

**LOCAL RESPONSE TO DECENTRALIZATION
AND ITS IMPACT ON THE BUSINESS ENVIRONMENT**

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Abstract

The main objective of the study is to find out the impact of implementation of regional autonomy policy in Indonesia. The study is a combination between desk study (secondary data analysis) with small field survey in three districts (Yogyakarta, Bantul and Makassar). One of the main findings is that the central government clearly has not completed its big works to issue many regulations to make the policy effective and to avoid possible negative impact of the implementation of the policy. At district level, there are two contradictory responses by local governments. First, there is a spirit to release tight regulations on the business activities through (especially) one stop service office. But, on the other hand, the other spirit is to gain more local revenue from business activities. Meanwhile, the private sector (especially small medium enterprises) is in the “wait and see” position. Their main concern is whether the government (either at central level or local level) has an intention to “disturb” their market (rather than to levy them without disturbing the market). The big question to balance the interest of all agents is how to increase (local) revenue of local government without burdening the private sector. One of the possible answers to the question is to re-formulate the balancing fund allocation, particularly related to the distribution of corporate income tax. That is needed to make a clear link between enabling business environment with local government interest.

1. Background

Many authorities of (central) government have been transferred to the local governments under decentralization policy based on Law No 22/1999 and Law No 25/1999, including trade and industry policy, especially that involving SMEs. From the business perspective, that means that the local business climate will be mainly determined by local policies created by local governments, beside some regulations by the central government.

The central government itself has been implementing the policy by producing some government regulations (PP or “peraturan pemerintah”) and presidential decree (Keppres or “keputusan presiden”). By law, local governments should respond central government regulations by issuing local regulation (Perda or “peraturan daerah”) consistent with relevant central regulations.

Local governments respond decentralization policy by some ways. Based on several reports by mass media, in general, every district tends to be keen to protect industry located in their region, especially industries operated by SMEs. The problem is, tendency to be protective in every region may deteriorate each other local business

environment. For example, willingness to protect certain industry in certain district may cause market barrier to entry for similar products from other districts.

Also, certain response by certain local government may increase cost of production for SMEs in other districts. For illustration, quoted by some mass media that some regions plan to charge every truck containing products from other districts that pass the region.

Moreover, such in-productive responses by certain district may burdensome SMEs in its own region. The relevant policy for that issue is changes in Law No 18/1987 about local tax to be Law No 23/2001. In general, the new local tax law gives more authority to local government to set and determine the rate of local tax and user fees (“retribusi”). Since one of the big concern by local government is to raise their local revenue (PAD or “pendapatan asli daerah”), most of local government plan to create new local tax as well as increasing the rate of existing local taxes. In one hand, that may be effective to increase local revenue, but in the other hand, that can burdensome private sector, including (and mainly) SMEs.

It is important to remind, that the main player in Indonesian economy is SMEs. At local level, that phenomenon is partly indicated by the existence of centers of small industry in some regions. The role of the centers is very important, not only for regional economy but also for Indonesian economy as a whole.

Ideally, when responding decentralization policy local government should consider the situation. SMEs should be viewed by local government not only as source of fund, but also as the backbone of regional economy. By this consideration, local government should respond decentralization policy properly from business perspective. Otherwise, local economy, and national economy in turn, will be threatened.

It is very clear that responses of local government to the decentralization policy are need to be watched, as well as responses by private sector. The assessment is needed to formulate a kind of projection on the local economy during the decentralization policy. If the projection reflects that the economy will be better, that is fine, but if that will be worse due to inappropriate responses by certain agency, some advocacy activities will be very crucial. At central level, the information can be used as consideration in formulating a set of national policy that by law should be obeyed by local government, basically to guarantee that decentralization policy would not worsen business environment and the economy in turn.

2. Objective

In general, the focus of the study is to examine the impact of implementation of regional autonomy policy on the business environment, particularly in some SME business centers. The general objective can be divided into four specific ones as follow:

1. To assess responses by local government to the decentralization policy, especially that reflected by regulatory framework newly created in the regional autonomy era.
2. To assess responses by local SMEs to the policies by local government as well as by central government related to the decentralization.
3. To estimate the impact of both responses by local government and by SMEs on the regional economy in the future.
4. To build a set of business-like recommendations for both local and central governments to develop better regional economies.

3. Methodology

Regarding research method used in the study, there are two types of data collected, those are secondary data and primary data. As secondary data is defined as data collected by other agency for other purposes, the data are collected through some visits to relevant agencies, as well as studying some relevant publications by competent agencies (including report of studies conducted by other institutions)

Meanwhile, the primary data are collected directly in the field. There are two main sources of information in the primary data collection. The first is local government officials as the key player in implementing decentralization policy at local level. The second is SME owners as key stakeholder regarding any policy influencing business environment (For details, please see **Table-1**).

Table-1.
Source of Information and Data Collected in the Study

Group of information	Source of information	Data collected
Direction of decentralization policy	<ul style="list-style-type: none"> • Central government officials • Relevant publication 	<ul style="list-style-type: none"> • Regulations issued by central government
Implementation of decentralization	<ul style="list-style-type: none"> • Local government officials 	<ul style="list-style-type: none"> • Regulations issued by local government
Responses by local government	<ul style="list-style-type: none"> • Local government officials • Key informants 	<ul style="list-style-type: none"> • Perception on the decentralization policy • Understanding on the authority owned by local government under decentralization policy • Regulations issued by local government related to business practices • Regulations to be issued related to business practices • Background of issuance of some new regulations by local government • Purposes of issuance of some new regulations by local government • Changes in magnitude and structure of local budget (APBD) • Role and structure of local revenue in APBD • Others
Responses by SME	<ul style="list-style-type: none"> • SME Owners 	<ul style="list-style-type: none"> • Understanding of decentralization policy • Awareness on the responses by local government • Changes in business practices during decentralization era • Others
Impact of local responses to the business environment	<ul style="list-style-type: none"> • SME Owners 	<ul style="list-style-type: none"> • Changes in business performance (sales, profit, volume of production, labor absorption, etc) during the decentralization era • Problems and opportunity raised during the decentralization era • Others

Three locations known as center of certain small-medium industry are selected as research sites. The three sites are:

- **Kotagede-Kota Yogyakarta** in Yogyakarta province. Kotagede is one of the biggest centers of silver handicraft industry in Indonesia. The characteristic of the industry, so far, is the dependency on the supply of raw material from PT. Aneka Tambang (a state owned enterprise). It is interesting to see whether local government has concern on the need for changes in the raw material market for silver industry to be more enabling for SMEs.
- **Kasongan-Kabupaten Bantul** in Yogyakarta province as center of ceramics industry. Although Kasongan is in the same province as Kotagede, the characteristic of the industry is different with the other. As a resource based industry, the ceramics industry in Kasongan does not depend on the supply of raw materials from outer area. It is also interesting to see whether the local government can use their authority in the decentralization era to optimize the growth of the industry.
- **Makassar** in South Sulawesi province. Makassar is one of the big centers of beverage industry, especially passion fruit or *markissa* juice (the other one is Medan in North Sumatra). As an urban area, Makassar cannot provide *markissa* juice industry with raw materials. The *markissa* fruit as main raw material of the industry come from other districts in South Sulawesi. In the other word, the performance and sustainability of the industry in Makassar is depending much on the supply of raw material which is under the authority of local government of other the district where the industry located. That is an interesting case to see the linkage among districts in the decentralization era.

Initially, in each location 30 SMEs owners will be selected and interviewed to get information from SME side. But in practice, only 16 SMEs in Makassar could be interviewed, while in Yogyakarta City and Bantul Region are as expected.

It is understood that certain industry is not only affected by policies developed by local district, but also by those created by other districts. For example, if certain industry in District A purchase raw materials from District B, the policies by District B also influence them. The study will examine policies by some districts relevant to some industries mentioned above. The relevant districts are identified during interview with SME owners.

4. Progress of Decentralization Policy

Since its implementation in January 2001, decentralization policy has brought some important changes, especially in the increasing authority of local governments in managing many matters related to governance of their own region including financing. The increasing authority of local government is not only based on the Law No 22/1999 and Law No 25/1999, but also Law No 34/2000 that gives more authority to manage local tax. Actually the Law No 34/2000 is a revision on the UU 18/1997.

Central government fully understand that in order to keep regional autonomy on the right track, some regulations are needed as guidance for local government in implementing the policy at the local level. It is clear that the three laws are not enough to be an operational guidance. That is why the central government also produces some regulations in line with the three laws in the forms of Government Regulation (PP), Presidential Decree (Keppres), Ministerial Decree (Kepmen) and Announcement Letter (SE). Official at the Ministry of Home Affair and Regional Autonomy (MOHARA) said that until now there are 24 PPs, 13 Keppresses, 10

Kepprens and eight SEs regarding implementation of decentralization policy (for the list, see **Table 2**)¹.

Table-2
List of Central Government Regulation
as Implementation of Decentralization Policy So Far

No.	Regulation	About
I. Government Regulation (PP):		
1.	No. 45 Tahun 1992	Implementation of regional autonomy with stressing on the districts area.
2.	No. 8 Tahun 1995	Transfer of Some Government Matters to 26 Pilot Districts
3.	No. 25 Tahun 2000	Authority of Central Government and Province as Autonomous Region
4.	No. 47 Tahun 2000	Implementation of Consultation of Governor Candidates and Vice Governor Candidates, Approval and Inauguration of Them
5.	No. 84 tahun 2000	Guidance for Regional Organizational Structure
6.	No. 96 Tahun 2000	Authority of Appointing, Up-Grading and Termination of Civil Servants
7.	No. 97 Tahun 2000	Formation of Civil Servants
8.	No. 98 Tahun 2000	Supply of Civil Servants
9.	No. 99 Tahun 2000	Grading of Civil Servants
10.	No. 100 Tahun 2000	Appointing of Civil Servants for Structural Position
11.	No. 101 Tahun 2000	Education and Training for Civil Servants
12.	No. 104 Tahun 2000	Balancing Fund
13.	No. 105 Tahun 2000	Management and Accountability of Regional Finance
14.	No. 106 Tahun 2000	Management and Accountability of Finance in the Implementation of de-concentration and Assisting Tasks
15.	No. 107 Tahun 2000	Regional Debt
16.	No. 108 Tahun 2000	Guidance for Accountability of regional head
17.	No. 109 Tahun 2000	Position of Head of Regional Finance and the Vice Head of Regional Finance
18.	No. 110 Tahun 2000	Position of local parliament finance
19.	No. 129 Tahun 2000	Condition for Formation and Criteria for Development, Liquidation and Merging of Districts
20.	No. 141 Tahun 2000	Second Amendment of Government Regulation No. 15 about Fishery Business
21.	No. 142 Tahun 2000	Tariff on Non-Tax Government Revenue in the authority of Ministry of Sea and Fisheries
22.	No. 151 Tahun 2000	Guidance for Election, Approval and Termination of regional head and the vice head
23.	No. 1 Tahun 2001	Guidance for code of conduct of local parliament
24.	No. 2 Tahun 2001	Security and Transfer of State Owned Asset from central government to local government in the context of regional autonomy policy implementation
II. Presidential Decree (Keppres):		
1.	No. 134 Tahun 1999	Position, Task, Function, and Formation of Organization of State Ministry
2.	No. 136 Tahun 1999	Position, Task, Function, and Formation of Organization of Department
3.	No. 49 Tahun 2000	Regional Autonomy Consideration Council (“DPOD”)
4.	No. 52 Tahun 2000	Development of Coordination Team as a Follow Up on Law No. 22 Year 1999 and UU No. 25 Year 1999
5.	No. 84 Tahun 2000	Amendment of Presidential Decree No 49/2000 about “DPOD”
6.	No. 151 Tahun 2000	Amendment of Presidential Decree No. 49/ 2000 about “DPOD” that has been amended by Presidential Decree No

¹ This study was conducted in May-August 20001.

		84/2000
7.	No. 157 Tahun 2000	Development of Implementation Task Force for Law No 22/1999 and Law 25/1999
8.	No. 159 Tahun 2000	Guidance for Development of Regional Civil Servant Body
9.	No. 181 Tahun 2000	General Allocation Fund for Provinces and Districts in the Budget Year of 2001
10.	No. 5 Tahun 2001	Implementation of District's Authority
11.	No. 6 Tahun 2001	Determination of Number and Guidance for Fulfilling The Membership of Local Parliament that Developed After 1999 General Election Umum 1999
12.	No. 16 Tahun 2001	Amendment of Presidential Decree No. 166/2000 about Position, Task, Authority, Organizational Structure of Non-Department Governmental Agencies that Have Been Amended by Presidential Decree No. 173/2000
13.	No. 17 Tahun 2001	Amendment of Presidential Decree No 178/2000 about Organizational Structure and Task of Non-Department Governmental Agencies
III. Decree of Minister of Home Affair:		
1.	No. 4 Tahun 1999	Cancellation of Some MOHA Regulation, Ministerial Decree, etc in the context of Law No. 5 Tahun 1979 about Village Government
2.	No. 63 Tahun 1999	Technical Guidance and Idiom Adjustment in the Management of Village Government
3.	No. 64 Tahun 1999	General Guidance for Regulation on Village
4.	No. 65 Tahun 1999	General Guidance for Village Formation
5.	No. 16 Tahun 2000	Guidance for Development of Association of Regional Governments
6.	No. 19 Tahun 2000	Guidance for Selection of Regional Representative as Member of "DPOD"
7.	No. 110.05-336 Tahun 2000	Addition of Member of "DPOD" Secretariat
8.	No. 118.281 Tahun 2000	Formation of "DPOD" Secretariat
9.	No. 188.2-198 Tahun 2000	Formation of Task Force for Acceleration of Implementation of Regional Autonomy Policy
10.	No. 800.05-237 Tahun 2000	Formation of Sub-Team/Personnel Transfer/Civil Servants
IV. Announcement Letter (SE):		
1.	No. 118/1379/PUMDA Tahun 2000	Working Plan for Acceleration of Implementation of Regional Autonomy Policy
2.	No. 118/1500/PUMDA Tahun 2000	Management, Authority and Institution
3.	No. 800/2365/SJ Tahun 2000	Guidance of Reallocation and Positioning of Central Civil Servants at Local Level
4.	No. 045/2364/SJ Tahun 2000	Document Management
5.	No. 903/2735/SJ Tahun 2000	General Guidance for Development and Implementation of State Budget 2001
6.	Surat Edaran Bersama Direktur Jenderal Anggaran dan Direktur Jenderal Pemerintahan Umum Daerah No. SE-186/A/200 dan No. 911/2189/PUMDA Tanggal 14 Desember Tahun 2000	Guidance for Planning and Implementation of Routine Budget 2001 for Central Office that will be transferred to local government

7.	Surat Edaran Bersama Direktur Jenderal Anggaran dan Direktur Jenderal Pemerintahan Umum Daerah No. SE- 199/A/200 dan No. SE- 845.1/2233/PUMDA Tanggal 29 Desember Tahun 2000	Guidance for Cutting Procedure, Submission and Payment Compulsory Fee and House Saving for Local Civil Servants
8.	Surat Edaran Bersama Direktur Jenderal Anggaran dan Direktur Jenderal Pemerintahan Umum Daerah No. SE- 17/A/200 dan No. 902/228/PUMDA Tanggal 25 Januari Tahun 2001	Guidance for Use of Balancing Fund

5. Changing Business Environment

One of the main objective of this study is to answer a question whether the business environment become better (or worse) after the implementation of decentralization policy. In fact, it is not easy to answer such question due to the problem of isolating the impact of the policy from other factors which coincident with it.

In 1997, Indonesia is hampered by economic crisis, and the crisis has not been over until now. Meanwhile, decentralization policy was implemented in January 2001. The implication of the coincidence is the difficulty in measure the real impact of decentralization after isolated from other factors. Nevertheless, this part is trying to distinct the two variables.

5.1. Yogyakarta City (Silver Handicraft Industry)

Table 3 indicates that some changes are felt by SME during the regional autonomy era. The main change is in term of cost of production. The table shows that 93.3 per cent of the respondents say that the situation become worse, meaning the increasing cost of production, while only 6.7 per cent say that the situation is the same as before.

It is clear that the dramatic figure not necessarily due to the implementation of the decentralization policy. The main factor might be the increase in the price of raw material.

Although the price of raw material was dramatically increased, 100 per cent of the respondents say that the access to get the material remains the same as before. That clearly indicates that the problem related to raw material is price, rather than access.

The other problem is in marketing. Around 56.7 per cent out of 30 respondents in Yogyakarta City express their problem in marketing by saying that the situation becomes worse during the autonomy era. As problem in cost of production, the change cannot be claimed as the effect of implementation of the decentralization policy. The decrease of domestic demand due to the economic crisis, combined to the security problem imply decreasing number of foreign tourists, might be the more reasonable answer for that situation.

In term of licensing, practically there is no change felt by the SMEs in Yogyakarta City. Around 90 per cent of them say that, while the rest say that they do not know. The latter indicates that they are never in touch with licensing matters.

Table-3.
Changing Business Environment Felt by SME
During Regional Autonomy Era in Yogyakarta City, 2001

Direction of Change	Aspect of Business Environment							
	Licensing		Access to Raw Material		Cost of Production		Marketing	
	%	CASE	%	CASE	%	CASE	%	CASE
1. Better	-	-	-	-	-	-	-	-
2. Worse	-	-	-	-	93.3	28	56.7	17
3. No change	90.0	27	100.0	30	6.7	2	43.3	13
4. Do not know	10.0	3	-	-	-	-	-	-
Total	100.0	30	100.0	30	100.0	30	100.0	30

5.2. Bantul Region (Ceramic Industry)

Ceramic industry in Bantul is a kind of resource based industry. Almost all of raw material for the industry comes from the region itself. It is interesting to see, whether the difference in nature of industry implies the difference in business environment in the regional autonomy era.

Regarding cost of production, all respondents claim that the situation become worse, meaning the increasing cost of production. The increasing cost mainly due to the rise in price of raw material. It is quite interesting, because the material come from the region and no relationship at all with monetary crisis or rupiah depreciation.

It is interesting that economic crisis not only influence the price of imported materials, but also local natural resource. It is described in previous chapter of the report that raw material supply for ceramic industry in Kasongan-Bantul is controlled by around six enterprises. In the other word, the market structure of raw material in the industry tends to be a monopolistic. In such market structure, usually the increase in price of output (or input for ceramic industry) is much higher than the increase in cost of production (due to the economic crisis, in this case).

Table-4.
Changing Business Environment Felt by SME
During Regional Autonomy Era in Bantul Region, 2001

Direction of Change	Aspect of Business Environment							
	Licensing		Access to Raw Material		Cost of Production		Marketing	
	%	CASE	%	CASE	%	CASE	%	CASE
1. Better	-	-	-	-	-	-	-	-
2. Worse	-	-	16.7	5	100.0	30	70.0	21
3. No change	23.3	7	83.3	25	.	.	30.0	9
4. Do not know	76.7	23	-	-	-	-	-	-
Total	100.0	30	100.0	30	100.0	30	100.0	30

Although the SMEs is facing increasing cost of production, access to the material is relatively the same as before as stated by 83.3 per cent out of 30 respondents in Bantul (see **Table-4**). It is important to note that there are some

enterprises supply material for all SMEs in the ceramic industrial area in Kasongan, Bantul. Since the SMEs do not take the material by themselves, it is normal that there is 16.7 per cent of them says that they feel more difficult to access the raw material.

The other interesting thing is the fact that majority (76.7 per cent) of the respondent stated that they do not know about the situation regarding licensing, while the rest said no change. That happened because most of them never have license at all for their enterprise.

Like silver industry in Yogyakarta City, SMEs in Bantul that operate ceramic industry are facing problem in marketing. Around 70 per cent of the respondents said that market situation become worse during regional autonomy era, which is cannot be associated directly to the policy. Decreasing demand due to the economic crisis might be the main factor implied the worse market for ceramic industry in Bantul.

5.3. Makassar City (Passion Fruit or *Markissa* Juice Industry)

Table-5 shows that in term of marketing and cost of production, the situation in Makassar City is the same in that two other regions. Around 94 per cent of the respondents there said the cost of production become higher, while in term of marketing, around 63 per cent said that the situation become worse. It is very near to the conclusion that in the regional autonomy era which come relatively in the same time as the economic crisis, higher cost of production and worse market are the common situation faced by SMEs.

Although only claimed by one respondent (out of 16), it is interesting that there is a sign for better situation in licensing during the regional autonomy era in Makassar City. Theoretically, when the authority in licensing is transferred to the local government, SMEs can access it better than before, and the cost of getting license become lower due to the shorter bureaucracy chain.

Table-5.
Changing Business Environment Felt by SME
During Regional Autonomy Era in Makassar City, 2001

Direction of Change	Aspect of Business Environment							
	Licensing		Access to Raw Material		Cost of Production		Marketing	
	%	CASE	%	CASE	%	CASE	%	CASE
1. Better	6.2	1	-	-	-	-	-	-
2. Worse	25.0	4	75.0	12	93.8	15	62.5	10
3. No change	43.8	7	25.0	4	6.3	1	37.5	6
4. Do not know	25.0	4	-	-	-	-	-	-
Total	100.0	16	100.0	16	100.0	16	100.0	16

In contrast, four out of 16 respondents in Makassar said that the licensing procedure become more complicated. This fact proof that, although supported by theoretical analysis, there is no guarantee that in the hand of local government the licensing procedure will be more efficient and simpler.

The other interesting finding is related to the access to raw material aspect. Like described in the earlier chapter, the raw material for *markissa* juice industry in Makassar come from other district, that is Kabupaten Gowa. Majority (94 per cent) of the respondents claimed that their current access to the raw material is worse than last year.

The worse situation is not correlated to the implementation of regional autonomy, but to the characteristic of (fresh) *markissa* supply. Like other agriculture

products, the production of (fresh) *markissa* is seasonal. Currently, *markissa* juice producers cannot easily buy fresh *markissa* because this is not a production season.

For industry which need material from other district like *markissa* juice, the potential of problem in getting material is quite clear. Some districts, not covered by the study, released regulation in certain goods marketing which may imply the difficulties for industry that need the goods as raw material. But, it is not the case in South Sulawesi. There is a commitment among the districts not to restrict inter-regional flow of goods.

6. Concluding Remarks

1. There is clear evidence that central government still has a big work to produce implementation regulation of decentralization policy. There are some regulations have been released, but compared to those should be completed, there is a huge gap. For regions that are research sites of the study, they are waiting for the regulations very much, because they do not want to release local regulations that will be contradictory with upcoming central regulations. In one hand, that symptom indicates the lack of initiative at local level, but in the other hand, that reflects their understanding that even in the regional autonomy era, they still must obey the higher level central regulations such as laws, presidential decree and government regulation. The latter is a chance for central government to impose regulation that needed to avoid negative impact of the decentralization policy.
2. In general, there are two common responses by local government to the decentralization policy that relevant to business environment. The first is spirit to ease and to simplify licensing procedure. All three regions in this study have a one-stop service unit to process license for new entrepreneurs. By the one-stop service unit, the licensing will not only simpler, but also more transparent and accountable. That is why the central office, especially Ministry of Industry and Trade, should speed up the process of transferring authority in licensing to the local government.
3. But, secondly, there is very clear fact that the three regions have been planning to raise their local revenue (“PAD”) by maximizing regional tax and user fee, both through extensification and intensification. Although the magnitude will be various, but the impact of the plan in the future is very clear, that is increasing cost of production. It is important for central government to re-consider the policy of income tax distribution. If local governments have a significant portion of income tax (not only individual tax, but also corporate), they have alternative to raise their local revenue other than increasing regional tax and user fee that will burdensome private sector, especially SME, in there.
4. Basically, SMEs are in the position of “wait and see” what will be done by the government (both central and local). Until now, there is no impact of decentralization experienced by SMEs in three regions. However, they understand that local government has a plan to get more money from them through regional tax and user fee mechanism. In general, based on the fact that the share of tax and user fee in their cost structure is very limited, they do not mind with the plan. They can respond it by reduce profit margin, otherwise by raising the price of output. Their big concern is if the government releases new policy that directly affecting (worsening) their access to market and/or to raw material. Relating to the issue, the central government should continue its plan to release new law on domestic trade that imposes a minimal barrier to inter-region and intra-region trade. However, the local government should understand that in

the longer term, when the share of tax in the cost structure will be significant, the effort to raise regional tax and user fee revenue would significantly worsen the business climate.

5. If business climate become worse, and could not be accommodated by reducing profit margin anymore, SMEs would reduce their output and, in turn the labor absorption. That clearly will affect the local economy as the whole. That is why the local government should pay more attention on the impact of their plan anything that potentially could worsen the business environment. Otherwise, they will loss many things in the context of local economy.
6. The big question is, how to raise local revenue without worsening business environment to guarantee the long term regional economic development? The answer of the question is the distribution of (corporate) income tax. Until now, the corporate income tax is fully under the authority of central government. Although the tax revenue is redistributed to local governments through balancing fund mechanism, that does not answer the question about the local government interest to raise its local revenue. Assume that part the corporate income tax can be directly distributed to local government as local revenue, the local government has alternative to raise their own revenue other than raising local tax and user fee. The administrative problem following up on the new system will be the next question, but not unanswerable.
7. It is not the case in three regions in this study (Yogyakarta, Bantul and Makassar), but there is an unofficial information that some regions are over-regulating the economy. According to explanation of stone craft industry owner, certain region in Central Java is implementing “one door” policy that regulate anybody need the specific kind of stone as material must buy it from one agency appointed by the local government. Consequently, there is no competition in the market and the bad thing is that the highest price become the official price. The policy clearly hampers small business that usually can get cheaper material from their network. This is the kind of policy distorting inter-regional trade and should be abandoned by central government. In the other words, this is a sign for the need for Domestic Trade Law to minimize inter-regional trade barriers.

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