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# Village Fund and Poverty Alleviation


*This analysis is compiled by a team expert from KOMPAK[1] at the request of the Deputy for Population and Labour, Bappenas.*


## SUMMARY

This paper evaluates the formula of the Village Fund and discusses implications for the distribution of funds among provinces, regions and districts. This evaluation is crucial, as allocations in the future years will increase because of the government's commitment to meet the amount mandated by Village Law. According to the Village Fund Roadmap issued by the Ministry of Finance, the amount of funds managed by village governments is estimated to be 128 trillion Rupiah in 2017 and 178.5 trillion in 2019. This policy analysis presents data that suggests changing the formula for village fund distribution will reduce current inequities and strengthen poverty reduction efforts in poor and underdeveloped villages.

One of the biggest challenges in implementing Village Law is how to divide the fund fairly among 74,754 villages given the vast variations in size (population, total area), poverty levels, and the development level of villages in Indonesia. A second major challenge is how the Village Fund can be absorbed efficiently and effectively by villages to support the realisation of rural development objectives, namely poverty alleviation and the improvement of village community welfare and quality of human life.


[1] Team expert consists of Dr Hefrizal Handra, Dr Machfud Sidik, Sentot Satria, Suhirman, Erny Murniasih, Devi Suryani, Dylan Robertson.

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Village Law mandates that the Village Fund from the State Budget/APBN (Village Fund) be used to improve welfare and village development. The law stipulates that the fund be allocated equitably based on the number of villages, accounting for village demographics (population, poverty, total area, and the level of Village geographic difficulty). However, currently 90 percent of the Village Fund is divided equally among villages which is called the basic allocation (AD). The remaining 10 percent is distributed based on village needs derived from the aforementioned four variables. The result from this analysis shows that the current Village Fund formula contributes to an increase in disparity, given the wide diversity that exist among villages within and between districts, regions and provinces. In addition, findings suggest that the need to accommodate regional diversity in improving services and poverty reduction is not adequately addressed because only 10 percent of the fund is distributed based on need as defined by population, poverty, area, and the level of Village geographic difficulty. Regions with many villages, but with smaller numbers of poor people receive a larger amount of the Village Fund compared to regions with fewer villages, but with larger numbers of poor people. The current formula does not fully support the primary objectives of the Village Law which is to realise development equality and improve access of poor people to public services. This policy analysis proposes that the basic allocation of the Village Fund should be 65 percent, and the remaining 35 percent should be calculated based on the formula that takes into account the needs of poor and underdeveloped villages.

In terms of utilisation, existing data shows that 84 percent of the Village Fund is allocated for physical infrastructure and facilities development, 6.5 percent is allocated for economic empowerment, and the rest is used for government activities and social affairs. Although the development of infrastructure can contribute to the alleviation of poverty (e.g., building infrastructure with economic impacts), oftentimes villages build infrastructure, such as a village gate, office, or fence, which has little impact on the village economy, or poverty reduction. As poverty is a multidimensional phenomenon caused not only by economic factors, but also by limited access and unfulfilled demand for basic services, in addition to promoting infrastructure with economic impacts, the Village Fund should be used for activities that foster community economic empowerment and increase the availability of basic services.

## FOREWORD

Growth and the socioeconomic advancement of the community, as well as the changes in the economic structure of Indonesia, has contributed to two important consequences. First, the creation of a lower-middle class that has increased needs for a comprehensive social protection system. Second, the development of a bigger gap between low-income and middle-upper class people. A comprehensive and wrap around social protection system is essential to ensuring that basic needs are met. This system should improve access to services for underprivileged communities, and insulating people from short- and longer-term social and economic shocks. To narrow the economic gap between classes, improved access to employment opportunities and expanded sources of local economic activities are required.

To address the disparities between regions, villages, and cities, the government applies a paradigm of ‘Developing from the periphery’, which means building up regions and rural areas that are lagging behind the norm. The government believes that rural-based development is crucial and necessary to strengthen the foundation of the country’s economy, accelerate poverty alleviation, and reduce disparities between regions. As a solution for social change, villages are strategic as a base for change.

In such a context, drivers of economic growth must come from rural areas, so that villages become attractive places to live where people can make a living, because they provide opportunities for increased prosperity. Improvements to rural infrastructure, such as irrigation, roads and transportation, electricity, telephone, education facilities, health, and other crucial facilities will enable villages to advance and develop.

Based on the mandate of the National Long-Term Development Plan 2005–2025, and the Vision and Mission of the President, the main goal (impact) stipulated is to reduce the poverty rate to 7.0–8.0 percent by 2019. The development targets that all levels of society should benefit from include:

1. An increase of labour-intensive investment to increase job opportunities for the less fortunate in the community.
2. Improved access to micro and small enterprises to develop

skills, facilitation, and working capital, as well as technological development.

3. The establishment of government and private sector enterprises/partnerships that facilitate the development of local capacity and skills necessary to improve the livelihood of communities.
4. The availability of facilities and infrastructure to support quality economic activities.
5. Improved outreach of basic services, including legal identity, better-quality facilities and infrastructure for education and health, basic infrastructure, and inclusive economic development opportunities for disadvantaged communities especially for women, people with disabilities and elderly groups.
6. The improvement of social protection to enhance productivity, and fulfill the basic rights for disadvantaged groups.

With the large amount of funding being allocated to villages, villages are expected to contribute to the achievement of development targets. To accomplish this, villages and local government need clear guidelines of authority and the division of responsibility concerning social protection for the poor, basic service delivery, and environmental development and protection.

## ANALYTICAL FRAMEWORK

### Theoretical Framework

The current formula to allocate the Village Fund is stipulated in the Government Regulation No. 22/2015 (last amended by Government Regulation No. 8/2016), and incudes the allocation of funds from the central level to the districts and municipalities level, and from the districts and municipalities level to the villages. The allocation formula is dominated by the Basic Allocation (Alokasi Dasar), which is an equal distribution formula, without taking into account the needs of respective regions and villages. Based on a public finance point of view, such a formula needs to be evaluated for whether the result of funds distribution with the current formula complies with efficient and equitable allocation. The definition is as follows:

- **Pareto Efficiency**

  ***"An economy's resources are used efficiently when they are used in a way that has fully exploited all opportunities to make everyone better off. Or,***
  ***An economy is efficient if it takes all opportunities to make some people better off without making other people worse off."***

  From the perspective of allocation efficiency with the goal of alleviating poverty, we can argue that:
  - An efficient Village Fund allocation allows for various alternatives and opportunities to improve village conditions, so that the people in the village especially the poor and vulnerable are better off; or
  - An efficient Village Fund allocation is able to facilitate improvement of conditions for all people in the village, without exacerbating other conditions.
- **Equity**
  - Horizontal Equity (*equal treatment of equals*):
    - Villages with the same size (area and population) should receive relatively similar amounts of the Village Fund.
    - Districts with the same size (area and population) should receive relatively similar amounts of the Village Fund.
    - Districts with a similar population of poor people should receive relatively similar amounts of the Village Fund, unless there is another determining factor.
  - Vertical Equity (*unequal treatment of unequals*)
    - Villages with different needs should receive different amounts of the Village Fund.
    - Villages with greater poverty related needs should receive greater amounts of the Village Fund compared to those with lesser needs.

## Legal Framework

The Village Fund is one of seven sources of village revenue. Based on Law No. 6/2014 concerning Villages, the amount of the Village Fund from the State Budget (APBN) is 10 percent calculated on the basis of the number of villages, and allocated by taking into consideration the population, poverty rate, total area, and geographic constraints, to improve the prosperity and equitable village development (as explained in Article 72 Verse 2 of the Village Law). The arrangements for gradual allocation of the fund are regulated in the Presidential Regulation No 22/2014 (Article 30A), namely, at least 3 percent in 2015, at least 6 percent in 2016, and 10 percent in 2017.

In addition to the Village Fund from the State Budget (APBN), based on Law No. 6/2016, villages also have six other sources of revenue, which are: (1) Villlage Fund Allocation (ADD) with the amount of 10 percent of the General Allocation Fund (DAU) and the Revenue Sharing (DBH) of Districts and Municipalities; (2) 10 percent of local tax revenue sharing and the redistribution of Districts and Municipalities (revenue sharing Local Tax and Redistribution/PDRD); (3) fund assistance from the width budget; (4) fund assistance from the Provincial Budget (APBD); (5) unbound grants from third parties; and (6) other legal village revenues. Based on the data from the Ministry of Finance, in 2016 the national average shows that each village received revenue of a minimum IDR 1 billion from the three biggest revenue sources, namely, APBN, ADD, and revenue sharing of PDRD.

Principles of equality and equity, as mandated by the Law, are (AD) of 90 percent, as the elements of equality and equity are designed to be realised through the distribution based on the allocation formula. The allocation formula is 10 percent, taking into consideration the population, poverty rate, total area, and geographic constraints of the villages. The respective weight of the formula-based variables is 25 percent based on population, 35 percent for the poverty rate, 10 percent for the area width, and 30 percent for the geographic constraints level of the village. Such provision is regulated in Presidential Regulation No. 60/2014 concerning the Village Fund from APBN, as amended by Presidential Regulation No. 22/2015, and confirmed by Presidential Regulation No. 8/2016. Furthermore, the allocation of the Village Fund is technically regulated in the Minister of Finance Regulation No. 49/2016 concerning Allocation, Distribution, Utilisation, Monitoring and Evaluation Mechanism of Village Fund.

The second biggest revenue source for the village budget (approximately 30–35% from Village Budget) is the Village Fund Allocation (ADD), part of the Equalization Fund received by the Districts and Municipalities. ADD is at least 10 percent of the Equalization Fund received by the Districts and Municipalities in the Local Budget after deducting the Special Allocation Fund (DAK).

The regulation mandate can be simply described by the following calculation per width and per village:

**Table 1. Calculations per District/Municipality and Village**

| Calculations per District/ Municipality | Calculations per Village |
|---|---|
| Total villages x basic allocation per village (90% of total Village Fund divided by number of villages in Indonesia) | Basic Allocation (90%) |
| The remaining 10% is calculated based on the population variable (weighted 25%), poverty rate (weighted 35%), total area (weighted 10%), and construction cost index (IKK-weighted 30%).<br><br>Note:<br>Construction cost index is used as a proxy to measure the level of geographic constraints. | Allocations are calculated with the key variables, namely the population, poverty rate, total area, and geographic constraint level of each village (determined by factors including the availability of basic service infrastructure, infrastructure conditions, and accessibility/ transport). |
| Determined by Central Government | Determined by Mayor/Head of District |

## Policy Framework

From the context of policy, village management by the national, provincial, or district/municipality government aims to realise the effectiveness of village administration implementation, accelerate the improvement of public services quality, improve the quality of village governance, and improve the competitiveness of villages. Therefore, village development aims to improve the welfare of the village community and the quality of human life, as well as alleviate poverty through fulfilment of basic needs, rural infrastructure development, local economic potential development, as well as sustainable use of natural resources and environment.

The allocation of the Village Fund in the draft of APBN for 2017 is the third year of the Village Fund implementation and the plan is to allocate IDR 60,000 billion or increase 27.7 percent compared to the budget allocated in the amended State Budget of 2016, which was IDR 46,982.1 billion. The policy to increase the Village Fund allocation for 2017 APBN is aimed to maintain the fiscal capacity of the villages sustainably, and ensure that it is not less than the national average in 2016. Therefore, the main points of Village Fund policy in 2017 include the following elements:

1. Allocate the Village Fund, taking into account equality and equity aspects.
2. Improve the quality of Village Fund management through the improvement of channeling implementation, and provide discretion to villages in deciding how to use the fund with the priorities of community development and empowerment, as well as strengthen the monitoring and evaluation of the Village Fund.
3. Enhance the capacity of village officials through village training and facilitation to improve the effectiveness of Village Fund management and utilisation.

The data used to calculate the number of villages is from the village data of the Ministry of Home Affairs, in which there has been an increase of 200 villages in the number of villages, from the village calculation data in 2016; i.e. from 74,754 villages to 74,954 villages in 2017. The increase of the number of villages is due to the following reasons:

- Villages with a code (identification number) are 215 villages.
- The change of village status to sub-district applies to 8 villages.
- The change of status of Kelurahan to village applies to 6 villages.
- The elimination of a village applies to 13 villages

The database for the population of the village, poverty rate of the village, total area of the village, as well as geographic constraints, which is used in Village Fund formulation, is derived from the result of the Village Potential Data survey conducted by the Central Bureau of Statistics in 2014. This data is a region-based thematic data source that is able to depict the potential of villages in Indonesia. Village Potential Data 2014 can be used for various purposes by any parties that require the region-based database. In 2014, village potential data collection was conducted in April 2014, covering all village-level administrative areas, including *nagari khusus* (similar to village) in West Sumatra Province. The data collection of Village Potential is conducted every four years and will be conducted again in 2018 by the Central Bureau of Statistics. To update the population data, alternative data for population that is used in the formulation of the Village Fund is the population and civil registration data from the Ministry of Home Affairs.

## VILLAGE FUND UTILISATION

Village Law states that the Village Fund is the budget for the villages, transferred via the local budget (APBD) to fund the governance, development, community empowerment, and social activities in the village. Further, Article 74 of the Village Law states that the spending of the village (in which the Village Fund is the main source of revenue of the village) is prioritised to fulfill the needs and development agreed in the deliberations of the village and should be in line with the priority of the local government, as well as the provincial and central governments. The development needs comprise but are not limited to primary needs, basic services, the environment, and also village community empowerment activities.

Article 78 of Village Law also states that village development aims to improve the welfare of village communities and the quality of human life, and alleviate poverty, through fulfilment of basic needs, rural infrastructure development, local economic potential development, and sustainable use of natural resources and the environment.

Meanwhile, the Minister of Villages Regulation No. 21/2015 states that villages should prioritise the implementation of local-scale programs and activities in the field of village development and community empowerment, with emphasis on:

- The construction, development, and maintenance of infrastructure or physical infrastructure and facilities for livelihoods, including food security and settlements.
- The construction, development, and maintenance of public health infrastructure and facilities, educational, social, and cultural facilities.
- Community economic development efforts, including the development and maintenance of infrastructure of production and distribution.
- Construction and development of renewable energy facilities and infrastructure and environmental conservation practices.

## EVALUATION RESULT

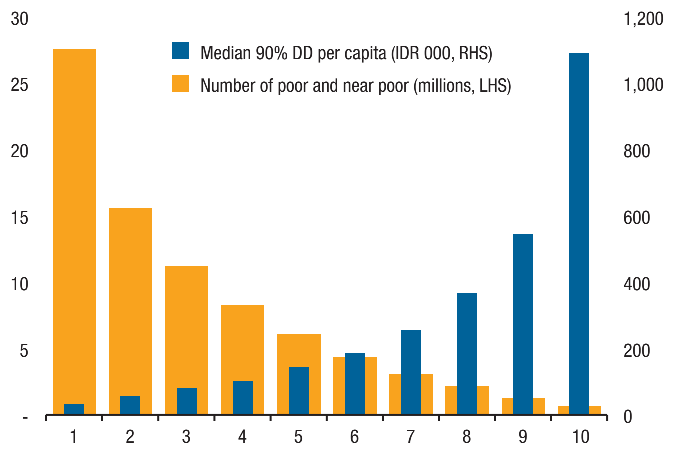
### Village Fund Formula Evaluation (Results of Previous Study)

In the 2015–2016 financial year, the formula to distribute the Village Fund equally divides 90 percent of total village funds between all of the villages, while the remaining 10 percent is determined by demographic and geographic variables. As a result, large villages with vast areas in which poor and near-poor communities live receive a similar amount of village funds to that received by small villages with small populations. Approximately 34 percent or 27 million poor and near-poor communities reside in 10 percent of the villages with the smallest Village Fund per capita.[2]

The current formula fails to adequately fulfill the mandate of the Village Law and is considered by some to contribute to a rise in inequality.

For example, Lewis (2015) and Article 33[3] conducted an analysis on the Village Fund distribution formula and provided recommendations to improve the formula for Village Fund distribution. This analysis builds upon prior research and leverages existing data to make recommendations that do not radically alter the current formula for Village Fund distribution. Figure 1 explain in the 2015–2016 financial year, the formula to distribute the Village Fund equally divides 90 percent of total village funds between all of the villages, while the remaining 10 percent is determined by demographic and geographic variables. As a result, large villages with vast areas in which poor and near-poor communities live receive a similar amount of village funds to that received by small villages with small populations. Approximately 34 percent or 27 million poor and near-poor communities reside in 10 percent of the villages with the smallest Village Fund per capita.

**Figure 1. Distribution of Village Fund Allocation and Numbers of Poor and Near Poor, by decile (2015)**




*Source*: Indonesia Economic Quarterly Update December 2015 – World Bank

Based on the results of the study, the formula of a percentage split 90/10 tends to disregard the high heterogeneity of more than 74,000 villages in Indonesia from their total area, population, and their progress (Figure 2). This formula causes excessive gaps of Village Fund per capita between villages with a high population of poor groups and villages with small populations. As a result, villages with high populations of poor groups have a small output of Village Fund allocation, particularly in basic services delivery–for example, clean water supply, housing for poor people, education, and health–and this affects the expected impact of the Village Fund towards decreasing the rate of poverty. On the contrary, small villages in the district with a high fiscal capacity will have high revenue from the Village Fund budget beyond their needs, while the relevant local government will have limited fiscal capacity to build facilities and infrastructure in the area. Furthermore, such a formula also neglects the fact that villages have other sources of revenue (e.g. ADD, PDRD), which may be larger amounts than the Village Fund, particularly for districts with high fiscal capacity from sharing revenue from oil, gas, and other mining resources.

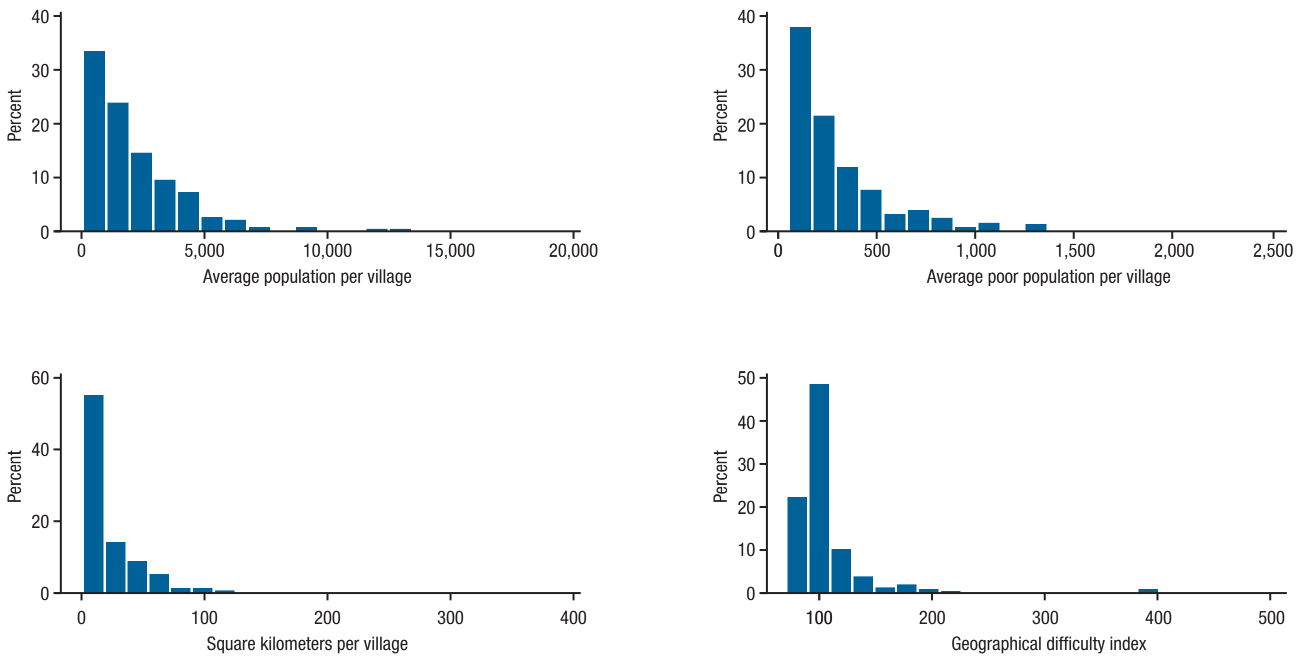
Lewis (2015) and Article 33 (KSI) conducted a study on the formula of Village Fund distribution based on three policies, namely:

1. The distribution of the Village Fund based on the Minister of Finance Regulation No. 49/PMK.07/2016, as a derivative of Presidential Regulation No. 22/2015 (currently implemented).
2. The distribution of the Village Fund using the mechanism of Village Fund Allocation based on the Circular Letter of the Minister of Home Affairs No. 140/640/S. This formula is commonly used by districts to distribute the Village Fund from the district to the villages.
3. The distribution of the Village Fund following the mechanism in Presidential Regulation No. 55/2005 concerning the distribution of Equalization Fund: General Fund Allocation (DAU), Revenue Sharing Fund (DBH) and Special Allocation Fund (DAK).

[2] IEQ December 2015. World Bank.

[3] Lewis, B.D., 2015, Decentralising to Villages in Indonesia: Money (and Other) Mistakes, Public Administration and Development 2015. Published online in Wiley Online Library Article 33 is a preliminary draft of the academic study 'Village Fund Formula Alternative' conducted by Rofikoh, Rokhim, Wardatul, Adawiyah, Melia, Retno, Astrini, 2016.

**Figure 2. Heterogeneity of Villages in Indonesia by Population, Number of Poor People, Total Area, and Index of Geographic Constraints in Districts**




*Sumber*: Blane Lewis, 2015

**Table 2. Village Fund Distribution 2016 by Region**

| Region | Village Fund in 2016 (Thousand Rp) | | Population in 2015 | | Poor (2015) | |
|---|---|---|---|---|---|---|
| | Amount | % | Amount | % | Amount | % |
| Sumatera | 14,093,209,252 | 30.0 | 34,789,721 | 20.8 | 5,126,571 | 24.7 |
| Jawa-Bali | 15,035,200,315 | 32.0 | 103,383,610 | 61.8 | 10,512,500 | 50.8 |
| Kalimantan | 4,103,079,154 | 8.7 | 8,530,785 | 5.1 | 1,303,287 | 6.3 |
| Sulawesi | 5,355,842,053 | 11.4 | 9,990,559 | 6.0 | 1,655,887 | 8.0 |
| NT-Maluku | 3,934,942,530 | 8.4 | 8,462,253 | 5.1 | 1,496,829 | 7.2 |
| Papua | 4,459,806,696 | 9.5 | 2,052,618 | 1.2 | 618,479 | 3.0 |
| **Total** | **46,982,080,000** | **100.0** | **167,209,618** | **100.0** | **20,713,533** | **100.0** |

*Note*: Population data and poor in village: Data limited on area in available population and poverty data (63,810 villages in 412 districts). Population data is based on 2010 census and adjusted for 2015 using population growth data per province (2011 to 2015) reported by BPS. Poor population is a total amount from respective area sourced from Regional Poverty Index (abbreviated IKW1) and developed by Bappenas and the National Team of Poverty Countermeasures Acceleration (TNP2K).

Variables and indicators used in the three formulas are generally similar; the only difference is the portion of standard allocation. The Circular Letter of Minister of Home Affairs specified 60 percent for the basic allocation and 40 percent be distributed based on variables.

Article 33 conducted the simulation based on the above three formulas, the formula used by Lewis (2015), as well as the India, Cambodia, and Analytic Hierarchy Process (AHP) formula, and recommended two options for alternative formulas.

## Distribution Evaluation and Allocation

Village Fund distribution of 2016 can be found in Table 2. Table 2 shows that Java-Bali regions obtained a smaller proportion of the Village Fund given their population and population of poor groups. Meanwhile, Sumatera, Kalimantan, Sulawesi, and Papua obtain a larger proportion relative to their population and population of poor groups. This data shows that apart from Java and Bali, all regions obtain a high proportion of the Village Fund relative to their poor population. It is fair to say that the distribution of the Village Fund is less proportionate with the number of poor people.

Table 3 shows the distribution variation of Village Fund per region; in which the variation coefficient of variation (which describes the amount of variability relative to the mean) shows that regions with very disproportional Village Fund distribution are Sumatera, followed by Kalimantan and Papua. The regions with the lowest disparity of distribution are Maluku, Nusa Tengara, Java, and Bali. Such a disparity of Village Fund distribution is overall very high, and much higher than the disparity within respective regions.

## Analysis of the Effect of the Determinant Variable of Village Fund Allocation 2016

A regression test of the determinant variable of Village Fund allocation in 2016 shows that the number of villages is very dominant in determining the amount of Village Fund per district/city, followed by the variable number of the poor, the population, the total area, and the last is cost of construction (IKK). The variable of the number of poor is at the second rank, with only 8 percent partial effect far below the partial effect of the number of villages (93.4 percent).

With the result of the regression test, we can interpret that:

- The variable of village numbers is very dominant in determining the allocation of the Village Fund per district/city that can be seen from the coefficient of IDR 567,900,000 per village.
- The variable of the number of poor people is the other influential variable, shown with a value of IDR 84,400 or one poor individual.
- The population number variable is worth IDR 4,140 or a person.
- The area width variable is worth IDR 236,800 for one km$^2$.
- The IKK variable is worth IDR 18,900,000 for one IKK.

**Table 3. Variation of Village Fund Distribution by Region**

| Region | Average Number of Residents per Village | Regional Poverty Index (%) | Village Fund per Capita (thousand rupiah) | Standard of Deviation | Minimum Value (thousand rupiah) | Maximum Value (thousand rupiah) | Coefficient of variation |
|---|---|---|---|---|---|---|---|
| Sumatera | 1,708.3 | 18.1 | 877,8 | 1,186.5 | 9.6 | 41,769.0 | 1.35 |
| Jawa-Bali | 4,517.5 | 11.8 | 200,9 | 185.8 | 6.6 | 9,392.7 | 0.93 |
| Kalimantan | 1,561.0 | 18.2 | 714,0 | 763.9 | 8.7 | 12,570.1 | 1.07 |
| Sulawesi | 1,429.5 | 18.7 | 677,5 | 766.1 | 31.0 | 35,374.6 | 1.13 |
| NT-Maluku | 1,904.6 | 21.7 | 638,3 | 586.1 | 9.2 | 9,146.0 | 0.92 |
| Papua | 560,4 | 33.0 | 2,274,1 | 2,364.0 | 40.3 | 29,110.2 | 1.04 |
| **Total** | **2,620.4** | **17.0** | **662,5** | **1,077.5** | **6.6** | **41,769.0** | **1.62** |

*Note*: The analysis at village level is conducted on 63,810 villages in 412 districts. The analysis is limited to villages eligible to receive Village Fund revenue, and also has population data and poor rate data at village level. Source: processed from BPS data and DJPK-MoF data.

**Table 4. Calculation Results with Multiple Regression**

| Variable | B | SE B | ß |
|---|---|---|---|
| Constants | 542351.06* | 288333.76 | -- |
| Number of Villages | 567915.636*** | 1027.158 | 0.934 |
| Total Population | 4.142*** | 0.344 | 0.035 |
| Land Width | 236.823*** | 17.127 | 0.02 |
| Construction Cost Index (IKK) | 18896.672*** | 2120.951 | 0.013 |
| Number of Poor People | 84324.654*** | 3224.925 | 0.08 |
| R2 | 0.999 | | |
| **F** | **105050** | | |

*Note*: *** p<0.01, ** p<0.05, * p<0.1. *Note*: processed from BPS and DJPK-MoF data.

## Village Fund Distribution and Poverty Rate

Based on poverty rate data (September 2015) per province (source: BPS), the distribution of the Village Fund per poor person between provinces is very imbalanced. This is evident from the coefficient of variation in Table 3 and the comparison between the minimum and maximum number between provinces as stated in Table 5.

**Table 5. Village Fund per Poor Person in the Provinces**

| Indicator | Amount (Rp) |
|---|---|
| Maximum | 8,994,567 |
| Minimum | 592,503 |
| Average | 2,815,360 |
| Deviation standard | 1,948,729 |
| Coficient of variation | 0.69 |

*Source*: processed from BPS data.

If the comparison is conducted across provinces, the imbalanced distribution of the Village Fund is also associated with poverty rate. Comparison between the amount of the Village Fund for Aceh Province and NTB province is very imbalanced, with the amount of the Village Fund for Aceh province around five times more than NTB, whereas the number of poor in both regions is not far different. It means that the amount of funds managed by village government in NTB is far below that in Aceh Government, although the number of poor between the two regions is similar. The imbalance of fund allocation is due to the fact that the number of villages in Aceh is six times the number of villages in NTB. The calculation of comparison between some provinces related to the Village Fund distribution and poor people can be seen in Table 6.

**Table 6. Comparison of Distribution of Village Fund per Province**

| Province | Number of Villages | Amount (thousand IDR) | Number of Poor (thousand) | IDR per Poor |
|---|---|---|---|---|
| Province Aceh | 6,474 | 3,829,751,986 | 859.41 | 4,456,257 |
| Province Nusa Tenggara Barat | 995 | 667,494,427 | 802.29 | 844,451 |
| Province Nusa Tenggara Timur | 2,995 | 1,849,353,802 | 1,160.53 | 1,593,542 |
| Province Papua | 5,419 | 3,385,116,457 | 898.21 | 3,768,736 |

*Source*: processed from BPS data and DJPK-MoF data.

**Table 7. Comparison of Village Fund and Poverty Rate on Selected Districts**

| District/ Municipality | Number of Villages | Number of Poor (thousand) | Poverty Gap Index | Poverty Severity Index | Village Fund 2016 (thousand) |
|---|---|---|---|---|---|
| District Kebumen | 449.00 | 242.3 | 2.78 | 0.61 | 282,401,546 |
| District Sampang | 180.00 | 239.6 | 3.71 | 0.71 | 131,129,306 |
| | | | | | |
| District Aceh Utara | 852.00 | 112.7 | 3.08 | 0.74 | 498,839,552 |
| District Lombok Barat | 119.00 | 110.7 | 3.14 | 0.85 | 84,996,512 |
| District Musi Banyuasin | 227.00 | 105.1 | 2.83 | 0.7 | 143,055,161 |
| | | | | | |
| District Sumbawa | 157.00 | 73.9 | 2.9 | 0.76 | 101,242,549 |
| District Lombok Utara | 33.00 | 72.2 | 7.28 | 2.26 | 27,022,708 |
| District Bireun | 609.00 | 72.2 | 2.21 | 0.53 | 356,336,571 |

*Source*: processed from BPS data and DJPK-MoF data.

If the comparison is carried out within specific provinces, the imbalance of Village Fund distribution related to the poverty rate can also be seen; for example in the Districts of Sampang and Kebumen, both districts have relatively the same number of poor people, but the amount of Village Fund received by Kebumen is two times greater than the amount received by Sampang. The most imbalanced distribution of the Village Fund is shown between North Aceh and West Lombok Districts. Although the number of poor people in both districts is relatively similar, North Aceh receives five times more than the amount of the Village Fund received by West Lombok. The cause of this imbalanced distribution of the Village Fund is related in great part to the number of villages. In general, under the current formula districts with more villages receive more village funds relative to districts with fewer villages irrespective of poverty related factors. The comparison of the amount of Village Fund and the poverty rate in some districts can be seen in Table 7.

Based on the evaluation and comparison above, it can be concluded that the formula providing a basic allocation of 90 percent is less relevant if the distribution of the Village Fund is aimed at poverty alleviation efforts, or to facilitate access of poor communities to public services.

### Evaluation of Village Fund Use

KOMPAK conducted a study to observe the implementation of the Village Law in 12 villages, 7 districts, and 5 provinces (Aceh, Central Java, East Java, West Nusa Tenggara, and South Sulawesi) for the period of March–April 2016.

The results of this study found that in those respective locations, the Village Fund (DD) in the year 2015 was predominately used for the construction of facilities and infrastructure activities, with the most selected activity being the construction of roads, bridges, and physical structures. The usage of DD for activities such as capacity building, improvement in health and education, and village economy was limited.

The purpose of this observational study was to:

- Assess how the implementation and management of village infrastructure development is technically supported by village facilitators, village local facilitators, and village cadre.
- Review whether the development of village facilities and infrastructure is based on good financial governance, such as the adoption of reasonable unit prices, and a beneficial procurement of goods and services for the villages, and guided by the regulations issued by government.

From the result of visits to selected villages, the information and data obtained showed that almost all villages allocated the majority of their funds for the development of village infrastructure. In fact, there were villages that allocated almost 100 percent of the Village Fund for village infrastructure development. The amount of allocation for physical development seems to be related to the directions from the Government–through the President and Minister of Villages–to allocate the Village Fund for infrastructure development as it will absorb labour, and theoretically revive the economy of the villages. Observations suggested that infrastructure projects were guided by the instructions from central government and endorsed by many heads of villages but they rarely yielded economic or social benefits for the village. For example, there were cases in which the Village Fund was used to build a village gate.

In addition, the quality of infrastructure that was built with the Village Fund in the financial year 2015 was relatively low. This was presumably because the design and infrastructure budget planning were inadequate, the procurement of goods and services for construction were not appropriately regulated, environmental impacts and ongoing maintenance were not considered. Unfortunately, villages lacked facilitators with adequate technical expertise on village infrastructure development, and training for village officials on infrastructure management planning was virtually nonexistent.

There are three serious issues commonly encountered by villages, namely:

- The average cost of village facilities and infrastructure is much more expensive because it refers to Self-Estimation Price at district (HPS), which was determined by district base without survey or goods and services bidding, and more commonly conducted through direct purchases.
- The village facilitator had minimal technical competence, and the development of infrastructure was usually conducted without assistance and monitoring from a village technical facilitator, technical cadre, or Village Community Empowerment Cadre (KPMD). The training for infrastructure development technical aspects was quite limited. As a result, the quality of infrastructure and facilities built were low in terms of the technical and expedience aspects.


- Maintenance and usefulness aspects were less than optimum, due to the fact that the infrastructure built was not based on the urgent needs for a village/community, but more likely the desire of the village elite or village officers.

The results from KOMPAK's observations are consistent with the evaluation findings from the Ministry of Finance (DJPK) reported

**Table 8. Evaluation of Village Fund Use 2015**

| No | Use | Percentage |
|---|---|---|
| 1 | Construction of facilities and physical infrastructure | 83.9% |
| 2 | Economic empowerment activities | 6.5% |
| 4 | Administration activities | 5.7% |
| 3 | Community social development activities | 3.8% |
| 5 | Others | 0.1% |

*Source*: Presentation of DJPK, June 2016

in June 2015. DJPK found that 83.9 percent of the Village Fund was used for physical infrastructure and facilities, 6.5 percent for community economic empowerment, with 9.6 percent being used for administration and community social development activities (see Table 8).

Another issue related to the use of the Village Fund is the Minister of Home Affairs Regulation No. 113/2014 on Village Financial Governance, which obliges the village treasurer to collect Income Tax (PPH) and other taxes from village expenditures. This regulation can complicate self-management of the fund by the village, particularly in the procurement process of goods and in paying wages to individuals in the community who are involved in managing the Village Fund. It is caused by the fact that almost all suppliers of goods and services have no tax identity number (PPH or business tax number). Furthermore, it also highlights the inability of the village to fully absorb resources for village development, when self-management is at the core of Village Fund allocation, as stated by the President in the welcoming remarks of the Deliberation of APDESI, 'that the Village Fund should be used in the village, either to purchase goods; for instance timber and sand for construction from the community, or to pay the labor from the village'.[4] In terms of poverty alleviation, this strategy is the most appropriate, while it also potentially reduce urbanization that burdens the urban areas.

[4] Welcoming Remarks of The President of Republic Indonesia on the opening of Deliberation of Indonesian Village Apparatus Association (APDESI) in Solo, 26 December 2015.

Another regulation that seems to complicate management of the Village Fund is the Head of LKPP (Goods and Services Procurement Policy Institution) Regulation No. 13/2013 on Guidelines of Mechanism for Goods and Services Procurement in Village, which states that '*gotong royong* (work together)' in the development process is a voluntary activity and the person who is involved should not be paid. This policy makes the villages reluctant to involve poor groups in the development process, as they worry that the payment of fees to the poor people will violate the principles of *gotong royong*.

The overview of the usage of the Village Fund reiterates the opinion that the Village Fund has not been able to encourage inclusive economic growth, especially the employment of the poor and the procurement of goods and services by the public. It is understandable that the Village Fund will not be able to reduce poverty in provinces that receive the largest Village Fund allocations, particularly since only a small percentage of funds are used for community economic empowerment. On the other hand, the greater amount of fund allocation for physical development is not directly related to the poverty rate, because the physical developments are generally for public goods. However, in some cases there are villages that do direct physical development for the poor, such as the construction of low income housing (e.g., RUTILAHU, POSYANDU, and PAUD).

## FORMULA SIMULATION AND ITS IMPLICATIONS

The formula for allocation of the Village Fund consists of two stages: stage 1 is the sharing formula for each district/ municipality, and stage 2 is the sharing formula from each district/municipality to the villages. The formula also consists of two components, namely, the basic allocation (AD), which is the equal allocation for each village, and also the allocation based on fiscal needs (KF) that is determined by four variables (population, poverty, area, and the level of Village geographic difficulty).

For 2015 and 2016, the proportion of AD in determining the allocation is 90 percent, while the KF is 10 percent. When the contribution of KF is increased, the fund distribution will be arguably improved because allocations will be increased for villages that have higher fiscal needs related to poverty and deficits in infrastructure. Providing villages with a larger amount of funding determined by variables related to their needs along with proper guidance and technical expertise related to the use of funds should improve the wellbeing of undeveloped villages. Nevertheless, the efforts to achieve the minimum target of Village Fund revenue of 1 billion Rupiah for each village will take longer to achieve. This means that there is a trade-off between these two objectives, namely, the objective to create an allocation of the Village Fund in accordance with fiscal needs, and the objective to meet the minimum target of 1 billion Rupiah for each village.

**Table 9. Distribution Simulation of Village Fund with Three Budget Allocation Alternatives**

| District/ municipality | Number of Villages | Number of Poor (thousands) | Village Fund 2016 (AD 90%) IDR million | Village Fund 2016 (AD 50%) IDR million | Village Fund 2016 (AD 10%) IDR million |
|---|---|---|---|---|---|
| District Kebumen | 449.00 | 242.3 | 282,402 | 274,047 | 267,532 |
| District Sampang | 180.00 | 239.6 | 131,129 | 178,520 | 230,834 |
| District Aceh Utara | 852.00 | 112.7 | 498,840 | 341,264 | 185,897 |
| District Lombok Barat | 119.00 | 110.7 | 84,997 | 105,437 | 129,955 |

*Source*: processed from BPS data and DJPK-MoF data.

**Table 10. Distribution Simulation of Village Fund with Four Budget Allocation Alternatives**

| District/ municipality | Number of Villages | Number of Poor (thousands) | Village Fund 2016 (AD 90%) IDR million | Village Fund Simulation 2017 (IDR million) | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | AD 90% | AD 70% | AD 63% | AD 60% | AD 50% |
| District Kebumen | 449.00 | 242.3 | 282,402 | 358,302 | 354,141 | 352,685 | 352,061 | 349,981 |
| District Sampang | 180.00 | 239.6 | 131,129 | 161,176 | 194,581 | 206,272 | 211,283 | 227,985 |
| District Aceh Utara | 852.00 | 112.7 | 498,840 | 634,239 | 535,031 | 500,308 | 485,427 | 435,823 |
| District Lombok Barat | 119.00 | 110.7 | 84,997 | 103,341 | 118,996 | 124,476 | 126,824 | 134,652 |

*Source*: processed from BPS data and DJPK-MoF data.

**Table 11. Distribution Simulation of Village Fund 2017 with Four Budget Allocation Alternatives**

| District/ municipality | The increase of Village Fund 2017 compared to 2016 | | | | |
|---|---|---|---|---|---|
| | AD 90% | AD 70% | AD 63% | AD 60% | AD 50% |
| District Kebumen | 27% | 25% | 25% | 25% | 24% |
| District Sampang | 23% | 48% | 57% | 61% | 74% |
| District Aceh Utara | 27% | 7% | 0% | -3% | -13% |
| District Lombok Barat | 22% | 40% | 46% | 49% | 58% |

*Source*: processed from BPS data and DJPK-MoF data.

Table 9 shows a comparison of the Village Fund formula results (sharing from central to each districts) with three scenarios, namely: (1) with 90 percent AD (current allocation); (2) 50 percent AD; and (3) 10 percent AD. The result of the simulation clearly shows that the smaller the proportion of AD, the better the distribution of the Village Fund according to poverty levels. Sampang District, with a number of poor people almost similar to Kebumen District, would have an increased allocation (making it better off), while Kebumen District would have a decreased allocation. Likewise, West Lombok District, which has relatively the same number in poor people as North Aceh District, would have an increase in funding, while the North Aceh District would have decreased funding.

With the Village Fund being proposed in the RAPBN (State Budget Draft) for 2017 in the amount of IDR 60 trillion, four alternative AD proportions can be simulated, namely: (1) 90 percent; (2) 70 percent; (3) 63 percent; (4) 60 percent; (5) 50 percent. The simulation is conducted in relation to phase 1, namely, distribution of the Village Fund from central to district/ municipality level, with the data used from 2016. The results are shown in Table 10.

From Village Fund simulations for 2017 it is obvious that if 90 percent AD is still applied, then all districts in Table 9 will have an increase in Village Fund. Districts with the biggest increase, Aceh Utara and Kebumen (27 percent each), are districts with a high number of villages, while the increase in the districts of

Sampang and Lombok Barat will be smaller because they have fewer villages. This condition significantly raises the disparity of village funds between districts according to the poverty rate.

In the 2017 simulation, Aceh Utara will have increased Village Fund allocations by seven percent with 70 percent AD, but will experience a three percent decrease with 60 percent of AD, compared to 2016. Based on that simulation, it is also shown that with 63 percent AD, Aceh Utara will not have a decline in funding. Thus, it can generally be predicted that there will be no district/municipality that experiences decline of Village Fund revenue at the 65 percent AD allocation, compared to the amount received in 2016.

## CONCLUSIONS AND RECOMMENDATIONS

- The above analysis shows that the allocation formula of the Village Fund in 2016 resulted in an imbalanced distribution of funds between districts, cities, and regions. The formula results in large disparities and fails to meet the primary goal of the Village Fund which is to address poverty and increase access of poor communities to public services. Changes to the allocation formula are necessary to enhance the potential of the Village Law to contribute to the improvement of basic services and poverty alleviation efforts.

- With regard to the use of the Village Fund, it can generally be concluded that the majority of the Village Fund is used for the construction of facilities and infrastructure in the villages (84 percent), while the use for the community-based economy remains small at 6.5 percent. In addition, the quality of facilities and infrastructure that are built are inadequate and not well maintained because villages lack technical capacity, planning, administration, and management expertise.

- Recommendations to improve the Village Fund formula. The allocation formula of the Village Fund needs to be revised, mainly related to the percentage of the basic allocation (AD). Large AD results in a relatively similar amount of Village Fund revenue received by each village even though the fiscal needs of villages vary substantially. To alleviate poverty and achieve basic public service improvements, particularly for the poor and underdeveloped communities, changes to AD allocation is necessary.

- Based on the simulation using the Village Fund data for 2017, a recommendation is proposed that the basic allocation proportion be set at 65 percent. Analyses indicate based on a total budget of IDR 60 trillion and a basic allocation of 65 percent, there will be no district that receives less than what they received in 2016. Furthermore, the decreased basic allocation proportion will actually improve allocation equity between districts/municipalities, particularly related to the needs of the poor and underdeveloped villages. With the proportion of basic allocation at 65 percent, the regions with a large population of poor people will have significantly increased revenue from the Village Fund without reducing the Village Fund to other areas. In other words, additional Village Fund revenue in 2017 in the amount of IDR 13 trillion (compared to 2016) will be allocated to areas with relatively large populations of poor people..

- In line with the proposal of a basic allocation proportion of 65 percent, the formula for the Village Fund should consider variables that relate to alleviation of poverty and equity that are based on a combination of total poor population and percentage of poor population, the Human Development Index, total area, and the Geographic Constraints Index. Moreover, grouping (clustering) in the Village Fund formula is required based on economic potential (very high, high, moderate, and less).

- By taking into account the characteristics and needs of the less fortunate, the effort to reduce inequality can be conducted through inclusive development and a tangible affirmative policy, namely: (1) Develop a comprehensive and wrap-around social protection system; (2) Improve basic services for poor and underdeveloped communities; (3) Implement sustainable livehoods programs for the poor communities through labour distribution and the development of entrepreneurship. This agenda must be supported by accessible and reliable data for planning in an integrated and one stop information system that performs as a data exchange forum providing information and data for all actors, at different levels of government. Capacity strengthening of government apparatus at national and sub-national levels on key issues such as administration, planning and budgeting that is more pro-poor is also needed.

- Recommendations to improve Village Fund utilisation:
  - Focus the utilisation of the Village Fund with a clearer emphasis on poverty alleviation to improve the welfare of village communities. This can be conducted through specific sector priorities for capital expenditure, mainly in fulfilling basic needs in health, education, and infrastructure, development of local economy potential, as well as sustainable use of natural resources and the environment. It is also necessary to improve the quality of village governance and village competitiveness.
  - Simplify procurement and financial accountability of the overall village funds, with a specific arrangement that is adjusted to the ability of the village apparatus.
  - Review various regulations at national level that could potentially hinder villages from spending the Village Fund to absorb goods and services from the local community–particularly from poor communities–including provisions regarding implementation of development (self-management), taxation, and labour-intensive activities.
  - Advocate and facilitate development of local regulation on procurement of goods and services that can be used by the village, by empowering and involving the local community. This could take the form of Local Regulation on the procurement of goods and services that refer to an actual unit price in the village or a Self Forecast Price (HPS) per village through Head of District regulation.
  - Develop guidelines and facilitation related to how far the village is responsible and shares their tasks with the district for the fulfilment of basic needs and basic services, especially for the poor and marginalised, as well as how the Village Fund can be used for such needs. In addition, guidelines and facilitation are also required to encourage the use of the Village Fund for community economic empowerment.
  - Encourage the government to invest more to increase the capacity of village technical facilitators, village technical cadres, village apparatus, and also local government and sub-district apparatus who are involved in oversight and supervision of the implementation of Village Law.

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**KOMPAK**

Jalan Diponegoro No. 72, Jakarta 10320 Indonesia

T: +62 21 8067 5000 F: +62 21 3190 3090

E: info@kompak.or.id

www.kompak.or.id