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INTERGOVERNMENTAL TRANSFERS AND DECENTRALISATION IN INDONESIA

Christopher Silver
University of Illinois

Iwan J. Azis
Cornell University and University of Indonesia

Larry Schroeder
Syracuse University

A fundamental restructuring of intergovernmental relations involving decentralisation and expanded autonomy for provincial and local governments is under way in Indonesia. This paper explores the intergovernmental financial system that preceded the new General Allocation Fund (DAU), with particular attention to the old Inpres development grants. Like Inpres, the DAU attempts to address national development objectives, and can be seen as a logical consequence of reform efforts in intergovernmental finance that began long before the demise of the New Order government in 1998. The use of earmarked Inpres grants enabled the central government to ensure that key sectors such as roads, public health and education received adequate attention throughout Indonesia's diverse regions. Local governments' experience with Inpres should help in implementation of the DAU, yet Law 25/1999—which restructures fiscal relations between the various levels of government—may actually have increased local reliance on the central government.

INTRODUCTION

Indonesia's system of intergovernmental financial transfers accounts for more than 70% of all regional government revenues. It is widely recognised that 'Indonesia has ... one of the most centralised tax systems in the world' (Ma 1996: 29), making the system of transfers from central government to regional governments the determining factor in local fiscal capacity. The economic and political crisis that hit Indonesia in 1997 (Forrester and May 1999) accelerated a process of decentralisation in central-local government relations that had been under way for more than two decades (MacAndrews 1986; Walker 1991; Leigland 1993; Ranis and Stewart 1994; *JP*, 10/3/01). Two laws enacted in 1999 under the short-lived Habibie government framed the imminent transformation of central-local relations.

Law No. 22/1999 replaced the hierarchical governance system linking local governments to the centre with one that granted local governments considerably greater autonomy. With mayors and district heads now selected by local assemblies rather than appointed by the provincial governor, local governments have become accountable to the local

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population in a fundamentally new way (Alm and Bahl 1999). According to Rya'as Rasyid, who briefly headed a ministry created in 1999 by the Wahid administration to oversee implementation of Law 22, the 'new paradigm' in intergovernmental relations necessitated a fundamental shift from central to local dominance, with districts and municipalities to receive greatly expanded functions (Press release, US Embassy, Jakarta, 21/7/00).[1]

The companion act, Law No. 25/1999, revamped fiscal relations between the central government and the regions by restructuring the system of intergovernmental transfers. One significant change was that funding of regional civil servants' salaries through the Autonomous Region Subsidy (Subsidi Daerah Otonom, SDO) was discontinued, as was the extensive array of Inpres (Instruksi Presiden, Presidential Instruction) development grants. These were replaced by a single block grant, known as the General Allocation or General Purpose Fund (Dana Alokasi Umum, or DAU). While the language of Law 25 suggested the likely retention of several earmarked transfer grants, particularly for primary schools, public health, roads and water supply (Alm and Bahl 1999: 1–4), implementation of the DAU in January 2001 eliminated the dual system in favour of a single block grant.

In working out the fiscal aspects of decentralisation, a key concern has been whether local governments are capable of assuming the level of responsibility and discretion necessitated by a block grant system. One reason why decentralisation in Indonesia proceeded so slowly during the 1980s and 1990s was the commonly articulated view that local governments lacked both the capacity and the willingness to manage their affairs independently. This view was advanced by New Order government ministries that did not want to relinquish control of development funds to the regions, and was based largely on anecdotal evidence rather than any systematic appraisal of local performance. Throughout the year before Laws 22 and 25 were implemented, the unpreparedness of local governments for fiscal and administrative autonomy was a common refrain of decentralisation critics and sceptics. Yet, according to a variety of observers in the early months of 2001 when implementation was under way, the lack of preparedness argument could be seen to be overstated, and insufficient preparation was as much a consequence of central government inertia as of local incompetence. According to management consultant Owen Podger, every region in Indonesia 'was unique in its approach to decentralisation' and, in spite of inadequate guidance from the central government, relatively smooth decentralisation was proceeding throughout the nation. In Podger's view, what was undermining the process more than local unpreparedness were the fiscal constraints imposed by the new intergovernmental transfer system (Podger 2001). In short, many local governments appeared to have fewer funds available to handle a greater level of responsibility. University of Indonesia economist Bambang Brodjonegoro (2001) contends that many regions receive larger transfers under the new system than before. However, this is offset by declining locally generated revenues.

Although doubts about the administrative competence of local governments were a matter of longstanding concern, and had the effect of forestalling large-scale reform in the intergovernmental financial transfer program throughout the 1990s, there were some noteworthy incremental changes that anticipated the new approach of Law 25. These changes, which were encouraged by technical advisers from donor agencies through their counterparts in the Ministry of Finance (MOF), the Ministry of Home Affairs (MOHA), and the National Development Planning Board (Bappenas), focused on such critical issues as interregional fiscal disparities, the service needs of rapidly expanding urban areas (both municipalities and urbanising districts), and the lingering effects of poverty in municipalities and rural areas. In key respects, the kind of local fiscal discretion implicit in the DAU had a trial run through the creation of several smaller block grants under the Inpres program. Given the still fluid state of the intergovernmental financial transfer system, and remaining questions about how effectively the DAU supports the functions of local governments, it is useful to assess how revisions to the previous system succeeded (or failed) to support effective local autonomy.

This study focuses on the Inpres system, since these grants most closely approximated the DAU and encompassed both earmarked and discretionary transfers. Throughout the 1990s, changes in the Inpres grant system were instituted on the premise that expanded local discretionary spending for development would increase the efficiency of the intergovernmental transfer system. In what proved to be the final few years of the New Order government, there was an emerging consensus in Jakarta about the need to move toward a structure of governance with expanded local responsibilities, but there was no set timetable for implementation, or blueprint of how the restructured system would operate. As a *Jakarta Post* editorial noted in May 1996, it was 'imperative and urgent ... for the central government to speed up the development of local autonomy in the districts', including devolution of 'spending responsibility and revenue sources' (*JP*, 29/5/96). There was also a widely shared recognition that the intergovernmental transfer system would be improved if the basis for the transfers were formula-driven rather than based upon arbitrary allocations. In these two respects, the revolutionary changes in intergovernmental transfers incorporated into Law 25 were anticipated in approach if not in scope. For that reason, the strengths and limitations of the Inpres system may provide a useful guide to policy makers as they negotiate the uncharted waters of full-scale decentralisation. For local government officials, the experience under Inpres (and SDO) underscored their dependence on central government transfers to finance local services. Except in those few areas that benefit from natural resource revenues under the new arrangements, local dependence upon central government transfers may actually increase in the new 'decentralised' system if local own-source revenues do not keep pace with transfers.

AN EXPERIMENT IN DECENTRALISATION

The centrepiece of Indonesia's decentralisation policy reforms leading up to Laws 22 and 25 was an experiment in autonomy at the district (*kabupaten*) level. In 1995, the New Order government operationalised a 1974 law on decentralisation (Law No. 5/1974) by launching a two-year district autonomy pilot project involving transfer of selected functions from central and provincial levels to 26 districts (Beier and Ferrazzi 1998). The District Autonomy Pilot (DAP), as it was known, was a step toward governmental decentralisation, in that it combined national and local sectoral offices at the local level. A major limitation of the DAP was that it did not include complementary changes in local government finance. Local governments continued to be reliant upon grants and loans emanating from and administered by the central government (Devas 1989). For example, SDO grants, administered through the MOHA, traditionally constituted the single largest pool of funds for recurrent local expenditures (Riphat 1991: 99): in 1996/97, SDO grants totalled more than Rp 10 billion, compared with Rp 7 billion in the more discretionary Inpres program (MOF 1997: annex C). Since SDO grants paid the salaries of all local government officials (including school teachers), these workers were employees of the central government. Under the autonomy experiment, the combined central and district level sectoral offices continued to be funded through SDO grants, and local administrators had no power to shift personnel without approval from Jakarta. As a result, the elimination of the redundancy between national and local sectoral offices did not produce any management efficiencies.

Proposals throughout the 1980s and early 1990s to convert the SDO into a locally administered block grant were never given serious consideration by the central government, because this change would have disrupted local and central government administrative relationships in a fundamental way, and there was no support for this in the New Order government. With no advance warning, the passage of Law 25/1999 eliminated the SDO and, through the DAU, made it a local responsibility to allocate and fund employees. The DAU combined SDO and Inpres into a single grant from the centre to local governments, equal to no less than 25% of domestic revenues. While the SDO reform component of Law 25 was a key to decentralisation overall, the experience of local governments under SDO did not provide any relevant training in managing decentralisation. But Inpres grants did, since expenditures under these development funds were allocated and administered to some extent by local governments. There is a further connection, because the DAU had its antecedent in a discretionary block grant known as Inpres Umum (General Inpres). Inpres evolved from a single block grant in the 1970s into a complicated array of targeted transfers by the 1990s, but in the 1990s the Inpres Umum component was enlarged. From this vantage point, although the new system stipulated in Law 25 may offer an innovative model for intergovernmental fiscal relations, it is one that has direct links to the previous approach to local development efforts under Inpres.

FINANCING LOCAL GOVERNMENT UNDER THE NEW ORDER

During the New Order Period, finance for Indonesia's local governments was derived from a combination of sources. Local own-source revenues, including the nationally imposed property tax (Pajak Bumi dan Bangunan, or PBB) were one component. Locally generated and shared revenues[2] constituted roughly 31% of total local government revenues in FY 1994/95 (the then Indonesian fiscal year from April to March) (Kelly 1993; Shah *et al.* 1994; MOF 1997: 32). The rest were derived from various central government loans and grants, with the latter commonly the more important of the two. From the 1970s through 1998, grant-supported development spending by local governments was channelled through the Inpres and SDO grants. Inpres and SDO grants supported most components of local administration, infrastructure and services, including local government officials, roads, schools, land preparation, soil conservation, markets, clean water, sanitation and drainage systems, health, 'regreening' (planting trees along roadways), training, technical assistance and planning. Given relatively meagre locally generated own-source revenues in most regions, the capacity of local governments to achieve local (let alone national) development targets was a function of the volume and structure of intergovernmental transfer grants. The evolving structure of these grants, which was tacitly aligned with decentralisation efforts, supported the implementation of national policy objectives but did relatively little to address the unique needs of individual local governments.

Key program changes in intergovernmental transfers, especially under the sixth national five-year development plan (Repelita VI, 1994–98), sought to move these transfers from a collection of earmarked central government allocations toward a block grant program. At the same time, continuing pressure to use transfers to local governments to address national development objectives led to new targeted grants that ran counter to the policy of merging targeted (or earmarked) grants into a single general use block grant. The net effect was not more local discretion but rather an increasing share of transfer grants subject to central government strictures. Municipalities and districts experienced different impacts from these changes, but the typical experience was reduced overall discretion at the local level. The changes that took place were largely related to Inpres, with no fundamental alterations in the SDO. One other generally overlooked change was the conversion of funding from several sectoral project allocations, known as Daftar Isian Proyek (DIP), to Inpres. The basic difference between DIP and Inpres allocations was that the former were administered locally through the offices of the relevant central government ministries, whereas Inpres funds went into local government offices and were subject to local priorities. The shift from DIP to Inpres was a step toward reducing direct influence by central government offices in local expenditures.

Expansion of Inpres Transfers

Inpres grants supported a wide array of sectoral and general development needs for provincial and district/municipality governments through a combination of general use (Umum) and special use or earmarked (Khusus) grants. Inpres grants were introduced during the first national development plan (Repelita I, 1969–73) as block grants for rural infrastructure projects to stimulate employment (Booth 1996: 188–9). During the late 1970s and the 1980s a variety of earmarked grants were added, including funding for urban areas. By the late 1980s, earmarked Inpres grants exceeded general use block grants, as the central government sought to address priorities in different sectors through local projects. In the 1990s proponents of decentralisation called for enlargement of the block grant component of Inpres, both to counter the growing influence of central government ministries and to return to the initial structure of Inpres as a locally directed grant.

Despite its high visibility as a focal point of decentralisation efforts, as late as the 1980s Inpres remained a relatively small part of overall grant transfers, and its effectiveness was hampered by fluctuations in annual funding levels. For example, the total Inpres allocation of Rp 1.4 trillion for 1985/86 fell to Rp 0.9 trillion in 1987/88. Not until 1990/91 did the annual allocation exceed the 1985/86 level (table 1). Volatility in annual funding levels, coupled with a lack of fixed and transparent criteria in allocations to localities, made Inpres a problematic source of local financing in the 1980s. During the 1990s the overall Inpres

TABLE 1 *Annual Inpres and SDO Allocations, 1985/86–1996/97*

Year	Inpres (Rp trillion)	Change (%)	SDO (Rp trillion)	Inpres/ (Inpres + SDO) (%)
1985/86	1.4	–	2.4	37
1986/87	1.3	7	2.5	34
1987/88	0.9	31	2.6	26
1988/89	1.1	22	2.9	28
1989/90	1.3	18	2.6	33
1990/91	2.2	69	4.1	35
1991/92	3.4	55	4.6	43
1992/93	4.0	18	5.1	44
1993/94	4.8	20	5.9	45
1994/95	5.3	10	7.0	43
1995/96	5.4	2	7.3	43
1996/97	6.0	11	9.3	39

Source: MOF (1997).

funding level rose. This increase, together with stabilisation of the proportion of the national budget allocated to intergovernmental financial transfers in general, made Inpres a more reliable component of local government finance. Historically high levels of Inpres and SDO grants in the 1990s proved to be a significant factor in the transition to the DAU under Law 25. As Brodjonegoro (2001) notes, the politics of decentralisation required that the DAU be at least equal to the total of previous SDO and Inpres grants under the new system.

Although Inpres evolved from a single general use grant into a complicated collection of general use and specific use grants intended for small-scale local development projects, it is important to note that the general use Inpres Umum grant was retained for local government allocations. A combination of common practice and pressure from central government limited local discretion in the allocation of this grant, however. Many local governments were compelled to use Inpres Umum to finance projects when earmarked grants were insufficient for a scheduled project or when counterpart funds were required by foreign donors for projects initiated by the central government. Beginning in 1989/90, the central government determined that approximately 50% of the provincial Inpres should go toward road and irrigation projects, and created a targeted grant for this purpose from general use grant funds. Another priority of the central government, to improve local roads, led to a 'road Inpres' being carved out of the local government general use grant. Between 1989/90 and 1995/96, the road Inpres increased from Rp 173 billion to Rp 974 billion.

Other central government development priorities were accommodated through new grants for school construction, public health facilities, and 'regreening'. In the 1990s, national development priorities such as infrastructure finance for poor ('left behind') villages (Inpres Desa Tertinggal, or IDT), technical assistance to poor villagers, construction of public markets, expansion of the local planning function and, most recently, human settlement infrastructure financing in urban areas, were added to the Inpres agenda. Each grant employed separate allocation formulae and implementation criteria, and tended to reflect the priorities of the sponsoring central government ministry. By the mid 1990s, Inpres was no longer a general discretionary grant program but a highly prescribed, central government controlled, multi-purpose development fund.

Program Changes in Inpres

As the Inpres program evolved from a predominantly 'block' to a predominantly 'earmarked' grant program in the 1990s, two notable programmatic changes occurred.

First, distribution of Inpres grants became less reliant on a per capita allocation criterion. The use of land area and 'island status' factors in the allocation formula for the general use grant reduced the influence of the population variable, so that a larger proportion of Inpres went to less populous areas. The proliferation of earmarked grants, none of which used a per capita allocation factor, also favoured the less populated jurisdictions (Booth 1996: 199–201). In 1990/91, for example, sparsely populated Irian Jaya accounted for only 1% of the nation's population. But with one-fifth of Indonesia's land mass, it secured 8% of all Inpres grant funds. Densely populated regions in western Indonesia received proportionately smaller allocations.

As a result, 'by 1994/95, the top four recipients of per-capita Inpres were all in Eastern Indonesia (East Timor, Irian Jaya, Central Kalimantan and Central Sulawesi)', according to Iwan Jaya Azis (1996). Azis contended that 'virtually all provinces in Eastern Indonesia receive[d] a greater amount than the average per-capita for the whole country' (Azis 1996: 98), and that this was explainable by the allocation criteria used. The fact that Eastern Indonesian provinces received larger per capita amounts indicates that changes in the intergovernmental transfer system countered what government critics regarded as a previous 'Java bias' in the distribution of central government resources. The Inpres allocation process was addressing regional inequities, in that those areas receiving additional funding were outside Java and characterised by lower per capita incomes.

In fact, the dominant bias in the Inpres system in the mid 1990s was anti-urban rather than pro-Java, owing to the plethora of earmarked grants, coupled with the emphasis in allocation on factors such as area and 'island status'. Regions with relatively smaller populations (and greater land area) received proportionately more Inpres funds, and those with the highest concentrations of population, especially municipalities and urbanising districts on Java, received proportionately smaller Inpres allocations than would be expected in a system based upon per capita allocation. In short, municipalities and urbanising regions were the apparent losers under the changing allocation formulae, and rural areas, especially in the eastern regions, gained.

Second, the creation of the IDT grant program in 1994 further underscored the government's intention to use Inpres to address rural poverty, especially outside Java. It also introduced a novel development concept, micro-enterprise grants, which became a feature of social safety net programs during the economic crisis that began in 1997. Under IDT, a fixed Rp 20 million grant to finance revenue-generating projects went to each of 20,000 identified needy villages (Bappenas

1995b). In 1995/96, a special infrastructure development grant (the Village Improvement Program, VIP) was added to finance projects in poor villages outside Java. Of 22,054 villages funded under IDT in the 1996/97 allocation, only 2% (441) were located in urban areas. The architects of IDT cleverly limited its reach to what were termed 'productive or potentially productive' villages outside Java, and only a handful of very poor villages on Java. In effect, the substantially larger number of poor villages on Java were effectively screened out, and most IDT aid went to the needy off-Java islands (Schroeder 1995).

Increased allocations to assist in rural poverty alleviation beginning in 1994/95 accelerated the growth of overall Inpres funding. The total Inpres allocation to all jurisdictions from 1994/95 to 1997/98 (the years immediately preceding the passage of Law 25) is shown in table 2. According to local government officials, the proliferation of new Inpres grants and program changes affecting existing Inpres grants during this period imposed a staggering local administrative burden. The tendency to earmark grant allocations was the most obvious change, and this even affected the general purpose (Umum) grants. In 1994/95 and 1995/96, Umum grants included not only the population–land area based allocation, but also three small earmarked grants—one for spatial planning in municipalities (Inpres RUTR, Rencana Umum Tata Ruang), one for infrastructure improvement for the urbanised core of districts and municipalities (Inpres Pembangunan Perkotaan, Municipal Development Inpres), and one to support development of village housing. In 1996/97, these earmarked components of the Umum grant were terminated, and in their place the base allocation for regions was increased from Rp 5,000 to Rp 5,500 per capita. At the same time, however, the total allocation for all Khusus grants increased even more; expansion of the earmarked grants was the primary factor in the overall growth of Inpres funding in 1996/97.

The number and scope of Khusus grants grew substantially in the mid 1990s. In 1994/95 only four sectors were supported by Khusus grants—market development, rehabilitation of schools, 'regreening' and roads (table 2). The road Inpres was by far the largest, accounting for nearly three-quarters of the total. In 1995/96, an earmarked grant to fund rehabilitation of public local health centres, and another to support local government planning and monitoring of Inpres-financed projects, were added. In 1996/97 another grant to fund village and municipality subdistricts (*kecamatan*) was created, with the allocation to each jurisdiction dependent upon the number of *kecamatan* within the district.

In 1997/98, another five Khusus allocations were added, primarily as a result of the central government's decision to rechannel funds from centrally controlled development (DIP) expenditures to locally administered Inpres. Among the new Inpres funds were grants to support decentralisation of agricultural extension offices, small-scale agricultural development, and urban services in human settlements, including water and sanitation (solid waste, drainage and waste water). A new urban settlement infrastructure assistance grant (Inpres Prasarana Dasar Permukiman di Perkotaan, Inpres PDPP) was also included under the Inpres umbrella, although during the first year of funding (1997/98) allocations to individual jurisdictions were based on urban investment priorities determined previously by the Directorate General of Human Settlements in the Ministry of Public Works in Jakarta.

TABLE 2 *Total Inpres Allocations by Program, 1994/95–1997/98 (Rp billion)*

	1994/95	1995/96	1996/97	1997/98
Umum				
Block grant[a]	1,033.5	1,056.4	1,177.3	1,206.9
Urban planning	5.0	4.8	0	0
Urban development	55.6	50.6	0	0
Village housing	18.6	15.6	0	0
Total Umum	**1,112.7**	**1,127.5**	**1,177.3**	**1,206.9**
Khusus				
Public markets	5.0	6.0	7.0	8.0
Primary school rehabilitation	250.0	250.0	300.0	385.1
Regreening	82.5	88.9	99.7	99.7
Roads	967.6	997.6	1,097.4	1,188.5
Planning and monitoring	0	3.8	4.6	0
Health clinics	0	51.5	76.7	76.7
Subdistricts	0	0	7.7	0
Agricultural extension	0	0	0	72.2
Technical advice to poor villages	0	0	0	41.5
Environmental impact assessment	0	0	0	10.4
Urban infrastructure	0	0	0	290.0
Public assistance	0	0	0	25.0
Total Khusus	**1,305.2**	**1,397.8**	**1,593.1**	**2,197.1**
Umum + Khusus	**2,417.8**	**2,523.3**	**2,770.4**	**3,404.0**

[a]For 1997/98, the amounts include allocations previously shown as Khusus grants for subdistricts and local planning and monitoring.

Source: Bappenas (1994, 1995a, 1996, 1997).

This grant was intended to replace DIP financing, and eventually to shift to a formula-driven disbursement process tied to the performance of local governments in infrastructure development. A distinct feature of these urban infrastructure grants was that a portion was to be used as counterpart funds to support central government initiated urban infrastructure projects. This was intended to eliminate the practice of using local government general use grant funds as the local match for regional infrastructure projects. For some localities, the counterpart component of the Inpres PDPP was as high as 80% of the total allocation.

The additional Inpres components triggered a dramatic increase in the overall level of funding. At the same time, these program changes yielded a net decline in local discretion. Umum grant allocations increased annually by 1.3–4.4% between 1994/95 and 1996/97, but Khusus allocations rose by 7.1–14.0% per annum over the same period. In the next (and last) year for Inpres, Khusus grants increased by 37.9%, whereas Umum grants grew by just 2.5%. Although

TABLE 3 *Annual Change in Inpres Umum and Khusus Allocations for Selected Districts and Municipalities* (%)

District (D)/ Municipality (M)	1994/95			1995/96			1996/97		
	Umum	Khusus	Total	Umum	Khusus	Total	Umum	Khusus	Total
Java									
Bandung (D)	1.4	–8.5	–1.9	9.1	8.3	8.9	1.5	28.2	9.7
Bandung (M)	3.3	–42.3	–8.8	10.0	11.7	10.3	3.1	21.5	6.2
Semarang (M)	2.4	–22.8	–5.7	6.4	10.4	7.4	2.0	280.4	76.8
Sidoarjo (D)	3.4	–9.8	–0.2	8.6	2.4	7.1	3.5	84.0	22.3
Off Java									
Aceh Utara (D)	8.0	0.1	2.9	–1.8	2.7	1.0	3.3	54.1	35.4
Ambon (M)	8.6	25.8	18.8	–6.2	43.7	25.0	3.1	41.8	31.0
Buleleng (D)	–4.6	2.6	–1.7	6.1	15.2	10.1	1.3	59.6	27.0
Gowa (D)	–0.5	7.3	7.3	6.8	23.9	17.6	1.0	37.9	25.7
Kutai (D)	5.2	22.7	15.9	9.7	19.0	15.7	4.3	29.7	21.3
Lombok Tengah (D)	–2.8	–2.2	–2.6	6.1	69.1	33.1	1.6	67.3	37.4
Mataram (M)	2.2	17.1	10.5	3.8	25.6	16.6	2.8	124.7	80.1
Minahasa (D)	–6.4	18.3	8.9	1.7	29.4	20.2	0.5	35.9	26.0
Padang (M)	7.3	–28.5	–8.6	8.5	15.8	11.0	3.3	68.7	27.0
Samarinda (M)	10.4	7.5	9.1	5.4	25.1	14.4	5.9	35.9	20.9
Ujung Pandang (M)	2.3	–13.8	–3.3	7.5	22.0	12.0	3.1	54.0	20.2

Source: Data provided by Directorate General of Regional Development, Ministry of Home Affairs, Jakarta.

some Inpres program changes were introduced with the stated objective of supporting further decentralisation, the changing system of Inpres allocations to individual jurisdictions suggests that the central government used Inpres reforms to meet national development targets rather than to support decentralisation. The percentage increases in Khusus allocations outpaced growth rates in Umum allocations for individual jurisdictions. This was particularly the case in 1996/97 (table 3). In the municipalities of Semarang and Mataram, for example, there was a 280% and a 125% increase, respectively, in Khusus grant funds in just one year.

Redistributive Effects of Inpres

It is useful to observe differences across jurisdictions in the proportion of Inpres grants that permit greater local discretion. Table 4 assesses Umum grants as a proportion of total Inpres among a sample of 15 localities of varying size both on and off Java. The data show that in many of the off-Java jurisdictions Umum grants constituted only about one-third of total Inpres. In contrast, in the four Java localities (two municipalities and two districts), the Umum proportion was two-thirds or more of the total Inpres allocation. Since population was the single most important factor determining the level of Umum funding, local variations in funding levels were

TABLE 4 *Inpres Umum Grants as Proportion of Total Inpres, Selected Districts and Municipalities, 1994/95–1997/98* (%)

District (D)/Municipality (M)	1994/95	1995/96	1996/97	1997/98
Java				
Bandung (M)	71.7	81.2	83.0	80.5
Bandung (D)	65.6	67.8	69.2	64.0
Semarang (M)	65.2	70.4	73.1	42.2
Sidoarjo (D)	69.8	72.5	76.6	64.8
Off Java				
Aceh Utara (D)	33.4	33.0	36.8	28.1
Ambon (M)	36.2	31.2	28.1	22.1
Buleleng (D)	54.1	54.7	55.8	44.5
Gowa (D)	35.1	34.6	33.1	26.6
Kutai (D)	36.9	32.7	33.4	28.7
Lombok Tengah (D)	52.7	54.5	45.5	33.6
Mataram (M)	38.5	38.0	36.6	20.9
Minahasa (D)	33.4	30.2	27.9	22.2
Padang (M)	55.6	62.7	63.8	51.9
Samarinda (M)	48.0	49.1	49.9	43.7
Ujung Pandang (M)	61.7	65.6	66.3	56.9
Average for sample of 8 districts	**47.6**	**47.5**	**47.3**	**39.1**
Average for sample of 7 municipalities	**53.8**	**56.9**	**57.3**	**45.5**

due primarily to central government decisions concerning Khusus allocations. The central government used Khusus grants to bolster transfers to less developed and resource deprived areas, especially off Java. When a local government had a large Umum allocation because of its population size, or demonstrated potential to raise revenues of its own (based upon own-source revenue data), the Khusus allocation tended to be smaller. Only one of the off-Java localities, Ujung Pandang, had an Umum allocation greater than 66%.

Municipalities (*kota*) boasted relatively larger Umum allocations than non-urban *kabupaten*, and jurisdictions on Java in general enjoyed higher levels of Umum funds than those elsewhere. Many Java municipalities possessed greater fiscal management capabilities than those off Java, and did not require the same level of Khusus grants. Higher Khusus grants to non-urban districts were used to bolster local revenues, to compensate both for regional disparities in fiscal capacity and for inefficiencies in the local allocative process.

Municipalities diverge somewhat from the general pattern of local government dependence on central government transfers, as evidenced in data from a sample of districts and municipalities representing eastern and western Indonesia (tables 5.1–5.3). In 1994/95, for example, six municipalities (Mataram, Bengkulu, Sabang, Sawahlunto, Pangkal Pinang and Gorontalo)

TABLE 5.1 *Proportion of Central to Total Revenue in Large Municipalities, 1994/95*

Large Municipalities (7)	Central/Total Revenue (%)	Primary Local Revenue Sources[a]	User Fees	Property Tax
			(% of local revenue)	
Java				
Surabaya	32.5	PADL	21.9	13.4
Tangerang	43.5	PADL	15.3	19.4
Bandung	47.8	PADL	18.2	12.5
Semarang	54.4	PADL	17.4	8.2
Off Java				
Medan	46.5	PADL	16.2	14.4
Palembang	70.6	PBB	7.5	14.5
Ujung Pandang	75.5	PADL	6.9	6.8
Average (1994/95)	**52.9**	**PADL**	**14.8**	**12.7**
Average (1990/91)	**52.6**	**PADL**	**15.2**	**9.7**

[a]PADL: Pendapatan Asli Daerah Lain (Other Non-Tax Local Revenue); PBB: Pajak Bumi dan Bangunan (Property or Land and Building Tax).

TABLE 5.2 *Proportion of Central to Total Revenue in Medium Municipalities, 1994/95*

Medium Municipalities (26)	Central/Total Revenue (%)	Primary Local Revenue Sources[a]	User Fees	Property Tax
			(% of local revenue)	
Java				
Yogyakarta	50.5	PADL	18.8	12.4
Bogor	52.7	PADL	8.3	7.7
Cirebon	52.8	PADL	5.9	8
Malang	53.1	PADL	10.4	9
Surakarta	55.1	PADL	12.9	8.8
Tegal	55.6	PPD	8.2	10.5
Madiun	63.6	PADL	3	13.5
Probolinggo	64.5	PADL	2.6	12.4
Kediri	65.2	PADL	4.9	14.9
Pekalongan	66.0	PADL	9.2	8.8
Off Java				
Balikpapan	52.3	PBB	10.8	24.5
Denpasar	53.9	PPD	20.4	8.4
Banjarmasin	58.5	PPD	16.5	9.7
Pematang Siantar	62.3	PADL	6.3	13.6
Samarinda	64.8	PBB	7.7	18.8
Manado	70.7	PADL	10.6	6.0
Padang	71.6	PADL	1.8	5.6
Jambi	72.9	PADL	5.2	8.9
Binjai	74.3	PADL	6.3	7.2
Pekanbaru	74.5	PADL	6.2	9.2
Pontianak	74.5	PPD	9.8	8.2
Banda Aceh	74.8	PADL	6.8	7.8
Bandar Lampung	75.1	PADL	8.5	7.4
Ambon	78.1	PADL	3.6	6.9
Bengkulu	80.3	PADL	3.7	5.6
Mataram	85.7	PADL	2.5	4.5
Average (1994/95)	**64.5**	**PADL**	**8.5**	**9.9**
Average (1990/91)	**57.4**	**PADL**	**10.8**	**9.0**

[a]PADL: Pendapatan Asli Daerah Lain (Other Non-Tax Local Revenue); PBB: Pajak Bumi dan Bangunan (Property or Land and Building Tax); PPD: Pos Pajak Daerah (Other Local Tax – non-PBB).

TABLE 5.3 *Proportion of Central to Total Revenue in Small Municipalities, 1994/95*

Small Municipalities (21)	Central/Total Revenue (%)	Primary Local Revenue Sources[a]	User Fees (% of local revenue)	Property Tax (% of local revenue)
Java				
Magelang	57.6	PADL	5.2	9.7
Sukabumi	58.1	PADL	5	7.8
Salatiga	61.3	PADL	6.5	10.2
Mojokerto	66.5	PADL	4.1	14.4
Pasuruan	68.1	PADL	3.6	12.8
Palangkaraya	70.1	PBB	5.2	19.1
Blitar	70.5	PADL	2.4	10.6
Off Java				
Tebing Tinggi	68.8	PBB	6.2	15.4
Bukit Tinggi	69.4	PADL	6.6	4.2
Sibolga	70.1	PBB	3.1	15.7
Tanjung Balai	71.1	PBB	4.7	16.0
Solok	73.5	PADL	2.7	11.5
Pare Pare	75.0	PADL	3.6	9.2
Padang Panjang	75.8	PBB	1.8	12.3
Payakumbuh	77.4	PADL	2	9.2
Bitung	77.9	PBB	4.5	10.6
Jayapura	79.0	PBB	3.7	11.5
Sawahlunto	81.0	PBB	1.1	13.0
Pangkal Pinang	81.6	PBB	2.6	9.8
Gorontaio	84.3	PBB/PADL	2.3	6.7
Sabang	85.3	PBB	0.6	12.6
Average (1994/95)	**72.5**	**PBB**	**3.7**	**11.5**
Average (1990/91)	**77.8**	**PADL**	**4**	**3.8**

[a]As for table 5.1.

relied upon central government grants and transfers for more than 80% of total local revenues, and all these were located off Java. The average dependence for all municipalities (irrespective of size) was 66.6% in 1994/95, although two-thirds of all municipalities showed greater than average dependence. Large municipalities (those of over 1 million people) and medium municipalities (of 200,000 to 1 million people) were less dependent, with a combination of size and locational factors helping to explain this difference. Among the seven large municipalities, five (71.4%) were dependent upon the central government for less than 60% of total local revenues. Only 34.6% of the medium municipalities met that standard. In contrast, only 9.5% of small municipalities (with a population less than 200,000) achieved this level of fiscal self-reliance. Of the 16 municipalities (of all sizes) dependent upon central government transfers for less than 60% of local revenues, 12 were located on Java. This, and the fact that all six municipalities that derived more than 80% of their revenue from central government transfers were located off Java, shows that municipalities off Java had established the highest level of fiscal dependence under the Inpres system.

The aggregate Inpres funding data show that: (1) the central government consistently increased funding to local jurisdictions from 1994 to 1998 through Inpres; (2) changes in the Inpres program reduced the discretion that regions exercised in the allocation of those funds; (3) considerable year-to-year variation in the level of Inpres funding affected individual localities; (4) the proportion of Inpres funds through Umum grants differed substantially across jurisdictions; and (5) the existence of a 'Java bias' in the New Order financial transfer system is not substantiated by the evidence from the Inpres program. The government's decentralisation efforts did not have a uniform impact on localities. Changes to the Inpres grant program in the 1990s were intended to address national development objectives as defined by central government ministries, and only indirectly to support decentralisation. How the development objectives of central government ministries remain connected to the intergovernmental transfer program is a key issue that needs to be considered in the new transfer system being implemented under Law 25/1999.

FROM INPRES TO GENERAL ALLOCATION FUND

Before the creation of the DAU, local governments had almost two decades of experience in implementing Inpres-funded projects in a manner consistent with national development objectives. In theory, the new intergovernmental financial transfer builds upon the strengths of Inpres and the SDO. Like the previous system, the DAU should provide a reasonably stable (if not expanding) source of local finance, given that allocations are tagged to the central government's gross domestic revenue. Moreover, the DAU formula was designed explicitly to sustain previous efforts to address regional fiscal inequities and pockets of poverty (Lewis 2001). According to Brodjonegoro (2001), the DAU allocation scheme follows the practice initiated under Inpres of using grant transfers for the purpose of 'equalizing ... fiscal capacity outside Java' (p. 29).

Yet the level of local discretion implicit in the DAU, especially in relation to the allocation of human capital throughout local government services, is far greater than that allowed in managing discretionary and earmarked grants under Inpres. It is not clear that all local governments will receive comparable development benefits from the new intergovernmental grant program. The timing of the launch in January 2001 was problematic, given that the central government's revenues for 2001 are likely to fall considerably below budget projections, thereby reducing the overall DAU. Those local governments that receive funds from natural resource revenue sharing will be able to handle the crisis relatively easily: they will have higher local revenues than had been available under the former system, where 100% of natural resource revenues went to Jakarta. But many local governments will not. Until the distribution formula becomes routinised, and the national budget stabilises—which may take quite a few years of political give and take—local governments will be faced annually with even less fiscal certainty than under the former system.

Added to this uncertainty is the fact that in 2001 Indonesia is still labouring under a fiscal crisis, with rising inflation, so that the real value of transfers may actually decline. This places the onus on local governments to replace lost transfer funds with greater own-source revenues (Indrawati 2000). But this is not the option that it once was, because of restrictions on new local taxes growing out of the tax reform law (No. 18) of 1997. Although a revision to the 1997 law (Law 34/2000) enables localities to create new taxes (if approved by the central government), it is likely that mayors and district heads now accountable to the local legislatures may regard the political costs of using this power as outweighing the economic benefits. But in compensating for declining real central government transfers and increasing local needs, local revenue generation will be a part of the new management paradigm.

The success or failure of decentralisation is likely to rest on two pillars: first, how effectively local governments use the discretion built into the new block grant funds, and second, how they make use of autonomy to identify, capture and use new sources of local funds. Administering the increasingly complex Inpres grant system in the 1990s provided a useful preparation for autonomy in some localities, but overall the Inpres program did not foster the degree of experimentation, innovation and risk taking that would come with full-scale decentralisation.

Appropriately, local governments continue to look to the centre for ideas on how to exercise local autonomy. The MOHA has offered one prescription—using new institutional arrangements (including intergovernmental cooperation and privatisation) to improve the efficiency of local service delivery and to secure new private investment. A policy circular from the MOHA's Director General for Regional Affairs in 2000 encouraged Local Water Supply Utilities (Perusahaan Daerah Air Minum, or PDAM) to merge where feasible, or to enter into partnerships with the private sector to create more viable enterprises.

Another encouraging recent development is the growing incidence of community-based activism related to local development planning. Donor assistance has been supporting these efforts over the past few years. Since 1998, under the US Agency for International Development's CLEAN-Urban project, over 800 communities in East and West Java have been organised and trained in participatory planning techniques. In 1999, this community organisation effort was connected to a process of local capital investment planning referred to as the Urban Development Framework Program (Program Dasar Pembangunan Perkotaan, PDPP). In 2000, the MOHA issued general guidelines for local governments to prepare the PDPP using an unprecedented level of community participation, coupled with involvement of all relevant local government agencies, to identify problems, develop implementation priorities, and identify revenues to fund capital projects from all appropriate sources. While in the current economic climate expanding local debt is not a realistic option for financing infrastructure (local borrowing is firmly opposed by both the IMF and the World Bank), the move toward an inclusive local development planning and financing strategy must go hand in hand with building local capacity to secure and manage debt in order to meet local needs.

A single block grant such as the DAU for most local activities (including local government employee salaries) gives local governments wide latitude in determining how general development funds are spent. But without supplemental central government assistance in such critical sectors such as education and public health, there may be a problem of sustainability and equity in poorer regions, no matter how much the locality values those services. Even in highly decentralised systems such as that in the United States, federal and state supports to education, health and welfare seek to preserve some degree of equity and basic service across highly diverse regions. One way to accomplish the two objectives of facilitating decentralisation and sustaining national welfare in Indonesia is through creation of several 'sectoral block' grants in addition to the DAU, targeted to supplementing education and public health provision, and implemented by local governments. There is a mechanism for this under Law 25/1999, through the special allocation grants that are available but currently not coupled to any comprehensive policy objectives. This approach would also be aided by the use of a multi-year grant allocation process (albeit with annual disbursements), using annual progress reviews to identify where problems persist or to address new needs.

CONCLUDING COMMENTS

The restructuring process advanced through the implementation of Laws 22 and 25 of 1999 will be effective to the extent that it increases transparency in central and local government fiscal relations (Mahi 1999). Although there has been some criticism from local governments that believe they have been given inadequate grants, the new formula for the DAU meets the test of transparency in its creation and in its utilisation. Local administrative performance will be improved by a combination of certainty and fairness in the intergovernmental transfer process, along with the higher degree of accountability to the local community that is structured into the decentralisation design. The transformation of intergovernmental transfers into a formula-driven grant system needs to be continued to improve transparency in the allocative devices.

The evolution of Inpres since the 1970s demonstrates that central government grant transfers are still a necessary fiscal tool for local governments to meet the changing and growing needs of their constituents, and will remain so for most localities in the foreseeable future. Intergovernmental transfers in the form of revenue sharing will continue to anchor local finance in Indonesia's transition to a decentralised governance system.

The combination of the tax reform law of 1997, which eliminated a number of potential local revenue sources, the lingering economic crisis that is impeding efforts to bolster local own-source revenue, and the assumption that the DAU should address all local needs previously covered by Inpres and SDO funds has the potential to undermine local fiscal independence. Some of the larger and medium-sized Indonesian municipalities (especially on Java) had been moving to free themselves from dependence on central government transfers toward the end of the New Order era, but most small and medium municipalities remained locked into fiscal dependence. A shift in the emphasis of local government finance reform from strengthening local own-source revenues (through a combination of administrative efficiency and economic development efforts) to managing central government transfers is not likely, in itself, to reduce dependence. If the new system inaugurated by the DAU serves to strengthen local government finance it will be because block grants are often a first step toward central government withdrawal from prior financial commitments (as, for example, in the case of the US, where federal community development block grants in the 1970s were used to scale down federal obligations for urban poverty alleviation and redevelopment that had been increased under the Great Society programs of the 1960s). By sheer necessity, local governments in Indonesia may need to generate more own-source revenue to compensate for lower transfers. At the same time, improved own-source revenue generation will serve as a measure of success in Indonesia's quest to make the transition from one of the most centralised systems in the world to a society characterised by strong and responsive local governments.

NOTES

1 The cabinet created by former President Abdurrahman Wahid in August 2000 eliminated the Ministry of Regional Autonomy established in 1999, in effect returning to the Ministry of Home Affairs the responsibility for overseeing decentralisation.

2 Revenues collected by the central government and shared with regional governments.

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