

# Local Development Planning and Budgeting in Decentralized Indonesia : Missing Links in the Bottom-up Approach

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## **Local Development Planning and Budgeting in Decentralized Indonesia: Missing Links in the Bottom-up Approach\***

Norio Usui and Armida S. Alisjahbana

This paper focuses on the workings of Indonesia's local development planning and budgeting mechanisms after decentralization, where citizen participation becomes a central theme for all stakeholders including policy makers. If real local needs are to be articulated, bottom-up mechanisms need to be strengthened through its institutionalization in local government structures. At the same time, it can not be overlooked that effective and efficient local planning and budgeting in decentralized administration structure much requires good coordination between higher and lower levels of government (vertical linkages), and between neighboring local governments (horizontal linkages). Indonesia needs to make the best strategic use of matching or earmarked grant to link development plans and budgets at all levels of government. For horizontal linkage, role of provincial governments need to be enhanced to set up a formal coordination system.

Keywords: Participatory Planning and Budgeting, Policy Coordination, Matching Grants

### **1. Introduction**

Facing enormous difficulties in maintaining national integrity after economic and political crises, the Government of Indonesia (the Government) initiated a drastic decentralization program in fiscal year (FY) 2001. The hierarchical relationship between provincial and local governments (Kabupaten/Kota) was eliminated, and replaced

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by far-reaching authority delegated to local governments. The devolution was in the areas of development planning, public expenditures, and service deliveries. Provincial governments act with autonomy, but retain hierarchical relationships with the central government. In the case of local governments, the election of local heads (Bupati/Walikota) no longer requires approval by higher levels of government. The local heads are accountable only to local parliaments (DPRD). As a part of decentralization process, about two million central civil servants were transferred to the regions.

There is a strong rationale for decentralization in Indonesia, which has a diverse geography, culture, and natural and human resource endowments, and consequentially a diversity in local needs as well as large variations in public service delivery costs. A key objective of decentralization is to move decision-making closer to the people so that public service delivery is more responsive to the diverse local needs, priorities, and preferences. Development planning and budgeting are indispensable instruments in securing the aims of decentralization. Local governments need clear development strategies that fully meet their citizens' needs, and this can be achieved through active civil society engagement in planning. A solid link between planning and budgeting that reflects priorities is also a key prerequisite for successful decentralization.

However, the enormous diversity of the country can be a strong basis for centralization or top-down interventions, given that the Government needs to ensure certain minimum standards (Devas 1989). Indonesia adopted this approach for more than 30 years under the New Order regime, and, as shown by the experiences of many decentralized countries, top-down approach is still needed even after decentralization. The debate therefore tends to be continuous over the balance between central control and regional autonomy. A key challenge for the Government is to find the right balance between the top-down and bottom-up approaches.

Coordination mechanisms between local and higher levels of government (vertical linkages) and between neighboring local governments (horizontal linkages) acquire importance in local planning and budgeting after decentralization. In Indonesia, there are three levels of autonomous sub-national governments: provinces, districts

(Kabupaten/Kota), and villages (Desa/Kelurahan). There are also sub-districts (Kecamatan) between districts and villages. Indonesia's policy makers need to consider how these different levels of government can coordinate their planning and budgeting. A question is how higher levels of government can effectively promote their priorities at the local level in decentralized administration structures without interfering in local government affairs. Another requirement is an effective coordination network to maximize synergies with neighboring local governments. Successful decentralization requires both vertical and horizontal integration of planning and budgeting.

This paper analyzes Indonesia's three years of post decentralization experience in local development planning and budgeting. Discussion in this paper is based largely on our findings in a series of field studies in Kabupaten Lombok Tengah (Central Lombok District) and Kabupaten Bandung (Bandung District)<sup>1</sup>. Major changes in local development planning practice after decentralization are discussed in Section 2, Section 3 reviews local budgeting processes and implementation, and Section 4 focuses on vertical and horizontal linkages in local development planning and budgeting. The final section is conclusions and summaries with policy implications.

## **2. Local Development Planning**

Local development planning in Indonesia has been, and still is, a mixture of top-down and bottom-up approaches. The top-down process starts from discussions on national policy guideline (GBHN) at the consultative assembly (MPR) level, which is followed by the preparation of five-year development plans (Propenas) to provide guidelines on national development objectives, policies and programs. Strategic development plans of central line ministries and agencies (Renstra) are then based on the Propenas. These are followed by annual national development plan (Repeta) defining priorities for the national development budget. All local governments are required to produce a basic strategy statement (Polda) with a similar

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<sup>1</sup> Field studies were conducted in August 2002, and July to August 2003. Armida Alisjahbana covered the case study in Kabupaten Bandung, and Usui joined the one in Kabupaten Lombok Tengah

status to GBHN at the national level. This is a master plan document incorporating political commitment with vision, mission, direction and strategy for long- and medium-term local development. Local governments use the Polda as the basis for their five-year development plans (Propeda), strategic development plans (Renstrada), and annual development plans (Repetada). It is expected that local governments will consider national and provincial development priorities in their planning processes. In principle, coordination between different levels of government is secured through consultations at development planning coordination meetings.

The bottom-up process of consultation involves each level of government formulating draft annual development proposals that are based on propositions submitted from lower government levels. The process starts with sub-village development meeting (Musbangdus) that feed into project proposals reviewed at village level meetings (Musbangdes). Similar consultation processes continue at sub-district (UDKP), district (Rakorbang Kabupaten/Kota), provincial (Rakorbang Propinsi), and national (Rakorbangnas) levels. On the basis of the discussions at Rakorbangnas, the central government finalizes project proposals that will be financed by the national budget (APBN) in the next fiscal year.

Indonesia's traditional development planning practices, which consisted of the top-down and bottom-up approaches, seemed to guarantee a delicate balance between central priorities and local demand in local development plans. However, in reality, they failed to pick up true local demands because local residents were almost completely left out of the decision making process from the very beginning of local development planning. Before decentralization, there was no separation of executives and legislatives powers at the village level. The village head was the chairman of the village assembly (LMD) and other LMD members were appointed by the village head. The village head was not accountable to LMD, but to higher authority (sub-district chairman (Camat)). Moreover, the village community resilience boards (LKMD), which were, in principle, institution for forwarding villagers' needs were dominated by village elites appointed by the village head; therefore, project proposals consisted mostly of priority projects of the village head and elites

(Antlöv Hans 2000 and Leni Dharmawan 2002). Further, most project proposals from villages were filtered out at a series of coordination meeting, where higher level government's proposals were tabled without incorporating people's aspirations. Consequently, final proposals were usually dominated by priority projects of higher levels of government, particularly those of the central government. Despite the formal coordination mechanism, local development planning was actually in the firm control of the central government.

In the last three years, community participation has become a reality in many regions, which was confirmed by our case studies where many stakeholders expressed satisfaction with their deeper involvement in the planning process. A decisive factor in successful community participation is the regional government law (UU No.29/1999) that dictates village government reform. After decentralization, the village head has become responsible to the village representative council (BPD), which replaced the LMD. The members of the BPDs are elected by villagers. BPDs are authorized draft village legislation, approve village budgets, monitor village governments, and propose replacements of village heads to local government. Thus, the village head is no longer the sole authority in the village. These reforms have brought about more transparency and accountability into decision-making at the village level.

Local governments are currently creating more genuine local development planning system, instead of the former centrally inspired systems, to tap into local demands and aspirations. Local governments have developed some innovative and creative responses, even though their magnitude and quality vary across the regions. Examples are: 1) some local governments reorganized their planning process by empowering traditional communities. As mentioned, the bottom-up planning system starts from the sub-village level. However, in some regions, local governments realize that traditional communities are more efficient than administrative village units in picking up local demands by stimulating voluntary participation of local people. A typical case can be found in the 'Nagari' system in West Sumatra (Widjono Ngoediji 2000); 2) local governments have been, and still are, suffering from over-staffing problems arising from the large-scale staff transfer from the central government.

Many regions tried to resolve this problem by establishing new technical bureaus (Dinas and Badan) to absorb the transferred officials. Some regions enabled effective absorption of local needs through closer communications with their constituents by establishing new branches at sub-district level (Cabang Dinas Kecamatan) and allocate more staff there. A typical case was found in Kabupaten Lombok Tengah; and 3) some local governments, including Kabupaten Lombok Tengah, introduced discretionary transfers to sub-districts and villages to better support bottom-up projects.

Despite these innovative moves and the positive impacts of the village government reform, many local people feel that they are still outside the planning process. They claim that, even when they are invited to coordination meetings, it is a formality and their demands will not be reflected in local development plans. Some local governments, despite realizing the need for active community involvement, are reluctant to increase public participation because it implies longer planning and budgeting processes. To address this issue, the Government enacted a Ministry of Home Affairs circular letter (SE MOHA No. 050/987/SJ) in FY2003 to provide general guidelines for participatory planning, and to define procedures for consultation and participation in coordinating meetings. Development coordination meetings at local level are divided in three stages: Pre-Rakorbang, Rakorbang, and Post-Rakorbang. In the first, heads of technical bureaus and Camats are invited to attend and guidelines for development activities are discussed on the basis of the local development strategy and shared among the participants to facilitate discussion at Rakorbang. The Post-Rakorbang checks for consistency between the results of Rakorbang and the local budget for the coming fiscal year.

Another new system with the circular letter is a scoring sheet for the prioritization of local development proposals. It provides a general guide to setting quantitative priority rankings for all proposals. Indicators include degree of participation, consistency with local development plans, and impacts on human resources and regional development. Following the guidelines, local governments prepare their own scoring sheets. This arrangement can facilitate discussion at Rakorbang and improve its transparency. However, in our inter-

views, there was an impression that the diversity of views in coordinating meetings at lower levels may result in smaller, minimum scale, and less beneficial programs because the externalities across villages and sub-districts cannot be well exploited. The implication is that local technical bureaucrats, while respecting the bottom-up proposals, may need to intervene to make necessary adjustments in the planning process. The success of the new scoring system depends on whether local governments can prepare a well-balanced mechanism that can guarantee a balance between the bottom-up approach and top-down intervention (Usui and Catur Sugiyanto 2003).

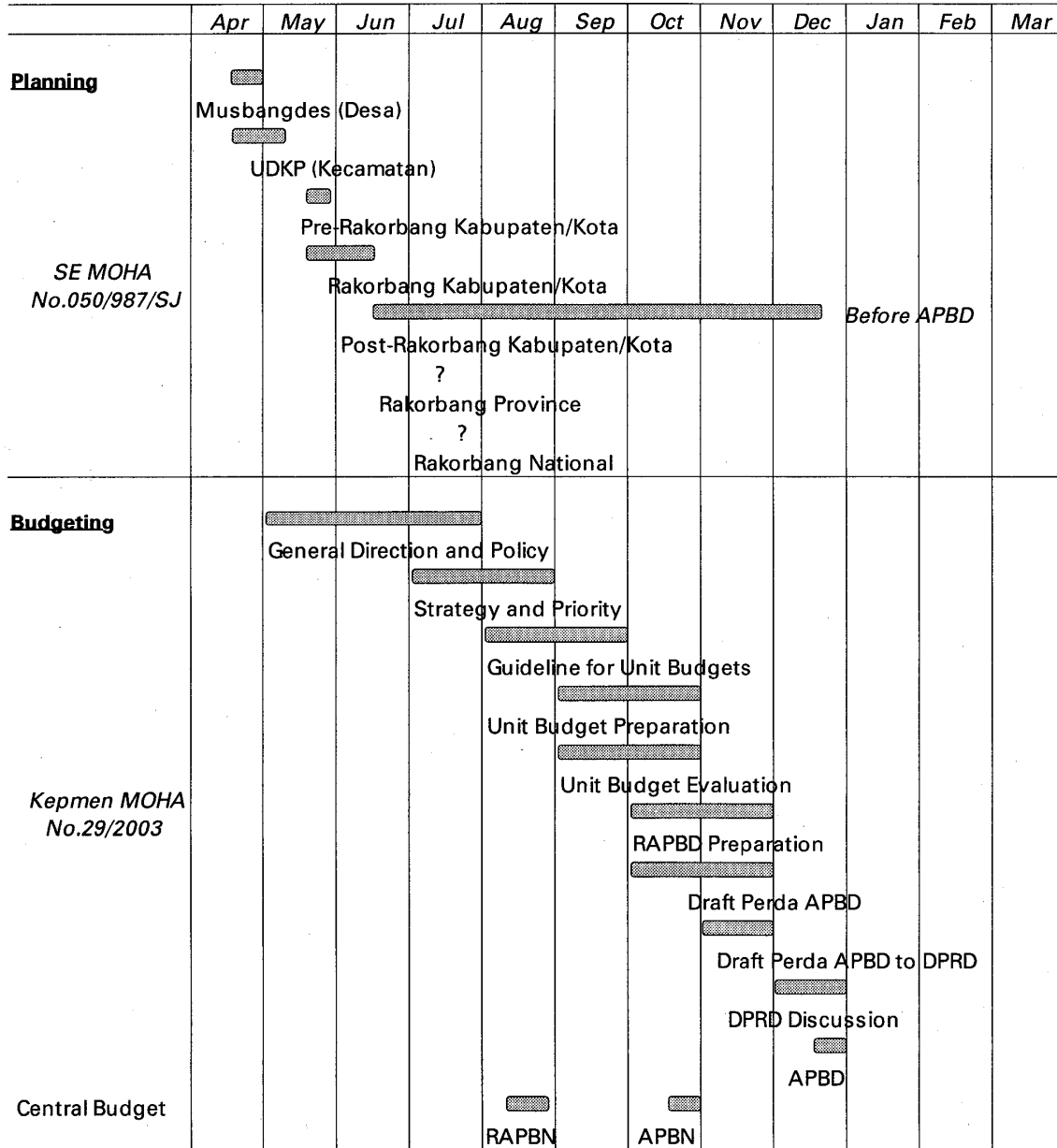
With the aim of closer integration between annual development plans and budgets, the circular letter sets an earlier local planning calendar. However, because local budgets depend heavily on transfers from the central government, earlier planning makes it more difficult for local governments to consider revenue estimates in their planning process. For effective planning, lower levels of government need budget information of higher levels of governments. The Government needs to find a compromise between earlier planning, for closer integration between development plans and budgets, and effective planning reflecting real financial conditions.

A key challenge for local governments is how to institutionalize participatory planning into government structures and planning mechanisms. In many countries, stakeholder participation is institutionalized through councils and boards representing the main sectors. For example, in the Philippines, stakeholder participation is built into local government structures through development councils, health boards, and school boards by laws (Guevara 2003). In Indonesia, Proenas 2001-2005 mandates the establishment of Education Boards (Dewan Pendidikan) and School Committees (Komite Sekolah). Many regions have not yet established them, although in some regions, including Kabupaten Bandung, these new institutions have become proactive in local planning and budgeting. The Government may wish to consider the extrapolation of the good practice in the education sector to other sectors.

The major challenges that confront local governments after decentralization are discussed next. As mentioned, all local governments are required to produce planning documents such as Polda,



**FIGURE 1 New Local Planning and Budgeting Calendars**



SE MOHA No.050/987/SJ keeps silence on the timings of Rakorbang Province and Rakorbang National.

Propeda, Renstrada, and Repetada. Although, in principle, all these documents should be prepared in a consistent manner to realize the development goals revealed in the Poldas, in practice they often lack mutual consistency. Some local governments produce only the Renstrada without the Poldas and Propeda, because the Renstrada is

a political document, i.e., the performance of local head can be evaluated on the basis of the Renstrada at the end of his/her term of office. Even in regions that have the complete suite of planning documents, they may contain 'cut-and-paste' type descriptions of each other. In particular, it is not always easy to find differences between the Propeda and Renstrada. In principle, the Renstrada needs to provide a short list of program and project activities for each sector identified in the Propeda. However, the vagueness of development goals in the Propeda has led to very wide interpretations by local executives and legislatures in preparing the Renstrada. This has resulted in failure to set up clear priorities, timetables and institutional responsibilities for implementation. Government regulations (PP No. 108/2000 and PP No. 106/2000) stipulate that the Renstrada targets development activities funded only by local budgets (APBD), whereas the Propeda covers overall activities funded from all sources including off-budget revenues such as central line ministries' budgets or DIPs. This means that, under the current arrangement, local development plans are fragmented according to funding sources, which makes it difficult to establish a direct link between the two plans. Further, it is difficult to assess overall performance of local heads, because they are responsible only for development activities funded by local budgets. In our case studies, local government officials repeatedly raised this issue as a major fault in the current requirements of the Renstrada.

One of the key elements introduced with decentralization is a performance based strategic planning approach. Local governments are required to prepare clear indicative targets, detailed costed plans, and their fiscal perspectives for planning activities. Although we found in Kabupaten Bandung, the Renstrada containing indicative targets to be achieved at the end of the plan for each sector, most local governments have not yet produced indicative targets, and, even where there are targets, they remain qualitative, rather than quantitative. Reliance on qualitative targets creates difficulty in the evaluation of performance of development activities.

Before decentralization, local governments had been discouraged from building their own planning information system. Indeed, there was little need to have it, because local development activities were

dominated by centrally prioritized projects, and financial resources were provided from central budgets. As a result, capacity building for planning and budgeting officials was absent. A lack of qualified officials now makes it difficult to establish much needed development information system. Consequently, local development plans tend to remain only 'wish list'.

There is a need to refer to the unclear roles of Kecamatan in the planning process. At all levels of government, there is separation of power between the executives and legislatures. However, there is no legislative institution at the Kecamatan level. Camat and their staff are all local government employees, and their posts regularly rotate. These officials worked for technical bureaus of local government before filling their Kecamatan posts, and will return to technical bureaus after finishing their services at the Kecamatan. However, in the planning system, UDKP is granted the same status as other coordinating meetings. One of UDKP's roles is to filter out proposals from the village level before they go to Rakorbang Kabupaten/Kota. If the Government needs to maintain UDKP, the authority of the Camat needs to be strengthened to guarantee that it can act independently of its position as a local government employee to absorb village needs and aspirations. However, this will be difficult because the job position (echelon) of Camat is below that of heads of local technical bureaus<sup>2</sup>.

In some regions, local legislators openly argue that they are representatives of constituents and, hence, there is no need to foster community participation. In their logic, all of the people's demands can be incorporated into local development plans and budgets through their discussions at DPRD. However, there seems to be a general feeling among people that legislators do not represent them because voting is for registered political parties and not for DPRD members. This has been the practice under the current system which may also be the case at central level. The proposal for reforming the local election system, by MOHA in 2002, is a reflection of this concern.

### **3. Local Budgeting Processes and Implementation**

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<sup>2</sup> Echelon position of Camats is III/B, while that of local technical bureaus heads (Kepala Dinas/Bagian) is II/B.

Local governments have long followed a MOHA manual (Regional Financial Administration Manual 1980), which regulates budget preparation, treasury administration, accounting, and reporting. In addition, MOHA annually provides budget guidelines to local governments for the coming fiscal year. Under decentralization, there have been no clear guidelines for local budgeting and financial management; however, decentralization laws do require local governments to prepare their own financial management systems. In July 2002, MOHA released a Ministerial Decree (Kepmen No. 29/2002) requiring local governments to adopt performance budgeting. The decree outlines the required structure of regional budgets, budget preparation and approval processes. It includes directives on the budgeting calendar, budget revisions, financial management, accounting principles, and reporting and accountability issues. A major change introduced is the switch from the tradition that distinguishes between routine and development budgets, to a unified budget with double-entry accounting.

Because of the delayed release of the new guideline, many regions still use the old budget formats and follow old budgeting practices. Over the period of July to September, each technical bureau formulates a budget team (Tim Anggaran) and draws up its budget for both routine and development expenses. These proposals are submitted to an executive budget team (Komite Anggaran), which usually comprise the Secretary of the Region (Sekwilda), Finance Bureau (Bagian Keuangan), Planning Agency (Bappeda), Revenue Office (Dispenda) and chiefs of spending units. Traditionally, the Bagian Keuangan (for routine budget) and the Bappeda (for development budget) dominated this process. Simultaneously, the Dispenda prepares revenue forecasts. In October, the team starts reviewing the revenue estimates and budget proposals from each unit to finalize local budget proposals. In the process, a couple of bilateral meetings are held by the team with spending units to discuss details of their proposals. In theory, local demands are incorporated into the budget proposal on the basis of discussion at the Rakorbang Kabupaten/Kota, held in parallel with the budgeting process.

Once the final budget proposal is approved by the

Bupati/Walikota, it is submitted to DPRD, as annual budget proposal (RAPBD), in October or November. The DPRD budget team (Komisi C) leads discussions and is authorized to make amendments to the proposal. Before decentralization, amendments were generally minimal, because Komisi C members were already involved at the RAPBD preparation stage. The approved budget (APBD) serves as a ceiling on expenditures for the fiscal year. On the basis of the APBD, Bagian Keuangan as well as all spending units start preparing budget documents, for both routine and development expenses, for the purpose of funds allocation. Then, the APBD moves to its implementation stage.

In principle, budgeting is the most effective tool to realize the local needs, priorities, and preferences, established in local development plans. In theory, the annual budget should be based on the Repetada which reflects the key strategies of the Renstrada. In reality, there is often no strong linkage between the plans, which results in another weak linkage between budget allocations and development plans. There is a possibility that the present annual consultation exercise may worsen this problem. As mentioned, the coordination meetings are held annually at all levels of government, with discussions being dominated by issues of development strategy and budget for the coming fiscal year. The annual nature of consultation tends to make local planning and budgeting shortsighted. Local budgets tend to be prepared in each year on the basis of fund availability, even though medium-term strategic planning and performance budgeting theoretically become the new practices with decentralization. Project selection is based mainly on ad hoc factors (results of the Rakorbang Kabupaten/Kota and bilateral negotiations within local governments) rather than medium-term development priorities. Further, they fail to take into account the effect on subsequent years' expenditures that result from current year projects. The Government may wish to consider the possibility of shifting from the current annual system to a medium-term consultation system or, even better, if it could adopt both simultaneously.

In our case studies, numerous complaints about DPRD intervention were raised by local officials, who had tried to maintain consistency of budget allocation with strategic priorities. Evidently, DPRD

members often intervened for the sake of their own interests, disregarding priorities set in the Repetada and Renstrada. An additional problem in defining development goals has been their vagueness in planning documents leading to different interpretations by DPRD members in their discussions on RAPBD.

**TABLE 1 Aggregated Regional Budgets  
(Rp trillion)**

	FY2000 <sup>1</sup>				FY2001			
	Provinces (%)		Local Governments (%)		Provinces (%)		Local Governments (%)	
Revenues	13.0	100.0	39.7	100.0	29.4	100.0	79.5	100.0
Previous Year's Surplus	1.2	9.1	1.8	4.4	4.1	13.8	2.2	2.7
Region's Own Revenues	4.0	30.4	3.6	9.1	10.1	34.5	5.2	6.6
Central Transfers	7.8	60.2	33.3	84.0	14.2	48.2	68.8	86.6
Revenue Sharing	1.7	13.1	4.5	11.2	7.5	25.5	14.0	17.6
DAU <sup>2</sup>	6.1	47.1	28.4	71.6	6.5	22.1	54.0	67.9
DAK <sup>3</sup>	0.0	0.0	0.5	1.2	0.2	0.5	0.8	1.1
Local Borrowing	0.0	0.2	1.0	2.5	0.0	0.0	0.5	0.6
Others	0.0	0.0	0.0	0.0	1.0	3.5	2.8	3.5
Expenditures	11.6	100.0	37.7	100.0	23.1	100.0	69.6	100.0
Routine Expenditure	5.9	51.0	25.1	66.7	14.7	63.7	48.3	69.3
Development Expenditure	5.7	49.0	12.5	33.3	8.4	36.3	21.4	30.7
Balances(% to total revenues)	1.3	10.4	2.0	5.0	6.3	21.4	9.8	12.4

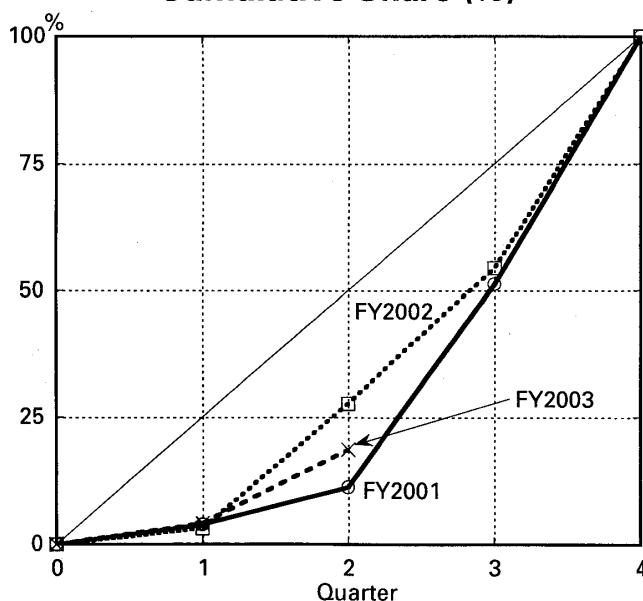
<sup>1</sup> annualized. <sup>2</sup> SDO plus INPRES for FY2000. <sup>3</sup> Specific purpose INPRES for FY2000.

Source: Ministry of Finance.

Uncertainty about the level of central transfers, which still form the bulk of local revenues, remains a problem. Even after decentralization, local governments rely on transfers from the central government for over 80% of their revenues. In discussing budget proposals, Komite Anggaran reviews revenue forecasts before assessment of expenditure proposals. However, in the last three years, the announcement of central transfers has been delayed because of the late approval of the APBN. For example, in Kabupaten Lombok Tengah, APBD for FY2003 was approved by DPRD in late March

2003, three months after the fiscal year started, because APBN was passed by the people's representative council (DPR) in early December 2002. Late budget approval makes it difficult for local governments to formulate APBDs with reliable information on their fund availabilities, and further risks inefficient resource management through delays in program and project implementation. This problem is exacerbated by delayed disbursements of central transfers, particularly shared revenues from natural resources, during the budget implementation stage. In FY2001, shared revenues from natural resources were disbursed to regions at a very late stage and, according to local officials, were delivered after the end of the fiscal year. As a result, many regions were forced to carry over most of their received revenues into the following fiscal year.

**FIGURE 2 Quarterly Disbursements of Sharing Revenues:  
Cumulative Share (%)**



Source: Ministry of Finance.

Local governments are facing extreme difficulty in obtaining information on DIP budgets, or 'deconcentration' funds. Because deconcentration funds are not included in APBD and are distributed directly to local technical bureaus via the provinces, even the Bappeda, which takes primary responsibility for local development

planning and development budget preparation, cannot easily obtain the information. In the case of Kabupaten Lombok Tengah, the Bappeda contacts all technical bureaus and the provincial Bappeda to obtain information. However, the required information cannot be obtained even after the DPRD approved the APBD.

Local governments have long adopted the 'target system' in their local revenue administration, where a certain target was set for each revenue item and the Dispenda, which is responsible for all local revenues, collected them. Even after decentralization, many local governments still use this practice. The revenue targets are generally based on the previous year's achievements, which have nothing to do with actual revenue potentials. For example, in Lombok Tengah, Dispenda officials acknowledged that their revenue projections are prepared on the basis of the previous year's achievements, and by taking into account an inflation factor (usually at 10 %). This target system also has a negative impact on local revenue mobilization because there is no incentive for Dispenda officials to collect revenues over the targets because larger revenues imply higher targets in the next fiscal year. The same problem can be found on the expenditure side. Major routine expenditure items such as utilities, supplies and rents are estimated from current prices plus an inflation factor. To improve budgeting efficiency, the Dispenda needs to submit local revenue projections for budget preparations.

In considering the implementation of performance budgeting, local governments need to fully recognize their obligatory functions (Kewenangan Wajib or KW) and their minimum service standards (Standar Pelayanan Minimal or SPM) that they need to achieve. Quantitative, not qualitative, indicative targets need to be based on SPMs. Furthermore, carefully estimated unit costs for each SPM must be utilized to cost up each project. However, Indonesia's decentralization was initiated without clear expenditure assignments<sup>3</sup>. Local governments' expenditure responsibility has been only vaguely defined, which causes considerable confusion

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<sup>3</sup> Decentralization laws and regulations define roles of regional governments only in general terms: local governments take primary responsibilities for public works, health, education, agriculture, communication, industry and trade, investment, environment, land matters, cooperatives, and human resources, while provincial governments play coordinating roles.



about the demarcation of authority between the different levels of government (Alm, Aten and Bahl 2001 and World Bank 2003). Accordingly, the KWs and SPMs have not yet been established. Even if local governments adopt their new responsibilities, they are not easily reflected in their budgets, because the SPMs are still not available, much less unit costs. In our case study areas, both governments still utilize unit costing based on the previous year's budget adjusted for inflation.

**TABLE 2 Regional Governments Adopted New Budget Format**

	Total	of which, submitted APBD FY2003		
		Total	New Format	%
Provincial Governments	30	28	14	50.0
Local Governments	348	309	185	59.9
Total	378	337	199	59.1

*Source:* Ministry of Finance.

Kepmen No. 29/2002 makes three key recommendations for local budgeting: 1) change from the traditional routine and development budget approach to a program-based approach (unified budgeting); 2) change to a new budget structure consisting of revenue, expenditure, and financing components; and 3) include clearer budget estimates based on line item budgeting. All these elements are highly required to redress the problems involved in the old, but still dominant budgeting practice. However, there is now growing concern about the timetable for implementation, because the decree stipulates that the new budget systems can be the basis for budget preparation starting in FY2003. According to the Ministry of Finance (MOF), about 60% of local governments reported that they have adopted the new budget format in FY2003. However, this does not necessarily mean that those governments have shifted to performance-based budgeting, because most governments have not yet prepared quantitative targets which are indispensable requisites.

#### **4. The Need for Horizontal and Vertical Linkages**

After decentralization, almost all public attention goes towards civil society engagement through bottom-up mechanisms. Major donor

agencies have provided broad support for capacity building in local level participatory planning and budgeting. Although it is beyond dispute that Indonesia needs to establish bottom-up mechanisms, reform of the top-down process has received very little attention. An inevitable reaction against the abiding centralized authoritarian regime is the profound aversion by local people to control by higher levels of government, particularly by the central government. Policy makers at the center also seem to be hesitant in advocating reform of central intervention, even they realize its importance for managing the country.

Although national and provincial development plans should be based on an agreement with local governments (PP No. 25/2000), local development plans do not necessarily fully reflect the basic ideas and strategies of higher levels of government. Decentralization, by its nature, gives the highest priority to local governments to respond to local demands. At the same time, local development plans need to be consistent with those of provincial and central governments. However, even with decentralization fully in place, some elements of top-down intervention are needed to ensure the priorities of higher levels of government are considered at the local level. The challenge is to integrate key elements of national and provincial development plans with local plans.

Before decentralization, center-funded projects were managed by central line ministries through their local branches (Kanwil and Kandep). Local governments sometimes did not know anything about the projects even the projects were implemented in their areas. In such a situation, local project ownership was weak, which affect project sustainability (Devas 1989). Moreover, the New Order's centralistic and uniform approach to local development activities deeply discouraged local initiative and responsibility. Direct control through central line ministry budgets is no longer appropriate instrument in decentralized Indonesia. The central government now has available three policy instruments to foster the linkage between national and local development plans and budgets: 1) consultation at development coordination meetings; 2) development budgets of central line ministries (DIP) or deconcentration funds; and 3) matching or earmarked grants, called DAK. The first two instruments are

closely related, because it is the development coordination meeting process that determines allocation from central development budgets to regions.

In theory, there are two basic objectives in giving matching grants: 1) internalizing spill-over effects across regions; and 2) financing nationally prioritized projects in regions. Projects to achieve SPMs in regions can be included in the second category. DAK can be a powerful policy tool to foster the linkage between central and local development plans and budgets. Matching funds play a major role in the intergovernmental fiscal relations in many decentralized countries. The Government needs to realize that DAK is a key instrument for exerting influences at the local level. Based on bitter experiences, many local governments in Indonesia may feel that even DAK-funded projects are centralistic and not different from DIP projects. However, through the DAK mechanism, the Government can improve local project ownership, because the initiatives and part of the funding have emanated from local governments (PP No. 104/2000).

During the first two years of decentralization, the use of DAK has been limited for reforestation activities. A major reason is the difficult budget position of the central government after the economic crisis. Nevertheless, it must be noted that budgets of central line ministries (DIP) still contain funds for some decentralized functions. Some observers point out that central development budgets for FY2002 still hold as much as Rp. 10-20 trillion to finance the devolution of functions to regions, even though the fiscal decentralization law (UU No. 25/1999) stipulates that all decentralized functions must be financed and managed through local government budgets (Hofman and Kaiser 2002). The implication is that the Government still possesses enough fiscal resources for DAK. A possible justification of the large DIP budget after decentralization is to avoid public service delivery disruptions at the local level, because many local governments lack sufficient capacity to carry out the newly devolved functions. At the same time, the large DIP budgets post-decentralization reflect central line ministries' unwillingness to relinquish their control over development funds to regions. The Government should gradually phase out the DIP mechanism and shift available funds to

DAK.

In FY2003 central budget, the Government allocated about Rp. 2.3 trillion for non-reforestation DAK projects, including education, health, and infrastructure (road and irrigation). It was the first test of the use of the DAK channel for non-reforestation projects after

**TABLE 3 Central Budgets and DAK  
(Rp trillion)**

	FY2001	FY2002	FY2003	Targets of DAK Projects
Revenues	263.2	301.9	336.2	
Expenditures	315.8	344.0	370.6	
Central Government	234.1	246.0	253.7	
Routine Expenditures	190.2	193.7	188.6	
Development Expenditures (DIP)	44.0	52.3	65.1	
Transfers to Regions	81.7	98.0	116.9	
Balanced Funds	81.7	94.5	107.5	
Revenue Sharing	20.3	24.6	27.9	
DAU	60.5	69.1	77.0	
<b>DAK</b>	0.7	0.8	2.6	
Reforestation	0.7	0.8	0.3	
Non-Reforestation	--	--	2.3	
Education	--	--	0.6	rehabilitation of primary school buildings
Health	--	--	0.4	rehabilitation of rural clinics and local hospitals
Infrastructure	--	--	1.2	
Road	--	--	0.8	provincial and local roads
Irrigation	--	--	0.3	operation, maintenance, and rehabilitation
Others	--	--	0.1	office buildings for new local governments
Special Autonomy & Balancing Funds	0.0	3.4	9.4	

Source: Ministry of Finance.

decentralization. Although PP No. 104/2000 stipulates that DAK allocation must be based on proposals from local governments, the allocation sectors and project details of the DAK funded projects

were, in fact, determined by the central government. There were two critical issues in determining DAK allocations among regions: 1) identification of eligible local governments; and 2) matching rate setting. To clarify the deficiencies in the current DAK allocation procedure, we review these two issues.

There were two steps in the screening process of eligible local governments for DAK. First, the Government ranked all local governments according to fiscal capacity. Fiscal capacity was defined as total revenues in the local budget, excluding the surplus from previous year, minus personnel expenditures. A fiscal capacity index (FCI) was calculated as a ratio of fiscal capacity to the national average. A cut-off line was set at  $FCI < 1$ , which resulted in the poorer 238 local governments being eligible for DAK allocation. Second, the National Development Planning Agency (Bappenas), in coordination with three line ministries (education, health, and public works), reviewed sectoral indicators to check the eligibility of local governments. However, sectoral indicators were mainly used to determine allocation amounts, not for the eligibility test, because all local governments that survived the fiscal capacity screening could receive DAK allocations for the education, health, and road sectors (excluding irrigation). In practice, the Government first determined a minimum allocation, or lump-sum allocation, to all eligible governments, and, the remaining DAK funds were subsequently allocated on the basis of formulas established by sectoral indicators. Only for irrigation projects was DAK funding allocated solely on a formula.

Since DAK is a matching grant, it is required to set a matching rate for each type of project. PP No. 104/2000 stipulates that a minimum of 10 % of the project cost should be financed by local government. In general, the matching rate can be determined based on two key factors: 1) differences in fiscal capacities across local governments; and 2) differences in financial return of projects, i.e., profitable infrastructure projects or non-profitable social sector projects. Local governments with higher fiscal capacities can bear higher burdens in their counterpart funding provisions. Lower matching rates can be applied to non-profitable projects. However, mainly because of the tight schedule in finalizing the FY2003 budget, the

**TABLE 4 FY2003 DAK Allocation Concept**

Rank in FCI		Education		Health		Road		Irrigation
		MA	FA	MA	FA	MA	FA	FA
1	Local Government A (poorest)	X	X	X	X	X	X	--
2	Local Government B	X	X	X	X	X	X	--
3	Local Government C	X	X	X	X	X	X	X
4	S	X	X	X	X	X	X	--
		X	X	X	X	X	X	--
		X	X	X	X	X	X	X
<b>238</b>		X	X	X	X	X	X	--
239								

Not eligible (FCI&gt;1)

370

X: eligible, --: not eligible.

MA: Minimum Allocation (Lump-sum), FA: Formula Based Allocation (technical indicators).

Government failed to prepare clear matching rates for all sectors. Consequently, in FY2003, the matching rate of 10 %, the minimum requirement in the law, was applied to all (eligible) local governments and to all types of projects, irrespective of the differences in fiscal capacities and financial profitabilities of projects.

In FY2003 DAK allocation procedures show a lack of understanding of the chief objective of matching grants by the Government. DAK seems to merely supplement the equalizing performance of block or discretionary grants (DAU) through its lump-sum allocations across all relatively poor regions. It is well recognized that the current DAU allocation method fails to attain the expected equalizing impact because of various weaknesses in its allocation formula and political interventions in some regions (Lewis 2002 and Usui 2003) . Its poor equalization performance should be resolved by revising the DAU allocation procedure itself and not by allocations from DAK. A key challenge for decentralized Indonesia is its lack of effective policy instruments to inculcate national priorities at the local level. The traditional consultation process at development coordination meetings fails to make an impact on local development plans and budgets. It is emphasized here that DIP is no longer an appropriate tool to

control local governments. Policy makers need to reconsider the chief objective of DAK and establish an effective DAK allocation scheme, given that DAK may be the only available and effective instrument to establish vertical integration of development plans and budgets.

Indonesia's decentralization process has resulted in a tenuous relationship between local governments and provinces. The FY2001 decentralization policy built a direct relationship between the central and local governments, while provinces were assigned coordinating roles. In practice, local development plans refer to the national development plans, particularly the Propenas, however, they rarely mention provincial plans. In some regions, local government officials do not even participate in meetings arranged by provinces. In the case of horizontal coordination, it is recognized that there are some local initiatives fostering cooperation with neighboring local governments to internalize spill-over effects in local service deliveries. For example, the Kabupaten Bandung invites representatives from adjacent local governments to its Rakorbang meeting to secure coordination in local planning and budgeting. In another example, in Lombok Tengah, heads of local technical bureaus proposed a regular meeting with their counterparts in neighboring local governments to elicit inter-regional cooperation. However, they report that this coordination needs the involvement of provincial technical bureaus. The Government is currently working on revising the UU No.22/1999 so that coordinating roles of the provinces are strengthened. It is strongly recommended here that the revision should enable a more active role of provinces in institutionalizing the horizontal linkages in local development plans and budgets. The Government may also wish to utilize existing regional government associations (Apsi, Apkasi, and Apeksi) to foster inter-regional cooperation. In addition, provincial governments may wish to utilize the newly introduced provincial tax-sharing scheme to link their development plans and budgets with local ones. In the new local tax

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<sup>4</sup> Major challenges of the current DAU allocation method are: 1) conceptual and design weaknesses of fiscal capacity and expenditure needs specifications in the allocation formula; 2) unequalizing effects of non-formula allocations, in particular balancing factor allocations; 3) inappropriate sharing arrangement between provinces and local governments; and 4) prohibition of non-negative transfers. For details, see Usui 2003.

law (UU No. 34/2000), provincial tax revenues from motorized vehicles, change of title on motorized vehicles, motor vehicle fuel, and the use of underground water, need to be shared with local governments. A vital point is that provincial governments are authorized to set up sharing arrangements and can assert their indirect influence over local governments by incorporating provincial priorities into sharing arrangements.

### **5. Concluding Remarks**

This paper analyzes the first three years experience of Indonesia's decentralized local development planning and budgeting system. The analytical focus is on the balance between top-down and bottom-up approaches. With the implementation of decentralization, the balance has theoretically shifted to a bottom-up approach in local planning and budgeting. Even in the decentralized state structure, however, a top-down element remains necessary for effective linkage between development plans and budgets at all levels of government. It is very important for policy makers to recognize that the key challenge is on how to attain the right balance between the bottom-up and top-down elements. The key findings of this paper can be summarized as follows.

Stakeholder participation, particularly community participation, has intensified after decentralization mainly because of village government reform, which has provided better opportunities for villagers to voice their needs and take control of village decisions. Local governments also introduced several innovations. The new guidelines for participatory planning have accelerated stakeholder participation since FY2003. However, it is very important to institutionalize participatory procedures through building stakeholder participation into local government structures. An effective example of how the performance and accountability of local public services can be strengthened is stakeholder participation through the establishment of Education Boards at the district level and School Committees at the school level.

In parallel with supporting community engagement, the Government needs to find a more effective mechanism to link local development plans and budgets with central development objec-



tives. The current consultation-based coordination system and direct control through central line ministry budgets are no longer effective instruments within a decentralized state structure. It is concluded that DAK is the most suitable tool to inculcate national priorities and to internalize spill-over effects in local development plans and budgets. A major role of DAK, as a matching grant system, lies in its function of guiding local development strategies and budgets towards national priorities, without unnecessary interventions into local government affairs. Horizontal fiscal balance should be resolved through appropriate allocations of DAU. DAK should not be utilized to supplement the DAU's equalizing effect. Further, it is concluded that DAK is the most appropriate channel for donor resources to regions. At the same time, coordination with neighboring local governments also needs to be fostered to internalize spill-over effects across regions in local service deliveries. The Government needs to strengthen the roles of provincial governments to set up systematic horizontal coordination mechanisms, given that it is clearly stipulated in Indonesia's laws and regulations that the particular mission of provincial government after decentralization lies in its coordinating role.

Strategic multi-period planning and performance budgeting are, in principle, inseparably linked. Local needs and preferences can be realized through effective fiscal resource allocations in response to established priorities based on people's aspirations. Development plans and budgets should be kept under constant review, and adjusted to economic and political realities. Although about 60% of local governments have adopted the new budget format since FY2003, this does not imply those governments have successfully shifted to performance-based budgeting. In fact, local governments are still facing difficulties in establishing local priorities. Linkages between development plans remain weak, much less linkages between development plans and budgets. Major contributing factors include: 1) delayed release of new guidelines for local financial managements; 2) vague expenditure assignments (and the resultant lack of KWs and SPMs); and 3) lack of qualified local planning and budgeting officials.

In particular, we found extreme weaknesses in the capacities of

local planning and budgeting personnel. Most local government personnel are still in the rut of the center-inspired planning and budgeting practice, and they have little or no, experience of conducting strategic planning and performance budgeting. Limited capacity building support is available from the central government. Training initiatives need to come from local governments themselves, although strong central and provincial governments' initiatives in the provision of coordinated support to local governments are urgently needed. This is especially so for the requirement that local governments adopt new budgeting and financial management systems. Again, we emphasize that sufficient human capacity is vital for successful decentralization.

Indonesia's decentralization program was initiated to accommodate the enormous difficulties in maintaining national unity. As a result, decentralization policy was embarked upon without a clear consensus on the state structure or system required to guide the basic design of decentralization policy (Asanuma and Bambang Brodjonegoro 2003). The missing links we found in local development planning and budgeting are rooted in this lack of consensus among policy makers, as are other major challenges overshadowing Indonesia's decentralization. The first three year's experience shows that the Government needs to step back at this stage and try to build a clear vision of decentralized Indonesia in order to supply the missing links. Decentralization, by its nature, must be a long process, and the expected goals will only achieved after a long process of trial and error. It should, therefore, come as no surprise that Indonesia's drastic program has some shortcomings at its initial stage. Nevertheless, it is the role of the responsible government to pursue a consistent decentralization policy with a clear vision and a carefully thought-out strategy.

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