



## Political budget cycles in Indonesia at the district level



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### HIGHLIGHTS

- First to analyze political budget cycles (PBCs) in newly democratized Indonesia.
- First to analyze PBCs for indirect and direct elections in the same country.
- PBCs exist only for direct elections, especially if the incumbent runs for reelection.
- PBCs are clearly identified due to exogenous and different timing of elections.
- Shows that the identification of PBCs may require a disaggregated approach.

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### ABSTRACT

We find significant political budget cycles (PBCs) for Indonesian districts only for direct, not for indirect, elections. PBCs are significantly stronger if the incumbent runs for reelection. They are well identified due to the exogenously different timing of elections.

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### 1. Introduction

The bulk of empirical evidence supports the notion that political budget cycles (PBCs) may be found in young democracies, while there is much less evidence that voters in established democracies reward pre-election increases in spending (Brender, 2003; Brender and Drazen, 2005; Shi and Svensson, 2006).<sup>1</sup> Even in new democracies voters may not reward this (Arvate et al., 2009). We investigate PBC at the local level in Indonesia, a newly democratized and decentralized state that devolved the spending of approximately 40% of consolidated budget to the local level in 2001 (World Bank, 2007) and stipulated that district heads had to be elected by the local parliament and, starting in 2005, directly by the local population. Since district elections take place at exogenously determined

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<sup>1</sup> Portugal is an exception to this rule; cf. Aidt et al. (2011).

different points in time, a PBC effect is very well identified – unlike in many other countries in which local elections take place at the same time and thus PBC may coincide with other time effects. Moreover, this is the first paper that can distinguish PBC for indirect and direct elections within the same country; to the best of our knowledge it is the first paper to study PBC in Indonesia – the fourth largest country in the world.

Local elections in Indonesia are plagued by corruption, money politics, and strong patronage relationships between candidates and voters (Hadiz, 2010; Mietzner, 2010). In exchange for votes and loyalty, voters expect candidates to care for them not only through cash handouts at rallies, but also through other donations and provisions during election time (Simandjuntak, 2012). While many of these transfers are off-budget and illegal and have resulted in a significant number of corruption cases against district heads and provincial governors (Mietzner, 2011), there are indications that some of these donations may be on budget.<sup>2</sup>

<sup>2</sup> In a West Java district of Sumedang, an official of the state auditing board claimed that a significant amount of the district's budget had been used to finance

We disaggregate the administrative expenditure to disentangle the discretionary and non-discretionary components. We hypothesize that incumbents raise their discretionary funds in election years to donate to religious and/or social institutions or activities such as places of worship (mosques), society groups or sports in order to increase their popularity. In some cases they channel these funds to finance their campaign activities. These discretionary funds, which can be spent relatively freely in contrast to other items, are budgeted as donation (*hibah*) or social assistance (*dana bantuan sosial*) under administrative expenditures, subcategory “others”.

We find that this expenditure category displays a strongly cyclical behavior—only in direct elections and especially if the incumbent is running for reelection. Thus PBC exist in Indonesia at the local level, but they are conditional on the institutional arrangement (direct elections) and the budget category (discretionary spending). Section 2 presents our data and identification strategy, Section 3 contains the results, Section 4 concludes.

## 2. Data and identification

*Endogenous variables:* We created an unbalanced panel data set for district expenditures for all Indonesian districts except for those in Aceh, Papua, and Jakarta for the period 2001–2009.<sup>3</sup> The number of districts in our sample increased from 336 to 477 due to district splitting. We use as endogenous variables overall district expenditure, administrative expenditure of the districts, and the subcategory “other” of administrative expenditure, all in log expenditure per capita. Administrative expenditure is all spending of the districts for their own administration, including capital and personnel expenditure, but excluding all administrative spending that can be assigned to a specific sector such as health, education, or infrastructure. Expenditure items classified under “other administrative expenditures” include unspecified spending, unforeseeable spending, interest payments, financial assistance to lower regions (sub-districts or villages), social assistance spending (*belanja bantuan sosial*), and donations (*hibah*). The last three spending items include discretionary funds of the district heads to provide financial assistance or to finance small scale programs benefiting core constituencies.<sup>4</sup> From 2001 to 2009, staff expenditures received on average 37% out of total government administrative spending, followed by spending for goods and services (30%), others (25%), and capital (10%). Thus “other expenditures” are a major budget item. Our main source of fiscal data is the Regional Finance Information System (*Sistem Informasi Keuangan Daerah/SIKD*) from the Ministry of Finance.

There is a lack of checks and balances in local governments’ budgeting and reporting process. The local governments, led by the district’s heads, have the executive power to plan, execute and report the budget. The planned and realized budget must be

the incumbent’s campaign activities in 2008 (Mietzner, 2011). The Indonesian Corruption Watch (ICW) suspected that Banten’s and Jakarta’s provincial budgets had been used for incumbents’ campaign activities in 2011 and 2012 respectively (ICW, 2012; ICW and LBH Jakarta, 2012). ICW found that there were donations and social assistances that had been allocated to fictitious recipients or to organizations that were chaired by members of the incumbent’s family (ICW, 2012).

<sup>3</sup> We exclude the districts in the provinces of Nanggroe Aceh Darussalam, Papua, and Papua Barat due to the significant number of missing data and the capital, DKI Jakarta, because the districts in Jakarta are not autonomous.

<sup>4</sup> This usually happens in the form of financial assistance for places of worship, religious schools (*pesantren*), sports activities, specific villages, sub-districts or civil society groups which asked for financial assistance. The loose description of these budget items indicates how discretionary they are to local governments (see Ministry of Home Affairs decree 29/2002 article 8, Ministry of Home Affairs Regulations 13/2006 and 59/2007 article 42, 45 and 47).

approved by the local parliament. In practice, however, the process is lacking of transparency and suffering from poor record keeping, and internal and external audits are weak (World Bank, 2007). This gives district heads discretionary scope over parts of the budget.<sup>5</sup>

*Political cycles:* The effect of the electoral cycle is identified through the exogenous timing of the local indirect and later of direct elections (*Pilkada*), which differs across districts. After Soeharto’s demise, the decentralization law 22/1999 was passed in 1999. It stipulated that regional parliaments were to be elected and that these local parliaments would elect the district heads (*Bupati/Walikota*). The incumbent – effectively appointed – district heads from the Soeharto era were allowed to serve their full terms of five years, which ended at different points in time. The revised law on regional autonomy, Law 32/2004, passed in 2004, states that district heads are to be elected directly by the district population with the first direct elections taking place in 2005; again the incumbent district heads were allowed to complete their terms, which came to an end in different years. Moreover, a number of districts split, which required the election of new district heads for the child districts, whereas the parent districts kept their old district heads. Table 1 shows the proliferation of districts and the increasing share of district heads that were directly elected. All district heads are elected for five year terms (indirect and direct elections). This exogenous and different timing of the first direct elections on the local level allows identifying clearly the political budget cycle effects.<sup>6</sup>

Possible political budget cycle effects are captured by dummies for the two pre-election years and the election year (ELECT-2, ELECT-1, ELECT). PBC may be different for direct and indirect elections of the district heads: in indirect elections candidates need to win over a majority of the members of parliament only, whereas in direct elections a majority of the constituency is required. In a patronage democracy the latter may require much more resources. To account for this, we interacted the pre-election and election year dummies with a dummy for direct elections (DIRECT). Political budget cycles, however, are to be expected only if the incumbent seeks reelection, because in Indonesia candidates are only loosely attached to the sponsoring party and are therefore disinclined to increase election probabilities of a succeeding candidate sponsored by the same party.<sup>7</sup> Thus we collected data on whether an incumbent was running for reelection (also unsuccessfully), which is captured again in a dummy variable (INCUMBENT).

*Controls:* The cost of maintaining a functioning administration depends on the characteristics of the district in terms of accessibility and possible scale economies. We control for population size, district area, number of villages (in 100), share of villages with flat surface, share of villages that are landlocked, urbanization rate, and the log of the distance to the capital Jakarta. Expenditures for administration per capita depend on the overall district budget as measured by the log of total fiscal revenue of the district per capita; they may vary with income and education as these variables might capture the ability of the electorate to monitor and sanction excessive spending of the district governments on themselves. We

<sup>5</sup> The budget is financed mostly through transfers from the center; only around 8% of the total revenue in 2009 is raised locally through taxes and user charges. This weakens accountability to the local populace further.

<sup>6</sup> We constructed these data from various sources: General Election Commission (*Komisi Pemilihan Umum/KPU*), Min. of Home Affairs, the Asia Foundation Indonesia, and the World Bank Indonesia.

<sup>7</sup> Mietzner (2010) argues that local elections are very personalized and that the required party sponsorship for the candidate is not built on mutual loyalty between the candidate and the party, but rather constitutes a business transaction, in which the candidate pays the party to get its sponsorship required by law.

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