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New Paradigm for Local Financial Management: A Review of Local Budgeting System

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Abstract: *Fiscal decentralization gives authority to the head of region and regional parliament to manage the local budget. The outcomes of the research indicate that the Good Financial Governance principle has been subject to frequent study in its understanding as a new paradigm for local financial management. As it turns out in practice, however, it has certain weaknesses, particularly in view of the accountability and legitimacy aspects of its establishment. In fact, the local budget has become a vehicle for corruption by the state administration is in the center of power, local autonomy shift some corruptor from the center to the local. The issue is how to manage the local budget in order to minimize corruption. If the commitment of the management of local budget is based on new principles in the local financial management, it believed that the local budget is governed annually by the local government will lead to the people's welfare in the region. Based on such view, the Good Financial Governance principles appears to be the ideal approach to be applied in managing the local budgeting system.*

Keywords: *Corruption; Fiscal Decentralization; Good Financial Governance; Local Autonomy; Regional Government*

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INTRODUCTION

As an integral part of national development, regional development policies require a harmony of growth rate among the regions. The concept of local autonomy that proclaimed post-reform is expected to provide broad authority and accountable to the autonomous regions to develop a region as the spirit and mandate of the 1945 Constitution as the supreme law in Indonesia.

In practical level, the implementation of the local autonomy policy has been in effect since 1 January 2002[1] has changed the pattern of administration and fiscal management in Indonesia – from centralism to decentralism. In addition, there has been a shift in the concept of "financial balance of central and local" into "fiscal decentralization

[1] In the era of reform, the implementation of local autonomy based on Act No. 22 of 1999 on Regional Government and Act No. 25 of 1999 on financial relations for both center and region. Both of these laws regulate the autonomous authority that broadly given to local governments. Hereafter, in 2004, both of Act No. 22 of 1999 and Act No. 25, 1999 are repealed and substituted by Act No. 32 of 2004 on Regional Government. Lastly, Act No. 32 of 2004 repealed and substituted by Act No. 23 of 2014 on Regional Government.

policy". Direct implication of this policy is the region given discretion to manage their revenues and expenditures in a responsible and pro-people. This certainly appropriate to the needs and development priorities of each autonomous regions.

Local autonomy is the realization of decentralization idea.[2] Autonomous region is a concrete manifestation of the policy of decentralization itself. In this context, autonomy should be understood functionally, in the sense that the orientation of autonomy should the efforts to optimize the functions of government, both in terms of the setting, service, and empowerment, so that can be done quickly and as close as possible to the needs of the people.[3] Thus, equitable development, poverty alleviation, to empowering people to prosperity should be the main jargon when regional autonomy should be put on its basic objective.[4] Based on this, the regional autonomy that is managed by local governments and legislators should be the welfare of the people, because autonomy without welfare is injustice. In view of Gibson *et al.,*[5] in this matter, citizens play a secondary role in setting agendas, developing budgets, implementing programs, or evaluating outcomes. The authority to manage local finances should be truly given for the welfare of people, avoid abuse of financial management.[6]

Sources of revenue and funding in the Regional Budget can be allocated to fund the implementation of the obligatory functions and alternative affairs in the form of programs and activities related to the improvement of public services, job creation, poverty alleviation, improvement of environmental quality, and local economic growth. The implications of these policies, the need for funds to finance the implementation of the functions that have become regional authority is also increasing. Therefore, it is important, the implementation of fiscal decentralization policy through the financial balance between the center and local in accordance with the *money follows function* as an effort to support the financing of various affairs and the authority has been transferred to the autonomous regions continue to be driven.

Fiscal decentralization gives full authority to the autonomous region to; (1) managing fund transfer (2) managing local taxes and retribution, and (3) managing legitimate other income of the region. The essence of fiscal decentralization is to reduce inequality and or fiscal gap between the central and local governments, as well as reduce the fiscal capacity gap between regions. Furthermore, the policy of funding to the autonomous regions in orders to run the affairs and authorities has delegated; the broad discretion is important and useful when the head of region as the head of autonomous regional government has the intention and sincerity to man-

[2] Syamsuddin Haris, (2005). *Desentralisasi dan Otonomi Daerah*. Jakarta: Yayasan Obor Indonesia, p. 10

[3] Based on the general provisions of Article 1 paragraph (6) of Act No. 23 of 2014 concerning Regional Government, stipulated that local autonomy is basically the rights and obligations and the authority for the autonomous regions to set up and administer own region, both in administration and interest their people.

[4] H. Samsul Wahidin. (2013). *Hukum Pemerintahan Daerah, Pendulum Otonomi Daerah dari Masa ke Masa.* Yogyakarta: Pustaka Pelajar, p. 26

[5] Pamela D. Gibson, Donald P. Lacy, and Michael J. Dougherty. (2005). "Improving Performance and Accountability in Local Government with Citizen Participation", *The Innovation Journal: The Public Sector Innovation Journal,* 10(1): 1-12

[6] Abdullah Zainie. (2007). *Dilema Pelaksanaan Perimbangan Keuangan Pusat dan Daerah.* Jakarta: LIPI Press, p. 266

age income and expenditure pro-people. In view of Citizens play a secondary role in setting agendas, developing budgets, implementing programs, or evaluating outcomes.

Fiscal decentralization was intended to strengthen the authority of local government in order to implement better the autonomy region when supported by several important indicators includes: (1) government's political will pro-people, (2) strong internal controls and law enforcement, (3) reinforced with the availability of human resources that are reliable and adequate in the local government officials, and (4) there is a balance and clarity in terms of the division of authority and responsibility to do the taxes and retribution in order to increase revenue (local original revenue).

In practice, local financial management still arises a complicated issue because there is still reluctance of regional heads to release a Local Budget policy pro-people. The Local Budget pro-people is a local budget in the budgeting and financing directly touch the interests of people that include infrastructure development, education, health, small and medium enterprises (SMEs) and other development priorities in accordance territorial characteristics of each region.

In order to implement the good financial governance principles in managing the local budgeting system, it needed a courage of regional head to release a policy to cut indirect spending to be directed to the direct spending for the people, followed by improvement of local financial management and increased understanding of *Good Financial Governance* as a form the new paradigm of the local financial management; local financial management that emphasized on the principle of participation, transparency, accountability and fairness.

ANALYSIS AND DISCUSSION

Implementing Good Financial Governance Principles in Local Budgeting System

In a perspective of constitutional state the Local Budget is people-owned, not the government. The authority of local governments is to manage the budget well and distributed to build the social and economic life of the people. One important indicator to assess the success of local autonomy is should be able to manage the natural resources to increase local revenue. So, the transfer of funds from the center to the local is supplement alone. Inevitability the autonomous region to realize the welfare of the people, not arises social poverty and birth the rich little kings.

Based on data from the Directorate General of Regional Autonomy the Ministry of Domestic Affairs of the Republic of Indonesia,[7] in 2014 has created 542 autonomous areas of 34 Provinces, 415 Districts and 93 Cities. It indicates so many centers of executive power in the regions have been created, added with tens of thousands of members of parliament both provincial and district/city that implement the functions of *budgeting*, *legislation* and *controlling*. In relation to the management of local budget, through the National Budget for Fiscal Year 2014 has been transferred to the region

[7] Data source: Direktorat Penataan Daerah, Otonomi Khusus, dan Dewan Pertimbangan Otonomi Daerah, Direktorat Jenderal Otonomi Daerah Kementerian Dalam Negeri Republik Indonesia. (2014). *"Pembentukan Daerah-daerah Otonom di Indonesia Tahun 2014"*. Retrieve from: http://otda.kemendagri.go.id/CMS/Images/SubMenu/totalDOB.pdf Accessed on 16 March 2016.

a balance funds amounting to 592.6 trillion (24.8%) of the total national budget is 1812.5 trillion. Total funds transfer center to the local as one of the local revenue beyond the management of local taxes and retribution as a source of local revenue, so that each autonomous regions manage the local budget each fiscal year above Rp. 600 billion depends on the condition of each autonomous regions (area wide, total population and potential of natural resources).

Fiscal decentralization gives authority to the head of region and regional parliament to manage the local budget based on the principles of *Good Financial Governance*. But in fact, the local budget has become a vehicle for corruption by the state administration is in the center of power, local autonomy shift some corruptor from the center to the local.[8] A phenomenon called Lord Acton as "*power tends to corrupt, and absolute power corrupts absolutely"* is more real. The issue is how to manage the local budget in order to minimize corruption? According to the authors, it needed a new paradigm of local budget in the concept of good financial governance. at least there are 4 (four) aspects that should be a priority of region. *First*, local financial management involves the community (participatory); *Second*, local financial management is open (transparency); *Third*, local financial management is responsible (accountability); and *Fourth*, local financial management is fair (fairness).

The principle of good financial governance is a part of the reform of state finance management through the instruments of the Finance Act (Act 17 of 2003 *jo.* Act No.1 of 2004 *jo.* Act No.15 of 2004). In fact, the implementation of *Good Financial Governance* is difficult for local governments (Regional Head and Parliament) at this time, because reduce the authority of local governments in the management of local budget. This is main issues why corruption in local budget is more acute. A mode of corruption of local budget is budget distention (leakage), budget robbery (abusing authority), and budget burglary (budget duplication) to the invisible budget (substitute budget).

Corrupt of local budget from year to year is more acute and alarming. People money is used according to the ability and willingness of the spending of regional head and parliament, not what the willingness and wishes of people. Local expenditure is not according to ability and financial capacity of the region, but according to the wishes of local government to spend. Unfortunately, which oversees the implementation of local budget, in this case parliament is participate to enjoy the results. New paradigm of local financial management in question is to change the orientation of local budget management from *profit orientate* into *social orientate* for the welfare of the people. By changing the pattern of local budget management by creates a principle of *Good Financial Governance* as a base of management becomes important, so that the local budget set annually by local governments really beneficial to improving the welfare of the people. In addition, required effective supervision through *Internal Control System*, for preventing and combating practices of financial governance that deviate.

8 Muladi. (2002). "Sistem Pembuktian Terbalik (*Omkering van Bewijslast*)", Majalah *Varia Peradilan*, Vol. 2 No. 1, p. 119

Good Financial Governance principles include; (1) public participation (2) transparent or openness, (3) fairness in the distribution of budget allocation, and (4) accountability in any use of the budget[9] as a new paradigm of financial management should be strengthened in the preparation of ratification budget as a local governments' commitment to allocate the budget for the public interest. It is time for a paradigm of financial management changed to better accommodate the public interests (participation budgeting). To realize a good financial budgeting, required political will of local governments and legislators as an entry point to build a region through the provision of maximum funds for the welfare of the people.

Policy of local autonomy and fiscal decentralization has clear dimensions for region in government and services and financial management based on the principles of participation, transparency, fairness and accountability. Local budgets to be important and is the "lifeblood" for the implementation of government and an important indicator towards democratic and equitable governances. Thus, the funding system of governance can be run efficiently, effectively and on general policy direction of local budget management that agreed with the local governments and parliament.

In addition, the major issue in fiscal decentralization is devolution of authority from central to local governments must be realized by putting strong principles and implementation of *Good Financial Governance*. In order to improve the efficiency and effectiveness of the management of financial resources and services to the public, then the spirit of local autonomy are decentralized in 5 (five) dimensions, among other 1) fiscal decentralization; 2) revenue decentralization; 3) expenditure decentralization; 4) asset decentralization; and 5) personnel decentralization. The fifth dimensions of local financial management is needed in order to create discipline in the management of local budget, that is effectiveness, efficiency, transparency and accountability, so that people can enjoy directly the impact of local budget management each year.

A paradigm of financial management till now the orientation is still prioritize indirect spending (apparatus), it should be changed to prioritize direct spending (public), so that the affairs of financial management must become a mandatory affairs for people, not for the interest of the apparatus. To change the paradigm of local financial management needed courage of local governments and legislators through *budgeting politics*. Budgeting politics determines the direction and fiscal policy of region as part of the local budget management, to establish development programs and budgets directly touch on the basic needs of people. Avoided budget management practices are wasteful and do not raise rural people life, because really the local budget is people-owned and the designation belongs to the people for the welfare of the people, as the purpose of the state, a state realize the welfare as a constitutional mandate.

Reorientation of Local Revenue Budget

Local autonomy develops dynamically and finds a format that suits to the characteristic

9 Hendra Karianga. (2011). *Partisipasi Masyarakat dalam Pengelolaan Keuangan Daerah: Perspektif Hukum dan Demokrasi*. Bandung: Alumni, p. 23.

of territorial within the frame of the Unitary of the Republic of Indonesia. Various studies and discussions so far continue to study whether it has achieved the expected objective which is to accelerate the realization of people development and welfare. The amendment of Act No. 32 of 2004 into 3 (three) namely; Act No. 23 of 2014 regarding Regional Government; Act No. 6 of 2014 on the village; and Act No. 10 of 2016 concerning Regional Election, as part of legal policy of legislation to form the positive law in the field of local governance is more linear in accordance with the interests and local development needs by placing the village as a central point of future development of Indonesia.

It indicated that the local autonomy in Indonesia is growing dynamically. One important aspect of local autonomy is the funding and financing of government activity and development derived from the management of local budget each year.[10] Admittedly, the local budget each year of autonomous regions, both of the funds transfer and management of local revenue, largely as result of the collection of natural resources management are owned by their respective regions. Thus, it is time for the people not only as the object of development, but there must also be the subject of development.

People must get major portion of financing through the local budget, this commitment needs to continue declared and voiced. Local autonomy should be interpreted as regional independence in allocating resources for the welfare of the people. Without supported by local financial management orderly and adequate, the goal of local autonomy will not achieve. Therefore, need a commitment and seriousness (*political will*) of local governments and legislators in directing the priorities and budgeting pro-people.

National development planning as stipulated in Act No. 25 of 2004 on National Development Planning should be integrated fundamentally with the Medium-Term Regional Development Plan as the vision and mission of the regional head. Based on these problems, then the next question that needs to be addressed is the local budget got who? To answer these questions, we must go back to the ideals of the beginning of the state in accordance with the 1945 Constitution; the state realizes the ideals of the welfare of people. Article 33 of the 1945 Constitution is the philosophy of local financial management, which put state to controls and not possess, control over all natural resources potential should be for the welfare of the people. Local budgets obtained from all the natural resources management in the region including local taxes and retribution. Thus, 100% of the source of local budget derived from the exploitation of natural resources and taxes paid directly by the people to the state. On this basis, the orientation of the local budget management leads to the welfare of the people.

In relation to the local authorities to manage the local budget, it set annually by local governments and legislators as a means of development stability of region to must overcome 3 (three) main points. *First*, the local budget is managed and oriented

[10] Sait Abdullah. (2005). "Desentralisasi: Konsep, Teori dan Perdebatannya". *Jurnal Desentralisasi*, 6(4): 61-74.

towards growth (*pro-growth*); *Second*, the local budget is managed and should be able to open employment (*pro-job*); and third, the local budget is managed and should be able to overcome poverty (*pro-poor*). There is no other way to accelerate the ideals of welfare of the people in the spirit of regional autonomy and decentralization but to remain focused on the concrete orientation of the local budget that owned by people and for the people. The local budget is public money that should be managed and maximum allocation for the interest of the people. Without that achievement, local financial management will be distorted by the narrow interests that are not in favor of the public interest.

More specifically, a new paradigm in the elaboration of local financial management is based on the principles of *Good Financial Governance*. Principle of management based on several important aspects as follows: *First*, the local budget should be based on the public interest; *Second*, the local budget must be managed with work better and cost less; *Third*, the local budget should be able to provide transparency and accountability in a rational way for the entire budget cycle; *Fourth*, the local budget must be managed with performance approach (*performance oriented*) for all types of expenditure and revenue; *Fifth*, the local budget should be able to foster work professionalism in every organization concerned; and *Sixth*, the local budget should be able to provide flexibility for the implementation to maximize the management of their funds on the principle of *value for money*. If the commitment of the local budget management is based on new principles in the local financial management, it can be believed that the local budget that managed annually by the local government will lead to the welfare of the people.

Political Dimension in the Local Budgeting System

Local financial management besides conducted as the provisions on relevant legislation, it also requires a political decision by the Regional Representatives Council or legislator. Political process becomes important because it has the authority to approve or reject budgeting program that is planned by the local government. Statement to reject or accept the work program of local government and budgeting by Parliament is a political decision with regard to budgeting rights are governed by the law governing the rights and obligations of parliament. Synergy of relationship of regional head and parliament become a key of budgeting politic process to answer where the direction of regional development and the budget implemented within one year budget cycle. Local budget management is conducted through the mature planning process, transparent implementation, credible oversight and accountability timely according to the carrying capacity of accountable report.

Budget Public Policy (or KUA– *Kebijakan Anggaran Umum*) signed jointly between the regional head and the head of legislator after a discussion with the team of the Local Government Budget and the Budget Committee of Parliament, it is a political decision in the first step between Regional Head and Parliament as an important point of *budgeting politic*. Local government must carry out the functions of planning budgeting with proper budgeting politic arguments and convincing in order to get the approval of parliament, why? Because budgeting politics right in the parliament, hence parliament is more dominant in establishing the regional development programs and its budgeting, and should the Parliament is strong in budgeting politics so that the aspirations of people can be realized through the budget as a function of political stability to promote economic growth, overcome disparities development and reduce unemployment in the region.[11] Parliament has strong control and budgeting function should be more dominant in deciding *budgeting politics*, so the local budget that ratified is really for the people.

Dimension of budgeting politics is the entry point in establishing regional development programs, whether in favor of the interests of the people or not. Thus, the role of Parliament as a credible regulator understands the legal policy of governance and democracy, as the breaker of the local government budget policy is needed. In the era of local autonomy, local government law has been accompanied by a new paradigm that is more focused on the development of decentralization and local autonomy in order to accelerate the realization of public welfare.[12] That is, the meaning in the 1945 Constitution of Article 18 paragraph (5): "The regional governments run the widest possible autonomy", must be within the framework of people welfare.[13] People should be the object and subject of managing the local budget, so that the orientation of regional development based planning and budgeting are set each year is for the welfare of the people.

Obviously, this paradigm is not enough to be interpreted and understood merely as a legal text. But more than that, the constitutional order to be very meaningful to see how far the political implementation of the local autonomy law has been interpreted correctly. In the financial affairs of the region, the social welfare paradigm is also an integral part, as mandated in the 1945 Constitution Article 18A paragraph (2):

> *"Financial relationship, general services, utilization of natural resources and other resources between the central government and regional administrations shall be stipulated and implemented justly and harmoniously based on the law."*

Regional regulation on the management of the local budget that is owned by each local government should really set fundamentally what the rights of people and implemented clearly in politics budgeting di the region.

Implementation of Local Budget for the People

Depart from the premise that the local budget is people-owned, must be synergized with the new paradigm of financial management as described above. For example, the local budget of Morotai Island district in North Maluku Province 2014. Morotai Island

[11] Johnny Lembong. (2011)."Pengelolaan Keuangan Daerah Yang Partisipatif Sebagai Perwujudan Prinsip Good Governance", *Jurnal Ilmu Hukum Amanna Gappa, 19*(3): 344-353

[12] See: Considerations of Act No.32 of 2004.

[13] R. Herlambang Perdana Wiratraman. (2007). "Paradigma Hukum dan Demokratisasi dalam Pengelolaan Keuangan Daerah", *Jurnal Transisi,* Volume 1, No. 1, May 2007.

District for Fiscal Year 2014 in the post of direct expenditure per village is one Billion. Thus, 86 (eighty six) village in Morotai Island get "*One Milliard, One Village*" outside funding for development priority program of Morotai Island.[14] By not intended to influence the autonomous regions in Indonesia, the of courage Regional Head of Morotai Island district to provide one village one billion should be appreciated. Therefore, long before Act 6 of 2014 concerning the village is ratified, the local government of Morotai Island has implemented populist-based budget.

The caring of Local Government of Morotai Island opens straight road for implementing the development from village to city. Local budget priority for people has implemented in Morotai Island district. This region became the new autonomous region under Act 53 of 2008, but the local government has a vision of a populist budget management. The allocation of '*One Milliard, One Village'* program distributed in order for rural economic development can be accelerated, followed by rural infrastructure development. It is intended to pursue a variety of underdevelopment and inequality of development in the village which has become one of the main problems of regional development in the era of decentralization.

The decision of budgeting politics undertaken by the government of Morotai Island district is also answered questions the local budgets for whom. We must not only build areas of downtown districts, because such development model arise disparity in the development (inter-region gap) that does not comply with the spirit of regional autonomy. Disparity in the autonomous region has led to various social inequalities and poverty that leads to economic growth becomes insignificant. Many villages are economically poor, underdeveloped and neglected, whereas in fact 85% of Indonesia's population living in rural areas. That condition if left will lead to the gap of development, causing social injustice and poverty that should not happen. People should have the right of budgeting priority in the local budget.

Political will and budgeting politics decision for regional head in the regions can play an important role in managing the implementation of local budget pro-people. Morotai Island district will be a model of the implementation of local budget for the people, *One milliard One Village* is a big vision a regional head who want to work for the people, not limited to a dream but implemented in a real work to build cities from the village for prosperous Indonesia as the purpose of state constitutional 1945. One milliard one village is a form of participatory budget that is able to respond quickly what the needs of rural communities. This should be the spirit of regional development according to the principles of *Good Financial Governance* that put community as a subject as well as object of development. Budgeting politic decision allocates *one milliard one village* already meets the expectations of the local budget pro-people and become a model of the local budget management according to the principle of democracy state.

[14] Local Regulation of Morotai Island District No. 1 of 2014 concerning the Local Budget of Morotai Island 2014.

CONCLUSION

Local autonomy is not only a format of development center to local, but a delegation of power so that the development in the region is really implemented for the welfare of the people as mandated by the 1945 Constitutional as the highest law. One important dimension of regional development is the management of local budget for the people. The local budget as a stability tool of local development should be able to address 3 (three) main points. *First*, the local budget is managed and oriented to the on growth (*pro-growth*); *Second*, the local budget is managed and should be able to open employment (*pro-job*); and *Third*, the local budget is managed and should be able to overcome poverty (*pro-poor*); *Second*, the local budget must be managed with work better and cost less; *Third*, the local budget should be able to provide transparency and accountability in a rational way for all budget cycle; *Fourth*, the local budget must be managed with performance approach (performance oriented) for all types of expenditure and revenue; *Fifth*, the local budget should be able to foster job professionalism in every organization concerned; and *Sixth*, the local budget should be able to provide flexibility for the implementation to maximize the management of their funds based on the principle of *value for money*. If the commitment of the management of local budget is based on new principles in the local financial management, it believed that the local budget is governed annually by the local government will lead to the people's welfare in the region.

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