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## The Financial Balance Policy Between Central and Local Government: Toward More Just Financial Allocation

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### Abstract

Government finance policy in Indonesia has become an issue that leads to corruption in Indonesia. Remembering that Indonesia is a unitary rather than a parliamentary country, the financial distribution must come from the center of the government, which in most cases leads to corruption since the allocation of the finance does not arrive in the hands of the local government based on the real number. It is interesting to discuss the system that governs the financial distribution from the central government to the local government, and the problems that arise within the system itself. This paper will discuss the financial distribution system from the central government to the local government, as well as the problems that arise within the system that has been used by Indonesia since its establishment. In addition, an example of a case will be discussed here to provide a deeper understanding of the readers. Therefore, a good understanding towards the idea of financial balance between central and local governments will be achieved by the readers.

**Keywords:** Financial; Government; Law.

### Introduction

Decentralization is a process in which the Regional Government carries out the widest possible autonomy with the aim of improving people's welfare, public services, and regional competitiveness. The local government has the authority to carry out all government affairs except those relating to foreign policy affairs, land, security, justice, monetary and fiscal nationals, and religion, which is the authority of the center.

In essence, the relationship between the Central Government and Regional Governments in the administration of government is regulated in Law No. 23 of 2014 on Regional Government. The regional Government has the authority

to conduct government affairs according to the principles of autonomy and co-administration with the principle of broadest autonomy within the framework of the Unitary State of the Republic of Indonesia. The principle of broadest autonomy adopted by Indonesia is reflected in the financial relationship between the Central and Regional Governments, which is key to the success of the implementation of regional household affairs.<sup>1</sup>

Autonomy is a derivative of decentralization, so an autonomous region is independent of initiative. The degree of independence and the derivation of the degree of decentralization show that the higher the degree of decentralization, the higher is the level of regional autonomy.

Finance is an important factor in a country because of its influence, which determines the complexity of the survival of a country and its people. The influence of state finances, among other things, also reflects the quality of the government's existence in carrying out its state functions. If the source of funding from state finances is getting better, then the position of the government in carrying out state organization, both in the context of carrying out government affairs and development as well as services to its citizens, will be more stable and positive in the eyes of its people. Conversely, a government faces various complicated problems in facilitating the implementation of all functions and duties of the state if it is not supported by good state financial conditions. Given that finance is vital for a country, the government will make every effort to create and utilize all available financial sources. there is. The results obtained are then used to finance expenditures on government and development activities. Most of the revenue generated from efforts to utilize all the financial potential successfully received by the Central Government is channeled and used through the sectors specified in the state revenue and expenditure budget.<sup>2</sup>

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<sup>1</sup> Martina A, and Nursadi, H 'Hubungan Keuangan Pemerintah Pusat Dan Daerah Dalam Penyelenggaraan Jaminan Kesehatan Nasional' (2019) 50 Jurnal Hukum & Pembangunan.[213].

<sup>2</sup> F. Nasution, 'Kebijakan Perimbangan Keuangan Antara Pemerintah Pusat Dan Daerah Pasca Reformasi' (2011) 3 Jurnal Hukum.[382].

In a unitary state, both centralized and decentralized, those that are given autonomous rights to regions, organs, or institutions are gifts from the central government, and the granting of these autonomous rights can be withdrawn, both the authority and laws and regulations at the regional level without having to seek prior approval from the regions. The reforms in Indonesia that occurred in 1998 required changes to the system of government in Indonesia from the central government to the local government by amending the 1945 Constitution of the Republic of Indonesia and changes to laws, one of which is the Law on Regional Government. Changes to local government laws as part of the spirit of reform have resulted in changes in the pattern of relations between the central and local governments and the pattern of local government financial management.<sup>3</sup>

In the framework of the implementation of autonomous regional and fiscal decentralization, government areas are given the discretion to manage and take advantage of sources of acceptance corresponding to local people's aspirations. Implementation of regional autonomy will bring something the logical consequence that each region must be capable of adversity himself, both in the interest economy, social development, and meeting the need for building the area as well as carrying out service improvements to the public. from the case of the Regent of Meranti and the Ministry of Finance is a problem with the central and regional financial balance policy, which is due to the non-distribution of Revenue Sharing Funds (DBH) to the Meranti area, resulting in protests from the region over the DBH. Therefore, this research discusses the following topics: How is the current financial balance policy between central and regional governments? What is the ideal concept of financial balance between central and local governments for realizing more financial allocation in the future?.

The research was carried out in the nature of normative law by paying attention to legal concerns related to the financial balance policy between central and local governments, as well as to become one of the sources for further research. This

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<sup>3</sup> F Muin, 'Otonomi Daerah Dalam Perspektif Pembagian Urusan Pemerintah – Pemerintah Daerah Dan Keuangan Daerah.' (2014) 8 Jurnal Ilmu Hukum.[71].

study analyzed ideas, legal principles, and regulations. Furthermore, this study uses a case study approach. The information was obtained from books, legal journals, newspapers, and other sources. Furthermore, legal documents are examined and categorized based on discussions and interpretations related to important ideas on issues that are emphasized and described qualitatively using deductive-inductive methods to find solutions to problems.

### **Legal Perspective on Government Financial Allocation**

The Juridical foundation between central and regional financial relations began in 1999 with the issuance of several packages of laws and regulations that followed them:

1. Law of the Republic of Indonesia Number 17 of 2003 concerning State Finance.
2. Law of the Republic of Indonesia Number 1 2004 concerning the State Treasury.
3. Law of the Republic of Indonesia Number 32 of 2004. Concerning Regional Government.
4. Law of the Republic of Indonesia Number 33 of the Financial Balance Between the Central Government and Regional Governments.
5. Law no. 15 of 2004 concerning auditing and responsibility for managing state finances.
6. Law Number 28 of 2009 Concerning Regional Taxes and Regional Levies.

The financial relationship between the central government and local governments is described as follows:

- a. The President, as the head of the government, holds the power to manage state finances, which are part of the government's power.
- b. The President hands over this power to regional heads (governors/regents/mayors) as heads of regional administrations to manage regional finances and represent regional governments in separate ownership of assets.
- c. The relationship between the center and the regions concerns the relationship between revenue management and expenditure for both routine expenditure and regional development in the context of providing quality, responsible, and accountable public services.
- d. The concept of the relationship between the center and the regions is administrative and regional relations, so the central government allocates balancing funds to regional governments in accordance with statutory regulations.

In Indonesia, decentralization followed by fiscal decentralization began with Law No. 22 of 1999 concerning Governance Region and Law No. 5 of 1999

concerning Financial Balance between the Central and Regional Governments and became Law No. 32 of 2004 concerning Regional Government and Law No. 33 of 2004 concerning Financial Balance between the Central and Regional Governments. With the implementation of this fiscal decentralization policy, the regions have rights and obligations to manage their finances according to the allocations received.<sup>4</sup>

In the explanation of Law Number 17 of 2003 regarding State Finance, the Regional Head is the manager of regional finance. To assist the Regional Head in managing regional finances, part of this power is delegated to the Finance Bureau/Department as fiscal manager and representatives of local government ownership of assets separated areas, as well as to the Head of the Unit Work/Department as the user of the budget.<sup>5</sup>

### **How is the Current Policy of Financial Balance Between Central and Regional Government?**

Histories indicate that the connection between the Center and the Regions is heavily influenced by the tug-of-war between the centralized interests of the center and the regional pressures that divert attention. The division of activities, tasks, roles, and responsibilities between the Center and the Regions demonstrates that the center cannot handle all government affairs on its own. This recognition affords the regions the opportunity to attempt to establish, control, and operate their own government. Thus, the regulation of central and regional interactions, particularly in the financial sector, is an issue that requires competent, comprehensive, and adaptable management in response to the needs of regional autonomy and development.<sup>6</sup> The Financial Relations (Balancing) Policy between the Center and the Regions, which is now being implemented by the government, is a policy aimed at enhancing the

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<sup>4</sup> Edward, 'Perimbangan Keuangan Antara Pemerintah Pusat Dengan Pemerintah Daerah Dalam Pengelolaan Keuangan Daerah' (2016) 42 Jurnal Ilmu Pemerintahan Widyapraja.[3].

<sup>5</sup> Ika Setyorini, 'Kewenangan Kebijakan Keuangan Pusat Dan Daerah Dalam Perspektif Hukum Tata Negara' (2020) 6 Syariati: Jurnal Studi Al-Qur'an dan Hukum.[1].

<sup>6</sup> I Yahya, 'Akuntabilitas Dan Transparansi Pengelolaan Keuangan Daerah' (2006) 7 Jurnal Sistem teknik Industri.[28].

regions' capacity for public service. In addition, it is an effort to establish rights and responsibilities as an independent zone to handle money that has become their duty. This strategy is implemented in accordance with the regional administration policy and in the spirit of "Money Follows Functions".

Since the beginning of the reform wave, regional autonomy has become one of the most frequently addressed central issues. In 1999, the government of Indonesia enacted Law No. 22 and Law No. 25, governing the delegation of governmental authority to regional governments and the financial balance between the central government and regional governments. Nonetheless, the process of creating regional autonomy, which has been ongoing since January 1, 2000, has encountered numerous conceptual and practical challenges. Experts, practitioners, bureaucrats, and observers who had been working on regional autonomy issues convened in 2002 for a workshop to address this issue.<sup>7</sup>

According to Aries Djaenuri, Davey's explanation of the financial connection between the center and the regions is connected to the allocation of sources of income to cover costs associated with carrying out responsibilities with the goal of achieving a potential balance while remaining within the government. The way money is allocated between the federal and regional levels of government, as well as how local funding sources are identified to support public sector operations, can be regulated by the fiscal connection between the two levels of government. To ensure a system of relations between the center and regions, four criteria must be employed as a guide:

1. The system must ensure that, in accordance with the general decentralization plan, the distribution of authority and resources between government levels is reasonable.
2. Regional implementation and development is funded by a suitable portion of the system's total financing sources.
3. The system should prioritize equalizing the delivery of some essential services throughout the areas or, at the very least, divide public money as equitably as

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<sup>7</sup> Rina Christina and Muhammad Afif Muttaqin 'Desentralisasi Dan Otonomi Daerah; Desentralisasi, Demokratisasi Dan Akuntabilitas Pemerintah Daerah' (2020) 13 Jurnal Wacana Kinerja.[1].

possible among them.

4. The taxes and levies levied by local governments are in line with the equitable allocation of the total cost of public spending.

Therefore, the allocation of money sources by central and regional governments constitutes the core of the financial relationship between centers and regions. Therefore, financial relationships in the central region should properly allocate fiscal capacity to the local governments. It is necessary to enhance regional fiscal capability and avoid widening the gap between wealthy and impoverished regions. First, the system must ensure that the distribution of power among the various levels of government is reasonable, and that the system's decentralized funding model is followed with regard to both the authority to access and use the various sources of government funding. For instance, in a system in which money follows a function, the source of revenue offered should correspond to the level of government authority, which is the area's domestic affairs. Second, for regions with a high population, limited natural resources, and an underdeveloped trade and service sector, the system must offer an adequate share of the revenue sources necessary to finance the implementation of the responsibilities for delivering community services, managing the government, and development. Third, the system must allocate federal funds to the areas as fairly as possible. Fourth, the local taxes and levies collected by local governments must be in line with a division of the total cost of living in society. Regional governments must base their local taxes and levies on the concept of the ability to pay. Fifth, the system's formula is fixed, in that neither it nor its components change frequently. Sixth, the formula for this system should be clear, understandable, and accessible so that the regions can compute their own revenue as well as any financial transfers from the federal government to the regions.

Naturally, the supply of public services in the same area of each region is also a result of this central and regional financial link. Without defined regional budgetary arrangements, the administration of government devoted to the regions is difficult to work. The transfer of fiscal authority from national authorities to autonomous regions is known as fiscal decentralization in the setting of a unitary state.

The freedom to decide on the budget and the ability to distribute resources owned by the district to pay for public services that are required by the region fall under the umbrella of fiscal autonomy. Fiscal decentralization is a method of allocating APBN monies pertinent to national fiscal policy to achieve fiscal sustainability and promote local economic activity.

Financial decentralization aims to fulfill regional aspirations to control state financial resources, encourage local government accountability and transparency, boost community involvement in regional development processes, reduce disparities between regions, guarantee the implementation of a minimum level of public services in each region, and ultimately boost welfare. The development of society as a whole can be accomplished through market systems, but it also requires the involvement of the government through budgetary measures. Further research reveals that fiscal decentralization policies are the outcomes of the government's political decisions regarding the implementation of decentralization or regional autonomy programs. If regional autonomy is not fully supported by fiscal policy through transfers to the regions for support, it is unlikely to prosper.

Regional autonomy requires substantial funding. The primary financial source provided by PAD may be used to fund investments and development. However, transfers from the federal government are also included in the regional financial component, in addition to PAD. Transfers from the center were carried out in accordance with Law No. 33 of 2004 through Balancing Funds, which are made up of Revenue Sharing Funds (DBH), General Allocation Funds (DAU), and Special Allocation Funds (DAK). These funds' objectives are to lessen vertical fiscal imbalances (between the central government and regional governments) and to help regional finance initiatives in accordance with their legal rights.

Law No. 18 of 2001 concerning special autonomy for the province of the Special Region of Aceh as the province of Nanggroe Aceh Darussalam; Law No. 39 of 2007 concerning amendments to Law No. 11 of 1995 concerning excise; Law No. 28 of 2009 concerning regional taxes and levies; Law No. 6 of 2014 concerning villages; Law No. 23 of 2014 concerning regional government; and other laws and regulations.



The passage of numerous statutes affected the creation of laws pertaining to local revenue sources. For instance, the Tobacco Excise Revenue Sharing Fund, the Special Autonomy Fund, the Privileges Fund for the Special Region of Yogyakarta, and the Village Fund as specified in Law No. 23 of 2014 concerning Regional Government all require adjustments to the regulation of regional financial resources that is included in Article 5 of Law No. 33 of 2004.

A few issues and difficulties with Law No. 28 of the 2009 regulation still need to be resolved. Although 16 different types of regional taxes have been controlled, there are only three bases that apply to all of them collectively: consumption, property, and natural resources. The arrangement of 32 different regional fees includes levies for printing KTPs and civil registry certificates, retribution for testing fire extinguishers, retribution for corpse funerals and creation, and calibration and recalibration retribution. Some of these levies are for public services that the local government is required to provide to its citizens, and if they are still collected, they could result in high economic costs.

Law No. 28 of 2009's provisions has also been examined and decided upon by the Constitutional Court (MK), which undoubtedly affects how various articles, including:

1. The MK Decision No. 52/PUU-IX/2011 about golf tax items.
2. Constitutional Court Decision No. 46/PUU-XII/2014 related to control fees for telecom towers based on the sales value of the tax object (NJOP).
3. MK Decision No. 15/PUU-XV/2017 on Heavy Equipment Motor Vehicle Tax.
4. MK Decision No. 80/PUU-XV/2017 on the levy on electricity used for street lighting.

The organization of Restaurant Tax objects has not rigorously regulated the borders between restaurants that provide food/beverage services (Restaurant Tax objects) and stores that sell only food/drinks, which is an issue in its implementation (VAT objects). resulting in misunderstandings. In addition, there are rules that call for confirmation, and hotel tax rules, which are given in the general explanation but are not listed in the body, can cause controversy.<sup>8</sup>

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<sup>8</sup> Alit Ayu Meinarsari and Harsanto Nursadi, 'Arah Baru Hubungan Keuangan Pemerintah Pusat Dan Pemerintahan Daerah: Sentralisasi Atau Desentralisasi' (2022) 7 Syntax Literate: Jurnal Ilmiah Indonesia.[10517].

After the amendment of Regulation Number 25 of 1999 regarding the Financial Balance between the Center and the Regions, but after the amendment of Regulation Number 33 of 2004 regarding the Financial Balance between the Center and the Regions, the allocation of asset adjustments shifted to the distribution of some normal assets in the area. Because of the implementation of decentralization rules enacted by the 1945 Constitution, the subject under investigation is where regional finances might grow and find sources of income that would bolster their independence. Utilizing essential literature studies, specified rules, and materials as research methods. The test consisted of tertiary legal texts and subjective standardization. With the issuance of the amended regulation on Fiscal Balance between the Center and the Regions, it demonstrates very large results for the implementation of provincial independence, given that regional supporting sources are not generally based solely on Regional Revenue (PAD) results; however, the regions also have different sources of initial funding from the regions, which were previously only enjoyed by the central government.<sup>9</sup>

The implementation of decentralization in Indonesia will move in a new direction because of the new regulation of central and regional financial relations established by Law No. 1 in 2022. Because of regional autonomy, the quality of fundamental and general government services will be enhanced and delivered more equitably to communities. Because a portion of the DBH will be awarded based on environmental maintenance performance, the quality of environmental maintenance in natural resource-producing regions has improved and can be enhanced further. Local governments immediately adjacent to natural resource-producing regions receive a portion of the Revenue Sharing Fund, which can be used to mitigate negative externalities, thereby bolstering the security of communities in proximity. In addition, regional tax policies represent the central government's resolution to bolster regional autonomy while preserving access to public services and the economic climate of the area. By bolstering regional expenditure enhancements,

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<sup>9</sup> Rizky Pratama, [et.al.] 'Kebijakan UU No 1 Tahun 2022 Mengenai Perimbangan Keuangan Antar Pusat Dan Daerah Pasca Reformasi' (2022) 6 Lex Journal: Kajian Hukum & Keadilan. [123]

APBD will be made more efficient, effective, targeted, accountable, and synergistic. Furthermore, by establishing national fiscal synergies, the community can enjoy more targeted and sustained regional development.

### **New Direction of Financial Relations between Central and Regional Governments**

The financial relationship between the central and regional governments can be interpreted as a system that regulates how the amount of funds is divided between various levels of government and how to find sources of regional empowerment to support its public sector activities. This can also be considered a system that determines how much power is delegated to each level of government.<sup>10</sup>

Law No. 1 of 2022 Concerning Financial Relations between the Central Government and Regional Government, which is a substitute for Law Number 33 of 2004, namely, the efficient and effective allocation of national resources through relationships between the finances of the central government and regional governments that are transparent, accountable, and equitable, will serve as the guiding light for the financial relationship that exists between the central government and regional governments in the years to come. This law was passed in response to concerns that Law Number 33 of 2004 did not adequately address this issue. The drafting of this law is not aimed at recentralization but an effort to strengthen accountability and harmonize policies between the center and the regions.<sup>11</sup>

This new regulation was conceived based on five fundamental principles.

1. The first pillar focuses on reducing inequality across all levels of government, including national, provincial, district, and municipal levels, as well as the horizontal disparity that exists across regional governments operating at the same level. For this reason, a number of improvements have been made to policies, particularly those related to Transfers to Regions and Village Funds (TKDD), to minimize this inequality. One of these improvements was to reformulate

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<sup>10</sup> Dudung Abdullah, 'Hubungan Pemerintah Pusat Dengan Pemerintah Daerah' (2016) 1 Jurnal Hukum Positum.[85].

<sup>11</sup> Septiana Sari Saifudin, 'Effect of Regional Own Revenue, General Allocation on Fund and Special Allocation of Fund for Capital Expenditure Budget Allocation' (2016) 12 AKUISISI Journal Akutansi.[33].

the DAU with a higher precision of measuring needs so that the DAU for each region is allocated based on the Fiscal Gap, which no longer adds to the Basic Allocation formula. This was performed so that the DAU would be distributed more evenly.

2. In addition, DAK is now more focused on national goals, which has led to the consolidation of Regular DAK into the DAU formulation. Management of Transfers to Regions, which is based on Performance, with the Government also has the Ability to Provide Fiscal Incentives for Regional Governments as an Expression of Appreciation to Regions That Have Good Performance in Providing Public Services That Meet Certain Criteria. For example, the Regional Sukuk scheme, which was previously exclusively comprised of regional loans and bonds, is now available to you. This has not been the case before. Additionally, financial synergies between several current sources of financing come in the form of APBD and non-APBD funding synergies. These include expenditure for ministries and institutions, BUMN/D funding, private money, and cooperation with other regional governments.
3. The second pillar is the development of a local tax system that supports a more efficient allocation of national resources. The development of a local tax system by promoting the effective and equitable distribution of national resources was the second pillar. Harmonization of arrangements, while continuing to provide support to the business world, reducing fees for mandatory services, which should be the responsibility of the Regional Government by rationalizing fees from 32 to 18 services, and creating a new tax base through Central Tax synergy with Regional Taxes in the form of consumption, property, and natural resources are policies that have been formulated in order to strengthen the regional taxation system. In addition, there is an opportunity for regional taxation between provinces and regencies/cities to replace the profit-sharing scheme and adjustment of authority. This comes in the form of a Motor Vehicle Tax Opportunity, a Motor Vehicle Title Transfer Fee Option, and a Non-Metal and Rock Mineral Tax. These options are available in addition to the profit-sharing scheme and the adjustment of authority. The options for some of the three types of regional taxes will not make it more difficult for the taxpayer; rather, they will divide the payment made by the taxpayer so that part of it goes directly into the provincial general cash account and general cash account for the regency or city.
4. Because regional spending is supported by people's money, both in the form of regional taxes and payments from the Central Government, the third pillar is to promote an improvement in the quality of spending in these regions. This is because regional spending is paid by people. Therefore, being able to make the greatest possible influence on the betterment of people living in the region is an absolute need. The management of performance-based TKDD and TKDD aims to enhance the quality and quantity of public services to enhance the overall quality of regional expenditures. The obligation to fulfill other mandatory expenditures in accordance with the mandate of statutory regulations is included in the regulations for regional spending that are regulated by this law. These regulations include a maximum personnel expenditure limit of 30

percent, minimum public service infrastructure spending limit of 40 percent, and maximum personnel expenditure limit of 30 percent. According to the findings of the DJPK, personnel spending accounts for the majority of APBD expenditures, with an average of 32.4 percent; in certain locations, it even reaches approximately 50 percent; in contrast, infrastructure spending accounts for only 11.5 percent of total expenditures. The expenditure on people and the investment in infrastructure are not fulfilled all at once, but rather in phases spread over a period of five years and three years, respectively.

5. The harmonization of central and regional expenditures is the fourth pillar, and its purpose is to deliver the highest possible quality of public services while preserving the viability of the public budget. The design for Transfer to Regions is outlined in the HKPD Bill. This design has the potential to serve as an anti-cyclical policy, an alignment of fiscal policies between the central and regional governments, a control of the APBD deficit, and a refocusing of the APBD under certain circumstances. In addition, there is also a need to synchronize the Standard Account Chart (BAS) to ensure that all programs, activities, and outputs are in line with one another.

An alignment of central and regional fiscal policies is required as a cooperative effort to achieve the economic growth and development targets set, and the many different kinds of programs and activities that exist in the regions can cause the regions to lose focus on what they should be doing.<sup>12</sup> This alignment is necessary to achieve the goals that have been set for economic growth and development. The number of programs and activities that took place in the regions reached 29,623 and 263,135, respectively, which is a significant number that resulted in a small allocation for each of them.<sup>13</sup>

## Conclusion

By granting the rights and obligations of regional financial management, the government, as well as giving the rights and obligations of its management to the regions, means the government consistently implements decentralization policies. The composition of the current distribution of financial balancing funds shows an increase in the distribution of regional fiscal capabilities and a reduction in fiscal

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<sup>12</sup> Gresia L Hasibuan, [et.al.] 'Allocation of COVID-19 Epidemic Funding Budgets in Indonesia' (2020) 7 International Journal of Research and Review.[78].

<sup>13</sup> Jouzar Farouq Ishak, [et.al.] 'The Financial Performance of Regional Government on Capital Expenditure' (2021) 5 Jurnal Riset Terapan Akuntansi.[13].

disparities between regions. With the application of a formula that has legitimacy and the process of calculating the Balancing Fund in a transparent and accountable manner, it can be said that the central and regional financial balance policy is currently bringing equity between regions. Improving the practice of administering this local government will bring improvements to democratic life in the regions by itself, which has an impact on improving life in Indonesian democracy. The value-for-money principle applies the principles of economy, efficiency, and effectiveness in process budgeting. The economy is related to the possession of a certain quality at the lowest price. Efficiency means that the use of public funds (public money) must produce maximum output (efficient). Furthermore, effectiveness means that the use of the budget must achieve targets or goals that concern public interest.

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