CENTRAL AND REGIONAL FINANCE LAW A LEGAL STUDY OF FISCAL DECENTRALIZATION AND FISCAL RELATIONS BETWEEN THE CENTRAL GOVERNMENT AND REGIONAL GOVERNMENTS IN INDONESIA

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Abstract

Fiscal relations between the central government and regional governments constitute one of the fundamental issues in the administration of a unitary state that adheres to the principle of decentralization. This article aims to analyze the legal construction of central and regional finance in Indonesia, particularly following the enactment of Law Number 1 of 2022 on Fiscal Relations between the Central Government and Regional Governments (the HKPD Law), which replaced Law Number 33 of 2004. This research employs a normative juridical method with a statute approach and a conceptual approach. The findings indicate that the reform of central-regional fiscal relations is directed toward strengthening local taxing power, synchronizing national fiscal policy, improving the quality of regional expenditure, and harmonizing central and regional spending through funding-synergy schemes. Nevertheless, implementation still faces the challenges of interregional fiscal disparity, dependency on transfer funds, and weak institutional capacity in regional financial management.

Keywords: *state finance; fiscal decentralization; central-regional fiscal relations; regional autonomy.*

A. Introduction

The Republic of Indonesia, as a unitary state (*unitary state*) that adheres to the principle of decentralization, grants regions the authority to regulate and administer their own governmental affairs based on the principle of the broadest possible autonomy. A logical consequence of granting such autonomy is the need for adequate financial resources to enable regions to independently carry out governmental, developmental, and public-service functions. State finance in the broad sense therefore cannot be separated from regional finance, since both form a single, interrelated system of public financial management within the framework of the Unitary State of the Republic of Indonesia (NKRI).[1]

Constitutionally, the authority to manage state finance is regulated in Chapter VIII of the 1945 Constitution, particularly Article 23, which affirms that the State Budget (APBN) is determined annually by law and is implemented openly and responsibly for the greatest

[1]Republic of Indonesia, 1945 Constitution of the Republic of Indonesia, Art. 23(1).

possible prosperity of the people.2 This provision serves as the primary basis for further regulation of state financial management, including regional finance, which is subsequently elaborated in a package of laws in the field of state finance, namely Law Number 17 of 2003 on State Finance, Law Number 1 of 2004 on State Treasury, and Law Number 15 of 2004 on the Audit of the Management and Accountability of State Finance.[3]

On the other hand, the relationship between the central government and regional governments in the financial field is specifically regulated in Article 18 of the 1945 Constitution, which states that fiscal relations between the central government and regional governments shall be regulated and implemented fairly and harmoniously on the basis of law.[4] The phrase "fairly and harmoniously" implies that the division of financial resources between the center and the regions must take into account the balance of authority (money follows function) as well as interregional equity, given that the geographic, demographic, and economic conditions of each region in Indonesia are highly diverse.[5]

The regulation of central-regional fiscal relations has undergone several paradigm shifts, beginning with Law Number 25 of 1999, later replaced by Law Number 33 of 2004 on Fiscal Balance between the Central Government and Regional Governments, and most recently by Law Number 1 of 2022 on Fiscal Relations between the Central Government and Regional Governments (hereinafter referred to as the HKPD Law).[6] The change in nomenclature from "fiscal balance" to "fiscal relations" is not merely a change in terminology; rather, it reflects a paradigm shift from a technical-administrative approach toward a more comprehensive approach oriented toward strengthening the quality of regional expenditure, central-regional funding synergy, and the enhancement of local taxing power.[7]

Although the legal framework has been refined, in practice the implementation of central-regional fiscal relations still faces a number of problems, including: the high fiscal

[2]Indonesia, Law on State Finance, Law No. 17 of 2003, State Gazette No. 47 of 2003, Supplement to State Gazette No. 4286, Art. 1(1).
[3] Arifin P. Soeria Atmadja, Public Finance in Legal Perspective: Theory, Practice, and Critique (Jakarta: Rajawali Pers, 2010), pp. 15–18.
[4] Muhammad Djafar Saidi, State Finance Law, Revised Edition (Jakarta: RajaGrafindo Persada, 2014), pp. 5–7.
[5] Indonesia, Law on State Treasury, Law No. 1 of 2004, State Gazette No. 5 of 2004, Supplement to State Gazette No. 4355.
[6] Indonesia, Law on the Audit of the Management and Accountability of State Finance, Law No. 15 of 2004, State Gazette No. 66 of 2004, Supplement to State Gazette No. 4400.
[7] 1945 Constitution, Art. 23C in conjunction with Art. 23E (1).

dependency of regions on transfer funds from the central government, the low fiscal capacity of regions to develop their own Locally Generated Revenue (PAD), a fairly wide fiscal disparity between regions, and the weak quality of planning and accountability of Regional Revenue and Expenditure Budgets (APBD).[8] Based on the foregoing, this article examines the legal construction of central and regional finance in Indonesia, focusing on three principal issues: first, the legal basis and principles governing central and regional finance in Indonesia; second, the legal construction of central-regional fiscal relations following the enactment of the HKPD Law; and third, the legal challenges in the implementation of such fiscal relations.

The study of central-regional fiscal relations is not an entirely new theme in the literature on constitutional law and state finance law in Indonesia. A number of earlier studies have examined aspects of fiscal balance between the center and the regions during the era of Law Number 33 of 2004, focusing primarily on the mechanisms of the General Allocation Fund and the Revenue-Sharing Fund.[9] However, studies that specifically analyze the legal construction of central-regional fiscal relations following the enactment of Law Number 1 of 2022 on the HKPD, comprehensively linking it to constitutional aspects, the theory of fiscal decentralization, the practice of special autonomy, and the role of Constitutional Court decisions, remain relatively limited. This study is therefore expected to make a contribution, both theoretically, by mapping the legal construction of central and regional finance following the reform, and practically, as input for policymakers in refining the future implementation of the HKPD Law.

Based on the foregoing background, the problem statement of this study may be formulated as follows: (1) what is the legal basis and what are the principles of central and regional finance under Indonesian legislation?; (2) what is the legal construction of central-regional fiscal relations following the enactment of Law Number 1 of 2022 on the HKPD?; and (3) what legal and practical challenges are encountered in the implementation of central-regional fiscal relations in Indonesia?

These three research questions are systematically interrelated: an understanding of the legal basis and principles of central and regional finance (the first question) provides the foundation for analyzing the legal construction of central-regional fiscal relations after

[8] 1945 Constitution, Art. 18(2) and (5).
[9] See, e.g., Machfud Sidik, op. cit., pp. 20–25; and Bhenyamin Hoessein, op. cit., pp. 30–33, examining the mechanisms of the General Allocation Fund and the Revenue-Sharing Fund under Law No. 33 of 2004.

the HKPD Law (the second question), which in turn requires an examination of the realities of its implementation on the ground in order to identify the gap between das Sollen (the law as it ought to be) and das Sein (the reality of practice) in the management of central and regional finance (the third question).

This study aims to analyze the legal basis and principles governing the management of central and regional finance, to describe the legal construction of central-regional fiscal relations following the HKPD reform, and to identify the legal and practical challenges in its implementation, so as to provide input for the development of a fairer and more sustainable fiscal decentralization policy. More specifically, this study also seeks to provide a thorough understanding of the interconnection between constitutional principles, statutory norms, and empirical practice in the management of central and regional finance, so that it may serve as an academic reference for policy development and further research in the field of state finance law.

B. Research Method

This study employs a normative legal research method (yuridis normatif) focusing on the positive legal norms governing central and regional finance.10 The approaches used include the statute approach, which examines the legislation relating to state finance and regional finance, and the conceptual approach, which draws on the views and doctrines of state finance law scholars. The legal materials used consist of primary legal materials, namely the 1945 Constitution and related legislation; secondary legal materials, namely books, scholarly journals, and prior research; and tertiary legal materials, namely legal dictionaries and encyclopedias. The analysis is conducted qualitatively using a descriptive-analytical method to obtain a comprehensive picture of the legal construction of central and regional finance in Indonesia.

C. Discussion

1. The Concept and Principles of State Finance Law

Doctrinally, state finance may be understood from two perspectives: the object perspective and the subject perspective. From the object perspective, state finance encompasses all rights and obligations of the state that can be valued in monetary terms, as well as anything, whether in the form of money or goods, that can become state

[10]Bagir Manan, The Relationship between the Central Government and the Regions under the 1945 Constitution (Jakarta: Sinar Harapan, 1994), pp. 32–35.

property in connection with the exercise of such rights and obligations.[11] This definition is explicitly set out in Article 1(1) of Law Number 17 of 2003 on State Finance, which defines state finance as all rights and obligations of the state that can be valued in monetary terms, as well as anything, whether in the form of money or goods, that can become state property in connection with the exercise of such rights and obligations.[12]

The scope of state finance as regulated in Article 2 of Law Number 17 of 2003 covers not only finance managed directly by the central government, but also state/regional assets managed independently or by other parties in the form of money, securities, receivables, goods, and other rights that can be valued in monetary terms, including assets separated into state/regional enterprises. Juridically, therefore, regional finance forms an integral part of state finance in the broad sense, so that its management must be subject to the general principles of state financial management.[13]

There are a number of principles underlying the management of state and regional finance, among others: the principle of unity, the principle of universality, the principle of annuality, the principle of specialty, as well as newer principles reflecting best practices in financial management, namely the principle of results-oriented accountability, the principle of professionalism, the principle of proportionality, the principle of openness in state financial management, and the auditing of finances by a free and independent audit body.[14] These principles apply mutatis mutandis to the management of regional finance, as affirmed in Article 3(1) of Law Number 17 of 2003, which states that state finance must be managed in an orderly manner, in compliance with legislation, efficiently, economically, effectively, transparently, and responsibly, with due regard to a sense of justice and propriety.[15]

2. The Legal Basis of Central and Regional Finance

The legal framework governing central and regional finance in Indonesia may be mapped across several layers of legislation. At the constitutional level, Article 23 of the 1945 Constitution governs the State Budget (APBN), Article 23A governs taxes and other

[11]1945 Constitution, Art. 18A (2).
[12]Indonesia, Law on Regional Government, Law No. 23 of 2014, State Gazette No. 244 of 2014, Supplement to State Gazette No. 5587, Art. 1(2), as last amended by Law No. 6 of 2023.
[13] Indonesia, Law on Fiscal Relations between the Central Government and Regional Governments, Law No. 1 of 2022, State Gazette No. 4 of 2022, Supplement to State Gazette No. 6757, Recital (b).
[14] Indonesia, Law on Fiscal Balance between the Central Government and Regional Governments, Law No. 33 of 2004, State Gazette No. 126 of 2004, Supplement to State Gazette No. 4438 (repealed and replaced by Law No. 1 of 2022).
[15] Machfud Sidik, "Fiscal Decentralization in Indonesia within the Framework of Regional Autonomy," Journal of Public Finance, Vol. 3, No. 1 (2005), pp. 12–14.

compulsory levies for the purposes of the state, Article 23C governs the types and value of currency, and Articles 18 and 18A govern the relationship of authority and finance between the central government and regional governments.[16] At the level of organic statutes, there are three principal groups of regulation: (1) the package of state finance laws (Law Number 17 of 2003, Law Number 1 of 2004, and Law Number 15 of 2004); (2) the law on regional government (Law Number 23 of 2014 and its amendments); and (3) the law on central-regional fiscal relations (Law Number 1 of 2022 on the HKPD).

At the level of implementing regulations, technical provisions on the management of regional finance are further set out in Government Regulation Number 12 of 2019 on Regional Financial Management, which replaced Government Regulation Number 58 of 2005. That Government Regulation sets out in detail the planning, budgeting, implementation, administration, reporting, accountability, and supervision of regional finance.[17] In addition, each year the Minister of Home Affairs issues a Regulation of the Minister of Home Affairs on Guidelines for the Preparation of Regional Budgets as a technical reference for regional governments in drafting their regional budgets.

This hierarchical regulatory structure shows that central and regional finance law is hierarchical and interconnected in nature, whereby lower-level regulations may not conflict with higher-level regulations (the principle of lex superior derogat legi inferiori). Such hierarchical consistency is essential to ensure legal certainty in financial management, given that central and regional finance concerns strategic public financial interests for the continuity of government administration.

3. Fiscal Decentralization as the Basis of Central-Regional Fiscal Relations

Fiscal decentralization is a logical consequence of applying the principle of decentralization in the administration of government. According to the theory of fiscal decentralization, the devolution of authority from the central government to regional governments must be accompanied by the devolution of adequate financial resources (*money follows function*), so that regions are able to finance the administration of the governmental affairs within their authority.18 Without adequate fiscal support, regional autonomy will amount to no more than a quasi-autonomy.

[16] Richard M. Bird and François Vaillancourt, Fiscal Decentralization in Developing Countries (Cambridge: Cambridge University Press, 1998), pp. 1–4.
[17] Wayne Thirsk, ed., Tax Reform in Developing Countries (Washington DC: World Bank, 1997), p. 45.
[18] Arifin P. Soeria Atmadja, op. cit., pp. 40–42.

In the context of developing countries, fiscal decentralization is generally directed toward three main objectives: the efficient allocation of public resources, equitable development across regions, and the strengthening of the accountability of regional governments to their communities. These three objectives are reflected in the recitals of Law Number 1 of 2022, which affirm that fiscal relations between the central government and regional governments need to be directed toward supporting the equitable provision of public services across regions, improving the quality of regional expenditure, and encouraging synergy in national fiscal policy.19

The HKPD Law explicitly sets out the objectives of regulating central-regional fiscal relations in Article 2(2), which include: reducing the gap in the financing of government between the central government and regional governments (vertical imbalance) as well as among regions (horizontal imbalance); producing a quality of regional expenditure oriented toward improved public services and community welfare; aligning national fiscal policy with regional fiscal policy; enhancing fiscal-policy synergy between the central government and regional governments in support of sustainable development; and enhancing funding synergy between the central government and regional governments in the implementation of national priority programs.

4. Instruments of Central-Regional Fiscal Relations: Regional Revenue, Transfers to Regions, and Financing

The HKPD Law classifies the instruments of central-regional fiscal relations into several main components. First, Locally Generated Revenue (PAD), sourced from regional taxes, regional levies, the proceeds of the management of separated regional assets, and other lawful sources of locally generated revenue. The HKPD Law reforms the types and rates of regional taxes with the aim of broadening the local tax base (local taxing power) while simultaneously simplifying tax administration through the consolidation of tax types, for example the merger of the Hotel Tax, Restaurant Tax, Entertainment Tax, and Parking Tax into a single Tax on Certain Goods and Services (PBJT).20

Second, Transfers to Regions (TKD), consisting of the Revenue-Sharing Fund (DBH), the General Allocation Fund (DAU), the Special Allocation Fund (DAK), whether

[19]Muhammad Djafar Saidi, op. cit., pp. 55–58.
[20] Indonesia, Government Regulation on Regional Financial Management, Government Regulation No. 12 of 2019, State Gazette No. 42 of 2019, Supplement to State Gazette No. 6322.

physical or non-physical, the Special Autonomy Fund, the Special Status Fund, and the Village Fund. Transfers to Regions function as an equalization instrument to reduce the fiscal gap between a region's fiscal needs and its fiscal capacity, and simultaneously as an instrument for equalizing financial capability across regions.[21] The General Allocation Fund, for example, is allocated with reference to the fiscal gap and a basic allocation, whereas the Revenue-Sharing Fund is allocated based on a certain percentage of state revenue originating from the producing region, such as land and building tax, tobacco excise, and natural resources.[22]

Third, regional financing instruments, which include the Budget Surplus Carried Forward (SiLPA), regional borrowing receipts, and the issuance of regional bonds, which serve to cover regional budget deficits as well as to finance regional infrastructure development.[23] Fourth, the HKPD Law also introduces a new instrument in the form of funding synergy between the central government and regional governments (creative financing and co-financing) as an effort to optimize the financing of national priority programs that require regional funding support, such as the handling of stunting, extreme poverty, and the development of connectivity infrastructure.[24]

With respect to the Village Fund in particular, its regulation stems from the mandate of Article 72(1)(b) of Law Number 6 of 2014 on Villages, which stipulates that the Village Fund is sourced from central government expenditure, aimed at making village-based programs effective on an equitable and fair basis.[25] The Village Fund is then transferred through the mechanism of the state general treasury account to the regional general treasury account, and subsequently disbursed to the village treasury account, with priority given to village development and community empowerment.

5. Management and the Budget Cycle of the Regional Revenue and Expenditure Budget (APBD)

Regional financial management, according to Government Regulation Number 12 of 2019, is defined as the entirety of activities encompassing the planning, budgeting,

[21] M. Ryaas Rasyid, "Regional Autonomy: Background and Future Prospects," in Syamsuddin Haris, ed., Decentralization and Regional Autonomy (Jakarta: LIPI Press, 2005), p. 78.
[22] Law No. 1 of 2022, Arts. 131–140.
[23] Law No. 1 of 2022, Elucidation of Art. 131.
[24] Indonesia, Law on Villages, Law No. 6 of 2014, State Gazette No. 7 of 2014, Supplement to State Gazette No. 5495, Art. 72(1)(b).
[25] Indonesia, Government Regulation on Village Funds Sourced from the State Budget, Government Regulation No. 60 of 2014, as last amended by Government Regulation No. 8 of 2016.

implementation, administration, reporting, accountability, and supervision of regional finance. This regional financial management cycle reflects the application, at the regional level, of the general principles of state financial management, carried out in an orderly manner, in compliance with legislation, efficiently, economically, effectively, transparently, and responsibly, with due regard to the principles of justice, propriety, and benefit to the community.

The planning and budgeting stage is realized through the preparation of the Regional Government Work Plan (RKPD), which forms the basis for the preparation of the General Budget Policy (KUA) and the Provisional Budget Priorities and Ceilings (PPAS), which are subsequently set out in the Draft Regional Budget for deliberation and joint approval by the head of the region and the Regional People's Representative Council (DPRD). Once jointly approved, the Regional Budget is then enacted by a Regional Regulation on the Regional Budget, and if the DPRD does not approve the draft Regional Budget, the regional government may incur expenditure up to the amount of the previous fiscal year's Regional Budget.

The implementation and administration stage of the Regional Budget is carried out through the mechanism of the Budget Implementation Document (DPA) of each Regional Government Working Unit (SKPD), which regulates the detailed use of the budget by each regional apparatus. The accountability stage, in turn, is realized in the form of the Regional Government Financial Statement (LKPD), prepared in accordance with Government Accounting Standards (SAP) and submitted to the DPRD in the form of a Draft Regional Regulation on the Accountability for the Implementation of the Regional Budget, after first being audited by the Audit Board (BPK).

6. Supervision and Accountability of Regional Finance

Supervision is a crucial element of central and regional finance law in ensuring the accountability of public financial management. External supervision is carried out by the Audit Board of the Republic of Indonesia (BPK), as mandated by Article 23E of the 1945 Constitution, which is authorized to audit the management and accountability of state finance, including regional finance, freely and independently. The BPK conducts three types of audits, namely financial audits, performance audits, and audits for specific purposes, the results of which are expressed as an opinion on the fairness of financial

statements, ranging from an Unqualified Opinion (WTP), a Qualified Opinion (WDP), an Adverse Opinion, to a Disclaimer of Opinion.

In addition to external supervision by the BPK, there is also internal supervision carried out by the Government Internal Supervisory Apparatus (APIP), as well as general guidance and supervision of the administration of regional government by the Minister of Home Affairs for general government affairs, and by the relevant minister or head of a non-ministerial government agency for sectoral government affairs. In practice, the results of BPK audits, as set out in the Summary of Semester Audit Results (IHPS), frequently reveal various problems in the management of regional finance, ranging from weaknesses in internal control systems to indications of state/regional financial losses that may give rise to criminal acts of corruption.[26]

7. Legal Problems and Challenges in the Implementation of Central-Regional Fiscal Relations

Although the legal framework governing central-regional fiscal relations has been refined through the HKPD Law, its implementation in practice still faces a number of legal and structural challenges. First, the high fiscal dependency of regions on transfer funds from the central government, given that most regions, particularly those outside Java, have a relatively low ratio of Locally Generated Revenue to total regional revenue, meaning that regional fiscal independence remains a fundamental problem.

Second, the fairly wide fiscal disparity between regions resulting from differences in natural-resource potential and economic base, which has implications for inequality in the quality of public services across regions. Although the General Allocation Fund instrument is designed to reduce the fiscal gap, in practice the amount of DAU received by regions does not yet fully reflect their real needs, given that the fiscal-gap formula still leaves room for various methodological debates.[27]

Third, from an institutional perspective, the human-resource capacity of regional financial managers, particularly in regions with low fiscal capacity, remains an obstacle to the preparation of quality budget planning and accountability, which in turn contributes to low budget absorption and a high number of BPK audit findings relating

[26] Audit Board of the Republic of Indonesia (BPK), Summary of Semester Audit Results (IHPS), published periodically each semester.
[27] Yustinus Prastowo, The Political Economy of Taxation and Regional Autonomy (Jakarta: DDTC, 2019), pp. 101–104.

to weaknesses in internal control systems. Fourth, the harmonization of national fiscal policy and regional fiscal policy still faces coordination challenges, particularly in synchronizing national priority programs with regional development priorities, given the differing planning cycles and local political interests.

8. Legal Analysis: The HKPD Law as a Reform of Central-Regional Fiscal Relations

The enactment of Law Number 1 of 2022 on the HKPD may be regarded as a reformative step in central and regional finance law in Indonesia, for this law does not merely replace the nomenclature of "fiscal balance" with "fiscal relations," but also introduces a number of new instruments and approaches not previously regulated explicitly in Law Number 33 of 2004. Several important breakthroughs include: the strengthening of local taxing power through the consolidation and simplification of types of regional taxes; more targeted earmarking of regional expenditure to support basic services such as education, health, and infrastructure; the regulation of funding synergy between the central government and regional governments; and the strengthening of controls over regional deficits and debt financing so as to remain within fiscally sustainable limits.

From the perspective of unitary-state theory, the regulation of central-regional fiscal relations in a manner that is "fair and harmonious," as mandated by Article 18(2) of the 1945 Constitution, requires a balance between the interest of maintaining national fiscal unity and the interest of providing regions with sufficient fiscal space to innovate and be creative (diversity) within limits set by legislation. The HKPD Law has, to a certain extent, sought to accommodate that balance, although its implementation still requires gradual adjustment given the complexity of the highly diverse fiscal conditions of Indonesia's 514 regencies/cities and 38 provinces.

It may thus be said that central and regional finance law in Indonesia has transformed from a mechanistic-distributive approach toward an approach that is more oriented toward the quality of spending (spending better) and fiscal-policy synergy. Nevertheless, the success of this reform ultimately depends heavily on the consistency of implementation at the technical level, regional institutional capacity, and political commitment to consistently apply the principles of good financial governance.

9. Special Autonomy and Special Status Funds in Central-Regional Fiscal Relations

In addition to the general scheme of Transfers to Regions, central and regional finance law in Indonesia also recognizes a scheme of fiscal affirmative action for certain regions with special or distinctive status, namely Aceh Province, Papua Province and its resulting provinces, and the Special Region of Yogyakarta. Aceh Province, under Law Number 11 of 2006 on the Governing of Aceh, receives a Special Autonomy Fund equivalent to 2% of the national DAU ceiling, allocated to finance the development and maintenance of infrastructure, the economic empowerment of the people, poverty alleviation, and the funding of education, social affairs, and health.

Similarly, Papua Province and its resulting provinces receive a Special Autonomy Fund under Law Number 21 of 2001 as amended by Law Number 2 of 2021, with an amount likewise pegged to the national DAU ceiling and directed in its use primarily toward education, health, and the economic empowerment of the indigenous Papuan community. Meanwhile, the Special Region of Yogyakarta receives a Special Status Fund under Law Number 13 of 2012, the use of which is directed toward financing special authority in the fields of land, spatial planning, culture, institutional arrangements, and the procedure for filling the offices of Governor and Deputy Governor. The HKPD Law accommodates the existence of such affirmative funds as part of Transfers to Regions, while continuing to respect the specific regulation set out in the special-autonomy and special-status laws of each region. The existence of this fiscal affirmative-action scheme shows that central and regional finance law in Indonesia is not entirely uniform, but also accommodates asymmetry (asymmetric decentralization) as a response to particular historical, social, and political conditions.

10. The Role of Constitutional Court Decisions in Shaping Central and Regional Finance Law

The Constitutional Court, in its capacity as the institution authorized to review laws against the 1945 Constitution, has also made an important contribution to shaping and affirming the principles of central and regional finance law through its decisions.[28] In several decisions relating to the judicial review of Law Number 23 of 2014 on Regional Government, the Constitutional Court affirmed that the authority of the central government to guide and supervise regional finance, including the authority to impose sanctions in the form of suspending or reducing transfer funds, must

[28]Constitutional Court of the Republic of Indonesia, Decision No. 137/PUU-XIII/2015 on the Judicial Review of Law No. 23 of 2014 on Regional Government.

continue to respect the principle of regional autonomy and must not diminish the essence of regional independence in managing its own finances.[29]

These Constitutional Court decisions reinforce the understanding that central-regional fiscal relations are not purely subordinate in nature, but rather a partnership relationship subject to the principle of checks and balances within the framework of a unitary state.[30] This constitutional-review function is important given that the provisions on fiscal sanctions against regions, as regulated in Articles 167 to 176 of the HKPD Law, grant fairly extensive authority to the central government to suspend or reduce Transfers to Regions where a region fails to meet certain obligations, so that a mechanism of constitutional control is needed to ensure that such authority is not abused and remains proportionate.[31]

11. A Brief Comparison with Fiscal Decentralization Practices in Other Countries

For the sake of comparison, the practice of fiscal decentralization in various countries shows a variety of models influenced by the form of the state, the system of government, and the socio-political context of each. In federal states such as Canada and Germany, fiscal relations between the federal government and the constituent states are regulated through an equalization-payment mechanism aimed at guaranteeing a minimum standard of public service throughout the country, although the fiscal independence of the constituent states is relatively high compared with regions in a unitary state.[32] Wallace E. Oates, in his theory of fiscal federalism, asserts that the allocation of functions and financing sources across levels of government should ideally be based on the principle of subsidiarity, whereby functions whose benefits are local in nature should be financed and managed by regional governments, while functions whose benefits are national in nature remain the responsibility of the central government.[33]

In other developing countries such as the Philippines and India, fiscal decentralization generally still faces challenges similar to those in Indonesia, namely a

[29]Constitutional Court of the Republic of Indonesia, Decision No. 24/PUU-XII/2014 concerning authority over regional financial management.
[30]Zainal Arifin Mochtar, Independent State Institutions: The Dynamics of Development and the Urgency of Reordering Them within Indonesia's Constitutional System (Jakarta: Rajawali Pers, 2016), p. 89.
[31]1945 Constitution, Art. 24C(1) on the authority of the Constitutional Court to review laws against the 1945 Constitution.
[32]Anwar Shah, ed., The Practice of Fiscal Federalism: Comparative Perspectives (Montreal: McGill-Queen's University Press, 2007), pp. 3–7.
[33]Wallace E. Oates, Fiscal Federalism (New York: Harcourt Brace Jovanovich, 1972), p. 55.

high dependency on central transfer funds and a gap in fiscal capacity across regions, which shows that this problem is a common feature of fiscal decentralization in developing countries and is not unique to Indonesia alone.[34] A World Bank study on measuring the impact of fiscal decentralization likewise asserts that the success of fiscal decentralization is largely determined by a clear institutional design for the division of authority (expenditure assignment) and the division of revenue sources (revenue assignment) across levels of government, which must be matched with one another so as not to give rise to excessive vertical imbalance.[35] This comparative experience offers an important lesson for Indonesia: the reform of central and regional finance law through the HKPD Law needs to be continuously evaluated so that its institutional design becomes increasingly adaptive to the ever-evolving dynamics of regional fiscal needs.[36]

12. Contemporary Issues: Green Financing and Carbon Tax in Central-Regional Fiscal Relations

Recent developments in central and regional finance law cannot be separated from the issue of environmental sustainability and climate change. Law Number 7 of 2021 on the Harmonization of Tax Regulations introduces the carbon tax as part of national fiscal policy aimed at encouraging the transition toward a low-carbon economy. Although the collection of carbon tax falls within the authority of the central government, its revenue has the potential to produce a fiscal impact on regions through the Revenue-Sharing Fund scheme as well as through earmarking for sustainable-development programs at the regional level.[37]

The HKPD Law likewise accommodates this orientation toward sustainable development by affirming that regional fiscal policy must be aligned with national fiscal policy, including in support of environmentally sound development (green fiscal policy). Going forward, the integration of the principles of fiscal and environmental sustainability into central and regional finance law is expected to become increasingly relevant, given that Indonesia's commitment to reducing greenhouse-gas emissions, as

[34]Roy Bahl and Johannes Linn, Urban Public Finance in Developing Countries (New York: Oxford University Press, 1992), pp. 385–390.
[35]Robert D. Ebel and Serdar Yilmaz, "On the Measurement and Impact of Fiscal Decentralization," World Bank Policy Research Working Paper No. 2809 (2002), p. 4.
[36]Sri Mulyani Indrawati, "Reforming State and Regional Finance: Challenges and Policy Direction," Indonesian Journal of Economics and Finance, Vol. 20 (2019), p. 3.
[37]Ministry of Finance of the Republic of Indonesia, Academic Paper on Carbon Tax Policy in Indonesia (Jakarta: Fiscal Policy Agency, 2021), p. 14.

set out in its Nationally Determined Contribution, requires financing support involving the active role of regional governments, particularly in the forestry, land-use, and local-scale renewable-energy sectors.

13. Digitalization of Regional Financial Management as an Instrument for Strengthening Accountability

One other important development in the practice of regional finance law is the digitalization of the regional financial management system through the Regional Government Information System (SIPD), whose use is mandated by Regulation of the Minister of Home Affairs Number 70 of 2019 and reinforced by Article 81 of Government Regulation Number 12 of 2019.[38] This digitalization aims to integrate every stage of regional financial planning, budgeting, administration, and reporting into a single, nationally connected electronic system, thereby making it easier for the central government to monitor and evaluate regional financial performance in real time.[39]

The Corruption Eradication Commission, in its study, considers that the digitalization of regional financial management has great potential to reduce the scope for discretion that is prone to abuse in the process of regional planning and procurement of goods/services, while simultaneously increasing transparency and public participation in the oversight of the Regional Budget.[40] Nevertheless, the success of such digitalization depends heavily on the readiness of information-technology infrastructure and the human-resource capacity of regional officials, given that a significant digital-capacity gap still exists between urban regions and underdeveloped, outermost, and frontier (3T) regions.[41] Digitalization of regional finance therefore needs to be accompanied by affirmative policies in the form of infrastructure strengthening and human-resource training for regions with limited digital capacity.

14. Policy Direction and the Agenda for Further Reform

[38]Ministry of Home Affairs of the Republic of Indonesia, Regulation of the Minister of Home Affairs on Regional Financial Management Based on the Regional Government Information System (SIPD), Ministerial Regulation No. 70 of 2019.
[39]Government Regulation No. 12 of 2019, Art. 81, on the implementation of an electronic regional financial management information system.
[40]Corruption Eradication Commission of the Republic of Indonesia (KPK), Study on the Electronic-Based Regional Financial Management System (Jakarta: KPK, 2020), p. 7.
[41]Teguh Dartanto, et al., "Digitalization of Regional Finance and Fiscal Accountability," Journal of Public Policy Economics, Vol. 11 (2021), p. 55.

Based on the analysis set out above, there are several further reform agenda items that warrant attention in the future development of central and regional finance law. First, the strengthening of an integrated national fiscal database combining population data, regional economic-potential data, and basic-service-needs data, so that the formulation of Transfers to Regions can more accurately reflect each region's real needs and reduce the scope for subjectivity in determining allocations.[42] Second, the strengthening of a more transparent, performance-based reward-and-punishment mechanism, so that regions demonstrating good financial-management performance receive fiscal incentives, while negligent regions may be subject to proportionate and fair sanctions in accordance with the central government's mechanism for guiding and supervising regional finance.[43]

Third, there is a need to strengthen institutional coordination among the Ministry of Finance, the Ministry of Home Affairs, sectoral ministries/agencies, and regional governments, so that national and regional fiscal policy can proceed synergistically and without overlap. Fourth, periodic evaluation of the effectiveness of the HKPD Law needs to continue through academic and policy studies, given that the complexity of regional fiscal issues is dynamic and continues to evolve alongside changes in domestic and global economic, social, and political conditions. The reform of central and regional finance law is, in essence, an ongoing process, not something final and complete merely upon the enactment of the HKPD Law.

15. Resolution of Disputes over Financial Authority between the Central Government and Regional Governments

In the practice of central-regional fiscal relations, disputes not infrequently arise from central government policies considered detrimental to regional fiscal interests, for example a region's objection to the amount of its Special Allocation Fund allocation or to a policy suspending the disbursement of Transfers to Regions. With respect to regulations below the level of statute, such as a Regulation of the Minister of Finance or a Regulation of the Minister of Home Affairs considered to conflict with a higher-ranking statute, a regional government or any interested party may file a petition for judicial review with the Supreme Court under the authority granted by Article 31 of

[42]Law No. 1 of 2022, Arts. 167–176 (provisions on sanctions and the suspension/reduction of Transfers to Regions).
[43]Government Regulation No. 12 of 2019, Arts. 330–342 (guidance and supervision of regional financial management by the central government).

Law Number 14 of 1985 on the Supreme Court.[44] As an example, the Supreme Court has examined and decided a petition for judicial review of a ministerial regulation governing the mechanism for allocating the Special Allocation Fund, showing that judicial control over technical regional-finance regulations has operated in Indonesia's constitutional practice.[45]

Besides the judicial-review route, disputes over central and regional finance may also be resolved through an administrative mechanism in the form of an objection or administrative remedy addressed to the issuing agency, as governed by the general principles of administrative law.[46] The availability of dispute-resolution channels, whether administrative or judicial, is a manifestation of respect for the principle of the rule of law (rechtsstaat) in the management of central and regional finance, while also serving as an instrument of checks and balances to prevent arbitrariness in the exercise of fiscal authority by both the central government and regional governments.[47]

D. Closing

Indonesian central and regional finance law is constitutionally grounded in Articles 18, 18A, and 23 of the 1945 Constitution and further regulated through the state finance law framework and Law Number 1 of 2022 on Financial Relations between the Central Government and Regional Governments (HKPD Law). The HKPD Law has introduced significant reforms by strengthening regional taxing authority, restructuring Transfers to Regions, promoting fiscal funding synergy, and reinforcing regional fiscal discipline. Nevertheless, its implementation continues to face challenges, including regional fiscal dependency, interregional fiscal disparities, limited institutional capacity, and the harmonization of national and regional fiscal policies. Theoretically, central and regional finance law constitutes an interdisciplinary field integrating constitutional law, administrative law, and public finance. Practically, the effectiveness of fiscal decentralization depends not only on the quality of legal norms but also on consistent implementation, institutional capacity, and commitment to the principles of good public financial governance.

[44]Indonesia, Law on the Supreme Court, Law No. 14 of 1985, as last amended by Law No. 3 of 2009, Art. 31, on the authority to conduct judicial review of regulations below the level of statute.
[45]Supreme Court of the Republic of Indonesia, Decision No. 23 P/HUM/2018 on the judicial review of a Ministerial Regulation concerning the allocation of the Special Allocation Fund.
[46]Philipus M. Hadjon, et al., Introduction to Indonesian Administrative Law (Yogyakarta: Gadjah Mada University Press, 2011), pp. 130–133.
[47]S.F. Marbun, State Administrative Justice and Administrative Remedies in Indonesia (Yogyakarta: UII Press, 2003), p. 45.

The central government should strengthen regional fiscal capacity through technical assistance and improved databases on the potential of regional taxes and levies to gradually enhance fiscal independence. Furthermore, the allocation mechanisms for the General Allocation Fund (DAU) and Revenue-Sharing Fund (DBH) should be periodically evaluated to better reflect regional needs and reduce fiscal disparities. Regional governments should also enhance the competence of financial management personnel and accelerate the digitalization of regional financial management systems to improve the planning, implementation, and accountability of Regional Budgets (APBD). These measures should be supported by stronger coordination between central and regional governments to ensure policy harmonization, consistent enforcement of fiscal regulations, and the sustainable realization of equitable and accountable fiscal decentralization.

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