

# **Decentralization and Institutional Development in Indonesia**

## ***(A Literature Study)***

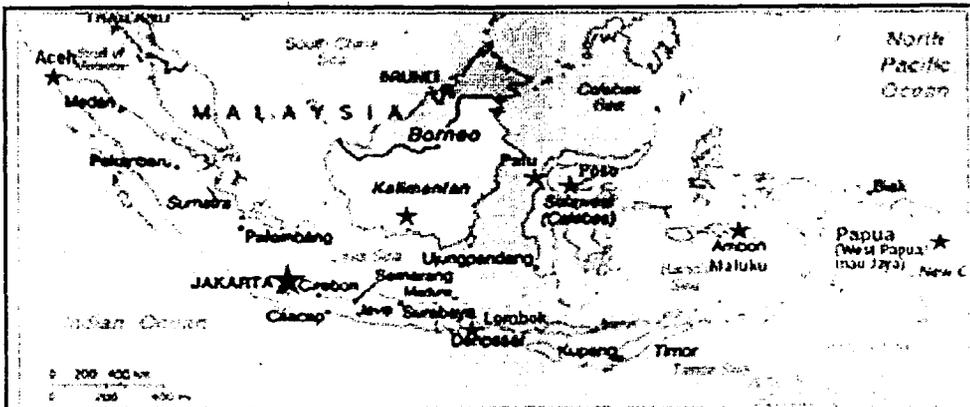
**Candra Fajri Ananda**  
Brawijaya University, Indonesia

### **Abstract**

Institutional development for better governance, to allow for better implementation of decentralization [included fiscal] and other policies, will take years, as unfinished if not decades, to complete. Such institutions must be built domestically, or even locally, they can not be imported from others. German experiences have shown how their adjustment efforts against the environment changes such as globalization, European Union, domestic inter-regional disparity (reunification) for a better quality of development. By analyzing some theories and comparison German and Indonesian experiences, there are three recommendations: (i) existing cultural context, (ii) influencing of changing role and relationship, and (iii) questions on timing and sequencing of the policy. These three institutional aspects should be considered in policy design at all level of the governments and need consequently a strong central government to lead and manage the process.

Keywords: **Decentralization, local institutions, comprehensive**

**Introduction**



Population (2006): 222 Million people  
 Surface Area: 1,860.4 thousand per sq km  
 Population growth: 1.34% (2000 - 2005)  
 Population below national poverty line (2006): 17.75%  
 Gini index: 0.35  
 Economic Growth (2006): 5.50  
 GDP (2006): 1,663 Billion US\$  
 Source: Biro Pusat Statistik, 2007

After more than three decades under a very centralized national government, Indonesia adopted a policy of regional autonomy in May 1999. The decentralization policy was embodied in Law 22 and Law 25 of 1999.<sup>1</sup> Its full implementation took place in January 1, 2001. The policy is one of the cornerstones of Indonesia's long overdue reforms, to which people put a lot of expectation. Like in many countries, the decentralization policy intends to bring development closer to people. As government decentralized and moves closer to

<sup>1</sup> These laws were in 2004 revised to be law no 32 and 33/ 2004.

The author thanks DAAD for financial support and Prof. Winfried Manig -- Institute of Rural Development, Göttingen University for supervising and kindness during my stay in Germany. The views expressed in this paper are those of the author, and not those of Government of the Republic of Indonesia.

people, the cost of monitoring politician should decrease and so should the country's chronic problem — corruption.

Under Laws 22 and 25 of 1999 [also law 32 and 33 of 2004] which, respectively provide the framework for political and fiscal devolution, local governments assumed new important functions and powers previously assigned to the central government. Law 22 [revised to law 32] has devolved all areas to local government with the exception of national defense, international relations, justice, police, monetary, development planning, religion, and finance. Six years after the full implementation of the decentralization policy, things have gone much better than many expected although some improvements are still needed. However, many issues and concerns have also emerged, both in the areas of administrative and fiscal decentralization. After briefly outlined the structure of government after fiscal decentralization, this paper highlights some of the above issues and concerns. Then, the paper discusses some institutional challenges that need to be taken for better implementation of fiscal decentralization in Indonesia.

Decentralization is focused at the district and municipality levels. This has always been the third tier of government below the central and the provincial levels. In 2001, there are 341 such administrations in Indonesia and 26 provinces (SMERU, 2001). However, in 2007 the number of districts increased significantly about 434 districts and municipalities, while number of province also increased drastically 33 provinces (MoF, 2007).<sup>2</sup>

As mentioned above, the decentralization is according to the law (22/99 and also 32/2004) focused at the district and municipality levels. This focused decentralization area brings consequently some implementation problems at the district and municipality level due to lower capacity at district level (SMERU, 2002; Hofmann and Kaiser, 2002) such as:

- 1) Transparency in defining the mechanism for equalization fund allocation; transparency in the utilization of equalization funds in each region;
- 2) Fairness in the allocation of the DAU;
- 3) Sufficiency of the DAU allocation for each region, consisting of:
  - a. sufficiency measured by the need of the routine budget for the transfer of personnel;<sup>3</sup>

---

<sup>2</sup> Actually according to the law 22/1999, the region that cannot finance its own financial budget should merge with other regions. In the implementation, the number of regions are increasing drastically. Answering this situation, the government revised the law 22/1999 to law 32/2004.

<sup>3</sup> According to the law 25/1999, local governments have authority to determine their budget structure. They should be able to catch the needs of their society.

b. sufficiency measured by the need of additional funds for salary increases.

- 4) A limited Special Allocation Grant (DAK) allocation, in total amount or breadth, which so far has been limited only to reforestation. Law 25/1999 directs DAK towards supporting special needs in the regions. However, there is still considerable debate among institutions regarding the definition of “special needs” (Bünte, 2003)

Although the new law 32 and 33/2004 have been implemented, the problems are still facing remain the same even strongly wider as follows:

- 5) The transparency and responsibility of local government and also high people participation in local politic stay behind. Most of local politicians work only for their own interest. The decentralization here can be understood as decentralized corruption (Bünte, 2004; Volbracht, 2005);
- 6) Due to different perception on decentralization, it leads to a new conflict between central and local government. The local government performance that more focused on their individual or party interest deteriorates “the trust” regarding to the relation between central and local governments. This situation brings dangerously the nation integrity (Bünte, 2004);<sup>4</sup>
- 7) The military reform should bring the better democracy at the region, however their political influence is still imperative at national and local level and it can less encourage the democracy process (Bünte, 2004);
- 8) In the fiscal decentralization, due to high dependency on national income the local government tries to create local taxation policy to increase their local budget. However, it distorts mostly their existing economic activities (Schreiner, 2000; Ray, 2003);
- 9) Decentralization is not absolute medicine to resolve the main problems in Indonesia such as democratization, since they still have low capacity of local public official and demands for independency in such regions (Eissel/Grasse, 2005);

Based on the mentioned problems above, Bünte (2004) has estimated four scenarios for Indonesian decentralization:

- 1) Chaotic decentralization;
- 2) Anomalistic decentralization;
- 3) special decentralization;

---

<sup>4</sup> This situation instigates *pemekaran* (*Aufblühen*) some regions, from 341 in 2001 to be 434 districts and municipalities in 2007.

#### 4) Re-centralization;

The decentralization forms **above**, according to Bunte (2004) can take place based on internal efforts, **between** central and local government, in enhancing the political, economic, and **social** cooperation to achieve a better results of decentralization's goals.

It seems that decentralization policy implemented in Indonesia is still facing many problems. The considerable different capacity of local governments leads to different achievements of decentralization itself. A detail explanation should be made to describe the process of decentralization in Indonesia, especially its impact in improving public services, reducing poverty and unemployment, corruption and boosting economic growth. A comparison study should be made to have clear picture and best practices for better further policy. German fiscal decentralization will be chosen due to a better practice and longer experiences. Since public and fiscal policy is related with democratization process, the study will use an institutional approach to explore the issues.

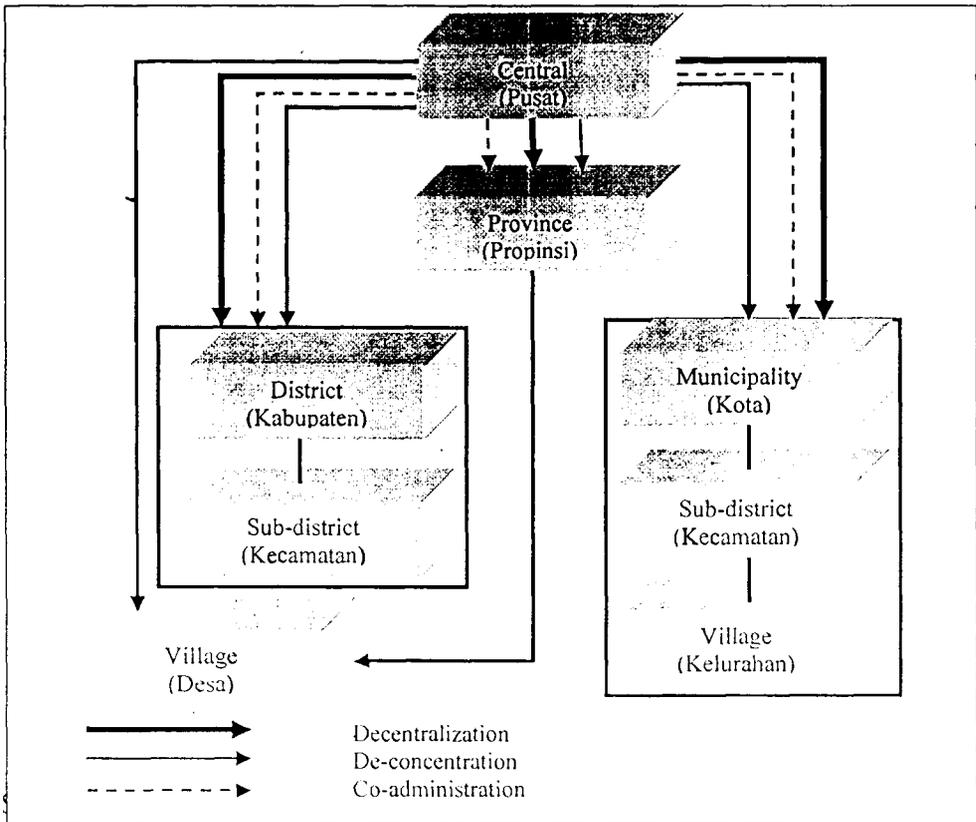
#### *Structure of Government after decentralization in Indonesia*

The territory of Indonesia is divided into autonomous provinces, districts (*kabupaten*) and municipalities (*kota*). Districts and municipalities are technically the same level of government.<sup>5</sup> Moreover, this distinction is based also on whether the government administration is located in a rural area (district) or an urban area (municipality). Within districts and municipalities there are sub-districts (*kecamatan*) which are smaller administrative government units. Each sub-district is further divided into villages. Villages in rural areas are called *desa*, while in an urban areas there are referred to as *kelurahan* (see Figure 1).

---

<sup>5</sup> The difference between district and municipalities is the number of districts. District involves more than 5 or six sub-districts, while municipalities involve on the average 3 to 5 sub-districts.

**Figure 1: Framework of Government according to the Law 22/1999**



**Conceptual Framework of the Study**

*Decentralization Concept in Brief*

Decentralization is the main issue of this paper as the “big bang policy” (meaning an all-at-once process of decentralization rather than a gradual process) influencing social, economic and political condition in Indonesia. A brief explanation on concept of decentralization is necessary to position the fiscal decentralization within the broader context of decentralization.

The degree of decentralization is generally divided into three levels: de-concentration, delegation, and devolution. *De-concentration* occurs when the central government disperses responsibilities for certain services to its regional branch offices. With de-concentration there is no transfer of authority to lower levels of government; rather, decision-making has simply been shifted to national

government staff that are located in the regions. In contrast, *delegation* occurs when the central government transfers responsibility for decision-making and administration of public functions to local government or semiautonomous organizations that are not wholly controlled by the central government, but are ultimately accountable to it. Finally, *devolution* occurs when the central government transfers authority for decision-making, finance and management to quasi-autonomous units of local government, who are accountable to their constituencies for their performance (Litvak, Ahmad and Bird, 1998; Usman, 2001).

These different degrees of decentralization can be applied across political, fiscal and administrative dimensions of decentralization. By definition, political decentralization only exists with delegation and devolution, with the two levels being distinguished by the degree of local versus central accountability. Fiscal decentralization deals with who sets and collects what taxes, who is responsible for what expenditure decisions, and how the 'vertical imbalance' (measured as the transfers to sub-national government as a share of total sub-national expenditures) is resolved. Administrative decentralization deals with the staff and bureaucratic structures that deliver services (Evans, Manning, 2004; Bahl, 2001).

According to law 22 and 25/1999 [revised 32 and 33/2004], the structure of Indonesian government in the decentralized government is divided into decentralization, de-concentration, and co-administration. Some central government authorities are assigned while others are only shifted to local governments (see previous explanation). So, it can be concluded that Indonesia government structure is similar with the theoretical government structure in decentralization framework.

**Error! Reference source not found.** describes the key features of the political, fiscal and administrative concept within the context of de-concentration, delegation and devolution. In practice, however, these different dimensions do not always line up. For instance, even though there may be locally elected governments that are accountable to their constituents, the degree of fiscal decentralization may be more characteristic of delegated authority. In some cases, there may be extensive fiscal autonomy in the form of taxing authority and formula-based unconditional grants, but centrally determined wage rates and establishment controls may effectively dictate how those funds are spent. Similarly, full local authority over hiring, firing and establishment controls may be overshadowed by fiscal arrangements that are governed by detailed conditionality.

As the above analysis implies, the treatment of staff and related administrative issues can have a direct effect on how well the intended degree of decentralization is achieved in practice. This is not to say that more administrative decentralization is necessarily better; in fact, extensive decentralization can have negative consequences for developing a strong, professional civil service at the

local level, if mobility, promotional and financial opportunities are curtailed as a result. Rather, the conclusion that should be drawn is that the interaction of fiscal, political and administrative features needs to be taken into account if the intended degree of decentralization is to be realized.

**Table 1: Key Feature of Political, Fiscal and administrative Concept**

Source: Evans and Manning, 2004

	Political Features	Fiscal Features	Administrative Features
Deconcentration (minimal)	<ul style="list-style-type: none"> <li>No locally elected governmental authority.</li> <li>Local leadership is vested in local officials, such as a governor or mayor, who are appointed by and accountable to the central government.</li> </ul>	<ul style="list-style-type: none"> <li>Local government is a service delivery arm of the central government, and has little or no discretion over how or where service is provided.</li> <li>Funding is provided by central government through individual ministry budgets.</li> <li>There are no independent revenue sources.</li> </ul>	<ul style="list-style-type: none"> <li>Staff working at the local level are employees of the central government, and fully accountable to the center, usually through their respective ministries.</li> </ul>
Delegation (intermediate)	<ul style="list-style-type: none"> <li>Government at the local level is lead by locally elected politicians, but they are accountable, or partially accountable, to the central government.</li> </ul>	<ul style="list-style-type: none"> <li>Spending priorities are set centrally, as well as program norms and standards; local government has some management authority over allocation of resources to meet local circumstances.</li> </ul>	<ul style="list-style-type: none"> <li>Staff could be employees of the central or local government, but pay and conditions of employment are typically set by the center.</li> </ul>

		<ul style="list-style-type: none"> <li>• Funding is provided by the central government through transfers, usually a combination of block and conditional grants.</li> <li>• There are no independent revenue sources.</li> </ul>	<ul style="list-style-type: none"> <li>• Local government has some authority over hiring and location of staff, but is less likely to have authority over firing.</li> </ul>
<p>Devolution (substantial)</p>	<ul style="list-style-type: none"> <li>• Government at the local level is lead by locally elected politicians who are fully accountable to their electorate.</li> </ul>	<ul style="list-style-type: none"> <li>• Subject to meeting nationally-set minimum standards, local government can set spending priorities and determine how to best meet functional obligations.</li> <li>• Funding can come from local revenues, revenue sharing arrangements and transfers (possibly with broad conditions) from central government.</li> </ul>	<ul style="list-style-type: none"> <li>• Staff are employees of local government.</li> <li>• Local government has full discretion over salary levels, staffing numbers and allocation, and authority to hire and fire.</li> <li>• (Standards and procedures for hiring and managing staff, however, may still be established within an overarching civil service framework covering local governments generally).</li> </ul>

*Indonesian Fiscal Decentralization in Brief: Concept, Law 25/1999 and 33/2004*

Fiscal Decentralization also has become part of a world-wide “reform” agenda of decentralization policy itself, has become an integral part of economic development and governance strategies in developing and transitional economies (Bahl, 2001). Along with “globalization,” fiscal decentralization and the desire for local discretion and devolution of power is seeded by the World Bank as one of the most important forces shaping governance and development today (World Bank, 1999).

Why this renewed interest in fiscal decentralization as reform? There are three basic reasons (Kee, 2003) as follows:

1. Central governments increasingly are finding that it is impossible for them to meet all of the competing needs of their various constituencies, and are attempting to build local capacity by delegating responsibilities downward to their regional governments.
2. Central governments are looking to local and regional governments to assist them on national economic development strategies.
3. Regional and local political leaders are demanding more autonomy and want the taxation powers that go along with their expenditure responsibility.

Fiscal decentralization is now seen as part of a reform agenda of many nations to strengthen their regional and local governments to meet the challenges of the 21st Century.

Theoretically, we can conclude that a “proper” distribution of tax authority and expenditure responsibility is an extremely complex issue. Economists generally focus only on issues of efficiency and equity, while public administration and political science scholars tend to focus on distribution of powers, responsiveness and accountability, and tax competition and coordination. Economist Richard Musgrave’s framework for analyzing roles or functions is widely accepted (Musgrave, 1959, 1961; see also Oates, 1977). The Stabilization Function involves the role of tax and spending policies and monetary policy in managing the overall level of economic activity. It is widely agreed that this macroeconomic function should be assigned to the national government. This suggests that the national government must have a broad-based tax suitable for this role. The case for assigning this function to the national government rests on two assumptions that:

- 1) The national government’s broad taxing powers can more easily redistribute income; and
- 2) The ability of taxpayers to move from one jurisdiction to another to take advantage of more attractive spending and taxation policies weakens local government’s ability to “soak the rich and redistribute to the poor.”

There are some arguments for fiscal decentralization. The theoretical case for fiscal decentralization dates from 17th and 18th Century philosophers, including Rousseau, Mill, de Tocqueville, Montesquieu and Madison. Central governments were “distrusted” and small, democratic governments were seen as the principal hope to preserve the liberties of free men (Bennet, 1990). The modern case for decentralized government was articulated by Wollmann (in Bennet, 1990). Wollmann divided the proponent arguments under two headings: Efficiency Values and Governance Values.

*Efficiency Value* is an economic value seen as the “maximization” of social welfare. The public sector does not contain the same price signals as the private sector, to regulate supply and demand. Public sector allocation of goods and services are inherently political; however, as nearly as possible tax and service packages should reflect “the aggregate preferences of community members” (Wollmann, 1997). However, within any political jurisdiction, some people will prefer more, some less, public services. As a result there is a “divergence between the preferences of individual community members and the tax and service packages reflecting the aggregate community preferences”. Since such divergence reduces social welfare, it is desirable to hold those to a minimum and they will be less in smaller communities (e.g., municipalities) than in larger, more heterogeneous areas (the nation).

*Governance values* include responsiveness and accountability, diversity, and political participation (Wollmann, 1997). Decentralization places distributional decision making closer to the people. This fosters greater responsiveness of local officials and greater accountability to citizens. This is because we expect local decision makers to be more knowledgeable about the problems and needs of their local area than centralized decision makers. Further, to the extent that there is accountability through local elections, those elections are more likely driven by issues of local allocation, whereas national elections are seldom focused on local service delivery. Diversity in public policy is a second governance argument for fiscal decentralization. It is valued because it offers citizens a greater choice in public service and tax options when they are deciding where to reside (Tiebout, 1956). In addition, it helps to create “laboratories” for innovation and experimentation, which sometime serves as models for later implementation by the central government or by example to other local governments. Finally, fiscal decentralization is thought to enhance political participation at the local level. This has the potential to enhance democratic values and political stability at the local level. It provides a forum for local debate about local priorities, and can be a proving ground for future political leaders.

Meanwhile, there are also some arguments against fiscal decentralization (Hommes, 1995; Tanzi, 1995, Prud’homme, 1995). Tanzi (1995) summarizes this critique by raising a number of situations or conditions, especially in developing countries, where fiscal decentralization may lead to less than an optimal result:

1. Taxpayers may have insufficient information or no political power to pressure local policymakers to make resource-efficient decisions.
2. Local politicians may be more corrupt than national politicians or at least find themselves in more corrupting situations.

3. The quality of national bureaucracies is likely to be better than local bureaucracies.
4. Technological change and increased mobility may reduce the number of services that are truly “local” in nature.
5. Local governments often lack good public expenditure management systems to assist them in their tax and budget choices.
6. Fiscal decentralization may worsen a central government’s ability to deal with structural fiscal imbalances.

Prud’homme (1995) finds other potential flaws in the theory of fiscal decentralization. The economic efficiency argument, he suggests, requires roughly even regional fiscal capacities—a condition not existing in developing countries. Fiscal inequities may actually increase with decentralization. In addition, localities might engage in destructive competition to attract industry. Finally, to the extent that local governments are viewed as agents of the central government, fiscal decentralization may limit the ability of the principal (the central government) to influence policy at the local level. Hommes (1995) sees decentralization as “essentially a political problem”. Thus, for Hommes (1995) an irony of fiscal decentralization may be the need for more central government controls to protect against this danger.

The concerns raised have been partially addressed by other scholars (McClure, 1995; Oates, 1995). McClure argues that Prud’homme (1995) sets up a straw man—pure decentralization of fiscal federalism—and easily details its flaws. Decentralization done badly says McClure, will cause problems. However, no one proposes full decentralization; rather, what is proposed is decentralization of some functions. Clearly, the central government must retain sufficient revenues (and discretion) to be effective in both their stabilization and distribution roles. Perhaps the most important issue raised by opponents is the “local capacity” issue. However, it is not self-evident that national politicians and bureaucracies are superior to or less corrupt than their local counterparts. If political decision making is decentralized to the local level, you may see an increase in the capacities of local governments. One of the major objectives of reform is building the capacity of local government and local citizens to actively participate in their governmental decisions. Prud’homme (1995) and Hommes (1995) are correct that a simple division of responsibilities is seldom appropriate. A good illustration of this issue is environmental protection, where national standards are appropriate, and regional or local governments may enforce, regulate, and produce. e.g., deforestation (Nurrochmat, 2004).

Financing could easily be a shared responsibility. Hommes (1995) would provide grants with strings attached to enforce local accountability. Hommes (1995) notes the seeming paradox of decentralization is that it demands of the central government more sophisticated political control. Ultimately, however, effective decentralization requires the relinquishing of some central control.

From the different explanations above, we can conclude that fiscal decentralization is not a devolution of authority from the central government to local governments (province, district/kabupaten, municipalities/ kota), but also political institutions where people participation, involving local values and people awareness [through learning process] will increase the quality of fiscal decentralization itself. This paper is trying to examine the underlying theory supporting and opposing fiscal decentralization, especially with the fiscal decentralization implemented in Indonesia.

In Indonesia, the fiscal decentralization is formed in law 25/1999 and 33/2004 where local government are assigned to provide and manage local tax. Table 2 below explains the distributed responsibilities between central, provincial and local government in Indonesia.

**Table 2:** Responsibility agency in fiscal decentralization in Indonesia

Revenue sources	Government in charge		
	Basis	Rate	Administration
Oil (non tax) revenue	C	C	C
Corporate Income tax	C	C	C
Value Added tax	C	C	C
Import tax	C	C	C
Excise tax	C	C	C
Export tax	C	C	C
Personal Income tax	C	C	C
Land and Building tax (PBB)	C	C	C, P,L
Land and Building Transfer Fee (BPHTB)	C	C	C
Forestry: Resource Rent (PSDH)	C	C	C
Forestry: Land Rent (IHPH)	C	C	C
Mining: land rent	C	C	C
Mining: Royalty	C	C	C
Motor vehicle tax	C, P	P	P

Motor vehicle ownership tax	C, P	P	P
Fuel tax (BBM)	C, P	P	P
Water surface/ground use tax	C, P	P	P
Hotel tax	P, L	L	L
Restaurant tax	P, L	L	L
Entertainment tax	P, L	L	L
Advertising tax	P, L	L	L
Road lighting tax	P, L	L	L
Mining type C tax	P, L	L	L
Parking tax	P, L	L	L

Note: C= Central government, P= Provincial government and L: Local Government

Source: Ministry of Finance, law 25/1999 and law 33/2004

As explained above that decentralization policy has some various pictures due to different resources (especially natural resources), local capacity, and low trust [bad perception] to central government. These all factors lead to high demand from some regions for special autonomy,<sup>6</sup> e.g., provincial government of Aceh and Jayapura. The reasons of demanding this special autonomy are mostly based on political and economic aspects. Since the both regions have high endowment factors such as LNG, Oil and Gas, forestry, fishery, however their regional development unfortunately achieves less behind other regions in Indonesia. Their regions are rich ones, on the other side most of their population live under poverty, under bad health services, low education facilities, etc.<sup>7</sup> It is expected that through a better financial sharing, the lack of its development can be reduced and expected welfare can be obtained respectively.

Due to different natural endowments, some of regions occupy more and others not, the central government creates an equalization grant, the so-called DAU (general allocation grant), DAK (specific allocation grant). General Allocation Fund (DAU) is a discretionary block grant designed to equalize the fiscal capacities of regional governments. The DAU is transferred monthly and directly from the

<sup>6</sup> See also Bünte, 2004;

<sup>7</sup> In the both regions, there are movements against national government. they demand for independency such as GAM (Free Aceh Movement) and OPM (Independent Papua Organization).

center to regional governments. It is allocated based on a national formula that consists of fiscal gap and basic allocation. Fiscal gap is obtained from the difference between the fiscal needs and fiscal capacity of each region. Fiscal needs to take into account variables such as population, regional area, regional gross domestic product (RGDP) per capita, and human development index. Fiscal capacity is measured by own-source revenue and regional percent of revenue-sharing. Basic allocation is calculated based on the budget spending on civil servants' salary in the related region. DAU is distributed to the regions in the proportion of 10 percent for province and 90 percent for local government.<sup>8</sup> The DAU allocation among local governments is obtained by multiplying each local government's weight by the total amount of DAU for all local government. The weight itself is determined by the proportion of fiscal gap of the related local government to the total fiscal gap of all local government.

Specific Allocation Fund (DAK) or earmarked grant is a conditional grant reflecting national priorities provided to finance regions' specific needs not covered by the DAU's formula. DAK cannot be used for research, training, administration, and official travel. The source of DAK is the national budget (APBN). Except for regions with limited financial capacity, a region is required to provide from the regional government budget (APDB) a matching grant of a minimum of 10 percent of the project budget. DAK is transferred quarterly based on project progress. Based on a Ministry of Finance (MoF) decree, DAK is transferred directly to provincial and local government. Starting in 2003, DAK covers several sectors such as education, health, infrastructure, and government facilities (for new local governments).

De-concentrated and Emergency Funds are also revenue sources of such local government where central government prioritizes which local governments selected.<sup>9</sup> De-concentration can be considered revenue for the province and local government since the actual implementation is in the region. The fund is transferred to the province based on central government priorities in the form of development expenditures that do not cover routine/recurrent spending of vertical agencies in the region for nonphysical projects. Law 33/2004 specifies that provinces can request emergency funds from the central government to finance extraordinary and urgent needs, such as natural disasters, that cannot be covered by regional government budget (APBD). Although the program is implemented by the province and local government, de-concentration is not recorded in the provincial and local government budget (APBD). Instead, de-concentration is recorded in the

---

<sup>8</sup> Based on Government Regulation PP 55/2005

<sup>9</sup> The detailed arrangement of the de-concentration fund is stipulated in law 33/2004. The de-concentration fund is central government development spending in the region carried out by the province or local government as a part of line ministries' responsibilities. The main objective is to finance central government functions and activities related to national priorities by financing nonphysical assets (de-concentration - *dekonsentrasi*) and physical assets (*tugas pembantuan*).

national budget (APBN). The province and local government report their spending, and are accountable directly, to central government.

Own-Source Revenue (PAD); the revised decentralization law has given local governments the opportunity to expand their revenue base, particularly from taxes. Law 33/2004 allows for local taxes, local levies, revenues from local state-owned enterprises, and other eligible local revenues. Generally, arrangements on local taxes are based on Law 34/2000 and government regulations (PP 65/2001 and 66/2001) on regional tax and levies.

How budget process at local government is established? Budget Process of local government is based on five pieces of legislation governing budget processes and accountability, i.e., Law 17/2003, Law 15/2004, Law 32/2004, Law 33/2004, and Ministerial Decree 29/2002. The budget process starts in January of the preceding year with the formulation of a regional work plan (RKPD) by the regional government to serve as the basis for the general policy of the regional budget (APBD). Mid-June, the regional government presents the APBD's general policy to Regional Parliament (DPRD). In the first week of October, the regional government submits a draft of the APBD to the DPRD in the form of a local government regulation, or Perda. The DPRD together with regional government should agree on the proposed APBD at least one month before the start of the fiscal year.

Budget evaluation begins with the presentation of the first semester budget realization and estimates of the second semester to the DPRD at the end of July of the fiscal year concerned. As the fiscal year ends, the realization of APBD is audited by BPK (National Auditing Agency) and the audit report should be submitted to DPRD within two months after the APBD is received. Finally, the head of the region (Bupati or walikota/major) submits a draft Perda and an accountability report to the DPRD for approval, at the latest six months after the end of the fiscal year concerned.

In practice, the budget process often does not follow the timeline set by the laws and regulations. In East Java province, a study on district governments' capacity showed that to receive budget approval by local parliament takes an average of 4 months. According to regulations, the budget should be submitted to the regional parliament in October and approved by the parliament before the new fiscal year begins. In a few districts, the budget was submitted after the new fiscal year had begun and was approved as late as June. Table 3 below describes the format of local government budget.

**Table 3: Format of local Government Budget**

Old Format		New Format
<b>1. Revenue</b>		<b>1. Revenue</b>
Carry over from previous year		
Regional Own Source Revenue	→	Regional Own Source Revenue
Balancing Fund	→	Balancing Fund
Regional borrowing		
Other resources	→	Other resources
	→	<b>2. Financing</b>
<b>2. Expenditure</b>		<b>3. Expenditure</b>
<b>2.1. Routine expenditure</b>		<b>3.1. Apparatus Expenditure</b>
	→	General Administration
	→	Operational and Maintenance
	→	Capital
<b>2.2. Development expenditure</b>		<b>3.2. Public Expenditure</b>
	→	General Administration
	→	Operational and Maintenance
	→	Capital

Source: World Bank, 2006

**Methodology of the Study**

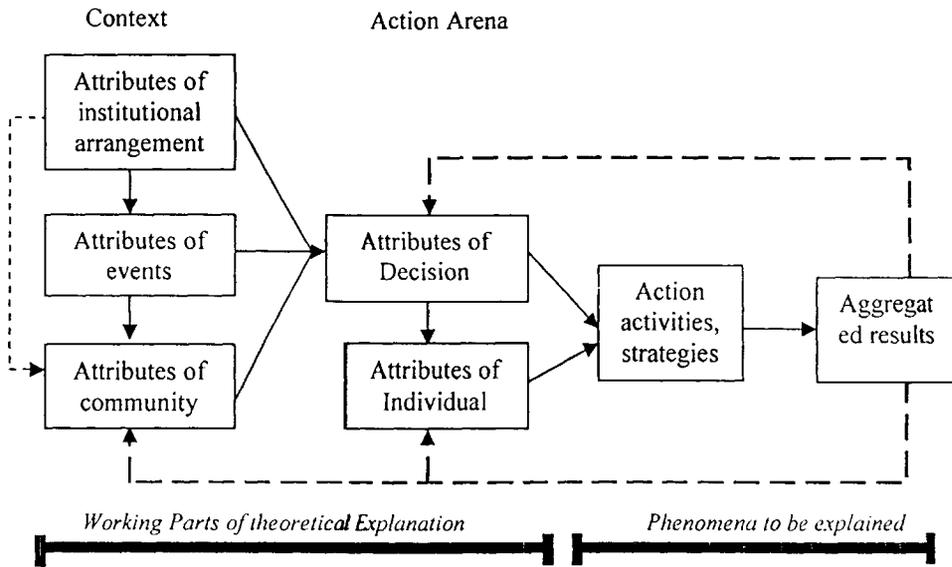
This study attempts to meet the challenges presented by the characteristics of the available literature by including, wherever possible, under-explored countries, e.g., Germany and Indonesia; and by drawing on both the scholarly and the non-specialist literature for its sources. In this regard, the authors hope to offer readers and field workers the combination of empirical information, case-study detail and general application that we referred to in the introduction above. Since the empirical evidence is a corner stone of this research, an inductive approach was adopted to the work. The first step of the work consisted of gathering as much empirical information on the experiences of fiscal decentralization experiences. The second step of the work consisted of ordering the empirical case data into broad categories. Seven categories were defined:

- 1) Lessons on resources, including three sub-categories: finances, human resources and infrastructure;
- 2) Political lessons including two sub-categories: political commitment and political actors;
- 3) Administrative lessons including two sub-categories: territorial and institutional aspects;
- 4) Lessons on democracy and good governance including four sub-categories: participation, accountability co-ordination and power-sharing;
- 5) Lessons on quality and efficiency;
- 6) Legal lessons; and Finally
- 7) Social and cultural lessons.

These categories are not exclusive, and in most cases they overlap. However, from a heuristic point of view it is necessary to structure our lessons in this manner in order to achieve a clear outline and a better organization of the information. The third step was to formulate 'lessons learned' on the basis of the ordered empirical information. The objective in this aspect of the work was to identify plausible general applicability out of the specific lessons presented by the empirical cases, either on a country level or on a sectoral level. Finally the different lessons were ordered hierarchically according to their importance.

The outline of this study tried to take that fact into account by starting with the category 'lessons on resources' and ending with 'cultural and social lessons'. Such a methodology limits the scope of a research. Taking into account various types of literature containing a large range of analytical depths and methodological designs makes it difficult to extract solid findings. Moreover, the decision not to focus on particular countries or sectors led often to incommensurable views and contradictory results. Nevertheless such a study has the advantage to present a general overview of relevant questions in the field of decentralization and to identify open issues and underestimated problems worth further analysis. Generally, we can use a methodology on institutional aspect study as Oakerson and Walker (1997) explained in figure 2 below:

**Figure 2: Institutional study methodology**



Notes:

Direct relationship

Feedback relationship in next time period and subsequently

Inter-relationship that have occurred over prior history

Source: Oakerson, J. Ronald, 1992

### German Decentralization and Fiscal Decentralization: an Overview

The federal elements of the German Constitution have historical roots reaching back beyond the existence of a democratic state in Germany. Without going into these historic details, some key features of the recent federal system as it was laid down in Basic Law (*Grund Gesetz*) in 1949 will be evolved from there. Today, there are 16 Länder, which are the regional units of the federal system, of which each has its own parliament and government. The Länder differ with regard

to size, number of inhabitants and economic performance substantially. There are regional cultural differences in the Länder, which is framed by one common language. On the federal level there are two main chambers: The Bundestag, whose members are elected in national elections every four years and of which a majority and its leading party form the Federal Government, and the Bundesrat. The Bundesrat or second chamber is the representation of the sum-total of the Länder interests and functions as a safeguard for intergovernmental coordination and cooperation between the Federal Government and the Länder Governments. It consists of those cabinet members of the sixteen Länder, who were delegated by the respective Länder governments. Each Land with less than two million inhabitants has three votes, those with from two to six million inhabitants have four, those with more than six million inhabitants have six votes and the votes of each Land must be cast uniformly. There is a strong judicial safeguarding of the Federal elements in the constitution, which is reflected in the fact that the Bundesrat cannot be dissolved by the Federal Government.

### *Three Levels of Intergovernmental Relations – Cooperative Federalism<sup>10</sup>*

While the Bundesrat mainly embodies inter-governmentalism on the regional level, the practical operation of the federal system as a whole also requires that intergovernmental relations are conducted between all levels of government. There are many more intergovernmental organs in German political practice, more or less always in communication with each other:

- a. The level of the 'whole state', on which political institutions both of the federation and the Länder, are represented on term of equal status.
- b. On the level of the federal state with institutions dealing with matters within federal competence or subject to federal procedure (also including the Joint Tasks, originally exercised by the Länder now based on specific, administrative agreements). The most important body is the Bundesrat. The Bundesrat's permanent advisory council of the Länder presidents is the main manager of the institution's political business.
- c. The 'third level' of horizontal cooperation between the Länder themselves preparing decisions that have to be taken between; (Conference of the Minister-Presidents – meets monthly and before the meeting of the Conferences of the Länder Heads of Government with the Chancellor).

The main functions of this institutional structure of intergovernmental relations, which is interdependent and overlapping much more in practice, are in summary:

- Mutual consultation and cooperation in all fields, but particular in overlapping fields of competence on the level of the Whole State

---

<sup>10</sup> THONE/JACOBS, 2001

- Coordination and preparation of voting, and finally voting itself, on legislation on the level of the federal state
- Coordination not just in the preparation of legislation but also and sometimes primarily on matters of administration on the third level.

Generally, the administrative role of the Länder is rather important in this model: The multi-faceted network of intergovernmental relations between the federation and the Länder reflects the fact that the Länder have always been the main administrators not just of their own laws but of most federal and directly applicable European legislation.

In general we can conclude the German decentralization picture where the federal order can be mentioned as follows (Bunderministerium der Finanzen, 2007)

- **Permanent division into Federation and Länder<sup>11</sup>**

The constitution prohibits the abolition of the Länder as such.<sup>12</sup> But it does not protect the existing Länder in their specific configuration. Länder borders may be altered and existing Länder subsumed into or combined with others.<sup>13</sup>

- **State character of the Länder**

The Länder are not merely large, self-governing entities in the same way as local authorities and administrative districts but have the character of states, which may be seen, for instance, from the fact that each has its own constitution. The constitutions of the Länder are distinct from and independent of the Basic Law.

- **Financial independence**

The Länder must have some degree of financial independence to enable them to pursue their own policies. Hence they are vested with their own powers of taxation. They are empowered to create and levy taxes, to administer the revenue thus raised and to decide how it is to be used.

---

<sup>11</sup> By stipulating that "The Federal Republic of Germany shall be a democratic and social federal state" (Article 20 paragraph 1 of the Basic Law - GG -) the constitution establishes federalism as a structural and regulatory principle

<sup>12</sup> Article 79 paragraph 3 GG declares the principle of federalism to be inviolable and un-amendable.

<sup>13</sup> The Federal Republic of Germany is a two-tier federal state comprising the Federation and the Länder. Hence the communes do not form a third tier of the state, but are part of the Länder. Yet towns, local authorities and administrative districts (in the following collectively referred to as the communes) play a prominent role within the administrative structure. Their prominent position is based on the right of communal self-government set out in Article 28 paragraph 2 GG.

Conversely, the federal state must also have at its disposal financial resources sufficient to ensure its political independence from the constituent states.

- **Participation in legislation**

The constitution gives the Länder in principle a guaranteed right to participate in legislation. This means, firstly, that the Länder have their own legislative powers. Secondly, it means that the Länder must be allowed to participate in the legislative process at federal level.

### *German Fiscal Decentralization*

In Germany the Länder collect the taxes. This revenue is divided in different ratios depending on which kind of tax with the different levels of government, including the local authorities and the national level. The latter allocates most of the tax revenues but this is then redistributed to the Länder as the regional governments are responsible for the delivery of programs. Furthermore, in Germany, there is a re-distribution between the states (*Länderfinanzausgleich*) depending on the socio-economic situation in the respective state. Today the Federation and the Länder share the most important sources of revenue jointly and finance an increasing number of tasks jointly.

There are four principal issues to which the constitutional rules on public finances in Germany apply:

- **Which level of government must finance which functions?**

In a federal regime, as in other regimes, the responsibility for a governmental function and the responsibility for financing that function must lie in one hand. Neither the Federation nor the Länder may finance projects that do not fall within their sphere of administrative responsibility. So there is in principle a clear-cut diversification of tasks assigned to the different levels of government, but there also is a grey zone, partly nebulous, serving as a flexible political instrument on the spot, partly institutionalized in the so called "*Gemeinschaftsaufgaben*" ("common tasks") or other rules of the fiscal part of the constitution. Nevertheless there is a principle in Germany: The Länder are autonomous in drawing up and managing their budgets and are answerable only to their parliaments.

It is clear from this that the Federation has no right whatever to intervene in sub-national budgets. But the budgets of the Länder account for about 50 % of public spending by political subdivisions and thus constitute a highly relevant factor with reference to the Maastricht criteria.

- **Who passes which tax laws – the federal state or the constituent states?**

<sup>14</sup>

Tax law is in fact largely federal law. The powers to pass tax laws are assigned as follows:

- The Federation has exclusive power to legislate only on customs duties and fiscal monopolies (Article 105 paragraph 1 GG, Customs Law, Customs Tariff Law, General Customs Regulations, and Federal Spirits Monopoly).
- The Federation has concurrent power to legislate on all other taxes (Article 105 paragraph 2 GG).
- This last provision is of major political and legal significance.
- In consequence, the Länder have scarcely any exclusive powers to legislate on taxes. They have power to legislate on local excise taxes as long as these are not identical with taxes imposed by federal legislation (Article 105 paragraph 2a GG).
- But, the first impression is often wrong. The Länder are by no means excluded from fiscal sovereignty. Article 105 paragraph 3 guarantees them the right to participate through the Bundesrat, the chamber of parliament in which they are represented. Federal legislation on taxes whose revenue accrues wholly or in part to the Länder or communes requires the consent of the Bundesrat. In this way the Länder are able through a majority veto to influence tax legislation in their favor and this veto is an absolute veto! Without consent the law can not pass.

- **How is total state revenue divided up between the different levels?**

The allocation of revenue determines both the financial, the economic and fiscal policy scope available to the federal state and the constituent states as well as their interaction on fiscal policy. One may distinguish between separate or combined revenue allocation systems, with separate allocation systems generally affording a greater degree of autonomy and/or greater incentive to secure an adequate amount of tax revenue.

The public finance reform in Germany in 1969 created a composite system of separate and combined revenue allocation with the aim of maximizing the benefits and minimizing the drawbacks of both systems. In Germany, only about **one quarter of tax revenue** is now allocated specifically to political subdivisions. The remainder is allocated to the three levels of government according to a **pre-determined formula**. The powers of the **communes** to impose and collect taxes are not inherent but are assigned to them under the legislation of the Länder. They collect local taxes under

---

<sup>14</sup> As mentioned by German Federal Ministry of Finance, 2007

their by-laws. However, the revenue from these taxes is not of great significance, amounting as it does to less than 5 % of the aggregate revenue accruing to local authorities. The communes and associations of communes are given a percentage of the share taken by the Länder of the total revenue from joint taxes. This percentage is set by Länder legislation. The communes also receive 15 % of the revenue from income and corporation tax and 2.2 % of VAT revenue for the whole of Germany. Trade tax and real property tax receipts accrue to the communes as well as the revenue from local excise taxes which, as already stated are hardly significant. However, the Federation and the Länder receive a share of trade tax receipts through an apportionment.

- **The role of the financial equalization system**

Despite the offsetting or leveling effects of tax revenue allocation there are still marked differences in the financial endowment of individual Länder. This may be attributable to geographical disadvantages, to weak infrastructure, or to misdirected policy decisions by a regional government. To lessen the impact of this, Germany has a very complex system of horizontal and vertical financial equalization. As it is closely linked to aggregate state spending and revenue it is a key parameter in the federal context that plays a frequently decisive part in all coordination processes. Where the individual tax receipts of the **communes** are insufficient to enable them to discharge the functions assigned to them, the Länder are primarily responsible for ensuring communal financial resources (communal financial equalization).

#### *Incurring debt*

Local authority budgets must be approved not only by communal parliaments but also by the supervisory authorities of the Länder as well. Whereas the Federation and the Länder are free to finance their budgets by borrowing, subject to constitutional rules, other legal requirements and the authorization of their parliaments, the scope available to the communes for raising funds by borrowing is limited and is strictly monitored by the supervisory authorities of the Länder.

There are some steps in German Fiscal decentralization concepts in distributing equalization grant where Germany's constitution guarantees that the Federation and Länder receive appropriate levels of funding. The procedural regulations in this regard can be divided into four phases:

1. First, the entire tax revenue is distributed to the two levels of government – namely the Federation and all the Länder – and the

municipalities receive a supplementary grant of revenue (vertical distribution).

2. Next, the total Länder portion of tax revenue is assigned among the various Länder (horizontal distribution).
3. In a third stage, there is equalization between poor Länder and rich Länder (financial equalization among the Länder).
4. In addition, poor Länder also receive funds from the Federation (supplementary federal grants). The details of the individual stages are subject to simple legal regulations in the Constitution.

#### Stage 1: Vertical distribution of tax revenue

The Constitution jointly allocates several particularly important taxes to the Federation, Länder and, to a degree, the municipalities. According to the Constitution, either the Federation, the Länder or the municipalities are entitled to the remaining types of tax in full. Income tax, corporation tax and VAT are divided between the Federation and the Länder as a whole. The municipalities are entitled to a share of the income tax and VAT. These taxes are therefore referred to as joint taxes. The Federation receives 42.5% of the income tax, 50% of the corporation tax and 2006 around 53% (from 2007 on around 55%) of VAT. The revenue accruing to the Länder is 42.5% of the income tax, 50% of the corporation tax and 2006 around 45% (from 2007 on around 43%) of VAT. 15% of the income tax and around 2% of VAT at present goes to the municipalities. Of all the types of tax, income tax and VAT generate by far the most revenue (Kastrop, 2007).

The Federation receives all of the revenue from the federal taxes. The majority of the excise duties (such as mineral oil duty and tobacco duty) as well as the insurance tax are federal taxes. The Länder are entitled to receive all of the revenue from Länder taxes. These include the **inheritance tax**, the **motor vehicle tax**, most types of **transactions taxes** (in particular, the **real property transfer tax**) as well as some other types of taxes that generate small amounts of revenue. The municipalities receive the revenue from the **trade tax**, the **real property tax** as well as the **local excise taxes**. The Federation and the Länder receive a share of the trade tax receipts through an apportionment.

#### Stage 2: Horizontal distribution of tax revenue

At the second stage, the tax revenue belonging to the Länder as a whole is distributed among the individual Länder. Apart from VAT, the individual Länder are entitled, in principle, to the tax revenue which is collected by the revenue authorities on their territory (principle of local revenue). In the case of income tax and corporation tax, the principle of local revenue is corrected by special regulations, or what is referred to as share. Companies pay corporation tax

centrally. In line with the principle of sharing, this tax is distributed to all states in which a company maintains a place of business. VAT is not distributed according to the principle of local revenue. A part of the Länder share of VAT, but not more than 25%, goes as a supplementary portion to those Länder whose receipts from the income tax, the corporation tax and the Land taxes per capita are lower than the per capita average of all the Länder. The distribution of VAT is thus, in itself, a first form of financial equalization, because its purpose and effect is to harmonize the tax receipts of the Länder. It massively increases the amount of tax revenue that financially weak Länder receive.

### Stage 3: Financial equalization among the Länder

The system of financial equalization among the Länder further reduces the differences in receipts among the Länder. Poor Länder receive adjustment payments. These payments have to be funded by the wealthy states. The system of financial equalization among the states ensures that fiscally weak states also have adequate financial resources to fulfill their tasks and develop their sovereignty. Aligning the revenue of the Länder is intended to create and maintain equal living conditions for the entire population in all of Germany.

The financial equalization among the Länder is not, on the other hand, intended to do away with their fiscal autonomy and sovereignty. This is why differences in receipts among the Länder are only reduced and not fully compensated.

In principle, all types of Länder and municipality revenue are taken into account when determining the financial capacity. However, there are exceptions to this rule. This means that, ultimately, the tax revenues of the Länder and municipalities mainly flow into the financial equalization among the Länder.

In principle, the system of financial equalization among the Länder assumes that the financial requirement per inhabitant is the same in all the Länder. This assumption is not appropriate in the case of the Länder of Berlin, Bremen and Hamburg, which are city-states. The city-states are simultaneously both cities and Länder in their own right. They have a much higher financial requirement per inhabitant than the normal Länder. Therefore, for the purposes of the equalization system, their populations are notionally increased by 35%. The exact size of the adjustment payments to a poor, fiscally weak Land depends on the amount by which its financial capacity per (fictitious) inhabitant falls below the average financial capacity per inhabitant. The difference from the average is topped-up partially, but not completely. A linear-progressive topping-up schedule is used to calculate by how much the difference is topped-up.

Similarly, the size of the adjustment amounts which a rich, fiscally strong Land has to pay depends on the amount by which its per capita financial capacity exceeds the

average fiscal capacity per inhabitant. The difference from the average is skimmed-off partially, but not completely. A linear-progressive skimming-off schedule is used, which is symmetrical to the topping-up schedule. To ensure the sum of the adjustment amounts correspond with the sum of the adjustment payments, the adjustment amounts are either increased or decreased by a corresponding percentage. The regulations are designed to ensure that the order of the Länder, in terms of financial capacity per inhabitant, does not change as a result of the financial equalization among the Länder. The system of financial equalization among the Länder further reduces the differences in the levels of their financial resources.

#### **Stage 4: Supplementary federal grants**

Supplementary federal grants are grants which the federal government makes to poor Länder to complement financial equalization among the Länder. These grants are uncommitted funds and serve to meet general financial requirements. There are two different kinds: general supplementary federal grants and supplementary federal grants for special needs.

General supplementary federal grants further reduce the gap between the average financial capacity per inhabitant and that of poor Länder which still remains after financial equalization among the Länder. General supplementary federal grants go to Länder whose financial capacity per inhabitant, after financial equalization among the Länder, is less than 99.5% of average financial capacity per inhabitant. The shortfall is made up proportionally.

This means that a financially weak Land, whose financial capacity per inhabitant stands at 70% or 90% of the average before financial equalization among the Länder, has 97½% or 98½% of the average per capita financial capacity once the equalization and general supplementary federal grants have been applied. The difference from the average for the Länder is therefore considerably and clearly reduced overall.

Furthermore, supplementary federal grants for special needs are also granted. These serve to compensate individual poor Länder for special burdens they have to bear. The special burdens merely provide the basis and reasons for granting supplementary federal grants for special needs. The funds are not legally tied to a specific purpose. The Länder receiving such federal grants for special needs bear sole responsibility for their use.

The 4 scenarios above for financial equalization in Germany are designed and intended to create equal quality of life for all German population (as mentioned in *Grundgesetz*). Moreover, there is still one scenario left to develop German Federation, namely special grants for Eastern Germany.

Currently, the eastern German Länder and Berlin receive special-need supplementary federal grants to build up their infrastructure, which is still

comparatively underdeveloped as a result of the partitioning of Germany and to compensate for the disproportionately weak financial capacity of their municipalities. At present, these funds amount to a total of €10 billion annually and are therefore extremely important to the Länder that receive them. They form part of the *Solidarpakt II* (Solidarity Pact II), which is intended to rectify the consequences of the division of Germany. These supplementary federal grants for special needs will gradually be phased out by 2019 (Bundesministerium der Finanzen, 2007).

In addition, the eastern German Länder receive special-need supplementary federal grants, worth a total €1 billion annually, to compensate for the special burdens placed on them by structural unemployment. These grants are limited until 2009. There will be a review in 2008 to identify whether they are still required above and beyond 2009 (Bundesministerium der Finanzen, 2007).

### **Some Lessons on Decentralization and Fiscal Decentralization**

Decentralization [incl. fiscal decentralization] is a complex process involving heterogeneous activities and engagements never completely wanted by anybody nor controlled by anyone. The following pages will give evidence of this complexity and reveal the numerous aspects to be taken into account when dealing with decentralization.

#### ***Resources***

The issue of the most appropriate allocation of revenue (taxing) and expenditure authority across different levels of government has assumed ever-increasing importance since fiscal decentralization policy implemented. This development has been spurred not by the developed world, but by the many newly democratizing states of the underdeveloped world. These are states that are often required to accommodate unstable economies, high degrees of poverty and inequality, high unemployment rates, high public debts, corroded public value-systems, low levels of bureaucratic and managerial expertise, the political aspirations of their populations, the pressures of globalization, and the requirements of constitution-making and nation-building.

#### ***Lessons on Financial Resources***

The lessons that follow will focus on the issue of macro-economic stability, on the technical aspects of the implementation of fiscal decentralization, and the issue of equity. The issues of efficiency and accountability that are associated with fiscal decentralization will be dealt with elsewhere in this report.

- Greater centralization of revenue authority in the developed nations in the world does not necessary protect against inflation.

Low levels of inflation are a key measure of macro-economic stability. In developing countries inflation, particularly as a result of government spending, is a considerable risk. Where greater control of inflation is contingent on greater revenue centralization, the case for the maintenance of central predominance in revenue collection would be appropriate. However, even in developed nations this relationship is far from established – on the contrary, as the multi-country case study referred to below shows, the relationship may even be an inverse one.

In Indonesia, there is strong reason from the central government to keep high share of some high potential revenue such as oil, gas, Forestry and other mining sector revenues, namely macro economy stability (inflation, debt payments, etc). The central government, together with central bank of Indonesia, has specific target to achieve low inflation (below 2 digits) and hindering this significant problem, the central government uses a simply formula to distribute the total revenue where according to law 25/1999, about 25% of the total national revenue is assigned to all local governments (all levels) as mentioned above (see table 3 and 4 above).<sup>15</sup>

In Germany, the federal government (*Bundesregierung*) also distributes the federal tax revenue especially from VAT, Income Tax (personal and corporate) to all local government with specific percentage (see above). This fiscal policy is also intended to maintain the macro economy stability such as the economic growth, inflation, employment and inter-regional disparity. Nevertheless, the German economic situation is deteriorating due to reunification, although macro economy stability is still gained.

- The perceived absence of financial resource limits or spending constraints at local (sub-national) level, either because of national government willingness to cover over-expenditure, or because of excessive sub-national borrowing on capital markets, is potentially detrimental to the macro-economic stability of a state.

Very few modern governments consider the individual sources of their income (revenue) when spending decisions are made during the annual budget. The link between income and expenditure is stretched even further in some fiscal federal systems in which most income is collected by the central government through taxes, and is redistributed to local government by means of ‘grants’ (this process is called ‘revenue-sharing’). This is reinforced where national governments are willing to come to the assistance of local governments that have overspent by covering the over-expenditure (this is called a national ‘bail-out’), or where local governments have unconstrained freedom to borrow money on the capital markets.

---

<sup>15</sup> In year 2007, about 27% of the total national revenue is decentralized (the percentage depends on the national revenue). The governments promised to increase gradually the decentralized budget when the national revenues rise intensify.

The result of such a process is that local governments are less likely to consider real income limits when they incur expenditures during a fiscal year. In these circumstances local governments may conduct their financial affairs to the detriment of the economic stability of the state as a whole.

- The failure to match grant allocations with actual service delivery and expenditure requirements at local/sub-national level results in 'unfunded' mandates. These will require that local governments must prioritize expenditure and may encourage them to neglect expenditure on important public services.
- The ability of local levels of government to predict the volumes of revenue that will be allocated to them is an important necessary, but on its own insufficient, condition for a stable intergovernmental fiscal system. Other factors that would be necessary to ensure stability would include overall macro-economic stability, sound financial management, the ease with which the intergovernmental fiscal system may be administered, the appropriate allocation of revenue and expenditure authority across levels of government, political accountability, and service efficacy.

In Indonesia, revenue is mostly still centralized. According to the law 25/1999 and also 33/2004, the revenue sharing has been established based on the formulae. One the most important revenue source of local government is DAU (General Allocation Fund) occupying about 80 – 90% of total revenue of local government budget (Ananda, 2007). It's still needed improving in the degree of transparency in the calculation of the formulae, especially in regarding with the revenue estimation of local government.

In Germany, Tax revenue (as federal main sources) is shared and apportioned among layers of governments according to constitution (income tax) and law (VAT) and disbursed horizontally among local governments based on formulae with strong equalization variables. However, the rules protect minority rather effectively through various asymmetric provision. In facts, it is so difficult to establish an exact amount for the transfer because of regional asymmetric in the expenditure and revenue of federal government (Spahn, 2001)

- Effective and operational decentralization requires an improvement in fiscal management and a stronger financial capacity at the regional and/or local level.

According to Nurrochmat (2004), the decentralization policy has two kinds of impacts, first increasing people participation, second, unfortunately it has contributed to larger social conflict in Jambi province. Moreover, the intensity conflict in forest concession, estate plantation, or transmigrant and local community increase significantly during the decentralization era. Ananda (2004) stated that fiscal decentralization in East Java could not reduce the inter-regional disparity since the local government has still high financial dependency to central government.

### ***Lessons on Human Resources***

- Decentralization implies in most cases a transfer of personnel from the national level to the local government. This can be a risk as well as an opportunity.

Rasyid in FORUMDESA report (2006) revealed that regional autonomy in Indonesia through revised law 32/2004 had aborted the spirit of autonomy itself due to abolishing of civil service management from district/municipalities to provincial level. According to FORUMDESA report (2006) local government still had problems in managing the local public official such as salary set up by central government where quality is still neglecting. Local government can however build organization structure as their needs although still hardly implemented. Moreover, transfer personals have contrary problems among local governments since an “*putra daerah*” [origin people] issue has rose up and limited the transfer process.

According to Reichard (2003), In Germany, the administrative reforms have not been particularly successful (see also Seibell, 2001, Wollmann, 1997). Most managerial reforms concerned only on bureaucratic structure instead of coordination and control. The local government reforms after reunification were not a reform primarily but only a text book administrative traditional models and concepts transferred from west to the east (see Reichard and Röbbler, 1993). It still needs an improvement in control and coordination between layers of governments.

- Decentralization requires increased coordination among and between the different sectors and ministries in order to train personnel adequately for their positions.

In Indonesia, anticipating “overlapping” in development planning, the central government has provided law 25/2004 – National Development Planning System – where district/municipalities, provincial and central government should work hand in hand designing and executing some agreed programs such as education development, poverty eradicating, health services. According to Bappeprop (2007) the different of time line of planning process and finally agreed budget lead to difficulties for local government providing sharing budget for committed programs (as national commitment such as education, poverty and health services). So, coordination is only simple talked, but actually difficult to be executed.

In Germany, local government, e.g., municipality, has constitutionally protected rights as long as their actions must not clash with higher authorities. Generally, municipalities' administrative is delegated to *Kreis* level and to *Regierungsbezirk* level (administrative sub-division of the *Länder*). According to Hesse (1991), governmental administrative in Germany is commonly matter of co-governance. According to Reichard (2003), local government in Germany had improved the coordination (horizontal and vertical) in planning and service delivery through imposing Information Technology (IT).

### *Lessons on Infrastructure*

- Appropriate resources at local government level contribute significantly to an increase in public confidence in the quality of service delivery. It is a recurrent problem of local government and contributes significantly to the loss of public confidence in its authority. A decentralized system in which power is not fully devolved may make decision-making more complex and thus complicate the procedure for approving projects such as infrastructure maintenance.

In Indonesia, SMERU (2006) has shown that 37 cities in Indonesia have large imbalance between cities and districts in contributing to the GDP. This situation suggests a large imbalance between large and small cities and also between districts. These interregional disparities cause rural areas to be left behind urban areas. This situation is exacerbated by the limited provision of job opportunities in rural areas and limited infrastructure supporting the development of human resources in villages; not to mention that the agricultural sector remains less profitable compared with other sectors.

In Germany, (Kastrop, 2007) reminded that the German fiscal policy/allocation are still marked differences in the financial endowment of individual *Länder*. This may be attributable to geographical disadvantages, to weak infrastructure, or to misdirected policy decisions by a regional government. To lessen the impact of this, Germany has a very complex system of horizontal and vertical financial equalization. The complex financial equalization system, intensified by the special problems following the unification of Germany, significantly encumbers the political and economic efficiency of the German federal regime.

- There is a tendency for newly decentralized local governments to favor spending on infrastructure rather than on public programs. Local governments must be sufficiently democratically accountable to ensure that financial resources are not diverted into prestigious capital projects that may be inconsistent with actual public needs.

In Indonesia, education sector has been less paid attention by the [local] governments, although the new constitution stipulated 20% expenses of total budget for education sector. Rukmantara (2006) exposed that there were about 8,000 schools across the country in utter disrepair, it so demanding greater budgetary support from the government; In 2004, the net participation rate (APM) for junior high school reached 72.7 per cent in urban areas but only 60.1 per cent in rural areas, while the gross participation rate (APK) for the lowest income quintile was a mere 63.8 and the highest income quintile at 97.2 per cent (BAPPENAS, 2005). These disparities suggest that significant effort must be devoted not only to achieving national targets but also to reducing sub-national disparities.

According to Busemayer (2007) fiscal decentralization has a positive impact on education spending, whether one looks at total, sectoral or per student expenditure. This research has been done in some OECD's countries included Germany where local governments have authority to manage the education sectors.

### *Political Lessons*

Decentralization is inherently a political process involving various actors at various levels with multiple interests. Perhaps a successful decentralization process requires, paradoxically, a strong state at the central level, able to coordinate and mediate between the different actors involved and to create favorable economic and social conditions.

Decentralization has often been seen as a threat to the central state since it is accompanied by a loss of authority from the central state to the sub-national levels. However the literature on decentralization reveals that by losing 'top-down' authority the state can acquire a new kind of power fundamental for the success of decentralization policies.

Decentralization is a way to promote a more democratic and participative society. At the same time a democratic and participative society is an important and favorable condition for democratic decentralization. Decentralization is seen as one important way to bring political issues closer to the population. This improves the prospects of their participation and enhances democratic debate. The most

successful decentralization processes are taking place in democratically organized societies where basic liberties such as freedom of expression, regular elections etc. are guaranteed.

A successful decentralization process requires more than just the accomplishment of institutional decentralization. Democratization measures must be realized at the same time. Democratization and decentralization are two sides of the same coin. Large numbers of new, elected local government authorities were created as an integral part of the democratization process. These newly elected representatives were institutionally separate from the central party, locally based and responsible for the development of their community. Thus the responsibility for development was decentralized to the local level and placed in the hands of elected local representatives (Crook and Manor 1998). There is a need to reconcile the political and the institutional decentralization process with public sector management reform.

Decentralization of the public service (administrative decentralization) should take place in concert with political decentralization. The absence or only partial decentralization of the public service may compromise the links between that public service and its corresponding political structures on the same horizon or tier of government. This may result, for example, in a public service that is only incompletely accountable to the political authorities on that tier; or it may require the corresponding political authorities to bear a level of responsibility for the performance of the public service that is inconsistent with the actual authority and control that these political authorities enjoy.

### ***Political Commitment***

- A political commitment to decentralization is a necessary but insufficient condition for the implementation of local government reforms.

The government of Indonesia has high commitment to execute decentralization policy through law 22 and 25/1999, and revised 32 and 33/2004. Nevertheless, this decentralization policy is focusing on expenditure side, potential revenue sources are still managed by central government. The low capacity, either at local bureaucracy and local parliaments [parties] has negative impacts on budget structure, corruption, low efficient management and low quality of delivery basic services (FORUMDESA, 2006).

In Germany, the GG has already stated in article 79 paragraph 3 that the principle of federalism to be inviolable and un-amendable. While Germany's federal and intergovernmental system is characterized by a wide range of responsibilities and functions and also by a significant political profile, one should be mindful, however, that /it needs to be reminded that the scope of autonomy and action is often limited and fettered by the legal provisions and financial conditions set by the "upper" levels of government "from above". The compliance to the GG and high commitment will positively influence the quality of implemented policy (Wollmann, 2002).

- The dependence of the local level on political commitment at the central level can be reduced by devolution rather than de-concentration.

The decentralization process in Indonesia has been frustrated by the inclination of new administrations at national level to overturn systems implemented by previous administrations. Local government reforms in Indonesia remained superficial and changes have often served personal political interests, rather than advanced good government (FORUMDESA, 2006).

### ***Political Actors***

- Decentralization processes, at least in their initial stage, are often dominated by civil servants rather than elected politicians. This may be explained by the greater administrative and technical competence that civil servants often enjoy over politicians. This leads to decentralization being presented as a technical rather than a political matter.

Before decentralization era, in the new order era, the government management was predominated by bureaucratic system and political party has less influences. However, after decentralization policy implemented the government management has been influenced by political system (Ananda, 2004). The most important point is actually not who is stronger, but how the decision process should be more transparent and participative (FORUMDESA, 2006)

- Non-governmental organizations can play an important role in democratic decentralization. The role played by NGOs can have positive effects on the overall democratization process, but NGOs should nonetheless be relied upon with caution.
- Decentralization critically affects the public sectors. Organized bottom-up opposition to decentralization projects is therefore likely to be supported where large numbers of public servants are well organized.

In Indonesia, the decentralization policy has affected government structure and followed by law and regulation to improve the quality of public services such as 43/1999, Government Regulation 84/2000 on wide discretion for local government to set up their own administrative structure and the newest Government Regulation 8/2003 contains on strengthening issues. According to FORUMDESA (2006), there were only 20% of local government has re-organized strictly within the stipulation Government Regulation 8/2003. Although some local governments such as Solok, Tanah Datar, Seleman, and Jogjakarta have made improvement as stipulated Government Regulation 8/2003 and showed an improvement in public service delivery.

In Germany, public organization has been facing some challenges, e.g., inserting new management values like NPM (New Public Management), globalization where efficiency and competitiveness are demanded. According to Reichard (2003) German local government has severe pressures and challenges about last ten years. Confronting with unemployment rate and citizens' demands and shrinking of financial resources, the needs for local government reforms increased significantly.

### *Institutional Lessons*

Institutional considerations refer us to the architecture of a decentralized system. The integrity, design, size and function of sub-national institutions are decisive in assuring the success of the system.

- When initiating a decentralization process it is essential to design sub-national or local units that are large enough to carry out local government functions and optimize service delivery.

Under law 22/1999 and 32/2004 creation of new municipalities or districts is the prerogative of the central government. According to MoF (2007) the number of district and municipality in Indonesia (2001 – 2007) increased significantly, from 26 provinces to 33 provinces and 341 districts/municipalities to 434 ones. Financially, all new local governments [also old local governments] are 80% still depending on national revenue sharing. Some of them are actually too small to provide a viable autonomous local council; revenue generation is still neglecting.

- Decentralization multiplies the number of institutions involved in the planning, decision-making and implementation of public policies. The composition of these bodies is a sensitive issue and a potential source of conflict.

In Indonesia, the national parliament members contains elected from 2 different sources, party and region. The party members are elected to represent their constituent needs and wishes (DPR), while region will represent more on regions' needs (DPD). DPR and DPD work closely together, although according to the constitution DPR has more power than DPD. (Ananda, 2004).

- National government institutions as well as organs representing civil society might be relied upon to monitor the implementation of a decentralization process and the conduct of the decentralized institutions of government.

The government of Indonesia has formed such an oversight committee to facilitate its decentralization process the so-called "Regional Autonomy Consideration Assembly (*Dewan Pertimbangan Otonomi Daerah*)" [Presidential Decree 28/2005] where the members are representing from Ministry of Home Affairs (as chairman of DPOD), Ministry of Finance (as vice chairman), Ministry of National Defense, Ministry of Law and Human Rights, Ministry of State Secretary, State Ministry of Empowering State Apparatus, State Ministry of National Development Planning, Representative of Local Government, and Experts. The committee addresses issues such as local finance and fiscal administration, local legislation, the relationship between local government units and NGOs and personnel administration. Now only those issues that cannot be settled locally by the transition actions teams are brought to the national oversight committee ([www.depdagri.go.id](http://www.depdagri.go.id))

- Both the methods and objectives of intergovernmental co-ordination must be determined clearly in order to prevent a complication of the processes of intergovernmental relations, or to compromise democracy, transparency and accessibility.

Law 22/1999 and 32/2004 explain for local government that cannot be financially independent, should merge with other regions. In facts, there are no regions merging to strengthen their economic and social potential. In the contrary, number of district and municipalities increase gradually. At the beginning of decentralization policy (Ray, 2003) revealed that the business environment at the local level was deteriorating due to un-appropriate taxing for escalating local revenues. It was also discouraging the neighbors' business environment. Presently all local regulations (for taxing) have to be sent to central government and evaluated. With about 2000 local regulation (*perda*) it needs about more than 6months to finish the evaluation. Therefore, most of the regulations have been implemented although its evaluation not finished yet.

***Lessons on Fundamental Principles of Good Governance***

One of the most important products of decentralization is the enhancement of the quality of democracy and governance in a state. A strong political commitment of the involved actors and well-designed institutions are all important aspects contributing to the improvement of a democratic society. Moreover, good governance understood in terms of democratic procedures requires at least four further factors, each of which deserves to be treated in its own section: participation, accountability, coordination and power sharing.

The body of literature that the others have consulted confirms that the decentralization of political and administrative authority will result in 'good government' where both citizen participation (that is: participation from the bottom); and direct accountability (that is: accountability downwards to local constituents) function effectively. Each of these in turn requires appropriate institutional manifestation. Accountability requires bureaucratic accountability to elected officials, and the accountability of the elected officials to the public, in turn. Participation requires regular elections, an active and capable civil society; institutions for civil society engagement between elections (public meetings, policy consultation forums, oversight and vigilance committees etc.), and a well functioning and critical media. However, for these principles to be effective certain preconditions should exist as follows:

***Participation***

- Democratic decentralization is not only a matter of designing the right institutions, but also depends on the civil and social context in which these institutions operate.

FORUMDESA (2006) in their reports explained that in referring to Government Regulation 8/2003, the Minister of Administrative Reform explains that the expansion of the organizational structure of local governments been driven by various interests of actors and stakeholders. The MoF indicated that if the expansion of local governments' organizations continued, it would soon run out of money to fund local governments through the Dana Alokasi Umum (DAU). The Central Government, therefore, is under pressure to impose a stronger regulatory control over the regions. On the other hand, the regions argue that the Central Government generalizes the issue of excessive organizational structure based on a limited number of isolated cases. The precise percentage of regions that established excessively large organizations has not been revealed by the Central Government.

- A sense of ownership must be created before the local population will feel motivated to participate in decentralized local government and to support its development projects.

SMERU (2006) revealed that in the regional autonomy era, the implementation of basic education became the responsibility of local governments. Nevertheless, it needed the cooperation of central, provincial and district government, as in (a) improving access and broadening learning opportunities in remote and isolated regions; (b) increasing the participation rate of women and children; (c) improving the quality and relevance of basic education; (d) managing efficiently the use of education resources; and (e) supporting the participation of the community. Meanwhile, the programs for improving the efficiency of educational management includes the consolidation and revitalization of schools, improving the management of education, empowering school boards, the participation of the community, the development of an information system on education management as well as systematic monitoring and evaluation.

- Indigenous non-governmental organizations can play an important role in facilitating the participation of poor and marginalized groups in the political system.

Partial reforms have been initiated in the regions through local innovations within the local governments' jurisdiction. Such reforms may be further encouraged if local government can secure sufficient financial independence to meet local demands. The process of initiation and innovative methods can be done collaboratively with donors and local institutions like universities and NGO's where they have played an important role in assisting local government to implement and sustain local innovations. It is also clear from the cases and field work that all stakeholders have gained experience over time in terms of effectiveness, feasibility and sustainability of such innovations. Best practices in one region may not be readily transferable to others. (FORUMDESA, 2006)

### *Accountability*

- Regular and free elections at all government levels are the best device to ensure accountability.

In case of Aceh province where Aceh was granted Special Autonomy status under Law 18/2001 due to inequality and the poor economic situation, the central government offered Aceh greater autonomy in managing its resources and governance functions. The three key features of Aceh's special autonomy are: 1) Large share of retained revenue from oil and gas; 2) Direct election of governor and head of local government (bupati/walikota); 3) Implementation of Syari'ah/(Sharia) Islamic law. These all offerings are intended to provide great opportunity for Acehnese to improve their communities' economic performance, attain better living standards, and move toward a good governance system. The direct election in Aceh was envisioned to be the first direct election at the local level in Indonesia before Law 32/2004 concerning local governance was passed. The law specifies that the direct election of head of local government is to be implemented nationally (World Bank, 2006).

**Quality and Transparency**

- The quality and efficiency of service delivery in local or regional areas can be improved significantly through a statistics service gathering data and producing demographic status analysis.

Some development issues and problems in Indonesia cannot be solved systematically due to availability and quality of data, e.g., education, poverty, health, etc. Moreover, FORUMDESA (2006) revealed that chief challenges in designing policies are the absence of clear guidelines and transparent procedures and the lack of a reliable database to record the changes.

Wollmann (2002) stated that in German public policy a data analysis is needed as basis argument in designing a new policy. NPM (New Public Management) implementation needs a high quality data for supporting a policy design, e.g., IT Implementation.

- It is important to institutionalize mechanisms for citizen feedback with regard to local government performance and service delivery.

According to World Bank report (2006) on Aceh Reconstruction Program, provincial and local governments will also be in charge of all reconstruction infrastructures. It is critical to engage local governments now in any new large-scale infrastructure projects. The 2007 budget process will provide an important signal of the province's and local governments' readiness to play a stronger role in the reconstruction process. Monitoring and evaluating local government spending will be important to ensure that public funds are properly spent. Therefore, BRR and the regional governments should strengthen monitoring and evaluation (*MandE*) systems.

Implementation of NPM is really demanded in Germany (Wollmann, 2002). Its concepts and measures introduce the logic of "performance management" of public organization in the (intra-) administrative operations with the help of (simplified and practicable) performance indicators and "controlling" ("feedback") mechanisms, including attempts at establishing and working with inter-district/municipal "benchmarking" (see also Kuhlmann 2002).

- In order to ensure the quality of services delivered at the local level, local service providers must have access to a comprehensive support system in order to implement national strategies.

An effective decentralization needs efficient public organization. In Indonesia, according to FORUMDESA report (2006), government structure has been legally reformed through some laws and government regulations, law 43/1999, Government Regulation 84/2000 and replaced with 8/2003. Nevertheless, no substantial reforms have been taking place where local governments have flexibilities to structure their organization as their local potential and resources.

In Germany as Wollmann (2002) stated the “local welfare state” pattern that the delivery of the personal social services (such as kindergartens, homes for the elderly) has been guided by the “subsidiarity principle” where the local government should restrict itself largely to (to use recent terminology) an “enabling” function, while the service provision itself should be left to the (non-public and non-profit) welfare organizations. In fact, some 70 to 80 percent of the social services (places in kindergartens, homes for seniors etc.) have been offered by the local branches of four large non-profit welfare organizations historically associated with the churches and workers movement.

### *Legal Lessons*

A decentralized system must rely on predetermined ‘rules of the game’. The Constitution, laws and regulation of a country constitute these rules and codify how a decentralized system is supposed to work. The Constitution sets the broad principles on which the decentralized system operates.

In Indonesia, Ray (2003) stated that compliance to the law has shown a relative good in trend. The problem was the quality of human resources in the legislative and executive members at the local levels. It can be seen in their legal products such as local regulation for new taxing that concern only on boosting tax revenue. Consequently, most local regulations have been deteriorating local economic development and discouraging the business environment at the local level.

Wollmann (2002) stated that Germany’s federal and intergovernmental system is characterized by a wide range of responsibilities and functions and also by a significant political profile, one should be mindful, however, that /it needs to be reminded that the scope of autonomy and action is often limited and fettered by the legal provisions and financial conditions set by the “upper” levels of government “from above”. Thus, as it was perceptively observed, the remarkably strong role which local government has in policy implementation in countries like Germany and the Scandinavian countries goes hand in hand with “national systems of rule, finance and public administration (that) standardize much of what local officials can do and how they can do”

### *Social and Cultural Lessons*

Although social structures and culture are regularly mentioned as determining factors for the success of decentralization programs, the literature rarely provides concrete examples of this. Gender issues, cultural development or the importance of networks and patron-client based relationships in decentralization processes and practices are often neglected by the literature on decentralization. The shortage of lessons reflects this state of affairs.

- The decentralization of political authority may take place according to predetermined contemporary models, but must incorporate local indigenous patterns of decision-making and authority.

Harjono (2005) revealed that decentralization policy in Indonesia still needs long process. The decentralization cannot lead improvement of life quality in the local level. Some other problems rise in some regions such as disregarding origin people and it tends finally to create new regions (*pemekaran*). Several districts have stipulated that the district head (*bupati/walikota*) must be a person not only born in that district but also of the same ethnicity as local indigenous people.

Wollmann (2002) explained the decentralization in Germany as the “unfinished business”. There are many local governments without a functionally viable basis seems to practically rule out any further-going measures towards “real”, that is bottom-line decentralization. If these “informed guesses” prove right, the divergence between the local government systems of the “North Middle European” type, on the one hand, and of those of the “Anglo” and “Franco” types will further increase. So, there is no exactly pattern of decentralization.

### Conclusions and recommendations

Despite the notion that decentralization is a new trend in governance, local government itself is actually not a new idea. In fact, “many, if not all, societies in Africa, Asia and Latin America have, at one time or another in their history, possessed strong traditions of local and regional governance through tribal or community self-help traditions. In many countries, these traditions have long been suppressed, in part as a result of external colonial rule, and in part as a result of the highly centralized nature of many, if not most, post-colonial political regimes and governance systems” (United Nations 1996). In recent years the international community, and specifically international donor agencies and NGOs, have been concerned with improving these governance systems. According to the United Nations Development Program, good governance can be defined as “participatory, transparent and accountable. It is also effective and equitable. And it promotes the rule of law. Good governance ensures that political, social and economic priorities are based on broad consensus in society and that the voices of the poorest and the most vulnerable are heard in decision-making over the allocation of development resources” (UNDP 1997).

Decentralization is a process that is considered to improve governance and is therefore being implemented in many countries. Decentralization is a process that involves both risks and opportunities. The opportunities include greater popular participation; the ability to design social services to meet specific community needs; the capacity to tailor solutions for local problems to local

conditions; the opportunity for policy innovations and the ability to “scale up” successes; the ability to provide social services more efficiently; and the opportunity for increased accountability to the people. Decentralization is not without significant risks that include the possibility that inter-regional inequalities may be wider, the risk of capture by local elites, and the possibility of disparities between the resources available to sub-national governments and the responsibilities these governments must fulfill. Following will be concluded some lessons can be learnt mentioned above:

### *The crucial role played by the existing cultural context*

A decentralization program is not implemented in a cultural vacuum. Rather, it must take into consideration the existing context of beliefs and attitudes of society to such issues as authority, the role of government, the role of the citizen, the role of elites, the role of civil society (such as it exists), the role of traditional leaders, the role of the poor, etc. These factors are specific to each country setting and may also differ regionally within a country itself. The existing cultural context affects how people will respond to decentralized governance. Social and cultural factors have the ability to “make or break” a decentralization program and will almost certainly break one that does not take them into account. This reinforces the conclusion that decentralization should not be applied similarly from country to country, but must be tailored to the country, or even local, circumstances.

### *The influence of changing roles and relationships*

The implementation of a decentralization process will necessarily involve changes in the roles of political actors and relationships between them. Power, authority and responsibility will be transferred from one group (for example, from the central ministries) to local offices. For decentralization to work, all relevant actors must be “on board”. This includes politicians, the civil service and civil society. While these actors need to be on board, it is also important that citizens be aware of the changes made by the decentralization process to roles and relationships. A public relations strategy could continuously inform the people of what is happening as actors change roles or take on new roles.

The German experiences and also the literatures show particular emphasis on the importance of capacity building of newly empowered actors. Decentralization involves giving new power, authority and responsibility, and a new role to local levels of government, administration, or, in some cases, civil society. However, if the local level is to be able to effectively play its new role, a concerted effort must be made at building capacity at the local level. Capacity building aspects are important in this context insofar as they can enhance the quality of local support to a decentralization program.

### *The question of timing and sequencing*

It is important to think of decentralization as a process - as a means towards good governance - rather than an end in and of itself. A consensus on a decentralization program must not only be reached but must also be sustainable. A continuous effort must be made to keep a high level of agreement among actors throughout a decentralization process. The literature and German experiences do not provide a “**universal recipe**” for the sequencing of decentralization, though it is clear that sequencing is a challenge. If there is a universal recipe to be found it is that decentralization must be designed and implemented as an evolutionary process and that a “shock treatment” approach is not ideal. However, timing affects the sequencing. In the long term, decentralization should be understood as a **learning process** that must be adapted to fit the **needs and preferences** of citizens.

## **REFERENCES**

- Ahmad, Etisham and Hofman, Bert, 2000:** "Indonesia: Decentralization – Opportunities and Risks." A paper based on the report of a joint FAD-World Bank Team: "Indonesia: Decentralization –Managing the Risks", June 1999, by E. Ahmad, B. Hofman, J. Ma, C.R. Rye, and R. March 2000.
- Ananda, F. Candra, 2007:** Development and Environment in East Java Province, in: empowering regional economic development toward sustainable poverty alleviation. (Eds. Ananda, Resosudarmo, Nazara), IRSA Book Series no 6. (Forthcoming)
- Ananda, F. Candra, 2004:** Regional Autonomy after 3 years, presented at ISEI seminar, Jakarta (JCC) 16 September 2004
- Bahl, Roy, 2001:** "Challenges in Indonesia and Elsewhere". Report in one event in the periodic meetings with expert speakers. The program was sponsored by the Center for Institutional Reform and the Informal Sector and the United States-Indonesia Society. June 13, 2001. Washington, D.C. (Retrieved from <http://wbln0018.worldbank.org/N.../BF4949B27A009Ba185256AC3007A7B6F?OpenDocument>).
- BAPPENAS, 2005:** Ringkasan Laporan Perkembangan Pencapaian Millenium Development Goals, BAPPENAS
- Bappeprop, 2007:** Kajian Dampak Lumpur Lapindo, Kerjasama dengan Fakultas Ekonomi Unibraw, (unpublished)
- Barwise, K., and F. Castles. 1991:** The "New Federalism", Fiscal Decentralisation and Public Policy Outcomes. Australian National University Graduate Programme in *Public Policy Paper Series Number 27*.
- Bennet, R.J. 1990:** Decentralization: Local Governments and Markets. London: Clarendon Press Study.

**Biro Pusat Statistik, 2007:** Selected Socio Economic Indicators of Indonesia, Booklet, Jakarta ([www.bps.go.id](http://www.bps.go.id))

**Bundesministerium der Finanzen, 2007:** <http://www.bundesfinanzministerium.de>

**Bünte, Marco, 2003:** Dezentralisierung in Indonesien. Teil 1: Initiation und Inhalt, In: *Südostasien aktuell Jg. 22, Nr. 6*, S. 565-579, Hamburg

**Bünte Marco, 2004:** Dezentralisierung in Indonesien. Teil 2: Bilanz und Perspektiven, In: *Südostasien aktuell Jg. 23, Nr. 1*, S. 60-71, Hamburg

**Busemeyer, Marius R., 2007:** The Impact of Fiscal Decentralization on Education and Other Types of Spending, MPIFG Discussion Papers 07/8 ([www.mpifg.de](http://www.mpifg.de)).

**Crook, R. C. and Manor J., 1998.** Democracy and Decentralization in South Asia and West Africa. Cambridge: Cambridge University Press.

**Eissel, Dieter/Grasse, Alexander 2006:** The Vertical Dimension of Democracy and Development: Federalism, Regionalism, and Local Autonomy – Experiences from Europe, In: International Conference: Democracy in Indonesia: Challenges of Consolidation, Jakarta and Bandung, February 23-25, 2006, funded by Fritz-Thyssen-Foundation.

**Evans, Anne and Manning, Nick, 2004:** Decentralization - A Review of Staffing Practices in Eight Countries, Draft Paper Prepared for the World Bank (unpublished).

**Forumdesa, 2006:** Civil Service Reform in the Context of Decentralization. [http://www.forumdesa.org/download/drsp/civil\\_service.pdf](http://www.forumdesa.org/download/drsp/civil_service.pdf)

**Harjono, Joan, 2005:** Can Indonesia Hold? Unity and Diversity Revisited - material speech on the Herb Feith Memorial Lecture (<http://www.monash.edu.au/news/newslines/story/532>)

**Hendriks, Frank and Pieter Tops, 1999:** Between Democracy and Efficiency – Trends in Local Government Reform in the Netherland and Germany, *Public Administration, Vol 77. No 1*, Blackwell Publishing Ltd. Oxford, UK

**Hesse, Jens Joachim, 1991:** Local government in a federal state: the case of West Germany. In: Hesse, J.J. (ed.), 1991: Local Government and Urban Affairs in International Perspective, Nomos, Baden-Baden, pp. 353-386.

**Hofman, Bert and Kaiser, Kai, 2002:** “The Making of the Big Bang and its Aftermath: A Political Economy Perspective.” Paper presented at the Conference: Can Decentralization Help Rebuild Indonesia?, 1-3 May 2002, Atlanta, Georgia.

**Hommel, Rudolf. 1995.** “Conflicts and Dilemmas of Decentralization.” The World Bank Research Observer: 295-316. (<http://www.worldbank.org/eap/eap.nsf/CountryOffice/Indonesia>).

**Kastrop, Christian, 2007:** The principles of German fiscal federalism in the Maastricht / Stability and Growth Pact context. Some lessons for decentralization and fiscal policy. Head of Fiscal Policy Division – Federal Ministry of Finance, Berlin – Germany ([www.im.dk/publikationer/decentralisation/kap04.htm](http://www.im.dk/publikationer/decentralisation/kap04.htm))

**Kee, James Edwin, 2003:** Fiscal Decentralization – Theory as Reform, papers on Tax policy management and division of responsibilities among levels of government, George Washington University.

**Kuhlmann, Sabine 2002,** Benchmarking auf dem Prüfstand: Kosten, Nutzen und Wirkungen interkommunaler Leistungsvergleiche in Deutschland, in: Verwaltungsarchiv

**Litvak, Jennie, Junaid Ahmad and Richard Bird. 1998:** *Rethinking Decentralization in Developing Countries.* Report No. 21491. World Bank.

**McLure, Charles E. jr. 1995:** “Comment on ‘The Dangers of Decentralization’ by Prud’homme.” The World Bank Observer. 10 (2): 221-227.

Vol. 16, No. 2 December 2007

© Centre for Indonesian Accounting and Management Research  
Postgraduate Program, Brawijaya University

**Ministry of Finance, 2007:** Directorate General of Budget and Fiscal Balance,  
[www.djapk.depkeu.go.id](http://www.djapk.depkeu.go.id)

**Musgrave, Richard A., 1959:** *The Theory of Public Finance*, New York: McGraw Hill.

**Musgrave, Richard A., 1961:** "Approaches to a Fiscal Theory of Political Federalism." *Public Finances: Needs, Sources, and Utilization*. Princeton: NJ: Princeton University.

**Nurrochmat, Dodik, 2004:** *The Impact of Regional Autonomy on Political Dynamics, Socio – Economics and Forest Degradation, Case of Jambi Indonesia*, Dissertation (Unpublished)

**Oakerson, J. Ronald, 1992:** *Analyzing the commons: a Framework*, in Brmley (ed.) 1992.

**Oates, Wallace E., 1977:** *The Political Economy of Fiscal Federalism*. Lexington, Massachusetts: Lexington Books.

**Oates, Wallace E., 1993:** "Fiscal Decentralization and Economic Development." *National Tax Journal*. 46 (2): 237-243.

**Oates, Wallace E., 1995:** "Comment on 'Conflicts an Dilemmas of Decentralization' by Rudolf Hommes." *The World Bank Research Observer*: 323-325.

**Prud'homme, Remy. 1995:** "The Dangers of Decentralization." *The World Bank Research Observer*. 10 (2): 201-220

**Ray, David, 2003:** *Decentralization, Regulatory Reform and the Business Climate* Summary paper prepared for the PEG-USAID conference on "Decentralization, Regulatory Reform and the Business Climate," Borabudur Hotel, Jakarta, August 12, 2003

- Rodden, Jonathan, 2001:** And the Last Shall be First: Federalism and Fiscal Outcomes in Germany.  
<http://web.mit.edu/jrodde/www/materials/firstlast.pdf>
- Reichard, Christoph, 2003:** Local Public Management Reform in Germany, *Public Administration Vol 81., No 2*, Blackwell Publishing Ltd, Oxford, UK
- Reichard, Christoph and M. Röbbler, 1993:** Was kommt nach der Einheit? Die öffentliche Verwaltung in der Ehemaligen DDR zwischen Blaupause und Reform in G.J. Glaeßner (Ed.): *Der lange Weg zur Einheit*, Berlin: Dietz
- Rukmantara, Arie, 2006:** 'State Budget Against the Constitution', *Jakarta Post* 14 January 2006
- Schreiner, Klaus 2000:** Regionale Autonomie und Dezentralisierung in Indonesien. Königsweg oder Sackgasse?, In: Ziegenhain, Patrick (Hg.): *Politischer Wandel in Indonesien 1995-2000, für die Südostasien- Informationsstelle*, Essen
- Seibel, Wolfgang, 2001:** Administrative Reforms, in: König, Klaus/Siedentopf, Heinrich (eds.), *Public Administration in Germany*, Baden-Baden: Nomos, pp. 73- 84.
- SMERU, 2001:** The Budget Allocation and Its Implications for the Business Environment. A Paper Prepared for The Third EUROSEAS Conference Panel on Decentralization and Democratization in Southeast Asia. London, September 2001. [www.smeru.or.id](http://www.smeru.or.id)
- SMERU, 2002:** Regional Autonomy and Business Climate, Three Kabupaten Case Studies of Wes Java, June, [www.smeru.or.id](http://www.smeru.or.id)
- SMERU, 2006:** Unleashing the Potential for Poverty Reduction in Indonesia, papers presented on Promoting Growth and Ending Poverty ASIA 2015 Conference, [www.smeru.or.id](http://www.smeru.or.id)

**Spahn, P. Bernd, 2001:** Maintaining Fiscal Equilibrium in a Federation: Germany, <http://www.desequilibrefiscal.gouv.qc.ca/en/pdf/spahn.pdf>

**Syah, Anwar, 1997:** Fiscal Federalism and Macroeconomic Governance: For Better or For Worse? [http://lnweb18.worldbank.org/ESSD/sdvext.nsf/09ByDocName/FiscalFederalismandMacroeconomicGovernanceForBetterorForWorse/\\$FILE/208-Fiscal\\_Federalism\\_and\\_Macroeconomic\\_Governance.pdf](http://lnweb18.worldbank.org/ESSD/sdvext.nsf/09ByDocName/FiscalFederalismandMacroeconomicGovernanceForBetterorForWorse/$FILE/208-Fiscal_Federalism_and_Macroeconomic_Governance.pdf)

**Syah, Anwar, 2003:** Fiscal Decentralization in Developing And Transition Economies: Progress, Problems And The Promise. [http://www.fiscalreform.net/library/pdfs/fiscal\\_decentralization\\_progress\\_problems\\_and\\_promise-shah.pdf](http://www.fiscalreform.net/library/pdfs/fiscal_decentralization_progress_problems_and_promise-shah.pdf)

**Tanzi, Vito. 1995:** "Fiscal Federalism and Decentralization: A Review of Some Efficiency and Macroeconomic Aspects." *The World Bank Research Observer*. 295-316.

**Thöne, M. dan Jacobs, C., 2001:** *Länderfinanzausgleich in deutschland – Analyse und umsetzungsorientierte Reformmodelle*. Berlin: Duncker & Humboldt.

**Tiebout, Charles M., 1956:** "A Pure Theory of Local Expenditures," *Journal of Political Economy*.

**UNDP, 1997:** *Governance for Sustainable Human Development*. New York: Management Development and Governance Division, 'United Nations Development Programme.

**United Nations, 1996:** *Report of the United Nations Global Forum on Innovative Policies and Practices in Local Governance*. Gothenburg, Sweden: United Nations and Swedish International Services.

**Usman, Shaikhu, 2001:** "Indonesia's Decentralization Policy: Initial Experiences and Emerging Problems." A paper prepared for The Third EUROSEAS

Conference Panel on Decentralization and Democratization in South East Asia. London, September 2001. SMERU Working Paper. (Retrieved from [www.smeru.or.id/report/workpaper/regautofieldexpchall/regautofieldexpchall.htm](http://www.smeru.or.id/report/workpaper/regautofieldexpchall/regautofieldexpchall.htm)).

**Usman, shaikhu, 2002:** "Regional Autonomy in Indonesia: Field Experiences and Emerging Challenges." A paper prepared for the 7th PRSCO Summer Institute/The 4th Indonesian Regional Science Association International Conference: "Decentralization, Natural Resources, and Regional Development in the Pacific Rim: Bali, 20-21 June, 2002. SMERU Working Paper. (Retrieved from [www.smeru.or.id](http://www.smeru.or.id)).

**Volbracht, Renate 2005:** Bringt Dezentralisierung Autonomie in den Regionen?, In: Indonesien Information Jg. 14, Nr. 1, S.24-31, Berlin

**Volbracht, Renate 2005:** Konfliktreiche Dezentralisierungspolitik in West-Sulawesi oder: Sind Flächenbrände vermeidbar?, In: Indonesien Information Jg. 14, Nr. 1, S. 24-31, Berlin

**Werner, Jan, 2003:** The German Fiscal Federalism: in a state of Flux, World Bank paper.  
[Http://www1.worldbank.org/wbiep/decentralization/ecalib/Werner.pdf](http://www1.worldbank.org/wbiep/decentralization/ecalib/Werner.pdf)

**Westergaard, K. 2002.** Decentralisation in Bangladesh: Local Government and NGOs, Available from <http://www.yale.edu/ycias/events/decentralization/>

**Wollmann, Hellmut., 1997:** Modernization of the public sector and public administration in the Federal Republic of Germany, in M.Muramatso and F. NAschold (eds.), state and administration in Japan and Germany, Berlin:deGruyter.

**Wollmann, Helmut, 2002:** German local government under the impact of NPM modernization and new direct democratic citizen rights, Paper prepared for the International Conference on Reforming local government: Closing the gap between democracy and efficiency to be held at the University Stuttgart on September 26-27, 2002

**World Bank, 1999:** India 1998 Macroeconomic Update. Washington DC: World Bank Country

**World Bank, 2006:** Aceh Public Expenditure Analysis - Spending For Reconstruction and Poverty Reduction, The World Bank Office Jakarta, <http://www.worldbank.org/id>

### Acronyms, Abbreviations, and Non-English Terms

APBD	Anggaran dan Pendapatan Belanja Daerah, Regional Government Budget
APBN	Anggaran dan Pendapatan Belanja Negara, State Budget
APK	Angka Partisipasi Kasar, Gross Participation Rate
APM	Angka Partisipasi Mutlak, Nett Participation Rate
Bappenas	Badan Perencanaan Pembangunan Nasional
Bappeprop	Badan Perencanaan Pembangunan Propinsi
BPHTB	Biaya Perolehan Hak atas Tanah dan Bangunan, Land and Building Transfer Fee
BPK	Badan Pemeriksa Keuangan, National Auditing Agency
BRR	Badan Rekonstruksi dan Rehabilitasi, Reconstruction and Rehabilitation Agency
Bupati	Kepala Daerah Kabupaten, Head of District
DAK	Dana Alokasi Khusus, Specific Allocation Grants
DAU	Dana Alokasi Umum, General Allocation Grants
DPD	Dewan Perwakilan Daerah, Parliament member of Regional representatives
DPOD	Dewan Pertimbangan Otonomi Daerah, Regional Autonomy Consideration Assembly
DPRD	Dewan Perwakilan Rakyat Daerah, Regional Parliament
GDP	Gross Domestic Product
GG	Grund Gesetz, Undang – Undang Dasar
GRDP	Gross Regional Domestic Product
HDI	Human Development Index, Indeks Pembangunan Manusia
IHPH	Ijin Hak Pengelolaan Hutan, Land Rent in Forestry
Kabupaten	District
Kecamatan	Sub-district
Kelurahan	Villages in Urban areas
Kota	Municipality
LNG	Liquid Natural Gas

MandE	Monitoring and Evaluation
MoF	Ministry of Finance – Departemen Keuangan
MoHA	Ministry of Home Affair, Departemen Dalam Negeri
NGO	Non Governmental Organization
OECD	Organization for Economic Co-Operation and Development
PAD	Pendapatan Asli Daerah, Local Own Revenue
PBB	Pajak Bumi dan Bangunan, Land and Building Tax
Perda	Peraturan Daerah, Local Regulation
PP	Peraturan Pemerintah, Government Regulation
PPh Perorangan	Pajak Penghasilan, (Personal) Income Tax
RKPD	Rencana Kerja Pembangunan Daerah, Annual Work Plan Regional Development
UNDP	United Nations Development Programme
VAT	Value Added Tax, Pajak Pertambahan Nilai (PPN)