

## **CHAPTER SIX**

### **EXECUTION OF THE LOCAL GOVERNMENT BUDGET:**

#### **THE THIRD STAGE**

##### **6.1. Introduction**

The execution stage of the APBD is based on the operation of the political commitments of the executives and legislators, as set up earlier. The execution of the local budget consists of two main activities, including the collection of local revenue and the spending of local expenditure. In regards to revenue mobilisation, the performance of local officers in collecting local government income reflects to what extent the local executive are able to actualise the commitment previously made with local legislators. On the other hand, the execution of local government expenditure is the most crucial stage of the budgeting process as it indicates where the local budget is targeted, and also who the real beneficiaries of the budget are. The execution of local government expenditure is also a complex event because this is not only a purely managerial process but also involves political power and interests.

This chapter will analyse the process and various issues in the execution of the local government budget, particularly the collection of local revenues and the execution of local expenditures. In respect of revenue mobilisation, this chapter aims to elaborate on some critical queries, which, among others are: how do local government revenues get collected? What are the sources of local government revenues and what is the contribution of each source? How do local government

officials perform in collecting own-source revenue? In addition, a number of crucial questions related to the execution of local government expenditures will also be analysed, such as: where do local budget funds go? What are the sectoral priorities of local government expenditures? Who/what parties enjoy the funds of local government budget? What issues and distortions appear in the execution of the local government budget and why do those issues arise?

The first section of this chapter describes the execution process of the local government revenue budget. The next section elucidates the performance of local governments in collecting Own-Source Revenue, and is then followed up by analysis of the prominent factors that cause poor performance in the collection of local government revenue. Subsequently, the next sections elaborate upon the execution process of the local government budget which is then followed by the procurement process for local government projects. The following section identifies the sectoral priorities financed by APBD funds. Finally, the last two sections analyse the distortions, challenges, and other salient phenomena found in the process of project procurement and the execution process of the local government budget.

## **6.2. The Collection Process of the Local Government Revenue Budget**

Once the APBD has been validated and is ready to be executed, each SKPD (*Satuan Kerja Perangkat Daerah/* local body) formulates a document called the DPA-SKPD (*Dokumen Pelaksanaan Anggaran-Satuan Kerja Perangkat Daerah/*

document of budget execution of local body). The DPA-SKPD formulation process starts with the PPKD (*Pejabat pengelola Keuangan Daerah/* official of local finance management) who notifies all heads of local bodies to arrange the draft of the DPA-SKPD<sup>1</sup>. Thereafter, the heads of the SKPDs create the DPA-SKPD and then submit it to the PPKD.<sup>2</sup>

Subsequently, the PPKD hands the DPA-SKPD drafts to the TAPD (*Tim Anggaran Pemerintah Daerah/* Local government budget team). The next part of the process is that the TAPD invites the heads of the SKPDs to jointly verify and synchronise the proposed DPA-SKPD drafts<sup>3</sup>. After the TAPD and SKPD heads have completed the verification and synchronisation of the drafts, the results of the verification are finally checked by the Secretary of Local Government. If the Secretary of Local Government approves the drafts, then the PPKD formalises them. The validated DPA-SKPDs are then circulated to the SKPD heads, the *Bawasda* (*Badan Pengawas Daerah/* Supervisory Body of Local Government), and the BPK (*Badan Pemeriksa Keuangan/* Financial Supervisory Body) within seven working days of the validation of the DPA-SKPD. Afterwards, the formalised DPA-SKPD will be used by the SKPD officers for guidance in executing the annual budget of the respective institution.

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<sup>1</sup> As stated by the informants, the PPKD circulates the notification of the DPA-SKPD arrangements generally within three days after formalisation of the APBD. The draft of the DPA-SKPD contains the details of the targets, programs, and activities, as well as the budget allocated to achieve these targets. Moreover, it contains the plan for releasing funds, and revenue estimations, of each SKPD

<sup>2</sup> The informant explains that the heads of SKPDs (local bodies) complete the draft of the DPA-SKPD usually within six working days after the PPKD releases notification regarding the DPA-SKPD arrangements.

<sup>3</sup> This event mostly occurs within less than fifteen (15) working days of the TAPD accepting the DPA-SKPD draft.

The revenue of local government is collected and managed by the respective local bodies (SKPD/ *Satuan Kerja Perangkat Daerah*). The data show that not all local government bodies have potential revenue. For example, the Office of Education Affairs (*Dinas Pendidikan*), the Board of Community Empowerment (*Badan Pemberdayaan Masyarakat*), the Office of Social and Employment Affairs (*Dinas Sosial dan Tenaga Kerja*), and so forth, are some of the SKPDs that do not have any potential revenue. On the other hand, the Office of Local Revenue Affairs (*Dinas Pendapatan Daerah*), the Office of Industry and Trade (*Dinas Perindustrian dan Perdagangan*), the Office of Transportation (*Dinas Perhubungan*), and so on, are some of the local institutions that do have potential revenue.

Since the implementation of the local autonomy policy, starting in 2001, the mobilisation of local revenue starts by the beginning of January<sup>4</sup>. To execute and manage local government revenues, the heads of the SKPDs (local bodies) appoint officials to be treasurers for acceptance (*bendahara penerimaan*) who are in charge of receiving any revenue from the SKPD, either in cash or non-cash form. Subsequently, the treasurers must deposit these revenues into the general treasury account of local government within a maximum of one working day after receiving the income.

The SKPD's revenues received by the treasurer are not permitted to be spent immediately to finance any local expenditure, unless otherwise stipulated in the guidelines, such as for funding activities in emergency situations. Additionally, any local government income has to be supported by complete and valid evidence. The

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<sup>4</sup> Before 2001, the financial year for the local and national budgets (the APBD and the APBN) of Indonesia started on 1 April and ended on 31 March of the following year.

local agencies (the SKPDs) are only allowed to collect or quote local revenue from sources/ objects that have been appointed in the local regulations.

The SKPD treasurers in the research locations point out that they record and create a report of all income accepted from all sources. Then, the treasurers submit a monthly accountability report to the PPKD (*Pejabat Pengelola Keuangan Daerah/* official of local finance management) no later than the 10<sup>th</sup> day of every month. Subsequently, the PPKD verifies, evaluates, and analyses the submitted accountability reports. After reviewing the reports, the PPKD hands these to the head of local government (the *Bupati/* City Mayor) by the end of the month. Thereafter, the monthly reports are compiled by the PPKD into an annual report of local government revenue.

As mentioned above, execution of the APBD normally starts on 1 January and ends on 31 December. However, the evidence shows that execution of the APBD in the study locations is generally late every year. Over the last decade, the Surabaya City, Batu City, and Trenggalek Regency recorded being late by between two and eleven weeks in starting to execute the APBD, and in the worst case in 2011, the City of Surabaya was late by around three months.

The delay of APBD execution is caused by numerous factors, primarily because of delay in the completion of the previous stages (the formulation and validation stages). As explained in Chapter Four regarding the formulation process of the local budget, the delay in completing the formulation stage (the first stage of local budgeting) is caused by a number of technical-administrative problems, such as frequent changes in the regulations, the unpreparedness of local staff to

implement the new policy, and so forth. In addition, there are delays in the validation of the budget due to conflicts of interest and politics between local executives and legislators.

### **6.3. Performance of Local Governments in collecting PAD**

In general, local governments in the study locations have tended to record a greater than expected collection of PAD (Own-Source Revenue). The city of Surabaya, apart from in 2009, was successful in collecting PAD totalling more than the targeted amount. The same trend can be noticed in the City of Batu which recorded a positive result for APBD collection, except in 2009.

A number of officials from these two municipalities argue<sup>5</sup> that the poor achievement of PAD accumulation in 2009 was mainly due to the general elections (the legislative and presidential elections) held that year. As local staff concentrated more on these important affairs, the PAD was not collected in an optimal fashion<sup>6</sup>.

On the other hand, the general elections in 2009 did not significantly affect the Regency of Trenggalek in collecting the PAD. This happened because, as a rural community, the residents of Trenggalek were not really enthusiastic about getting involved in the bustle of the general election. As a result, this regency accumulated

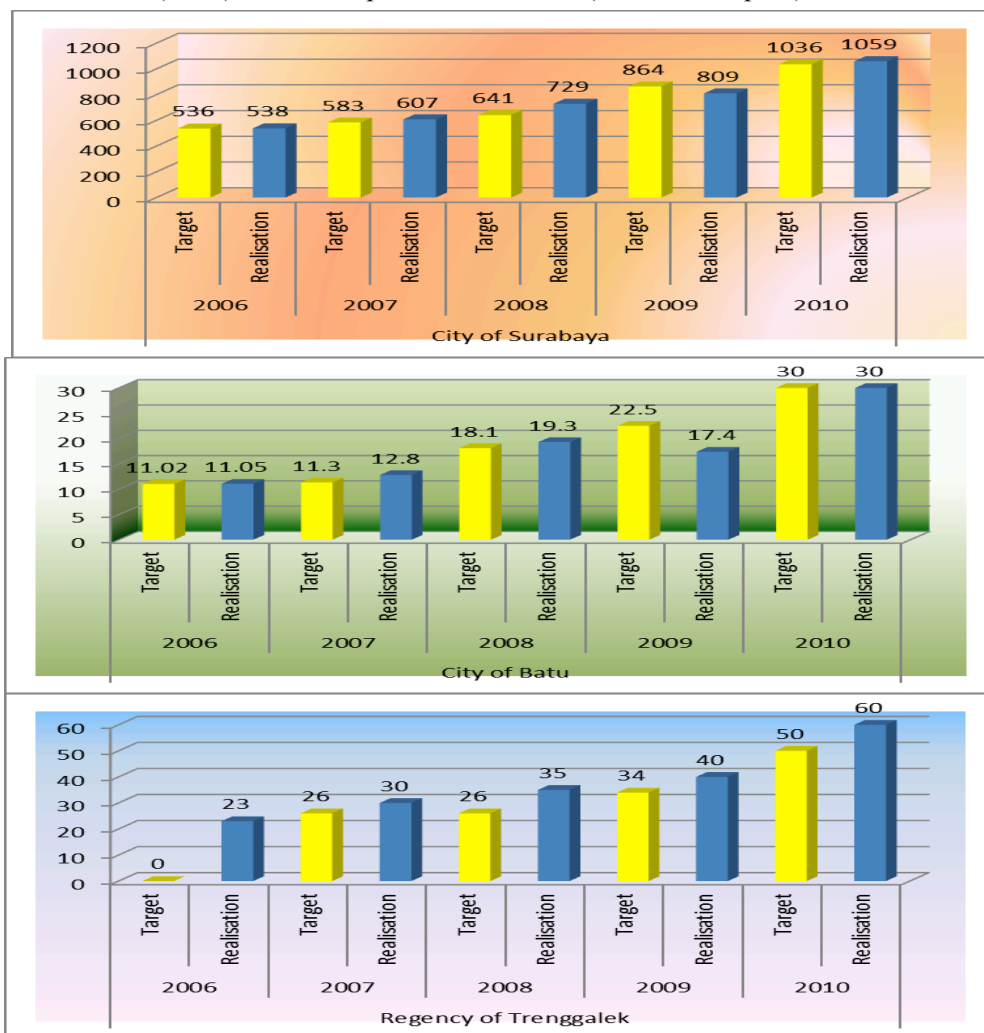
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<sup>5</sup> Based on numerous interviews conducted in Batu City (February-March 2011) and Surabaya City (April-May 2011)

<sup>6</sup> In 2009 the PAD was actually collected as normal and an appropriate amount as targeted recorded on the APBD. However, there was indication that a partial amount of the collected PAD funds was misused by the elites of local governments to finance the campaign of the political party that they are affiliated to. Therefore the total of collected PAD seems not to meet the target. In the light of this indication, the researcher failed to find the official proof/ documents which support the assumption of these informants

more than the targeted PAD amount in 2009 while the Cities of Surabaya and Batu recorded negative PAD performance.

**Figure 6.1.** Target and Realisation of the Collection of the Own-Source Revenue (PAD) within the period of 2006-10 (in billion Rupiah)<sup>7</sup>



Source: The APBD accountability report of Surabaya City, Batu City, and Trenggalek Regency for the financial year 2006-10

The data gathered in the field shows that local government revenue comes from three main sources, including Own-Source Revenue (PAD), the Balancing fund

<sup>7</sup> Detail data regarding target and realisation of the Own-Source Revenue (PAD) collection within the period of 2006-10 in Surabaya City, Batu City, and Trenggalek Regency can be found in the appendix

(Dana Perimbangan), and Miscellaneous Revenue (*Pendapatan Lain-lain yang Sah*).

This section elaborates on the contribution of each revenue source to the local government incomes of the City of Surabaya, the City of Batu, and the Regency of Trenggalek.

**TABLE 6.1.** Contribution of Revenue Sources to the Accumulation of Local Government Income in 2010<sup>8</sup>

Sources of Local Revenue	City of Surabaya		City of Batu		Regency of Trenggalek	
	Rp. (000,000)	%	Rp. (000,000)	%	Rp. (000,000)	%
<b>Own-source Revenue (PAD)</b>	<b>1,059,891</b>	<b>31.4</b>	<b>30,000</b>	<b>7.17</b>	<b>60,967</b>	<b>7.73</b>
Local Taxes	581,581	17.8	42,978	10.3	6,995	0.89
Local Levies	288,713	8.8	0	0	20,160	2.56
Profit of Local-Government - Owned Enterprises	63,581	1.94	247,723	59.2	2,643	0.34
Other Own-source Revenues	126,014	3.85	18,275	4.4	31,168	3.95
<b>Balancing fund</b>	<b>1,593,973</b>	<b>48.7</b>	<b>308,976</b>	<b>73.8</b>	<b>581,219</b>	<b>73.7</b>
Revenue-Sharing of Tax	881,554	26.9	42,978	10.3	48,151	6.11
Revenue-Sharing of Non-tax	0	0	0	0	0	0
General Allocation Fund (DAU)	652,532	19.9	247,723	59.2	472,359	59.9
Special Allocation Fund (DAK)	59,885	1.83	18,275	4.4	60,708	7.70
<b>Miscellaneous Local Revenue</b>	<b>617,556</b>	<b>18.8</b>	<b>79,349</b>	<b>18.9</b>	<b>146,460</b>	<b>18.6</b>
Grant	20,082	0.61	0	0	2,000	0.25
Emergency Fund	0	0	0	0	6,016	0.76
Revenue-Sharing of Tax from Provincial Government	353,546	10.8	25,758	6.16	30,841	3.91
Adjustment Fund and Special Autonomy	207,386	6.34	39,883	9.53	95,716	12.1
Financial Assistant from Provincial Government and other Local Governments	33,862	1.04	13,707	3.28	11,886	1.51
Revenue-Sharing of Non-Tax from Provincial Government and other Local Governments	2,679	0.08	0	0	0	0
Other Revenues	0	0	0	0	0	0
<b>TOTAL</b>	<b>3,271,421</b>	<b>100</b>	<b>418,326</b>	<b>100</b>	<b>788,648</b>	<b>100</b>

*Source:* Financial Report of APBD 2010

<sup>8</sup> Details data regarding the Contribution of Revenue Sources to the Accumulation of Local Government Income in the City of Surabaya, City of Batu, and Regency of Trenggalek in the period of 2006-10 are attached at the appendix of this thesis



## *The City of Surabaya*

The financial data show that the PAD of Surabaya City has increased almost 100% over the recorded five year period (from Rp. 538,369 million in 2006 to Rp. 1,059,891 million in 2010), however the share was stable at around 31% of total revenue. The PAD consists of four main components, being local taxes<sup>9</sup>, local levies<sup>10</sup>, profits from local government-owned enterprises, and Other Own-Source Revenue<sup>11</sup>. Among these sources, local taxes amounted to the largest portion of the PAD for Surabaya City, which was Rp. 305,405 million in 2006, increasing to Rp. 581,581 million in 2010, with a share on average of about 17.4%. This percentage share appears much larger in comparison to other local governments because, as the

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<sup>9</sup> Local government taxes consist of Hotel Tax, Restaurant Tax, Entertainment Tax, Advertisement Tax, Street Lighting Tax, Non-Metallic and Rock Mineral Tax, Parking Tax, Groundwater Tax, Swallow's Nest Tax, Tax on Acquisition of Land and Building, and Land and Building Tax.

<sup>10</sup> Local levies contain three primary types which are the Levy of General Service, Levy of Business Service, and Levy of Certain Licensing.

Levy of General Service consists of the levy of health service, levy of waste/hygiene service, levy of identity card and civil registration, levy of funerals and cremations, levy of parking services on the public roads, levy of market services, levy of motor vehicle inspections, levy of fire extinguisher inspections, levy of map printing, levy of lavatory suctioning, levy of liquid waste treatment, levy of chop/re-chop, levy of education services, and levy of telecommunication tower control

Levy of Business Service include the levy of use of local government assets, levy of wholesale market and/or shopping area, levy of auction sites, levy of public transport station, levy of special site for parking, levy of guesthouse/villa, levy of abattoir, levy of port, levy of recreation and sport spots, levy of water ferriage, and levy of local production sales

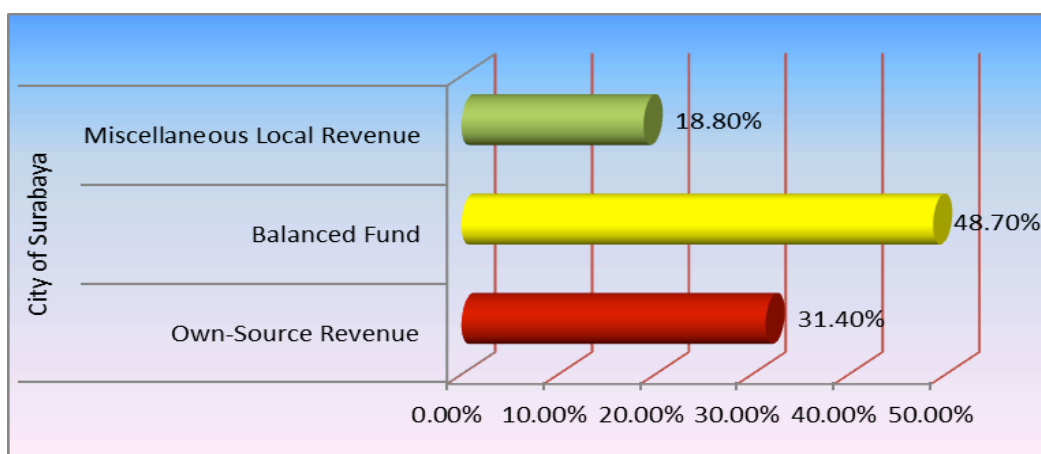
Levy of Certain Licensing contains the levy of permits for developing buildings, levy for selling liquor, levy of disturbance permit, levy of route permits for public transport, and levy of permits for fisheries businesses.

<sup>11</sup> Other own-source revenues might come from the selling of local government assets, interest from local government accounts, income from compensation claims, income from commissions and discounts in selling or goods/ services procurement, income gained from the gap in exchange rates against foreign currencies, revenue from fines due to delays in completing projects, income from tax penalties, income from levy penalties, income from execution of collateral, revenue gained from people using social and public facilities and revenue from provision of education and training.

second largest metropolitan area in Indonesia, Surabaya City has many potential income sources from local taxes, particularly from hotels, restaurants, entertainment, advertising, street lighting, parking, and land and building taxes.

Specifically regarding the water ferry levy, revenue from this source was mainly supplied by the facility that provides crossing services for people and vehicles from the port of Surabaya (Tanjung Perak Port) to Madura Island (Kamal Port) and *vice versa*. However, since 2011, the income from this levy has dramatically declined, because, in that year, the Indonesian government officially opened the longest bridge in Indonesia, connecting Surabaya (Java Island) to Kamal (Madura Island), known as the SURAMADU Bridge. Therefore, the people and vehicles intending to travel from Surabaya to Madura (and/or *vice versa*) mostly preferred to use the bridge rather than use the ferry service any longer.

**Figure 6.2.** Contribution of Three Types of Revenue Sources to the Accumulation of Local Government Income in the City of Surabaya in 2010



**Source:** the APBD Report of Surabaya City for Financial Year 2010

On the other hand, the Balancing fund (*Dana Perimbangan*) transferred from

the central government grew by around 75% in the recorded five year period (from Rp. 895,690 million in 2006 to Rp. 1,593,973 million in 2010). However, the share of overall revenue fell from 52.3% in 2006 to 48.7% five years later.

In addition, Other Local Revenue also recorded remarkable growth from Rp. 278,157 million in 2006 increasing to Rp. 617,556 million in 2010. The biggest contributor to this revenue type came from the Revenue-Sharing of Tax from the Provincial Government in the form of a Vehicle Tax, which recorded a share of more than 10% over three years (2008-10).

### ***The City of Batu***

The Own-Source Revenue collected by the City of Batu shows positive progress almost tripling from Rp. 11,050 million in 2006 to Rp. 30,000 million in 2010, with the share of overall revenue slightly fluctuating during this period. The largest contributor to Batu City's PAD was Local Taxes, of which revenue amounting to Rp. 13,750 million in 2010 was collected, growing from Rp. 4,696 million in 2006. The major sources of tax revenue came from hotel, restaurant, and entertainment taxes. This was as a result of Batu being widely known as a popular tourist destination, therefore many hotels, restaurants, and commercial recreation parks operate in this area.

The data show that 67 large hotels and hundreds of motels and villas operate in the Batu territory. Moreover, well-known tourist sites, such as JATIM Park I, JATIM Park II (the Museum and the Secret Zoo), Selecta Recreation Park, the Songgoriti area, the Batu Night Spectacular (BNS), and many more, attract hundreds

of thousands of domestic tourists and thousands of international tourists to this city every year.

However, the authorities in this municipality do not appear to be able to optimally accumulate revenue from this potential source. Data from an audit published by the BPK shows that a huge volume of potential revenue was left uncollected by local officials, amounting to more than Rp. 25 Billion (in 2008), around Rp. 15 billion (in 2009), and more than Rp. 10 billion (in 2010). These uncollected sources of income are primarily from the entertainment tax which is supposed to be collected from JATIM Park I, JATIM Park II (the Museum and the Secret Zoo), and the Batu Night Spectacular (BNS).

The study discovered<sup>12</sup> that this situation occurs because the current City Mayor has a significant share in these businesses. Additionally, the informants suspect that the main owner of the recreation areas<sup>13</sup> actively contributes funds to the City Mayor, either for personal or other needs<sup>14</sup>. Due to such conspiracies, respective local officials do not intentionally collect the entertainment tax in an optimal manner from these particular tourism sites, as ordered by their bosses. In the light of the large amount of uncollected PAD, the BPK has declared a status of 'Disclaimer' for the financial report for Batu City successively from 2008 to 2011<sup>15</sup>.

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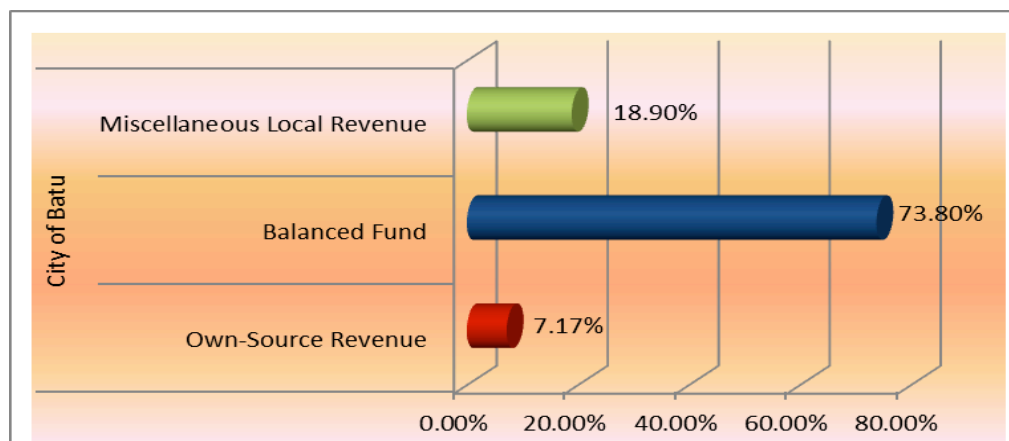
<sup>12</sup> Based on interviews conducted within February-March 2011

<sup>13</sup> The JATIM Park I, JATIM Park II (Museum and Secret Zoo), and Batu Night Spectacular (BNS) are owned by a person who is widely known as the crony of the *Walikota* (City Mayor)

<sup>14</sup> The informants further explain that because of support from the great volume of funds (largely donated by the owner of the recreational sites mentioned above), the *Walikota* was successful in obtaining the position in 2007 and then got elected for a second term at the end of 2012)

<sup>15</sup> Further analysis about this point will be presented in ChapterSeven regarding accountability and supervision of APBD.

**Figure 6.3.** Contribution of Three Types Revenue Sources to the Accumulation of Local Government Income in the City of Batu in 2010



*Source:* the APBD Report of Batu City for Financial Year 2010

On the other hand, revenue from the Balancing Fund (the *Dana Perimbangan*) of Batu City amounted to Rp. 308,976 million in 2010, increasing from Rp. 197,162 million in 2006. Nevertheless, the share of overall revenue decreased by almost 15% over five recorded years, from 87.1% in 2006 to 73.8% in 2010. In addition, as Table 7.6 shows, revenue collected from other sources has increased sharply from Rp. 16,068 million (share of 7.16%) in 2006 to Rp. 79,349 million (share 18.90%) in 2010. The 2010 data show that local revenue of this type was primarily contributed by three sources which are the adjustment and special autonomy fund, the revenue-sharing of tax from the provincial government, and financial assistance from the provincial government and from other local governments.

### ***The Regency of Trenggalek***

The data show that in 2010, the Regency of Trenggalek accumulated PAD of nearly triple the amount of five years earlier (Rp. 60,967 million in 2010 increasing

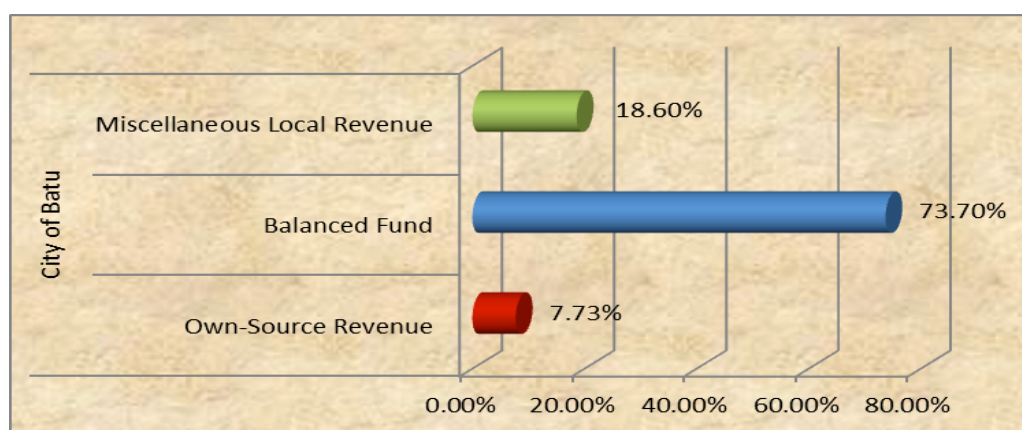
from Rp. 23,420 million in 2006). The share of this local revenue gradually increased from 4.78% in 2006 to 7.73% in 2010. Unlike other local governments, local taxes in this regency contributed only minimally to the collection of PAD (less than 1% of total revenue). This was because Trenggalek Regency is a rural local government with less potential tax sources. Local levies realised a larger contribution amounting to Rp. 7,417 million in 2006, escalating to Rp. 20,160 million in 2010. The revenue from local levies comes primarily from the levy on auction sites, particularly from the TPI (*Tempat Pelelangan Ikan*/ Fish Auction Site) operating in Prigi Harbour. As the National Fish Harbour, Prigi Port also contributes income in the form of port levies and permit levies for fisheries businesses. Other than this, revenue from local levies also comes from parking service charges on public roads, and the motor vehicle inspection levy.

The balancing fund was dominant in contributing local revenue for the Trenggalek Regency with a share of 90.19% (Rp. 441,615 million) in 2006, gradually reducing to 73.70% (Rp. 581,219 million) in 2010. With this type of local revenue, the General Allocation Fund (the DAU) supplied the largest contribution amounting to Rp. 384,418 million in 2006, up to Rp. 472,359 million in 2010. Similar to the situation in Batu City, the allocation from the DAU in this regency was mainly due to the large number of local staff (civil servants) that are paid using DAU funds. In addition, revenue for Trenggalek Regency from miscellaneous local revenues increased almost six-fold from only Rp. 24,610 million in 2006 to Rp. 146,460 in 2010.

The amount of Own-Source Revenue (PAD) stated in the APBD is the lowest

estimation that has to be collected by local officers within a financial year. This means that local governments must collect PAD amounting to at least that stated in the APBD, or even more, ideally, as they have to accumulate more PAD than the amount targeted in the APBD. As previously mentioned, local governments are allowed to collect more PAD than that which is targeted. Unfortunately, as the data demonstrate, so far, the PAD has not contributed significantly to the accumulation of local government revenues. The local government revenue is dominated by funds transferred from the central government in the form of the Balancing Fund (*Dana Perimbangan*), which consists of three main components, including the DAU (*Dana Alokasi Umum/ General Allocation Fund*), the DAK (*Dana Alokasi Khusus/ Special Allocation Fund*), and the Sharing Fund (*Dana Bagi Hasil*).

**Figure 6.4.** Contribution of Three-Types Revenue Sources to the Accumulation of Local Government Income in the Regency of Trenggalek in 2010



**Source:** Financial Report of APBD 2010

The data show that PAD contributes only minimally to the accumulation of local government revenue in Batu City and Trenggalek Regency. In these two local government areas, PAD contributes only 4.7% and 7.7% respectively, in the 2006-10

period. A larger contribution of PAD was recorded by Surabaya City in the same period, contributing around 29.9% to 31.4% of total local revenue. This was because the City of Surabaya has a wide range of revenue sources, particularly from local taxes and levies, as Surabaya is the second largest city in Indonesia.

Nonetheless, overall local government revenue is still dominated by funds transferred from the central government. On average, as shown in the three local governments, only 14.1% of local government revenue is contributed by local governments' own revenue (PAD), while miscellaneous revenues contribute approximately 12.7%. On the other hand, 73.2% of local government revenue comes from the central government in form of the balancing fund.

#### **6.4. Challenges in Optimising the Local Government Revenue**

Even though the collected PAD is almost always more than the targeted amount, however, overall the contribution of PAD to the accumulation of local government income, except in Surabaya City, is still minimal. This study has found a wide range of internal and external factors which significantly lead to the poor contribution of PAD to the total accumulation of local government revenue. The internal factors which cause low PAD collection are due to the fact that it is incrementally designed and because of the lack of reliable data. Local government officers are also suspected of working inefficiently and favouring keeping the deficit condition. As well, the poor accumulation of PAD may be due to irrelevant qualifications in human resources. On the other hand, external factors causing low PAD achievement, among others, are the disincentive policy of the DAU (General



Allocation Fund) and the centralised tax assignment process.

The following section will analyse both the internal and external factors indicated above. This will start with the phenomenon of unreliable data and incremental design in the planning of PAD collection.

#### **6.4.1. Unreliable Data and Incremental Design**

As the facts denote, the officials in the research locations commonly do not have reliable and detailed data regarding potential revenue in their areas. They do not know the precise number of tax payers living in their area or the volume of taxes and levies they should collect. The local governments actually have documents consisting of lists of tax payers, however they cannot guarantee that the data is accurate as it was created manually and based on rough estimates only. Furthermore, the local authorities often fail to monitor the migration of residents and tax payers within their territory. As a result, local revenue collection is habitually mobilised incrementally. In this case, local officials set up a target of local revenue execution which is usually based on the PAD accumulated in the previous year. An official (informant GO-11) gives the following example:

*Due to the lack of data, we usually arrange the target of PAD execution for the current year by referring to the volume of PAD collected in the previous year, and then we add it by certain percent which is usually 10% from the previous-year collected PAD ... (Interview: 05/03/11).*

To obtain more reliable data about local income sources, local governments in the research locations prefer to hire professional consultants to collect the local revenue data. Nevertheless, the quality of the work conducted by these consultants is

frequently sub-standard. The output of their work often provides sketchy and inaccurate rather than updated and detailed data. Professional consultants who are frequently hired by local governments argue that this happens because consultants do not get appropriate funding to conduct high-quality projects. In this case, local officials actually do allocate reasonable funding for the consultants. However, significant amounts of these funds are quoted by local officials themselves, so the remaining amount of funds available for executing projects (allocated to the consultants) remains minimal.

Both the consultants and local officials admit that this (quoting the project funds carried out by local government officials) is a common phenomenon in the management of local projects. Moreover, the consultants revealed that they are forced to execute the projects with inappropriate funding otherwise local officials might give the projects to other consultants. If so, these consultants would lose their jobs which would mean losing income. Further analysis regarding illegal quotations for project funds will be presented in sub-section 6.9.5. of this chapter.

#### **6.4.2. Irrelevant Qualifications and Inadequate Training of Officers**

The data from the local units in the study locations show that the qualifications of most of the local staff working in the finance units are not relevant for the main tasks they do in their jobs. Many of them graduated from disciplines which are completely irrelevant to their duties as a financial officer, such as engineering, agriculture, psychology, law, and other disciplines. An official of

Trenggalek Regency (informant GO-1) states that:

*... even there is a dentist holding an important position at Service of Local Finance and Assets Management (Dinas Pengelolaan Keuangan dan Aset Daerah/ DPPKAD) ... (Interview: 18/01/11).*

These officers who work in fields inappropriate to their education and training admit that, to some extent, they struggle to execute their tasks properly. They contend that they would be better able to contribute to the institution if they were employed in the right unit/ position. However, these local officers do not have the opportunity to choose their preferred unit to suit their background and capabilities as the policy for work placement is fully determined by the local government authorities themselves.

As a result of the local officials' irrelevant qualifications, local government staff often cannot contribute significantly in optimising local revenue execution and collection. According to informants for the local officials, these officers tend to only carry out their routine jobs without any creativity and innovation in maximising local revenue collection. Consequently, local governments often waste money on various forms of training for these staff members to improve their capabilities and professionalism as financial officers. Additionally, local governments also must spend their budget for hiring consultants to create financial documents, including estimation data of local revenue, potency and projections of local taxes, balance sheets of local government, and other documents, because the existing officers are not able to do this work.

The research notes that this is due to poor systems followed in the past. At the time, local governments did not set down in detail the specific requirements for recruiting officers, usually only requiring the minimum level of education. The

informants explained that, in order to deal with this issue, the recruitment system was fixed in 2005. The present recruitment system stipulates that candidates for local officer positions must have qualifications strictly in line with the tasks required in the finance unit. This improvement has led to initial positive signs now that the finance units currently have a larger number of staff with financial backgrounds. The local government elites expect that this situation will boost the performance of local government finance units in implementing their institutional tasks, including the maximisation of local government revenue collection.

### **6.4.3. The Disincentive in the DAU**

The tendency in the study areas shows that the policy regulating the DAU (General Allocation Fund)<sup>16</sup> might discourage local government officials from optimising the collection of PAD. The policy regarding the DAU stipulates that once the PAD of local governments reaches a certain amount, this may reduce the allocations from the General Allocation Fund to those local governments. In other words, the larger the amount of PAD collected by a particular local government, the lower would be the likely allocation of funding from the DAU for the respective local government<sup>17</sup>.

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<sup>16</sup> An explanation of the DAU (*Dana Alokasi Umum/* General Allocation Fund) has been briefly elaborated upon in Chapter Four.

<sup>17</sup> As stipulated in PP (*Peraturan Pemerintah/* Government Regulation) 55 of 2005 regarding the Balancing fund (*Dana Perimbangan*) article 45: (1) local governments that have a fiscal gap of more than 0 (zero) will receive from the DAU (*Dana Alokasi Umum/* General Allocation Fund) an amount equal to the 'basic allocation' added to the fiscal gap; (2) local governments that have a fiscal gap of 0 (zero) will receive from the DAU an amount equal to the basic allocation; (3) local governments that have a fiscal gap less than 0 (negative point) and the minus amount is less than the basic allocation will receive from the DAU an amount the same as the basic allocation; (4) local governments that have a fiscal gap less than 0 (negative point) and a negative point of the same or

The provision mentioned above is supposed to be well-understood by local government authorities, as the DAU policy aims to equalise the financial conditions among local governments across Indonesia. Consequently, if local governments already have a large amount of Own-Source Revenue (PAD), they will get a fairly smaller amount from the DAU. However, even though the local officials understand this stipulation very clearly, they mostly contend that this policy makes them unenthusiastic about the optimal collection of PAD, particularly those local governments that have a large potential for PAD. As found at the study sites, when collecting the PAD, local officers tend only to meet the targets stated in the APBD. They prefer to do so because if they collect PAD amounting to less than the targeted amount, their performance may be judged to be poor. On the contrary, if they accumulate too much PAD, the allocation from the DAU may possibly be reduced.

As shown in the study areas, a small amount of PAD leads to dependence by local governments on the income transferred from the central government. Nonetheless, this situation does not encourage local staff to maximise PAD collection. On the contrary, local officials seem to prefer to 'beg mercy' from the central authorities in order to get a larger amount of transferred funds from the central government, rather than working hard to increase PAD collection.

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more than the basic allocation, do not receive funding from the DAU. As the fiscal gap is determined by the volume of PAD collected by a local government, then those local governments that have a large volume of PAD (that reach a certain amount/ percentage) may have a reduced amount from the DAU allocated to them.

#### **6.4.4. Centralised Tax Assignment**

The low contribution of PAD to the APBD (the local budget) is the result of the tax assignment system in Indonesia which authorises the central government to collect ‘high-potential’ taxes such as income tax (*Pajak Penghasilan*), value-added tax (*Pajak Pertambahan Nilai/ PPN*), import duties (*Bea Masuk*) and others. In contrast, local governments are authorised to collect only the ‘lower-potential’ taxes. The highly centralised tax assignment system is indicated by the fact that the central government collects 96.61% of tax revenue, while only 3.39% of tax income goes to local governments (Soesanto, et al., 2005, p. 595).

This unequal proportion has slightly improved recently as a result of the issuance of Law 28 of 2009 regarding local taxes and levies which replaced Law 34 of 2000. This new law authorises local governments to collect a greater number of different types of taxes. One of the potential taxes delegated to the local level is the Land and Building Tax (*Pajak Bumi and Bangunan/ PBB*). Law 28 of 2009 stipulates that 64.8% of income from the Land and Building Tax (PBB) goes to local governments, while provincial governments earn 16.2%, the central government 10%, and 9% is allocated for collection costs.

The implementation of the new law on local taxes and levies has had a significant effect on the PAD collected by local governments. Since 2010, local governments in the study areas recorded an increase in PAD volumes of more than 30% compared to the 2009 period and earlier (before the issuance of the new local taxes and levies law). The most prominent progress in this regard is from Batu City which accumulated PAD of only Rp. 17.386 bn in 2009, which then sky-rocketed

to Rp. 30 bn in 2010. This means that the PAD for Batu City in 2010 grew 72.54% from the previous year.

**Table 6.2.** Progress of the Own-Source Revenue (PAD) Accumulation at Three Local Governments in the Period of 2006-2010

Local Government	Year	Own Local Revenue (Rp./IDR)	Progress (Rp./IDR)	Percentage (%)
District of Trenggalek	2006	23,420,083,039	-	-
	2007	30,975,537,855	7,555,454,816	32.25%
	2008	35,187,914,905	4,212,377,050	13.59%
	2009	40,435,991,178	5,248,076,273	14.91%
	2010	<b>60,967,446,000</b>	<b>20,531,454,822</b>	<b>50,77%</b>
City of Surabaya	2006	538,369,935,681	-	-
	2007	607,649,295,691	69,279,360,010	12.86%
	2008	729,213,319,344	121,564,023,653	20.05%
	2009	809,795,526,041	80,582,206,697	11.05%
	2010	<b>1,059,891,415,591</b>	<b>250,095,889,550</b>	<b>30,88%</b>
City of Batu	2006	11,050,384,065	-	-
	2007	12,802,148,512	1,751,764,447	15.85%
	2008	19,323,650,000	6,521,501,488	50.93%
	2009	17,386,741,568	-1,936,908,432	-10.02%
	2010	<b>30,000,000,000</b>	<b>12,613,258,432</b>	<b>72,54%</b>

*Rp.* = Rupiah (Indonesian Currency)

Source: Report of APBD 2006-2010

Nevertheless, even though the volume of PAD increased significantly after the implementation of the new local taxes and levies law, overall the percentage of PAD remains low in contributing to the accumulation of local government revenue. This can be seen in Table 6.1 which shows that the PAD (Own-Source Revenue), except in Surabaya City, contributes less than 8% of total local government income.

#### 6.4.5. Intentional Deficits

The study indicates that the financial deficits of local governments are "intentionally engineered" by the local authorities themselves. This strategy is designed to put pressure on the central government to increase allocations from the Balanced Fund (*Dana Perimbangan*) or the contingency fund. A scholar from Brawijaya University has clarified<sup>18</sup> that, although the claim that the deficits of local governments are intentionally engineered is debatable, it is difficult to prove otherwise<sup>19</sup>. Based on facts from the sites, local authorities appear to be comfortable with financial deficits in their areas. They do not make any meaningful effort to overcome this situation, except for the expectation that the central government will increase their allocation from the Balanced Fund (particularly the DAU/ General Allocation Fund) for their regions.

Another strategy in anticipating the deficit problem is for some SKPDs (local agencies) to optimise their efforts to obtain alternative funding from various sources, such as de-concentration funds (both from the central and the provincial government) and foreign aid (loans and/ or grants). This strategy is carried out, for example, by the Office of Maritime Affairs and Fisheries (*Dinas Kelautan dan Perikanan/ DKP*) in the Regency of Trenggalek. This strategy is able to eliminate the problem of the limited budget. Additionally, it also possibly supports the technical units to

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<sup>18</sup> Interview on 23 March 2011

<sup>19</sup> This scholar further explains that these deficits reflect that the fiscal capacity in a region is less than its fiscal need. Therefore, to solve this problem, the fiscal gap (which is the fiscal capacity subtracted by the fiscal need) has to be reduced. To reduce the fiscal gap, there must be intervention from the central government to increase the Balancing fund (*Dana Perimbangan*). Increasing the Balancing fund will improve the fiscal capacity of the region, so this will also automatically reduce the fiscal gap or deficit.



implement their programs and projects accordingly. In the light of low achievements in PAD collection, the national government strongly encourages local governments to take greater efforts to increase their PAD. Nonetheless, the attempts by local authorities to optimise local income often eventually burden the local economy.

The tendency in the study locations demonstrates that in attempting to accumulate PAD amounting to the targeted amounts in the APBD, local officials tend to take the simplest path in the form of increasing tariffs from existing local taxes and levies. In addition, they also prefer to set new kinds of local taxes and levies, and other types of quotations.

The data in the study areas confirm that the strategy of increasing the local tax and levy tariff, to some extent, contributes to an increase in PAD. However, the strategy undertaken by local officials to increase PAD collection often leads to a negative impact on the local economy as this policy often increases the burden on local businesses. Furthermore, this situation causes the advent of a 'high-cost economy' which possibly discourages investors from developing their businesses in these areas. Considering this situation, the DPRD (the local parliament) in Surabaya City has recently rejected a policy initiated by the Mayor of Surabaya City to dramatically increase the tariff on advertising taxes. The Mayor argued that this policy is intended to support the enhancement of PAD accumulation. On the other hand, the DPRD members insisted that the policy would burden the business community and may even hamper the growth of the local economy<sup>20</sup>.

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<sup>20</sup> The different perspective of the DPRD (the local parliament) and the City Mayor of Surabaya concerning the increase in the advertising tax has led to serious conflict among them. The nature of the conflict has been briefly explained in Chapter Six.

To minimise the burden on local businesses and the community resulting from the local policy on taxes and levies, the Indonesian Ministry of Home Affairs (MOHA) continuously reviews drafts of the local regulation (*Perda*) proposed by local governments. In cases where the draft of the *Perda* is considered to potentially burden local business and the community, the MOHA would instruct the local government to revise it, otherwise the draft of the *Perda* will be cancelled by the national authorities. The website of the Indonesian Ministry of Home Affairs reveals that 3,091 *Perda* drafts were cancelled by the MOHA in the 2001-2009 period. Moreover, 824 *Perda* drafts were cancelled, and 13,520 drafts were under evaluation in the period from 2010 to August 2012<sup>21</sup>.

## **6.5. The Process of Local Expenditure Execution**

This section elaborates the process of the execution of local expenditure and various associated issues. The section starts with the process of local expenditure execution, which is followed up by an analysis of the prominent phenomena that emerge in this process.

The execution process of local expenditure starts with the issuance of a SPP (*Surat Permintaan Pembayaran/ Request Letter for Payment*). The SPP is a letter requesting payment issued by officials of the SKPDs (the local bodies) who are responsible for the execution of projects or activities<sup>22</sup>. Based on the SPP, the heads

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<sup>21</sup> This data can be checked further at [www.depdagri.go.id/news/2012/08/24](http://www.depdagri.go.id/news/2012/08/24)

<sup>22</sup> To execute local expenditure, every expense funded by the APBD must be supported by complete and valid receipts. Additionally, these forms of evidence have to be approved by authorised officials. Local expenditures have to be executed under the principles of efficiency, effectiveness, transparency, and accountability, and must be in line with the provisions regulated by law.

of local agencies (*SKPD/ Satuan Kerja Perangkat Daerah*) issue a SPM<sup>23</sup> (*Surat Perintah Membayar/ Letter of Payment Order*). Every local spending can be executed only based on the SPM issued by the heads of the respective local bodies (the SKPDs). Moreover, an application to issue a SPM must be accompanied by the required documents, among others, the original contract document, a receipt completed with the requested amount, and the original of the progress report.

In the next part of the process, SKPD officials hand the SPM to the BUD (*Bendahara Umum Daerah/ General Treasurer of Local Government*) which is a position held by the chairman of the DPKAD (*Dinas Pengelolaan Keuangan dan Assets Daerah/ management unit of local government assets and finance*). After receiving the SPM, the BUD reviews it<sup>24</sup>. Based on the results of the review, the BUD might refuse to release the funds if the SPM is considered inconsistent with conditions outlined in the normative guidelines. Otherwise, once the BUD confirms that the proposed SPM is in line with the required conditions, they then issue a SP2D (*Surat Perintah Pencairan Dana/ Order Letter to Release Funds*). Afterwards, the BUD sends the SP2D to the appointed bank (which works in cooperation with the local government) not more than two working days after the acceptance of the SPM. The bank refers to the SP2D sent by the BUD, and then releases the requested funds.

The study finds that local governments tend to spend local budgets (APBD) to finance routine expenditures more than capital expenses. The local government

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<sup>23</sup>The SPM is a document issued and used by the budget authorisation holders/ heads of local bodies (*SKPD/ Satuan Kerja Perangkat Daerah*) to issue the SP2D (*Surat Perintah Pencairan Dana/ Order Letter to Release Funds*).

<sup>24</sup> The BUD reviews the SPB with the main activities including: (a) checking the completeness of the required documents attached to the proposed SPM; (b) verifying the accuracy of the bill amount stated on the SPM; and (c) confirming the availability of funds in the local government account.

officials also seem to execute the local budget incrementally instead of through scrupulous planning. Additionally, as the data show, the execution of local government projects is often delayed because of the shortage of project leaders. This situation causes the untimely APBD execution process in which this condition further leads to a high percentage of unutilised budgets and unfinished projects. Other than that, execution of the local budget is frequently subjected to intervention from powerful political and non-political parties. This leads to illegal projects such as *proyek titipan* (by-order projects) and *proyek fiktif* (fictitious projects). The various problems arising in the APBD execution process outlined above will be comprehensively elaborated and analysed in section 7.6 of this chapter<sup>25</sup>.

Any local spending financed by APBD funds cannot be executed before the local regulation regarding the APBD (the PERDA APBD) has been officially validated, unless in the case of an emergency situation as stipulated in the guidelines. As well, local bodies (SKPD/ *Satuan Kerja Perangkat Daerah*) are not permitted to spend local budgets for any items that are not stated in the APBD<sup>26</sup>. In addition, in regards to the execution of capital expenditure, local authorities have to establish a procurement process prior to executing any capital expenditure.

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<sup>25</sup> The tendency of prioritising the routine spending will be analysed in sub-section 7.6.1; The facts of the incremental design in executing local government expenditure is elucidated in sub-section 7.6.2; The phenomenon of the shortage of project leaders will be analysed in sub-section 7.6.3; The analysis regarding political intervention in the project execution as well as illegal projects (by-order projects and fictitious projects) resulting from this intervention is presented in sub-section 7.6.4; The untimely APBD execution process is analysed in sub-section 7.6.5; The indications concerning the high percentage of unutilised budgets will be analysed in sub-section 7.6.6; and the phenomenon of unfinished projects is elaborated in sub-section 7.6.8.

<sup>26</sup> The figure of expenditure stated on the APBD (*Anggaran Pendapatan dan Belanja Daerah*/ annual local budget) indicates the highest amount permitted to be spent by local officials. It means that the realisation of expenditure has to be less than, or the same as, the margin noted in the APBD.

## 6.6. The Procurement Process for Goods and Services

Procurement is guided by PERPRES (*Peraturan President/ Regulation of the President*) 54 of 2010 regarding the procurement of goods and services for government institutions. In the procurement of goods and service, local government institutions in the study areas apply various methods which may differ from one unit to another. However, in general, government units procure goods and services by: (a) planning for the selection of a goods and services supplier/ contractor; (b) selecting the procurement system; (c) determining the qualification assessment method; (d) arranging the timetable for the selection of a contractor/ supplier of goods/ services; (e) arranging the documents for goods/ services procurement; (f) determining the offering price; and (g) selecting the project contractor or supplier.

Local institutions also apply various methods to select project executors, which depends on the types of local government projects<sup>27</sup>. As found in the study sites, these institutions select the contractor or supplier of goods/ services through a number of methods, such as: simple auction<sup>28</sup> (*pelelangan sederhana*), simple selection<sup>29</sup> (*pemilihan sederhana*), direct selection<sup>30</sup> (*pemilihan langsung*), open auction<sup>31</sup> (*pelelangan umum*), direct appointment<sup>32</sup> (*penunjukan langsung*), direct

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<sup>27</sup> In general, local projects can be divided into three main types: supply of goods and/or services, construction jobs, and consulting services.

<sup>28</sup> The simple auction is a method to select a contractor or service provider for projects valued up to 5 billion Rupiahs.

<sup>29</sup> Simple selection is a method to select a service provider for consultancy projects worth up to 200 million Rupiahs.

<sup>30</sup> Direct appointment is a method of selecting a contractor for construction projects valued at less than 5 billion Rupiahs.

<sup>31</sup> Open auction is a method of selecting a contractor or supplier of goods/ construction works/ general services in which all eligible contractors/ providers can take part.

procurement<sup>33</sup> (*pengadaan langsung*), competition<sup>34</sup> (*sayembara*), or contest<sup>35</sup> (*kontes*).

To procure local projects worth up to 200 million Rupiahs, local governments are permitted to select a contractor using the method of direct procurement. Moreover, local bodies might apply the method of direct appointment or simple auction to appoint a project executor for projects valued up to 5 billion Rupiahs. Both methods of direct procurement and direct appointment are executed under the full discretion of the respective local bodies, therefore, local government agencies are allowed to select a project executor (contractor/ service provider) immediately without conducting an auction or a tender. The study finds that the authority of local officials to directly appoint project executors is a critical issue because it is viewed as an entry point to do corruption and collusion in the project execution. The issue regarding selection of the project executor will be further elaborated in sub-section 7.5.1; while the practice of splitting projects as a strategy to avoid open project tender is analysed in sub-section 7.5.2 of this chapter.

In addition, in the case of local institutions wishing to tender for large projects through open tendering, local officers publicise this information initially on the local government website, the official announcement board, and also on the

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<sup>32</sup> Direct appointment is a method for selecting a provider of goods/ services by directly appointing the provider to be under the full discretion of the respective local agency.

<sup>33</sup> Direct procurement is the procurement of goods/ services directly conducted by respective local bodies without conducting an auction/ selection/ direct appointment.

<sup>34</sup> Competition is a method to select a service provider through competition on the original idea, creativity, and innovation, where the specific price/ cost cannot be determined based on Unit Price.

<sup>35</sup> Contest is a method of selecting a supplier by placing goods/ objects that do not have a certain market price in competition with each other and the price/ cost cannot be determined based on Unit Price.

national procurement website. This announcement aims to circulate information about the details of the project procurement, thereby allowing the public and the business community to get involved in local project procurement and execution.

Once they apply the method of open tender, as the facts show, local bodies in the study locations generally follow 15 main steps<sup>36</sup>. Furthermore, local authorities release the project funds to the project executor with the following terms: (a) 40% when the contractor is ready to start; (b) 30% when 30% of the project has been completed; and (c) the final 30% when 60% of the project is finished. Eventually, once the project has been totally completed, the project executor (the contractor or service provider) hands over the project to the representative of local government who is usually represented by the project leader.

## **6.7. Sectoral Priorities of Local Government Expenditure: Where Does the Local Budget Go?**

To elaborate upon the utilisation of the local budget (the APBD), as regulated by *Permendagri* 13 of 2006, local governments summarise the expenditure in two versions, including a classification based on targeted sectors and another based on an economic classification. Local government expenditures are classified into two types,

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<sup>36</sup> The 15 steps of the open tender process are: (1) announcement of project specifications; (2) registration and pick up of the procurement document; (3) briefing by the project leader; (4) submission of the bidding document; (5) opening of the bidding document; (6) bidding evaluation; (7) evaluation and verification of qualifications; (8) documenting the auction results; (9) determining the winner; (10) announcement of the winner; (11) rebuttal (if any); (12) rebuttal appeal (if necessary); (13) determining the goods/ services provider; (14) signing the contract for goods/ services procurement; and (15) execution of the contract.

local expenditures allocated for the obligatory affairs of local government, and those that are considered to be optional affairs<sup>37</sup>.

**ABLE 6.3.** Allocation of Local Expenditure (per-sector) at Three Local Governments in 2010<sup>38</sup>

Sector of Local Expenditure	City of Surabaya		City of Batu		Regency of Trenggalek	
	Rp. (000,000)	%	Rp. (000,000)	%	Rp. (000,000)	%
<b>OBLIGATORY AFFAIRS</b>						
Education	1,189,919	27.3	117,167	26.39	458,091	52.3
Health	308,163	7.06	17,669	3.98	105,356	12.1
General Work	681,864	15.6	85,137	9.17	40,455	4.61
Settlement	89,636	2.05	392	0.09	39,703	4.53
Spatial	420,769	9.64	274	0.06	0	0
Development Plan	29,219	0.67	6,416	1.45	5,226	0.60
Transportation	92,975	2.13	5,807	1.31	6,753	0.77
Environment	292,810	6.71	22,480	5.06	7,179	0.82
Agrarian affairs	0	0	0	0	0	0
Population and Civil Registration	14,731	0.34	3,045	0.69	3,322	0.38
Empowerment of Women & Protection of Children	0	0	2,858	0.64	0	0
Family Plan and Welfare	37,660	0.86	1,040	0.23	4,674	0.53
Social	27,467	0.63	1,162	0.26	0	0
Employment	24,658	0.56	839	0.19	2,801	0.32
Cooperative and SMEs	16,674	0.38	4,855	1.09	5,719	0.65
Investment	7,957	0.18	392	0.09	1,706	0.19
Culture	20,018	0.46	4,479	1.01	0	0
Youth and Sport	15,962	0.37	5,188	1.17	6,795	0.78
National Unity and Domestic Politics	38,156	0.87	5,758	1.30	5,238	0.60
General Affairs of Government	942,412	21.6	131,502	29.6	155,647	17.76
Personnel Affairs	2,072	0.05	0	0	0	0
Empowerment of Community and Village	0	0	850	0.17	2,699	0.31
Statistic Affairs	0	0	34	0.01	0	0
Archives Affairs	0	0	201	0.05	0	0
Communication and Information	24,918	0.57	1,351	0.30	0	0
Library Affairs	15,058	0.35	1,503	0.34	833	0.10
Food Sufficiency	2,072	0.05	377	0.08	1,305	0.15
<b>OPTIONAL AFFAIRS</b>						
Agricul.....	.....	.....	.....	.....	.....	.....

<sup>37</sup> Government Regulation (*Peraturan Pemerintah/ PP*) 38 of 2007 regarding the Division of Authority of Central and Local Government, divides local government affairs into two divisions, Obligatory Affairs and Optional Affairs.

Obligatory Affairs consist of: (1) education; (2) health; (3) general work; (4) settlement; (5) spatial; (6) development planning; (7) transportation/ environment; (8) agrarian affairs; (9) population and civil registration; (10) empowerment of women and protection of children; (11) Family Planning and Welfare; (12) Social; (13) Employment; (14) Cooperative and SMEs; (15) Investment; (16) Culture; (17) Youth and Sport; (18) National Unity and Domestic Politics; (19) General Affairs of Government; (20) Personnel Affairs; (21) Empowerment of Community and Village; (22) Statistical Affairs; (23) Archives Affairs; (24) Communication and Information; (25) library Affairs; (26) Food Sufficiency.

Meanwhile, the type of Optional Affairs contain the sectors of (1) Agriculture; (2) Forestry; (3) Energy and Mineral Resources; (4) Tourism; (5) Fishery and Marine; (6) Trading; (7) Industry; and (8) Transmigration

<sup>38</sup> Details of Allocation of Local Expenditure (per-sector) in the City of Surabaya, City of Batu, and Regency of Trenggalek in the Period of 2006-2010 can be seen at the appendix of this thesis.



Sector of Local Expenditure	City of Surabaya		City of Batu		Regency of Trenggalek	
	Rp. (000,000)	%	Rp. (000,000)	%	Rp. (000,000)	%
Agriculture	43,605	1.0	14,559	3.28	16,559	1.89
Forestry	0	0	852	0.19	0	0
Energy and Mineral Resources	0	0	285	0.06	0	0
Tourism	0	0	5,208	1.17	0	0
Fishery and Marine	0	0	1,322	0.30	6,560	0.75
Trading	25,597	0.59	420	0.09	0	0
Industry	0	0	584	0.13	0	0
Transmigration	0	0	0	0	0	0
<b>T O T A L</b>	<b>4,364,383</b>	<b>100</b>	<b>444,022</b>	<b>100</b>	<b>876,631</b>	<b>100</b>

*Source:* The APBD Report of Financial Year 2010

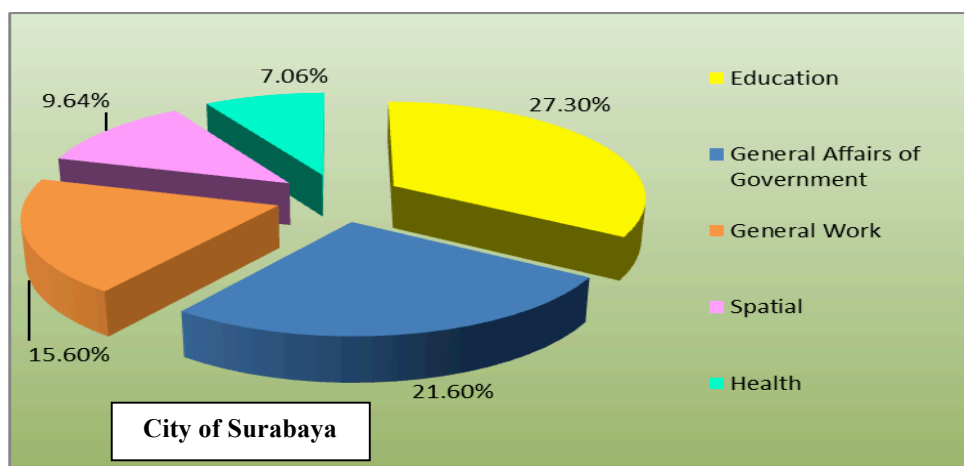
### *The City of Surabaya*

The municipality of Surabaya allocates the five largest portions of the local budget (the APBD) to the education, general affairs of local government, general work, spatial, and health sectors respectively. The education sector was allocated APBD funds valued at Rp. 1,189 billion (27.3%) in 2010. This proportion is in line with the provisions stated in the formal regulations which stipulate that both the central and local governments have to allocate funding of more than 20% for the education sector.

As the data display, the general affairs of the government sector received the second largest portion of the APBD funds, amounting to Rp. 942 billion (21.6%) in 2010. Furthermore, the third largest portion of the APBD went to the General Work sector which spent Rp. 681 billion in 2010. The majority of the funds for this sector were spent on developing and maintaining roads, bridges, drainage and irrigation channels, and other public facilities. However, the respective officials managing these affairs appear to be unable to manage and control the projects under their responsibility. Evidently, many projects in the general work sector are not completed

on time. Moreover, local officers have failed to execute quite a number of institutional projects, therefore there is a huge percentage of APBD funds allocated to this sector which are not utilised<sup>39</sup>.

**Graph 6.5.** Top Five Sectors which receive the largest Allocation from the APBD in City of Surabaya in 2010



*Source:* APBD Report of financial year 2010

For the Spatial sector, the local budget allocation was Rp. 420 billion (9.64%) in 2010. Additionally, APBD funding for the Health sector was 308 billion in 2010. The largest proportion of the Health sector budget was spent on improving the quality of health facilities, particularly at the municipality-owned hospitals and the PUSKESMAS (*Pusat Kesehatan Masyarakat/ Community Health Centres*) operating in the territory of Surabaya. In addition, the budget was also utilised to fund health insurance for the poorer members of the community (*ASKESKIN/ Asuransi Kesehatan untuk Masyarakat Miskin*).

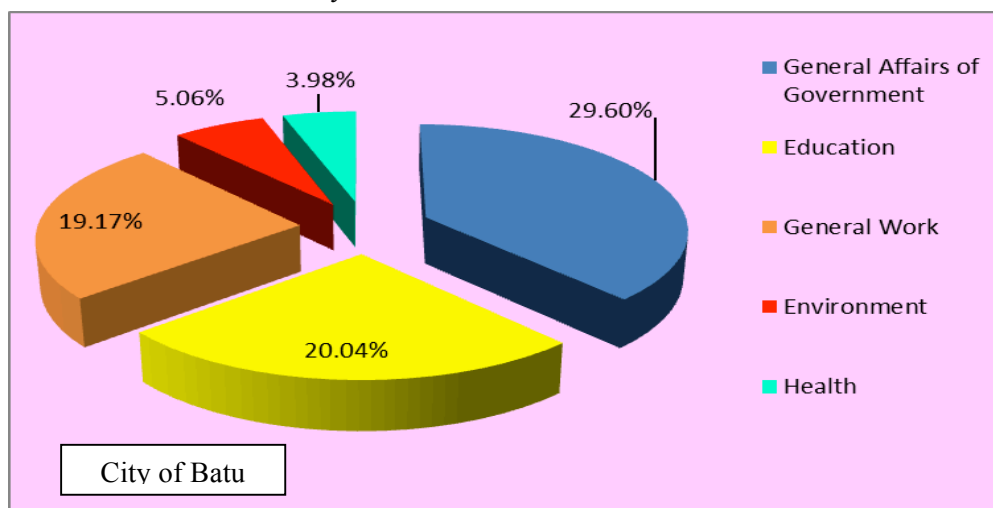
<sup>39</sup> The phenomenon of unfinished projects and unutilised APBD funds will be further analysed in the final section of this chapter.

### ***The City of Batu***

In the 2006-10 period, the APBD funds for Batu City were spent on numerous sectors, the five largest portions going to the general affairs of government, education, general work, environment, and health sectors. The General Affairs of Government sector spent the largest portion of the local budget at 74 million Rupiahs in 2006 which then escalated to 131 million Rupiahs in 2010. The education sector received the second largest allocation worth 40 million Rupiahs (20.04%) in 2006, which increased to 117 million Rupiahs (26.39%) in 2010. This figure met the legal requirement which stipulates that the education sector must receive at least 20% of the annual budget.

In addition, the general work sector received the third largest allocation of APBD funding in 2010, valued at 85 million Rupiahs (19.17%). Moreover, the budget for the environment sector was 22 million Rupiahs with a percentage of 5.06% in 2010. The City of Batu had a large budget for the environment sector, particularly in 2007 and 2010, because in these years, there were a number of natural disasters such as landslides and flash flooding, therefore the local government spent extra from the budget for recovering damaged areas and undertaking reforestation.

**Graph 6.6.** Top Five Sectors which receive the largest Allocation from the APBD in City of Batu in 2010



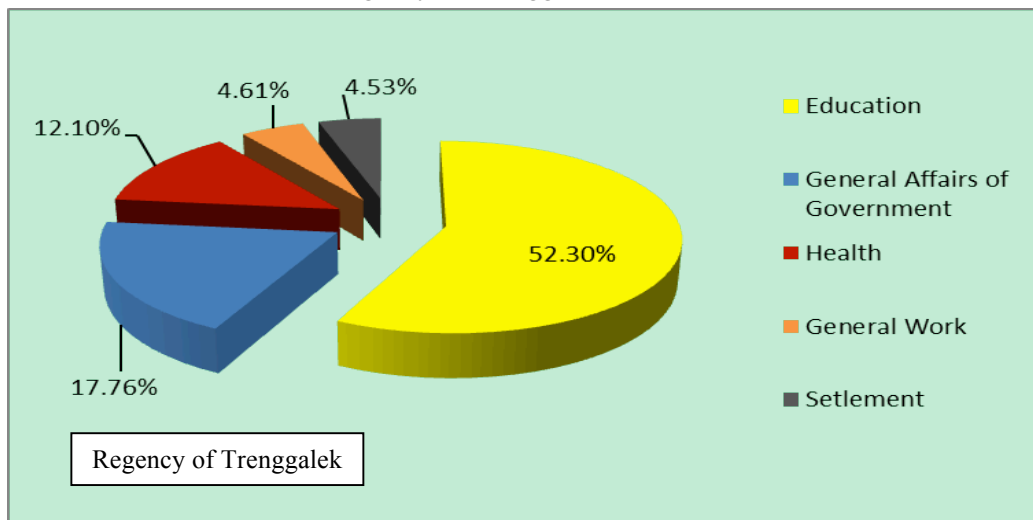
**Source:** APBD Report of financial year 2010

In terms of the health sector, the Batu municipality spent funds of more than 7 billion Rupiahs in 2006, which more than doubled to 17 billion Rupiahs in 2010, the largest portion of these funds being used to finance health insurance for poor people. Ironically, the agriculture sector received a relatively small portion of the annual budget, mostly less than 5% for every one of the five years, despite Batu City being a farming-based area. This municipality is even well-known as the ‘Apple City’ because most local apples in Indonesia are grown around this city. The present situation demonstrates that most apple growers face serious barriers in their businesses as they struggle to rejuvenate their plantations due to a shortage of capital. Nonetheless, this leading sector seems to be denied appropriate attention from the local authorities which is reflected in the low portion of the budget allocated to the agriculture sector.

## *The Regency of Trenggalek*

The education, general affairs of government, health, general work, and settlement sectors received the largest allocation of local budget (APBD) funds in the 2006-10 period. As the data show, the education sector received a very large APBD allocation which amounted to more than 40% every year in this period. In 2010, this sector received 52.3% of the total budget. In nominal terms, the education sector spent 187 billion Rupiahs in 2006 which increased more than 250% to 458 billion Rupiahs in 2010. However, this huge budget portion did not have a significant effect on improving the quality of education infrastructure, as the funds were primarily used to pay the salaries of teachers and administrative staff in the schools.

**Graph 6.7.** Top Five Sectors which receive the largest Allocation from the APBD in Regency of Trenggalek in 2010



*Source:* APBD Report of financial year 2010

In addition, the general affairs of government sector spent the second largest volume of the budget increasing from 121 billion Rupiahs in 2006 to 155 billion Rupiahs in 2010. Moreover, the health sector spent APBD funds of 33 billion

(7.68%) in 2006 which increased to 105 billion (12.1%) in 2010. As elsewhere, the largest part of these funds were used to finance health insurance for poor people (ASKESKIN/ *Asuransi Kesehatan Masyarakat Miskin*) which consumed more than 80% of the allocated funds. In 2010, the local budget for the general work sector amounted to 40 billion Rupiahs. This volume of the budget declined from three years earlier because the local authorities prioritised spending for the education and health sectors in this period.

### **Proportion of Local Expenditure by Economic Classification**

The economic classification consists of two sections, indirect expenditure (Routine Expenditure) and direct spending (Development Expenditure). This classification is set up to understand the proportion of the local budget to be spent for internal local government and parliament activities (which is reflected in the Indirect/ Routine Expenditure portion), and how much of the budget goes to the community (reflected in the amount of the budget allocated for Development/ Capital programmes/ projects).

The proportion of local government expenditure by economic classification at the City of Surabaya, City of Batu, and Regency of Trenggalek in 2010 is displayed in the table below:

**TABLE 6.4.** Proportion of Local Expenditure by Economic Classification in 2010<sup>40</sup>

Kind of Local Expenditure	City of Surabaya		City of Batu		Regency of Trenggalek	
	Rp. (000,000)	%	Rp. (000,000)	%	Rp. (000,000)	%
<b>INDIRECT EXPENDITURE</b>	<b>1,702,849</b>	<b>39.1</b>	<b>236,244</b>	<b>52.2</b>	<b>575,315</b>	<b>65.6</b>
Personnel	1,312,880	30.1	179,401	40.4	494,198	56.4
Interest	7,102	0.16	0	0	0	0
Grant/Subsidy	366,366	8.39	20,459	4.61	29,430	3.36
Social Assistance	4,600	0.11	17,045	3.84	13,296	1.52
Sharing Fund for the lower-level Area/Institutions	0	0	0	0	2,644	0.30
Assistance for lower-level Area/Institutions	1,900	0.04	17,588	3.96	35,180	4.01
Unpredicted Expenditure	10,000	0.23	1,750	0.39	565	0.06
Assistance to the Vertical Institutions	0	0	0	0	0	0
Official trips						
Maintenance cost						
<b>DIRECT EXPENDITURE</b>	<b>2,661,533</b>	<b>60.1</b>	<b>207,777</b>	<b>46.8</b>	<b>301,315</b>	<b>34.4</b>
Personnel	325,430	7.46	25,160	5.67	34,638	3.95
Goods and Services	1,012,082	23.2	65,294	14.7	127,224	14.5
Capital Spending	1,324,020	30.3	117,322	26.4	139,452	15.9
<b>TOTAL</b>	<b>4,364,383</b>	<b>100</b>	<b>444,022</b>	<b>100</b>	<b>876,631</b>	<b>100</b>

*Source:* APBD Report of financial year 2010

### *The City of Surabaya*

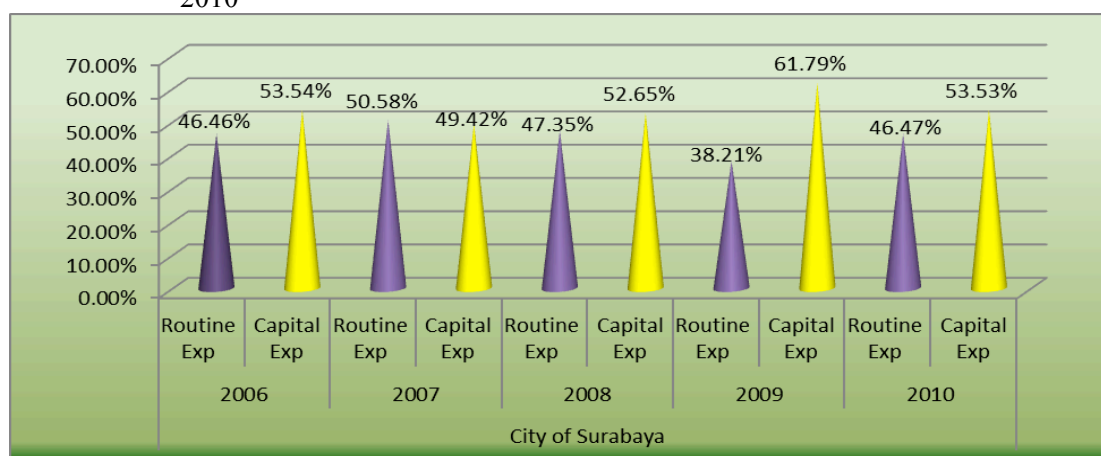
Indirect expenditures (Routine Spending) for Surabaya City were allocated a local budget of less than 40% of the total budget in the 2006-10 period. The largest proportion of this expenditure was used to finance personnel spending, particularly for salary and allowances which amounted to 596 billion Rupiahs in 2006, increasing to 1,312 trillion Rupiahs in 2010. On the other hand, direct expenditure (Development/ Capital Spending) received an allocation higher than that for indirect

<sup>40</sup> Details of Proportion of Local Expenditure by Economic Classification in the City of Surabaya, City of Batu, and Regency of Trenggalek in the period of 2006-10 can be checked at the appendix of this thesis

expenditure, amounting to 490 billion Rupiahs in 2006, which then increased more than fivefold to 2,661 trillion Rupiahs in 2010.

This phenomenon (development expenditure being more than routine spending) is not a common trend in Indonesia, because Indonesian local governments usually spend more on their local budget for routine activities than for development spending. The data released by the provincial government of East Java show that among 38 local governments in the province, only two municipalities (the City of Surabaya and the City of Mojokerto) have higher development expenditure than routine expenditure. The other 36 local governments spend more on routine expenses than on development activities.

**Graph 6.8.** Proportion of Routine and Capital Expenditure in City of Surabaya in 2010



**Source:** APBD Report of financial year 2010

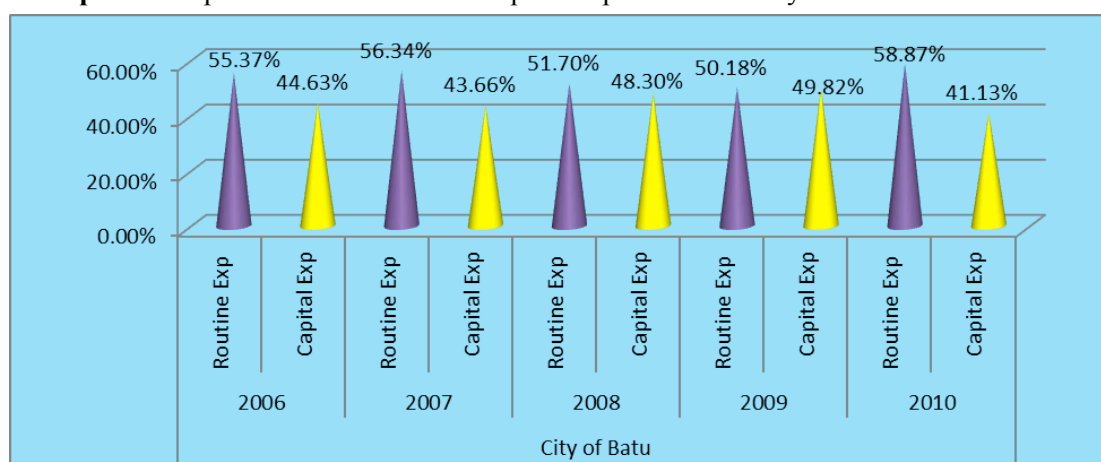
### ***The City of Batu***

The City of Batu had Indirect Expenditure (Routine Spending) of 123 billion Rupiahs (55.37%) in 2006 which rose to 236 billion Rupiahs (58.87) in 2010. Indirect



Expenditure was dominated by personnel expenditure which amounted to 77 billion Rupiahs in 2006, more than doubling to 179 million Rupiahs in 2010. On the other hand, Direct Expenditure (development spending) increased nearly three-fold in the five year period from 76 billion Rupiahs (44.63%) in 2006 to 207 billion Rupiahs (41.13%) in 2010. This was allocated to three kinds of expenditure including personnel, goods and services, and capital spending. However, overall the proportion of the budget allocated on the development (capital) expenditure remains lower compared to the budget allocation for Routine Expenditure.

**Graph 6.9** Proportion of Routine and Capital Expenditure in City of Batu in 2010



Source: APBD Report of financial year 2010

Particularly in 2010, Routine Expenditure accounted for a larger part of the budget than Capital Expenditure because this city government had to pay more in salaries to local staff, as in 2010 local staff salaries increased by 15-20% from the previous year. Moreover, this municipality recruited more than 300 new local officers. Other than this, the City of Batu also spent 20 billion Rupiahs (4.61%) in 2010 on grants/ subsidies. Unfortunately, these grants/ subsidies (*Dana Hibah*) were

not used to support productive sectors, but instead were used to finance the Batu City-owned soccer club, PERSIKOBA (*Persatuan Sepakbola Kota Batu/ Batu City Football Association*)<sup>41</sup>.

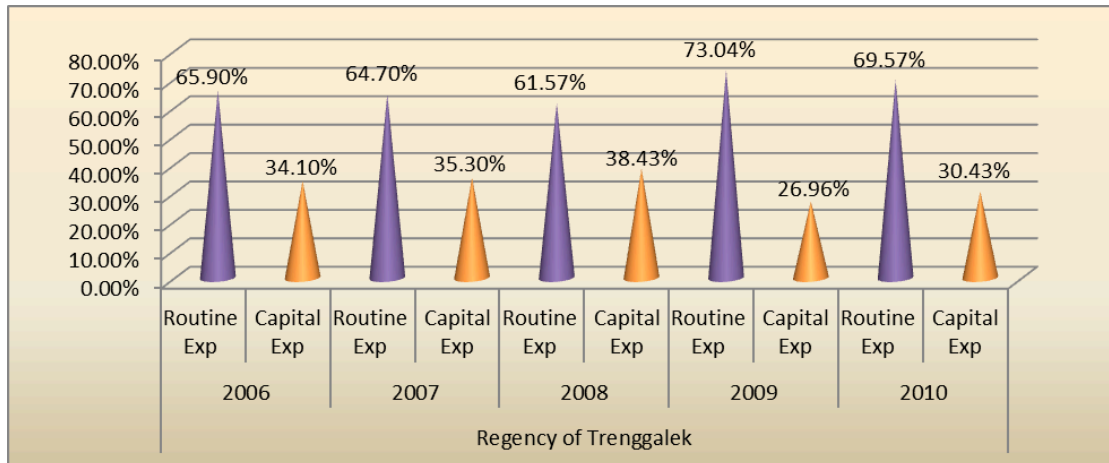
### ***The Regency of Trenggalek***

The economic classification of Trenggalek Regency budget shows that routine expenses accounted for more than 60% of the local budget. The Routine Expenditure spent 65.90% (298 billion Rupiahs) of the local budget in 2006, then increased to 69.57% (575 billion Rupiahs) in 2010. As elsewhere, the largest part of the routine expense funds were spent on financing personnel expenditure which more than doubled from 239 billion (55.1%) in 2006 to 494 billion (56.4%) in 2010. This situation contrasted greatly with other sectors which had much smaller budget allocations for personnel expenditure. Consequently, local development has stagnated to a very slow level of progress.

**Graph 6.10.** Proportion of Routine and Capital Expenditure in Regency of Trenggalek in 2010

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<sup>41</sup> According to informants in the field, financing the soccer club is a strategy of the local elites - particularly the city mayor - to maintain his popularity, as soccer has many fanatical supporters.



Source: APBD Report of financial year 2010

## 6.8. Current Issues in Local Project Procurement

The normative regulations for the procurement of local government projects have initiated a number of improvements to the current system of government project procurement. The regulations outline that, whether held conventionally or electronically, project procurements should encourage transparency, public participation and accountability, as well as encouraging the alleviation of corruption and collusion. Moreover, the procurement must also provide a fair market price so that local governments can get the best goods or services at a reasonable price.

Officials from the *Bappeda* (the Local Development Plan Board) state that prior to starting the procurement process, local agencies (SKPDs) should publicise the timetable, the terms and conditions, and the specifications of the project. In this way, the tender will be executed transparently and possibly accessed by the community. The current system of local procurement also requires all potential bidders and contractors to present the offering price as well as the specifications of

the offered goods and services. This situation offers a better chance for local governments to obtain the best quality goods and services at fair market price.

As revealed by small-scale local contractors in the study areas, the recently implemented system allows all elements of local business to take part in the local project tender and execution. The public is also permitted to oversee this process. Consequently, this transparent and accountable system requires local government officials to execute tenders and to spend the public budget in a more responsible manner.

In spite of the positive expectations mentioned in the normative guidelines, the study has found several persistent issues in the local project procurement process. This section identifies and analyses these issues, particularly: (1) the selection of the project executor; (2) splitting of projects: a strategy to avoid open tender; (3) the policy of increasing the margin: to provide a greater opportunity to manipulate the project tender and execution processes; and (4) the obligation to choose the lowest offer, which leads to the poor quality of goods and services.

### **6.8.1. Selection of the Project Executor**

One of the most crucial issues related to the execution of development spending is the selection of the project executor (the contractor or supplier of goods and services). As mentioned earlier, there are various methods to appoint a project executor. Nevertheless, the facts show that local officials prefer to select a project executor through direct procurement/ appointment or the simple auction method instead of through open tendering. They favour this because, in these methods (direct

procurement/ appointment or simple auction), the tender committee has full discretion to select the project executor, hence this enables the tender committee to collude with the appointed contractor. In this context, the tender committee would give a project to a contractor as long as the contractor pays compensation (mostly in the form of cash money) as required by the tender organiser. A local officer (informant GO-23) who often organises local tenders stated:

*We request a certain percent of the project fund to be refunded to us. If the contractor agrees with our requirement, then we give the project to them. Otherwise, we offer that project to other contractors which are willing to accept our requirement (Interview: 3/04/11).*

This modus was found across study locations. Moreover, local businesses in the research areas admit that they habitually accept the requirements proposed by the tender committee because if they reject or bargain about the requirements, they will possibly lose the project. In the light of this, even though they are not happy with the conditions set up by the tender committee, the contractors are forced to accept the conditions because they do not want the project to go to their competitors. Furthermore, to maintain their opportunity to ensure direct appointments and to avoid open tender, local officials in the research locations usually apply the strategy of splitting the projects.

### **6.8.2. Splitting Projects: a Strategy to avoid Open Tender**

The local community and NGOs in the study areas criticise the ways in which the local authorities select project executors, either through direct appointment/ procurement or by simple auction, which are both proven to be rife with opportunities for collusion. However, local government officials contend that the preference for

appointing project executors through direct appointment/ procurement or simple auction does not infringe the law. As stipulated in PERPRES (*Peraturan President/ Regulation of the President*) 54 of 2010, government institutions are allowed to select a contractor by applying the method of direct procurement (*pengadaan langsung*) for projects worth up to 100 Million Rupiahs. As well, government bodies are permitted to appoint project executors through simple auction (*lelang sederhana*) and direct appointment (*penunjukan langsung*) for projects worth up to 200 million Rupiahs instead of through open auction.

In actual practice, local officials often manipulate these provisions with the aim of avoiding the obligation to conduct an open tender. As admitted by a local unit official (informant GO-26), he and his colleagues often split large projects into several smaller projects, therefore each project is valued at less than 100 million Rupiahs. He explains further:

*...For an example, once I led the execution of the project of road and irrigation channel maintenance located in the northern village, honestly this project was actually valued at three hundred sixty million Rupiah (Rp. 360,000,000). Then we split it to be four projects hence each project was worth under a hundred million Rupiah (Rp. 100,000,000), so those projects were eligible to not be openly tendered ... (Interview: 13/02/11).*

They apply this strategy in order to appear to be legal so as to conduct direct procurement, therefore, they have full authority to select the project executor, as well as setting up the conditions and quotations requested of the prospective contractors. This phenomenon contributes significantly to the escalation of corruption, collusion, and manipulation practices in the project management. In view of this, the Indonesian government has encouraged all auditing bodies to intensify their

supervision of the project procurement and execution process in order to reduce the tendency for corruption, collusion, and manipulation in project management.

Nevertheless, at this point in time, the public feels pessimistic about this obsession to lower corruption and other illegal practices in the project tender and execution process because the national government has just released the new PERPRES (*Peraturan Presiden/ Presidential regulation*) 70 of 2012, which stipulates an increase in the margin for projects that would make them ineligible for open tendering. This stipulation is viewed as being counter-productive to efforts to reduce corruption, collusion, and manipulation in the project tender and execution process.

### **6.8.3. The Policy of Increasing the Margin: Providing a greater chance to manipulate the Projects Tender and Execution**

Under the new PERPRES 70 of 2012<sup>42</sup>, the method of direct procurement can be conducted for any projects worth up to 200 million Rupiahs. This margin has doubled from the 100 million Rupiahs stipulated in PERPRES 54 of 2010. In addition, the margin of projects eligible to be tendered using the method of simple auction and direct appointment has dramatically increased to 5 billion Rupiahs. This has greatly increased from the 200 million Rupiahs stipulated in PERPRES 54 of 2010.

The increase in the margin value of projects provides a greater opportunity for local bureaucrats to appoint project executors under their own discretion instead. This

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<sup>42</sup> The PERPRES 70 of 2012 revises the PERPRES 54 of 2010 regarding the procurement of goods and services at government institutions. The PERPRES 70 of 2012 also regulates the increasing of the margin of government projects eligible to be tendered under the system of direct procurement, simple auction, and direct appointment.

means that local officials have more opportunity to become involved in collusion, nepotism, and other illegal practices to select a project executor.

This atmosphere obviously disappoints many parties, particularly the local community and the business sector. As explained by a contractor (informant PS-3) in the Malang area, it is now more difficult to win projects, as most local projects are currently executed by contractors appointed directly by the local authorities without the conduct of a tender. As a result, only contractors who have close connections with local officials win the local projects. Furthermore, the informant points out:

*It is really crazy. Presently projects worth up to five billion Rupiah are eligible to be tendered through simple auction and direct selection. You know, more than ninety per cent of local projects are valued at under five billion Rupiah, so only a small number of projects would be tendered openly. Moreover, how can we expect the process of project tender and execution will run fairly and objectively while local authorities have full authority to select project executors. I am completely sure that the trend of collusion, corruption, and nepotism in local project management will get worse ... (Interview: 26/02/11).*

A number of local contractors and consultants in the study areas have expressed similar disappointment in response to the new provision stipulated in PERPRES 70 of 2012. One consultant from Surabaya City argued that the methods of direct appointment, direct procurement, and simple auction are vulnerable to the issue of price mark-up due to the absence of competitors for the designated project executors. In addition, these methods take place through a closed process, and thus contradict the transparent atmosphere promoted by the Indonesian government itself.

On the other hand, local officials are enthusiastic in their response to the new



provision in PERPRES 70 of 2012. As they state, the new provision enables local governments to accelerate project execution because they do not need to conduct complicated tenders prior to executing projects. This argument is in line with the clarification by the Indonesian government attached to the new PERPRES, which states that the main objective of the issuance of PERPRES 70 of 2012 was to accelerate the execution of local projects which are evaluated as running too slowly and not being completed in a timely manner. The other issue, in addition to the procurement and execution of local projects, is the obligation of the tender committee to choose the lowest offer. This obligation potentially leads to a poor quality of goods and services obtained by local governments.

#### **6.8.4. Obligation to Choose the Lowest Offer Leads to a Poor Quality**

In procuring goods and services tendered through open auction, local authorities are obliged to choose the lowest price offered by the bidders. This obligation often forces the SKPDs (the local government agencies) to purchase goods and services that do not meet a good quality standard. This happens as a result of the competition of the bidders to offer the lowest price in order to win the auction. However, in the reality, the lowest bidder frequently provides a poor quality of goods and services.

An official from the Public Work Service (*Dinas Pekerjaan Umum/ DPU*) of Batu City states that the committee of goods/ services procurement of the DPU often receives irrationally low-priced offers from some bidders. He gives an example that he once led the procurement committee on a project to asphalt a road at the beginning of 2010. A participant in the tender made an offer worth around 20% below

market value. According to the regulations, the committee had to determine this bidder as the winner of the tender. Unfortunately, only two months after completing the project, the asphalted road had cracked due to the very low quality of the asphalt and the other materials. In the light of this case, as the leader of the tender committee, he was suspected of colluding with the contractor and also accused of wasting public funds. Consequently, he was investigated and interrogated by the auditor bodies and also the attorney's office. Fortunately, he escaped imprisonment because he could prove that the contractor was at fault<sup>43</sup>.

Local officials in the research areas admit that determining the option of “whether or not to choose the lowest offer in a tender” is a tough dilemma. They explain that if they do not agree to the lowest offer, they would be blamed and suspected of committing collusion with the chosen bidder. They are also accused of wasting the public budget and spending public finances inefficiently. On the other hand, if they select the lowest offer and are then found to have obtained low quality goods and services, they will be judged as being careless in doing their job. A number of informants stated that once there is any issue in the project procurement and execution process, the project leader is the first party interrogated either by auditors, police officers, or the attorney. It is not unusual for project leaders to eventually be taken to court or even to be put in jail. Due to this dilemma, local officials are often not willing to be appointed as leaders of project tendering and execution because of the high risk.

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<sup>43</sup> In this case, the informant also admits that he spent a huge amount of money to bribe the auditor, the police, and the attorney officers in order to be released from the threat of prosecution.

## **6.9. Distortions and Challenges in Executing Local Government Expenditure**

This study has found numerous problems in the implementation of local government expenditure. This section specifies and analyses the distortions and challenges that occur in the management of local government spending, as follows: (1) a priority on personnel and routine expenditure; (2) the incremental design; (3) the shortage of project leaders; (4) political intervention and project brokers which lead to the *Proyek Titipan* (by-Order Projects) and the *Proyek Fiktif* (Fictitious Projects); (5) from “Direct Quotation” to “Cash Refund”: a strategy to quote project funds; (6) the high percentage of unutilised budgets; and (7) unfinished projects.

### **6.9.1. Priority on Personnel and Routine Expenditure**

The national authorities encourage local governments to allocate more to development expenditure than to routine expenses<sup>44</sup>. However, as shown in Table 7.2, capital expenditure for development activities, except for the City of Surabaya,<sup>45</sup> generally amount to a lesser portion in comparison to the allocation for routine expenditure. Officials in the study areas explain that routine expenses receive a large allocation because local governments have to pay personnel expenditure for the huge number of civil servants (PNS/ *Pegawai Negeri Sipil*). The data in the field denote

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<sup>44</sup> The regulations and guidelines (such as Law 17 Of 2003, PP 58 of 2005, PERMENDAGRI 13 of 2006, and others) stipulate that local governments must prioritise development activities in the allocation of the annual budget (APBD). The explanation of these regulations states that, ideally, local government should allocate at least 60%-70% of APBD funds for capital spending.

<sup>45</sup> As mentioned earlier, the phenomenon that occurred in Surabaya City, whereby capital expenditure received a larger budget allocation than routine spending is uncommon. This happened because the City of Surabaya, as Indonesia’s second largest city, has plenty of potential revenue sources. On the other hand, Indonesian local governments usually allocate the routine budget to be larger than development expenses. This happens because the income of local governments, particularly from own-source revenue (PAD), is mostly low and poorly managed.

that 62% to 78% of routine expenditures are allocated for personnel spending. Moreover, every year, local governments recruit new civil servants, so the burden of local governments steadily increases. The elites of local government favour continuously recruiting new staff members because this recruitment gives local elites the chance to financially profit. This happens because applicants for public service positions are generally willing to pay bribes in order to be recruited by local government officers<sup>46</sup>. Therefore, the recruitment of new PNSs, to some extent, becomes a potential source for local government elites to obtain additional income.

The trend to consuming the largest portion of APBD funds for personnel expenditure is nothing unique to the research locations. As reported in the Indonesian mass media, this is a common tendency in most local governments across Indonesia, such as in the Purworejo Regency, which spent 70% of APBD funds on Personnel Expenditure (Tribunjogja.com in bloggerpurworejo.com, 2013<sup>47</sup>), the Regency of Merangin, which spent more than 50% (Tribun Jambi, 2013<sup>48</sup>), Sragen Regency, which spent 67% (KRjogja, 2013<sup>49</sup>), the Regency of Kuningan consumed 74% (Kompasiana, 2012<sup>50</sup>), the City of Baubau spent around 70% (Sultra-online, 2012<sup>51</sup>),

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<sup>46</sup> Informants state that applicants with high-school qualifications have to pay around 60-100 million Rupiahs, while applicants with bachelor degrees usually are quoted around 100-160 million Rupiahs by local authorities.

<sup>47</sup> Tribun News – Jogja in Blogger Purworeja, 7 April 2013, <http://bloggerpurworejo.com/2013/04/70-apbd-purworejo-habis-untuk-membayar-gaji-pegawai/>

<sup>48</sup> Tribun News – jambi, 14 March 2013, <http://jambi.tribunnews.com/2013/03/14/rp-400-miliar-untuk-gaji-pns-merangin>

<sup>49</sup> Kedaulatan Rakyat Jogjakarta, <http://117.20.63.123/read/153738/67-persen-apbd-untuk-gaji-pegawai.kr>

<sup>50</sup> Kompasiana, 12 December 2012, <http://regional.kompasiana.com/2012/12/18/parah-74-apbd-kab-kuningan-hanya-untuk-bayar-pegawai-516946.html>

<sup>51</sup> Sultra – On line, <http://sultra-online.com/daerah/97-arsip-berita/1070-belanja-pegawai-habiskan-70-persen-apbd>

Karanganyar Regency spent almost 70% of APBD funds on Personnel Expenses (Koran Sindo, 2013<sup>52</sup>), and others.

As a result of APBD funds being more focused on the financing of routine expenses, there is a lower portion of capital expenditures allocated to develop public infrastructure. Moreover, capital expenditure is also frequently used for improper spending, such as to build official houses, to buy cars, and so forth, which are obviously in the interests of local bureaucrats and legislators instead of for public needs. Other than the phenomenon above, the APBD funds are not utilised efficiently and effectively because local officials often set the budget for routine expenses incrementally.

### **6.9.2. Incremental design**

The findings indicate that a lack of updated data about asset management impacts on the execution of routine expenditure, the majority of which is undertaken incrementally. The data show that local officers often spend funds of routine expenses based on previous year realisations, instead of an accurate plan based on updated data. Consequently, budget implementation runs inefficiently leading to poor quality results, which can also be easily manipulated and open to corruption.

The facts in the study areas exhibit that maintenance costs are one of the local expenditures that are most frequently manipulated and engineered to be ‘fictitious expenses’. In such cases, local officials keep allocating the cost of maintaining certain assets which do not actually require maintenance any longer, such as assets which

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<sup>52</sup> Koran Sindo, <http://m.koran-sindo.com/node/312222>

have either been completely damaged (that cannot be fixed), lost, or sold. Subsequently, the allocated funds for these assets are then illegally taken by local staff members. This condition is a result of a lack of transparency and administrative misconduct when managing the write-off and alienation of local assets. The asset reporting system is often undertaken simply by filling out a form without validating the real condition of the assets.

In addition, local officers habitually use local government assets beyond office hours and not for official purposes. Furthermore, they also frequently commercialise local assets (such as hiring out buses, halls, or other property that belongs to local government) without depositing the earned income in the local government account. Since the local assets are often illegally commercialised, these assets are also more easily damaged. Consequently, local governments must spend more funds on maintenance costs or on buying new assets to replace the old or damaged assets.

### **6.9.3. The shortage of project leaders**

As required by PERPRES (Regulation of the President) number 70 of 2012, in order to be eligible to be appointed as a procurement and execution project leader, local officers must have a certificate of goods/ services procurement obtained through training provided by the BAPPENAS (*Badan Perencanaan Pembangunan Nasional/ Board of National Development Plan*).

To accelerate the number of local staff eligible to be project leaders, local governments in the research areas regularly send their staff to undergo required

training. Unfortunately, many of the local staff members fail the final examination for the training, so they are not awarded the certificate and are therefore not eligible to be appointed as leaders for project procurement and implementation. The research has discovered, in fact, that the failure of local staff in this examination is actually committed intentionally by the officers themselves. They do so because they do not want to be appointed as leaders of project management as they are worried about facing trouble associated with prosecution by the law.

The limited number of local staff holding certificates of goods/ services procurement significantly hampers the execution of local projects, because project operation cannot be started if there is no project leader available. The data show that, until 2010, each local body (SKPD) in Surabaya City, Batu City, and Trenggalek Regency, on average, had only two or three staff eligible to be project leaders. Meanwhile, each local body generally has more than 30 projects, and some SKPDs even have more than 50 projects in a financial year.

To reduce the tendency to delay local project execution because of the shortage of project leaders, the Indonesian government has issued PERPRES (*Peraturan Presiden/ Regulation of the President*) 70 of 2012<sup>53</sup> stipulating that if the project leader is appointed from among officials of echelon 1 or 2 or by the head of the SKPD (local body), then these officials do not need the certificate of procurement of goods and services. This means that all heads of SKPDs and echelon 1 and 2 officials are eligible to be leaders of project procurement and execution, even though

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<sup>53</sup> PERPRES (*Peraturan Presiden/ Regulation of President*) 70 of 2012 is basically a revision of PERPRES 54 of 2010 regarding Procurement of Government Goods and Services.

they do not have the certificate of goods and services procurement<sup>54</sup>. This initiative is expected to deal with the problem presented by the shortage of project leaders<sup>55</sup>.

Other than the numerous technical problems mentioned above, local officials in the research locations also frequently face intervention from local legislators and other pressure groups in the process of project procurement and execution.

#### **6.9.4. Political Intervention and Project Brokers**

Intervention from powerful parties in the process of project procurement and execution often results in prolonged debate and negotiation between the local executives and legislators. To hasten the deal with legislators, local officials often apply a strategy of giving special funds allocated to parliamentary members in the form of the discretion fund, *Dana Hibah* (grants), *Bantuan Sosial* (social assistance), *Dana Aspirasi* (the aspiration fund), or other project funds which can be utilised under the full discretion of local legislators.

The facts also indicate that such intervention from powerful parties often leads to the emergence of a project broker. In view of this, some officials from local government and the parliament often refute the existence of political brokers in the local budgeting process. The local elites argue that it is now impossible to act as a broker in the management of APBD-funded projects because the auditing bodies are very active in inspecting and auditing all projects executed by local governments.

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<sup>54</sup> This stipulation revised the old provision stipulated in the PERPRES 54 of 2010 (that has been replaced by the PERPRES 70 of 2012) obligating all officials at any level and echelon have to have the certificate of procurement of government goods and service to be eligible as project leaders.

<sup>55</sup> Unfortunately this study cannot identify precisely the effectiveness of this initiative as the study completed just after the issuance of the policy.



Moreover, local authorities claim that every element of society has access to oversee any local government activity, so the practice of political brokering would be easily detected.

Nonetheless, a number of members of the local elites and the community admit that political brokering practices still exist in the local budgeting process. As revealed by a former chairman (*informant FL-1*) of the *Banggar* (budget board) of the DPRD (the local parliament):

*Allegations saying that local executives and legislatives often work as political brokers are not entirely wrong. This practice exists until the present, even I reckon it gets worse than in the past ... We do this practice because we must cover many expenses, while we have limited income. Otherwise we will suffer the deficient condition ... (Interview: 09/01/11).*

Based on the reality observed in the field, the practice of political brokering leads to emergence of an illegal category of projects known as *proyek titipan* (by-order projects) and *proyek fiktif* (fictitious projects).

### ***Proyek Titipan (by-Order Projects)***

*Proyek titipan* is a kind of project ordered by powerful pressure groups, such as local legislators, political parties, NGOs, financiers, the inner-circle of local government elites and other powerful groups. Local bureaucrats state that it is highly problematic to reject these projects due to the fact that they are proposed by powerful groups. Moreover, the elites in the SKPDs (the local government units) believe that the rejection of project proposals, in particular projects ordered by local legislators, will have the effect of reducing the SKPD's annual budget, approved by the local parliament.

Based on the facts in the field, the strategy of these powerful parties in ordering *proyek titipan* (by-order projects) can be summarised as follows: they initially make contact with the key officials of the respective local agency (the SKPD/*Satuan Kerja Pemerintah Daerah*)<sup>56</sup> and express their intention to order a project. Afterward, these parties submit a project proposal to the SKPD officials, then both parties (the SKPD elites and the parties proposing the projects) arrange a commitment regarding the details of the project as well as an amount of the quotation to be shared with the SKPD/ local government and other related parties<sup>57</sup>.

Motives to order a project vary depending on the party proposing the project. Projects ordered by local legislators may be based on several motives. The first is a partisan motive. In this case, local legislators intend to contribute money to their political parties because the main income of local-level political parties comes primarily from contributions from their cadres who hold positions in local government or in the parliament. The second is a constituency motive, where they would like to realise their commitment to their constituents. In this situation, the type of legislator-ordered project would mostly be based on the needs of, or a request by, the constituents. Finally, local politicians acting as project brokers can be stimulated by an individual motive, whereby they want to gain profit for themselves. On the other hand, in terms of *proyek titipan* ordered by other pressure groups, this is mostly stimulated by an economic motive because they want to finance the daily expenses of

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<sup>56</sup> They (the powerful parties) have to contact the SKPD elites first, because any local project must be listed on the work and budget plan of the local agency (the RKA-SKPD).

<sup>57</sup> The funds would usually be shared with these related parties after the projects have been completed and the funds have been released from the local government accounts.

their organisation, as local NGOs and mass organisations in Indonesia generally struggle to fund their daily expenses by themselves.

Nonetheless, a number of elites in the local NGOs from the study areas emphatically deny the above assumption. They claim that their interest in proposing projects is because they want to get actively involved in local development activities as they know the problems that exist in their area very well. Therefore, they are sure that they will be able to contribute significantly to solving the problems faced by the local people.

Local officials argue against the above claims of NGO activists. The officials state that they accommodate the project proposals put forward by local NGOs because government officers intend to minimise the ‘disturbance’ by NGO members. As frequently occurs, the implementation of local projects is not successful because these are ‘disturbed’ by local NGO activists. They disrupt the project execution process because they are disappointed that they are not involved and therefore, do not gain profits from the local projects. A head of section (informant GO-7) at a local body (SKPD) states:

*We have ever implemented an empowerment project for rural villagers. The core activity of project was to release the revolving fund given to local villagers who have small-scale businesses. It aims to strengthen their capital. The recipients have to return the funds by instalment system with very low interest. However, some local NGO administrators provoked recipients to not return the funds because they claimed that the fund was a grant and not a kind of loan. They insisted that the recipients are not obliged to return the funds. The project finally failed miserably because most recipients didn't pay instalments at all....inconsistently, when we recruited those NGO activists to take part at the implementation of another project, they are very enthusiastic and helpful, hence the project was very successful (Interview: 14/01/11)*

A similar situation was experienced by local officials in the City of Batu. They often

struggle to execute local projects because of problems caused by local NGOs. A staff member (*informant* GO-18) of a SKPD in the City of Batu informed that:

*A project implemented at a village in southern Batu almost failed because the local NGO rejected the project. They argue that this project might damage the environment and endanger local people ... eventually we offered them to be contractor of another project. They agreed straightway and their stance suddenly changed, even they totally supported our project. It is a completely ridiculous phenomenon (Interview: 13/03/11).*

Ironically, even though local authorities admit that they are not really sincere in giving projects to the local NGOs, they still receive money quoted from the project funds. Elites in the local NGOs reveal that they have to share project funds with the local officials amounting to around 25-45% for non-physical projects and 15-25% for physical projects.

The *proyek titipan* (by-order project) is not a unique phenomenon found only in the study areas. This can be seen in local governments across Indonesia, such as in the City of Kupang (Victory news media, 10 March 2012), the Capital Special Territory of Jakarta (Koransidak.com, 30 January 2012), the Regency of Minahasa Tenggara (manadotoday.com, 22 Juny 2011), the Regency of Kepulauan Sula (Koran pagi online, 13 December 2011), and the Regency of Serdang Bedagai (Starberita.com, 31 January 2012). Other examples include the procurement project for safety-deposit boxes in the Regency of Sidoarjo (Koran Sindo, 2013)<sup>58</sup>, *Proyek titipan* in the Capital Special Territory of Jakarta (SH News, 2013)<sup>59</sup>, by-order projects in the Service of General Work in the Regency of Musi Banyuasin (Buana

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<sup>58</sup> Koran Sindo, 24 May 2013, <http://www.koran-sindo.com/node/315979>

<sup>59</sup> SH News, 08 April 2013, <http://www.shnews.co/detile-17484-banyak-anggaran-titipan-dalam-proyek-dki.html>

Sumsel, 2010)<sup>60</sup>, institutional projects of the Service of Marine and Fishery Affairs ordered by local legislators from Maluku (Ambon Ekspres, 2012)<sup>61</sup>, and many other local governments.

Other than the phenomenon of the by-order project (*proyek titipan*) described above, the local authorities also often illegally use APBD funds by setting up fictitious projects (*proyek fiktif*).

### ***Proyek Fiktif (Fictitious Projects)***

As found in the field, *proyek fiktif* (fictitious projects) executed by local authorities can be categorised into two types, wholly-fictitious and partly-fictitious projects. A wholly-fictitious project is a type of project which is not entirely implemented, but the officers report that the project has been entirely executed. In such cases, local officials do not execute the project at all, but they claim the money (the project funds) as if they had implemented the project. On the other hand, the partly-fictitious project is a project that has actually been executed, but it does not truly match the project specifications stated in the local government program.

For example, an informant for the staff of a SKPD (local body) in one of the research locations tells of his experience in organising wholly fictitious projects in August 2010. At the time, the Head of Local Government was celebrating his birthday party, inviting more than a hundred orphans. At this party, the local government head entertained the orphans and spent funds amounting to more than 50

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<sup>60</sup> Buana Sumsel, 15 April 2010, <http://buanasumsel.com/di-insiyalir-banyak-proyek-titipan-di-dinas-pu-bina-marga-musi-banyuasin/>

<sup>61</sup> Ambon Ekspres, 12 January 2012, <Http://www.ambonekspres.com/index.php?option=read&cat=53&id=36411>

million Rupiahs. After the party ended, the local government head asked a chair of SKPD to contribute money to cover the cost of the party. To fulfil this request, the SKPD chair instructed the informant to engineer a fictitious project. Subsequently, he created a fictitious report that made it look as if the SKPD had conducted a comparative study (and an official trip to another local government) that involved a number of staff members from the SKPD. Afterwards, the informant asked some officers from the SKPD to sign the receipt as if they had been part of the activity and had received an allowance. Based on the fictitious report and receipts, the informant then claimed the funds from the finance unit. After the funds were released, he gave the money to his boss (the SKPD chair), which the boss then handed to the City Mayor. The informant (informant GO-36) also stated that:

*... I think all local government staff comprehend and have been familiar with this trick. They would sign the fictitious receipt although they got nothing, otherwise they would be judged disloyal to the boss. If so, their career might be stagnant ... (Interview: 03/03/11).*

In another example, an official from a budgeting unit revealed the misuse of local budget (APBD) funds to finance an inappropriate training session for local legislators, which can be categorised as a partly-fictitious project. In this case, the DPRD (the local parliament) had actually implemented the training. However, they did not execute it in a way that agreed with the plan as stated on the institutional program. As mentioned in the plan, the training for legislators was designed to last for five days. In fact, the DPRD authorities ran it for only two days, nevertheless, they claimed the APBD funds for a full five days of training. Accidentally, the auditing body detected this fraud and, as a result, a number of key officials from the

DPRD were investigated by the auditing body on allegations of corruption.

Use of fictitious projects is one of the common strategies of local government officers in illegally utilising APBD funds. Other than this, the largest amounts of illegal funds received by local officers are quotes from project funds. As mentioned earlier, local officers almost always quote (a certain percentage of) project funds to be released to the project executors. To minimise the possibility of their illegal practices being detected by the auditing bodies or by law enforcement agencies, local officials and contractors have changed their methods of quoting and handling of project funds.

#### **6.9.5. From “Direct Quotation” to “Cash Refund”: the Strategy to Quote Project Funds Illegally**

The reality shows that local officials and legislators have changed their strategy in the quoting of project funds. In the past, local authorities have preferred to directly quote the project funds prior to their release to the project executors/contractors. In such cases, the local authorities used to release project funds that did not amount to the 100% allocated in the APBD. Instead, they would release the funds according to the net amount after the quote. As an illustration, a local government implements a project worth 100 million Rupiahs, and local officials have an agreement with the project contractor that 25% of the project funds will be quoted by the local authorities; therefore, the local officials release the project funds to the project contractor to the tune of only 75 million Rupiahs, while the remaining 25 million Rupiahs would be taken by the respective officials from the local executive

and legislature. Nonetheless, even though the local officials release the project funds for only 75% of the overall value, the project contractor still has to sign a receipt stating that the contractor received 100% of the project funds.

The findings point to the fact that presently the local authorities no longer apply the process illustrated above, because this method is considered to be unsafe. A number of informants revealed that this practice can easily be detected by the auditing bodies, as currently there is an institution named the PPATK (*Pusat Pelaporan dan Analisis Transaksi Keuangan/ Centre of Report and Analysis of Financial Transactions*) that has the authority to inspect and investigate any transaction in the bank account of any individual or corporation.

In the light of this, in quoting project funds, both local officials and project contractors nowadays prefer to do “cash refunds”. In this context, local government officials release 100% of the project funds and then transfer the funds to the contractor’s bank account. The contractor then lets the funds stay in the account for at least two weeks. Subsequently, the contractor withdraws some of the funds amounting to the quote as agreed earlier with the local officials (for example 25%) and hands this cash directly to the respective officials. Both the local authorities and the project contractors in the study areas contend that this new way is much more secure and relatively difficult to be detected by the auditing bodies, unless they are caught red-handed when actually conducting the transaction. In addition, as found in the field, the execution of local government projects is mostly poorly managed because of untimely project execution.



### **6.9.6. High Percentage of Unutilised Budgets**

The study finds that the execution of the APBD repeatedly starts late due to delays in completing the previous stages (the formulation and validation of the APBD). Consequently, the execution of projects becomes more instant, hurried, and carelessly conducted due to the limited amount of time. The finance minister has actually initiated a policy intending to suspend the release of the DAU (*Dana Alokasi Umum*/ General Allocation Fund) and will even cut the volume of the DAU if the APBD execution starts after March 31<sup>st</sup>. Nevertheless, due to the tolerance for delays of three months from the expected completion time (1 January-31 March), delays in the APBD execution still occur at a fairly high rate. As published by Seknas-FITRA (2010), in 2009, only 23.14% or 118 local governments executed their APBD in a timely manner by the beginning of January. Meanwhile, 348 local governments (68.24%) started executing their budget in the period from 1 January to 31 March, while 44 other local governments (8.63%) executed their APBD after March 31.

To lessen this tendency of untimely APBD execution, the central government intends to apply a strict policy in the form of giving attractive incentives (additional funds) to local governments that are able to execute the APBD on time, otherwise a reduction in the transferred funds from the DAU, the DAK and/ or the DBH would be applied to local governments that fail to formulate and validate the APBD in a timely manner<sup>62</sup>.

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<sup>62</sup> To support this initiative, the central government undertakes sustainable trainings for local government officials. Those trainings are focused on informing and implementing the updated regulations and guidelines about local budgeting. Moreover, the central government also conducts regular evaluation to assess the compatibility of law and guideline regarding local budgeting. This effort will be followed up by revising or accomplishing those regulations if needed.

The delay and various problems of APBD execution elaborated earlier impact on the utilisation of APBD funds allocated to execute local projects and programs. The data display that the amount of remaining APBD funds that do not get utilised by local governments to execute local projects is very high every financial year, as displayed below.

**TABLE 6.5.** The Remaining APBD Funds at Three Local Governments in 2006-10

Local Government	Year	Total Expenditure	Remaining of APBD Funds	Percentage (%)
Regency of Trenggalek	2006	434,753,965,760	37,084,697,101	8.53%
	2007	529,745,640,087	80,109,098,773	15.12%
	2008	701,336,342,054	126,882,626,285	18.09%
	2009	731,710,291,951	95,430,935,842	13.04%
	2010	876,631,558,924	75,133,544,178	8.57%
<b>Average</b>				<b>12.67%</b>
City of Surabaya	2006	1,386,340,966,461	525,402,078,095	37.89%
	2007	1,556,472,090,169	836,530,514,333	53.74%
	2008	2,019,238,286,368	1,290,518,738,166	63.91%
	2009	3,127,363,165,157	1,579,082,113,082	50.49%
	2010	4,364,383,307,302	1,113,962,650,931	25.52%
<b>Average</b>				<b>46.31%</b>
City of Batu	2006	199,816,226,001	16,013,502,041	8.01%
	2007	279,573,640,373	11,551,783,000	4.13%
	2008	343,918,388,809	40,641,527,877	11.81%
	2009	395,421,064,072	55,348,519,138	13.99%
	2010	444,022,185,283	26,423,274,555	5.95%
<b>Average</b>				<b>8.78%</b>

*Source:* The APBD report for financial year 2006-10

As seen in the table above, the City of Batu recorded the lowest percentage of unutilised budget with an average of 8.78% during the 2006-2010 period, while the Regency of Trenggalek had 12.67% of unutilised funds in the same period. Surprisingly, the highest percentage was recorded by the City of Surabaya which had an average of 46.31% during the five year period. In view of this, some informants explain that a number of strategic efforts have been carried out by the elites in the

municipalities to improve the situation. However, these attempts have not produced very promising results. The data show that this negative tendency continues to occur.

As noted in 2011, the results of the evaluation of Surabaya City, undertaken by the DPRD, indicates that local officials still used APBD funds amounting to 1.257 trillion Rupiahs by the end of July 2011. This means that during the first semester of the 2011 financial year, the municipality only spent 25% of the total budget of 5.1 trillion Rupiahs, instead of, ideally, 50% of a total budget of 2.55 trillion Rupiahs<sup>63</sup>. The phenomenon of the high percentage of unutilised budget, as found in the City of Surabaya, is quite ironic because, at the same time, many public facilities have been damaged and have not been maintained, as municipality officials claim that there are no funds available to do so. As found across Surabaya City in 2012, there were 27 damaged school buildings, more than 20 kilometres of damaged main road, more than 40 damaged drainage channels, and so forth. Unfortunately, the DPUBMP (*Dinas Pekerjaan Umum Bina Marga dan Pematusan/* the Service of General Work, Road, and Drainage) and the DCKTR (*Dinas Cipta Karya dan Tata Ruang/* the Service of General Work and Spatial), which are supposed to be the institutions responsible for building and maintaining the physical facilities, do not give serious attention to these important issues. The officials from the DCKTR and the DPUBMP make the excuse that they cannot repair these broken public facilities because they do not have any budget allocated for improving these amenities. In actual fact, as revealed by the

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<sup>63</sup> Surabaya Post, 29 July 2011, [http://www.surabayapost.co.id/?mnu=berita&act=view&id=4e256f67\\_d6ee0c63bd62c3bdcc4c1fca&jenis=d41d8cd98f00b204e9800998ecf8427e](http://www.surabayapost.co.id/?mnu=berita&act=view&id=4e256f67_d6ee0c63bd62c3bdcc4c1fca&jenis=d41d8cd98f00b204e9800998ecf8427e)

DPRD authorities, these two local bodies have unutilised funds valued at 900 billion Rupiahs laying idle in their institutional accounts<sup>64</sup>.

In the light of this situation, officials from the DCKTR in Surabaya City admit that there are huge amounts of unutilised funds in the institutional account of the DCKTR. However, these funds are not allowed to be spent to finance other projects because they have been allocated for the financing of particular projects that had been decided at an earlier time. The formal guidelines strictly forbid local staff to utilise funds that have been allocated for particular projects to finance other projects. If they do, they stand to be accused of misusing APBD funds. As found in the study sites, one of the main factors that cause the high percentage of the unutilised budgets is improper project execution and the large number of unfinished local government projects.

### **6.9.7. Unfinished Projects**

A high number of projects in the study locations have not been completely finished but local governments have fully paid the project funds to the contractors. As the data show, a number of projects in the City of Batu were not completed by the contractors prior to the end of the financial year. One of these is the development of 18 kiosks in the Batu City bus station, which has been unfinished since 2008, whereas the government of the municipality has paid the contractor amounts of more than 250 million Rupiah<sup>65</sup>. Moreover, the development of an office block in the Batu

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<sup>64</sup> Surabaya Post, <http://www.surabayapost.co.id/?mnu=berita&act=view&id=73faf500755025e1a36dc50880b1739b&jenis=c4ca4238a0b923820dcc509a6f75849b>

<sup>65</sup> Surya Online, *18 Ruko Terminal Mangkrak*, 4 November 2012 <http://surabaya.tribunnews.com/m/index.php/2012/11/04/18-ruko-terminal-mangkrak>,

municipality is unfinished as well, even though the 36 billion Rupiah of APBD funds have been spent to build the first stage of the office block<sup>66</sup>.

The worst phenomenon of stalled projects occurs in the City of Surabaya. Data for the 2012 financial year show that 35 large projects funded through the APBD were not completed by the end of the 2012 fiscal year, meanwhile these projects are supposed to be accomplished before 31 December 2012. These 35 projects are under the control of two local bodies (SKPDs), of which 18 projects were executed by the Service of General Work and Spatial (*Dinas Cipta Karya dan Tata Ruang/ DCKTR*) and the other 17 projects were implemented by the Service of General Work, Road, and Drainage (*Dinas Pekerjaan Umum Bina Marga dan Pematusan/ DPUMP*)<sup>67</sup>.

Based on information collected in the field, one of the factors that cause these unfinished projects is that the contractors experience a lack of materials. Additionally, the execution of some of the projects is delayed because the tender process has to be rescheduled due to a number of technical problems. Moreover, there are also some project tenders that have declared a winner; however the winning contractor suddenly pulls out as the project executor.

The facts in the research locations also show that the phenomenon of unfinished projects becomes worse because of the prolonged and complicated process of land acquisition for the development of buildings, roads, or other public

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<sup>66</sup> Surabaya Post, 17 March 2011, Sebelum Revisi, Proyek BO Harus Dihentikan, [http://www.surabayapost.co.id/?mnu=berita&act=view&id=e57c6446502bd9c94cc78c3d92dc0c5c&jenis=1679091\\_c5a880faf6fb5\\_e6087eb\\_1b2dc](http://www.surabayapost.co.id/?mnu=berita&act=view&id=e57c6446502bd9c94cc78c3d92dc0c5c&jenis=1679091_c5a880faf6fb5_e6087eb_1b2dc),

<sup>67</sup> Surabaya Post, [http://www.surabayapost.co.id/?mnu=berita&act=view&id=73faf500755025e1a36dc50880\\_b1739b\\_&jenis=c4ca4238a0b923820dcc509a6f75849b](http://www.surabayapost.co.id/?mnu=berita&act=view&id=73faf500755025e1a36dc50880_b1739b_&jenis=c4ca4238a0b923820dcc509a6f75849b)

facilities. Furthermore, many small to medium scale projects (valued under 2.5 billion Rupiah) are subcontracted out by the winning contractor to smaller operators<sup>68</sup>. Unfortunately, most of the subcontracted contractors fail to execute the projects properly and in a timely manner.

As part of the solution for dealing with these unfinished projects, the DCKTR and DPUMP authorities in Surabaya City provide additional time of 50 more days (from the due date of the initial contract) to the contractors to completely finish the projects. However, the contractors have to pay a fine of five percent of the project value<sup>69</sup>. Furthermore, the informants explain that in the case of contractors not paying the fine or failing to complete the projects within the extended deadline, the contractors will then be blacklisted by local officials. Basically, these contractors will not be allowed to execute local projects any longer. Moreover, the results of the evaluation show that 10 contractors failed to completely finish their projects by the extended deadline. Consequently, these contractors were fined and will not be permitted to be involved any longer in implementing local government projects. Unfortunately, as indicated in the field, the local authorities do not appear to apply fair sanctions to all contractors who fail to accomplish the projects properly and in a timely manner. As a result, the number of unfinished projects remains substantial. From another perspective, informants from the local community and from non-

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<sup>68</sup> As stipulated in the Regulation of the President (PERPRESS) 17 of 2010 regarding the procurement of public goods and services, the winning contractors are strictly forbidden to subcontract to other contractors for projects worth under 2.5 billion Rupiah.

<sup>69</sup> The policy to give additional time and fines to the contractors that fail to accomplish projects in a timely manner is stipulated in the Regulation of the President (PERPRES) 70 of 2012 concerning the second revision on the Regulation of the President (PERPRES) 54 of 2010 regarding the Procurement of Government Goods and Services.

government parties contend that this tendency occurs because there has been a hidden conspiracy between local officials and project contractors. In this case, the informants explained that local officials (project leaders and the tender committee) have often received quotation money from the contractors. Therefore, once the contractors fail to complete the projects as scheduled, the local officials cannot put significant pressure on the contractors, as the contractors will use the excuse that some of the project funds had gone to local staff.

### **6.10. Summary**

The execution of the APBD usually starts late due to delays in the completion of previous stages of the APBD budgeting. The collection of PAD (Own-Source Revenue) almost always meets the target stated in the APBD. However, apart from Surabaya City, the volume of collected PAD remains low. Consequently, local governments mostly rely on funds transferred from the central government. This condition is caused by several factors, including: (1) the poor design of the PAD collection process and the lack of reliable data; (2) inadequate training for, and the irrelevant qualifications of, local finance officers; (3) the disincentive inherent in the DAU (General Allocation Fund). and (4) the centralised nature of tax assignment as potential sources are mostly collected by the central government. It is encouraging that this situation is currently improving as, in 2010, the central government has been delegating the collection of the Land and Building Tax (PBB) to the regions; therefore the volume of PAD has gradually increased.

Thurmaier (2007) elucidates that budget is the tool for executing the management plan to achieve the goals and mission of local government. As seen in the fields, the largest portion of APBD funds is generally allocated for a number of sectors, particularly the Education, General Affairs of Government, General Work, Health, and Spatial and Settlement sectors. Unfortunately, the allocated funds are mostly utilised for paying the salaries of staff members working in these sectors. As a result, the funds spent for the public interest (financing of development activities) remains low, hence local development is much slower than expected. Moreover, in executing local expenditure, local governments tend to prioritise routine expenditure over capital spending. Also, due to the lack of data, routine expenditure is mostly executed incrementally.

Currently, even though execution of the local budget in the sites shows positive progress compared to the previous era, however, in selecting a project executor, local officials prefer to conduct either a direct appointment/ procurement or a simple auction instead of an open tender. They favour these methods because manipulation and collusion can be easily conducted with potential contractors. Furthermore, to avoid the open tender process, local officials apply a strategy of splitting projects. Even the current atmosphere is considered to be worsening as the Indonesian government has just issued a new policy providing greater opportunities for local authorities to not apply open tendering in the selection of a project executor.

Additionally, local executives often experience powerful parties interfering in the execution of local projects. This interference often leads to the rise of illegal category projects such as *Proyek Titipan* (by-Order Projects) and *Proyek Fiktif*



(Fictitious Projects). This is what Wildavsky (1964) and Thurmaier (2007, p. 270) had referred to as the politics of budgeting. Moreover, local officials have changed the strategy from the old method of ‘direct quotation’ to the new method of ‘cash refunds’ in illegally quoting project funds, as the new method is viewed to be more secure from detection by auditors or law enforcement institutions.

A recent, World Bank (2011, pp. 3-5) study reveals a number of prominent phenomena that occur in the budget execution process as: allocated budgets are not released in a timely manner; technical and institutional capacity is limited at the local level; political wrangling has contributed to poor budgetary practices; user committees are susceptible to capture by political interests; and monitoring and supervision is often irregular and unsystematic.

Earlier the World Bank (2007, p. 96) noted that budget execution, particularly of development projects, was typically slow and skewed prior to the end of the fiscal year. Slow disbursements are a symptom of structural blockages throughout the entire budget cycle, including overly-detailed documentation, complicated and lengthy revision procedures, massive mid-year budget revisions, and slow procurement processes.

The current research found evidence that largely supports the above indications. It has revealed issues which cause a cumulative delay in local development execution, thus the time available to execute local development projects is very limited. A further impact is that this reality leads to poor utilisation of funds allocated for development as well as a high number of unfinished development projects.

All in all, it can be concluded that presently, the local budget has not optimally contributed to improving local community livelihood because it is primarily utilised by local legislators, local executives, interest groups and other political powers. The evaluation of, and accountability for, APBD execution will be presented in the next chapter entitled “Accountability, Supervision and Evaluation of the Annual Local Budget (APBD): the Fourth Stage”.