



## Improving Regional Fiscal Capacity in Central Java Province Indonesia

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### Abstract

This study discusses the development of fiscal capacity in Central Java, Indonesia. The purpose of this study is to analyze internal and external factors that increase regional fiscal capacity, and formulate strategies by analyzing internal and external elements to obtain four alternative strategies namely 'strength - opportunity' strategy, 'strength - threat' strategy, 'weakness - opportunity' strategy and Strategy for 'weaknesses - threats'. This study uses secondary data to analyze indicators of regional fiscal capacity and primary data collected through focused discussions, to analyze strategies. The results of the analysis indicate that there are several main strategies to increase regional fiscal in Central Java Province, namely the program of intensification and extensification of regional taxes; improving the quality of human resources with special competencies in the field of taxation; synergy and internal coordination between regional government institutions; improvement of the supervision system for taxpayers; realizing clear and legal regional regulations, simplifying the mechanism for managing investment licenses in Central Java and optimizing regional revenues through modernizing the collection of taxes and levies by utilizing technology. Modernization of increasing regional fiscal capacity will encourage the achievement of equitable regional revenue, increase public participation, administrative efficiency, consistent law enforcement, and improve the level of public confidence in the implementation of good governance.

## INTRODUCING

Several studies on decentralization of regional fiscal policies reveal that decentralization is a good policy to enhance economic progress and has positive impact for developing countries. It is seen as a policy that represents the affordability on many community activities in broader range, covers several political groups, religion, ethnics, and tribes in the process of making development decisions (Rondinelli, 1990). This representation is believed can lead to greater equity in the allocation of resources and government funding. Additionally, decentralization is able to improve political stabilization and national unity since each region can freely make decision for development. The limitation of national planning that is centrally controlled can also be overcome by delegating a greater authority into local government that leads into appropriate approach and involves local community in making decision. Decentralization can also reduce the provision of public service cost by reducing diseconomy scale that is considered being inherent on central planned system (Rondinelli and Cheema, 1983).

Indonesia political decision in the implementation of regional autonomy which began on January 1st, 2001 has a broad and serious implication. Further, regional autonomy is a political phenomenon that makes bureaucratic and centralized government administration into participatory decentralization. The new paradigm in regional autonomy implementation handles the economy fully, broadly, and responsibly in regencies and cities. This change is intended to enhance the effectiveness of community service and improve the spirit of democratization and the implementation of regional development sustainably. Further, it is expected to ensure a balanced authority and responsibility between central and regional government. In accordance with the principle of money follows function, the regional authority delivery goes along with funding source delivery that is previously

controlled by central government. This source of funding will be manifested through strong Locally-Generated Revenue (LGR) structure and will be funding source and represent the real condition of a region. If the structure of LGR has been strong, a region is considered having a strong funding ability and transfer from central government in the form of General Allocation Fund (GAF) that only supports the implementation of government and development in a region. Several studies on fiscal decentralization show the need of special strategies as the limitation of regional fiscal capacity. Many obstacles occur because of unpreparedness of a region and unclean budget management practices. Even, in several regions, development funds management is disrupted by corruption and budget mismanagement (Sadli, 2000; Brodjonegoro and Asanuma, 2000).

Basically, fiscal decentralization is one of central government policies whose principles and objectives is to reduce fiscal imbalance between central and regional government (vertical fiscal imbalance) and between regions (horizontal fiscal imbalance), improve the quality of public service in region, and reduce the imbalance of public service between region; improve the efficiency of the utilization of national resource, management, transparency, and accountability in the implementation of transfer allocation into region precisely, on time, efficiently, and fairly, and support fiscal sustainability in macro economy policies. In addition, it also aims to increase the accountability of regional financial management. The region is authorized to collect local taxes and regional levies (local taxing power). For more, two main things that are often discussed regarding the regional autonomy are fiscal needs and fiscal capacity that are related to the effort to optimize the LGR and become an issue of economic competition between regions. The difference between fiscal needs and fiscal capacities is called as gap. Fiscal capacity is a component that is included to the formula of General Allocation Fund (DAU) calculation in

which its allocation is based on a formula of fiscal gap concept.

Meanwhile, the amount of fund transferred by the central government to the regional government in the form of DAU is allocated based on fiscal gap and basic allocation.

Moreover, fiscal decentralization policy brings consequences on the increase in budget needs as well as financial planning activities. The forecasting technique discussed in the chapter must be relevant (Schneider 2005; Shah, 2004; Shah, 2006). The regional government in developing countries deals with increasing fiscal pressure when the infrastructure development increases, but the revenue growth does not rapidly develop. Therefore, regional government is trying to increase its fiscal capacity, especially through institutional management (Fölscher in Shah, 2007). Many institutional tools are available to facilitate and enforce government fiscal discipline in fiscal decentralization. However, the budget planning in increasing regional fiscal capacity is highly important. Fiscal relationship between government should be based on stable, transparent, not arbitrary, universal, and unnegotiable rules. Besides, the level of resources provided to local government must be sufficient to equalize the expenditure responsibility. When the expenditure responsibility is moved into central government, it should be in line with stable income source. At the same time, regional government budget must have flexibility to meet local condition and needs. (Fölscher in Shah, 2007).

This study aimed to analyze the development of regional fiscal capacity in Central Java. One of problems that is still faced in regional autonomy implementation in Indonesia is the high level of regional fiscal dependence toward central government. With this circumstance, the ability of a region to carry out the government functions that becomes its authority is constrained. The average of fiscal dependence showed with LGR ratio toward income total for 35 regencies/ cities in Central Java was 14.19% in 2016. In 2017, the average of fiscal dependence has increased yet it was relatively low of 15.13%. On the contrary, the

ratio of fiscal independence of Central Java province government was much higher of 58.79% in 2016, but it decreased in 2017 into 49.23%. Particularly, this study aimed to identify the internal and external factors that affected the increase in regional fiscal capacity and analyze the strategies by combining internal element with external element using four alternative strategies, namely strength – opportunities, strength – threats, weakness – opportunities, and weakness – threats strategies.

## RESEARCH METHOD

To analyze the data, this study used quantitative descriptive analysis. This analysis was conducted by interpreting and analyzing the calculation results of regional fiscal performance indicators. This study used primary and secondary data. The secondary data used were regional tax realization and original revenue of Central Java province in 2012 – 2018. Meanwhile the primary data were collected through interview with questionnaire guide in focused group discussion to identify strength, weakness, opportunities, and threats.

The analysis of regional fiscal performance used in this study was regional tax contribution criteria, namely mapping the criteria of regional tax of Central Java toward regional revenue obtained.

**Table 1.** Regional Tax Contribution Criteria

Percentage	Criteria
0,00% - 10%	Very Poor
10,10% - 20%	Poor
20,10% - 30%	Fair
30,10% - 40%	Fairly Good
40,10% - 50%	Good
≥ 50%	Excellent

Source: Litbang Depdagri-Fisipol team of UGM (1991)

The second analysis mapped was fiscal effectiveness which was performed by rationalizing revenue realization compared to the local tax target.

By combining the performance of regional tax growth realization, potential mapping was performed and categorized into 4 parts. Firstly, prime category is applied when the level of growth and its contribution was high. Secondly, potential category is applied when the growth level was low yet its contribution was high. Thirdly, developing category is applied when the growth level was high yet its contribution was low. Fourthly, underdeveloped category is applied when the regional tax had low growth and contribution levels (Litbang Depdagri-Fisipol Team of UGM, 1991).

**Table 2.** Effectiveness Criteria

Percentage	Criteria
> 100%	Very Effective
90-100%	Effective
80-90%	Fairly Effective
60-80%	Less Effective
< 60%	Ineffective

Source: Litbang Depdagri-Fisipol Team of UGM (1991)

The second analysis method was evaluation matrix of internal and external factors (Internal Factor Evaluation IFE Matrix and External Factor Evaluation-EFE Matrix). It was a tool to summarize and evaluate external information covering information about economy, social, cultural, demographic, environment, politic, government, law, technology, and competition. The matching and guiding stages are important to conduct to complete weighting and rating values of two strategy factors. Weighting is put in the second column of IFE and EFE matrix, meanwhile rating is put in the third column of IFE and EFE matrix. From the results of IFE and EFE identification, the strategies were then formulated by using SWOT analysis. The strategy design was done to increase the fiscal capacity of regional government of Bogor city especially from regional tax sector by using SWOT analysis.

Furthermore, this analysis consisted of 2 strategy factors namely internal factors which contain strength and weakness and external

factors which contain opportunities and threats. There are several advantages of SWOT, including creating future extrapolation, creating multifunctional and simple future. Additionally, SWOT analysis is in line with other techniques in strategy design (Mardiasmo, 2002; Rangkuti 2011)

## RESULTS AND DISCUSSION

Analysis of Regional Fiscal Performance, based on the analysis, Central Java financial performance toward overall collected regional tax by Central Java province government showed positive result. The ratio between the realization of regional tax revenue toward local generated revenue was in excellent criteria with the average above 83% (Table 3). The contribution of regional tax of Central Java province was the highest among other revenue sources. Regional tax performance phenomena that dominated local generated revenue relatively happened almost in all provinces in Indonesia. The similar study conducted by Lumikis (2015) and Susnawati, et al. (2014) indicate that local generated revenue historically has largest contribution for regional revenue.

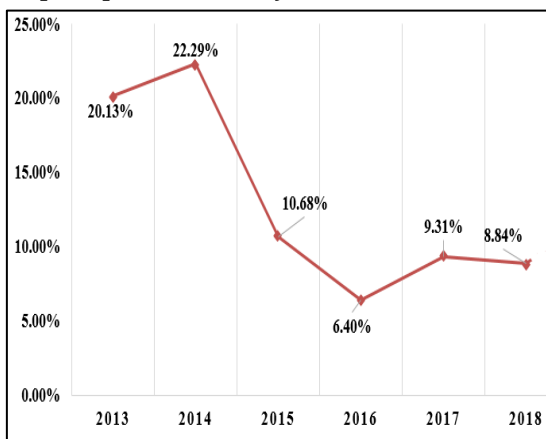
**Table 3.** Analysis of Regional Tax Criteria of Central Java Province in 2012 – 2018

Year	(%) Contribution	Criteria
2012	84,33	Excellent
2013	81,78	Excellent
2014	82,82	Excellent
2015	83,36	Excellent
2016	83,81	Excellent
2017	84,26	Excellent
2018	83,92	Excellent

Source: BPPD of Central Java Province, processed data

However, one thing to keep an eye on in regional fiscal performance in Central Java was the decreasing growth rate trend. Although it still positively grew and fluctuated, yet the growth rate tended to decrease (Figure 1). In 2018, the growth rate was 8.84% lower than previous year's growth rate (9.31%). One of reasons of this

decrease was the change of definition and the scope of province tax object-t.



**Figure 1.** Regional Tax Growth Central Java Province in 2013-2018

Source: BPPD of Central Java Province, processed

Based on the calculation, the tax revenue effectiveness as source of income indicated that the performance of regional tax revenue of Central Java province was effective. The effectiveness analysis was used to find out ability of government in tax revenue target realization. In 2012 – 2018, realization of tax revenue always exceeded the target. The realization of regional tax is said good if it is greater than the target of regional tax. The higher regional tax effectiveness is, the more effective regional taxation will be. Several studies concerning to regional tax effectivities indicate that the most regions are able to exceed the target, even on the

higher effectiveness level (more than 100%). The result of this study indicates that there were 2 possibilities. First, regional taxation performance was optimal, meaning that the management of taxation resource was very good and supported by public's awareness to pay high tax. However, it is also possible that the target from regional government was still lower than its potential. It makes any set target is easily realized. (Smeru, 2000 and Shah, 2006).

**Tabel 4.** Aalysis of Regional Tax Effectiveness of Central Java Provice in 2012 - 2018

Year	% Effectiveness	Criteria
2012	106.0	Very Effective
2013	111.6	Very Effective
2014	105.0	Very Effective
2015	86.5	Fairly Effective
2016	88.6	Fairly Effective
2017	103.5	Very Effective
2018	103.8	Very Effective

Source: BPPD data of Central Java Province (processed)

Based on previous three analysis, potential matrix of regional tax revenue in Central Java province in 2012 – 2018 was included to primary. It showed that regional tax greatly contributed (very potential) for local generated revenue and its growth rate is rapidly increasing or tends to be stable (table 5).

**Tabel 5.** Analysis of Regional Tax Potential of Central Java Province inn 2012 – 2018

Regional Tax Potential Matrix				Supporting Variable
Category	Year	Contribution	Growth	Effectiveness
Primary	2012 -2018	Excellent	Excellent	Very Effective

Source: BPPD of Central Java Province (processed)

Analysis of Regional Fiscal Capacity Increase Strategy, based on interview results through FGD and observation, the internal factors were identified in the terms of strength,

weakness, external factor, namely opportunity, and threat. The identification of internal factor (IFE) that is strength in regional fiscal capacity increase through tax increase is presented on the following table.

**Table 6.** Analysis of IFE Regional Tax Increase of Central Java Province

Internal Factor	Weight	Rating	Score
<b>Strength Factor</b>			
Regional government (Pemda) has taxation authority	0.08	4	0.32
Technology utilization	0.15	6	0.90
Taxation human resource technical guide	0.09	7	0.63
Tax campaign by the local government	0.12	8	0.96
Socialization by the local government	0.09	4	0.36
<b>Weakness factors</b>			
The absence of tax auditor and bailiff	0.08	4	0.32
The absence of socialization to utilize technology	0.12	4	0.48
Non-optimal internal control of tax collection	0.09	5	0.45
Evaluation and monitoring process	0.09	4	0.36
Continuous and structured coordination	0.09	4	0.36
<b>Total</b>	<b>1.00</b>	<b>50</b>	<b>5.14</b>

Source: primary data, processed

Based on the observation of internal factors, the strengths of Regional revenue office (Dispenda) in tax management were in the regional tax campaign (0.96), and the utilization of information and technology (0.9). One of the technology used was Online Vehicle Tax Administration System (SAKPOLE) that is the electronic networking service held by Central Java Vehicle Document Registration Center

(samsat) coaches team. This application is accessible via mobile phone. Meanwhile, the greatest weakness factor was the socialization with the technology users that has not been too massive. Technological factor eventually became strength as well as weakness in increasing regional tax revenue. Besides, internal control in tax collection was also considered as the second greatest weakness (0.45).

**Table 7.** EFE Analysis of Central Java Province Regional Tax Increase

External factors	Weight	Rate	Score
<b>Opportunity Factors</b>			
Laws on regional tax and levies	0.10	6	0.60
Regional Regulation of regional tax and levies	0.15	7	1.05
Commitment to increase PAD	0.12	7	0.84
Stakeholder positive expectation of Regional Government	0.12	5	0.60
Increase in community awareness	0.10	4	0.40
<b>Threat Factors</b>			
Changes in the technical and implementation regulations	0.08	4	0.32
Negative issues of tax management	0.12	5	0.60
More dynamic and advanced technology	0.09	5	0.45
Community readiness to use technology	0.12	7	0.84
<b>Total</b>	<b>1.00</b>	<b>50.00</b>	<b>5.70</b>

Source : Primary Data, Prozesse

Based on the external factor observation (table 7) it was found that regional regulations and other technical and implementation derivative regulations were opportunities for the increase in Central Java Province regional tax. In addition, the commitment of regional agencies to realize the desired tax collection took place in the second highest opportunity (0.84). On the other hand, an aspect that threatened the external factors for the increase in Central Java regional tax was community readiness to use technology (0.84). Luckily, the threat level of this aspect would gradually reduce as long as there is mass socialization of tax payment applications that facilitate community to pay tax. The second threat was in association with negative issues of regional financial management. Therefore, the government needs to be thorough in working on this aspect to maintain community trust.

Internal critical factors of regional tax management gained the score of 5.14, while the external critical factors gained 5.70 so that their IE matrix position was in the quadrant or cell I. Therefore, the right strategy to do was growth and build strategy, which consists of an intensive strategy (market penetration, market development and product development) or integrative strategies (backward integration, forward integration and integration horizontal). According to the identification of internal and external factors, the researchers offer several strategies analyzed using SWOT analysis as follows:

SO Strategies, done by optimizing the intensification and extensification programs of tax / levies collection from existing taxpayers. This potential tax finding is done by mapping, profiling, and benchmarking the taxpayers, perform data clearing and data cleaning of the current taxpayers and new taxpayers continuously. These are done to update the potential of unregistered taxpayers because the existing regional tax potential may be more than the determined targets. It is because the regional government calculate tax real potential without

performing direct field approach, add facilities for regional tax collection, evaluation on the addition of regional tax collection personnel, socialization and dissemination of services to community regarding the terms and condition of regional tax collected by Central Java Province, increase supervision and control, especially tax collection technical procedures, fast and comprehensive service to taxpayers and administration control for human resources on administration.

WO Strategies, prepare human resources who have special competencies in the taxation field, provide special training and assistance regarding probing technique in tax collection, improve the analysis competency of human resources, especially in determining the calculation of tax potential., labor planning in taxation, improve internal coordination between related agencies.

ST Strategies, improve supervision and evaluation of taxpayers, make clear and legally binding regional regulations, stipulation of punishment for tax offenders, give rewards for taxpayers, educate taxpayers about digitalization of tax services.

WT Strategies, the acceleration of regional tax increase through the innovation of taxation information and technology-based payments., provide socialization to community regarding clean regional government in managing taxes to increase public trust, responsive to central and local regulations regarding local tax revenue.

## CONCLUSION

Fiscal capacity development, especial Central Java Regional Government tax experiences better performance after fiscal decentralization. It was showed by the contribution, growth, and the effectiveness of excellent tax collection within 2012-2018 period.

This study is regional tax aggregate-based, namely the analysis was performed to the whole regional tax of Central Java Province. Due to this limitation, it is recommended that the future studies further investigate specific local tax

sources. This is because problems and policies can be suggested to increase revenue into more detail.

Internal and external aspects generally can be mapped pretty clear so that the recommended strategies are based on strengths and weakness from internal aspects, and opportunity, and threat from external aspects can be identified.

The specific strategy suggested by this study is related to the use of technology to increase regional tax revenue. Technology advances need to be followed up by socialization activities to the community. The ease of taxation to community will lead to the increase in the future tax collection. The second strategy deals with the increase in quantity and quality of human resources taxation competencies started from the increase in human resources who have analytical skills to determine tax potential, up to those who are able to execute and deal directly with the community in local tax collection.

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