

# Enhancing Local Own-Revenues

## *Problems and Challenges*

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**Abstract**— Fiscal decentralization demand the regions to improve their creativity in collecting funds for financing local expenditures according to their needs (self-financing). The objective of this paper is to identify problems and challenges in enhancing local own-revenues faced by the local governments. This research used the qualitative method by comparing two case studies on the enhancement of local own-revenues. Both the local governments of A and B face problems in optimizing local own-revenues. the enhancement of local own-revenues is faced with two main challenges. For undeveloped regions, the challenge is the making of an urban-biased policy and for regions with urban characteristics the challenge is the emergence of urban problems due to high business opportunities in the urban regions. Another challenge faced by every local government is dependency on the sector of local taxes as the sector with large contribution to local own-revenues.

**Keywords:** *local own-revenues; local taxes; local charges; local government owned enterprises*

### I. INTRODUCTION

Indonesia has embarked on a program of fiscal, administrative, and political decentralization at the same time; moving the country from one of the most centralized systems in the world to one of the most decentralized. Many new regions have been formed after the reform, which brought about the term of “Big Bang” of decentralization. There are three main objectives of decentralization according to the laws, namely, improving public services, improving people’s prosperity, and improving the regions competitiveness.

In accordance with the principle of *money follows function*, decentralization does not only have a political and administrative meaning but also a fiscal one, which is known as fiscal decentralization. Fiscal decentralization regulates the financial relation between the central and regional governments, which is reflected, among other things, in the structure of local revenues which comprises local own-revenues (PAD), transferred revenues, and other legal local revenues. Fiscal decentralization does not only regulate the financial relation between central and local governments (among other things, in the form of transferred revenues) but also demand the regions to improve their creativity in collecting funds for financing local expenditures according to their needs (self-financing). One of the forms of self-financing is to keep the

contribution of local own-revenues, whether it comes from the sectors of local taxes, local charges, or other legal local own-revenues, showing an increasing trend to local revenues. Good contribution from local own-revenues to local revenues also indicates that it is an advanced and independent region.

Data from the Ministry of Finance shows that in some regions the percentage local own-revenues dominate their local revenues and in some regions balancing funds dominate their local revenues. This paper would describe problems and challenges in enhancing local own-revenues in the local government of A which is a local government whose contribution of local revenues is dominated by local own-revenues and the local government of B which is a local government whose contribution of local revenues is dominated by balancing funds.

The research question of this paper is what are problems and challenges in enhancing local own-revenues faced by the local government of A and the local government of B. This research aims to identify problems and challenges in enhancing local own-revenues faced by the local governments.

### II. RESEARCH METHOD

This research used the qualitative method by comparing two case studies on the enhancement of local own-revenues. The type of data used in this research is a combination of primary data and secondary data. Primary data were obtained through interviews, while secondary data used financial report.

Informants of the research were key persons of the financial division in both local governments. Data are collected from multiple sources, such as focused group discussion, interviews, observations, and literature reviews. Therefore, the combination of data collection was expected to result in more accurate data.

The first stage in data analysis techniques was to reduce data; data collected during the research process were grouped by using the coding technique, discarding unnecessary data, and organizing data in order to facilitate conclusion drawing. The second stage was to present data, whether in the forms of texts, graphs, and tables. The third stage is to draw a conclusion by formulating a statement related to the research question. Meanwhile, the credibility of data was tested by using source triangulation.

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### III. RESULT AND DISCUSSION

#### A. Profile of Local Governments

A is a city which in 2016 its local own-revenues contributed to 43% of the total of local revenues, and in 2017 it increased to 47%. Hence, in 2017 local own-revenues had the largest contribution to the total of local revenues. B is one of regencies which quite highly depend on National Revenues and Expenditures Budget. Data of the last two years shows that the proportion of balancing funds to local revenues was 83%. Meanwhile, the proportion of local own-revenues shows that the average self-financing power was 8% over two years (2016-2017) and 8% of other contributions.

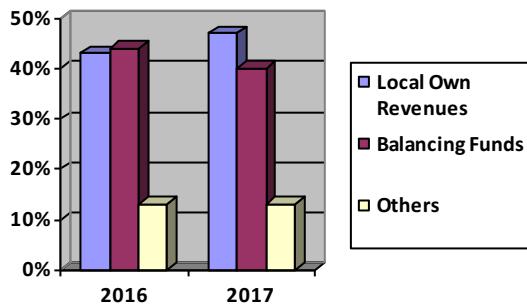


Fig. 1 Structure of Revenues of City A

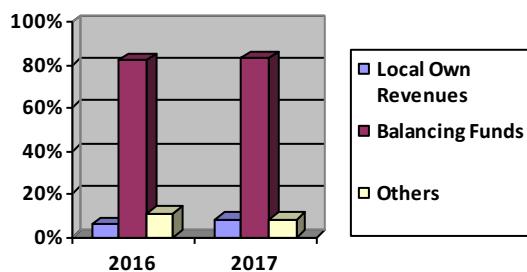


Fig 2. Structure of Revenues of Regency B

The population of Regency B is equal to 8% of that of City A with the level of job participation above 60% for both regions. Meanwhile, sources of livelihood for the people in both regions are as follows:

Table 1 Main Industry in A and B

Main Industry	A	B
Agriculture, Forestry, Hunting, Fisheries	0.8%	41.3%
Manufacturing Industry	20.1%	5.8%
Wholesale Trade, Retail Trade, Restaurants, Hotels	34.3%	19.2%
Community, Social, and Personal Services	25.6%	11.8%
Others	19.3%	22.0%

Source: Statistics Data of City A and Regency B, 2017

#### B. Problems

Central Government has given an authority to local governments to manage their local own-revenues, which shows their independency in managing local autonomy.

In 2017 local own-revenues of City A were dominant in the structure of local revenues. It shows a better condition of local finance compared to that of previous years. However, there are still some following problems regarding the enhancement of local own-revenues:

1. There does not yet exist any accurate data on tax potential, hence the implementation of taxation target is still incremental. It makes some local taxation targets are set too high (advertising tax).
2. The highest percentage of main industry is in sectors of wholesale trade, retail trade, restaurants, and hotels (34.3%), but the number of people who register themselves as taxpayers is still low (66.91% on average for tax types of entertainment tax, restaurant tax, and parking tax).
3. Letter of Determination of Local Taxes/Letter of Notification of Owed Taxes (SKPD/SPPT) are sent late to taxable subjects.
4. Financial performance of local government owned enterprises has not been optimal.

Some specific problems in optimizing local own-revenues faced by Regency B are as follows.

1. Taxpayers derived from the local population are still low.
2. Local government has not been able to optimize potential of tourism.
3. There is dependence on the mining of natural resources as one of the main sources of livelihood of local residents. Local taxes/local charges cannot be imposed on this sector.
4. The data of tax potential is weak.
5. There are some obsolete regulations of the determination of charge tariff which need a review.

The mandate of Law Number 28 of 2009 on Local Taxation and Charges gives a chance to the regions to perform a more optimized collection. Both the local governments of A and B face the problems regarding the optimization of local own-revenues. The same problem faced by both local governments is the lack of accurate data of tax potential hence there is a bias in setting taxation targets and the public's awareness of paying taxes is still low.

On the other hand, the local government of B faces more complex problems. B has the potential to increase its local own-revenues, especially from the sector of tax revenues because its GRDP is higher than that of other regencies/cities in the Province. GRDP closely relates to local taxes because it can depict the people's economic activities. If a region has a high economic growth rate, it certainly will become the potential of tax revenues in the area. Based on the reason, the strategy for optimizing local own-revenues must be driven towards the development of the areas, which can stimulate the people or other parties who have activities in the area of B.

The most serious problem faced by B is local people's behavior, among other things, difficulties in fostering creativity, because most of the people work in the mining sector, which does not demand high creativity. Meanwhile, the

increase of local own-revenues highly depends on the creativity of local governments and the people.

### C. Challenges

Based on data in Fig. 1 and Fig 2, the financial performance of A is better than that of B, because A is able to improve the public's participation in paying taxes and charges so that A is able to self-finance its local needs. However, it is not the case with the Regency Government of B which highly depends on transfer funds from the central government. The urban characteristic of a region may determine its success in enhancing local own-revenues. A is a region that has good urban facilities and it is one of tourist destinations in Indonesia. The employment rate of A is much higher than that of B.

Thus, the challenge faced by the Regency Government of B is in encouraging the local government to make urban-biased policies through

- Tourism Sector

*First*, creating a grand design to develop tourism. *Second*, to encourage tourists to visit the region, one of the efforts that can be taken is providing sufficient facilities and infrastructures for tourism. At the moment, charges for tourists who visit natural tourist attractions, marine tourist attractions, historical tourist attraction, and agro-based tourist attractions have not been collected. It is because the facilities and infrastructures have not yet been well managed by the local government so that it cannot collect the charges. *Third*, promoting tourist and cultural activities which are integrated with empowerment and development programs. The development of the tourism sector and the empowerment of micro, small, and middle enterprises will not succeed if the government does not promote them massively and continuously. Promotion can be made through media to attract tourists to visit B and it can be done by cooperating with several parties involved in the activities of tourism, such as tourist travel agencies, tourist buses agencies, and so on. *Fourth*, establishing the local culture so that it will be able to become the tourist potential.

- Micro, Small, and Middle Enterprises Sector

*First*, establishing communities who are aware of tourism. In this case, they are made aware of their tourism potential so that they are able to respond it by selling the excellent products of local people. *Second*, financial aids. *Third*, support for marketing local products, such as swallow's nest, tin handicrafts, peppers, mushrooms, et cetera through exhibitions and the establishment of business center's for the products of micro, small, and middle enterprises at strategic locations. *Fourth*, optimizing the connecting lane by encouraging people to develop businesses by utilizing the geographical position of B which is located within the connecting lane between Sumatra and Bangka Islands.

- Improving Bureaucrats' Capacities

The improvement of bureaucrats' capacities can be undertaken by making employees take part in education

and training activities which are able to improve their competence in supporting the effort to optimize local own-revenues.

- Optimizing Investment Cooperation

In providing local infrastructures, the local government should be able to cooperate with private parties in the form of public private partnership. It responds the problem of limited fund for providing public infrastructures faced by the local government. The investment activities do not only aim to provide the government's services but also other activities of service business so that the city will grow, and the region will have complete facilities. People can fulfill their needs in B so that the money they have spent will increase local own-revenues.

- Enhancing public education [1]

Considering the condition of the people who are mostly tin miners, there is a need to diversify their livelihood. This is because the activities of tin mining may bring about negative impacts in social, cultural, and environmental fields. In the environmental field, the impact is the environmental damage that needs a high cost for reclamation. Meanwhile, in the sociocultural field it leads to high dependency to tin, pragmatic life attitude and the lack of creativity of the people in diversifying their livelihood.

A cultural change needs a continuous and consistent effort. It can be done directly through socialization and education, and indirectly through structural development and social process. Therefore, the cultural change involves 3 main aspects, namely structural, cultural, and social processes [2]. In the structural aspect, it is necessary to make a policy on illegal tin mining business and mining activities which are accompanied by reclamation. Besides that, it needs a policy to provide facilities and aids to the economic activities which are expected to flourish in B. For example, if the expected business is commerce, this sector needs some facilities, such as soft loans and the provision of trading locations. Similarly, if the expected sector is tin handicraft, it is necessary to establish handicraft centers and to provide soft loans for the craftsmen.

The change at the cultural level is made through socialization and education. The activities of socialization can be done both formally and informally through some agents of socialization, such as families, peers, schools, and mass media. Considering the surrounding circle (families and peers) mostly come from the circle of miners, the role of schools (education institutions) and media can be intensified. The role of the mass media can be intensified by utilizing local media, banners, bulletins, et cetera to deliver the message on the negative impact of illegal tin mining and other roles expected by the people of B. The role of education institutions can be intensified through the curriculum of education by giving subjects which emphasize the problem of environment and livelihood. This learning material can be delivered by integrating it to the existing subjects or local contents. At the level of elementary schools and junior high schools, for example, it can be done by strengthening the learning material

on the love for environment and by inculcating behaviors which promote the environmental conservation related to specific condition of B. Meanwhile, at the level of senior high schools the introduction of other occupations, outside the tin miner, can be started with business practices (started from planning the business to performing the business activities), agricultural activities, et cetera.

The urban characteristic of a region will significantly contribute to the enhancement of local own-revenues, because there are many bases of local taxes that can be collected due to the activities of its citizens. However, there is also a challenge faced by the City Government of A due to the urban-biased policy regarding the urban problems, such as traffic jam, overpopulation, and unemployment.

Therefore, the enhancement of local own-revenues in Indonesia is faced with two main challenges. For undeveloped regions the challenge is the making of an urban-biased policy and for regions with urban characteristics urban problems will arise due to high business opportunities in the urban regions.

Another challenge faced by every region is dependency on local taxes as the sector that has the largest contribution to local own-revenues. Hence, the amount of local own-revenues depends on the public's participation in paying local taxes. This policy causes a negative impact, in which the public feel they are burdened with taxes in every business activity, because taxes are imposed on almost all business sectors. On the other hand, the benefit of taxes which is not directly felt by the public may cause their reluctance to pay taxes.

Thus, concentration of local governments in enhancing local own-revenues must start to shift from the tax sector to the nontax sector [3], this can be done through the development of units of public services managed by local governments or local government owned enterprises, hence the government is able to make profits from services provided to the public. Therefore, the sector of local charges and profits of local government owned enterprises can replace the domination of the local taxes. In some countries, local government charges also became more important over time. Charges are more important than the individual income tax and sales tax [4]. Another strategies can be done through reducing expenditure [5] [1], efficiency of the revenue administration system[6],

#### IV.CONCLUSION

Both the local governments of A and B face problems in optimizing local own-revenues. Both local governments face the problem of the lack of accurate data on tax potential hence there is a bias in setting taxation targets and the problem of low awareness of the public in paying taxes. However, the local government of B faces more complex problems because it must change the public's culture by creating business diversification.

In the aspect of challenges, the enhancement of local own-revenues is faced with two main challenges. For undeveloped regions the challenge is the making of an urban-biased policy and for regions with urban characteristics the

challenge is the emergence of urban problems due to high business opportunities in the urban regions. Another challenge faced by every local government is dependency on the sector of local taxes as the sector with large contribution to local own-revenues. In the future, local governments must be able to improve public services in order that the sector of nontax revenue such as local government charges and profits of local government owned enterprises can be relied on in the enhancement of local own-revenues.

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