

Articles on Public Sector Management Reform in *Jakarta Post*

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Fiscal balance is still not balancing

Owen Podger, Jakarta

The Jakarta Post recognized the significance of the new law on fiscal balance in an editorial on Monday Oct. 4, 2004, by stating:

"The most important elements of the new legislation lie in its elaborate, clear-cut provisions on budget accountability and domestic borrowing by regional administrations."

Indeed there are improvements, but not as many as one would hope for. Many of the changes were unnecessary because they are already covered under Law 17/2003, the State Finance Act, Law 1/2004 on treasury operations and Law 15/2004 on auditing.

For example, the new law gives the national government the right to withhold funds from regions that raise revenue outside the new provisions. This will only penalize the citizens of the region, and not the officials who broke the law. There are existing stronger sanctions in Law 17/2003, including restoration of funds, fines and imprisonment for officers who misuse public money.

The formula for the general allocation grant (DAU), which accounts for over 80 percent of the budget in most regions, has not changed significantly and still does not directly address the fiscal needs of regions. The old formula for DAU did not "balance" funds to regions, but linked funding to population size.

The average budget for districts (*kota and kabupaten*) with more than one million population was Rp 280,000 per capita, while districts half this size received 30 percent more funding per capita. Districts with population between 100,000 and 200,000 have budgets that average Rp 1,000,000 per capita, and districts of half this size receive over 60 percent more.

This type of distribution provides incentives for districts to split into smaller units, not join up to achieve economies of scale through shared overheads and operations.

Another disappointment with the new law is that it does not address the distortion caused by "revenue sharing" of central government income from natural resources.

The more that resource-rich districts receive from the exploitation of their resources, the more DAU they receive, and this disadvantages poor regions with few resources. Revision of the law was a lost opportunity to redistribute funds according to their needs to provide citizens with services.

The DAU formula in the old law was distorted in budget implementation by adding a lump sum for each region regardless of its size. These lump sums were the immediate cause of the distortions reported above, and we trust that the new government will not distort the new law in the same way.

The core problem is getting a fairer budget distribution for all Indonesians. This will not be achieved under this new law, which still equates "funding need" to some formula comprising population, area, building costs, and size of the economy. This is simply wrong, because it cannot define the needs of the people. They want their fair share of good government: Equal

access to good schools, hospitals, infrastructure, environmental protection, development controls, security, housing, etc.

The revised law contains articles on regional borrowing. These are misplaced because the scope of this law should be budget distribution, not financial management. The principles of good financial management are contained in Laws 17/2003 and 1/2004. This includes assessing whether borrowing is an appropriate form of financing based on financial return, economic benefits, social and environmental consequences and considering all risks.

The revised law also strengthens management of deconcentrated funds. Over recent years the largest ministries, education, health and human settlements, have had huge budgets that are "deconcentrated" to provinces, who then "contracted" with districts to fund unknown investments, against the principles of decentralization and transparency. The new law allows this funding to continue, though how they are compatible with local strategic planning, and the need for fair allocation between regions, is not addressed at all.

This revised law on budget distribution will make little difference, as it fails to address satisfactorily the central question of budgeting: How can scarce resources be distributed wisely, to implement the objectives and functions of government, to reduce poverty, create jobs, provide services, and protect the environment, for all Indonesians wherever they live? Fiddling with formulae will not achieve this result.

A concerted effort of public sector management reform across all of government is needed, so that there is a clear and proper basis for determining the financial needs of each region.

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