

# Decentralized System and Budget Allocation for Rural Development in Indonesia

A Case study of Purbalingga District, Central Java Province

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## 1. Introduction

Decentralized system is often perceived as an important strategy for effective public spending. By granting the power of budgetary decision-making to local government, public spending will more match with public preferences. This will also improve transparency, responsiveness and accountability of local government (Cheema & Rondinelli [1], Cohen & Peterson [2], Parker [7])

Although advocated by many, the results of decentralized system are often ambiguous. In case of Indonesia, recent studies indicate that a larger percentage of budgeted revenue is allocated for recurrent rather than development expenditure (Dixon & Hakim [4], Mahi [6], World Bank [15]). However, the reasons of disproportionate allocation of district revenue for recurrent expenditure remains unaddressed by the existing studies. This is because most of them analyzed Indonesian decentralization from the national perspective that do not analyze the local socio-political realities.

This study aims to analyze Indonesian decentralization more locally through a case study at one selected district in two steps. Firstly, this paper examines findings of existing studies on district government spending. Secondly, it discusses the process of budget formulation in order to understand more about local socio-political realities behind the budgeting process. The rest of this paper is organized as follows: Section two presents the overview of Indonesian decentralization; Section three describes research location and methodology; Section four discusses the budget of the selected district; Section five traces the process of budget formulation; Section six draws conclusion and provide policy recommendation.

## 2. Decentralization in Indonesia: Historical and Legal Overview

Indonesian administration tiers consist of four levels, which are centre, province, district (in rural areas) or municipality (in urban areas) and village. As a product of political process, the pattern of intergovernmental relationship was changed over time (Figure 1). This section will discuss only the latest changes and design of decentralized system.

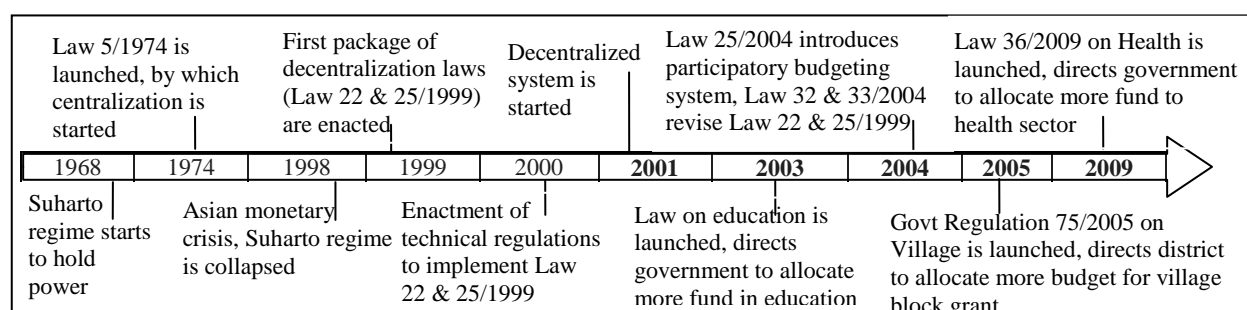


Figure 1. Time Line of Decentralization Policy in Indonesia

Before 2001, there was a chain of command whereby the lower level of government was answerable to authorities at the higher level. Despite that, the central ministries also established field offices in every province and district. Overall, central government played dominant role in development of the country as a whole. Through top-down mechanism, the central government outlines the programs to be implemented by the local governments and the field offices. Fiscal transfers for the local governments came from various ministries, mostly in the form of earmarked funds<sup>1)</sup> (Ranis & Stewart [13], Tinker & Walker [14]).

In 2001, however, the government quickly started decentralization through the enactment of Law 22/1999 on Regional Governance and Law 25/1999 on Fiscal Balance. According to the laws, central government and province had limited operational tasks in the development programs. Central government acted more to establish the national policy, while province acted more as central government arms to coordinate and supervise the districts. District government became the focus of decentralization where most tasks to provide public services were devolved. Village government became the part of district government, and the later was responsible to supervise the former. Transfer of human resources was done by merging the field offices of central ministries and their civil servants to the district governments. About 2.1 million of central government civil servants were transferred to province and district governments in 2001 (World Bank [15])

In order to ensure that local governments had enough revenue to deliver the newly devolved tasks, Law 25/1999 significantly increased fiscal transfer to them. The fiscal transfer consisted of three elements: general grant distributed based on equalization of population, area and poverty rate; revenue sharing from natural resources; and special grants to perform the programs of central government at the local level<sup>2)</sup>. Further, previously scattered from various ministries' earmarked funds, fiscal transfer is now unified and transferred directly from the Ministry of Finance. Except for special grant, the utilization of the fund is decided by local government. However, the fiscal transfer from central government is given only to the province and district/municipality government, but not to the village government. According to the law, village budget is allocated from district government.

Some laws were enacted to strengthen decentralization and enhance economic development. For instance, Laws 20/2003 directs district government to allocate 20%<sup>3)</sup> of the budget to education sector, Regulation 75/2005 directs district government to allocate 10%<sup>4)</sup> of the district budget as Village Block Grant, law 36/2009 directs district government to allocate at least 5%<sup>5)</sup> of district budget to health sector. In terms of strengthening the decentralization process, Law 25/2004 formalized rural people participation in the district budgeting process through the public hearing mechanism. Also, in 2004, the first laws on decentralization (Law 22 and 25/1999) were changed to Law 32/2004 and Law 33/2004. Law 32/2004 introduced direct election of the district head/governor, and Law 33/2004 authorized the increased fiscal transfer to the district government by broadening the scope of taxes revenue sharing<sup>6)</sup> to the district government.

### **3. Research Location and Methodology**

This study purposively selected Purbalingga district in Central Java as the research location. Central Java was selected as it is one of the provinces with the highest poverty rate. Purbalingga was selected as it is far from the urban areas, thus the character of rural areas is still dominant.

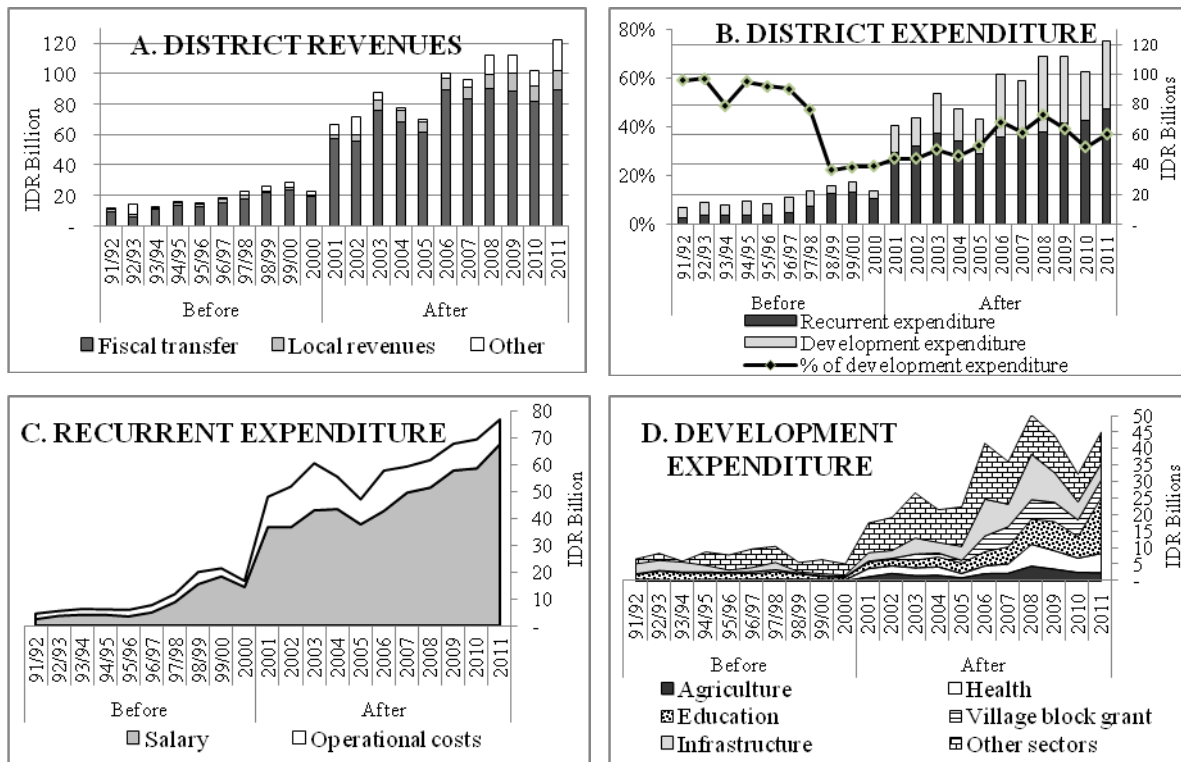
The district covers an area of 778 km<sup>2</sup>, which is divided into 18 sub-districts and 239 villages. Purbalingga Statistical Agency [10] notes that agriculture sector was the main livelihood for 43% of the population in 2010. The sector contributed one third of Gross Regional Domestic Product (GRDP) in the last ten years. This district is also still dealing with rural poverty problems. By 2010, 23% of population was poor<sup>7)</sup>, and the score of local Human Development Index (HDI) was 70.9<sup>8)</sup>. Moreover, education sector strongly needs improvement, as enrolment rate of primary, lower and upper secondary school was 91%, 68% and 31%, respectively. In health sector, 95% of births had been assisted by medical personnel, and life expectancy was 70 years. However, only 43% of households were covered by health insurance. In care of rural infrastructure, 65% of the existing road was badly deteriorate and needing urgent repair by 2010. District government is also the main provider of most of the rural services. In education sector, 75% of the schools are the government school. In health sector, despite of the two private and one government hospitals available at the district centre, rural people rely on the 161 village polyclinics and 22 sub-district health centers to obtain primary health treatment. In general, from these socio-economic conditions, there is strong rationale for this district to focus the spending on rural development programs, especially in agriculture, education, health and rural infrastructure.

The data in this study were collected through participant observation, interview and documentary study. In analyzing the budget, an approach of "before and after" comparison will be used by putting 2001 as cut-off year. Furthermore, to present the budgeting process, an approach of process documentation research will be applied with a case of 2010 budgeting process.

#### 4. The Budget of Purbalingga District

District revenues come from three main sources. They are local revenues which consist of regional state enterprises, taxes on property, advertisement, hotel and user charges collected by the district government itself; fiscal transfer, which consist of general grant, revenue sharing and special grant from Ministry of Finance; and other revenues, which consists of the remainder of previous year budget, emergency funds and donation. Furthermore, in this study, district spending will be classified into recurrent expenditure (salary and operational costs) and development expenditure. The development expenditure of district government will also be divided into sectoral programs and village block grant (grants distributed to village government by considering landmass, population and poverty rate). Revenues of village government come from village block grant and accepted proposals submitted to district government. Village budget is usually spent for small scale rural infrastructure within village like road improvement or small irrigation.

When decentralization was started in 2001, district revenues increased by more than 200%, due to the increase in fiscal transfer from the central government (Figure 2.A). As mentioned in Section 3, in accordance to district socio-economic condition, the revenue inflow from the central government was expected to be used for development expenditure in agriculture, education, health and infrastructure. In practice, however, a larger portion of the budget was utilized for recurrent expenditure (Figure 2.B). In Purbalingga district, recurrent expenditures mostly consist of the salary of civil servants (Figure 3.C).



**Figure 2.** Purbalingga District Budget, 1991-2011

Source: Author's calculation from annual Purbalingga district budgets. Data are obtained from the homepage of Ministry of Finance at <http://www.djpk.depkeu.go.id/datadjpk/105/> and <http://www.djpk.depkeu.go.id/datadjpk/131/>

Note: The value of money is converted into real values of 1991 by considering inflation rate

As presented in Figure 2.C, recurrent expenditure basically increased since 1998, the time when Indonesia was hit by the monetary crisis. With the drastic decline in the exchange rate of Indonesian Rupiah (IDR) at the time, the government had no option but to increase the salaries of civil servants by about 100% to meet the living costs. Moreover, the merger of central ministry field offices with the district government as a result of decentralization in 2001 increased the number of civil servants from 1,743 to 8,907 persons due to the transfers from the central government to the district government (Purbalingga Statistical Agency [9]). In addition to this, the poor recruitment system had exacerbated the

condition. There was so far no workload analysis to identify the number and qualifications of the civil servants needed in this district, thus the recruitment of civil servant is not well planned. The number of civil servants always increases over years, reaching the figure of 10,384 persons by 2010 (Purbalingga Statistical Agency [10]).

It is difficult to determine the optimal number of civil servants because of limited workload analysis. Some indication of organizational inefficiency can be seen from the number of district agencies. The current district organization structure consists of 27 agencies with some potentially overlapping functions. For example, the tasks in agriculture sector, which may be more efficient to be handled by a single agency, was currently managed by four different agencies, namely Forestry and Farming Agency, Poultry Agency, Agriculture Extension Agency and Food Security Agency. When the district government enlarged its agencies more than what is needed, it is not surprising that the operational costs as well as the number of civil servants tend to increase over years.

In terms of development expenditure, education, health and village block grant are the sectors whose spending has been consistently increasing (Figure 2.D). However, it is debatable to say that this increase was fully initiated by the district government. This is because, as mentioned in Section 2, there were Law 20/2003 on National Education System, Law 36/2009 on Health and Regulation 75/2005 on Village , which directs the district government to allocate more funds in these sectors. Thus, this study argues that the increase in spending for education, health and village block grant was more because of national intervention on these sectors rather than the process of decentralization itself. This argument might be true, because the spending in agriculture and infrastructure, which have no related national regulation, have their spending fluctuating.

## 5. The Process of Budget Formulation

### 5.1. Legal Framework of Participatory Budgeting

After decentralization, Indonesian central government tried to include villagers in budgetary decision making by establishing public hearing mechanism (locally named *Musrenbang*) through Law 25/2004 on National Planning System. In general, the current process of budgeting consists of three main stages, which are public hearing, budget drafting and budget enactment (Figure 3).

The first stage, public hearing, consists of meetings held at village, sub-district and district levels. At village level, the village government conducts a meeting by inviting villagers to identify development proposals to be funded either by the village block grant or to submit the proposals to district government for funding, and to select the delegations to attend the sub-district meeting. Subsequently, the sub-district meeting is held by inviting the village delegations to find agreement on the priority proposals from this area to be proposed to the district meeting. Finally, the district meeting is held by inviting the delegations from the villages, district agencies, local associations and Non Governmental Organizations (NGO's). In the district meeting, the bottom up proposals from the village delegation as well as the programs from district government are discussed together by the participants in order to create an agreement on the list of priority programs to be funded by the district budget.

The public hearing is followed by the budget drafting, which is a process of matching the priority programs resulted from the public hearing with the projection of revenues. The process is relatively closed and done by district agencies under the supervision of the district head. After the budget is drafted, the district head will send the draft to the local parliament, from which they will conduct plenary session to decide whether they will directly approve, revise or reject it. District budget is jointly approved by the district head and the district parliament, and enacted accordingly.

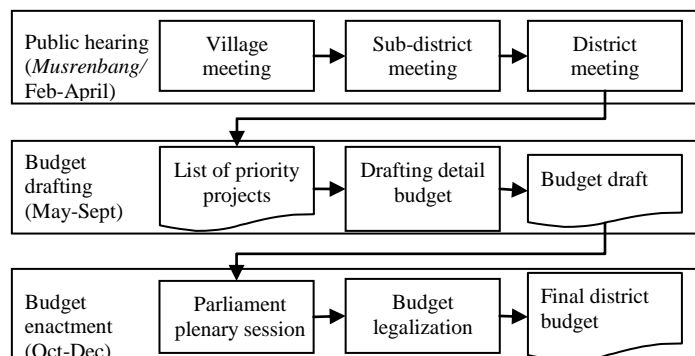
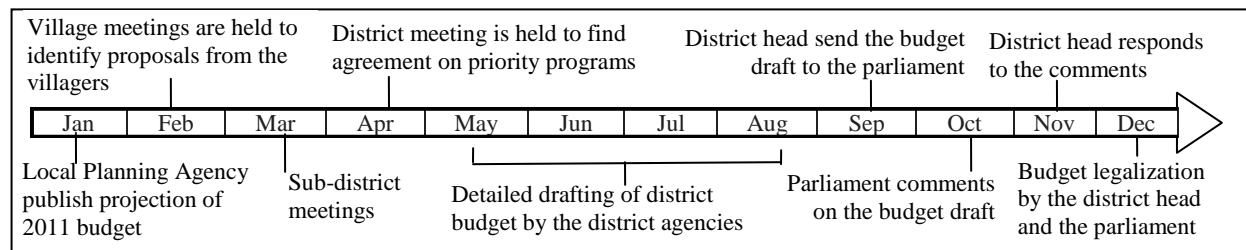


Figure 3. Stages of Budgeting Process

## 5.2. Proceedings of 2010 Budgeting Process

This section will present the process of budget formulation in 2010. Overall, the time line of budget formulation is presented in Figure 4.



**Figure 4.** Time Line of 2010 Budgeting Process in Purbalingga District

In January 2010, Purbalingga Local Planning Agency projected that the 2011 revenues would be IDR 860 billion, an increase by IDR 180 billion from the previous year. In line with the 2011 revenue projections, 2011 recurrent expenditure would be IDR 570 billion, an increase by IDR 100 billion from the previous year (Radar Banyumas daily news [11]). This implies that more than half of the revenue was used for recurrent expenditure rather than the development expenditure.

As annual routine, public hearings started with the village meetings in February, and the sub-district meetings in March. Documentary study on the database of village proposals show that there were about 1,540 projects proposed by rural community, which required funding of about IDR 298 billion. All of these proposals were submitted to district meeting, which was held in district hall in April 01, 2010, and attended by the delegation from rural communities (mostly village heads and some members of village assemblies), delegations from each district agency, some local associations and NGO's.

Sessions of the district meeting began in the morning, started with the speech from the district head. Thereafter, Local Planning Agency presented the projection of revenues and the general indicative budget allocated for each sector. However, lack of budget transparency was observed at the district meeting. Budget documents, especially operational expenses, were still considered confidential. Throughout the presentation, detail information about recurrent expenditure items were not provided<sup>9)</sup>. There were no agenda for the meeting to enable village delegations and other non-government participants to scrutinize the recurrent expenditure items. The reasons why the district government did not provide detail information about recurrent expenditures and openly discussed them remain unclear. This study tried to investigate the documents and found that the justification of many recurrent expenditure to be questionable. For example, there was transfer of operational cost as much IDR 0.9 billion to the sports committee, IDR 0.9 billion to the local political parties, and IDR 0.6 billion to a women group (namely *Pemberdayaan Kesejahteraan Keluarga* whose members are mostly wife's of the district officers) (Purbalingga District Government [8]).

During the afternoon session, the participants were divided into three groups to discuss the development proposals of each sector, namely economy, socio-cultural and infrastructure group. Although the meeting provided village delegations the opportunity to submit proposals, it did not guarantee the approval of funding. Each village proposal should compete not only with the proposals from the other villages, but also with the proposals from district agencies. With only one day meeting, it would be impossible to screen all proposals accurately. Some problems were unavoidable as there were no clear procedures to screen and prioritize the proposals. What really happens in the forum was a process of negotiation and competition that was often political in nature. Delegates from the rural communities, district agencies, local associations and NGOs discussed together. They had different level of social or political positions, as well as, different capacity to propose ideas and make favourable argument for their proposals. In the forum, the participants from district agencies were seen dominating discussions. Village delegations, with little power and experience, could not make strong argument for their proposals. In addition, proposals by the district agencies were given priority. After these groups discussion, they met again to conduct the final meeting. Final agreement on the list of 2011 priority projects should be officially created in this final meeting.

To illustrate the comparison between the projects proposed by the village governments and those getting the funding, this study goes through the database of the village proposals at that time. Among the 1,540 proposals with funding requirement of IDR 298 billion, 320 proposals were accepted with the funding of about IDR 29 billion<sup>10)</sup>. The largest part of the accepted proposals was those on rural

infrastructure, mainly rural road improvements. Among IDR 290 billion of total development expenditure in 2011, only about 10% of them was used to finance proposals from village (Purbalingga District Government [8]). Overall, the attendance of rural delegations did not influence much on budget allocation for the rural development. They had many proposals, yet they faced a classic problem of budget limitedness during the district meeting.

From the perspective of rural delegation, the participatory planning is a mere formality. A village head routinely attending district meeting as delegation from his village expressed his pessimistic about the effectiveness of public hearing to accommodate village proposals. He narrated how he, on several occasions, proposed the building of clean water facility for his village to the district government, but the proposal has not been accepted yet. He even questioned the rationale for annual meetings considering that previous proposals had not been funded yet. According him, if district government really wanted to improve the rural development, it would be more effective if it increased the amount of village block grant, from which rural people could use for developing their respective village<sup>11</sup>).

After the public hearing, next stage was detailed budget drafting by the district agencies, which was officially closed to the public. The last stage was local parliament's plenary session. This stage offers the last window of opportunity to gain a pro rural development budget after the public hearing could not optimally accommodate the village proposals. The parliament legally has high political power to revise the draft proposed by district government. Yet, the power of district parliament to revise budget estimates is hardly exercised. Generally, members of the parliament lack the capacity to evaluate the draft budget as only about 40% of 45 parliament members have graduated from upper secondary school. That is, the parliament does not normally revise the draft budget proposed by district government. Some points raised by the parliament during the plenary session were to allocate more for poorhouse reparation, scholarship for the poor children, to focus on the road repair rather than the new building and to develop a road network in some sub district. District head in fact accepted most of these comments<sup>12</sup>). Despite some minor revisions in development expenditure, there was no substantial comment to reduce the portion of recurrent expenditure or to examine the items of this expenditure in detail. Even, there was a proposal from some members of parliament to provide so called "aspiration fund"<sup>13</sup>), which was rejected after the province officer raised issues of legality about such as fund (Radar Banyumas daily news [12]). Above all, the parliament was also partly responsible for the rise in recurrent expenditure. They spent about IDR 5 billion for training, study tour and work visit on only 45 members as compared to a budget of only IDR 7.5 billion for irrigation (Purbalingga District Government [8]).

## **6. Conclusion and Policy Implication**

Portion of expenditure for rural development within the budget of Purbalingga district is lower than that of recurrent expenditure. Most of the budget is utilized for recurrent expenditure resulting from enlargement of civil service. The increase in recurrent expenditure was unavoidable in the initial years of decentralization. However, inefficiency of district government in establishing district agencies and non-existence of work load analysis for civil service recruitment accounted this increasing trend of recurrent expenditure. There are also many evidences that some recurrent expenditures are not truly necessary.

The current stages of budgeting have been fairly good. It has used multiple ways, starting from identifying the needs of proposal by public hearings and focus group discussions. The biggest implementation gap within the current mechanism is the governmental environment. However, in case of Purbalingga, low commitment from the district government has become the biggest obstacles for effectiveness of public participation. Authorities are reluctant to share the information and discuss the recurrent expenditures openly; there are no clear procedures to screen the village proposals; and the local parliament lack requisite capacity to analyse and approve the draft budgets. All of this implementation gaps are also responsible to the low allocation of budget for rural development.

This study recommends increased allocation for development expenditure, from both district and central government, to speed up rural development. Purbalingga district government is supposed to reform its organization to be more efficient. It can be started by restructuring the current district agencies and conducting study on workload analysis to identify the needs of civil service, and recruitment into civil servants should be based on this study. The district should also improve the implementation of budgeting forum by disseminating budget information freely and crafting clear-cut procedures for selecting

proposals. On the other hand, central government can strengthen its monitoring on utilization of the district budget. The experience from the regulations on education, health and village block grant shows that the allocation of development expenditure can be increased. Similar regulations, setting the minimum portion of district budget to be allocated, can be enacted for agriculture and rural infrastructure sectors.

#### ENDNOTES

- 1) Earmarked fund is the type of fund transfer where the utilization are determined by the central government
- 2) General grant always constitutes the largest part of the fiscal transfer. For example in 2011, fiscal transfer to province and district consisted of 65% general grant, 28% revenue sharing and 7% special grant. See the homepage of Ministry of Finance at <http://web.djpk.depkeu.go.id/daper/>
- 3) 20% of budget also includes the salary for teachers
- 4) 10% of fiscal transfer is after the deduction of the salary of civil servant
- 5) 5% of budget also includes the salary for medical personnel
- 6) Law 25/1999 only provided revenue sharing from natural resources (oil, natural gas and other mining), while revenue from value added tax, income tax and cigarette excise fully belonged to the central government. With the enactment of Law 33/2004, all revenues from taxes became object of sharing with local government
- 7) Indonesian poverty line is equivalent to US\$ 1.54 per people per day (Purchasing Power Parity)
- 8) The categorization of HDI score in Indonesia is: <50 = Low; 50-65.9 = Lower Medium; 66-79.9 = Upper medium; 80-100 = High
- 9) Analyzed from Head of Purbalingga Local Planning Agency [5]
- 10) Analyzed from list of village proposals and 2011 budget draft.
- 11) Interview with one village head in Kejobong sub-district on March 26, 2011.
- 12) Analyzed from District Head of Purbalingga [3].
- 13) Aspiration fund is additional allowance allocated to parliament member when he comes to the constituent.

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