

POTENTIAL LINK PATTERNS OF FISCAL DECENTRALIZATION TO POVERTY REDUCTION IN INDONESIA

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ABSTRACT

Fiscal decentralization is considered to give positive as well as negative impacts for development policy such as poverty reduction. The implementation of fiscal decentralization in Indonesia has changed the patterns of local governments' budget allocation for poverty reduction. Local governments have wider discretion to allocate their budget for poverty reduction strategy. This study aims at observing the potential link patterns of fiscal decentralization to poverty reduction in Indonesian provinces before and in the period of fiscal decentralization implementation. This study applies a descriptive analysis as a method for identifying the potential link patterns of fiscal decentralization to poverty reduction in Indonesia. Firstly, this study identifies the trend of several poverty indicators in Indonesia, namely 1) the percentage rate of poverty; 2) poverty gap index (P1) and poverty severity index (P2); and 3) Human Development Index (HDI). Secondly, the link of fiscal decentralization to poverty reduction in Indonesia is elaborated using the share of government budget expenditure on relevant sector to total expenditure and the percentage rate of poverty. This study shows that there is no clear link pattern of fiscal decentralization to poverty reduction in Indonesia. Three link patterns, namely positive link, negative link, and no link appear differently among provinces and regions. Several factors that support the conditions need to be elaborated more.

Key words: *Fiscal Decentralization, Poverty Reduction, Indonesia*

INTRODUCTION

Fiscal decentralization has been implemented by governments due to several goals, namely 1) to empower local citizens through their local governments; 2) to provide more equitable allocation of resources; and 3) to assure the improvement in the delivery of key services, such as education and health care (Boex *et al.*, 2006). In its implementation, fiscal decentralization appears to have influenced several aspects of governance and development in each country. Some scholars have elaborated the link of fiscal decentralization to various variables such as corruption (Arikan, 2004; Shah, 2006; Bardhan and Mookherjee, 2005), public service delivery (Ahmad *et al.*, 2005; Singh, 2008), and economic growth (Martinez-Vasquez and McNab, 2005; Faridi, 2011). Fiscal decentralization also becomes an interesting topic of research because of its perceived relationship to poverty reduction. Through fiscal decentralization, the local governments can have more opportunity to use their financial resources for more pro poor programs.

In the context of relationship between decentralization (fiscal decentralization) to poverty reduction, some international studies establish a relatively ambiguous link. Jütting *et al.* (2004) found that the usefulness of decentralization as a tool for poverty reduction varies distinctly between poor countries on the one side and emerging economies on the other side. In addition, Bird and Rodriguez (1999) mentioned that the essence of decentralization occurs in particular contexts instead of generally.

Indonesia is a developing country that officially started its fiscal decentralization policy in January 2001. In Indonesia, fiscal decentralization is implemented to increase the role and independence of its sub-national governments. Through fiscal decentralization policy, the sub-national governments become more important players in the development process. Fiscal decentralization policy has also provided wider discretions to local governments in Indonesia in allocating their budgets for the poverty reduction strategy.

After more than a decade of implementation, serious challenge still remains for development policy in Indonesia such as whether fiscal decentralization has successfully contributed to the poverty reduction or not. This study aims at finding the potential link patterns of fiscal decentralization to poverty reduction in Indonesia based on group of island. Indonesia is an interesting case study since it has been the most decentralized nation after being under centralized regime for almost 30 years.

RESEARCH METHOD

This study applies a descriptive analysis as a method for analyzing 26 provinces in Indonesia. In this study, the average ratio of government budget expenditure on relevant sector to total expenditure before fiscal decentralization (1996-2000) and in the period of fiscal decentralization (2001-2009) is analyzed in line with the average percentage rate of poverty.

As widely known, the fiscal decentralization in Indonesia was designed to strengthen the local government expenditure capacity. This study follows the framework of thinking from Eckardt (2008). He measured the impact of decentralization reforms on local governments' performance and public service delivery in Indonesia. Based on that, the local governments' spending levels and structure of expenditures that have impacts on their performance is connected to the performance of local governments in conducting poverty reduction strategies. Therefore, the variable of fiscal decentralization in this study is represented by local government expenditure capacity, specifically local government expenditure on education and on health. On the other side, poverty reduction is measured by the rate of poverty. This analysis uses secondary data from Indonesian Statistics Bureau (Badan Pusat Statistik-BPS), Ministry of Finance Republic of Indonesia (Direktorat Jenderal Perimbangan Keuangan-DJPK), The National Team for The Acceleration of Poverty Reduction (TNP2K) and other relevant sources.

In the data analysis, firstly, the trend of national poverty in Indonesia is analyzed using several indicators of poverty, namely 1) the percentage rate of poverty; 2) poverty gap index (P1) and poverty severity index (P2); and 3) Human Development Index. Secondly, the proxy of fiscal decentralization is determined. Fiscal decentralization is represented by budget allocation on the sectors which are suggested can influence the poverty reduction. In many literatures, two sectors which considered particularly relevant to poverty reduction are education and health sectors (Von Braun and Grote, 2000; Dethier, 2004). In order to see the contribution of fiscal decentralization to poverty reduction in Indonesia, this study analyzes the trend of provincial government expenditure on the education and health sectors. Following the study of Eckardt (2008), the higher level of expenditure in health and in education sectors is expected to increase performance in reducing the rate of poverty in Indonesia. Thirdly, the trend of provincial poverty rate in Indonesia is explored based on group of islands in Indonesia. Fourthly, the average percentage of poverty number is compared to the average ratio of expenditure on education sector and on health sector to total local governments' expenditure. It is expected that the relationships between the provincial government expenditure on both sectors and the movement of rate of poverty will result in positive link that is the reducing number in rate of poverty accompanies the increasing of provincial government expenditure on both sectors. In detail, the operational definition of link pattern of fiscal decentralization to poverty rate in this study is presented in Table 1.

Table 1. Operational definition of link pattern of fiscal decentralization to poverty rate

Link Pattern	Proxy of fiscal decentralization variables		Poverty rate
	Education expenditure/ total expenditure	Health expenditure/ total expenditure	
Positive			
Somewhat Positive	or	or	
Negative			
Somewhat Negative	or	or	
No Link			or

Source: Kusumaningrum, 2013

RESULTS AND DISCUSSION

The trend of poverty in Indonesia

Poverty has been one of serious problems in Indonesia. Nevertheless, the government has made positive progress in dealing with it. The poverty trend in Indonesia, as depicted in Figure 2, experienced rapid declining trend since 1976 until prior to the economic crisis of 1996. It had declined from 40.1 percent to 11.34 percent.¹ Unfortunately, the economic crisis in 1997 made the percentage of poverty in Indonesia to rise and reach its peak level of 23.4 percent in 1999. Two years later, Indonesia has formally embarked in the fiscal decentralization. In this process, Miranti *et al.* (2013) mentioned the period of 2001-2005 as early stage and since 2005 as full implementation of fiscal decentralization. Since 2003, the poverty levels were back to the level before the crisis that was 17.4 percent. This number kept decreasing until 2005 and tended to increase again in 2006 because of the increase in rice prices (World Bank, 2006). In the last years, the poverty level kept decreasing gradually.

Based on Figure 1, during the period of 1999 to 2013, there is a significant decrease in the percentage of poverty rate in Indonesia. It is decreasing from 23.4 percent to 11,47 in 2013. The following analysis will try to elaborate whether that condition appears as an effect of fiscal decentralization policy or not.

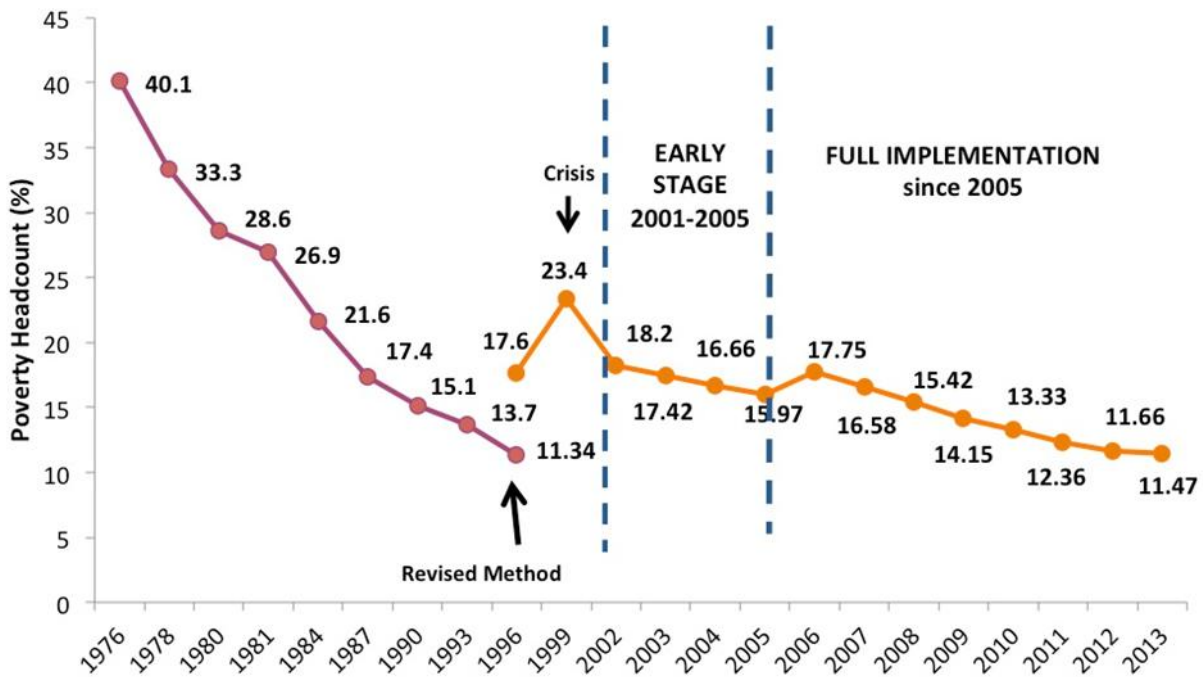


Figure 1: Poverty Trend in Indonesia, 1976-2013
 (Source: The World Bank, 2006, p. iv; BPS, various years (processed); TNP2K)

The trend of Poverty Gap Index and Poverty Severity Index

The trend of Poverty Gap Index and Poverty Severity Index in Indonesia is depicted in Figure 2. The data shows that there is a gradual declining trend in both indexes. In the early stage of fiscal decentralization era, the poverty gap index was around 3 and the poverty severity index was around 0.8. While in the full implementation of fiscal decentralization, the poverty gap index was around 2.5 and the poverty severity index was around 0.7.

Table 2 presents the average poverty gap index and poverty severity index during the period of 2002 to 2013. Both indexes are also analyzed at the level of urban and rural area. In general, the average poverty gap is higher in rural area than in urban area. At the same time, the rural area has more severe poverty rate than urban area.

¹Due to revision method in poverty counting, the percentage of poverty in 1996 was changed from 11.34 percent into 17.6 percent (World Bank, 2006)

Potential link patterns of fiscal decentralization to poverty reduction in Indonesia

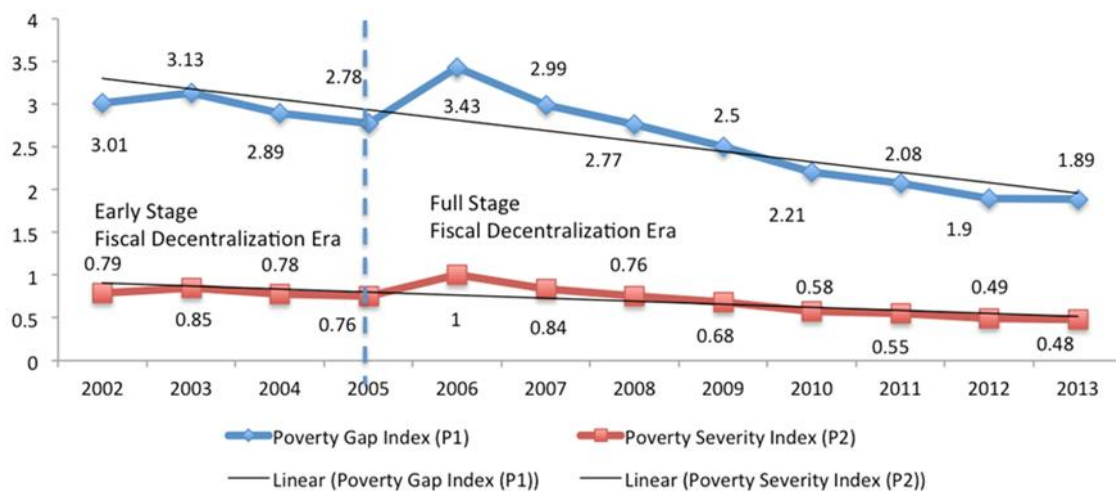


Figure 2: Trend of Poverty Gap and Poverty Severity Index in Indonesia, 2002-2013
(Source: TNP2K)

Table 2 Average of Poverty Gap Index (P1) and Poverty Severity Index (P2), 2002-2012

Indonesia	Average 2002-2012
P1	2.67
P1-Urban	1.98
P1-Rural	3.25
P2	0.73
P2-Urban	0.54
P2-Rural	0.88

(Source: TNP2K)

The trend of Human Development Index (HDI)

The Human Development Index presents the achievement of development on human that is based on life expectancy, educational attainment, and GDP per capita. The analysis of trend of HDI in Indonesia at national level as well as at provincial level are depicted in Figure 3 and Figure 4. At the national level, Indonesia has been experiencing an increasing HDI trend during the period of 1996 to 2009. The average HDI during that period was 68.9. At the provincial level, the highest HDI was reached by DKI Jakarta Province (75.93), while the lowest HDI was reached by Nusa Tenggara Barat Province (60.81) and Papua Province (61.86).

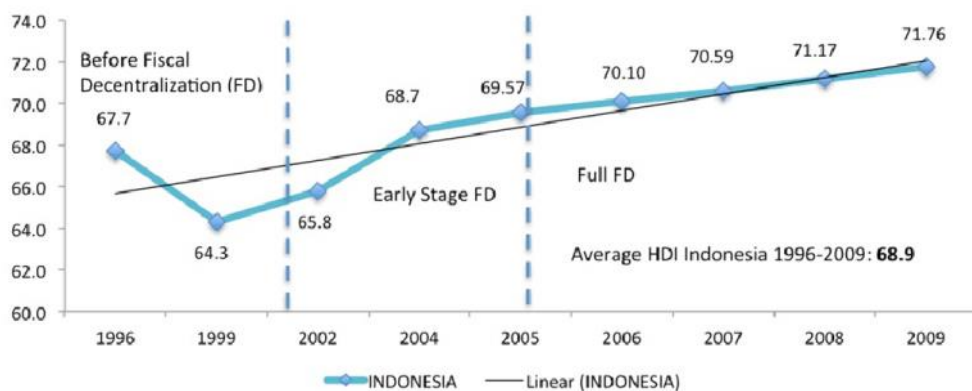


Figure 3: Trend of HDI Indonesia, 1996-2009
(Source: TNP2K)

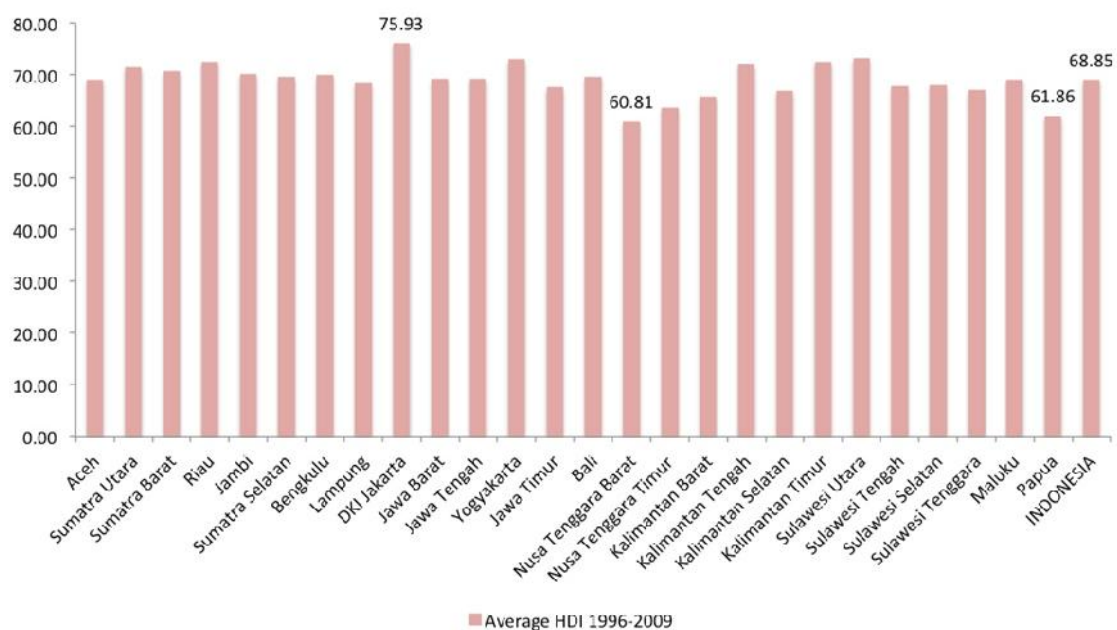


Figure 4: Trend of average HDI provinces in Indonesia, 1996-2009 (Source: TNP2K)

Potential link of fiscal decentralization to poverty reduction in Indonesia

The potential link patterns of fiscal decentralization to poverty reduction in Indonesia are elaborated based on previous study in Kusumaningrum (2013). Firstly, the analysis on the difference between average ratio of education expenditure to total governments’ expenditure and average ratio of health expenditure to total governments’ expenditure as a proxy of fiscal decentralization and the condition of average rate of poverty is elaborated in this part. The analysis is carried out by comparing the condition before (1996-2000) and in the period (2001-2009) of fiscal decentralization era using a statistical test (Paired Samples Test). The averages of each applied variables of 26 provinces are presented in Table 3, while the result of paired samples test is presented in Table 4.

Table 3. Averages of each applied variables of 26 provinces before and in the period of fiscal decentralization

Average ratio of EduExp/TotExp		Average ratio of HealthExp/TotExp		Average percentage of poverty rate	
96-00	01-09	96-00	01-09	96-00	01-09
0.0868	0.0652	0.0426	0.0908	18.9010	17.7350

Source: Kusumaningrum, 2013

Table 4 Result of paired samples test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. deviation	Std. error mean	95% confidence interval of the difference				
					Lower	Upper			
Pair 1	EduTot96_00 - EduTot01_09	0.022	0.020	0.004	0.014	0.030	5.478	25	0.000
Pair 2	HealthTot96_00 - Health-Tot01_09	-0.048	0.032	0.006	-0.061	-0.035	-7.758	25	0.000
Pair 3	Pov96_00 - Pov01_09	1.166	4.065	0.797	-0.476	2.808	1.463	25	0.156

There are three conditions as a result of analysis based on Table 2 and Table 3 as follows.

1. The number of average ratio of education expenditure to total expenditure of Indonesian provinces is decreasing from 8.7 percent to 6.5 percent. The result of Paired Samples Test also shows that the difference of its average ratio is statistically significant. The significance level is 0.000. This condition is thought to occur because the proportion of local governments' expenditure for personnel is bigger than the education service
2. There is an increasing number of average ratio of health expenditure to total governments' expenditure, that is increasing from 4.3 percent to 9.1 percent. The result of Paired Samples Test shows that the difference of its average ratio is statistically significant. The significance level is 0.000. This condition might exist because since the implementation of fiscal decentralization, there were few provinces that increase their health expenditure to support the program of health insurance in their area.
3. There is a slightly decreasing number of average percentage of poverty rate in Indonesia provinces, that is decreasing from 18.9 percent to 17.35 percent. However, the result of Paired Samples Test shows that the difference of average poverty rate between the two periods is not statistically significant. The significance level is 0.156. This condition is thought to occur due to the portion of expenditure on personnel and routine expenditure of local government that are still high. The analysis of Ministry of Finance (DJP, 2010 & 2013) for the Local Governments' Budget (APBD) 2007-2013 mentioned that the portion of expenditure on personnel to APBD is still approximately 45 - 60 percent. This condition might bring implication for the minimum allocation of direct expenditure for poverty reduction.

Secondly, in order to simply understand the potential link patterns of fiscal decentralization to poverty reduction, the condition of average ratio of education expenditure to total expenditure, average ratio of health expenditure to total expenditure, and average poverty rate are depicted in Table 5-10. Each table shows the link patterns of fiscal decentralization and poverty reduction in each province in Indonesia based on group of island, namely Sumatra (Table 5), Java (Table 6), Bali and Nusa Tenggara (Table 7), Borneo (Table 8), Sulawesi (Table 9), and Maluku and Papua (Table 10).

Based on previous tables, it can be observed that in general, there is no clear link pattern of fiscal decentralization to poverty rate in Indonesian provinces. The link pattern of fiscal decentralization and poverty reduction in one province as well as one island appears differently to the others. The result of analysis is presented in Table 11. In general, three link patterns, namely positive link, negative link, and no link can be identified as follows.

1. Positive link, a province is said to have a positive link when the increase in average ratio of education expenditure to total expenditure and the average ratio of health expenditure to total expenditure is accompanied by the decrease in the average rate of poverty. There are only three provinces in Indonesia that have such link, i.e. Jawa Timur (Java Island), Kalimantan Barat (Borneo Island), and Sulawesi Utara (Sulawesi Island). Somewhat positive link patterns are found in Jambi, Lampung, DKI Jakarta, Jawa Tengah, Yogyakarta, Nusa Tenggara Barat, Nusa Tenggara Timur, Kalimantan Tengah, Kalimantan Selatan, Kalimantan Timur, Maluku, and Papua
2. Negative link, a province is said to have a negative link when the increase in average ratio of education expenditure to total expenditure and the average ratio of health expenditure to total expenditure is accompanied by the increase in the average rate of poverty. Somewhat negative link tends to occur in Aceh, Sumatera Utara, Sumatera Barat, Riau, Sumatera Selatan, Bengkulu, Bali, Sulawesi Tengah, Sulawesi Selatan, Sulawesi Tenggara.
3. In the case of no link pattern, this condition is occurred in when the decrease or increase in average number of poverty rate occurs at the same time with the decrease in average ratio of education expenditure to total expenditure and the average ratio of health expenditure to total expenditure. Jawa Barat province seems have no link since the decrease in average number of poverty rate occurs at the same time with the decrease in average ratio of education expenditure to total expenditure and the average ratio of health expenditure to total expenditure.

It is interesting to investigate why such situation tends to occur in Indonesia as follows. As mentioned in Kusumaningrum (2013), the situation can be investigated from the perspectives of system level, organizational level, and individual level as follows.

1. From the system level, the "by default" system of fiscal decentralization in Indonesia has influenced the performance of government in conducting its basic responsibilities in the early years of decentralization

Table 5. Potential link patterns of fiscal decentralization and poverty rate in Sumatra Island, Indonesia

Provinces	Average ratio of EduExp/TotExp		Average ratio of HealthExp/TotExp		Average percentage of poverty rate	
	96-00	01-09	96-00	01-09	96-00	01-09
Aceh	0.166	0.160	0.0478	0.071	18.457	27.321
Sumatra Utara	0.044	0.036	0.0427	0.088	13.570	13.833
Sumatra Barat	0.087	0.059	0.0324	0.138	11.143	11.519
Riau	0.152	0.061	0.0427	0.074	10.773	11.513
Jambi	0.108	0.089	0.0403	0.075	18.950	12.055
Sumatra Selatan	0.100	0.056	0.0191	0.057	17.207	19.023
Bengkulu	0.052	0.028	0.0281	0.109	15.663	21.461
Lampung	0.096	0.069	0.0281	0.112	23.397	22.480
Average	0.101	0.070	0.0352	0.090	16.145	17.401

* Pairs of cell with number in red colour show one of three conditions: an increasing average education expenditure/total expenditure or an increasing average health expenditure/total expenditure or a decreasing average poverty rate.

Table 6. Potential link patterns of fiscal decentralization and poverty rate in Java Island, Indonesia

Provinces	Average Ratio of EduExp/TotExp		Average Ratio of HealthExp/TotExp		Average percentage of poverty rate	
	96-00	01-09	96-00	01-09	96-00	01-09
DKI Jakarta	0.098	0.076	0.059	0.087	3.810	3.7875
Jawa Barat	0.110	0.084	0.050	0.046	15.020	13.036
Jawa Tengah	0.082	0.079	0.070	0.136	21.177	20.696
Yogyakarta	0.109	0.101	0.057	0.071	23.303	19.816
Jawa Timur	0.084	0.101	0.046	0.091	21.350	19.995
Average	0.097	0.088	0.057	0.086	16.932	15.466

*Pairs of cell with number in red colour show one of three conditions: an increasing average education expenditure/total expenditure or an increasing average health expenditure/total expenditure or a decreasing average poverty rate

Table 7. Potential link patterns of fiscal decentralization and poverty rate in Bali and Nusa Tenggara Island, Indonesia

Provinces	Average Ratio of EduExp/TotExp		Average Ratio of HealthExp/TotExp		Average percentage of poverty rate	
	96-00	01-09	96-00	01-09	96-00	01-09
Bali	0.084	0.069	0.055	0.059	6.167	6.623
Nusa Tenggara Barat	0.064	0.031	0.036	0.107	26.233	25.555
Nusa Tenggara Timur	0.067	0.040	0.045	0.178	34.607	28.088
Average	0.071	0.046	0.045	0.115	22.336	20.088

*Pairs of cell with number in red colour show one of three conditions: an increasing average education expenditure/total expenditure or an increasing average health expenditure/total expenditure or a decreasing average poverty rate.

Potential link patterns of fiscal decentralization to poverty reduction in Indonesia

Table 8. Potential link patterns of fiscal decentralization and poverty rate in Borneo Island, Indonesia

Provinces	Average ratio of EduExp/TotExp		Average ratio of HealthExp/TotExp		Average percentage of poverty rate	
	96-00	01-09	96-00	01-09	96-00	01-09
Kalimantan Barat	0.089	0.091	0.044	0.094	25.857	14.021
Kalimantan Tengah	0.080	0.061	0.035	0.091	12.757	9.961
Kalimantan Selatan	0.085	0.059	0.056	0.121	13.910	7.756
Kalimantan Timur	0.113	0.066	0.044	0.085	15.233	11.349
Average	0.094	0.069	0.045	0.098	16.939	10.772

* Pairs of cell with number in red colour show one of three conditions: an increasing average education expenditure/total expenditure or an increasing average health expenditure/total expenditure or a decreasing average poverty rate.

Table 9. Potential link patterns of fiscal decentralization and poverty rate in Sulawesi Island, Indonesia

Provinces	Average ratio of EduExp/TotExp		Average ratio of HealthExp/TotExp		Average percentage of poverty rate	
	96-00	01-09	96-00	01-09	96-00	01-09
Sulawesi Utara	0.068	0.069	0.027	0.059	13.940	10.708
Sulawesi Tengah	0.054	0.026	0.031	0.120	20.460	22.591
Sulawesi Selatan	0.053	0.041	0.046	0.074	13.927	14.610
Sulawesi Tenggara	0.061	0.029	0.029	0.058	20.623	22.105
Average	0.059	0.041	0.033	0.078	17.238	17.504

* Pairs of cell with number in red colour show one of three conditions: an increasing average education expenditure/total expenditure or an increasing average health expenditure/total expenditure or a decreasing average poverty rate

Table 10. Potential link patterns of fiscal decentralization and poverty rate in Maluku and Papua Islands, Indonesia

Provinces	Average ratio of EduExp/TotExp		Average ratio of HealthExp/TotExp		Average percentage of poverty rate	
	96-00	01-09	96-00	01-09	96-00	01-09
Maluku	0.069	0.047	0.023	0.071	33.470	31.713
Papua	0.081	0.069	0.074	0.091	40.423	39.496
Average	0.075	0.058	0.048	0.081	36.947	35.604

* Pairs of cell with number in red colour show one of three conditions: an increasing average education expenditure/total expenditure or an increasing average health expenditure/total expenditure or a decreasing average poverty rate

implementation. The fulfillment of local governments' responsibilities based on fiscal federalism theory has not yet met due to institutional preparation. The poverty reduction was not the main aim of fiscal decentralization in Indonesia. The formulation of poverty reduction strategy has not yet related to pro-poor budgeting.

- From the organization level, the implementation of fiscal decentralization has not yet well-managed. It is assumed that the proportion of budget still tends to be allocated on organizational necessities such as personnel expenses, maintenance expenses, etc. This will influence the budget allocation for pro-poor programs. Moreover, the decision making process in the sub-national government in Indonesia still not based on appropriate monitoring and evaluation system in planning and budgeting.

Table 11. Results of link patterns of fiscal decentralization and poverty rate in Indonesia provinces

Link pattern	Proxy of fiscal decentralization variables		Poverty rate	Provinces
	Education expenditure/ total expenditure	Health expenditure/ total Expenditure		
Positive				Jawa Timur, Kalimantan Barat, Sulawesi Utara
Somewhat Positive	or	or		Jambi, Lampung, DKI Jakarta, Jawa Tengah, Yogyakarta, Nusa Tenggara Barat, Nusa Tenggara Timur, Kalimantan Tengah, Kalimantan Selatan, Kalimantan Timur, Maluku, and Papua
Negative				-
Somewhat Negative	or	or		Aceh, Sumatera Utara, Sumatera Barat, Riau, Sumatera Selatan, Bengkulu, Bali, Sulawesi Tengah, Sulawesi Selatan, Sulawesi Tenggara
No Link			or	Jawa Barat

Source: Kusumaningrum, 2013

- From the individual level, many personnel in sub-national governments in Indonesia are still lacking capacity in the financial management and budget allocation. The parliament's members who approve the budget also still lack of capacity in the budget allocation as well as in putting poverty reduction effort as a budget priority. This will influence the implementation of poverty reduction strategy. Therefore, although in theory, through fiscal decentralization, the governments become closer to the citizen to fulfill citizens' need. Nevertheless, the citizen still could not reach the potential benefit of basic needs, including some poverty alleviation programs.

CONCLUSION

This study shows that there is a slightly decreasing number of average percentage of poverty rate of Indonesian provinces before fiscal decentralization and in the period of fiscal decentralization. However, the difference of average percentage of poverty rate of Indonesian provinces in those periods is not statistically significant. This condition is thought to occur because the allocation of direct expenditure for poverty reduction is still minimal.

There is no clear relationship and pattern between fiscal decentralization and poverty reduction in Indonesia. Among provinces in Indonesia, the reducing in the average rate of poverty which is accompanied by the increasing in the average percentage of expenditure on public health sector or on education sector tends to occur in Jawa Timur (Java Island), Kalimantan Barat (Borneo Island), and Sulawesi Utara (Sulawesi Island). While in other provinces, link between one province and one sector is occurred in different way. In other words, it is occurred only in case by case.

Furthermore, in the period of analysis, almost all provincial governments tend to allocate their budget for providing services on health sector rather than on education sector. However, not all provinces in Indonesia have experienced decreasing in average poverty rate. Those provinces are mostly located in Sumatra and Sulawesi islands.

The study on the link between fiscal decentralization and poverty reduction is still an interesting topic to be elaborated in order to provide more complete picture. A future research agenda need to be proposed since the increase of spending on expenditure and health are not enough to reduce poverty. In addition, the effectiveness of the spending also depends on the target. In the education sector, for instance, budget allocation on the primary education is assumed to have different impact on poverty reduction than spending on the higher education. It is important to deeply elaborate the role of expenditure on education and health in reducing poverty in order to see its impact at different levels.

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