

Republic of Indonesia

(Republik Indonesia)

Capital: Jakarta

Inhabitants: 222.000.000 (2005)

Area: 1.919.440 km²



Indonesia is a unitary state adopting Republic System, which got its independence in August 1945. An archipelago country situated in the equator zone, it consists of seventeen thousands islands with the total area of 1,919,440 sq km. The country is inhabited by more than 222¹ millions people from about 400 ethnic groups. There are four high institutions forming the National Government, namely President, National Parliament (DPR), Supreme Audit Board (BPK), and Supreme Court (MA). There are two levels of sub-national government, namely provincial level, and municipality or city level (hereafter municipality and city will be referred to as local government). In 1998, Indonesia had 24 provinces, 2 Special Districts (same level as province), and 1 Capital District. In August 1999, a UN-organized referendum for the province of East Timor resulted in the independent

country of Timor Leste. However, with the rapid development of decentralisation since 2001, the number of provinces has expanded to 33 by mid of 2006.

Local government is headed by a governor for a province, a *Bupati* for a municipality or a mayor for a city. Until 2004, the country had adopted representative democracy in which citizens vote the political party that would assign its representatives in the parliament. National parliament would select the President, meanwhile local parliament would select the Governor, *Bupati* and Mayor were subject to approval from the minister of Interior and the president. The 2004 national election is the first election in the country in which people voted directly for the President and the Vice President.

Since January 2001, Indonesia has been implementing new Laws on Local Government and Intergovernmental Fiscal Balance which are popularly known as "Autonomy Laws". The Laws were revised in 2004, and one of significant changes is that *Bupati* and Mayor since then are directly elected by citizens. Except for the areas of defence, foreign affairs, religion affairs, justice, monetary, fiscal and macro-economic policies that are in the hand of national government, the rest of government functions are given to the local authority. Even though the new era of decentralisation legally characterises

¹ Estimated in 2005 by Central Bureau Statistics Indonesia



involvement of public participation in local policies, it is not fully implemented.

2. Territorial Organization

2.1 Government Tiers and Their Nature

National Government is located in the capital, Jakarta. The Special Capital District is led by a Governor assisted by one vice Governor and five mayors. There are three other Special Districts –based on historical and political reasons– NAD (formerly Aceh), Jogjakarta, and Papua.

The previous law of Local Government in 1999 version describes that there is no hierarchical relationship between provincial and local governments because local governments are autonomous. The revised law in 2004 returns some former authorities back to provincial government. Conceptually, provincial government works as coordinator in the case of intra-province cooperation, provincial scale development as well as inter-province coordination. The law stipulates that this will include: development planning and controlling, landscape planning and usage, infrastructure development, healthcare, education, social problems, labour, environment, settlement and housing, civil

service, investment, and other assignments that cannot be accomplished by municipal government.

Indonesia's population is unevenly distributed, with the highest concentration in Jakarta (13,225 inhabitants / km²) and the lowest in Papua Island (6 inhabitants / km²). Among the five biggest islands, Sumatra, Kalimantan, Java, Sulawesi and Papua, Java is inhabited by 59% of total population. The density of Java is 951 / km², far above Sumatera (96), Sulawesi (86), and Kalimantan (34)².

2.2 Financial Indicators

(see Table 1: public Expenditures in 2005)

2.3 The Capital City

Jakarta Special Capital District (DKI Jakarta) is inhabited by 7,559,206 people (Civil Service Unit of DKI Jakarta: October 2007) and supported by the four satellite cities Bogor, Tangerang, Bekasi and Depok. According its special status (Law 34/1999), Jakarta has an autonomous government equivalent to the province level. There are five cities and one administrative municipality within the metropolitan area; in addition, the city keeps close partnership by means of arrangements with its satellite cities.

Table 1: Public Expenditures in 2005 (in million Rp except stated otherwise)

Local Public Expenditures	161,300,217	6.1% of GDP
Central Public Expenditures	333,600,000	
Total Public Expenditures	494,900,217	18.8% of GDP
Population (thousand people)	222,051	equivalent with:
Local Expenditures per capita	0.726	€ 62 per capita
Total Expenditures per capita	2.229	€ 189 per capita
Ratio Local Public Exp. / Total Public Exp.	0.326	
Local Public Investment	33,308,490	
Ratio Local Public Investment Exp / Total Civil Public Investment Expenditure	0.36	

Source: National Budget and Financial Notes 2005-2006, Ministry of Finance, the Government of Indonesia

² Data of 2004 by Central Bureau Statistics Indonesia



Under city level, there are *Camats* who lead counties (*Kecamatans*) and are assigned with considerable administrative responsibilities to deliver public services. Each *Kecamatan* consists of several *Kelurahans* headed by a *Lurah* as subordinate of a *Camat*. While a *Camat* reports to a Mayor, a Mayor is subordinate to a Governor in a hierarchical relationship. An Administrative municipality is Pulau Seribu, a group of small islands in the northern part of Jakarta's sea territory.

2.4 Territorial Reform

As one of the special districts, NAD has been granted special autonomous rights by the law from 18/2001. This law allows the NAD government to benefit from additional revenue sources such as *zakat* or wealth levy according to islamic principles. Moreover, apart from having regular intergovernmental transfer, it also receives extra shares so called "special revenue".

The law has granted that NAD is eligible to receive revenue shares from oil production as much as 55% and from gas production as much as 40% until 2009 and afterward the shares will be declined to 35% and 20% respectively. This scheme is higher than the rest of the provinces' percentage shares. Another special treatment is on loan scheme. While it is very difficult for other sub-national governments to issue local bonds, NAD is allowed to make domestic debt subject to approval from local parliament, and foreign debt subject to approval from local parliament and central government. In case of foreign grants, NAD can receive them by only notifying central government, in the meantime, other sub-national governments need approval from the government.

Another special district is the province of Papua (former Irian Jaya). Having similar problems with NAD on separatism and disparity issues, Papua is granted special autonomy through Law 21/1999. This law asserts Papua to guard the Papuan People Assembly which aimed to protect cultural

values and interests. It also requires that the governor should be a native. Furthermore, Papuans are allowed to establish local parties.

In the case of special revenue sources, Papua will receive 80% revenue shares from oil production and 70% from gas production for 25 years or until 2024. Afterward, the shares will become 50% for both oil and gas production's revenues. Apart from this, Papua is eligible to obtain additional block grants as much as 2% of total national block grants as earmarked funds for health and education. The scheme for foreign loan is similar to that of NAD.

3. Local democracy

3.1 Democracy System at National and Local Levels

The Revised Autonomy Law in 2004 states that local election is to be conducted by the Commission for District Election (KPUD) in which the head and the vice head of local government are elected directly by the local citizens. Prior to the new law, Indonesian decentralisation was centred at municipal government level with strong involvement of the local parliaments.

Several cases in the past indicate that the power has been politicised such that a mayor or *Bupati* could be impeached and fired by the local parliament due to political pressure received from interest parties or in order to win popularity from voters.

Since the 2004 national election, 24 political parties have representatives in the national parliament. Some of the small parties can only have representatives in few regions. To be eligible to participate in the next national election, a political party is required to win at least 3% seats in national parliament and at least 4% seats of local parliament in minimum of half of regions. The national elections use proportional representation.



The candidates backed up by Golkar - the oldest and once the most dominant political party in the previous regime - won about 30% of all local elections in 2005. The mayor and *Bupati* can be re-elected twice. Neither local Parliament nor citizens can reappoint the mayor. The Minister can lay off the mayor only if he committed a crime proven by court. The mayors and the *Bupatis* are elected through separated local elections according to the previous mayor or *Bupati* period's termination date.

Local parliament consists of several constituencies and is based on proportional rule. The representatives serve for 5 years of mandate and there is no limitation for re-election.

Changes in the political system have therefore changed many sub-systems in public governance. Some regions use their greater autonomy as an opportunity to bring up new ideas and innovative approaches. A report from the World Bank in 2003 indicated that most people felt that the quality of public service had not been improved; however, similar repeated study in 2005 denoted that the situation may have been stabilised and even modestly improved.

3.2. Citizen Participation

One of the democratic pillars is civil society participation in policy-making and development process. In practice, several cases show that public participation has been empowered quite significantly; however, this is not the general case. As Indonesia is a large country with different characteristics of culture, resources, and geographical condition, it is quite complicated to withdraw a conclusive assessment without making excessive generalisation.

Depending on society's culture and education level, public participation varies from very active to very little. It occurs from the lowest level of governmental unit or limited only to few groups or units of

local government. The law also gives room for public participation at villages, the lowest level of local government unit. To issue a local regulation, executive bodies (i.e. local government) propose the draft to local parliament. Local parliament then usually conducts public hearing before giving corrections, rejection, or approval to the bill.

The new approach in the governance system is nevertheless facing resistance from old-fashioned ones. In several regions, traditional approaches and institutions still exist and local governments have no way other than to adopt "local wisdoms" in order to support good governance. Regulation recognises the existence of some customary institutions, such as allowing "tribal society norms", "traditional principles" or "religious law" to be used in daily practices as long as they do not conflict with higher regulation.

4. Central-local relationships

4.1 General Issues

Local government is an autonomous government body responsible to deliver all aspects of local government's tasks. In early times of decentralisation, municipality and city are the centres of local autonomy. The revised Law withdraws the authorities from municipality and city to province and assigns province as coordinating body to harmonise cross border relationship between municipalities and cities.

Former agencies under line ministries in pre-decentralisation era have been transformed into units of local government or abolished. Central government now has only limited branches to conduct related central government tasks in the regions, such as tax offices, customs, central bank, military bases, and courts.



4.2 Supervision of Local Government

In general, the Ministry of Interior is responsible to oversee local government action, for example, new local regulations are subject to approval from Ministry of Interior and elected Mayor/*Bupati* is appointed by the Minister. Financial oversight is performed by Ministry of Finance and Supreme Audit Board. Sectoral oversight is a bit unclear. Line ministries have no power to evaluate performance of local government in each respective sector.

Poor local financial report can result in delay or cancellation of transfer disbursement. Local regulation that is considered distorting economy or conflicting with higher law is subject to revision or abolition. Ministry of Interior has been trying to formulate tasks division for each institution at all levels, and after 3 years of discussions and debates among the institutions, in July 2007, the Government Regulation or PP No 38/2007 was issued. However, the problems of coordination between central government bodies and local government still exist.

4.3 Protection of Local Government's Rights and Interests

The central government has the rights to revoke local government which violates the law and may withdraw parts of its entitlement. This has not happened yet, since local and central relationship is quite good.

At national level, there is a Regions' Representatives Board (DPD) in the national parliament whose members are elected by each region to represent them and are expected to bring local issues into national concerns. However, its rights are limited.

There are several local government associations Indonesia:

- a. APKASI or Association of Municipality Governments of Indonesia, which is the largest one.
- b. APEKSI or Association of City Governments of Indonesia.
- c. APPSI or Association of Provincial Governments of Indonesia.
- d. ADKASI or Association of Municipality Parliaments of Indonesia.
- e. ADEKSI or Association of City Parliaments of Indonesia.
- f. Recently, Islands Provinces formed an Association in order to improve their bargaining position towards the central government related to their complex characteristics as islands provinces.

For their concerns, these associations conduct meetings, partnerships, and lobby National Parliament and central government. On the other hand, the Committee for Oversight of Autonomy Implementation (KKPOD) is an independent organisation, established by research institutes and the chamber of commerce.

5. Local responsibilities and Functions

The Ministry of Interior has issued a decree that explains the performance budget system in which the bottom-up planning procedures in every step require public participation. In the past, allocation of local budget was mainly set through a centralised planning system; line ministries and the Planning Agency decided development projects for each region. Transfers from central government were determined on a project basis and local government officers were paid by the central government. Proposed budget by a local government had to be approved by the respective local parliament, governor and Minister of Interior.

In the new system, line ministries no longer decide the development projects for regions, except for some critical projects, involving inter-provincial or national level interests. These types of projects are



usually made on the basis of matching-grant. On the other hand, block transfers are decided by a particular formula and aimed to compensate the fiscal gap among regions.

Even though almost all of local public service functions have been delegated to the local government, together with the expenditures authority, it is not used by the authority to generate significant local revenues. Generally, local governments finance their public expenses by using fiscal transfers.

The levels of authority given to the local government vary depending on the nature – scope and scale – of the functions. For selected sectors below, the level of authorities given to the local government are as follows:

a. Planning. At the level of local planning, the local authority has full command. Local governments are responsible to decide their own priorities, as well as to allocate public expenditures to finance them. Inter-municipal planning requires a coordinating role of province(s), while inter-provinces or projects that are subject to national level planning usually requires coordination with the central government.

b. Education. Primary education is a local government's task; however, the Ministry of National Education sets national standards.

c. Provision of social services. This task is performed by local government and financed out of local budget. Local government is also responsible to decide priorities for the services.

d. Provision of health services. In the case of healthcare insurance for poor families, National Health Insurance acts on behalf of the Ministry of Health. The financial scheme is jointly shared by the central government and the local government. Critical cases such as avian flu, SARS, dengue fever, or other epidemic diseases

as well as basic vaccination for infants belong to central government's responsibility.

e. Water supply. Clean water is basically provided by local government either directly through locally-owned enterprises or indirectly by contracting out the service fully or partially to a third party.

f. Energy supply. After a long time under a monopolistic system, in 2004, a new law of electricity mandated to decentralise and privatise several business units of the National Power Company. However, before unbundling process occurred, the Constitutional Court abandoned the new law. A similar story happened to the new law of oil and gas. Therefore, Indonesia still applies a centralised system in the energy sector.

g. Public transport. Public transport is generally decentralised and open for the private sector. In small cities and municipalities, local governments usually do not provide the service, but support the facilities such as providing terminals, related local regulations, license etc. On the regional or national level, except for railway service, it is open for all players – both government and private - to participate in the market. However, central government still regulates the ceiling price to prevent consumers from unfair market practices such as price collusion by providers.

h. Business development support. At the local level, there is the Local Investment Board and some local governments have established One Stop Shop (OSS) system to foster a good investment climate. However, due to capacity problems, only few local governments have good OSS.

In brief, the local government tasks that are rather decentralised are the provision of primary education, health services, and local development planning.

On the contrary, three local government tasks are rather centralised: energy



supply, higher education, and land management.

6. Local finance and management

6.1 Local Government Incomes

The following table characterises local government's revenue sources.

Local tax types and rates are determined by the central government. Even though there is an option for local government to create new local taxes that is subject to central government approval. This rule is made to prevent local government from exploiting the economy. According to Law 33/04, sub-national governments are prohibited to issue local regulation that can lead to a high cost economy and restrain mobility of people, goods and service, as well as export and import activities.

According to the law, there are four types of taxes assigned to provincial

governments and other nine belong to local governments. Provincial taxes are also shared to local governments, as described in following table:

Municipal taxes consist of hotel tax, restaurant tax, entertainment tax, advertisement tax, road illumination tax, tax on non-strategic and non-vital mining, parking tax, underground water tax, and environment tax. The central government sets the maximum rate of local taxes, varying from 5 to 35%.

Tax sharing across government levels consists of property taxes and personal income tax. Meanwhile, non-tax sharing is obtained from natural resources i.e. forestry, mining, fishery, as well as production of oil, gas and geothermal. In 2005, tax sharing and block grants contributed as much as 70.4% to the total local income, while local tax revenues contributed only 20.8%.

Between 1996 and 2000, total sub-national government spending is 16.7 % on average to the national government spending. Meanwhile in the period of 2001 to 2005, the ratio increased significantly to 33.8 %. Prior to decentralisation, the ratio of own-source revenue to the total spending on local budget was only about 10 to 12 percent. Decentralisation does not

Table 3: Local Budget: Revenue Structure

Own-source Revenue	<i>Local Taxes Local Charges Profit from State-owned Companies Other Authorised Local Revenues</i>
Balancing Grants	<i>Tax Sharing Non-tax Sharing General Purpose Grant Conditional Grant</i>
Borrowing	<i>Domestic Borrowing State Obligation Foreign Borrowing</i>
Other Authorised Revenues	<i>Revenue from Central Government Revenue from Provincial Government Revenue from Other Municipalities Emergency Funds</i>

Table 4: Revenue Sharing from Province Taxes

Tax	Province	City
Taxes on motorised vehicles	Max 70%	Min 30%
Name-change fees for motorised vehicles	Max 70%	Min 30%
Tax on fuel	Max 30%	Min 70%
Tax on surface water	Max 50%	Min 50%

Source: Law 33/2004



increase the ratio; instead it decreases the share of own-source revenue, because the transfer received from the national government has increased sharply while local taxes capacity only increased slightly. On the expenditure side, local government has higher autonomy to allocate a bulk of transfer. On the revenue side, tax authority is not yet decentralised: local government has no power to set the rate or new sources of taxes.

6.2. Local Government Personnel and Management

The number of local government officers in June 2006 is 2,781,476 persons (The National Civil Service Agency, 2006) or about 76.5% of total government employees. About 25% of the personnel are low rank employees (grade I and II). The recruitments are done through examination and the officers are appointed by public law. Recruitment process, especially for low rank positions, usually is prioritised for contract workers who have worked for significant years. Meanwhile high rank position is generally filled based on career promotion. Training for local officers is mandated implicitly by the law. It can be in the forms of scholarships provided by local authority and central government, or training conducted by central government, or joined partnership between both public and private/international institutions. To prevent biased preference and political manipulation, the government officers are not allowed to become activists in political party.

Corruption is a serious problem in Indonesia's governmental system. According to ADB survey in 2005, local corruption and national corruption are ranked in the 3rd and the 4th of the most frequent problems faced by investors. One of the sources of corruption are state-own enterprises. It has been openly criticised that SOEs' performance is very poor - many of them accumulate large unpaid

debt, work inefficiently, provide bad services and book loss. The condition calls for the idea of privatisation. Since the political reform in 1998, the new regime has started to release government's shares in several SOEs. Some of SOEs have been sold to public.

The government has established a National Ministry of SOE to take care of the management of SOEs. The opponents criticise that the Ministry only sells SOEs at discount prices to fill the budget deficit, meanwhile some others see that the costs of inefficient and corrupt SOEs are better cut from nation's burden. There are both success and failure stories of privatisation even though this is subject to debate. Recently, the idea to bring corporate values and norms into governmental bodies starts to be discussed again. Some local governments have moved forward by contracting out several functions to private group, borrowing the idea of new public management - for example, contracting out waste management, or privatising local water supply enterprises.

Institutional setting and capacity issues do contribute to significant problems. The lack of competent human resources particularly in local level makes intertwined institutional relationship become more complex. In early years of decentralisation, many local governments booked surplus budget, not because they were prudent to allocate and spend money but because of lacking planning and executing capability. Moreover, disbursement of transfer in those years was often behind schedule.

However, local government has been evolving together with public awareness on decentralisation. Many NGOs and the media that support public voices on local government's policies become noticeable. To some extent, local governments have learnt their lessons even though the level of improvement cannot be qualified precisely. Several court cases on corrupt local officers and representatives also



indicate that control and law enforcement have improved.

There are a lot of changes towards good local governance but there are still many things to be improved. Among important problems are a less welfare-oriented government, dispute on interests between local and central government, inefficiency, the local level's increasing fiscal dependency the central administration, the lack of alternative local revenue sources, dissonant regulations, the inter-governmental coordination and the high disparities in regional development

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