

The Importance Of Good Corporate Governance In Order To Enhance Economic Efficiency On A Decentralized Government

The importance of economic efficiency is clearly stated as a key to enhance welfare. It is noted that economic efficiency in a country is an important effect to the national income, because economic efficiency involves efficient producing, efficient usage of resources (human and natural), and efficient governance, so national income will rise due to the effective process of its components. Development and growth will be easy to achieve once economic efficiency is achieved.

Economic Efficiency depended heavily on the market mechanism; this is why the government factor, as a policy maker of a country, is a very important factor in enhancing economic efficiency.

For the past decade the world is aware of the significant importance in the role of the private sector in economic development and job creation, awareness of the importance of private corporations for the welfare of individuals has increased (market-based approaches to the economy). Corporation creates jobs, generates tax income, produce a wide array of goods and services at reasonable prices. Growing reliance world wide for the private sector has made corporate governance an important matter.

Since the Asian crisis of 1997, it is clear that a healthy development and growth of a country has to have a healthy government management, or else the development and growth would be vulnerable. This is proved by the Asian countries (East Asian Miracles), which has tremendous development and growth, but collapse instantly on a single crisis and is still struggling to survive, especially on facing globalization. Good corporate governance includes good government

management on the production sector (environment and efficiency), and also transparency in implementing the process.

Since decentralization became a popular issue worldwide, tales of implementing decentralization in various countries has triggered several conclusions and opinions on decentralization to emerge. Because it is a process that is inseparable with the governmental system, we cannot avoid the issue of decentralization in the corporate governance matter, especially when it comes to good government management. A decentralized government system will have a more complex authority allocation; that's why the variety of different sub-national government resources will make the process of decentralization more complicated financially and administratively. Although decentralization is said to be the key to eliminating political power concentration, in this case on a centralized government system that usually stimulates corruption and bad corporate governmental system, we cannot always assume that all decentralization will succeed implemented in any country; a difference in political, economical, and social tradition of a country will affect the result of decentralization. A successful decentralization will improve efficiency and responsiveness of the public sector while accommodating potentially explosive political forces, while an unsuccessful will threaten economic and political stability and disrupts the delivery of public services³. So decentralization is a matter that needs to be highly considered in enhancing corporate governance and economic efficiency and needs to be carefully revised especially on the decentralization process it self.

Indonesia is now on the process of implementing decentralization, through legislation No. 25 1999 Indonesia is on the process of decentralization on several governmental functions, although it is now on its third year implementation, many problems still occur moreover the result has not yet been

experienced by the Indonesian society, especially in the improvements of public service delivery in sub-national areas. This particular phenomena needs to be given extra attention from the Indonesian government. As stated above, the success of decentralization is a very crucial matter; therefore revision of the decentralization process in Indonesia needs to be done immediately.

Decentralization

Decentralization it self has a general meaning, according to the World Bank, decentralization is the transfer of authority and responsibility for public functions from the central government to intermediate and local government or quasi-independent government organizations and the private sector. There are many types of decentralization, they are⁴:

1. Political decentralization

Political decentralization aims to give citizens or their elected representatives more power in public decision-making. This concept implies that the selection or representatives from local electoral allow citizens to know better their political representatives and allow the elected officials to know better the needs and desires of their constituents.

2. Administrative decentralization

Administrative decentralization is the transfer of responsibility for the planning, financing and management of certain public functions from the central government and its agencies to field units of government agencies, subordinate units or level of government, semi-autonomous public authorities or corporations, or area wide, regional or functional authority. It redistributes authority, responsibility, and financial resource for providing public service among different levels of government.

3. Fiscal decentralization

Fiscal decentralization relates to the financial responsibility. This type of

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decentralization can function effectively only if the local governments and private organizations have an adequate level of revenue – either raised locally or transferred from central government - and the authority to make decisions about expenditure.

4. Economic or Market decentralization

In economic or market decentralization, the government shift responsibility for functions from the public to private sector, that is through privatization and deregulation.

Much of the decentralization that has taken place in many countries has been motivated by political concern, as an essential part of the democratization process. In some cases (particularly in East Asia), decentralization is motivated by the need to improve public service delivery (for examples: health, education, etc.) to large populations and the recognition of the limitations of central government. The political objectives of decentralization are to increase political responsiveness, participation at the local level, and mainly to maintain the political stability, while the economic objectives are to have better decisions about the use of public resources and to increase the willingness to pay for local services. Decentralization affects political stability, public service performance, equity, and macroeconomic stability; and it has both advantages and disadvantages.

The potential advantages of decentralization, especially if it works effectively, are:

1. Improving governance and public service delivery by increasing allocative efficiency - through better matching of public services to local preferences, and productive efficiency - through increased accountability of local governments to citizens, fewer levels of bureaucracy, and better knowledge of local cost
2. Increasing political stability and national unit by allowing citizen to have better control public programs at the local level.

While the potential disadvantages of decentralization are⁵:

1. The loss of economies of scale and control over scarce financial resources by the central government
2. In some areas of the country, services is delivered less efficiently and effectively because of weak administrative or technical capacity at local level government
3. Difficult to make equitable distribution and provision of services, because of inadequate financial resource
4. Make the coordination of national policies become more complex. Distrust between public and private sector may undermine cooperation at the local level

Appropriate balance of centralization and decentralization is important and essential to the effective and efficient functioning of government. Not all of functions can be financed or managed through decentralization. The central government is still need to have supervisory roles and retain important policy. The design of decentralization and institutional arrangements governing its implementation are the key factors in determining the success of decentralization. Decentralization can promote allocative efficiency and productive efficiency only if the devolution of functions occurs within an institutional environment that provide political, administrative, and financial authority to local governments, along with effective channels of local accountability and central oversight. The poorly design decentralization policies can create incentives for sub-national governments to spend irresponsibility and unsustainably.

In reality, decentralization is still inconclusive. Whether decentralization increase or decrease social welfare and efficiency is still on debate and unresolved. The empirical results of decentralization study are mixed. Study by Rondinelli, et.al. (1984), reports that in Indonesia, Morocco, Thailand, and Pakistan showed small improvements in

resource distribution, local participation, the extension of public services in rural areas, project identification and implementation, and employment generation after implementing decentralization in the public sector. Another study found that decentralizing service delivery offers benefits, but these benefits have not always appeared. Some factors that make decentralization in public service not achieve its efficiency goals are: local government has limited authority, citizen influences at local level have limited information, and local governments have weak capacity.

There are at least five conditions that are important for the successfulness of the decentralization⁶.

1. The decentralization framework must link local financing and fiscal authority to the service provision responsibilities and functions of the local government
2. The local community must be informed about the costs of services and service delivery options involved and the resource envelope and its source
3. There must be a mechanism by which the community can express its preferences in a way that is binding on the politicians, as a credible incentives for people to participate
4. There must be a system of accountability that relies on public and transparent information that enables community to monitor the performance of the local government effectively and react appropriately to that performance
5. The instruments of decentralization (i.e. legal and institutional framework constitutional, the structure of service delivery responsibilities, and the intergovernmental fiscal system) are designed to support the political objectives

ECONOMIC EFFICIENCY

Economic efficiency has value as its criterion, so a change that increases value is an efficient change and a change that

decreases value is an inefficient change.

Economic efficiency is an interesting matter; this is caused by two reasons⁷:

1. Positive reason; based on the observation that people search for value. The search for value is the driving force of market economies
2. Normative reason; a desire to make policy recommendations, predictions and comparison can be made about certain policies to certain situations.

There are 3 conditions needed for an economy to be efficient; that are⁸:

1. Production efficiency; an economy is economically efficient when it is on its production-possibilities frontier (PPF), any position above the PPF will imply that more can be produced with the given resources, and greater production will increase value, so it is efficient (every production on the PPF is production efficient). On the contrary producing below the PPF is inefficient to be on the PPF requires the use of all resources.
2. Exchange efficiency; exist when there are no possible mutual advantageous trades. Trade that benefit one transaction without harming the other will make it possible for improvements; then the original situation is economically inefficient. Trade would increase value that people receive, and thus will increase economic efficiency.
3. Product-Mix efficiency; trading with nature must have the same price as trading with people. An economy is on the PPF, thus more of one specific good can be produced only by shifting resources and thus producing less of another good.

GOVERNMENT AND ECONOMIC EFFICIENCY

In modern economies there is a general presumption that markets are the most efficient mechanism for allocating resources and the most affective mechanism for creating and increasing national income.

The concept of economic efficiency

requires balance between economic growth and the prudent management of resources, improving opportunities and social outcomes.

Market mechanism does not always succeed in overcoming economic problems, this is where the governments are involved, this rests on two arguments⁹:

1. That there are market failures which result in economic inefficiencies and which can be corrected or overcome through government intervention.
 2. That there are distributional considerations, which justifies government intervention irrespective of the efficiency or otherwise of market processes.
- Market failure is likely to be associated with 4 broad types of phenomenon that are¹⁰:
1. Public goods; have two defining features, not excludable (those that do not pay for a public good cannot be excluded from benefiting from it), and non-rival (each person consuming the public good does not diminish the ability of others to also consume that good).
 2. Externalities; are the external costs and benefits from an activity that are not reflected in the private costs and benefits experienced by the participants in that activity. Markets will only work efficiently if producers and consumers bear the full costs of their production and consumption decisions and are fully rewarded for the benefits arising from their production and consumption.
 3. Imperfect information; where one or more parties to a transaction are unaware of the full costs or benefits of their activities. Decisions without key relevant information may have large and potentially permanent adverse effects.
 4. Structural economic adjustment; may impose excessive economic, social, and other costs. The market adjustment process may be slow because of imperfections in the labor, capital, and product markets, speed of the market the

market adjustment process is important as delay may impose additional economic and social costs.

Distributional and equity objectives concerns about economic efficiency, and has 2 broad dimensions, at one level, they are about equity, or perceptions of equity, at another level, they are about the poverty and social exclusion of deprived people. Rural areas suffer disadvantage because of low incomes, poor housing, lack of access to services, and the absence of employment opportunities. Economic efficiency is not independent of distributional outcome. Structural economic adjustment exacerbates problems of poverty and social exclusion; this may threaten the efficient functioning of markets and local economies.

In reaching a decision on intervention, an analysis of government failure as well as market failure is crucial in coming to the direction of the policy.

THE LINK BETWEEN GOOD CORPORATE GOVERNANCE -ECONOMIC EFFICIENCY – DECENTRALIZED GOVERNMENT

Corporate governance refers to the private and public institutions, including laws, regulations and accepted business practices, which together govern the relationship, in a market economy, between corporate managers and entrepreneurs also those who invested resources in corporations.

The institutions of corporate governance serve two objectives; that are¹¹:

1. Enhance the performance of corporations; by facilitating and stimulating the performance of corporations (principle generators of economic wealth and growth in society) by creating and maintaining a business environment that motivates managers and entrepreneurs to maximize firm's operational efficiency, returns on investment and productivity growth.
2. Ensure corporate conformance; by limiting the abuse power, the siphoning-off of assets, moral hazard, and the significant

wastage of corporate.

Enhanced corporate governance can not only improve the allocation of real investment resources but also reduce the wastage of these resources, thus good corporate governance will enhance economic efficiency.

Corporate governance matters for development, as stated above, that an important factor in achieving economic efficiency is the importance of productivity growth, thus growth of private corporations. Good corporate governance helps to assure that corporations use their capital efficiently. Corporate governance is affected by the relationships among participants in the governance system. Government involvement in initiatives for corporate responsibility has been extensive; there are 4 types of involvement¹²:

1. Legal and regulatory incentives.
2. Tax expenditure.
3. Contributions to compliance expertise.
4. Moral suasion.

The most influential government measures have been closely coordinated with broader public strategy, especially in the relation to regulatory reform.

Changes however are needed significantly to improve corporate governance, especially actions of the oligopolistic coalitions and powerful vested interest groups, who operated simultaneously in the marketplace. An obstacle in obtaining a good corporate is transparency and no corruption. The private sector needed to be involved in the anti-corruption strategies because the private sector is one of the main actors of public corruption.

Most decentralization is implemented to achieve economic efficiency, especially in public service delivery. And to achieve its goals decentralization needs good corporate governance. Without good corporate governance a decentralized governmental system would be unsuccessful and results in instability (political, social, and economic). That's why there is a strong connection

between decentralization and good corporate governance in achieving economic efficiency. Government human resource, as the main motor of good corporate governance, must be prepared and organized carefully, because the main factor of failure in successful good corporate governance is human resource. Failure in selecting the appropriate resource will have a domino effect that results in government failure and therefore unsuccessful decentralization.

Improvement in the human resource factor can be done by several ways; that are:

1. Skill progression, by implementing educational and training programs for government employees, especially in the sub-national level.
2. Candidate selections, implement a proper selection in recruiting candidates for the sub-national level. This is done in order to enhance labor quality in the sub-national level.

CONCLUSION

Economic efficiency is an important matter for a country, especially in order of enhancing development and growth. A country can increase its welfare and income when its economy is efficient.

Government has a role to interfere in enhancing these efficiencies by using fiscal instruments on the market (cover market failure). Corporate governance has a huge effect on economic efficiency; it increases economic efficiency. That is why corporate governance matters for development. It has a central role in increasing the flow of financial capital and lower the cost that firm needs to finance their investment activity.

Equally important are the potential benefits of improved corporate governance for achieving productivity growth in the real economy. Volatility combined with excessive rigidities and huge wastage of real investment resources (human and material), reflect the actions of distributional cartels in countries.

Decentralization is an important and

crucial democracy process of a country. It is a process that improves efficiency, as well as in the economical side and government management. That is why in implementing this process, a legal institutional framework supported by proper human resource basic has to be developed on the central government level as well as on the lowest level of the government system. Not forgetting to enhance accountability, transparency, and moral principals (implemented on the government management system and resource system) to eliminate level of corruption, collusion, and nepotism that leads to failure in deriving good corporate governance. A proper process of

decentralization done with good corporate government; will eventually result in economic efficiency and productivity efficiency.

Looking at Indonesia we can conclude that for this third year of decentralization process, problems occurring are mainly caused by the unprepared condition on the central government it self and especially on the lower levels of the sub-national government system. Indonesia still needs to improve its legal framework for decentralization and human resource quality. Incapable human resource can disrupt the structure and implementation of good corporate governance in decentralization.

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Footnotes

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