

**PROCESS OF BUDGETING AT LOCAL
GOVERNMENT LEVEL UNDER INDONESIA'S
FISCAL DECENTRALISATION POLICY**

Fadillah Amin

2065804

(Dokterandus in Public Administration, University of
Brawijaya, Indonesia;
Master of Public Administration, University of Brawijaya,
Indonesia)

A thesis submitted to satisfy the requirements for a Doctor of Philosophy
Department of Politics and Public Policy
Flinders University, South Australia
April 2014

Abstract

This study intends to elaborate upon and critically analyse the current process of budgeting at the local government level in Indonesia. In particular, this study aims to analyse the policy-practice gaps in the budgeting process of APBD (*Anggaran Pendapatan dan Belanja Daerah/ Annual Local Budget*), and identify the challenges and issues associated with this process. This study was undertaken in three locations, the City of Surabaya, City of Batu, and Regency of Trenggalek, each of which is considered to be representative of urban, sub-urban, and rural areas. The present study applies a qualitative approach and in particular employs grounded theory method.

Budgeting reforms started at the beginning of the 2000s as an integral part of the governance reforms initiated after the collapse of the ORBA authoritarian regime. The reform has changed the budget structure and the budgetary process. The budgeting process operates in four main stages namely formulation, validation, execution, and accountability and supervision. In the APBD formulation stage, several crucial steps have been changed to make this phase more effective and all stakeholders can participate equally. Nevertheless, local executives have remained highly dominant in this phase. In spite of their domination, local officials generally struggle to obtain valid data and also to maintain coordination and synchronisation among local institutions. Also, local authorities often fail to complete the process in a timely fashion. Additionally, local elites habitually ignore the obligation to make the APBD structure and figure public.

In the APBD validation process, the DPRD (local parliament) members play a fairly dominant role as they currently have great power in determining the composition and size of the APBD. However, most local legislators lack skills and experience, which leads to their dependence on the executives. Moreover, the legislators often do not perform their roles objectively and transparently. The real process of APBD validation is primarily conducted ‘behind’ the formal sessions through various political compromises and bargaining processes. These practices have led to hidden conspiracies to misuse the budget funds, aiming to use those for the interests of the local elites and their cronies instead of the public interest

In regard to the execution stage, local officers are mostly able to generate own-source revenue (PAD) as targeted in the APBD. Nonetheless, the volume of collected PAD remains low, therefore local governments generally rely on funds transferred from the central government. The local governments appear to prioritise financing routine expenditures rather than capital spending. Also, due to the lack of reliable data, routine expenditure is mostly executed incrementally.

In procuring goods and services, local officials prefer to conduct either a direct appointment or a simple auction instead of an open tender because manipulation and collusion can easily be carried out with potential contractors. Interventions from powerful parties in the procurement and execution of local projects induce to the rise of illegal types of projects such as *Proyek Titipan* and *Proyek Fiktif*. The study shows that a great deal of funds remains unutilised and high number of development projects remains unfinished because of improper APBD execution.

The quality of APBD supervision undertaken by local parliament members, supervisory units, NGOs, and community is now better compared to the New Order period. However, except for the KPK, these supervisory agencies are unable to play effective role in supervising the APBD management due to obstacles such as lack of capacity, political powerlessness, vagueness and overlapping of authority.

In conclusion, the normative policies regarding local finance and budget management look better compared to the pre-reform period. Nevertheless, the local finance and budget cannot be managed properly because this is frequently interfered by various hidden conspiracies, political conflicts, and administrative misconduct. As a result, Indonesia has not adequately enjoyed the benefits of fiscal decentralisation and budgetary reform policy. Furthermore, the APBD funds appear unable to optimally contribute in improving the life of the local community and accelerating local developments.

Declaration of Originality

I certify that this thesis does not incorporate without acknowledgement any material previously submitted for a degree or a diploma in any university; and that to the best of my knowledge and belief it does not contain any material previously published or written by another person except where due reference is made in the text.

Fadillah Amin

Candidate

Date: / /

I believe that this thesis is properly presented, conforms to the specifications of thesis presentation in the University and is *prima facie* worthy of examination.

Dr. Noore Alam Siddiquee

Principal Supervisor

Date:/...../.....

Dr. Priyambudi Sulistiyanto

Co-Supervisor

Date:/...../.....

Acknowledgements

Along with the completion of this thesis, I am deeply indebted to my principal supervisor, Dr Noore Alam Siddiquee, and my co-supervisor, Dr Priyambudi Sulistiyanto, for their encouragement, support, clear guidance and understanding during my study in the School of Social and Policy Studies, Flinders University.

My great appreciation also goes to many academic staff and ISSU staff of Flinders University for their administrative assistances.

My great thanks to all informants, including local government officials, local parliament members and staff, as well as local community living in the research locations, for the enthusiastic and sincerely support in supplying data and information needed by the author.

The DIKTI of Indonesian National Education Ministry has made this research possible through its scholarship. Without its financial support, the study would not have eventuated.

Heartfelt appreciation is intended to the officials of the Brawijaya University particularly officials of the Faculty of Administrative Sciences such as Prof. Dr. Bambang Supriyono, MS (Dean), and Prof. Dr. Suhadak M.Ec and Prof. Dr. Sumartono, MS (Former Dean) who have given invaluable supports to me and my study. As well, my appreciation goes to my teachers in Brawijaya University who have taught me in my previous studies.

My highest appreciation is given to my mother Andi Machsunah and my deceased father Rachmad Winardi as well as my mother in-law Masruroh and my deceased father in-law Muhammad Surur for their sincere prayer and support to me, my family, and my career.

I highly dedicated this thesis and my achievement to my dearest wife *dik* NINIS for her extremely hard work to cover domestic finance during my study. Also to my beloved kids *mbak* AISH and *dik* NAUFAL, hope it will inspire you to pursue higher achievement.

I am also grateful to all my family members for their sincere prayer, supports and helps.

List of Contents

Abstract.....	ii
Declaration of Originality.....	iv
Acknowledgement.....	v
Lists of Contents.....	vi
List of Tables.....	xi
List of Figures.....	xii
List of Appendices.....	xiii
List of Acronyms and Terms.....	xiv

CHAPTER ONE

INTRODUCTION AND RESEARCH METHODOLOGY 1 - 38

1.1. Background.....	1
1.2. Objectives of the Study and Research Questions.....	12
1.3. Significance of the Study.....	13
1.4. Limitations of the Study.....	14
1.5. Research Locations.....	16
1. City of Surabaya.....	17
2. City of Batu.....	20
3. Regency of Trenggalek.....	22
1.6. Research Methodology.....	24
1.6.1. Research Type.....	24
1.6.2. Focus of the Research.....	26
1.6.3. Sampling.....	26
1.6.4. Data Source.....	27
1.6.5. Data Collection Methods.....	30
1.6.6. Data Analysis.....	34
1.6.7. Reliability and Validity of Research.....	36
1.7. Structure of the Thesis.....	37

CHAPTER TWO

THE LOCAL GOVERNMENT BUDGETING PROCESS: A THEORETICAL OVERVIEW 39 - 74

2.1. Introduction.....	39
2.2. Fiscal Decentralization and the Budgeting System.....	40
2.3. Budgeting Reform: The Crucial Points.....	46
2.3.1. From the Traditional to Performance-Based Budgeting System.....	47
2.3.2. From Annual Budgeting to Medium-Term Expenditure Framework...	50
2.3.3. Accounting System: From Cash-Based to Accrual-Based.....	52
2.3.4. Participation of the Local Community in the Budgeting Process.....	55
2.4. Public Budgeting Process.....	60
2.4.1. Formulation of the Annual Budget.....	62
2.4.2. Validation of the Annual Budget.....	64

2.4.3. Execution of the Annual Budget.....	67
2.4.4. Accountability, Evaluation, and Supervision of the Annual Budget...	69
2.5. Summary.....	72

CHAPTER THREE

LOCAL GOVERNMENT BUDGETING SYSTEM IN INDONESIA: DEVELOPMENT UNDER FISCAL DECENTRALISATION 75 - 110

3.1. Introduction.....	75
3.2. Local Government Budgeting: the Scenario Prior to Current Reform.....	76
3.2.1. The Traditional Budgeting System	76
3.2.2. The Budgeting Process at a Glance	81
3.2.3. Structure of APBD and Local Government Financial Resources.....	84
3.2.4. The Accounting System	87
3.3. Local Government Budgeting under Current Local Autonomy	88
3.3.1. The General Policy on Budget and Financial Management.....	89
3.3.2. The Current Structure of the Local Government Budget	96
3.3.3. New Budgeting Approaches.....	104
4.6. Summary.....	107

CHAPTER FOUR

FORMULATION OF THE ANNUAL LOCAL BUDGET: THE FIRST STAGE 111 - 145

4.1. Introduction.....	111
4.2. Formulation Process of APBD: The Policy-Practice Gap	112
4.2.1. Preparation of the RKPD draft	114
4.2.2. Arrangement of the <i>Renja-SKPD</i> (Work Plan of Local Government Agency)	114
4.2.3. <i>Musrenbang</i> (Discussion of Development Planning).....	116
4.2.4. Finalisation of the RKPD (Work Plan of Local Government).....	117
4.2.5. General Policy of APBD (KUA)	118
4.2.6. PPAS (Temporary Budget Margin and Priority).....	120
4.2.7. RKA-SKPD (Work and Budget Plan of Local Government Agency)..	121
4.2.8. Formulation of the APBD	122
4.3. Emerging Issues	125
4.3.1. Disproportionate Role of Local Executives and Legislatives at the APBD Formulation Process	126
4.3.2. Unreliable Data and Unintegrated Planning and Budgeting	128
4.3.3. Lack of Inter-Agency Coordination and Understanding	131
4.3.4. The Emergence of non-Procedural Local Projects	133
4.3.5. Non-Compliance to Make APBD Draft Public	135
4.3.6. Untimely Process in Formulating Budget Documents	136
4.3.7. Too Many New Regulations: The Challenge in Mastering Them.....	138
4.3.8. Contracting Out: The Instant Way Out	140
4.4. Summary	142

CHAPTER FIVE

VALIDATION OF THE ANNUAL LOCAL BUDGET: THE SECOND 146-182

STAGE

5.1. Introduction	146
5.2. The APBD Validation Process	147
5.2.1. Submission of the APBD Draft to the Local Parliament.....	147
5.2.2. Discussion of the Draft of APBD	148
5.2.3. Evaluation by the Governor	155
5.2.4. Legalisation the Draft of the Local Regulation on the APBD.....	157
5.3. Rhetoric and Realities of the APBD Validation Process.....	159
5.3.1. Political Conflict Leads to an Untimely Validation Process	159
5.3.2. The Role of Local Legislators	162
5.3.3. Lack of Capacity of Local Legislators	164
5.3.4. Issues in Accommodating the Community's Proposals	166
5.3.5. The <i>Banggar</i> of the DPRD: The Key Player in the Validation Process	167
5.3.6. The <i>Banggar</i> Discussion: 'Process in a Black Box'	170
5.3.7. Political Compromises and Bargaining: the Process Behind the Scene	173
5.4. Summary.....	179

CHAPTER SIX

EXECUTION OF THE LOCAL ANNUAL BUDGET: THE THIRD

183-256

STAGE

6.1. Introduction.....	183
6.2. The Collection Process of the Local Government Revenue	184
6.3. Performance of Local Governments in collecting PAD (Own-source Revenue)	188
6.4. Challenges in Optimising the Collection of Local Government Revenue...	198
6.4.1. Unreliable Data and Incremental Design.....	199
6.4.2. Irrelevant Qualifications and Inadequate Training of Officers	200
6.4.3. Disincentive Policy of the DAU (General Allocation Fund)	202
6.4.4. Centralistic Tax Assignment	204
6.4.5. Intentionally Deficit	206
6.5. The Process of Local Expenditure Execution	208
6.6. The Procurement Process for Goods and Services	211
6.7. Sectoral Priorities of Local Government Expenditure: Where Does the Local Budget Go?	213
6.8. Current Issues in Local Project Procurement.....	225
6.8.1. Selection of Project Executor.....	226
6.8.2. Splitting Projects: The Strategy to Avoid Open Tender	227
6.8.3. Policy of Increasing the Margin: Providing a Greater Chance to Manipulate the Projects Tender and Execution	229
6.8.4. Obligation to Choose the Lowest Offer Leads to a Poor Quality	231
6.9. Distortions and Challenges in Executing Local Government Expenditure...	233
6.9.1. Priority on the Personnel and Routine Expenditure	233
6.9.2. Incrementally designed	235
6.9.3. The shortage of Project Leader	236
6.9.4. Political Intervention and Project Broker	238
6.9.5. From "Direct Quotation" to "Cash Refund": the Strategy to Quote Project Funds Illegally	245
6.9.6. High Percentage of Unutilised Budget.....	247

6.9.7. Unfinished Projects	250
6.10. Summary	253

CHAPTER SEVEN

ACCOUNTABILITY AND SUPERVISION OF THE ANNUAL LOCAL BUDGET: THE FOURTH STAGE **257-283**

7.1. Introduction	257
7.2. Accountability Report and Audit of the APBD	258
7.2.1. Report of First-Semester APBD Execution	258
7.2.2. Annual Accountability Report of APBD Execution	260
7.2.3. Audit by the BPK (Indonesian Audit Supreme Institution)	263
7.3. Supervision of the APBD: Assessing the Effectiveness	266
7.3.1. Supervision by Local Parliament	266
7.3.2. Supervision by Government Agencies	270
7.3.3. Supervision by the Public: the Community and NGOs	273
7.3.4. Supervision by the KPK (Corruption Eradication Commission)	277
7.4. The Poor Supervision and Its Impacts	279
7.4.1. Corruption and Manipulation	280
7.4.2. ‘Sharp Downward yet Blunt Upward’	285
7.4.3. The Phenomenon of “ATM Machine”	288
7.4.4. Desperate staff	292
7.5. Summary	294

CHAPTER EIGHT

APBD MANAGEMENT UNDER THE CURRENT BUDGETING POLICY: AN ANALYSIS **298-334**

8.1. Introduction	298
8.2. Adoption of New Budgeting Approaches	299
8.2.1. Performance-Based Budgeting System	299
8.2.2. Medium-Term Expenditure Framework	307
8.2.3. Accrual-Based Accounting	314
8.3. Budgeting Process: Managerial or Political Event?	318
8.4. Bottom-Up versus Top-Down Approach to Budgeting	323
8.4.1. Lack of Education and Knowledge leads to passive participants	327
8.4.2. Time Constraints and Apathy of the local community	328
8.4.3. Elitist representation and the issue of mobilisation instead of genuine participation	330
8.4.4. Formalistic and Top-Down Planning and Budgeting	331
8.4.5. Improper placement of the <i>Musrenbang</i> stage in the APBD formulation process	334
8.5. Local Finance Management under the Fiscal Decentralisation.....	337
8.6. Summary	343

CHAPTER NINE

**SUMMARY OF FINDINGS, POLICY RECOMMENDATIONS, AND
CONCLUSION**

	344-364
9.1. Summary of Findings	344
9.2. Policy Recommendations.....	358
9.3. Conclusion and Directions for Future Research.....	361
REFERENCES.....	365-377
APPENDICES.....	378-383

List of Tables

Table 1.1	Number of Informants.....	27
Table 3.1	The Current Structure of APBD in the Format of I-account...	91
Table 6.1	Contribution of Revenue Sources to the Accumulation of Local Government Income in 2010.....	178
Table 6.2	Proportion of Local Government Revenues in 2006-10.....	193
Table 6.3	Allocation of Local Expenditure (per-sector) in 2010.....	202
Table 6.4	Proportion of Local Expenditure by Economic Classification in 2010.....	209
Table 6.5	The Remaining APBD Funds in 2010	236
Table 8.1	The Old Structure of APBD (Pre-Reform Period) in the T-account Format.....	296
Table 8.2	Details of <i>Musrenbang</i>	308

List of Figures

Figure 1.1	Location of East Java Province.....	15
Figure 1.2	Location of the City of Surabaya, City of Batu, and Regency of Treggalek.....	22
Figure 2.1	Budget Cycle and Institutional Roles.....	56
Figure 4.1	Process of APBD Formulation.....	115
Figure 5.1	Mechanism of Evaluation of APBD Draft by the Governor....	147
Figure 6.1	Target and Realisation of the Collection of the Own-Source Revenue (PAD) within the period of 2006-10 (in billion Rupiah).....	177
Figure 6.2	Contribution of Three Types of Revenue Sources to the Accumulation of Local Government Income in the City of Surabaya in 2010.....	180
Figure 6.3	Contribution of Three Types of Revenue Sources to the Accumulation of Local Government Income in the City of Batu in 2010.....	183
Figure 6.4	Contribution of Three Types of Revenue Sources to the Accumulation of Local Government Income in the Regency of Treggalek in 2010.....	185
Figure 6.5	Top Five Sectors Which Receive the Largest Allocation from the APBD in City of Surabaya in 2010	204
Figure 6.6	Top Five Sectors which receive the largest Allocation from the APBD in City of Batu in 2010	206
Figure 6.7	Top Five Sectors which Receive the Largest Allocation from the APBD in Regency of Treggalek in 2010.....	207
Figure 6.8	Proportion of Routine and Capital Expenditure in City of Surabaya in 2010	210
Figure 6.9	Proportion of Routine and Capital Expenditure in City of Batu in 2010.....	211
Figure 6.10	Proportion of Routine and Capital Expenditure in City of Treggalek in 2010	212

List of Appendices

Appendix 1	Achievement of Surabaya City in collecting the Own-source Revenue (PAD) within the Period of 2006-10	378
Appendix 2	Achievement of Batu City in collecting the Own-source Revenue (PAD) within the Period of 2006-10	378
Appendix 3	Achievement of Trenggalek Regency in collecting the Own-source Revenue (PAD) within the Period of 2006-10	378
Appendix 4	Sources of Local Revenue of Surabaya City in the Period of 2006-2010	379
Appendix 5	Sources of Local Revenue of Batu City in the Period of 2006-2010	380
Appendix 6	Sources of Local Revenue of Trenggalek Regency in the Period of 2006-2010	381
Appendix 7	Local Expenditure (per-sector) of Surabaya City in the Period of 2006-10	382
Appendix 8	Local Expenditure (per-sector) of Batu City in the Period of 2006 - 2010	383
Appendix 9	Local Expenditure (per-sector) of Trenggalek Regency in the Period of 2006-10	384
Appendix 10	Local Expenditure by Economic Classification of Surabaya City within the Period of 2006-10	385
Appendix 11	Local Expenditure by Economic Classification of Batu City within the Period of 2006-10	386
Appendix 12	Local Expenditure by Economic Classification of Trenggalek Regency within the Period of 2006-10	387
Appendix 13	Official Permission for conducting research in the City of Surabaya	388
Appendix 14	Official Permission for conducting research in the City of Batu	389
Appendix 15	Official Permission for conducting research in the Regency of Trenggalek	390

List of Acronyms and Terms

APBD	:	<i>Anggaran Pendapatan dan Belanja Daerah/</i> Local Revenue and Expenditure Budget / Annual Local Budget
APBN	:	Anggaran Pendapatan dan Belanja Negara (Annual National Budget)
<i>Banggar</i> DPRD	:	(<i>Badan Anggaran DPRD/</i> Budget Board of Local Parliament)
<i>Banpres</i>	:	<i>Bantuan Presiden</i> (Presidential Assistance)
BAPPEDA	:	<i>Badan Perencanaan Pembangunan Daerah</i> (Board of Local Government Development Planning)
BAPPEDA	:	<i>Badan Perencanaan Pembangunan Nasional</i> (National Development Plan Board)
BANPRES	:	<i>Bantuan Presiden</i> (Presidential Assistance)
<i>Bupati</i>	:	Head of local government/ regency
<i>Dana Perimbangan</i>	:	Balancing Fund; one of types of local government revenue sourced from the central government transfer. The balance fund consists of three components include DAU, DAK and DBH.
DAU	:	<i>Dana Alokasi Umum/</i> General Allocation Fund; one of components of balance fund
DAK	:	<i>Dana Alokasi Khusus/Special</i> Allocation Fund; one of components of balance fund
DBH	:	<i>Dana Bagi Hasil/</i> Sharing Fund; one of components of balance fund
DKP	:	<i>Dinas Kelautan dan Perikanan</i> (Office of Maritime Affairs and Fisheries)
DPKAD	:	<i>Dinas Pengelola Keuangan dan Aset Daerah</i> (Financial and Asset Management of Local Government)
DPRD	:	<i>Dewan Perwakilan Rakyat Daerah</i> (local parliament)
DUKDA	:	<i>Daftar Usulan Kegiatan Daerah</i> (List of Local Government Proposed Activities)
DUPDA	:	<i>Daftar Usulan Pembangunan Daerah</i> (List of Local Government Proposed Projects)
<i>Inpres</i>	:	<i>Instruksi Presiden</i> (instructions of the President)

<i>Kepmendagri</i>	:	<i>Keputusan Menteri Dalam Negeri/ Decree of Minister of Home Affairs (MOHA)</i>
KUA	:	<i>Kebijakan Umum APBD (General Policy of APBD)</i>
MTEF	:	Medium-Term Expenditure Framework
<i>Musrenbang</i>	:	<i>(Musyawarah Perencanaan Pembangunan/ Development Planning Meeting)</i>
ORBA regime	:	<i>Orde Baru (New Order) regime; the centralistic-authoritarian regime under the administration of President Soeharto who held position between 1966 - 1998</i>
PAD	:	<i>Pendapatan Asli Daerah (own-source revenue)</i>
PBB	:	<i>Pajak Bumi dan Bangunan (Land and Building Tax)</i>
PBBS	:	Performance-Based Budgeting System
<i>Permendagri</i>	:	<i>Peraturan Menteri Dalam Negeri/ Regulation of Minister of Home Affairs (MOHA)</i>
<i>Poldas</i>	:	<i>Pola Dasar Pembangunan (Local Development Basic Pattern)</i>
PP	:	<i>Peraturan Pemerintah (Government Regulation)</i>
PPAS	:	<i>Prioritas dan Plafon Anggaran Sementara (Temporary Budget Margin and Priority)</i>
<i>Renja-SKPD</i>	:	<i>Rencana Kerja-SKPD (work plan of the local government agency)</i>
<i>Repelita</i>	:	<i>Rencana Pembangunan Lima Tahun (Five-Year Development Plan of Local Government)</i>
RKPD	:	<i>Rencana Kerja Pemerintah Daerah (Work Plan of Local Government)</i>
RKA-SKPD	:	<i>Rencana Kerja dan Anggaran SKPD (Work Plan and Budget of Local Body)</i>
RPJMD	:	<i>Rencana Pembangunan Jangka Menengah Daerah (Mid-Term Development Plan for Local Government)</i>
RUTPD	:	<i>Rencana Umum Tata Ruang dan Pembangunan Daerah (Master Plan of Local Government)</i>
SDO	:	<i>Subsidi Daerah Otonom (Autonomous Local Subsidy)</i>
SKO	:	<i>Surat Keputusan Otorisasi (Decree of Authorisation)</i>
SKPD	:	Satuan Kerja Perangkat Daerah (Local Government Institution)

SPJ	:	<i>Surat Pertanggungjawaban</i> (Letter of Accountability)
SPMU	:	<i>Surat Perintah membayar Uang</i> (Order Letter for Payment)
SPP	:	<i>Surat Permintaan Pembayaran</i> (Request Letter for Payment)
TAPD	:	<i>Tim Anggaran Pemerintah Daerah</i> (Budget Team of Local Government)
UU	:	<i>Undang-Undang</i> / Law
<i>Walikota</i>	:	Head of local government/ city (city mayor)