

## **Fiscal decentralization: its impact on cities growth**

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### **Abstrak**

Indonesia currently adopts a new decentralization policy. In the past, central government had been the major role of regional and cities development. With the new policy, central government has transferred its role in developing cities and regions to the local governments. This policy adopts two complimentary laws. Law No.22/1999, which is basically the devolution policy, has been accompanied by Law No.25/1999, which basically is the fiscal decentralization policy. Both laws reflect that decentralization policy in Indonesia has adopted the concept of "money follows functions".

Before the implementation of decentralization policy, the government of cities had been benefited from many facilities built by central government on the city area. With the decentralization policy, it is expected that a reduced role of central government will have a significant impact on the growth of cities in Indonesia. The policy has three major fiscal instruments; a block grant funding, a specific grant and revenue sharing. The block grant funding is considered as the most important instruments of fiscal decentralization in Indonesia. About 80 percent of financial transfer from central to local governments will be in the block grant type of transfer. In the past, the use of transfers was determined by central government specifically. Therefore, the role of block grant was very minimal. With the new fiscal decentralization scheme, the benefits of cities from central government investments are expected to decrease. Therefore, there is a question to what extent the cities will be sustainable in the decentralization era.

This paper attempts to answer the impacts of current fiscal decentralization policy on the growth of the cities. The first objective of the paper is to evaluate the current intergovernmental transfers and their impact to cities revenues. Secondly, by utilizing a regional macroeconometric model, this paper also elaborates the implication of the transfers to the city growth and interregional disparity in Indonesia.