupted local governments hopefully can be avoided or minimized, as the new regulation enforces a tighter rule for creating a new local government.

8. Village Law

Villages have already played an important role in supporting national programs. Along with this role, the central government also gives a commitment to develop better villages. In the past, such a commitment was followed by an allocation of village funding under a Presidential Instruction. Recently, the status of the village was clarified and strengthened by the issuing of the Village Law of 2014.

Under this law, the definitions and regulations pertaining to the existence of a village are clarified. The management of villages overall is under the control of the district or municipal government. The meaning of the term of “village” may be different by region, but it has the same meaning in terms of the entity. For example, a village is nationally known as “desa”, but the village in the West Sumatra is called as “nagari”.

The law also stipulates the structure of the village government, which consists of the Head of the Village, supported by the technical units. The Head of Village is limited to the 6 (six) year term in office, and can be renewed to a maximum of 3 (three) times through the village election. The Head of the Village receives a monthly fixed salary, allowances, and other incomes including the health insurance.

There are some sources of village funding as stipulated in the Law. The main sources are as follows:

- a) Direct transfer from the central government. The aggregate transfer from the central government is in the amount of 10% of total

transfer to local governments, but the amount itself is outside of the current total transfer to the local governments.

- b) A minimum of 10% of revenue owned by the district/municipality (local taxes and user charges) must be dedicated for village funding.
- c) An allocation of a minimum of 10% of total transfer to the specific district (where the village located), excluding the specific grant (“DAK”). The money is directly transferred to the village.
- d) In addition to those above, a village could have its owned revenue (from village people), grants from third parties (without any commitment) and also financial assistance when needed.

To allocate the transfer from central government to the villages, the law has specified some criteria and also a formula accommodating some indicators, namely population, number of people living in poverty, land area and geographical difficulties index.

According to the data from the Bureau of Statistics and the Ministry of Home Affairs, there are about 74,045 villages in Indonesia (see **Table 6**). The distribution of villages is depicted on a geographical map as shown in **Figure 4**.

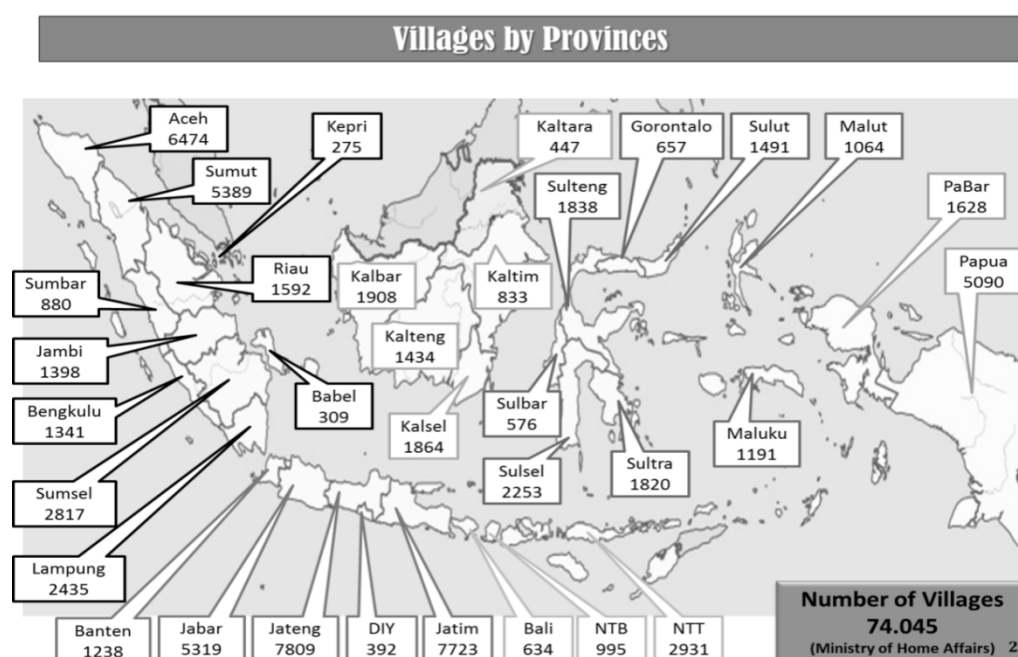
The issuance of the village law does not change the governance status of the village; it is still under the management of the district/municipality. However, as a community, the village is autonomous; it is allowed to have its own local election, to determine the new Head of the Village.

The status of the village in Indonesia is different from the status of the village (*barangay*) in The Philippines, where the *barangay* is itself a local government. The village in Indonesia is not considered to be a local government; rather it is still an autonomous entity under the administration of municipal or district government. The Village Law, however, has made the position of the village stronger with certain functions and financial sources. In the future, the village could have the possibility of obtaining the status of a local government, similar to the *barangay* in the Philippines.

Table 6. Data on Provinces, Districts, Municipalities and Villages

No	Island	Σ Prov	Σ dist	Σ Muni	Σ Vil	Area (km ²)	Population (people)
1.	Sumatra	10	120	34	22,910	480,793.28	56,874,456
2.	Java	6	84	29	22,481	129,438.28	139,846,727
3.	Bali & Nusa Tenggara	3	37	4	4,560	73,070.48	14,579,150
4.	Kalimantan	5	47	9	6,486	544,150.07	15,535,884
5.	Sulawesi	6	70	11	8,635	190,166.67	19,984,495
6.	Mollucca	2	17	4	2,255	78,896.53	3,047,430
7.	Papua	2	40	2	6,718	418,707.68	4,957,892
Total		34	415	93	74,045	1,915,222.99	254,826,034

Source: BPS and MoHA



Source: BPS and MoHA

Figure 4. Distribution of Villages across Provinces in Indonesia

9. Local Direct Election

Direct elections at the local level — or *Pilkada* — have been in place in Indonesia since June 2005. The Indonesian parliament in 2014 passed a bill to end direct local elections, and replaced it with the indirect local election law. Members of parliament had various arguments to support the idea of terminating local direct election, particularly their high cost.

Since there was strong public disagreement with regard to this policy, the outgoing President Susilo Bambang Yudhoyono issued an emergency presidential decree to overturn the decision and restore the local direct elections.

In January 2015, the emergency presidential decree was accepted by the Parliament to become the law on local elections. Therefore, the current local direct election law is based on the emergency presidential decree, which covers issues such as reducing the cost of local direct election, eliminating black campaigns commonly conducted by candidates during the local election process, and abolishing any use of the local budget (by incumbents) for the purpose of winning the election.

The next local elections in Indonesia were planned to be held on December 9, 2015. It would be the first local election conducted

simultaneously in one day. On one hand, these simultaneous local direct elections could reduce the high cost of elections; on the other hand, they meant that there was potential for political disorder if the government failed to maintain a peaceful election process. Therefore, to reduce the potential conflicts during simultaneous local elections, the government, particularly the General Election Commission (*Komisi Pemilihan Umum* or KPU), should make better preparation as early as possible.

9.1. Some Findings about Local Direct Elections

The following are observations taken from the East Asia Forum (October 2014); which provide some highlights of the Indonesian local election:

- a) An estimate from the 2012 scholarly study shows that the average cost of holding an election in a district/municipality and a province amounts to about US\$2.1 million and US\$8.2 million respectively.
- b) Political decentralization via direct voting, in some cases, creates problems. Recent cases show that the networks of decentralized political dynasties exploit the *Pilkada* system to their advantage.
- c) Local elections and greater regional autonomy was also driven by some local needs which are not accommodated nationally, such as those based on ethnicity or religion.
- d) On the other hand, the proponents of the *Pilkada* system in general believe that the gains in democratic capital more than make up for the inefficiencies of the system. While money politics and corruption remains a perennial scourge to any democratization and decentralization process, direct local elections on the whole have a stimulating effect on the economy.

FUTURE PERSPECTIVES ON DECENTRALIZATION IN INDONESIA

It is not easy to predict the future of Indonesian decentralization. Political dynamics could shift the pendulum from decentralization back to centralization. Such a situation occurred last year when the decision to replace the local direct

election system with a local indirect election system was accepted by the Parliament. Fortunately, the process was cancelled, as the President issued an emergency regulation to restore the direct local election process. To prevent decentralization policy from being subjected to frequent changes, it is important for the government to have a long term guideline on decentralization policy.

The future of decentralization policy depends on its ability to support the implementation of national priorities, such as infrastructure development, climate change and also other national priorities. Clarity and certainty of the decentralization policy are important to support the accomplishment of national priorities. The future of decentralization policy also depends on the outcome of the policy, particularly to what extent the policy has helped to improve local welfare.

To minimize frequent changes to decentralization policy, the government is urged to have a grand design for decentralization. This strategy is useful to keep the policy on the right tracks, and consistently to support the future development of Indonesia. At present, only a grand design for fiscal decentralization is available. This grand design focusses not only on the revenue side, but also on the expenditure side of the local government budget.

Under this grand strategy, the future scheme of local revenue and expenditure are formulated based on the future needs. The local revenue is expected to be stronger, buoyant and efficient. Under Law No.28/2009, locally generated revenue was empowered with property tax which is known as a good local tax. In the future, the piggy-backing of national taxes, namely personal income tax, is under a consideration to increase the locally controlled revenue.

The grand strategy of fiscal decentralization also places importance on the expenditure side, particularly on the effectiveness and the efficiency of the local spending. Based on the present evidence, local government budgets still focus mainly on spending on salaries. The grand design of fiscal decentralization encourages an increase of local spending on capital, in particu-

lar for building local infrastructure. In addition, the grand design of fiscal decentralization also recommends the implementation of MTEF (the Medium Term Expenditure Framework) for accommodating long-term investment in local budgets. Finally, to help the fulfillment of the national priorities, a specific grant (DAK) needs to be increased significantly over the years.

CONCLUSIONS AND RECOMMENDATIONS

Based on the evaluation of current decentralization, the paper highlights some findings:

- Regional economic growth and HDI show improvement in the welfare of local people. This improvement is not necessarily the result of the decentralization, however, given that some improvements in the budget allocation, particularly increasing the portion of budget spending on education and health, but there is evidence that the welfare improvement is a result of decentralization.
- Other public services, mainly public infrastructure, have also increased over time, after decentralization. Unfortunately, the data show a lack of maintenance of this public infrastructure, namely road facilities. This might give the wrong impression that not much has been done in practical terms toward the availability of the infrastructure across Indonesia.
- According to current observations, people are still in favor of local direct elections. This system makes people able to choose their best leader to guide them towards prosperity.
- For a long history, the allocation of productive investment is distributed unequally across Indonesia, which results in a relatively higher portion of GDP for Java and Sumatra. In the future, an affirmative intervention is needed to reduce this interregional disparity.

Recently, there have been some efforts to amend the law. The law on local government has been revised to include better division of government affairs between the levels of government. It is a challenge for the government to use this new guideline for practical purposes.

There are always potential conflicts between central and local governments when discussing detailed issues related to programs and activities. To reduce the potential conflict, further technical regulations are needed, and those should be made available as soon as possible.

The new law also changes the process of proliferation which requires much better preparation steps to create a new local government. In the past, the motivation of the proliferation did not always come from the central government, but more often it came from the parliament. Since the endorsement of proliferation under the new law requires more technical evaluation, it is recommended that in the future, the initiative of proliferation only comes first from the central government, and submitted to the Parliament for discussion and approval.

Fiscal decentralization could improve local financial management to make it more accountable. In addition to this, fiscal decentralization policy could also help the achievement of national priorities, by enhancing the instrument of fiscal decentralization policy such as the specific grant of DAK. Such important progress has been accommodated in the upcoming National Budget Planning. To maintain stability and certainty for the new policy, it is suggested that the new direction of fiscal decentralization could be incorporated in the new Central-Local Fiscal Balance Bill, which is expected to be issued in 2016.

Finally, to guide the future of the decentralization policy, the government could make a road-map or a grand design. At present, the only one available is for fiscal decentralization. In order to guide the future decentralization policy, it is recommended that the government to formulate a comprehensive grand design to incorporate not only fiscal, but also non-fiscal issues of decentralization.

REFERENCES

- Law No.23/2014 on Local Government.
 Law No.6/2014 on Village.
 Ministry of Finance, 2008. *Grand Design of Fiscal Decentralization*.

- Mahi, B. R., 2013. Presentation for *GRIPS Research Meeting*.
- Mahi, B. R. and R. M. Qibthiyah, 2015. "Intergovernmental Transfers: Effectiveness and Response on Government" in: A. Nasution, *Macroeconomic Policies in Indonesia: Indonesia Economy since the Asian Financial Crisis of 1997*. Oxon and New York: Routledge.
- Green, K., 2005. "Decentralization and Good Governance: The Case of Indonesia", MPRA Paper No. 18097. Available at: https://mpra.ub.uni-muenchen.de/18097/1/Decentralization_and_Good_Governance-The_Case_of_Indonesia.pdf.
- Hofman, B. and K. Kaiser, 2002. "*The Making of the Big Bang and its Aftermath: A Political Economy Perspective*", Paper Presented at the Conference 'Can Decentralization Help Rebuild Indonesia?'. Atlanta: Georgia State University.
- Keuleers, P., 2002. *The role of the Governor and of the provincial administration: Comparative experiences*, UNDP. Available at: http://web.iaincirebon.ac.id/ebook/moon/Decentralization/Q%201.4%20-%20UNDP%20-%20role_of_the_governor_020902.pdf.