

**Redirecting Specific Grants for Specific Purposes:
The Indonesian Policy Agenda on DAK Schemes for Financing Minimum
Service Standards and Local Initiatives on Greenhouse Gas Reductions**

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1. Background: The DAK and Fiscal Decentralization Policy in Indonesia

In accordance to the implementation of fiscal decentralization policy in Indonesia, there have been three major instruments of development finance effective since 2001: the DBH (*Dana Bagi Hasil*, the Revenue-Sharing Funds), the DAU (*Dana Alokasi Umum*, the General Allocation Funds), and the DAK (*Dana Alokasi Khusus*, the Specific Allocation Funds). Although the DAK has been relatively small in terms of amount and proportion, it remains an important financial instrument under decentralized governance in the country. The DAK funding has been evolved in terms of the funds being allocated, the number of recipients in the regions, and the coverage of activities being financed. During the last decade the DAK funding, there is an increasing tendency in all these three variables.

As described in following Table, the amount of money transferred to the sub-national governments under the schemes of DAK has increased from only Rp 2.26 trillion in 2003 to Rp 25.23 trillion in 2011. Except for the 2010 budget, the amount of DAK funds has been steadily increased. The data also shows that the average funds being transferred to sub-national governments through DAK has increased from Rp 6 billion in 2003 to Rp 41 billion for provinces and to Rp 49 billion for kabupaten/kota in 2011.

The increasing amount of DAK can also be understood from the increasing number of administrative jurisdictions that are covered by the financial scheme. At present, nearly all the provinces and kabupaten/kota received DAK funds. For the provincial level, the Jakarta Special Region is the only exception. For the kabupaten/kota level, aside from five municipalities and one kabupaten in Jakarta, only Samarinda and Tarakan (East Kalimantan province) and kabupaten Tanjung Jabung Barat (Jambi province) that do not receive DAK funds in 2011.

In terms of proportion, the DAK funds remains low at about 10 percent compared to the other types of intergovernmental transfers. In 2012, while the DAU is budgeted at Rp 269.52 trillion, the DAK is budgeted only at Rp 26.12 trillion,. Nevertheless, the DAK constitutes an important element of fiscal decentralization in Indonesia as it is still considered as the strategic part of action plan in the Grand Design of Fiscal Decentralization until 2015. Also, the DAK is proven to be very important source of development finance in regencies where much of the public funds have been absorbed for personnel wage-bill. In the newly created kabupaten Tolikara of the Papua province, for example, the DAK constituted 26 percent of the total genuine revenues (*Pendapatan Asli Daerah, PAD*). In kabupaten Sabu Raijua of the East Nusatenggara province, the DAK constituted 15 percent of the total genuine revenues. An average of 54.5 percent of the kabupaten/kota governments have the budgets where the DAK proportion is greater than the local genuine revenues. The DAK funds are essential for financing local infrastructure and facilities. It is because, by design, the DAK funds are specifically targeted for “physical” projects at the sub-national levels.

Table 1. The DAK Allotment 2003-2011

Comparison Elements	2003	2004	2005	2006	2007	2008	2009	2010	2011
Provinces									
Area coverage	24	0	2	0	0	25	29	32	32
Total number of provinces	30	33	33	33	33	33	33	33	33
Percent coverage	80	0	6	0	0	76	88	97	97
Allotment (Rp billion)	143	0	20	0	0	763	1,360	829	1,305
Allotment average	6	0	10	0	0	31	47	26	41
Kabupaten / Kota									
Area coverage	330	353	377	434	434	451	477	486	488
Total number of kabupaten / kota	440	440	440	440	465	465	497	497	497
Percent coverage	75	80	86	99	93	97	96	98	98
Allotment (Rp billion)	2,126	2,533	3,994	11,560	17,094	20,440	23,459	20,304	23,927
Allotment average (Rp billion)	6	7	11	27	39	45	49	42	49
Total allotment (Rp billion)	2,269	2,533	4,014	11,560	17,094	21,202	24,820	21,133	25,233

Source: www.tkp2e-dak.org

It is perturbing, therefore, that the DAK characteristics for financing specific purposes is currently in the wane as the development areas to be financed by the DAK is continually expanding. In 2003 there were only five areas of development financed by the DAK, namely: education, health, roads, irrigation, and local government facilities. In the next five years, six more areas were included: marine and fishery, agriculture, drinking water, environment, family planning, and forestry. In 2009 and 2010 three more areas were included: rural infrastructure, trade, and sanitation. Then, in 2011 five more areas were included: rural electricity, rural transport, infrastructure for boundary regions, housing-settlement, and land transport safety. Overall, the DAK funds have been expanded to cover 19 areas of local development.

This paper is aimed at evaluating the past performance of DAK financing in Indonesia and arguing the importance of redirecting the DAK for specific purposes. Conceptual arguments are to be explained to bring the specific grants back to the specific development objectives in the regions. The paper offers objective and balanced assessment on DAK as one of the critical elements of fiscal decentralization policy in Indonesia. Finally, it offers a policy agenda to refocus the DAK finance into two essential areas in the future: the public service quality improvement and the local initiatives to reduce green-house gas emissions.

2. Theoretical Review on Specific Grants

Decentralization policy is not only a matter of delegating authorities and functions from the central government to sub-national governments, but also a matter of giving out appropriate financial resources to the lower level of governments. And strategies for transferring funds are not only about accounting or other technical matters, but it should be geared to sound and viable objectives. In general, the transfer of funds from national government to sub-national governments can be categorized into three types, namely: the deficit grants, the unit cost grants, and the capitalization grants. The deficit grants usually refer to a mechanism where the central government subsidizes sub-national governments according to the volume of deficit among the sub-national governments, the unit-cost grants refer to subsidies according to the unit-cost of services at the sub-national levels, while the capitalization grants refer to subsidies that are focused more on medium and long term development programs.

The objective of deficit grants is basically to cover local government deficits. The danger of having deficit grants is that it can create a moral hazard where the local governments could blame their weakness and irresponsibility on the central government. The deficit grants may weaken efforts for obtaining local revenues and efficient use of resources (Devas, 2003). The unit-cost grants are given based on the cost of delivering public services. For example, the government might come to a term of Rp 1 million per kilometer of road maintenance or Rp 50,000 or daily scholarship for one student in a primary school. It may be easy to make these assumptions but the reality in public services for each locality might need more complex costing. The capitalization or project grants are allocated to push capital investment by the local governments. Transfers can take a form of financial lending to the local government for certain investments. But it requires long-term visions on the part of sub-national governments, which might be difficult given their capacity limitations.

It appears that since the implementation of fiscal decentralization policy, most of the grants in Indonesia can be considered as deficit grants. The main objective is basically to cover the budget deficit of provincial and kabupaten/kota governments. There have been initiatives to move towards unit-cost grants, but aside from technical difficulties there have been obstacles for administering unit-cost grants as stakeholders usually find it hard to come to an agreement on costing. There are efforts to link the grants with the Minimum Service Standard (Standar Pelayanan Minimum) in the last five years but its full implementation is still at an early stage. In line with the path of capitalization grants, there is a call for creating the MTEF (Medium Term Expenditure Frameworks) to the local budget. Yet, unless a very strong and decisive move is taken by authorities, not much progress would be made towards the idea of capitalization grants.

Transfers are typically from the national or central government to the provincial and local governments, and are aimed at addressing problems of vertical as well as horizontal financial imbalances. In general, the international literatures distinguish two kinds of transfers or grants: 1) general/block/unconditional grants, and 2) specific/conditional/ earmarked grants. The general grants are the most commonly adopted by countries that are decentralizing financial matters (Bahl and Linn, 1992). The grants are given without any conditions for its allocations so that sub-national governments have all the discretionary power to use the funds. Experts say that general grant is the best instrument for improving local economy in general based on the argument that local governments know the best what is good for their populace (Shah, 1994; Wuryanto, 1996).

The contending argument against general or block grant is centered on the issue of local government accountability to the local people. When the local

governments' accountability is weak, it would be difficult to ensure that the programs financed by the grants are directly linked to the local needs. Under a block grant scheme, the central government would not be able to control and supervise development programs while there is no incentive for the local populace to hold local governments accountable because the funds are not from the local taxes paid by them.

On the other hand, specific grant is given to sub-national governments with certain conditions for financing certain areas or certain projects that are considered to be strategic or important by the central government. The use of the funds is predetermined by the central government so that there is limited discretion on the part of local governments. Specific grant has its disadvantages as there are inherent potentials for priority conflicts between the central and local governments. Inefficiency and inflexibility are among the issues frequently raised in various schemes of specific grant.

However, specific grant would be very useful in a political setting where local governments' accountability is weak and the national government has certain development priorities that can only be achieved under intensive intergovernmental cooperation. By determining the programs and projects to be financed by a specific grant, the central government would ostensibly be able to control the programs' performance and to impose its accountability even when the source of funds is not from the local people. Moreover, a specific grant would be able to overcome the negative impact of local financing called "inter-jurisdictional spillover effects" (Broadway et al, 2011). When a local government is taxing or subsidizing certain area of services, there always possibilities that such policy would influence the neighboring government as normally local people as the tax payers would react in support or against the policy by comparing that of the neighboring governments.

DAK can be theoretically referred to the internationally called specific grant or conditional grant. Law No.25/1999 on Local Government Systems, which was then revised by Law No.33/2004, stated that the objective of allocating the DAK is to finance the "national priority" programs. When it was firstly implemented 2001 by the Indonesian government, the DAK schemes only covered six programs: education, health, roads, irrigation, and local government facilities. One might concludes that these were the national priorities at that time. Nevertheless, the definition of "national priority" has changed over time. The Government Regulation (Peraturan Pemerintah) No.25/2005 on Fiscal Balance (Dana Perimbangan) defined that the DAK is allocated for financing the local functions (*urusan daerah*) that is relevant to the national priorities. Then, inconsistencies and unclear definition of the DAK objectives persisted in various regulations.¹ As described and will be explained further, unclear policy orientation on this specific grants has caused inefficiencies, overlapped funding, and poor performance of public financial management in the country.

3. What Worked and Did Not Work in the DAK Scheme

Local development programs that have been financed through the DAK seemed to be able to respond the needs of local populace. The good thing about DAK is that the scheme has a relatively better linkage to tangible outputs of the local government. This is an important feature because, immediately after decentralization, many of the local leaders did not seem to have a strong commitment and enough capacity to plan and to carry out development programs

¹ For a rigorous analysis on inconsistencies of the DAK objectives, see Anonymous, DAK Whitepaper, Bappenas-GIZ-UNDP, 2011, pp. 7-20.

² The report highlights the mechanisms and practices of DAK allotment and how the funds were

and public services that are badly needed by the people. Having been accustomed with a centralistic and authoritarian system in more than three decades of the New Order government, it is not easy for local leaders and bureaucrats to take their own initiative for local development, to carry out programs and to control its performance, and to be responsive to the local populace. When DAU as block grants were allocated to the regions, many of the officials did not know what to do with the funds and how it should be used for the betterment of the local people. Instead, most of the DAU funds were used only for personnel salaries and allowance, supporting administrative activities and other irrelevant costs. Data from the Directorate General of Fiscal Balance, Ministry of Finance, showed that the proportion of local expenditure on personnel has been steadily increasing from 38.29% in 2007 to 46.16% in 2011. In contrast, the local capital spending has been decreasing from 30.87% to 23.14% in the same period (Harjoprawiro, 2011).

Therefore, the DAK allocation in some kabupaten/kota has in fact been able to offset the unproductive tendency of the DAU financing. It has helped to ensure that primary school buildings are maintained, new roads are built and renovated, *Puskesmas* (Community Health Clinics) services are developed, and other locally initiated projects are undertaken. In many of the newly created kabupaten/kota, while the DAU funds were absorbed only for bureaucratic purposes, the DAK funds could help in financing programs that are directly linked to the local needs. A survey from Banda Aceh, Wonogiri, Gorontalo and Kupang reported by the SMERU shows that amid its weaknesses and complexity in allocation, the DAK funds has been able to address problems of infrastructure in the regions (Syaikhu, et al, 2008).² As explained earlier, the DAK has assisted the local governments in coping with the budgetary constraints due to limited genuine local revenues.

Nevertheless, there are inconsistencies and loopholes with regards to the DAK budget planning, allocation mechanisms, monitoring and evaluations, and its accountability. Law No.33/2004 and its ancillary framework of regulations do not show consistency and coherence in terms of the DAK ultimate objectives, purposes, and the accountability mechanisms. There is a tension between the requirement for the DAK scheme to be responsive to the national priority and the need to be focused on specific purpose of the localities.

The planning for DAK funding has not been integrated into the standardized mechanisms of *Musrenbangda* (Regional Development Planning Forum) and *Musrenbangnas* (National Development Planning Forum). Law No.17/2003 on the state finance and Law No.25/2004 on national development planning systems stated that the annual RKP (*Rencana Kerja Pemerintah*, Government Work-plans) must determines all the activities to be funded through the DAK. However, PP No.55/2005 only requires that the RKP should lay out the main DAK programs with its indicators while the activities are to be determined in the inter-ministerial forum involving the Bappenas, MoF and other line ministries. The detailed activities in the RKP creates inflexibilities in DAK budgeting since everything is locked in by the MoF as the only central government agency determining public budgets. The formula to allocate DAK itself is too complicated as it has 50 to 100 variables (ADB, 2011), which makes the DAK funding unpredictable and, in terms of amount, it has a wide range of variety among the local governments.

In determining the projects to be financed through DAK, the role of the sub-national governments is limited. Most of the governors are not involved in the planning process and sometimes do not even aware that certain DAK projects are

² The report highlights the mechanisms and practices of DAK allotment and how the funds were used by local governments. See Usman, S. et al, *Mekanisme dan Penggunaan Dana Alokasi Khusus*, SMERU, 2008.

being undertaken in their jurisdictions. There is PP No.19/2010 with a main provision of strengthening the role of provincial governors in development planning and coordination among sub-national governments. It remains to be seen, however, whether this provision will have a significant impact on the DAK planning in the regions. Given their strategic roles at the sub-national levels, it is also disappointing that the Bappeda (Regional Development Planning Boards) at the provincial and the kabupaten/kota levels are not involved in most of the DAK planning process.

As required in the PP No.55/2005, local governments have to provide a 10% of the DAK fund before any project can be approved, which makes the DAK is essentially a matching specific grant. Also, as the DAK project proposal must be in line with the national priority that is guided by the line ministries, the plans and disbursement procedures have to be in accordance with the Juklak (Petunjuk Pelaksanaan, Managing Manual) and Juknis (Petunjuk Teknis, Technical Manual) that are set up by the line ministries. Unfortunately, the Juklak and Juknis usually come late and it is difficult to predict when the DAK fund can be disbursed. Therefore, the local governments have to cope with complexities and uncertainties as they plan the DAK projects in their local budgets.

A closer analysis on the performance of DAK funding can be traced from a Granger causality test as described in Table 2. This test is basically used to determine whether the DAK programs have influenced development outcomes, such as Human Development Index, Schooling Period Average, etc., or in fact the development outcomes variables are those that influenced the variation of DAK allotment in the regions.

Table 2. Granger Causality Test for the DAK Performance on Education and Health

No.	Causality Direction	F	P Value	Conclusions
1	DAK Education – HDI	4.09 *	0.0028	Accept H1
2	HDI – DAK Education	0.60	0.6629	Reject H1
3	DAK Education – SPA	11.84 *	0.0000	Accept H1
4	SPA – DAK Education	4.26 *	0.0000	Accept H1
5	DAK Education – LR	0.57	0.6848	Reject H1
6	LR – DAK Education	0.93	0.4482	Reject H1
7	DAK Health – HDI	4.66 *	0.0011	Accept H1
8	HDI – DAK Health	4.29 *	0.0020	Accept H1
9	DAK Health – LE	2.34 *	0.0500	Accept H1
10	LE – DAK Health	1.02	0.3960	Reject H1

Notes:

DAK : *Dana Alokasi Khusus* (Specific Allocation Funds)

HDI : Human Development Index

SPA : Schooling Period Average

LR : Literacy Rate

LE : Life Expectancy

Source: DAK Whitepaper, 2011

It appears from Table 2 that while the DAK for education has a causal link with the variable of HDI although there is no vice versa. The DAK for education has a causal link with the SPA and also the vice versa (both F test for No.3 and No.4 are significant). The DAK for education does not have causal link with the literacy rate and the vice versa (both F test for No.5 and No.6 are insignificant). The DAK for

health has a causal link with the variable of HDI and the vice versa (both F test for No.7 and No.8 are significant). The DAK for health has a casual link with Life Expectancy although there is no vice versa (F test for No.9 is significant but for No.10 is insignificant). It can be concluded that most of one-way relation among the DAK programs to development indicators at the local level is generally significant.

Table 3. Estimates of DAK Influence on Development Performance

Independent Var.	Dependent Var.	Coefficient	R-Square	t	P-Value	n-Prob
DAK Agriculture	Economic Growth	.0000212	0.6557	0.136	0.176	492
DAK Irrigation	Economic Growth	-.0000305	0.4436	-0.390	0.698	690
DAK Road	Economic Growth	-3.5e-06	0.3261	-0.230	0.819	1220
DAK Health	Economic Growth	-2.19e-06	0.2864	-0.380	0.702	1110
DAK Environment	Economic Growth	.0002363	0.8249	1.280	0.200	666
DAK Education	Economic Growth	.0000212	0.3553	0.152	0.128	1160
DAK Sanitation	Economic Growth	-8.88e-07	0.3334	-0.010	0.991	832
Log DAK Health	Human Devt. Index	.9842207	0.7654	4.550	0.000	1332
Log DAK Health	Life Expectancy	5.811507	0.2272	0.410	0.682	1330
Log DAK Environment	Life Expectancy	-.5680732	0.7712	-0.970	0.334	888
Log DAK Education	Schooling Period Average	-.0220796	0.9691	-0.390	0.700	1392
Log DAK Education	Literacy Rate	-.2547758	0.8112	-0.400	0.686	1392
Log DAK Education	Human Devt. Index	-.4437785	0.7375	-1.000	0.317	1392

Source: DAK Whitepaper, 2011

A model of panel data regression using a Least Square Dummy Variables technique is shown in Table 3. Along with the Granger causality test, the HDI, the growth of Regional Gross Domestic Product (RGDP), life expectancy, SPA and literacy rate are treated as dependent variables. It appears that only the DAK for agriculture, environment and education that show positive influence towards the economic growth. On the contrary, against expectation, there is no positive influence in DAK for irrigation, roads, health, and sanitation towards economic growth. Some even show negative influence.

It can be concluded, therefore, that the positive influence of DAK allotment towards regional economic growth is not convincing. Even after dummy variables are incorporated, the DAK influences on development indicators remain insignificant. Again, this analysis substantiates an argument that the DAK allotment is not significant compared to that of other intergovernmental transfers. More importantly, the DAK is no longer characterized as a specific grant that is aimed at addressing

specific development issues in the regions. Further simulation model with an increased DAK allotment (Whitepaper, 2011) shows that the weak influence of DAK to local development indicators is not because of its relatively small amount. Instead, it is because the DAK allotment is not specifically targeted to appropriate priorities at the local jurisdictions.

4. DAK for Minimum Service Standards (MSS) of Public Services

As indicated earlier, this paper would argue that it is important to redirect the DAK for specific purposes. Not only that this policy would be in line with theoretical assumptions on specific grants, it would also strengthen the effectiveness of the inter-governmental transfers. Among the strategic areas for such kind of policy redirection is to link the DAK for sectoral Minimum Service Standard (MSS) at the sub-national levels. After decentralization, many areas of public services have been delegated to provincial and kabupaten/kota governments. As the standard for public services is not clear, however, the quality of services is not improved or even deteriorated.

The Indonesian government is currently in the process of revising Law 33/2004 on Fiscal Balance between the Central and Local Government. According to the plan, the government will submit the draft of law revision to the parliament for further deliberation in 2012. One of the key changes proposed in the latest draft is on the use of DAK. Article No.42 in the latest draft of the law revision stated that DAK would be designed for three purposes:

- To finance Minimum Service Standards (MSS) in three priority sectors: education, health, and infrastructure (road, bridge, sanitation, irrigation and drinking water).
- To finance national priorities.
- To finance specific policies as specified in the laws and regulations.

If the above policy is fully incorporated in the revision of Law 33/2004 and the policy of refocusing the DAK is consistently implemented, there is a strong optimism among the experts that this would substantially change the DAK orientation toward specific purposes in the sub-national governments. Unfortunately, there is limited study on the DAK, especially on how it should be redirected towards basic services in the sub-national levels. The two latest studies on DAK are mostly focus on the review of DAK implementation (ADB, 2011; Bappenas, 2012) rather than what should be ideally financed through DAK schemes. The Bappenas study (2012) suggests two fundamental changes to make DAK more effective: 1) to shift from the input based approach to performance based approach with orientation to the outputs and outcomes of development targets, and 2) to adopt a mid-term planning perspective with the RPJMN (*Rencana Pembangunan Jangka Menengah Nasional*, National Medium-Term Development Planning).

On the other hand, studies related to the financing aspect of MSS are mostly focused on costing, planning and budgeting for the implementation of MSS at the regions. ADB has been assisting the Ministry of Education in conducting a survey to determine the costs of achieving MSS in the Education sector with samples in 60 districts/cities (ADB, 2010). The German GIZ assisted the Ministry of Health to conduct a cost estimation study for the implementation of MSS in Health sector with a sample in 30 districts/cities (GIZ, 2010). Meanwhile the Decentralization Support Facility (DSF) of the World Bank tried to develop an e-costing concept, for financial planning purpose of MSS implementation in selected districts / cities in six provinces (DSF, 2011). It is important that the Indonesian government conduct

a study to analyze the relations between the DAK funding to the achievement of MSS in strategic sectors such as education, health and infrastructure.

Insofar, the government agencies have formulated 15 MSS, ranging from sectors of education, health, public works, environment, and transports. However, it can be seen from these MSS that the formulation and the level of standards are not similar from one to the other. For example, the standards in health sector MSS are mostly using output indicators while the standards in education sector are mostly using the input indicators (see Table 4). It has to be analyzed whether this level of formulation will create problem for the implementation of DAK later on.

Table 4. MSS in Various Sectors

Area of Services	Examples	Input/Process/Output	Outcomes
Primary education	Availability of syllabus (<i>Satuan Pendidikan</i>) in the primary schools (SD and MI).	All the SD and MI have to be built within a walking distance or having 3 km maximum distance from the residential areas.	Schooling Participation Rate (<i>Angka Partisipasi Sekolah, APS</i>)
	Academic qualifications of the teachers in secondary schools (SMP / MTs).	70% of the teachers have university degree or D4 certificates.	To be identified
Basic Health	Pregnant women visit to gynecologists, 2015.	95% of pregnant women visit at least 4 times in the health clinics or gynecologists.	Mortality rate of mother giving births.
Kabupaten / kota Roads	The roads connecting activity centers in the districts, 2014.	100% of roads facility connecting activity centers in the districts.	To be identified
	Road constructions for safe travelling, 2014.	The provision of quality roads that ensure 60% of safety travelling.	To be identified

Source: Excerpts from the Sectoral MSS.

In order to ensure that the DAK would achieve its objectives in relations to the MSS, a clear design of mechanisms is required in: (i) the allocation phase, (ii) the implementation phase, and (iii) the monitoring and evaluation phase. At present, the Directorate General of Fiscal Balance in the Ministry of Finance has to work together with agencies in the Bappenas, Ministry of Home Affairs, Ministry of Education, Ministry of Health, Ministry of Public Works and relevant members of parliament before DAK for the MSS can be fully implemented in the next fiscal year. Among the issues to be addressed is related to the general design of DAK for financing MSS at the sub-national levels. The policy design is expected to address the fundamental challenge that the level of MSS in each concerned sector varies considerably. The principles to guide the selection of local governments to be eligible for DAK on MSS have to be stated clearly.

One of the issues for DAK, as regulated under PP 25/2005, is the requirement that the fund is only appropriated for physical (or tangible) projects. This can be a hindrance to make a direct link between the DAK and the MSS as many of the MSS indicators have non-physical features. The more challenging in policy implementation is how to measure the actual level of MSS achievement, how to come up with concrete gap assessment, and how to assess local government proposals that are acquiring DAK funding. Then, precise procedures, roles and responsibilities in the Ministry of Finance must be clarified in detail and

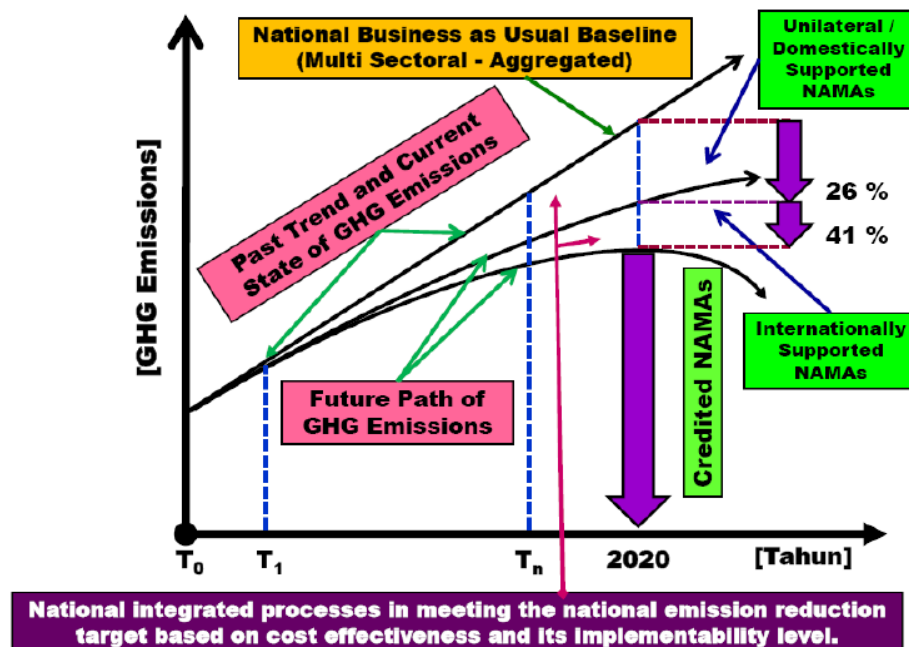
consequences in financial terms and regulatory terms have to be adjusted accordingly.

5. DAK for Greenhouse Gas (GHG) Emission Reductions

Another area that is appropriate to redirect the DAK to specific purposes is the global policy agenda related to climate change. In 2009, the President announced Indonesia's commitment to reduce greenhouse gases (GHG) emission by 26 % until 2020 with own resources and up to 41 % in case of international support being rendered to Indonesia. As response to this commitment, last year the government launched a Presidential Regulation 61/2011 on National Action Plan for GHG Emission Reduction (*Rencana Aksi Nasional, Pengurangan Emisi Gas Rumah Kaca, RAN-GRK*). This national policy is in accordance with international call that all countries are asked to undertake voluntary Nationally Appropriate Mitigation Actions (NAMAs) in order to ensure that the national GHG emissions are reduced below the Business-As-Usual scenario (see Exhibit 1 for the Indonesian proposed target for NAMA).

As Indonesia has been considerably decentralized, many decisions and activities related to GHG emission reduction would have to involve sub-national governments. Against this background, the RAN GRK mandated local governments, under the coordination of the provincial government, to formulate local action plan for GHG emission reduction (*Rencana Aksi Daerah Penurunan Emisi Gas Rumah Kaca, RAD-GRK*). Local governments are expected to formulate RAD GRK until the end of 2012. The Bappenas and Ministry of Home Affairs are currently disseminating the guideline for RAD GRK formulation.

Exhibit 1. The Underlying Policy for GHG Emission Reductions



Source: Lubis, 2012

The Ministry of Finance "Policy Brief on Instruments and Mechanisms for Financing of GHG Emission Reduction in the Land Based Sector" brings forward

three possible instruments that could be used to channel fund from the central government to local governments for financing local GHG emission reduction activities (RAD-GRK). The instruments are grants (*Dana Hibah*), Specific Allocation Fund (Dana Alokasi Khusus – DAK) and Local Incentive Fund (*Dana Insentif Daerah* - DID). Dana Hibah could be used for channelling grants received from international donors or domestic sources. DAK could be used in a top down process in which central government provide incentive to local governments to implement national priorities. Meanwhile DID could be used in a bottom up process in which central government pays incentive to local governments based on the proposal they submit to central government. The payment is made once local government achieve certain results as agreed by central government and the respective local government. These funding instruments will play a great role to guarantee the success of RAD-GRK implementation. The central government is expected also to be ready with the funding instruments that could be used to incentivize local governments.

The *Dana Hibah* could be suitable for channeling funds received from international donors as well as fund received from domestic sources. The disbursement is easier and it covers various area of local development. However, there are still doubt concerning the accountability of the allocation process, the implementation as well as the monitoring and evaluation. More importantly, if the Indonesian government only relies on the international Dana Hibah, the national commitment for GHG emission reduction might not be considered as strong enough in the international agenda for mitigating climate changes. Meanwhile, the *Dana Insentif Daerah* (DID) is currently used as part of the adjustment fund (*Dana Penyesuaian*). The basis for the allocation of DID is still limited to the performance of local governments on local financial management. It is therefore necessary to verify whether it would be sufficient to extend the current design of the DID (through additional indicators), or whether a different incentive fund (or incentive elements within DAK) needs to be designed to satisfy specific requirements of funding/rewarding actions for GHG emission reduction. These arguments leave the DAK as the best alternative for financing the RAD-GRK in the long run.

The DAK still faces various problems with regard to its rules, procedures and modalities. A thorough analysis to assess suitability of DAK for financing GHG emission reduction activities is required. For instance, it needs to be assessed, if characteristics pertaining to climate change mitigation actions can be accommodated by a specially designed DAK. Issues to be addressed on this regards are: 1) the cross and multi-sectoral nature of climate change (which are reflected in the RAD-GRK as multi-sectoral plans), 2) the necessary training and capacity building measures (i.e., readiness phase for mitigation actions), and 3) the long-term nature of climate change mitigation actions.

An appropriate feasibility study is needed to clarify the target of funding for GHG emission reduction through DAK given the fact that there have been conventional DAK transfers in various sectors (such as village transportation, trade, village electrification, agriculture, forestry, environment). As GHG emission reduction is a relatively new area of policy where indicators for performance might not be understood and available at the local level, it is important to consider various aspects of monitoring, reporting and verification of DAK-funded investments to be consistent with requirements for GHG emission reductions while remaining feasible and realistic. For the DAK to finance RAD-GRK, it is critical to synchronize the incentive elements and conditional grants within DAK mechanisms to achieve synergistic effects.

At present, the Bappenas requires the 33 provincial governments to submit their RAD-GRK to the central government with all the activities, proposed financial support, and the realistic targets for GHG emission reductions. The activities for

GHG emission reductions are fall under five categories, namely: energy, industry, agriculture, forestry, and waste management. However, since many of technical activities and public personnel are managed by kabupaten/kota governments, the policy on RAD-GRK and supporting funds has to be linked with the kabupaten/kota level of administration. The climate change is by all means a global issue, but the actual actions are undertaken by local governments and communities.

6. Concluding Remarks

Given its wrong tendency of DAK financing in the last decade, this paper offers alternatives for redirecting the DAK funds into more specific objectives that are obviously important in decentralized governance: the radical improvement of local public services and the response to global initiatives on reducing green-house gas emissions. It is argued that by focusing the DAK financing for the public service improvements, the decentralization policy in the country would be more meaningful. Also, as Indonesia has a vital role in reducing the green-house gas emission, there are open alternatives for the DAK to be used for encouraging local government initiatives to reduce GHG emission.

Decentralization policy can only be meaningful if it has concrete impacts on the quality of public services and the current challenge in development. Therefore, a reorientation of inter-government financial transfer towards these objectives is an important measure to be seriously considered by policy makers in Indonesia. Among the important way to gauge the decentralization effectiveness in Indonesia is to measure whether the DAK can be directly linked to specific purposes of local development.

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