



**INDONESIA  
DEVELOPMENT  
FORUM 2018**  
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**KNOWLEDGE  
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# **Pathways to Tackle Regional Disparities ACROSS the Archipelago**

## **Sub-Theme : Smarter Funding for Better Outcomes**





# Local government spending and service delivery in Indonesia: The perverse effects of substantial fiscal resources\*

\* *Regional Studies*, vol. 51 no. 11: 1695-1707, 2017

Blane D. Lewis  
Arndt-Corden Department of Economics  
Crawford School of Public Policy  
Australian National University  
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# How does government spending affect service delivery across countries of the world?

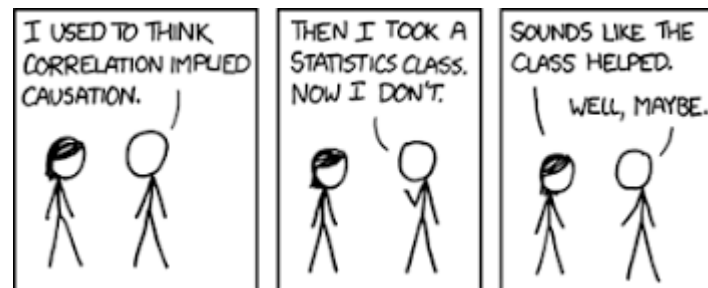
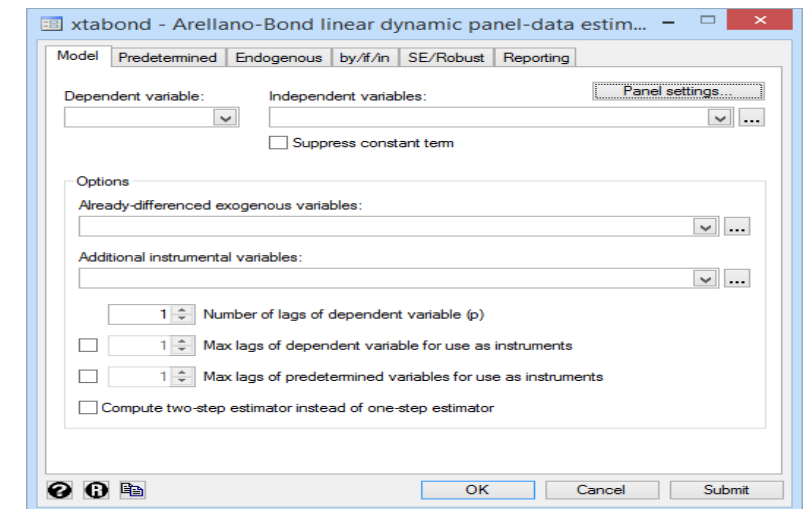
- The academic literature is unsure:
  - Spending has no impact (Hanushek, 1995; Tan, 1992 and 1998; Filmer and Pritchett, 1999)
  - Spending has positive effect (Or, 2000; Gupta et al, 2002; Jackson et al, 2015)
  - Impact of spending on services “depends” (Filmer et al, 2000; Baldacci, 2003; Rajkumar and Swaroop, 2008)



# How does local government spending affect service delivery in Indonesia?

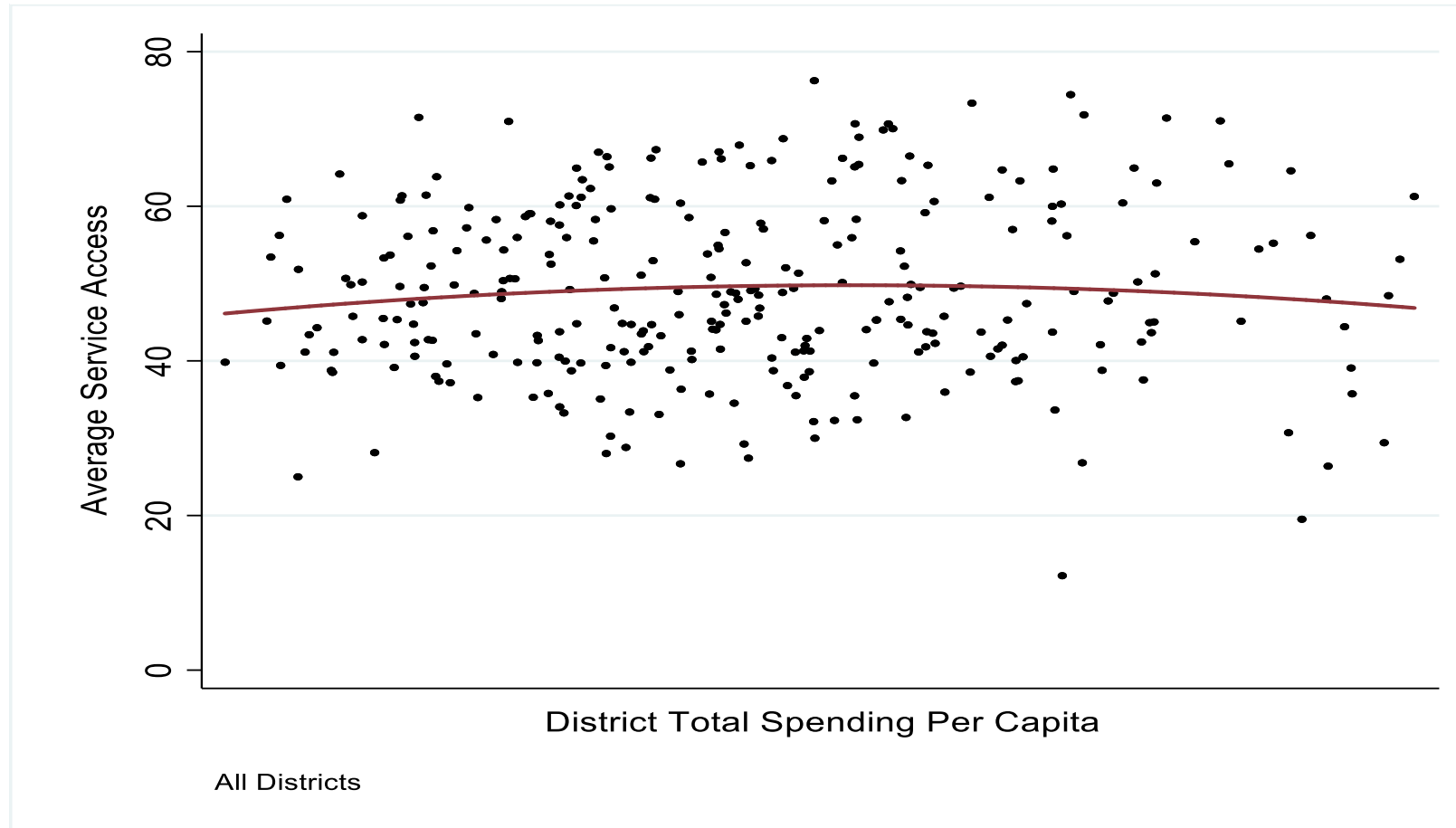
I study the impact of district spending on education, health, and infrastructure service access, 2006-2013:

- In a dynamic, fixed effects framework,
- Specifying district spending as endogenous





# For all districts taken together, spending appears to have no impact on service access



## Drilling down...

- I divide districts into two groups:
  - Districts that perform well on BPK audits (qualified and unqualified opinions)
  - Districts that do not perform well on BPK audits (adverse opinions and disclaimers)



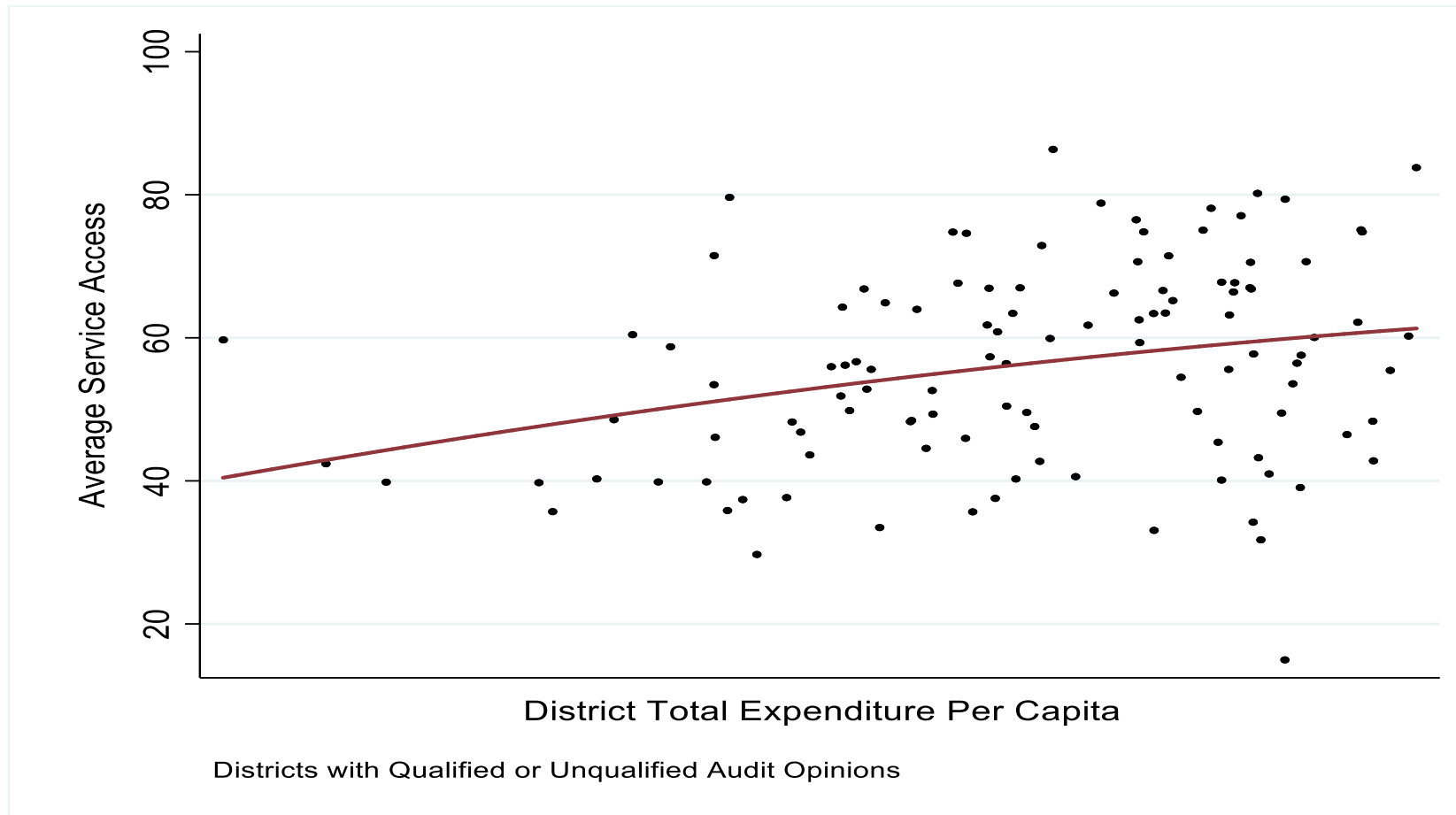
## ...Why those two groups?

- Audits broadly indicate:
  - Financial management performance
  - Waste, abuse, and fraud





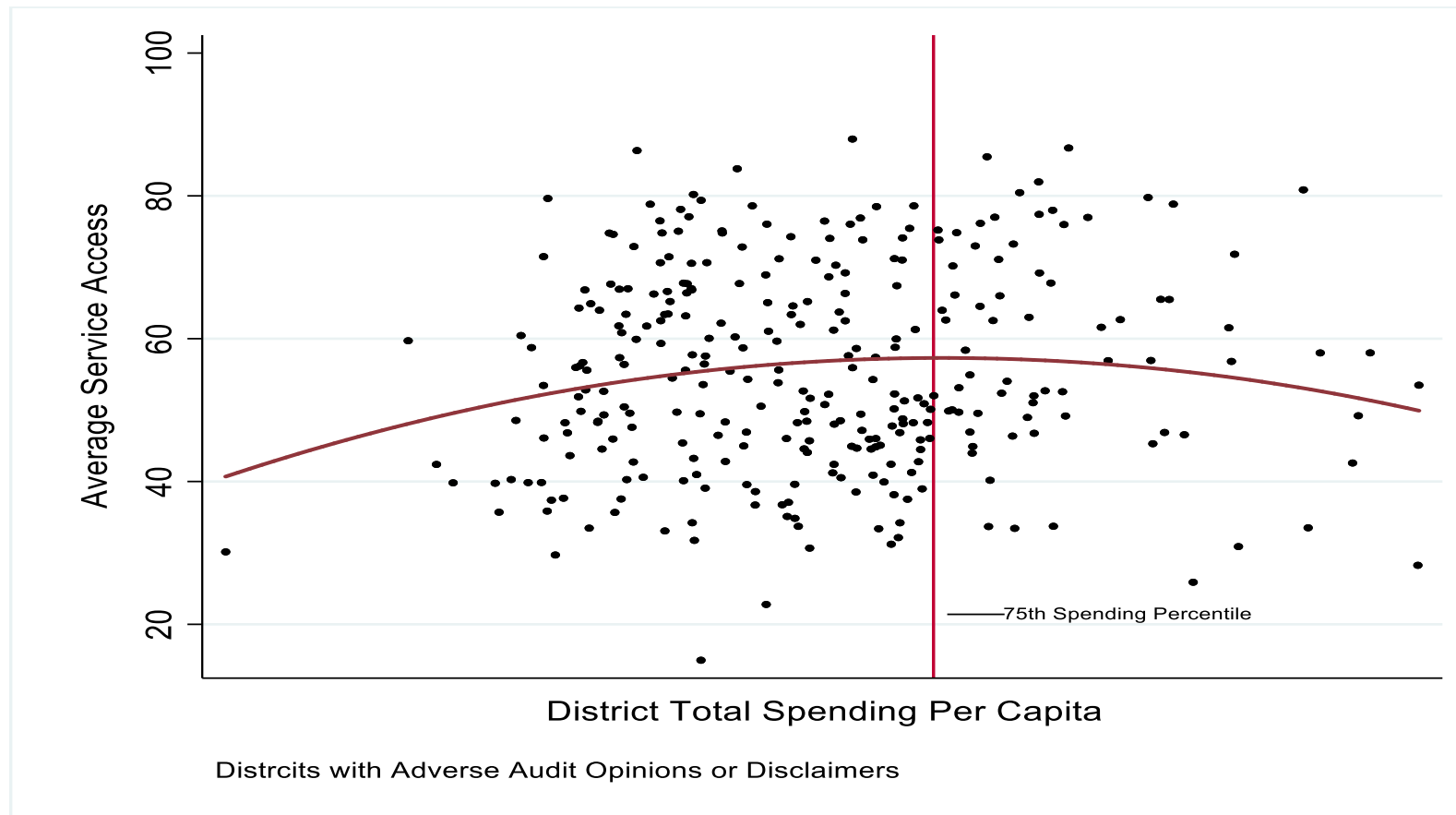
# For districts with good audit results, more spending means better service access



Cross-section illustration



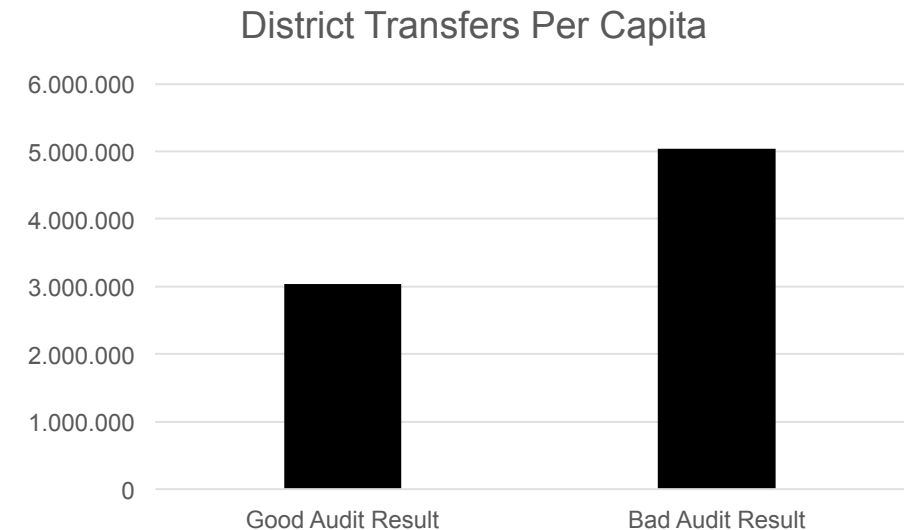
For districts with not so good audits, increased spending leads to better service access only up to a point, after which service access declines



Cross-section illustration

## What does it all mean?

- Substantial fiscal resources allocated to districts with weak financial management capacity and/or who are corrupt lead to perverse service access results
- Government gives “too much money” to those districts





# Who are these “perverse relationship” districts? (1)

## Provincial Location of "Perverse Relationship" Districts

Aceh	Riau	Jawa Tengah	Sulawesi Tengah	Papua Barat
Aceh	Riau	Jawa Timur	Sulawesi Tengah	Papua Barat
Aceh	Riau	Nusa Tenggara Barat	Sulawesi Tengah	Papua Barat
Aceh	Sumatera Selatan	Nusa Tenggara Timur	Sulawesi Selatan	Papua Barat
Aceh	Sumatera Selatan	Nusa Tenggara Timur	Sulawesi Selatan	Papua Barat
Aceh	Sumatera Selatan	Nusa Tenggara Timur	Sulawesi Selatan	Papua Barat
Aceh	Sumatera Selatan	Nusa Tenggara Timur	Sulawesi Tenggara	Papua Barat
Aceh	Bengkulu	Kalimantan Barat	Sulawesi Tenggara	Papua Barat
Aceh	Bengkulu	Kalimantan Barat	Sulawesi Tenggara	Papua
Aceh	Bengkulu	Kalimantan Tengah	Sulawesi Tenggara	Papua
Aceh	Bengkulu	Kalimantan Selatan	Sulawesi Tenggara	Papua
Aceh	Bengkulu	Kalimantan Selatan	Gorontalo	Papua
Aceh	Bengkulu	Kalimantan Selatan	Gorontalo	Papua
Sumatera Utara	Lampung	Kalimantan Timur	Sulawesi Barat	Papua
Sumatera Utara	Lampung	Kalimantan Timur	Sulawesi Barat	Papua
Sumatera Utara	Kepulauan Bangka Belitung	Kalimantan Timur	Maluku	Papua
Sumatera Utara	Kepulauan Bangka Belitung	Kalimantan Timur	Maluku	Papua
Sumatera Utara	Kepulauan Bangka Belitung	Kalimantan Timur	Maluku	Papua
Sumatera Utara	Kepulauan Bangka Belitung	Kalimantan Timur	Maluku	Papua
Sumatera Barat	Kepulauan Riau	Kalimantan Timur	Maluku	Papua
Sumatera Barat	Kepulauan Riau	Kalimantan Timur	Maluku Utara	Papua
Sumatera Barat	Kepulauan Riau	Kalimantan Timur	Maluku Utara	Papua
Sumatera Barat	Kepulauan Riau	Kalimantan Timur	Maluku Utara	Papua
Sumatera Barat	Kepulauan Riau	Kalimantan Timur	Maluku Utara	Papua
Sumatera Barat	Jawa Barat	Sulawesi Utara	Maluku Utara	
Sumatera Barat	Jawa Barat	Sulawesi Utara	Maluku Utara	
Sumatera Barat	Jawa Barat	Sulawesi Utara	Maluku Utara	
		Sulawesi Utara		
		Sulawesi Utara		

## Who are these “perverse relationship” districts? (2)

- Districts that are rich in natural resource revenues
- Districts with large land areas and small populations



## How to fix the problem

- Reform the DAU allocation formula:
  - Estimate district expenditure needs based on a per capita norm (instead of a district norm)

$$FiscalNeeds_i = \frac{TRE}{TotalPop} \cdot Pop_i \cdot \left( \beta_1 \frac{Area_i}{AvgArea} + \beta_2 \frac{HDI_i}{AvgHDI} + \beta_3 + \frac{IKK_i}{AvgIKK} \right)$$

- More fully equalize fiscal needs and fiscal capacities with respect to natural resource revenues

$$FiscalCapacity_i = \delta_1 PAD_1 + \delta_2 DBH \quad \delta_2=1$$

## Sounds easy but...

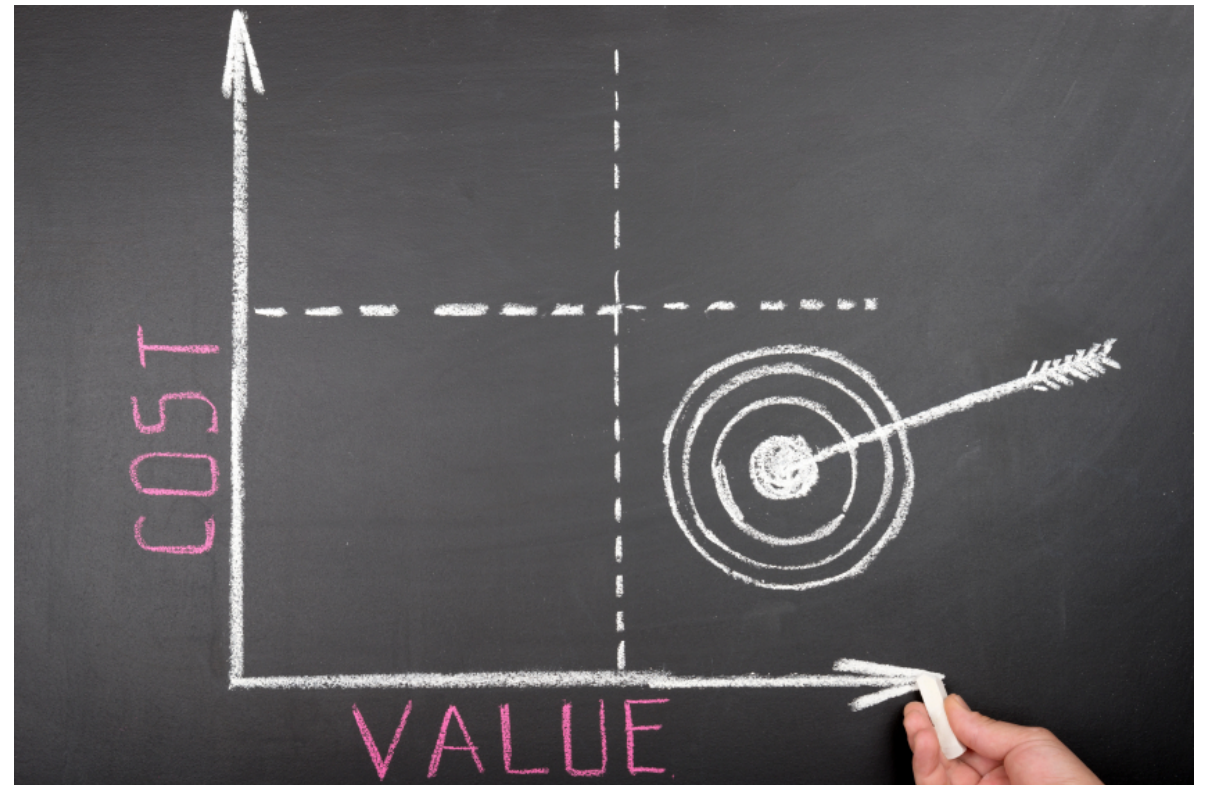
- Reforming the DAU in this manner would give more money to:
  - Districts on Java
  - Large urbanized districts
- Yikes!
- But that is what should happen.





# Ultimately the decision involves a trade-off between:

- The politics of fiscal resource allocation and
- Value for money



## What to watch for:

- Revisions to Law 33/2004 to be considered by DPR in 2019 (probably)





## New law will provide an answer to the question:

- Does Indonesia want better service delivery for its citizens, as the President insists should happen, or will politics rule the day?



“We need to remind all parties that we want to fix the existing service systems. Don’t let any obstacles get in the way”



Thanks for Your Attention!