

Local Governance and Development Outcomes

Indonesia Update: Regional Dynamics in Decentralized Indonesia

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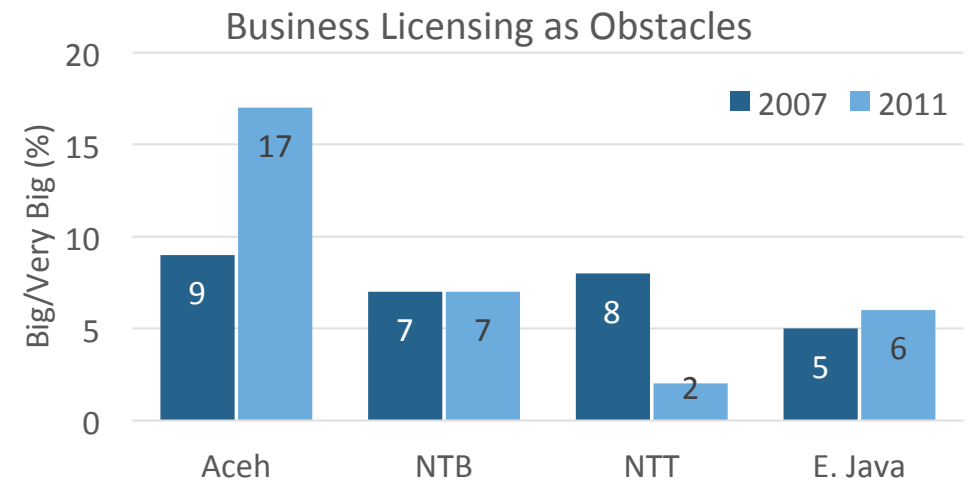
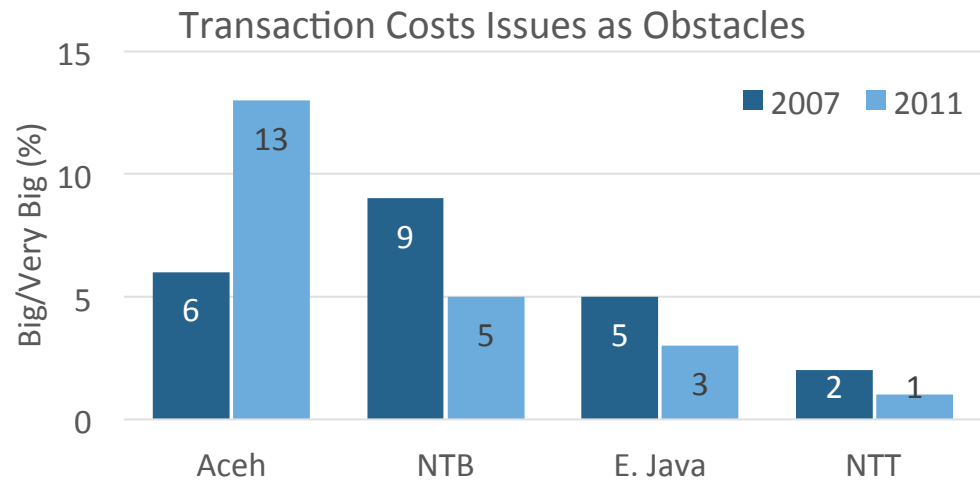
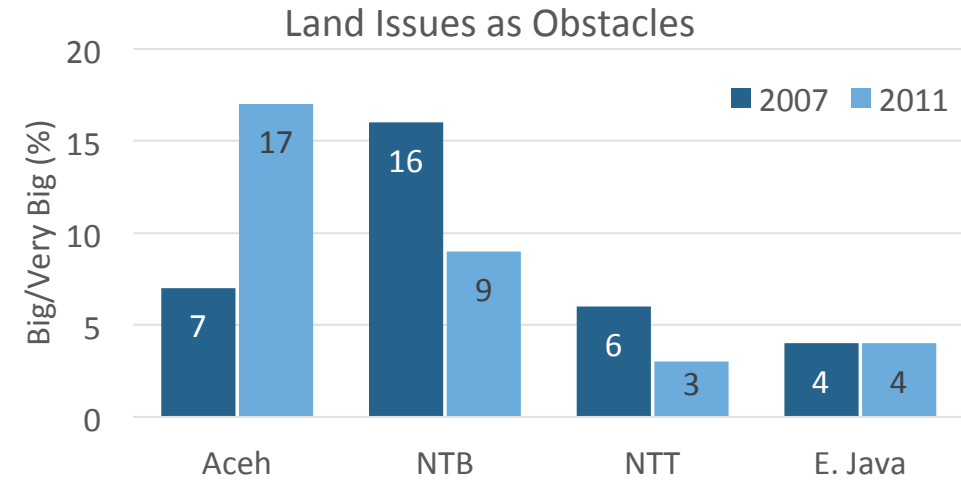
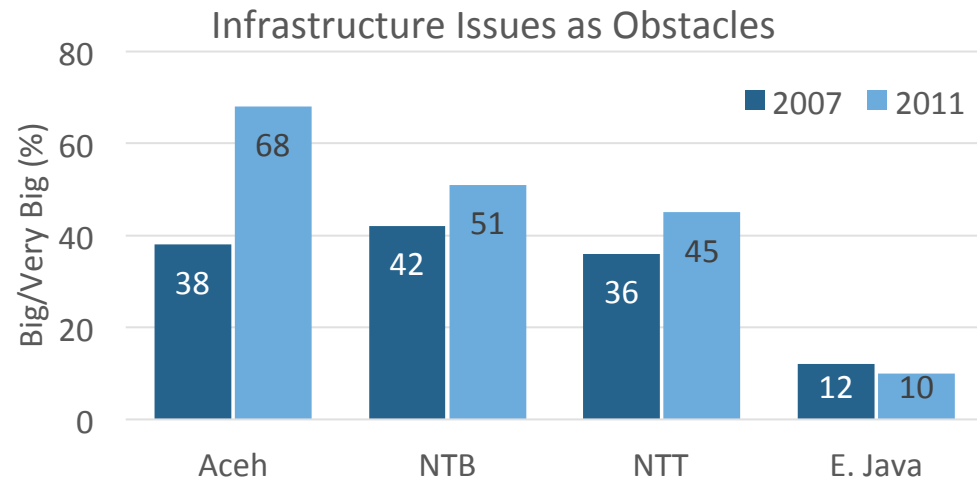
What we are trying to do

- Updating the progress of local governance
- Zooming into the progress and issues on local budget allocation and execution
- Analyzing the impact of local governance, local budget policy and other factors to development outcomes (expenditure per capita and HDI growths)
- Concluding and identifying policy implications

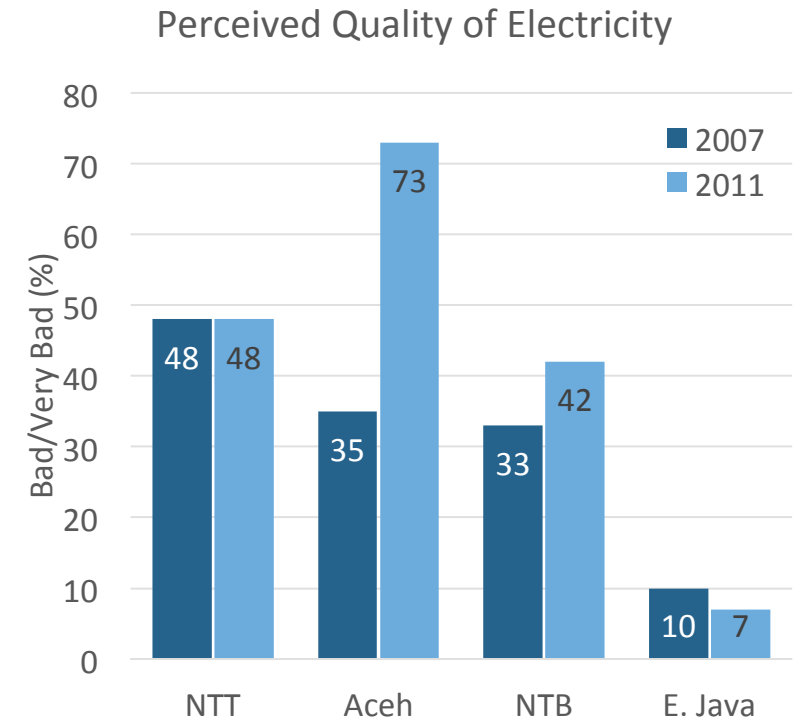
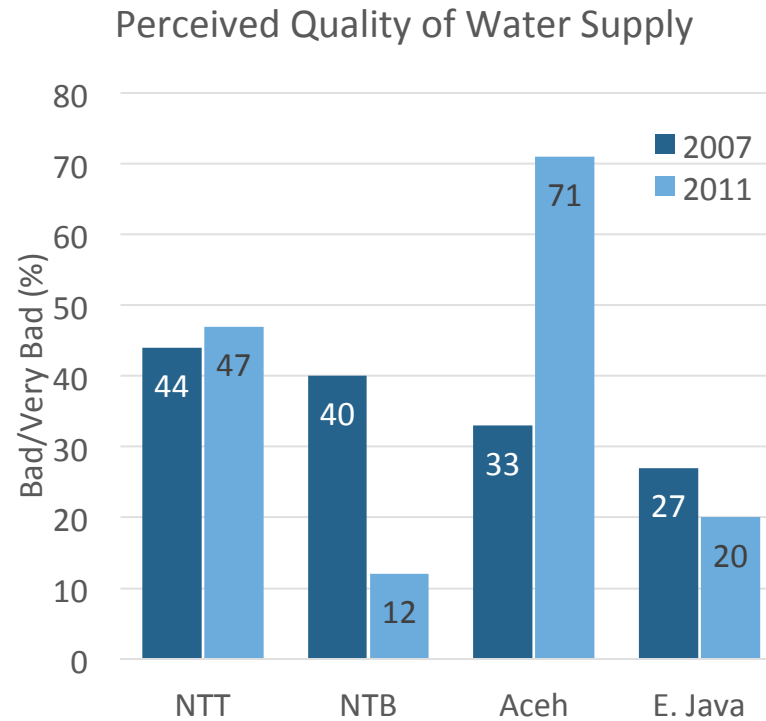
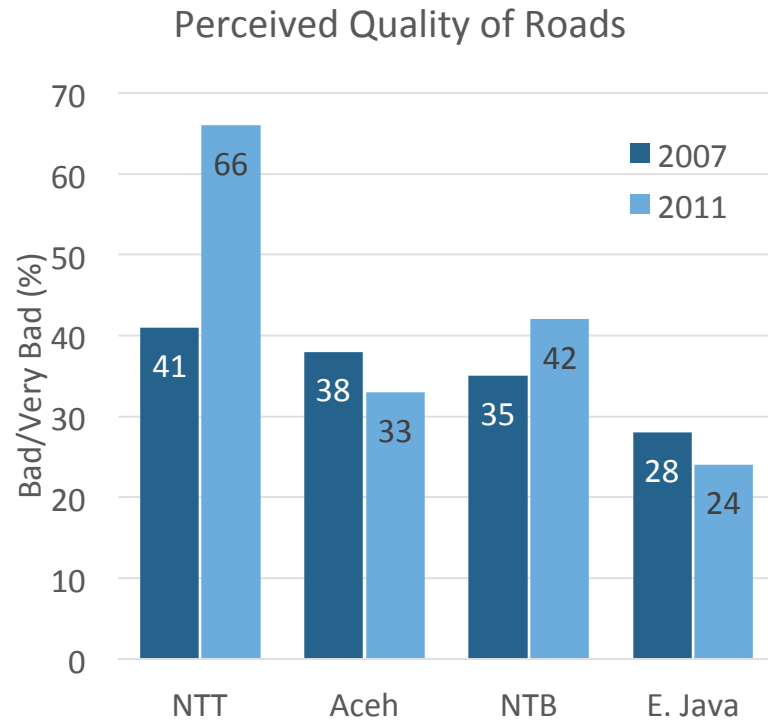
1. Local Governance

Local Governance and Development Outcomes

Local economic governance improved? No clear pattern



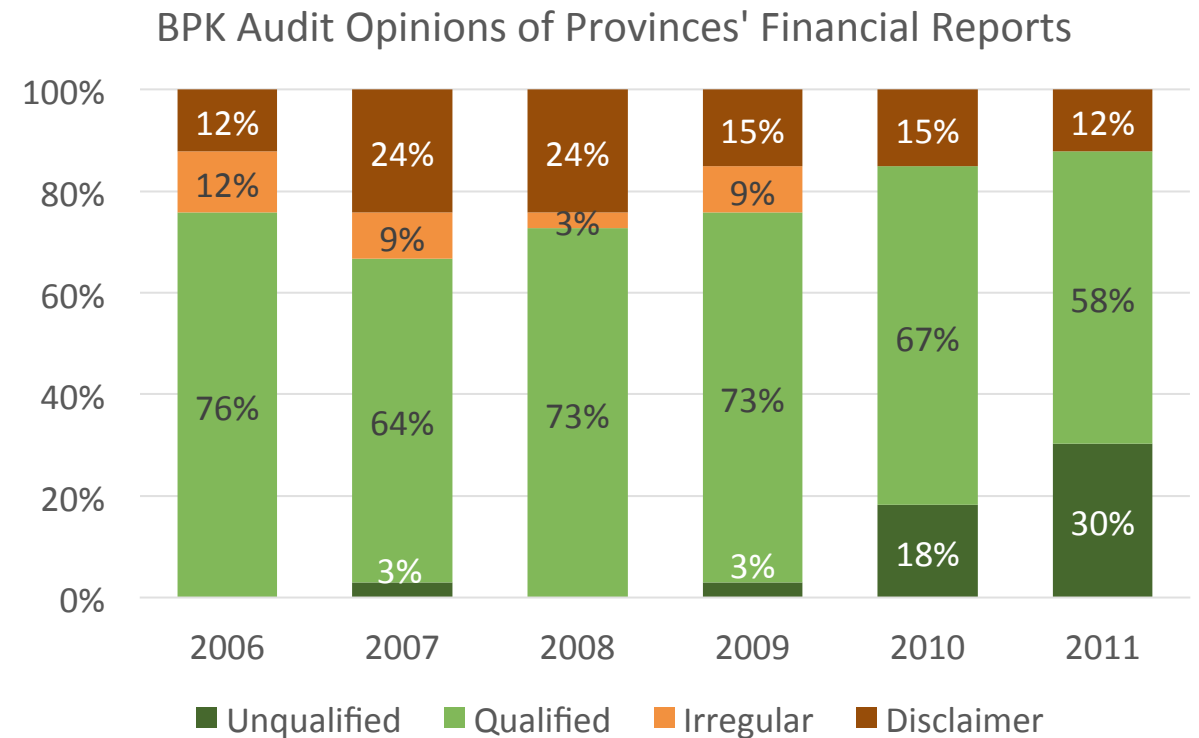
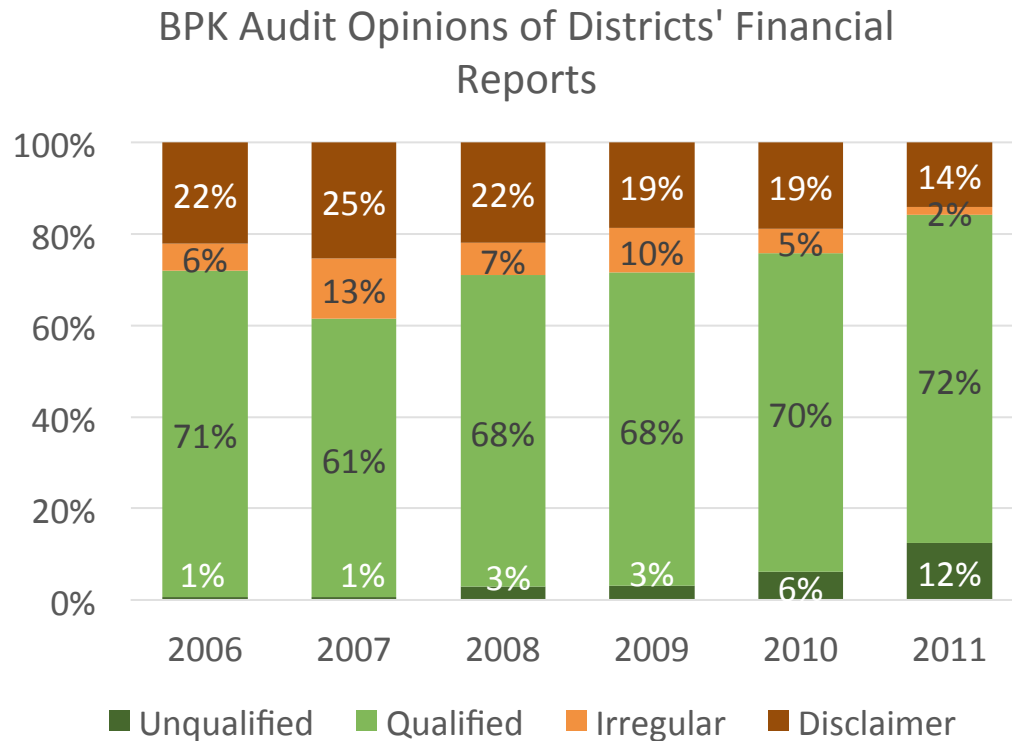
Perception on infrastructure quality (the most important governance aspect according to private sector): no clear pattern either



Interesting institutional development initiatives promoting better governance on business licensing, e-procurement and access to information

Initiative	Trial and Errors by LGs	Adoption by Nat'l Government	Progress	But...
One Stop Shop for Business Licensing (OSS)	Pilot by several LGs supported by nat'l gov't and donors in 1999-2005	Presidential Instruction and Ministry of Home Affairs Decree (2006), Law on Investment (2007)	16 Provincial Governments (PGs) and 404 LGs establish OSS by 2011	<ul style="list-style-type: none"> • Only 31% of the OSS have relatively high authority • Around 40% of the OSS issue simple licenses longer than the national standard
Electronic Procurement System (SPSE)	Surabaya developed e-procurement system in 2004, without any donor	Presidential Decree on Procurement (2010)	31 PGs and 378 LGs adopt SPSE by 2012	<ul style="list-style-type: none"> • 72% and 29% of the district and provincial SPSEs are only used to announce tenders • "Full e-proc" is only used to procure 11% and 21% of the "procurement budgets" • Limited competition and savings
Provincial Information Commission and Information & Documentation Office (PPID)	Local regulations (<i>perda</i>) on Freedom of Information in several districts in 2000-2005, supported by donors	Law on Transparency of Public Information (2008)	<ul style="list-style-type: none"> • 20 PGs establish Information Commission • Around 20% of the LGs establish PPID 	<ul style="list-style-type: none"> • Only 20% of budget documents (mostly summaries) are being published or accessible

Results of BPK audits show significant improvement in 2006-2011, with provinces are generally better than districts...

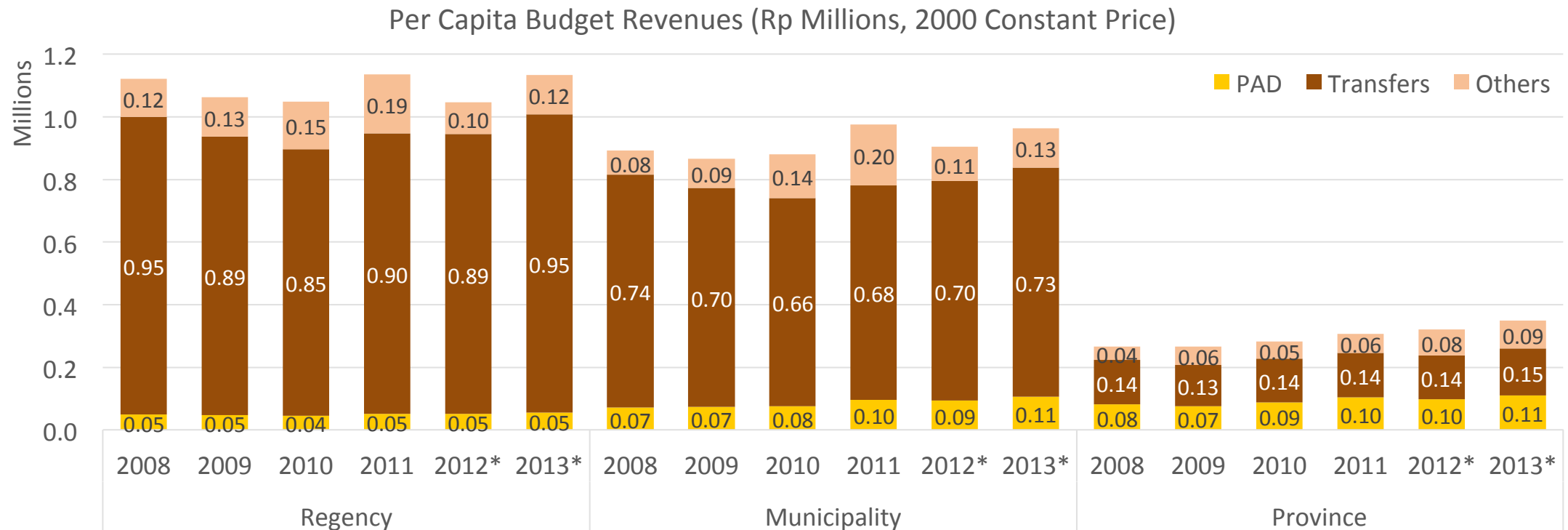


... but, qualitative review indicates high variance among different regions and years of audits

2. Local Budget Policy and Execution

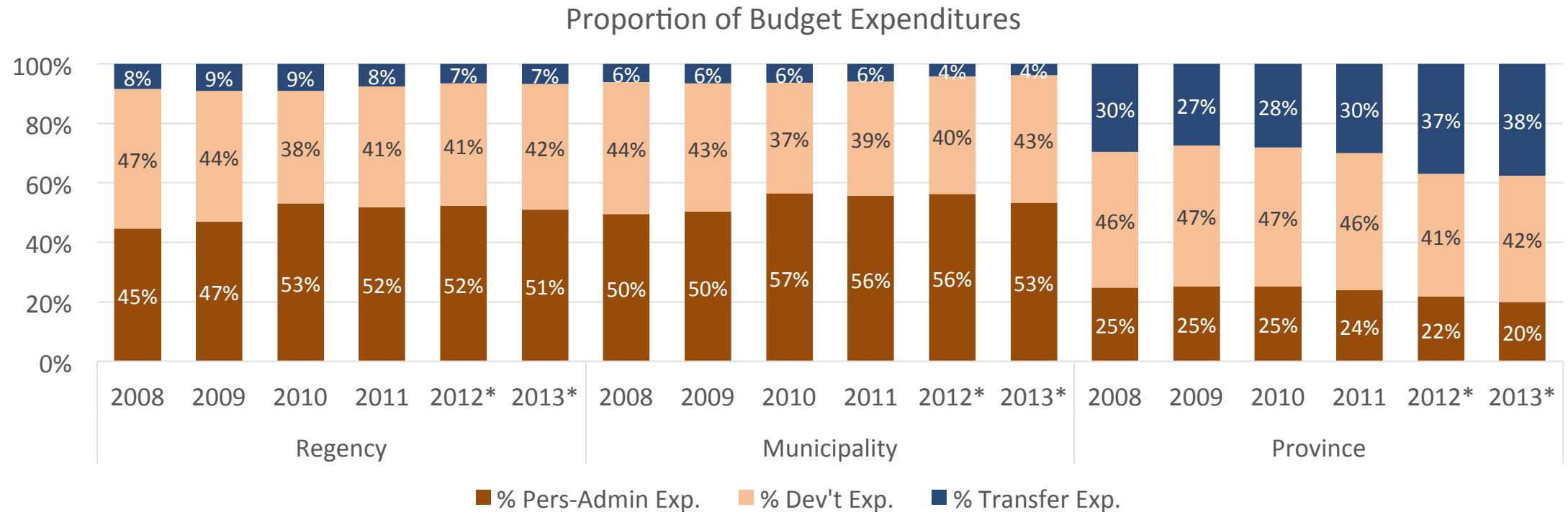
Local Governance and Development Outcomes

In real term, districts revenues – particularly locally generated revenue (PAD) and transfers – have not been significantly increased...



... but the significance of “other revenues” increased (particularly in 2008-2011) – driven by the problematic “Infrastructure Funds”

At the district level, personnel-admin expenditures limit the availability of budget for “development expenditures”

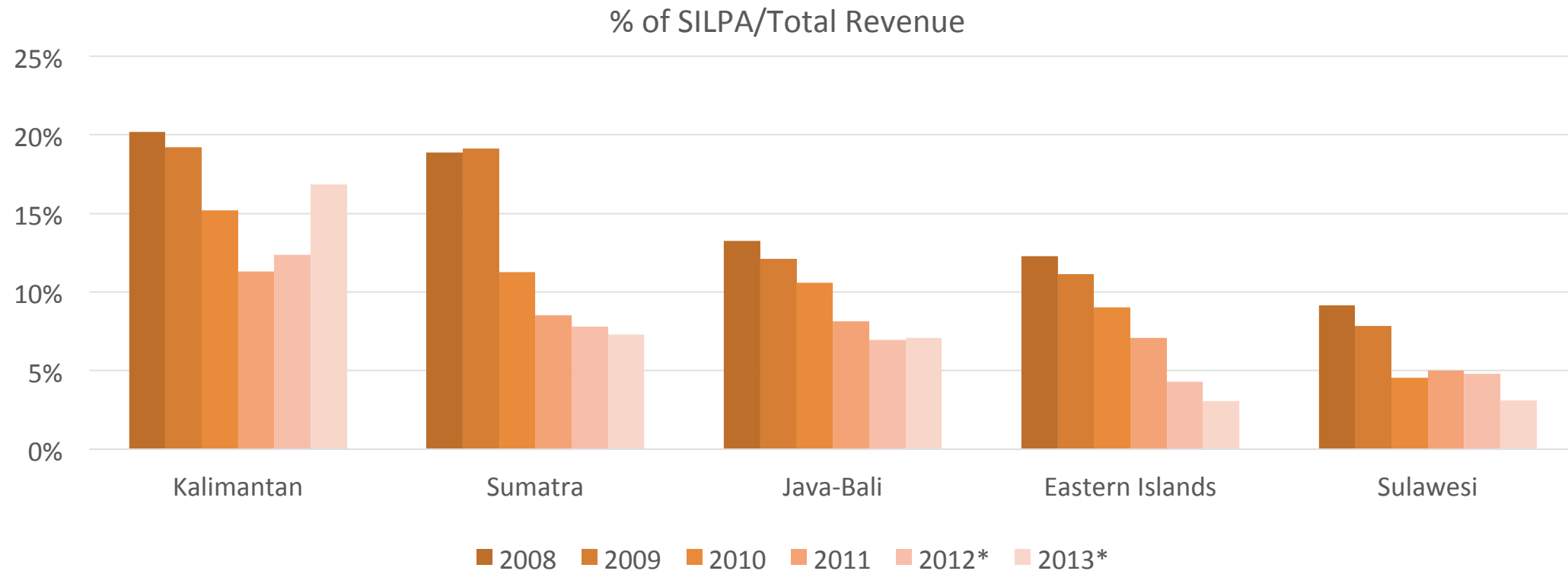


At the provincial level, transfers (to districts and villages) have been significantly increased, while dev’t and personnel-admin decreased

Several other budget policy and execution progress and issues

- Education budget: high and continuously increasing
 - District average: 29% (2007) → 39% (2011)
 - Also driven by the center: increasing civil servant salary, additional teacher allowance and decentralization of school grants (BOS)
- Health budget: still small and stagnant
 - District average: 8.6% (2007) → 9.6% (2011)
- Grants to village: small, but increasing
 - District average: 1.6% (2008) → 2.9% (2013)
- Impact of Direct Elections:
 - 2005 (Skoufias, et. al.): increasing total, health and education expenditures (particularly outside Java-Bali and when non-incumbent elected), PAD, and budget surplus; increasing public works spending in anticipation of the election
 - 2008 and 2010 (Rahman, et. al.): increasing capital and education spending (both batches); increasing health spending (only in 2008; But, lowering overall revenue and capital expenditure in *pilkada* year)

Budget execution is getting better – declining proportion of unspent budget (SILPA) to total revenues



Sources: SIKD-MoF database, compiled by Seknas FITRA, processed by authors.

Note: 2012 and 2013 data is based on budget plans, while budget realization is used for other years

3. Local Governance, Budget Policy v. Development Outcomes

Local Governance and Development Outcomes

Regression analysis

- Questions:
 - Does good governance lead to better outcomes?
 - Does good budget allocation lead to better outcomes?
 - What determines budget allocations, what type of districts get good opinion?
- Variables
 - Outcomes = $f(\text{good governance, budget policy, control})$
 - Outcomes: growth of household expenditure, change in HDI
 - Good governance: LEG index, LEG sub-indices, BPK audit opinions
 - Budget policy: share of development expenditures, share of personnel expenditures, unspent fund
 - Control: initial conditions, administrative characteristics
 - Admin: age of districts, dummy for split, dummy for location, dummy for type
 - Budget = $f(\text{admin characteristics})$

gepc711	(1)	(2)	(9)	(10)	(1)	(2)	(9)	(10)
	On 2007 LEG				On 2010 LEG			
index	0.0339 (0.0419)	0.0240 (0.0418)			0.0661 (0.0423)	0.0680 (0.0421)		
land			-0.0345 (0.0289)	-0.0323 (0.0288)			-0.0265 (0.0302)	-0.0267 (0.0300)
license			-0.0208 (0.0343)	-0.0229 (0.0341)			-0.00849 (0.0357)	-0.00747 (0.0355)
interact			0.0810** (0.0400)	0.0755* (0.0395)			-0.0396 (0.0389)	-0.0489 (0.0391)
BDP			-0.0155 (0.0207)	-0.0140 (0.0206)			-0.0144 (0.0217)	-0.00977 (0.0217)
integrity			-0.0531 (0.0333)	-0.0549* (0.0331)			-0.0258 (0.0325)	-0.0224 (0.0321)
trcost			-0.0236 (0.0220)	-0.0242 (0.0218)			0.0165 (0.0293)	0.0169 (0.0291)
infra			0.0516* (0.0290)	0.0514* (0.0289)			0.0844*** (0.0273)	0.0842*** (0.0271)
secure			0.0235 (0.0262)	0.0214 (0.0261)			0.0325 (0.0271)	0.0348 (0.0270)
bylaw			0.0144 (0.0155)	0.0148 (0.0154)			-0.00202 (0.0186)	0.00273 (0.0187)
BPK8	0.000142 (0.552)	0.0812 (0.551)	-0.00844 (0.561)	0.0845 (0.561)	0.791 (0.584)	0.855 (0.581)	0.968* (0.573)	1.017* (0.570)
SILPA8	-0.117 (1.881)	-1.248 (1.929)	-0.0618 (1.898)	-1.203 (1.953)	1.142 (2.398)	0.833 (2.374)	0.291 (2.402)	0.00902 (2.380)
DEV8	0.0246 (0.0328)		0.0139 (0.0342)		0.0380 (0.0360)		0.0711* (0.0386)	
Person8		-0.0610* (0.0334)		-0.0532 (0.0346)		-0.0717* (0.0391)		-0.100** (0.0421)
1.cNew	-0.165 (1.002)	-0.482 (1.007)	0.00757 (1.002)	-0.296 (1.008)	-0.0150 (1.076)	-0.186 (1.052)	-0.638 (1.045)	-0.645 (1.018)
2.cNew	0.470 (0.765)	0.277 (0.764)	0.502 (0.777)	0.317 (0.776)	1.237 (1.024)	0.963 (1.015)	1.485 (0.998)	1.309 (0.989)
3.cNew					0.336 (1.941)	0.228 (1.932)	0.220 (1.904)	0.0747 (1.895)
dsplit	0.238 (0.648)	0.257 (0.644)	0.264 (0.657)	0.291 (0.653)	0.286 (0.770)	0.245 (0.766)	0.200 (0.755)	0.203 (0.751)
RegCode	0.102 (0.802)	-0.0155 (0.791)	0.501 (0.832)	0.420 (0.821)	-2.178* (1.265)	-2.599** (1.290)	-2.365* (1.265)	-2.833** (1.287)
2.Cluster0	-1.955*** (0.739)	-1.780** (0.714)	-2.374*** (0.789)	-2.202*** (0.772)	-1.800* (0.938)	-2.007** (0.941)	-1.958** (0.959)	-2.175** (0.957)
Constant	32.62** (14.54)	40.80*** (15.07)	32.69** (14.59)	39.57*** (15.13)	39.92** (17.86)	49.13*** (18.52)	56.26*** (19.91)	69.02*** (20.83)
Control	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	242	242	242	242	230	230	224	224
R-squared	0.160	0.170	0.199	0.207	0.191	0.199	0.270	0.278

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Is good governance associated with higher economic growth?

- Infrastructure governance appears to be a very significant factor affecting household expenditure growth.
- Government-business interaction also contributes positively in some models. However, leaders' integrity comes with unexpected sign.
- Obtaining good opinion from BPK seems to be associated with higher economic growth.
- Higher development expenditures and lower personnel expenditures are associated with higher economic growth.
- Districts outside Java/Bali show higher household expenditure growth.
- Kota exhibits higher growth than Kabupaten.

HDI711	(1)	(2)	(9)	(10)	(1)	(2)	(9)	(10)
	On 2007 LEG				On 2010 LEG			
index	0.00223 (0.00150)	0.00192 (0.00150)			0.00579*** (0.00158)	0.00572*** (0.00158)		
land			-0.00138 (0.00103)	-0.00135 (0.00103)			-0.000800 (0.00109)	-0.000793 (0.00109)
license			0.000743 (0.00121)	0.000636 (0.00120)			-0.00223* (0.00132)	-0.00225* (0.00132)
interact			0.00319** (0.00141)	0.00295** (0.00140)			0.00136 (0.00144)	0.00142 (0.00145)
BDP			-0.000668 (0.000728)	-0.000615 (0.000726)			-0.000349 (0.000806)	-0.000342 (0.000808)
integrity			-0.000377 (0.00117)	-0.000415 (0.00117)			0.00124 (0.00120)	0.00115 (0.00119)
trcost			0.00151* (0.000777)	0.00149* (0.000777)			0.00254** (0.00109)	0.00254** (0.00109)
infra			-0.000435 (0.00101)	-0.000389 (0.00101)			0.00224** (0.000990)	0.00228** (0.000990)
secure			-0.000620 (0.000924)	-0.000637 (0.000923)			-6.42e-05 (0.00102)	-7.81e-05 (0.00102)
bylaw			-0.000329 (0.000547)	-0.000328 (0.000546)			-0.000192 (0.000688)	-0.000239 (0.000697)
BPK8	-0.0408** (0.0196)	-0.0378* (0.0196)	-0.0487** (0.0197)	-0.0457** (0.0198)	-0.00777 (0.0218)	-0.00920 (0.0218)	-0.00464 (0.0212)	-0.00454 (0.0213)
SILPA8	0.157** (0.0665)	0.118* (0.0685)	0.156** (0.0664)	0.118* (0.0690)	0.0809 (0.0901)	0.0926 (0.0898)	0.0687 (0.0894)	0.0662 (0.0891)
DEV8	0.000800 (0.00115)		-0.000370 (0.00119)		-2.03e-05 (0.00129)		-0.00125 (0.00134)	
Person8		-0.00195* (0.00116)		-0.000948 (0.00119)		0.000772 (0.00137)		0.00124 (0.00142)
1.cNew	-0.0169 (0.0333)	-0.0308 (0.0340)	-0.0223 (0.0333)	-0.0342 (0.0340)	-0.0112 (0.0403)	-0.00486 (0.0396)	-0.0106 (0.0388)	-0.0136 (0.0380)
2.cNew	-0.0575** (0.0271)	-0.0643** (0.0271)	-0.0673** (0.0273)	-0.0738*** (0.0274)	-0.0495 (0.0386)	-0.0423 (0.0382)	-0.0385 (0.0372)	-0.0397 (0.0370)
3.cNew					-0.149** (0.0722)	-0.149** (0.0722)	-0.218*** (0.0706)	-0.217*** (0.0707)
dsplit	0.0242 (0.0230)	0.0241 (0.0228)	0.0172 (0.0231)	0.0177 (0.0231)	0.0209 (0.0288)	0.0222 (0.0288)	0.0285 (0.0280)	0.0280 (0.0280)
RegCode	-0.0102 (0.0286)	-0.0122 (0.0280)	-0.00541 (0.0291)	-0.00342 (0.0287)	0.0374 (0.0487)	0.0404 (0.0489)	-0.000749 (0.0497)	0.00334 (0.0501)
2.Cluster0	-0.0168 (0.0262)	-0.0114 (0.0253)	-0.0116 (0.0276)	-0.00505 (0.0271)	0.0367 (0.0352)	0.0387 (0.0354)	0.0582 (0.0356)	0.0609* (0.0356)
Constant	2.664*** (0.332)	2.815*** (0.326)	2.751*** (0.349)	2.778*** (0.346)	1.795*** (0.426)	1.817*** (0.400)	2.592*** (0.495)	2.477*** (0.470)
Control	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	242	242	242	242	230	230	224	224
R-squared	0.581	0.586	0.608	0.609	0.545	0.545	0.598	0.598

Standard errors in parentheses
 *** p<0.01, ** p<0.05, * p<0.1

Is good governance associated with higher HDI growth?

- Government-business interaction, transaction cost, and infrastructure are significant factors affecting the growth of HDI. Business licensing, on the other hand, appears with unexpected sign.
- Signs on audit variable (BPK8) are unexpected. This might due to the very strong correlation between the opinion results with the 'age' of the districts as well as the location of the districts.
- Newly established districts (and those outside Java/Bali) perform lower HDI growth.
- Higher personnel expenditures are associated with lower HDI growth

all	gepc711	gepc711	HDI711	HDI711
pct_corr	-0.0108 (0.0122)	-0.00949 (0.0122)	0.000222 -0.000462	0.00023 -0.000462
pct_landd	0.0138 (0.00974)	0.0126 (0.00968)	0.000730* -0.000374	0.000724* -0.000374
pct_roadi	0.0159* (0.00850)	0.0155* (0.00844)	0.000351 -0.00032	0.000348 -0.00032
BPK8	0.248 (0.434)	0.332 (0.431)	-0.00262 -0.0163	-0.00207 -0.0163
SILPA8	-1.107 (1.380)	-1.763 (1.389)	0.0796 -0.0521	0.0748 -0.053
DEV8	0.0409* (0.0232)		0.000138 -0.000871	
Person8		-0.0703*** (0.0241)		-0.000333 -0.000897
1.cNew	-0.431 (0.704)	-0.620 (0.697)	-0.0573** -0.0263	-0.0591** -0.0263
2.cNew	0.719 (0.625)	0.492 (0.622)	-0.0642*** -0.0236	-0.0658*** -0.0236
3.cNew	-0.147 (1.563)	-0.330 (1.555)	-0.0205 -0.059	-0.0212 -0.0591
dsplit	-0.381 (0.506)	-0.406 (0.502)	-0.00107 -0.019	-0.00134 -0.019
RegCode	-0.668 (0.718)	-0.929 (0.720)	0.00182 -0.0275	0.00129 -0.0274
2.Cluster0	-1.520** (0.593)	-1.609*** (0.584)	-0.0355 -0.0226	-0.0356 -0.0224
Constant	43.13*** (11.29)	51.36*** (11.36)	2.368*** -0.273	2.377*** -0.253
Control	Yes	Yes	Yes	Yes
Observations	436	436	436	436
R-squared	0.189	0.199	0.453	0.453

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Using all observations

- Better road infrastructure is significant for higher economic growth (as proxied by per capita expenditure growth), while land access is more important in terms of change in HDI
- Development expenditures contribute positively to economic growth, while personnel expenditures play an opposite role
- Newly established districts have lower HDI growth compared to “old districts”. The impact of such proliferation on household expenditure growth is, however, insignificant.
- Districts outside Java/Bali have higher per capita expenditure growth.

VARIABLES	(1) DEV12	(2) Person12	(3) SILPA12
1.cNew	9.870*** (1.587)	-11.35*** (1.668)	0.0224 (0.0141)
2.cNew	10.35*** (1.270)	-11.22*** (1.335)	-0.00997 (0.0113)
3.cNew	16.28*** (1.848)	-16.90*** (1.942)	0.00300 (0.0165)
dsplit	2.655** (1.214)	-2.973** (1.276)	-0.0140 (0.0108)
RegCode	-0.242 (1.116)	-2.182* (1.174)	0.0108 (0.00995)
2.Cluster0	-3.895*** (1.165)	1.713 (1.225)	-0.00594 (0.0104)
Constant	37.60*** (1.157)	59.24*** (1.217)	0.0672*** (0.0103)
Observations	461	461	461
R-squared	0.330	0.307	0.015

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

What affects budget policy?

- Newly established districts tend to have higher portion of development expenditures and lower personnel expenditures
- Districts that split tend to have higher development expenditures and lower personnel expenditures
- Kota tends to have higher personnel expenditures compared to Kabupaten
- Districts outside Java/Bali tend to have higher development expenditures than those in Java/Bali.

VARIABLES	(1) BPK8	(2) BPK11	(3) BPK11	(4) BPK11
dindex	0.316 (0.361)	0.114 (0.320)	-0.135 (0.446)	
1.cNew	0.596 (0.689)	-1.088* (0.630)	0.725 (0.813)	-0.164 (0.483)
2.cNew	-0.115 (0.499)	-1.715*** (0.541)	-0.276 (0.546)	-1.164*** (0.375)
3.cNew		-2.272*** (0.611)		-1.869*** (0.487)
dsplit	-0.220 (0.447)	-0.850 (0.527)	-0.380 (0.500)	-0.573 (0.373)
RegCode	-0.0967 (0.415)	-1.180* (0.669)	-0.346 (0.571)	-0.706 (0.430)
2.Cluster0	0.635 (0.414)	1.812* (1.081)	3.413*** (1.067)	3.027*** (1.037)
Constant	1.096** (0.438)	3.092*** (0.753)	1.691*** (0.559)	2.443*** (0.441)
Observations	243	259	243	462

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

What kind of districts get good opinion?

- Newly established districts are less likely to obtain good opinion
- Kota is more likely to obtain good opinion than Kabupaten
- Districts in Java/Bali are more likely to obtain good opinion

4. Conclusions and Policy Implications

Local Governance and Development Outcomes

Good infrastructure governance and budget policy leads to improvement of better developmental outcomes

- Infrastructure governance is very important to accelerate household expenditure growth. The models for districts surveyed in 2010 also indicates the importance of infrastructure to HDI growth, although it is not significant for 2007.
- Improved transaction costs seems to accelerate HDI growth, although it is not significant to increase expenditure growth.
- Increasing capital/goods expenditures and reducing personnel expenditure is also important for household expenditure growth. But, this does not appear to accelerate HDI growth.
- District proliferation has negative impact to HDI growth – recently established districts have worse improvement in HDI rather than the “older” ones. However, this does not seem to be significant in expenditure models.
- Districts outside Java-Bali has higher household expenditure growth, although it is insignificant for HDI growth

Policy implications

- Infrastructure development:
 - Improving budget transfers from central to sub-national governments – streamlining DAKs, improving DAK allocation and decision-making mechanism, removing Infrastructure Funds completely
 - Procurement reform needs to be enhanced and reoriented towards better quality of infrastructure and increasing efficiency
 - Creating incentives for sub-national governments that increased development expenditures for infrastructure
- Reduction of transaction costs:
 - Enforcing the implementation of the Law No. 28/2009 on local taxes and charges that limit the types of taxes and charges – watch the “trick” (change from taxes/charges to donations)
 - More difficult: reduce unofficial charges
- Public financial management and budget allocation:
 - Continue improving budget allocation policies seems to be more important to development outcomes rather than other aspects of public financial management
- Regional proliferation
 - Tighten the requirements for proliferation (already in the new draft Decentralization Law)