

Financial capacity of provinces in Sumatra during regional autonomy era

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Abstract

The regional autonomy policy gives greater authority to regencies and cities to take responsibilities both in terms of regional revenue or regional expenditure. Ideally, all the local government expenditures can be fulfilled with their Local Own-source Revenue, so that the region fully becomes an autonomous region which means that the dependence of central government to local decreases. According to the percentage of direct expenditure to total regional revenue of provinces in Sumatra, the average amount is less than 50 percent of regional income. Meanwhile, more than 50 percent of the total regional revenue of provinces in Sumatra is used for indirect expenditure. The average degree of fiscal decentralization of provinces in Sumatra from 2015 to 2017 has amount about 37 percent. It means that the fiscal decentralization degree was low, thus the budgeting performance was poor/bad. Financial independence level of provinces in Sumatra is 57.36 percent which means that the regions are considered to be independent enough in implementing regional autonomy. Financial dependence level of region is about 63.55 percent which means that the fiscal dependence of provinces in Sumatra is great enough and its budget performance is not so good. This shows that the region dependence in Sumatra on the aids from central funds is still very much felt and noticeable.

Keywords: *Financial capacity, Local Own-source Revenue, Regional revenue, Regional expenditure*

JEL Classifications: E62, H30, H72

INTRODUCTION

The regional autonomy policy gives greater authority to regencies and cities to take responsibilities both in terms of regional revenue or regional expenditure. According to Altunbas & Thornton (2011), several economists have made the case for fiscal decentralization (regional autonomy) as a means to promote better governance

Ideally, all the local government expenditures can be fulfilled with their Local Own-source Revenue (PAD), so that the region fully becomes an autonomous region which means that the dependence of central government to local decreases. However, in reality, after implementing fiscal desentralization there was an increase in the role of transfer mechanism from central government through balancing fund (Mahi, 2005). In addition, Thornton (2007) stated that results from a cross section study of 19 OECD member countries suggest that when the measure of fiscal decentralization is limited to the revenues over which sub-national governments have full autonomy, its impact on economic growth is not statistically significant

Mardiasmo (2002) stated that before the autonomy era, there was a high expectation from regional governments to be able to develop their region based on their own ability and motivation. However, the real condition is getting further from year to year. There are fiscal dependency and subsidies as well as central government support as the manifestation of the inability of PAD in financing regional expenses.

Sumatra is one of the four biggest islands in Indonesia. This island has an area of 473,481 km² with 10 provinces and 55,700,000 inhabitants in 2017, which is the second largest population after Java. In terms of PAD in 2015, North Sumatra Province has the highest PAD at 4.883 trillion rupiah, followed by Riau Province at about 3.476 trillion rupiah, and South Sumatra Province at about 2.534 trillion rupiah. Bengkulu Province has the lowest Local Own-source Revenue in Sumatra at 701.330 billion rupiah. In 2016, the highest PAD was owned by North Sumatra at 4.630 trillion rupiah or it was decreasing by 5 percent from the earlier year, Riau Province's PAD was 3.495 trillion rupiah, and South Sumatra Province's PAD experienced an increase of 8 percent compared to the previous year.

In terms of the total amount of balancing fund provided by the central government, Riau got the highest balancing fund in Sumatra in 2015 amounting to 2.548 trillion rupiah, followed by South Sumatra at 2.329 trillion rupiah and Aceh at 1.561 trillion rupiah. In 2016, the highest balancing fund was still given to Riau of 4.085 trillion rupiah, followed by South Sumatra at 2.713 trillion rupiah and West Sumatra at 2.649 trillion rupiah.

In 2016, the biggest regional expenditure was owned by Aceh at about 12.874 trillion rupiah and North Sumatra at about 9.950 trillion rupiah. Based on the above conditions, it is considered that regional autonomy implementation will carry some consequences to the regional financial capacity or PAD that will differ according to its region capabilities and potential.

Regional expenditure that increases every year requires each region to increase their income. This case is also applied to provinces in Sumatra. From 10 provinces in Sumatra, it is found that revenues from PAD have not been able to finance region expenditure and the shortfall is covered by central government through balancing funds given to all provinces in Sumatra and from other regional revenues. As statement aforementioned, it can be concluded that the problem in this research are: 1) How is the budgeting allocation and regional expenditure of provinces in Sumatra?; 2) How is the financial capacity of the region, including degree of fiscal decentralization and financial independence/dependence level of region?

METHODS

The data used in this study are secondary data, namely time series data from 2013-2017. Main data were obtained from relevant agencies, such as Directorate-General of Regional Fiscal Balance (Ministry of Finance of the Republic Indonesia), Indonesian Central Bureau of Statistics and Indonesian National Development Planning Agency.

The descriptive statistics were used in analyzing the data. This research uses measurement of financial capacity that includes of:

Degree of fiscal desentralization calculated as: $DDF = PAD / TPD$

where: DDF = degree of fiscal decentralization

PAD = local own-source revenue

TPD = total of regional income

The measurement criteria are as in the Table 1.

Table 1. Classification of degree of fiscal decentralization

Ratio (%)	Summary
≤ 25	Fiscal capacity or degree of fiscal decentralization (DDF) is stated very low so that the budgeting performance is very low/bad as well.
25 – 50	Fiscal capacity or degree of fiscal decentralization (DDF) is stated low, so that the budgeting performance is low as well.
51 – 75	Fiscal capacity or degree of fiscal decentralization (DDF) is stated in medium, so that the budgeting performance is also medium or good enough.
76 - 100	Fiscal capacity or DDF is stated high, so that the budgeting performance is stated high or good.

Financial independence level of region calculated as: $TKD = PAD/TPT$

where: TKD = level of financial independence

PAD = Local Own-source Revenues

TPT = Total of transfer revenues

The measurement criteria are as in the Table 2.

Table 2. Classification of financial dependence level

Ratio %	Summary
≤ 25	The region is considered incapable
25 – 50	The region is considered not independent enough
51 – 75	The region is considered independent enough
76 - 100	The region is considered independent

Financial dependence level of region calculated as: $TKtD = PT/TPD$

where: TKtD = Level of financial dependence

PT = Transfer revenue

TPD = Total of Local Revenues

The measurement criteria are as in the Table 3.

Table 3. Classification of financial dependence level

Ratio (%)	Summary
≤ 25	Fiscal dependence is very little, which means that budgeting performance is excellent.
25 - 50	Fiscal dependence is good enough, which means the budgeting performance is good enough.
51 – 75	Fiscal dependence is great enough, which means the budgeting performance is not so good.
76 - 100	Fiscal dependence is very great, which means the budgeting performance is very bad.

RESULTS AND DISCUSSION

Allocation of income and regional expenditure in Sumatra

Prior to the era of regional autonomy, the government expenditure consisted of routine expenditure and development expenditure. The amount of routine expenditure is greater than that of development expenditure. After implementing regional autonomy,

routine expenditure of local government still has a dominant contribution if it is compared to the development expenditure. In the structure of routine expenditure, employee expenditure is still dominant, while in the structure of development expenditure, the biggest role comes from the transportation sector (Kusriyawanto, 2014).

Before the implementation of regional autonomy in 2000, there were eight provinces in Sumatra. In terms of the proportion of direct expenditure and indirect expenditure to the total income prior to regional autonomy, it shows that direct expenditure was greater than indirect expenditure to the total of regional income.

Allocation of direct expenditure was lower than indirect expenditure in 1997/1998. Regions that had allocation of direct expenditure of more than 50 percent were Jambi and Bengkulu, while other regions allocated their direct expenditure under 50 percent. In 1998/1999, even though the proportion of direct expenditure was still under 50 percent from the total income, there was a slightly increase from the previous period. Meanwhile there was a decline in indirect expenditure in 1998/1999. The increase was due to a decrease in total income and in indirect expenditure (Table 4).

The allocation of direct expenditure had bigger amount than indirect expenditure in 1999/2000. Most of provinces in Sumatra experienced an increase in direct expenditure. The increase of direct expenditure allocation in Sumatra had reached 50 percent. Along with the increase in direct expenditure allocation, the allocation of indirect expenditure experienced a decline as well. Increasing direct expenditure allocation is a commitment form between central government and regional governments to further enhance regional development and also the start of the implementation of regional autonomy.

Table 4. Allocation of direct expenditure and indirect expenditure provinces in Sumatra, before and after implementing regional autonomy (%)

Provinces	Before						After					
	1997/1998		1998/1999		1999/2000		2015		2016		2017	
	D	I	D	I	D	I	D	I	D	I	D	I
Aceh	28.99	63.35	39.67	60.14	59.09	43.16	43.29	60.6	54.42	48.16	52.20	50.89
North Sumatra	25.24	76.38	40.76	57.72	47.84	42.89	22.66	71.19	28.99	70.78	35.19	71.91
West Sumatra	44.17	56.99	38.26	51.52	39.14	49.20	41.03	58.22	45.98	57.90	33.37	68.51
Riau	45.31	43.48	44.32	40.52	42.85	44.13	47.71	64.58	73.58	71.01	63.26	61.00
Jambi	56.13	37.56	55.51	37.26	54.94	34.21	46.4	63.06	58.21	50.51	47.29	57.00
South Sumatra	41.63	48.48	34.61	55.64	43.02	44.98	34.75	51.89	31.68	50.23	39.90	43.62
Bengkulu	54.64	44.22	44.14	47.37	51.20	44.37	50.69	53.97	57.75	45.34	54.92	55.06
Lampung	43.75	60.03	45.59	48.24	46.95	51.43	44.00	55.87	41.66	58.49	34.82	66.36
Bangka Belitung	-	-	-	-	-	-	41.82	57.28	56.23	64.79	49.94	63.25
Kepulauan Riau	-	-	-	-	-	-	48.6	54.97	53.50	47.49	59.74	45.24

Notes: D = direct expenditure; I = indirect expenditure

Source: Directorate-General of Regional Fiscal Balance - Ministry of Finance of the Republic Indonesia (data processed)

In 2015 – 2016, there was an increase for direct expenditure allocation of provinces in Sumatra, goods and services expenditure and capital expenditure accounted for half of direct expenditure. Regions that had big portion of direct expenditure were Aceh, Riau, Bengkulu, Bangka Belitung and Riau Island as the developing provinces.

The amount of direct expenditure is an illustration of the government’s commitment to the community development. Ideally, direct expenditure takes 70 percent of the total regional expenditure. From the allocation of direct expenditure, it is found that goods and services expenditure has the largest part, followed by capital expenditure and employee expenditure. The decline of goods and services expenditure is followed by an increase in capital expenditure and employee expenditure. Unfortunately, the increase in employee expenditure is greater than the increase in capital expenditure.

Apart from direct expenditure, another regional expenditure is indirect expenditure. Allocation of indirect expenditure for each province in Sumatra is not equal. Allocation of indirect expenditure has an average number of more than 50 percent of total income. Most of indirect expenditure in Sumatra was approximately 60.71 percent in 2015, 57.58 percent in 2016, and 58.8 percent in 2017. This decline was due to a decrease in some components of indirect expenditure such as grant expenditure, profit sharing expenditure with provinces/regencies and cities.

Even though there was a decline in three components of indirect expenditure, employee expenditure has the biggest portion in indirect expenditure and experiences an incline every year. The increase is caused by the increase in the number of employees, civil servant in region and contract employee, which would cause additional amount of employment expenditure.

In terms of the percentage of direct expenditure to the total of regional income of provinces in Sumatra, less than 50 percent of the regional income is used for direct expenditure. Large amount of indirect expenditure shows that expenditure budget for each province in Sumatra is not yet on target. Ideally, the budget allocation for indirect expenditure is about 30 percent of the total expenditure allocation.

Employee expenditure that takes in indirect expenditure allocation does not give any positive impact on the region expenditure because it is not giving any good impact on community development. Regional expenditure should not only be spent on paying employee salaries as well as useless events, but it should be directed towards activities that have a direct impact on the development of local communities.

Financial capacity of provinces in Sumatra

Degree of fiscal decentralization

Prior to the implementation of fiscal decentralization in 1999 - 2000, local governments still relied on and mobilized the existing local revenues and expenditure budget to enhance economic development. This was due to the central government role in regulating and controlling the regional government budgeting. Entering fiscal decentralization in 2001 – 2004, the effect of decentralization has increased on economic growth. This is because local governments have been given authority to utilize their own financial resources and supported by balancing funds from central to region (Kharisma, 2013). Ideally, through regional autonomy, each region is expected to be able financing its own region in accordance with their local/Local Own-source Revenues.

Prior to regional autonomy, local own-source revenues in all provinces in Sumatra made a very small contribution. In 1997/1998, the average degree of fiscal decentralization of provinces in Sumatra was about 28.97 percent. It experienced a decline in 1998/1999 to 24.12 percent, and to 22.85 percent in 1999/2000. During these years before regional autonomy era, DDF experienced a decline. It was due to the low income from locally generated revenue (own-source revenue) such as regional tax and retribution. DDF of provinces in Sumatra before regional autonomy was very low with DDF ratio less than 25 percent (Table 5). It means that the budgeting performance was bad/poor as well and its Local Own-source Revenues gave a very small contribution to the total regional income.

The degree of fiscal decentralization after regional autonomy experiences an increase, from a very low to low budgeting performance. From Table 2 it can be stated that DDF of provinces in Sumatra during 2015 – 2017 has an average of 37 percent. It means that DDF is low so that the budgeting performance is still low/bad.

Table 5. Degree of fiscal decentralization of provinces in Sumatra, before and after implementing regional autonomy (%)

Provinces	Before			After		
	1997/1998	1998/1999	1999/2000	2015	2016	2017
Aceh	15.15	26.00	13.06	16.88	16.39	15.58
North Sumatra	27.55	35.33	36.36	57.59	46.43	40.47
West Sumatra	36.52	26.54	25.74	46.31	41.23	33.46
Riau	38.96	26.60	23.52	50.31	46.06	42.17
Jambi	25.66	16.91	20.40	39.66	37.01	33.46
South Sumatra	33.49	18.78	23.63	42.31	38.84	36.80
Bengkulu	18.28	14.96	14.09	32.16	30.84	29.77
Lampung	36.16	27.85	26.04	46.94	45.71	39.40
Bangka Belitung	-	-	-	30.30	28.16	28.82
Kepulauan Riau	-	-	-	40.30	36.64	34.49
Average	28.97	24.12	22.85	40.28	36.73	33.44

Source: Directorate-General of Regional Fiscal Balance -Ministry of Finance of the Republic Indonesia (data processed)

This case can be interpreted that the performance of provinces in Sumatra to implement autonomy is still very low. DDF was about 40.28 percent in 2015, 36.37 percent in 2016, and 33.44 percent in 2018. This means that the Local Own-source Revenues were still lower than the Total Regional Income.

Even though there is an increase on DDF of provinces in Sumatra after regional autonomy, the budgeting performance is still low which means that the Local Own-source Revenue still gives low contribution to the total regional income.

As stated by Setiaji & Hadi (2007), the contribution of Local Own-source Revenue to the regional expenditure during regional autonomy era is not much better than when it was before autonomy era, caused by the strong dependence of local governments on the central government. However, the growth of PAD during autonomy era has a positive difference compared to before autonomy.

Financial independence level of regions in Sumatra

Financial independence level of region is a ratio between Local Own-source Revenue and the total transfer revenue from central government. The bigger the value of TKD, the more independent the region is good enough.

Local Own-source Revenue before regional autonomy was smaller than in the earlier period of regional autonomy, which means that PAD experienced a big enough increase in the era of regional autonomy.

Level of regional independency of provinces in Sumatra before the regional autonomy was considered to be not independent enough. It can be seen from its average ratio of financial independence which was about 47.78 in 1997/1998, 35.15 in 1998/1999 and 35.30 in 1999/2000. TKD value less than 50 percent indicates that the Local Own-source Revenue is still very small compared to the transfer funds from central government. The support from the central government is used by the regional government to finance total regional expenditure that cannot be met by the Local Own-source Revenue (Tabel 6).

Level of financial independence of region of provinces in Sumatra during 2015 – 2017 (after regional autonomy) in average experienced a decline every year. Financial independence of region was 66.35 percent in 2015, 56.79 percent in 2016, and 48.94 percent in 2017. The TKD value shows that the regions are considered independent enough, which means that the role of central government has been decreasing and PAD’s ability to finance the region development is good enough.

Table 6. Financial independence level of provinces in Sumatra, before and after implementing regional autonomy (%)

Province	Before			After		
	1997/1998	1998/1999	1999/2000	2015	2016	2017
Aceh	19.30	35.74	15.04	20.45	19.62	18.49
North Sumatra	38.92	55.02	75.85	136.31	87.21	68.08
West Sumatra	65.92	38.38	38.38	87.54	70.41	50.59
Riau	79.24	44.32	35.34	101.38	85.46	72.96
Jambi	38.78	22.64	27.52	65.78	58.79	50.31
South Sumatra	57.55	27.03	34.85	73.99	64.28	58.28
Bengkulu	23.98	18.34	17.85	47.47	44.98	42.46
Lampung	58.57	39.72	37.55	89.16	84.75	65.30
Bangka Belitung	-	-	-	43.48	39.34	40.73
Kepulauan Riau	-	-	-	67.53	57.87	52.69
Average	47.78	35.15	35.30	66.35	56.79	48.94

Source: Directorate-General of Regional Fiscal Balance -Ministry of Finance of the Republic Indonesia (data processed)

Based on the financial independence level in 2015, there were 2 provinces that had TKD value more than 100 percent, North Sumatra and Riau which were categorized as independent. This is because of PAD of both provinces can support their own development in the region. The less independent regions are Bengkulu, Bangka Belitung, and Aceh. These three provinces could not let go their fiscal dependency on the central government through transfer funds due to their PAD which is smaller than the transfer funds from central.

After implementing regional autonomy, financial independence of provinces in Sumatra experiences a positive growth and is categorized as independent enough. The growth in the financial independence is caused by the increase in Local Own-source Revenue of provinces in Sumatra. This finding is in line with the research conducted by Frediyanto & Purwanti (2010), which concluded that there was a significant difference of regional income before and after regional autonomy, except for PAD ratio.

After the implementation of regional autonomy, local governments tried to increase their PAD (Local Own-source Revenue) through the increase of tax and retribution. Local governments in the regional autonomy era are able to increase their Local Own-source Revenues. Nevertheless, the increase in PAD does not give higher contribution to APBD. Prior to regional autonomy, it was found that most of (88.57) regions had low financial capacity and still relied on funding from central to finance their capital expenditure. This condition is still happened even after regional autonomy implementation, the number of regions with low financial capacity even escalated (from 88.57 percent to 91.43 percent).

Financial dependence level of regions in Sumatra

Before the implementation of regional autonomy, the financial dependence on central government felt real, the centralistic financial system does not motivate provinces to explore their big potential of their region which can be used as their Local Own-source Revenue (Halim, 2001).

From Table 7, local fiscal dependence on the central government were still strong. It can be seen from the average number of TKiD that was between 51 – 75 percent. In 1997/1998, the regional fiscal dependence ratio was 64.52 percent, experienced an increase to 70.25 percent, and in 1999/2000 the ratio was 69.82. The increase in the ratio shows that the budgeting performance of local government keeps decreasing. Almost all provinces in Sumatra has a strong financial dependence on the central government with

TKtD value above 50 percent. This was caused by the absence of motivation from local governments to explore and make use of their region potential.

Table 7. Financial dependence level of province in Sumatra, before and after implementing regional autonomy (%)

Province	Before			After		
	1997/1998	1998/1999	1999/2000	2015	2016	2017
Aceh	78.50	72.77	86.81	82.55	83.54	84.28
North Sumatra	70.77	64.21	47.94	42.25	53.23	59.45
West Sumatra	55.40	69.14	67.06	52.91	58.55	66.13
Riau	49.16	60.03	66.54	49.62	53.90	57.80
Jambi	66.16	75.68	74.15	60.29	62.95	66.50
South Sumatra	58.19	69.49	67.79	57.18	60.43	63.15
Bengkulu	76.22	81.54	78.93	67.75	68.56	70.13
Lampung	61.73	70.12	69.34	52.65	53.94	60.34
Bangka Belitung				69.70	71.59	70.75
Kepulauan Riau				59.67	63.32	65.47
Average	64.52	70.25	69.82	60.00	63.62	67.05

Source: Directorate-General of Regional Fiscal Balance (Ministry of Finance of the Republic Indonesia) (data processed) (data processed)

After the implementation of regional autonomy, local financial dependence since 2015 – 2017 experienced an increase every year. Almost all provinces in Sumatra relied on the transfer funds from central government as their source of income. In 2015, TKtD value experienced an increase to 60 percent, then added to 63.62 percent in 2016, and increased up to 67.05 percent in 2018. It means that the fiscal dependence in Sumatra is great enough and the budgeting performance and is not so good.

High level of regional financial dependence on transfer funds from central government shows that regional income sourced from PAD could not give big contribution to the total regional income. Kuncoro (2007); Amril, Erfit, Safri (2015); Ekawarna (2017) gave an empiric fact about the phenomenon of Flypaper Effect, that there is a high financial dependence level of local government (regency/city) on the income from central government, in the form of Balancing Funds (DAU, DAK, and DBH).

Small amount of PAD of provinces in Sumatra is not only local government’s mistake, because there is still a limited source of PAD that can be used. Sources of potential income are managed directly by the central government, meanwhile in another side, the effort to increase PAD through tax or regional retribution is not effective as it becomes a burden to community (Adi, 2012).

CONCLUSION AND RECOMMENDATION

Conclusion

Implementation of regional autonomy is expected to increase the efficiency, effectiveness, and accountability of the public sectors in Indonesia. It provides a great opportunity to the regions to improve its financial capability. Regions are required to look for alternative sources of development budgeting without lessening expectations to have aids and sharing from central government and use public funds according to its priorities and community aspirations.

Fiscal decentralization is the granting of authority to the regions to explore sources of revenue, the right to receive transfers from (upper) government and decide routine expenditure and investment. The most important factor in fiscal decentralization is to

what extent the regional government is given the authority to decide allocation based on their own expenditure. Another factor is the region capacity to improve its PAD. An increase in PAD as the budgeting source for the implementation of regional autonomy will determine the success of regional development in the future.

The research findings show that (1) percentage of direct expenditure to the total of regional income of provinces in Sumatra is less than 50 percent on average. (2) Based on the degree of fiscal decentralization, since 2015-2017 provinces in Sumatra got 37 percent in average, which means that the degree of fiscal decentralization is low and the budgeting performance is low. Local financial independence level of provinces in Sumatra was 57.36 percent, which means that the region is considered independent enough in implementing regional autonomy. The financial dependence was about 63.55 percent, which means that the fiscal dependence of provinces in Sumatra is great enough and the budgeting performance is not so good.

RECOMMENDATION

Provincial governments in Sumatra have to be more careful in managing regional finances, especially in allocating direct expenditure or indirect expenditure fund. Ideally, the portion of direct expenditure is about 70 percent of the total expenditure, particularly for capital expenditure. While for indirect expenditure is more focus focused on revenue sharing expenditure to province/region and city and village government and financial aids to province/region and city and village government so that regional development is successful and equal.

In the era of regional autonomy, local government dependence on central government should be decreasing. Provincial governments in Sumatra must be able to gradually reduce its dependence on higher government. Efforts must be made to increase revenues by exploring its resources of PAD, good management of natural resources and the promotion for investment (in collaboration with outsiders to invest in regional development), including human resource development. Investment activities are expected to provide a very large and good contribution to the efforts of local tax revenues in particular and PAD income in general.

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