

Decentralization and Farmers' Welfare in Indonesia

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ABSTRACT

This study examines the correlation between decentralization and farmers' welfare uses quantitative design data from 2004-2013 from 32 provinces of Indonesia. The hypothesis is decentralization improves farmers' welfare. The finding shows that DAU and PPL maintain a correlation with farmers' welfare, while the history of local elections does not have any correlation. DAU has a positive correlation, while the number of PPL have a negative correlation. These findings suggest that welfare of farmers only have relationship with fiscal decentralization, or it can be said that farmers' welfare increase through more DAU.

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1. Introduction

In Indonesia, decentralization commenced in 2001 and its implementation is based on Law No. 22 of 1999 regarding Local Government and Law No. 25 of 1999 regarding Intergovernmental Fiscal Relationship. The reason behind the implementation of decentralization in Indonesia is the economic motivation for local government to receive a greater portion of the natural resource revenues. Another factor is the strong political motivation to end the centralized government (Said, 2005).

Law No. 22 of 1999 which revised as Law No. 32 of 2004 and Law No. 23 of 2014 stated that local government authority covers all areas except foreign policy, security and defense, judicial, monetary and fiscal, and religion. Law No. 25 of 1999 which revised as Law No. 33 of 2004 mandate that economic resources for implementation of decentralization consist of: 1) transfer funds from central government, and 2) revenue generated internally by each local government.

Decentralization can be either administrative decentralization (transfer of civil servants and public functions to local government), fiscal decentralization (budget, revenues and expenditures on local government), political decentralization (decision makers) or a combination of all three. According to Musgrave (1983) and Oates (1993), through decentralization, government can increase their performance become more efficient. However, decentralization has disadvantages as it is in accordance with the capability of each region, and so there is the possible occurrence of welfare inequality amongst the local governments. Because of that, government must conceive their own potential and needs.

Poverty rate in developing countries, including Indonesia, still relatively high. Consequently, pro poor policies are needed in decentralization era. The poor people in Indonesia are usually live in village and become farm worker. So, agricultural sector is expected to reduce poverty in national development. In decentralization, local governments have the flexibility

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in the formulation of policy issues and agricultural development. Decentralization is expected to ensure the efficiency and effectiveness of agricultural development at the local level to provide maximum benefits for the farmers' welfare.

However, until recently, the agricultural sector still faced many problems. For example, there are some impediment in the agricultural development because of local government policies. In general, industrial sector gets more attention from government because this sector is considered to give higher income than agriculture. Since income is related to welfare, it can be concluded that the agricultural sector has not been able to provide a decent welfare for its workers.

Farmers' welfare indicators are measured by using the concept of Farmers' Terms of Trade (FTT). FTT has changed from year to year. In 2009, FTT has decreased from the previous year, but then rose again until 2011. However, in 2012 the FTT decreased yet once again. The FTT changes suggest that farmers have not been able to rely on agriculture for their welfare.

Based on the explanation above, farmers in Indonesia cannot be said to experience better welfare even after implementation of decentralization. Therefore, researcher is interested in conducting studies on the farmers' welfare after decentralization. This study measures the farmers' welfare using FTT data from 32 provinces in Indonesia during a period of 10 years (2004-2013). The hypothesis is decentralization improves farmers' welfare.

2. Theory

2.1. Decentralization

Decentralization – according to Falleti (2005), makes central government give their authority to local government to control their own region. Smith (1985) explains that the developing countries need decentralization because it is necessary for development of economic, social and political. In one hand, the idea of decentralization is necessary. In other hand, by the decentralization concept, local government burdened to develop their region. Developing countries find that the promise of decentralization performance is often disappointing and not as expected.

Litvack *et al.* (1998) divides decentralization into three types: 1) administrative decentralization – a representation of power and duty among the governments, 2) fiscal decentralization – a budget allocation among the governments to support the functions or duties which delegated from higher level of governments, and 3) political decentralization – a

greater delegation of authority to the regions related to various aspects of decision-making, including the establishment of standards and regulations.

Basically, the emergence of the decentralization idea is not separated from the weaknesses that exist in a centralized government. According to Devas (1989), there are three deficiency of a centralized government, namely: 1) the existence of difficulties to implement the program effectively, as the central government is responsible for all regions of the country, 2) centralized governments do not put the experience and knowledge from local area into the decision-making process or policy formulation, so the implementation of policies do not depict the necessity of local inhabitants, and 3) local government has a low chance to intervene national development program. In addition, centralized governments also make all the decisions and policies in general for all regions of the country. Therefore, to decide policy, government need a long time and become inefficient.

Based on the various weaknesses of a centralized government as described above, among others, the Indonesian government decided to implement decentralization throughout the country. There are two benefits that are usually expected to occur from decentralization according to Mardiasmo (2002), namely:

- (1) To encourage increased community participation and to promote equality development in the entire region by utilizing the resources and potential in each region
- (2) To delegate the public policies formulation to the local government where the most complete information about the region is held.

2.2. Measuring decentralization

Schneider (2003) describes some of the indicators that can be used to measure the level of decentralization. *First*, administrative decentralization can be measured using transfer grants and taxation. *Second*, fiscal decentralization can be measured using expenditure and revenue, which is a good measuring instrument to specify the level of fiscal decentralization, because it describes how much control local government on fiscal resources. *Third*, political decentralization can be measured using national and local elections. Political decentralization refers to the extent to which the process of democratic politics is run in the region. Local election is the best indicator to measure democracy, because democracy represent by local elections. Moreover, the

local elections might upgrade the prospect of the practice of democratic political functions.

2.3. Decentralization and farmers' welfare

Central government transfer their agricultural authorities to provincial, regency and city and this field is expected to play a major role in the national economy, as its importance in employment, source of income and poverty reduction particularly in rural areas. According to Saragih (2005), by decentralization, local governments have a lot of options to design specific local policies, while the MOA as the representation of central government, only responsible for developing and managing strategies, national policies and standards for agriculture. Furthermore, Haryono *et. al.* (2014) explains that with regards to agriculture the central government authorities are limited to national policies, such as fertilizer and seed subsidies, price and trade policies, research and development, loan guarantee, agricultural insurance, and cross-regional infrastructure.

Before decentralization, agricultural development was under the central government's authority, as part of the era of centralized government. One success story of agriculture sector centralized government is that rice reached self-sufficiency by 1984 after years of requiring importation. This program was planned by the central government but implemented by local government under strict monitoring. Under the former centralized government, the local government could not implement any program beyond those programs already defined by central government. Central government decide the program and the amount of the budget, while the local governments were just implementers. Although centralized agricultural development showed a good performance, the management of the centralized agricultural development scheme had several weaknesses, namely: 1) the potential of local resources were not utilized well, because the programs implemented were relatively homogeneous; 2) there was no opportunity for local governments to design programs that meet the social economic conditions of local community; and 3) monitoring and evaluation conducted by the central government was constrained by distances from the local region (Haryono *et. al.*, 2014).

BPS (2013) explains that as a main job of most people, agricultural sector's development should be able to improve farmers' welfare and farm workers. Improving the farmers' welfare will directly reduce poverty and increase the prosperity of the entire Indonesian people. Until now, agricultural sector still faces many obstacles, for example, farmers do not get benefit optimally. The farmers' welfare indicators are

measured by using the concept of FTT. The FTT concept refers to the purchasing power of farmers, which is the ability of the income received by farmers to meet their consumption needs. The changes of FTT show the changes of farmers' welfare. Even though FTT does not fully describe the welfare of farmer, FTT which is provided by BPS is the best indicator for farmers' welfare until the present (Rachmat, 2013).

3. Method

To analyze the correlation between decentralization and farmers' welfare, this study uses secondary data in the form of panel data. Data from the years 2004-2013 as a time series data, while data has been collected from 32 provinces in Indonesia as a cross section data. All data is processed with STATA program using Fixed Effect Model. Data consist of DAU from MOF, PPL from MOA and local election from MOHA (as independent variables); FTT from BPS (as dependent variable); PAD, DAK, DBH and agricultural expenditure from MOF; total area of agriculture from MOA; the number of farmers, total rainfall and ratio of cities and regencies from BPS (as control variables).

4. Result and Discussion

4.1. Correlation between FTT and DAU

Fiscal decentralization emphasizes the authority to manage finances, both explore the sources of income and determine expenditures. Fiscal responsibility is the core section of fiscal decentralization. In this case, DAU in every province is the indicator of fiscal decentralization and the existence of DAU is expected to make better condition of farmers. From Figure 1 below, correlation between FTT and DAU is positive ($r=0.23$). This situation signifies that the greater the DAU, the higher FTT will become.

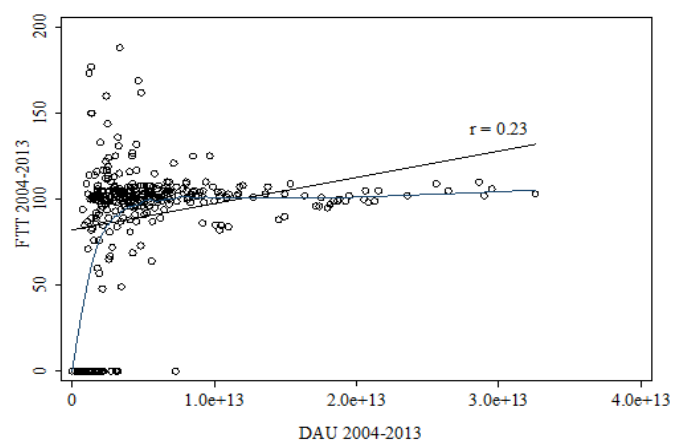


Figure 1. Relationship between FTT and DAU

Furthermore, there is a division in the provinces based on the correlation between FTT and DAU (Figure 2). This figure consists of four quadrants. *First*, Quadrant 1 illustrates provinces with low DAU and low FTT. Provinces are included in this quadrant are Nusa Tenggara Barat, Sumatra Barat and Riau. *Second*, Quadrant 2 depicts provinces with high DAU but low FTT. Three provinces that are included in this quadrant are Jawa Barat, Jawa Tengah and Jawa Timur. *Third*, Quadrant 3 describes provinces with low DAU but high FTT. Provinces include in quadrant 3 are Sulawesi Utara, Sulawesi Tenggara and Kalimantan Barat. *Last*, Quadrant 4 shows provinces with high DAU and high FTT. Provinces include in this quadrant are Jawa Barat, Jawa Tengah and Jawa Timur. These three provinces include in quadrant 2 and 4. This later situation is possible because FTT has changed from year to year for the last 10 years. From that Figure 2, we can note that most provinces in Indonesia are included in quadrant 3, provinces with a high FTT but low DAU.

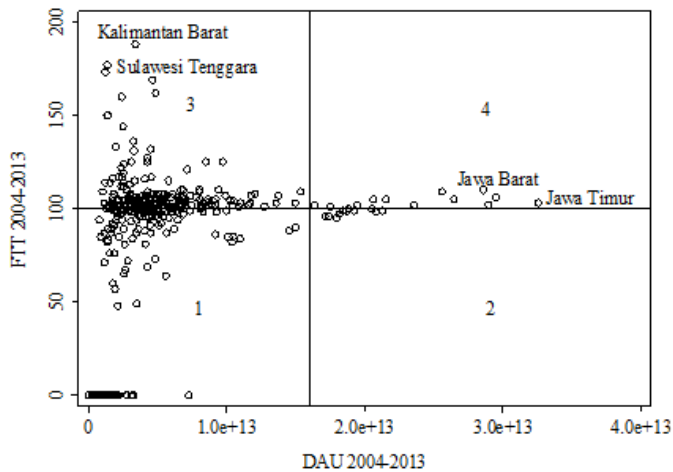


Figure 2. Quadrant of FTT and DAU

4.2. Correlation between FTT and the number of PPLs

Administrative decentralization emphasizes delegating authority to distribute authority and responsibility to provide public services. The delegation of responsibility consists of planning, funding and transferring of duties from the higher to the lower level of government (Litvack *et. al.*, 1998). In this study, administrative decentralization is measured by calculating the number of PPL of each province. The more PPL of every province is expected to strengthen the farmers' welfare and vice versa. Figure 3 shows the relationship between FTT and PPL.

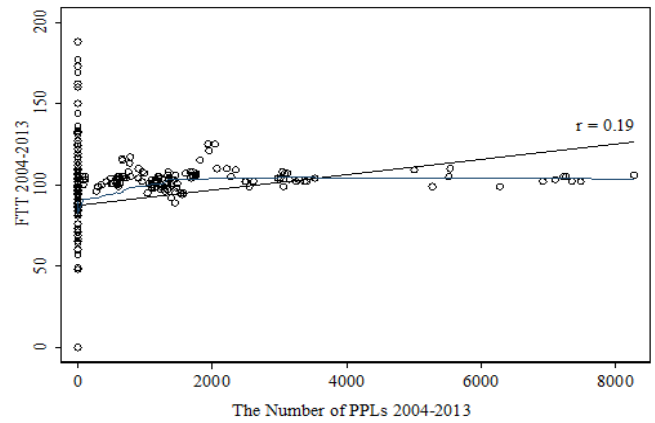


Figure 3. Relationship between FTT and PPL

From Figure 3 above, it can be concluded that the relationship between FTT and PPL is positive ($r=0.19$). This figure implies that the increase of PLL is in accordance with FTT. This condition occurs because PPL can increase knowledge and skills of farmers, thereby the production also increases, which will be a positive influence on farmers' welfare. Furthermore, Figure 4 illustrated division of provinces based on the correlation between FTT and PPL.

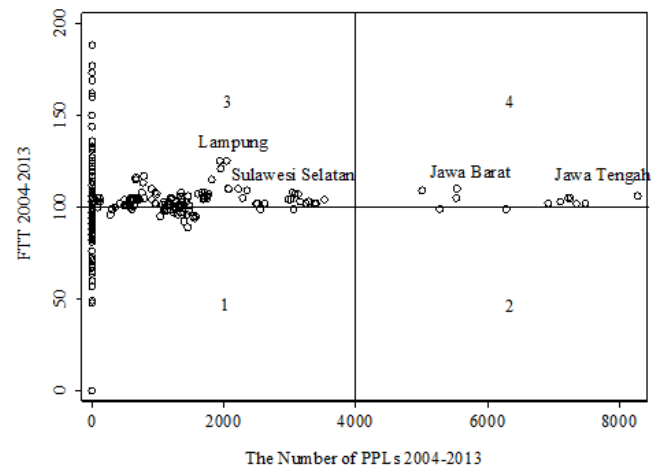


Figure 4. Quadrant of FTT and PPL

There are four quadrants in this figure. *First*, Quadrant 1 illustrates the provinces with a low number of PPL and low FTT. Three provinces include in this quadrant are Kepulauan Bangka Belitung, Nusa Tenggara Barat and Jambi. *Second*, Quadrant 2 depicts provinces with a high number of PPL but FTT is low. Provinces which are included in this category are Jawa Barat and Jawa Timur. *Third*, Quadrant 3 describes provinces with a low number of PPL but a high FTT. Some provinces which are included in this quadrant are Yogyakarta, Lampung and Sulawesi Selatan. *Last*, Quadrant 4 illustrates provinces with a high number of PPL and high FTT. Provinces in Jawa Island includes in this quadrant. Two provinces of this island are included

in quadrant 2 and 4 (Jawa Barat and Jawa Timur) as FTT has changed from year to year for the last 10 years. From Figure 4, we can note that most provinces in Indonesia are include in quadrant 3, and that these provinces have a high FTT but a low number PPL.

4.3. Correlation between FTT and the history of local elections

Political decentralization emphasizes on providing the right to make public decisions. Political decentralization can be measured by observing the existence of local elections. In this study, political decentralization is measured by analyzing the history of local elections in each province. The longer the period of local elections is expected to increase farmers' welfare, while the shorter period of local elections causes a decrease in farmers' welfare. Correlation and provinces' division between FTT and local elections are presented in figure below.

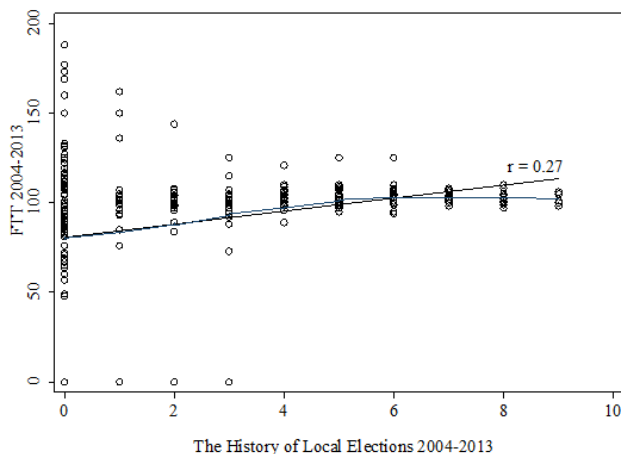


Figure 5. Relationship between FTT and local elections

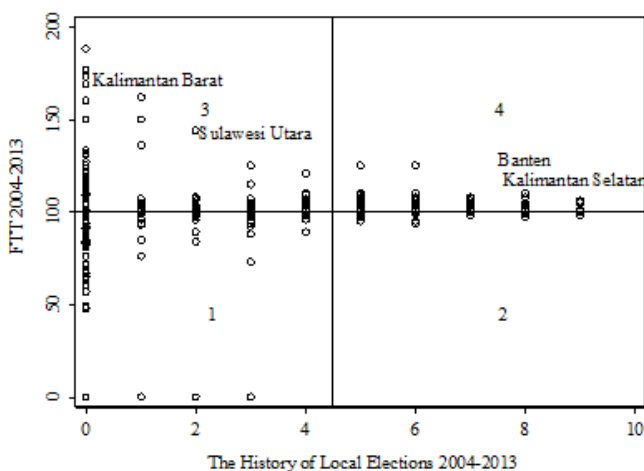


Figure 6. Quadrant of FTT and local elections

It can be concluded that the relationship between FTT and local elections (Figure 5) is positive ($r=0.27$). This situation means that the longer the local election, the higher FTT, and on the contrary, the shorter the local election, the lower the FTT. Figure 6 illustrates four quadrants. *First*, Quadrant 1 divided provinces based on a short period of local elections and low FTT. Provinces include in this quadrant are Kalimantan Selatan, Kalimantan Tengah and Jambi. *Second*, Quadrant 2 depicts the provinces that have a long period of local elections but FTT is low. Three provinces include in this quadrant are Kalimantan Barat, Sulawesi Tengah and Kalimantan Tengah. *Third*, Quadrant 3 divided provinces based on a short period of local elections but a high FTT. Provinces include in this quadrant are Sulawesi Utara, Sulawesi Tenggara and Kalimantan Barat. *Last*, Quadrant 4 illustrates provinces with a long period of local elections and a high FTT. Provinces classify in this quadrant are Kalimantan Selatan and Banten. Kalimantan Tengah includes quadrant 1 and 2, Kalimantan Barat includes quadrant 2 and 3, while Kalimantan Selatan includes quadrant 1 and 4. This condition occurs because FTT has changed from year to year during the term 2004-2013. In general, provinces in Indonesia are include in quadrant 3, and that these provinces have a high FTT but a short period of local elections.

4.4. Correlation between decentralization and farmers' welfare

This study uses the Fixed Effect Model to analyze panel data. The number of farmers, total area of agriculture, PAD, DAK, DBH, agricultural expenditures, total rainfall and ratio of cities and regencies are used to control the influence of independent to dependent variables so that not influences by external factors that are not examined. The result of statistical analysis can be seen in Table 1.

Table 1. Result of Statistical Analysis		
Variables	Coefficient	SE
PPL	-0.006 **	0.003
DAU	6.31e-12 ***	1.93e-12
The history of local elections	0.896	1.480
Constant	85.475 ***	6.479
Significance: *=P<0.1 **= P<0.05 ***=P<0.01		

Based on the results above, significant correlation achieved by PPL and DAU. Positive correlation for DAU and negative correlation for PPL. This situation means that the greater DAU, the better farmers' welfare. Moreover, the fewer the number of PPL, also the better

farmers' welfare. However, the history of local elections has no significant correlation with farmers' welfare.

The proceed of the statistical analysis is diverse after adding control variables. Before adding control variables, all of the variables have a positive correlation with farmers' welfare. This suggests that with the increase of DAU, PPL and the history of local elections cause an increase of farmers' welfare. However, after adding control variables, only DAU has a positive correlation, while the number of PPL has a negative correlation.

4.5. Discussion

Fiscal decentralization that is measured by DAU has a positive correlation. This is appropriate with Law No. 23 of 2014 regarding Local Governments, which states that the purpose of DAU is to deliver finance parity among the regions. By receiving a higher DAU, local governments have improved finances to implement their projects, including agricultural field.

The number of PPL as the indicator of administrative decentralization has a negative correlation. PPL has the responsibility to increase the farmers' skills, knowledge and ability to improve their farming activities through the agricultural extension program. In general, by this extension of agriculture, farmers have the urge to carry out good farming practices. So as they can achieve higher production and thereby increase their welfare. The result of the simple correlation shows positive correlation for PPL, in contrast, Fixed Effect Model shows a negative correlation. This result might be caused by the performance of PPL itself. There are common conditions of PPL in Indonesia: 1) lack of quality of PPL; 2) many PPL do not fulfil their duty. Extension and monitoring of the farmers' in field is not carried out; and 3) uneven distribution of PPL occurs. Many PPL prefer to work in cities than the rural area. This situation is supported by the data number of PPL. The highest number of PPL is located in Jawa Island, while the FTT of Jawa Island is not the biggest.

Since 2001, the agricultural extension program's authority has been delegated to the local governments. Through local autonomy, agricultural extension program performance is expected to increase (Mawardi, 2004). Hence, through local autonomy, development of agriculture is under the responsibility of local leader, not the authority of centralized agriculture department.

Implementation of the agricultural extension program through local autonomy has some problems.

For the regions where the local leader and local politicians paid a great deal of interest to the agricultural growth, the agricultural extension will increase. In contrast, the position of PPL becomes unclear and many staff were dismissed or transferred to another responsibility when they do not give a great concern to the agricultural growth. Mawardi (2004) identified several constraints faced by the program of agricultural extension:

- (1) Decline of PPL performance, as a consequence the agricultural extension programs are rarely carried out;
- (2) Difference perspective among stakeholders about the program of agricultural extension and its role in agricultural development, with many regions reallocating the role of agricultural extensions to technical institutions;
- (3) Limited budget for agricultural extension activities; and
- (4) Limited availability and support of agriculture information.

The history of local elections and the welfare of farmers are not interconnected. The history of local elections covers the period of democracy. Long period of democracy is expected that government administration would be more improved. By engaging in direct election, the local leader (provincial, city and regency) is elected directly by the local villagers. Furthermore, under the direct election policy, it is expected that the one who understands the potential of the local area becomes the leader. By understanding the local potential, the local leader is expected to carryout measures that work up the prosperity of the community. Moreover, it is expected that the farmers' welfare increases by the long period of local election, and vice versa. However, according to the result of Fixed Effect Model, there is no correlation between the history of local elections and welfare of farmers.

Improving the prosperity of society and harmonizing the relation among government in the central and local area are the main goal of decentralization. This correspond with Smith (1985) who signifies that one of the seven promises of decentralization is that decentralization is very relevant to meet the poor's needs. The program of development must involve the poor if the purpose of development is to reduce poverty. Poor people for this study refer to the poverty of farmers. This – poverty of farmers, is in accordance with our research findings. However, our research findings suggest that decentralization improves farmers' welfare only when fiscal decentralization happens. Thus, decentralization, without the fiscal part,

cannot deliver welfare to farmer and in this case even after more than 10 years of implementation. As described by Sujarwoto (2015), in its implementation, decentralization often fails to reduce poverty. To reduce poverty, decentralization needs some additional activity, namely: 1) to encourage local political competition, 2) to increase community participation, and 3) to increase the local governments' performance.

5. Conclusion and Recommendation

5.1. Conclusion

Generally, there is the common belief that decentralization brings improved conditions to the local government. This study's aim was to examine the correlation between decentralization and farmers' welfare, which is measured by DAU, PPL and the history of local elections and FTT. By the analysis, it can be concluded that only DAU and PPL have a correlation with farmers' welfare, while the history of local elections does not have any correlation. DAU has a positive correlation, while PPL has a negative correlation. These findings indicate that only fiscal decentralization may increase the farmers' welfare in Indonesia. The findings of this research show that decentralization increases farmers' welfare through more DAU.

5.2. Recommendation

Regarding the findings mentioned earlier, there are some recommendations can be proposed to the government of Indonesia, both central and provincial:

- (1) It is necessary for governments to increase the skill of PPL by regular training. Besides that, agricultural extension programs will be more efficient by first undertaking pilot projects and expanding direct practice, so farmers can practice with PPL directly.
- (2) The governments should focus on distribution of PPL especially in rural area, since the agricultural region is usually in rural area, by providing a special allowance, for example.
- (3) The governments should give chance to the farmers to participate in the programs and projects arrangement so that farmers can increase their welfare.

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