

LINK OF FISCAL DECENTRALIZATION TO POVERTY REDUCTION: INDONESIAN CONTEXT

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Abstrak: Kaitan antara Desentralisasi Fiskal dengan Penurunan Kemiskinan: Kasus Indonesia. Sesuai dengan kajian literatur, terdapat keterkaitan antara desentralisasi fiskal dengan penurunan kemiskinan. Namun, pola keterkaitan tersebut berbeda antara satu negara dengan negara lain maupun antarberbagai pemerintah daerah. Studi ini merupakan studi awal yang bertujuan mengamati pola keterkaitan antara desentralisasi fiskal dengan penurunan kemiskinan di provinsi-provinsi di Indonesia pada periode sebelum dan setelah pelaksanaan desentralisasi fiskal. Hasil studi yang dilakukan secara deskriptif ini menunjukkan bahwa tidak ada pola keterkaitan yang jelas antara desentralisasi fiskal dan penurunan kemiskinan di Indonesia. Tiga pola keterkaitan, yaitu keterkaitan secara positif, negatif, maupun tidak ada keterkaitan antara desentralisasi fiskal dan penurunan kemiskinan tampak berbeda-beda di provinsi-provinsi yang diamati di Indonesia. Elaborasi yang lebih mendalam di tingkat provinsi menggunakan variabel yang lebih bervariasi diperlukan untuk melihat keterkaitan yang lebih jelas antara desentralisasi fiskal dengan penurunan kemiskinan di Indonesia.

Kata kunci: Penurunan Kemiskinan, Desentralisasi Fiskal

Abstract: Link of Fiscal Decentralization to Poverty Reduction: Indonesian Context.

It is identified from the literature studies that there are links between fiscal decentralization and poverty reduction. However, the links occurs in different ways among countries and local governments. This is a preliminary study which aims at observing the potential link pattern of fiscal decentralization to poverty reduction in Indonesian provinces before and in the period of fiscal decentralization implementation. This descriptive study shows that there is no clear link pattern of fiscal decentralization to poverty reduction in Indonesian context. Three links patterns, namely positive link, negative link, and no link appears differently among provinces. Elaboration at the level of each province using various variables is needed in order to see the clearer link of fiscal decentralization to poverty reduction in Indonesian context.

Keywords: Poverty Reduction, Fiscal Decentralization

INTRODUCTION

Since 1980, the needs to shift fiscal responsibility from the national towards sub-national government have increased in various parts of the world. Many developed countries as well as developing countries have embarked upon fiscal decentralization. Tanzi (2002) stated that such countries like

Canada, China, Colombia, Indonesia, Italy, and Spain have pursued the fiscal decentralization to increase the role and independence of its sub-national governments. In the implementation, fiscal decentralization appears to have influenced several aspects of governance in each country.

Decentralization in general as well as fiscal decentralization in particular has been a popular topic of discussion with regards to development policy. It is considered to result in positive and negative impacts on development. Decentralization has been widely linked to certain variables *inter alia* corruption (Arikan, 2004; Shah, 2006; Bardhan & Mookherjee, 2005), public service delivery (Ahmad, et.al., 2005; Singh, 2008), and economic growth (Martinez-Vasquez & McNab, 2005; Faridi, 2011). Recently, decentralization is still an interesting topic of discussion because of its perceived relationship to poverty reduction.

Some international studies conducted in selected developing countries establish that the relationship between decentralization and poverty reduction resulted in a relatively ambiguous link. Jütting, et.al. (2004:7) found that the impact of decentralization on poverty is not straightforward. It is generally considered that the usefulness of decentralization as a tool for poverty reduction varies distinctly between poor countries on the one side and emerging economies on the other side. Other studies have also highlighted that the essence of decentralization occurs in particular contexts instead of generally. It means that "it may take many different forms in different countries at different times" (Bird & Rodriguez, 1999:299).

Indonesia is a developing country which started its decentralization program in 1999. Two main reasons why Indonesia embarked on fiscal decentralization were the economic

crisis of 1997 and the separatism threats arising from some regions of the country. Concerning the first reason, the economic crisis had increased poverty in Indonesia. Fiscal decentralization was meant to give local governments wider discretions in allocating their budgets for the poverty reduction strategy. Based on policy paper presented by the Ministry of Home Affairs Republic of Indonesia on Pre CGI (Consultative Group on Indonesia) Meeting in Jakarta (2001), the first year experience of Indonesia in implementing fiscal decentralization has changed the patterns of budgetary allocations for poverty reduction.

Concerning the second reason, Indonesia also experienced separatism threats from its regions. Some regions, especially resource-rich regions, felt unsatisfied with the central government's economic policy. Therefore, decentralization in Indonesia which gives local government greater autonomy to manage their resources was expected to reduce separatism.

Poverty has been one of serious problems in Indonesia. Nevertheless, the government has made positive progress in dealing with it. The poverty trend in Indonesia, as depicted in Figure 1, experienced declining trend since 1976 until prior to the economic crisis of 1996. It had declined from 40.1 percent to 11.34 percent.¹ Unfortunately, the economic crisis in 1997 made the percentage of poverty in Indonesia to rise and reach its peak level of 23.4 percent in 1999. Two years later, Indonesia has formally embarked in the

¹ Due to revision method in poverty counting, the percentage of poverty in 1996 was changed from 11.34 percent into 17.6 percent (World Bank, 2006:7)

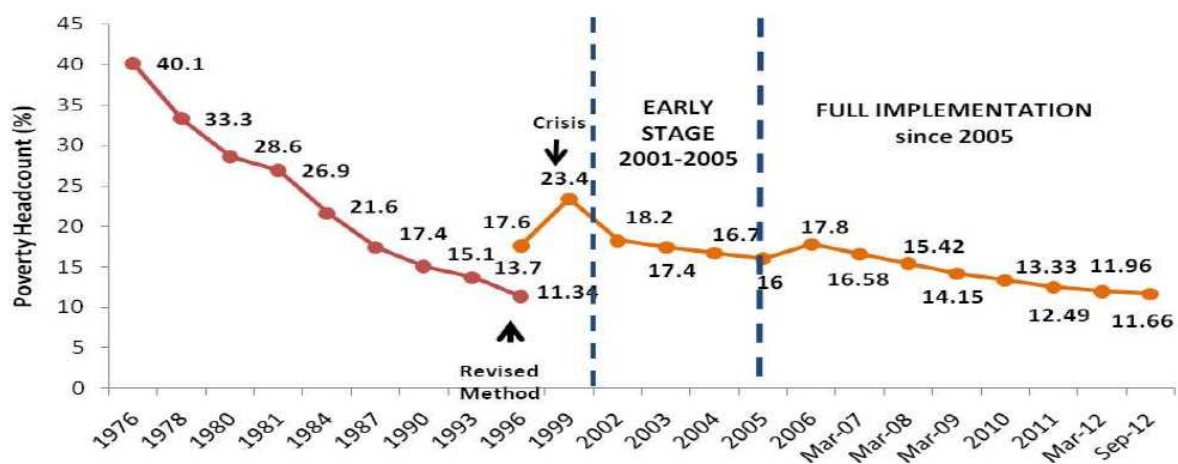


Figure 1. Poverty Trend in Indonesia, 1976-2012
 (Source: The World Bank, 2006:iv; BPS, various years (processed))

fiscal decentralization. In this process, Miranti, R., et.al. (2013) mentioned the period of 2001-2005 as early stage and since 2005 as full implementation of fiscal decentralization. Since 2003, the poverty levels were back to the level before the crisis which was 17.4 percent. This number kept decreasing until 2005 and tended to increase again in 2006 because of the increase in rice prices (World Bank, 2006:v). In the last years, the poverty level kept decreasing gradually.

Since 1 January 2001, Indonesia has officially implemented fiscal decentralization. Serious challenge still remains for development policy in Indonesia, especially in line with the achievement of Millennium Development goal in 2015. It is also a challenge whether fiscal decentralization has successfully contributed to the poverty reduction or not. This study focuses on finding the potential link pattern of fiscal decentralization to poverty reduction in Indonesian context. It takes Indonesia as a case study since it has been the most decentralized nation after being under centralized regime for almost 30

years. This study is also focused on fiscal decentralization because it is assumed that through fiscal decentralization local government can have more opportunity to use their financial resources for more pro poor programs.

The debate on the impact of decentralization on the welfare and economic development has been continuing. However, decentralization purely for reducing poverty is still very rare (UN ECOSOC, 2005: summary page; Steiner, 2005:6; Kaiser, 2006:315). Kaiser argued that in implementing decentralization, countries often based on several political factors such as democratization, state legitimacy, and center versus sub-national power relation. It was also argued by Boex, et.al. (2006:1) that: “poverty reduction and economic development in developing countries and transition countries have traditionally been approached exclusively as a central government challenge.”

In regard with fiscal decentralization, comprehensive analysis on its impact to poverty reduction is still very limited (Boex, et.al., 2006:6; Spulveda & Martinez-Vasquez,

2010: 2). Theoretical literatures on public finance do not give clear fundamental rationales on the linkage. However, it is widely accepted that fiscal decentralization can bring benefits to poverty reduction. Literatures which explore the linkage mainly consist of individual journals, international organization reports, and empirical studies in particular context. The results show positive and negative correlation (Jütting, et.al., 2004:14).

Rondinelli (1980:137) has defined decentralization as a transfer of legal and political authority in managing public resources from a central government to its sub-national governments. Further, he classified decentralization into three dimensions, namely administrative decentralization, political decentralization, and fiscal decentralization. In particular, fiscal decentralization can simply be defined as "how and in what way expenditures and revenues are organized between and across different levels of government in the national polity" UNDP (2005:2). Under fiscal decentralization, local governments have higher authority to manage their revenue and spend the money for current and investment expenditures (Von Braun & Grote, 2000:3).

The rationale of decentralization can be seen from practical points of view as well as from theoretical point of view. From the practical understanding, governments decided to decentralize in various ways. The decision can be a top down decision (such as in Russia, Spain, Estonia), a bottom up decision (such as in Tanzania, Thailand, Bulgaria), or both directions decision (such as in Mexico, India, Indonesia) (Bahl & Martinez-Vasquez, 2006:6).

From the theoretical point of view, several scholars such as Musgrave and Oates have argued about the theoretical rationale for decentralization using the theory of fiscal federalism. Fiscal federalism theory highlights that what should remain as central government's functions are stabilization and distribution functions, while allocation function is given to local government (Bird, 1999:151). The rationale for assigning the responsibility for local goods supply to the local level was given by Wallace Oates (1972) in his Decentralization Theorem. According to him, decentralization is better to be implemented when citizen preferences are heterogeneous and inter jurisdictional spillovers do not exist. When such conditions are not met, central government will be better to provide public good and services so that the benefits of public service provision will not only reached by certain district or region but also the other districts and regions within a country (Wallace Oates, 1972 in Bardhan, 2002:190).

In his later essay, Oates added that problems of imperfect information and limited central governments' capacity can be considered for implementing decentralization. Local governments which are closer to the citizen of their respective jurisdiction have better knowledge on the local preferences and cost of local public service provision. In addition, central governments have limited capacity to provide certain citizen's preferences in certain jurisdictions (Oates, 1999:1123).

Concerning revenue assigning, most local governments' revenues come from local taxes and user charges. Nevertheless, local governments likely end up with greater expenditure responsibilities than their revenue

capabilities. Therefore, fiscal federalism theory also recognized the importance of inter-governmental grants which are needed to close the revenue gap across different governments' levels (Bird, 1999:151).

With regard to poverty reduction, based on both practical and theoretical points of view which, it can be concluded that poverty reduction has not been the main aim for fiscal decentralization. However, fiscal decentralization is assumed to have link and channels for poverty reduction.

Boex, et.al. (2006:3) pointed out that the definition of poverty has evolved. In the very basic sense, poverty has been defined as the lack of condition to fulfill people's basic needs. This definition has evolved covering a wider humanity concept such as capabilities, dignity, autonomy, vulnerability, voice, empowerment, and participation. In "Voices of the Poor", Narayan, et.al. (2000:31) gave an explanation about six areas covering poverty, namely: material well-being, psychological aspect, basic infrastructure, illness, schooling, and assets.

In line with the achievement of millennium development goals, specific definition and measurement of poverty has been developed for comparing poverty in the world. The World Bank uses "US \$1 a day" as an international common standard to define what poverty means in the World's poorest countries.² Poverty in a country then is estimated by converting the US \$1 a day poverty line to local currency using the latest Purchasing Power Parity (PPP) exchange reductions for

consumption taken from World Bank estimates.

Recent study from Ahmed (2013) discussed multiple and more complex channels of poverty reduction through fiscal decentralization as can be seen in Figure 2. The simple version of framework has been previously discussed in Spulveda & Martinez-Vazquez (2010:11). Ahmed explained that fiscal decentralization system basically runs under the combination of four elements, i.e. expenditure decentralization, revenue decentralization, intergovernmental fiscal transfers and borrowing authority. Each of them brings its own impact on poverty directly and indirectly through other factors. Through the channels, fiscal decentralization is expected to have positive impact on poverty reduction, improved efficiency, and better public services for the poor such as health, education, water and sanitation, local infrastructure, agriculture, irrigation and rural development. In addition, poverty is indirectly influenced by other socioeconomic factors including macroeconomic stability, social, political system of the country, market arrangement, institutional setting, democratization and demographic configuration. Within the political economy framework, fiscal decentralization is expected can increase the participation of the poor, promotes the culture of accountability and governance, and enhances the chance of the selection of pro-poor investments.

² The latest World Bank's poverty measurement is elaborated in Chen & Ravallion (2008).

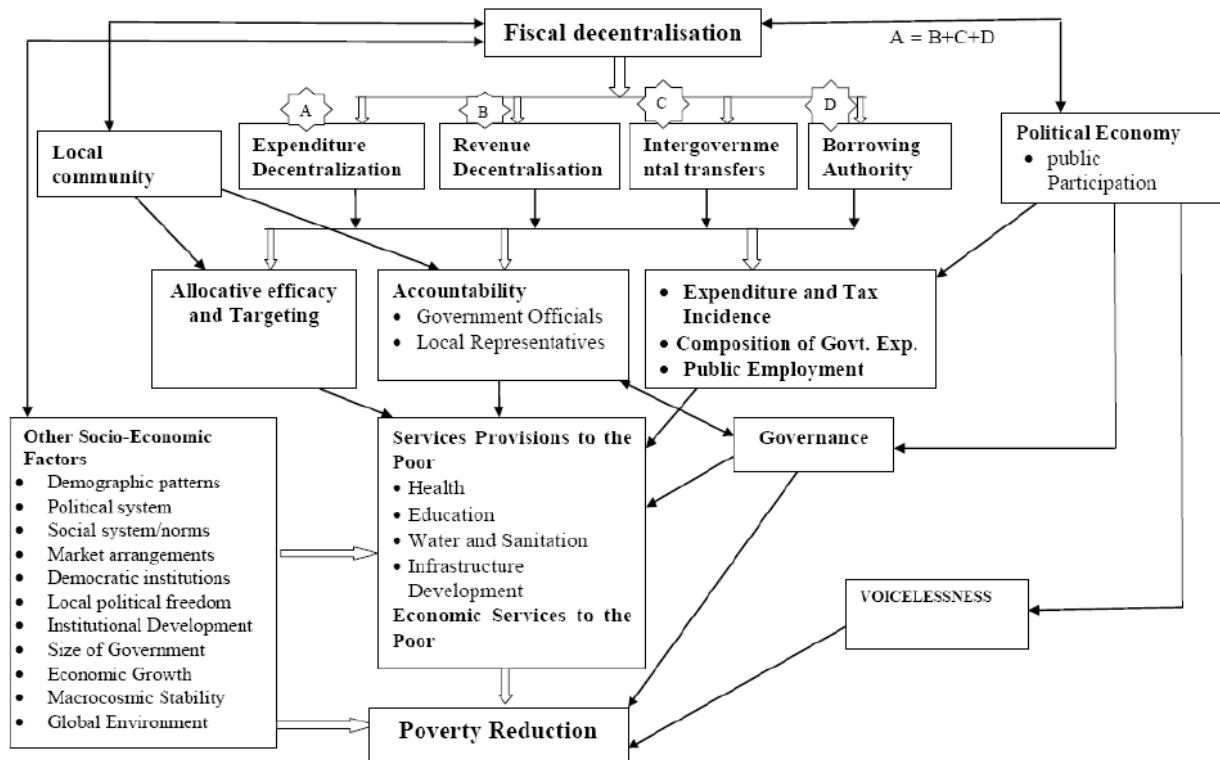


Figure 2. The Links between Fiscal Decentralization and Poverty Reduction (Source: Ahmed, 2013:37)

Put simply, fiscal decentralization can be channeled to poverty reduction through the assigning of expenditure responsibility and revenue raising power to local governments. As also summarized in the finding of Bird, et.al. (1995): “Spending and revenue decisions need to be more decentralized to ensure that the poverty alleviation policies adopted reflect the preferences, needs, and fiscal abilities of different regions of the country. The nature of that decentralization depends on the country.”

The patterns on the links between fiscal decentralization and poverty reduction were found in the literature study Jütting, et.al. (2004:14). Firstly, positive link (fiscal decentralization contributes to poverty reduction). Somewhat positive link was also found in the case of Ghana (Von Braun & Grote, 2000). Secondly, negative link (fiscal decentraliza-

tion does not contribute to poverty reduction). It was found in the case of China when the correlation between fiscal decentralization and provincial growth was evaluated in 1995s (Zhang & Zou, 1996). Nevertheless, it is assumed that there is also no link between fiscal decentralization and poverty reduction. Poverty can reduce without any influence from fiscal decentralization.

METHODS

This study follows the framework of thinking from Eckardt (2008). He measured the impact of decentralization reforms on local governments’ performance and public service delivery in Indonesia. Referring to that study, the hypothesis that spending levels and structure of expenditures have impacts on the performance of local govern

Table 1. Operational Definition of Link Pattern of Fiscal Decentralization to Poverty Rate

Link Pattern	Proxy of Fiscal Decentralization Variables						Poverty Rate
	Education Expenditure/ Total Expenditure			Health Expenditure/ Total Expenditure			
Positive		↑		↑			↓
Somewhat Positive	↓	or	↑	↑	or	↓	↓
Negative		↑		↑			↑
Somewhat Negative	↓	or	↑	↑	or	↓	↑
No Link		↓		↓			↑ or ↓

Source: Operational definitions are developed from various sources

ments is connected to the performance of local government in conducting poverty reduction strategies.

This study applies a descriptive analysis as a method of analysis. Due to data limitation, the analysis in this study is applied to 26 provinces in Indonesia. Further, the average ratio of government budget expenditure on relevant sector to total expenditure before fiscal decentralization (1996-2000) and in the period of fiscal decentralization (2001-2009) is analyzed in line with the average percentage rate of poverty. As widely known, the fiscal decentralization in Indonesia was designed to strengthen the local government expenditure capacity. Therefore, the variable of fiscal decentralization in this study is represented by local government expenditure capacity, specifically local government expenditure on education and on health. On the other side, poverty reduction is measured by the rate of poverty. This analysis uses secondary data from Indonesian Statistics Bureau (Badan Pusat Statistik-BPS), Ministry of Finance Republic of Indonesia (Direktorat

Jenderal Perimbangan Keuangan-DJPK), and other relevant sources.

In the data analysis, firstly, the proxy of fiscal decentralization is determined. Fiscal decentralization is represented by budget allocation on the sectors which are suggested can influence the poverty reduction. In many literatures, two sectors which considered particularly relevant to poverty reduction are education and health sectors (Von Braun & Grote, 2000:19; Dethier, 2004:9). In order to see the contribution of fiscal decentralization to poverty reduction in Indonesia, this study analyzes the trend of provincial government expenditure on the education and health sectors. Following the study of Eckardt (2008: 10), the higher level of expenditure in health and in education sectors is expected to increase performance in reducing the rate of poverty in Indonesia. Secondly, the trend of poverty rate in Indonesia is explored. Thirdly, the average percentage of poverty number is compared to the average ratio of expenditure on education sector and on health sector to total local governments' expenditure. It is expected that the relationships between

the provincial government expenditure on both sectors and the movement of rate of poverty will result in positive link that is the increasing of provincial government expenditure on both sectors is accompanied by the reducing number in rate of poverty. In detail, the operational definition of link pattern of fiscal decentralization to poverty rate in this study is presented in Table 1.

Simple analysis on average ratio of education expenditure to total expenditure of Indonesian provinces shows that there is a slightly decreasing number of it before fiscal decentralization (1996-2000) and in the period of fiscal decentralization (2000-2009). The number is decreasing from 8.7 percent to 6.5 percent. The result of Paired Sample Test also shows that the difference of its average ratio is statistically significant. The signifi-

Table 2. Result of Paired Samples Test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	EduTot96_00 - EduTot01_09	.0216462	.0201489	.0039515	.0135078	.0297845	5.478	25	.000
Pair 2	HealthTot96_00 - HealthTot01_09	-.0482385	.0317058	.0062180	-.0610447	-.0354322	-7.758	25	.000
Pair 3	Pov96_00 - Pov01_09	1.1660038	4.0647938	.7971716	-.4758019	2.8078096	1.463	25	.156

RESULT AND ANALYSIS

The analysis on the difference between average ratio of education expenditure to total governments’ expenditure and average ratio of health expenditure to total governments’ expenditure as a proxy of fiscal decentralization and the condition of average rate of poverty will be discussed in this part. The analysis is carried out by comparing the condition before and in the period of fiscal decentralization era using a statistical test (Paired Sample Test) as presented in Table 2.

It is interesting to discover that in general, the local governments of Indonesia experienced a decrease in their ratio of the education expenditure to total expenditure before and in the period of fiscal decentralization. However, at the same time, they experienced an increase in their ratio of health expenditure to total expenditure.

cance level is 0.000. The decreasing number of average ratio of education expenditure to total expenditure before and in the period of decentralization era is thought to occur because in the local government expenditure for education sector, the proportion of expenditure for personnel is bigger than the proportion of expenditure for education service.

On the other side, there is an increasing number of average ratio of health expenditure to total governments’ expenditure between the two periods, that is increasing from 4.3 percent to 9.1 percent. The result of Paired Sample Test shows that the difference of its average ratio is statistically significant. The significance level is 0.000. As understood, since the implementation of fiscal decentralization, there were few provinces that increase their health expenditure to support the program of health insurance in their area.

Table 3. Link Pattern of Fiscal Decentralization and Poverty Rate in Indonesian Context

Provinces	Average Ratio of EduExp/TotExp		Average Ratio of HealthExp/TotExp		Average Percentage of Poverty Rate	
	96-00	01-09	96-00	01-09	96-00	01-09
Aceh	0.1666	0.1596	0.0478	0.0706	18.4567	27.3213
Sumatra Utara	0.0445	0.036	0.0427	0.0884	13.57	13.8325
Sumatra Barat	0.0868	0.0586	0.0324	0.1378	11.1433	11.5188
Riau	0.1517	0.0605	0.0427	0.0736	10.7733	11.5125
Jambi	0.1082	0.0892	0.0403	0.0751	18.95	12.055
Sumatra Selatan	0.1001	0.0556	0.0191	0.057	17.2067	19.0225
Bengkulu	0.052	0.0277	0.0281	0.1088	15.6633	21.4613
Lampung	0.0956	0.0685	0.0281	0.112	23.3967	22.48
DKI Jakarta	0.0983	0.0759	0.0587	0.0872	3.81	3.7875
Jawa Barat	0.1101	0.0842	0.0499	0.0464	15.02	13.0363
Jawa Tengah	0.0821	0.0788	0.0704	0.1357	21.1767	20.6963
Yogyakarta	0.1091	0.1006	0.0571	0.0706	23.3033	19.8163
Jawa Timur	0.0843	0.1012	0.0475	0.0914	21.35	19.995
Bali	0.0835	0.069	0.0548	0.0589	6.1667	6.6225
Nusa Tenggara Barat	0.064	0.0307	0.0358	0.1067	26.2333	25.555
Nusa Tenggara Timur	0.0668	0.0397	0.0449	0.1778	34.6067	28.0875
Kalimantan Barat	0.0891	0.0908	0.0435	0.0945	25.8567	14.0213
Kalimantan Tengah	0.08	0.061	0.0352	0.0905	12.7567	9.9613
Kalimantan Selatan	0.0838	0.059	0.0562	0.1207	13.91	7.7563
Kalimantan Timur	0.1133	0.0658	0.0442	0.085	15.2333	11.3488
Sulawesi Utara	0.0682	0.0693	0.0269	0.0594	13.94	10.7075
Sulawesi Tengah	0.0541	0.0257	0.0307	0.1204	20.46	22.5913
Sulawesi Selatan	0.0534	0.0414	0.046	0.074	13.9267	14.61
Sulawesi Tenggara	0.061	0.029	0.0287	0.0581	20.6233	22.105
Maluku	0.069	0.0471	0.0226	0.0709	33.47	31.7125
Papua	0.0814	0.0693	0.0735	0.0905	40.4233	39.4963
Average	0.0868	0.0652	0.0426	0.0908	18.9010	17.7350

(Sources: BPS, various years; DJPK, various years)

*Pairs of cell with number in red colour show one of three conditions: an increasing average education expenditure/total expenditure or an increasing average health expenditure/total expenditure or a decreasing average poverty rate.

Simple analysis on average percentage of poverty rate of Indonesian provinces shows that there is a slightly decreasing number of it before fiscal decentralization (1996-2000) and in the period of fiscal decentralization (2000-2009), that is decreasing from 18.9 percent to 17.35 percent. However, the result of Paired Samples Test shows that the difference of average poverty rate between

the two periods is not statistically significant. The significance level is 0,156. This condition is thought to occur due to the portion of expenditure on personnel and routine expenditure of local government that are still high. The analysis of Ministry of Finance (DJPK, 2010 & 2013) for the Local Governments' Budget (APBD) 2007-2013 mentioned that the portion of expenditure on personnel to

APBD is still approximately 45 - 60 percent. This condition might bring implication for the minimum allocation of direct expenditure for poverty reduction.

pattern of fiscal decentralization and poverty reduction in one province appears differently to the others. The link pattern of fiscal decentralization and poverty reduction in each

Table 4. Results of Link Pattern of Fiscal Decentralization and Poverty Rate in Indonesia Provinces

Link Pattern	Proxy of Fiscal Decentralization Variables		Poverty Rate	Provinces
	Education Expenditure/ Total Expenditure	Health Expenditure/ Total Expenditure		
Positive	↑	↑	↓	Jawa Timur, Kalimantan Barat Sulawesi Utara
Somewhat Positive	↓ or ↑	↑ or ↓	↓	Jambi, Lampung, DKI Jakarta, Jawa Tengah, Yogyakarta, Nusa Tenggara Barat, Nusa Tenggara Timur, Kalimantan Tengah, Kalimantan Selatan, Kalimantan Timur, Maluku, and Papua
Negative	↑	↑	↑	-
Somewhat Negative	↓ or ↑	↑ or ↓	↑	Aceh, Sumatera Utara, Sumatera Barat, Riau, Sumatera Selatan, Bengkulu, Bali, Sulawesi Tengah, Sulawesi Selatan, Sulawesi Tenggara
No Link	↓	↓	↑ or ↓	Jawa Barat

In order to simply understand the potential pattern link of fiscal decentralization to poverty reduction, the condition of average ratio of education expenditure to total expenditure, average ratio of health expenditure to total expenditure, and average poverty rate are depicted in Table 3.

It can be observed that in general, there is no clear pattern link of fiscal decentralization to poverty rate in Indonesian provinces. This condition is in line with previous research that was conducted by Jütting, et.al. (2004:7). As mentioned before, he found that the impact of decentralization on poverty is not straightforward.

In detail, as found by Bird & Rodriguez (1999:299), the link of fiscal decentralization to poverty reduction may occur in particular contexts instead of generally. This also occurs in the case of Indonesia (Table 4). The link

province in Indonesia consist of 3 link pattern, namely positive link, negative link, as well as no link.

In this context, a province is said to have a positive link when the increase in average ratio of education expenditure to total expenditure and the average ratio of health expenditure to total expenditure is accompanied by the increase in the average rate of poverty. There are only three provinces in Indonesia which have such link, i.e. Jawa Timur, Kalimantan Barat, and Sulawesi Utara. The others have somewhat positive link (Jambi, Lampung, DKI Jakarta, Jawa Tengah, Yogyakarta, Nusa Tenggara Barat, Nusa Tenggara Timur, Kalimantan Tengah, Kalimantan Selatan, Kalimantan Timur, Maluku, and Papua).

On the other side, a province is said to have negative link when the increase in average ratio of education expenditure to total expenditure and the average ratio of health expenditure to total expenditure is accompanied by the decrease in the rate of poverty. Somewhat negative link tends to occur in Aceh, Sumatera Utara, Sumatera Barat, Riau, Sumatera Selatan, Bengkulu, Bali, Sulawesi Tengah, Sulawesi Selatan, Sulawesi Tenggara. In the case of no link pattern, there is also one province in Indonesia which experienced it. Jawa Barat seems have no link since the decrease in average number of poverty rate occurs at the same time with the decrease in average ratio of education expenditure to total expenditure and the average ratio of health expenditure to total expenditure.

It is interesting to investigate why such situation tends to occur in Indonesia. There are several factors which can influence. It can be investigated from the system level, the organizational level, and individual level. Firstly, the "by default" system of fiscal decentralization in Indonesia has influenced the performance of government in conducting its basic responsibilities in the early years of decentralization implementation. The fulfillment of local governments' responsibilities based on fiscal federalism theory has not yet met due to institutional preparation. The poverty reduction was not the main aim of fiscal decentralization in Indonesia. The formulation of poverty reduction strategy has not yet related to pro-poor budgeting.

Secondly, in the organization level, the implementation of fiscal decentralization has not yet well-managed. It is assumed that the

proportion of budget still tends to be allocated on organizational necessities such as personnel expenses, maintenance expenses, etc. This will influence the budget allocation for pro-poor programs. Moreover, the decision making process in the sub-national government in Indonesia still not based on appropriate monitoring and evaluation system in planning and budgeting.

Thirdly, in the individual level, many personnel in sub-national governments in Indonesia are still lacking capacity in the financial management and budget allocation. The parliament's members who approve the budget also still lacking capacity in the budget allocation and put poverty reduction effort as a budget priority. This will influence the implementation of poverty reduction strategy. Therefore, although in theory, through fiscal decentralization, the governments become closer to the citizen to fulfill citizens' need. Nevertheless, the citizen still could not reach the potential benefit of basic needs, including some poverty alleviation programs.

CONCLUSION

In this study, the potential link between fiscal decentralization and poverty reduction is applied to the case of provincial governments in Indonesia. Based on the framework of thinking that the expenditure levels and structure of expenditure as part of fiscal decentralization has impacts on the government's performance, this study applies the expenditure on public health sector and on education sector as the potential link between fiscal decentralization and poverty reduction in the case of Indonesia.

This study shows that there is a slightly decreasing number of average percentage of

poverty rate of Indonesian provinces before fiscal decentralization and in the period of fiscal decentralization. However, based on the Paired Sample Test, the difference of average percentage of poverty rate of Indonesian provinces in those periods is not statistically significant. This condition is thought to occur because the allocation of direct expenditure for poverty reduction is still minimal.

Simple data analysis is also conducted to see the relationship between fiscal decentralization and poverty reduction. The average ratio of expenditure on public health sector and expenditure on education sector before fiscal decentralization and in the period of fiscal decentralization are compared to the average percentage of poverty number in those two periods as well. It is found that in general there is still no clear pattern on the links between fiscal decentralization and poverty reduction in Indonesia.

Among all provinces in Indonesia that includes in this study, the reducing in the average rate of poverty which is accompanied by the increasing in the average percentage of expenditure on public health sector or on education sector tends to occur only in the case of Jawa Timur, Kalimantan Barat, and Sulawesi Utara. The link in one province and in one sector is occurred with different way in other provinces and in other sectors. In other words, it is occurred only in case by case.

In general, this is a preliminary study based on literatures review and simple data analysis. More comprehensive analysis using several variables and field survey would enrich the finding and the elaboration on such case. It is considered that there are still limitations and weaknesses in this study. Firstly, this study is conducted only based on simple

data analysis. More statistical analysis is needed. Secondly, due to data accessibility, the data analysis only covers a few years. Sufficient time series data and recent data on development expenditures which are broke down until the level of public health sector and education sector is not yet obtained.

In the future, this study needs further elaboration since the increase of spending on expenditure and health are not enough to reduce poverty. In addition, the effectiveness of the spending also depends on the target. For example, in the education sector, the allocation of spending on the primary education is assumed to have different impact on poverty reduction than the allocation of spending on the higher education. Therefore, the role of expenditure on education and health to reduce poverty should be carefully assessed in order to see its impact on different levels.

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