WORKING PAPER 40 - 2019

REFORM ON VILLAGE FUNDS FORMULATION

Ardi Adji
Priadi Asmanto
Hendratno Tuhiman

JUNE 2019

TNP2K
THE NATIONAL TEAM FOR THE ACCELERATION OF POVERTY REDUCTION

Australian Government

REFORM ON VILLAGE FUNDS FORMULATION

Ardi Adji
Priadi Asmanto
Hendratno Tuhiman

TNP2K Working Paper 40 - 2019
June 2019

The TNP2K Working Paper Series disseminates the findings of work in progress to encourage discussion and exchange of ideas on poverty, social protection and development issues.

Support to this publication is provided by the Australian Government through the MAHKOTA Program.

Suggested citation: Adji, A., Asmanto, P., Tuhiman, H. Reform on Village Funds Formulation. TNP2K Working Paper 40/2019. Jakarta, Indonesia.

To request copies of this paper or for more information, please contact: info@tnp2k.go.id.

The papers are also available at the TNP2K (www.tnp2k.go.id).

THE NATIONAL TEAM FOR THE ACCELERATION OF POVERTY REDUCTION
Office of the Vice President's Secretariat
Jl. Kebon Sirih Raya No.14, Jakarta Pusat, 10110

Abstract

The Law No. 6 of 2014 about the Village brought fundamental changes in the management, arrangement and implementation of village governance. In village finances, the law governs the source of village income which can implicates the budget allocation for the village, both sourced from the central budget as well as the regional budget. Since the year 2015, the allocation of village funds increased quite significantly, both nominal rupiah and proportion to the total funds transfer to the area. Over the last 5 years, the village fund increased almost 3.5 times to Rp 70 trillion in 2019, with a total allocation of Rp 257.2 trillion for five years. The National Team of Accelerating Poverty Reduction (TNP2K) has supported the Directorate General of Financial Balance (DJPK) of the Ministry of Finance to make adjustments to the allocation of the formula to be more equitable and equitable by considering Increase the nominal value of village funds in the national budget in the future.

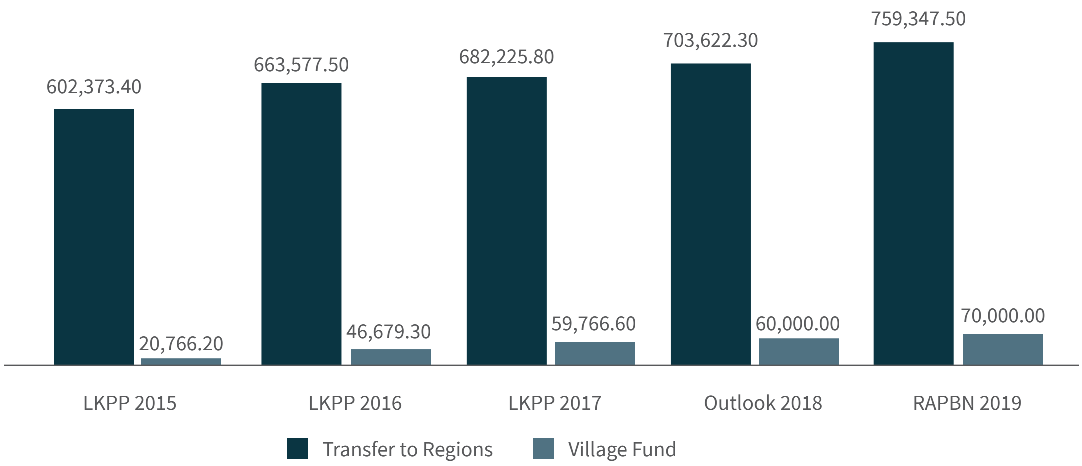
In the year 2015-2017, the proportion of basic allocation was 90% of the total village funds budgeted. After the adjustment process with various considerations and inputs, the basic allocation is gradually decreased to 77% and 72% respectively in the fiscal year 2018 and 2019. Some of the recommendations that need to be follow up include: i) to refine the allocation distribution of fairness by increasing the proportion of formula-based allocation; ii) to encourage accountability of priority utilization of village funds with priority-based planning; III) update index of geographical difficulties and transparency of calculations; and IV) to consider building institutional fund management of villages.

Background

Law No. 6/2014 on Villages brought fundamental changes in the management, regulation, and implementation of village governance. The law gives governance authority to villages to accelerate equitable village development. Villages as the lowest level of government administration need to be empowered to become strong, progressive, and independent. Village empowerment in the spirit of openness and freedom can be the basis for supporting national governance and development towards a fair, thriving, and prosperous society.

The Village Law regulates several aspects of village governance, such as village finances and assets. For village finances in particular, the Law regulates village sources of revenue that could have implications on special budget allocations for the village, both from the national budget (APBN) or the regional budget (APBD). Central transfer funds, or the Village Fund, is a source of revenue from the APBN that is transferred through the district/ city regional budget (APBD) and used to fund government administration, development, and community empowerment and development.

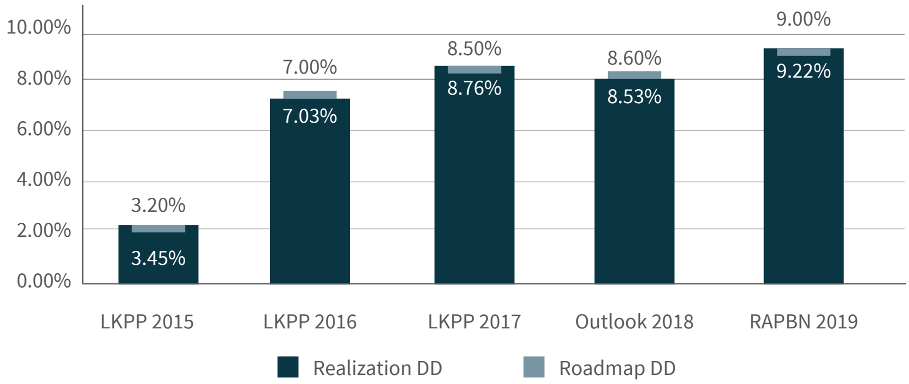
Figure 1: Village Funds Relative to Transfers to Regions in National Budget (APBN) (Trillions of Rupiah) (2015-2019)



Source: DJPK, Kementerian Keuangan, 2019.

Since 2015, the allocation of village funds has increased significantly, both in nominal rupiah terms and as a proportion of total fund transfers to regions. The Village Fund total in 2015 was Rp 20.76 trillion, increasing by almost 3.5 times to Rp 70 trillion in 2019. In five years (2015-2019) a total of Rp 257.2 trillion has been allocated from the APBN to the Village Fund.

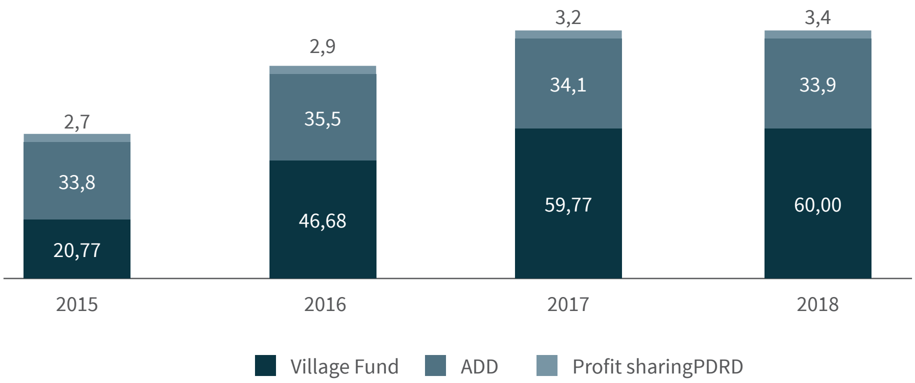
Figure 2: Realisation of, and Outlook for, Village Fund Allocation (2015-2019)



Source: DJPK, Kementerian Keuangan, 2019.

The Village Law stipulates that village funds should be the equivalent of 10 percent of the regional transfer fund. This target has been implemented gradually according to budget availability since the Law became effective. Referring to the established road map, the ratio of village funds to the total transfer to regions has increased gradually–from 3.2 percent in 2015 to 9 percent in 2019, nearing the set target.

Figure 3: Village Finances by Sources of Revenue (2015-2018)



Source: DJPK, Kementerian Keuangan, 2019.

There are three main sources of revenue for villages: (i) a budget allocation from the APBN called the Village Fund (Dana Desa – DD); (ii) a Village Fund Allocation *(Alokasi Dana Desa* – ADD) which is part of the Fiscal Balance Fund received from the District/City Regional Government of at least 10 percent.

from the share of regional tax and retribution from the district /city; and (iii) part of the Central and Regional Fiscal Balance Fund–funds received by districts/cities that constitute at least 10 percent of Regional Taxes and Retributions *(Pajak Daerah dan Retribusi Daerah* – PDRD).

Village Funds from the APBN is the largest contribution to village finances at an average of Rp 800 million/village in 2018, an increase from Rp 280 million/village in 2015. Villages received a total of Rp 33.8 trillion from ADD in 2015, increasing slightly to Rp 33.9 trillion in 2018. In 2018, total PDRD receipts was Rp 3.4 trillion–an increase from Rp 2.7 trillion in 2015.

The proportion of Village Funds from the APBN to total village finances has almost doubled from 36 percent in 2015 to 61 percent in 2018.

In 2019-2021, regional transfers and Village Funds are projected to continue increasing from 5.3 percent of GDP in 2019 to 5.7 percent of GDP in 2021. This increase is in line with strengthening the transfers to the regions and the Village Fund (*Dana Desa*) to support inclusive development.

Transfers to regions have a significant effect on the total allocation of Village Funds and are projected to increase proportionally every year. This increase is, however, yet to be accompanied by a more equitable allocation, where the proportion of fixed allocation that follows the principle of equity is still relatively large. To be more proportional, the basic allocation (*Alokasi Dasar* – AD) proportion of Village Funds should ideally be similar to the basic allocation as applied in the General Allocation Fund (Dana Alokasi Umum – DAU), which is indeed intended to improve the equity of fiscal capacity between regions.

Another problem is that the current organisational structure for delivery of the Village Fund has not been very effective in promoting development of rural areas due to inefficient bureaucracy and coordination at the central level, which has had implications on implementation at the village level. Authority for the Village Fund is currently shared between three ministries: (i) financial authority under the Ministry of Finance (MoF); (ii) administrative aspects under the Ministry of Home Affairs (MoHA); and (iii) utilization aspects under the Ministry of Villages, Disadvantaged Regions and Transmigration. A study by Corruption Eradication Commission (KPK) has shown a potential overlap of authorities between MoHA and the Ministry of Villages. In the study, the KPK recommended the formation of a steering committee for the implementation of Village Law led by a coordinating ministry.

A Geographic Difficulty Indicator (*Indikator Kesulitan Geografis* – IKG) is an effective instrument to evaluate village development and determine priorities for use of the Village Fund. Activity planning that is focused on indicators of disadvantaged villages, in terms of both quantity or quality, will help planning, budgeting and development to be more focused. In addition, such a focus would also make it easier to synchronize central and regional programs with village priorities, as well as assisting the process of program monitoring and evaluation.

This cycle is a continuous system where planning, implementation and evaluation is based on IKG-constituent indicators—one of the references in planning activities. For more detailed activities, an estimation of the size and percentage of the allocation for village development priorities and activities can refer to the various constituent components. In that way, the village administration will more easily determine allocations and priorities for village development.

The Challenge of Updating Composite Indicators

The main challenge in indicator-based planning for the utilization of Village Funds is that most indicators used in the models for calculating and determining allocations are not aligned with national development goals. For example, population constitutes 10 percent of the formula allocation (*Alokasi Formula* – AF). The consequence of this indicator is that the greater the population, the greater the Village Fund allocation. The implication of this indicator is that there is no incentive for village heads to contribute to the success of the Population Growth Rate Reduction Program. The village area contributes 15 percent to the AF–the problem with this indicator is that there is currently no official data on the size of the area that could be used as a reference.

These two indicators show that, proportionally, villages with relatively higher populations and larger areas will receive a larger AF than villages with relatively lower populations and smaller areas. Even if the village area and population are separated into distinct variables, it would be less relevant because area is a constant variable that will not change over the years, unless there is a village division.

A study by the World Bank shows a disparity in distribution of Village Funds between regions. Villages with a relatively large population, as an aggregate, receive relatively large allocations, but average per capita allocations tend to be lower compared to villages with relatively small populations. The reason is the large proportion of the AD compared to the AF, so the difference in population size between regions is not significant enough to determine the amount of allocation received by the village.

The number of poor people contributes 50 percent to the AF. The greater the Village Poverty Rate, the greater the Village Fund allocation. The implication of this indicator is that there is no incentive for villages to reduce the rate of poverty which is contrary to Article 78 of the Village Law. Until now, there has been no official data released by relevant ministries/institutions to provide poverty indicators at the village level.

The Construction Cost Index (*Indeks Kemahalan Konstruksi* – IKK) contributes 25 percent to the AF and is applied at district/city level. This indicator is a reference point for purchasing power between regions. Nevertheless, this indicator is very difficult to use as a basis for development at the village level.

The IKG contributes 25 percent and is applied at the village level. The greater the index, the greater the funds allocation. The IKG component can be used as a basis for village development but is less relevant than indicators at the district/city level. The main challenge for this indicator is that it is only available every three years following the Village Potential Survey (*Podes*) and, therefore, the IKG does not always describe the most current conditions in each village. In addition, the calculation of Village Funds for the past three years has faced problems of lack of information availability, especially for newly established villages, thus requiring special treatment for these areas.

The Purpose of Adjusting the Village Fund Formula

Study findings and evaluation of 2015-2017 allocations by several research institutions show the need to adjust the composition of both the AD and AF of the Village Funds to support the achievement of national development goals. Analysis shows that AD positively correlates only with poor population size. This confirms that the AD weight of 90 percent is not consistent with the principle of “equitable” allocation. In addition, the principle of “even distribution” in the AD does not clearly reflect the level of poverty, inequality and difficulty of each village in carrying out development.

Analysis of AF composition shows that it correlates negatively with village area. This is also supported by the finding that allocations before 2018 used a less ideal percentage composition for indicators of population, poverty rate, area, and IKK to calculate Village Funds at the district level, and/or the IKG on Village Funds calculations at the village level. In addition, the use of indicators that are not like-for-like–between the IKK at the district/city level and the IKG at the village level–is another problem.

Based on the two findings mentioned above, the Village Fund formula needs to be adjusted to make it more just without overriding the principle of equity. The formula adjustment needs to fulfil several prerequisites, namely:

(1) The total allocation of Village Funds per village should not be smaller than the previous year's allocation;
(2) The average ratio of the smallest and largest Village Fund recipient is the lowest;
(3) The proportion of the AF should be gradually increased while still considering the availability of government budget. Increasing the AF demonstrates a fairer allocation to reduce inequity in the Village Fund distribution.

Transformation of Village Fund Allocation Policy

Since the 2018 Fiscal Year, the government has implemented a series of Village Fund allocation policies to enhance an fairer allocation of Village Funds. First, the allocation of Village Funds for each village is now calculated by considering indicators of population, poverty rate, village area, and the IKG. Second, the Village Fund allocation formula was improved by adjusting the proportion of the AD and AF and applying affirmation to disadvantaged villages and highly disadvantaged villages with large poor populations. Third, there is a greater focus on alleviating poverty and inequality through the AF by giving a greater weight to the poverty rate and village area indicators. Fourth, the quality of distribution based on implementation performance has been improved, namely performance of absorption and achievement of program and activity outputs at the village level. Fifth, distribution through National Treasury Service Offices (Kantor Pelayanan Perbendaharaan Negara – KPPN) in regions to bring services closer, improve efficiency and facilitate coordination with local governments, and improve the effectiveness of monitoring and evaluation. Sixth, improve Village Fund utilization priorities for development and community empowerment directed at efforts to improve the quality of life of village communities to reduce poverty, inequality in the provision of basic infrastructure, and expand employment opportunities.

The formula adjustment was done by considering three main aspects that are the basic objectives of Village Fund allocation: (i) adjusting the weight of indicators with an emphasis on poor population size to accelerate poverty reduction; (ii) changing the proportion of the AD for equity and the AF composition for a fairer distribution; and (iii) adding affirmative policy consideration in calculating Village Funds for disadvantaged and highly disadvantaged regions, taking into account inequality between regions.

Table 1: Comparison of Component Proportion to Total National Allocation

Description	2015	2016	2017	2018
Number of Villages	74,093	74,754	74,954	74,958
Allocation Composite				
Basic Allocation	90%	90%	90%	77%
Formula Allocation	10%	10%	10%	20%
Population	25%	25%	25%	10%
Poor Population	35%	35%	35%	50%

Area Size	**2015**	**2016**	**2017**	**2018**
IKG/IKK	10%	10%	10%	15%
Affirmative Allocation	30%	30%	30%	25%
Total Allocation (Millions)	0	0	0	3%
Minimum				
Maximum	254.00	569.44	726.71	624.69
Basic Allocation (Millions)	1,121.00	2,221.00	2,280.00	8,854.47
Formula Allocation (Millions)	150.00	565.40	720.44	616.35
Minimum				
Maximum	104.00	4.04	6.27	8.34
Affirmation Allocation	971.00	1,656.00	2,099.00	8,238.13
Minimum				
Maximum	-	-	-	157.54
Number of Villages	-	-	-	315.09
Total Budget (Trillions)	-	-	-	9,943
Total Anggaran (Triliun)	20.77	46.68	59.77	60,00

Source: DJPK, Kementerian Keuangan, 2019.

Since 2017, The National Team for the Acceleration of Poverty Reduction (TNP2K) has provided technical support to the Directorate General of Fiscal Balance (DJPK) in the Ministry of Finance to adjust the Village Fund formula for the 2018 and 2019 fiscal years, including: (i) analysis of changes to Village Fund formulation by considering the principle of equity and improving the principle of fairness; (ii) harmonisation of indicators used as the basis for calculating the Village Fund and its allocations per village for the 2018 and 2019 fiscal years; (iii) providing a tool for optimising the weighting ratio of the AF; and (iv) initial simulation of Village Fund calculations for the 2018 and 2019 fiscal years.

The current Village Fund allocation is the best so far because: first, it considers aspects of equity and fairness; second, the ratio between the smallest and largest Village Fund receipts is the lowest, which is 1 to 4; third, it has a low standard deviation; fourth, it uses a calculation method that is consistent with previous years.

Overview of Village Fund Allocation

Adjustments to 2019 Village Fund formula are sought to fulfill the Village Law that mandates equitable and fair allocation. The principle of equity is applied to the AD, which is a fixed allocation for each village. The principle of fairness is applied to the AF which is a flexible budget distribution. The flexible allocation is strongly dependent on four indicators, namely: population size, poor population size, village area, and the geographic difficulty. Since the 2018 fiscal year, the Village Fund formulation has added an affirmative allocation component for disadvantaged and highly disadvantaged regions. Affirmative allocation is part of the fairness allocation but with a regional priority approach.

Basic Allocation (AD)

The AD is an allocation that is distributed equally to all villages to avoid disparities in the Village Fund amount that each village will receive. **The AD percentage that is currently used is based on the fair and equitable allocation principle of the Village Law. The 90:10 composition implemented from 2015-2017 has been improved with a 77:20:3 ratio since the 2018 fiscal year.** This proportion is the optimum simulation result according to the available budget.

Formula Allocation (AF)

The AF generally considers the level of inequality and poverty of the village, progress of development in the village, and population density of the area. The AF is calculated based on the village population, village poverty rate, village area, and the IKK for district/city level allocation and the IKG for village level allocation. **The AF has been increased from 10 percent to 20 percent of total Village Funds budgeted in 2018. In addition, since the 2018 fiscal year, the AF has given a greater weight to the size of the poor population (50 percent) and area (15 percent).** The IKG/IKK weight is decrease to 25 percent and, for the 2018 fiscal year, the population weight has, therefore, been reduced significantly from 25 percent to 10 percent.

Affirmative Allocation (AA)

An important innovation in the allocation of Village Funds in 2018 is the introduction of an Affirmative Allocation (AA), specifically for disadvantaged and highly disadvantaged regions using the principle of fairness and regional priority approach. **Nationally, the Village Fund allocation for Disadvantaged Regions (*Daerah Tertinggal* – DT) and Highly Disadvantaged Regions (*Daerah Sangat Tertinggal* – DST) has increased from Rp 36.7 trillion to Rp 37.3 trillion. The average Village Fund in DT and DST with a high number of poor increased from Rp 750 million to Rp 1.15 billion.**

In disadvantaged regions, border areas and remote islands, the Village Fund per capita in DT increased to Rp 587,000 and in DST Rp 1.182 million. This figure is greater than the Village Fund per capita in other regions which is Rp 269,500. The average Village Fund per capita in Papua is around Rp 1.517 million, Maluku (Rp 686,400), Sulawesi (Rp 555,600) and Kalimantan (Rp 522,600) which is higher than average Village Fund per capita on Java, Bali and Sumatra. Regional priority is not a new approach to development in Indonesia. The same approach had been used for Inpres Desa Tertinggal (IDT) program.[1]

[1] IDT (*Inpres Desa Tertinggal*): A funding program for disadvantaged villages that was established under Presidential Instruction No. 5/1993.

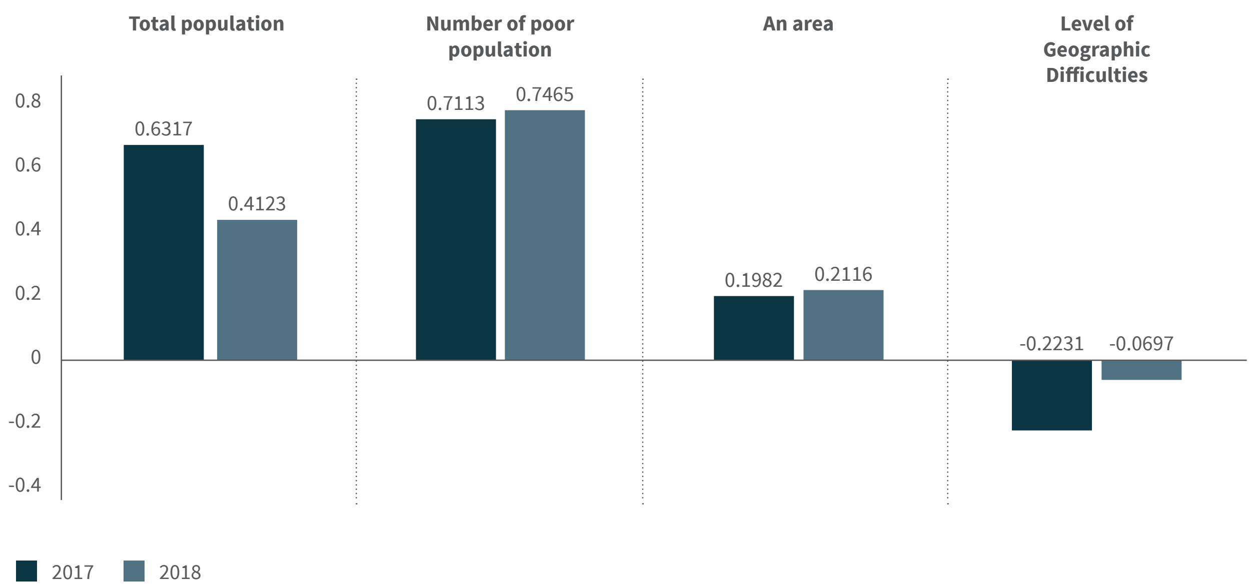
Evaluation of Allocation Before and After Reformulation

Correlation of Village Fund and Forming Indicators

From fiscal years 2015 to 2017, the composition of each indicator in the calculation of the AF was: total population (25 percent), total poor population (35 percent), area (10 percent) and geographic difficulty (30 percent). Under this distribution, regions that score high in these four indicators will receive a higher allocation than regions that have a lower score on these indicators. However, in general, the weight of these four indicators is not sufficient given that the equity-based AD still has quite a high weighting which is 90 percent of the total budget allocated each year. In other words, the principle of fairness represented by the AF with a weighting of only 10 percent is not sufficient to address regional needs.

Given this, in the 2018 fiscal year two important actions were taken to improve the allocation based on regional needs according to the principle of fairness: first, by adjusting the AF weighting to 20 percent from the previous 10 percent; and second, adjusting the weighting of the four AF indicators by reducing the weighting of population size and the IKK/IKG and raising the weighting of area and poor population size.

Figure 4: Correlation of Distribution of Village Funds to Population Size, Poor Population Size, Area, and IKK Indicators

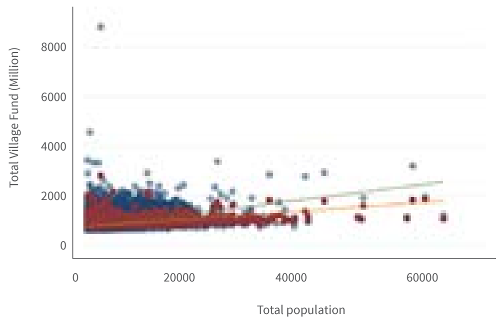


Source: Analysis result, 2018

A simple evaluation of indicators used in the 2018 Village Fund AF indicates that the correlation between the poor population size and village area has increased compared to the correlation in 2017. In addition, the correlation to geographic difficulty improved although it still tended to be negative. Regions with a high level of geographic difficulty have not yet obtained proportional Village Funds. Ideally, there should be a positive correlation between the distribution of Village Funds and AF constituent components.

There are two major component groups in the AF, namely independent components such as the ratios of village population, poverty rate, and village area, and one component that is a composite of various indicators that indicate the village IKG.

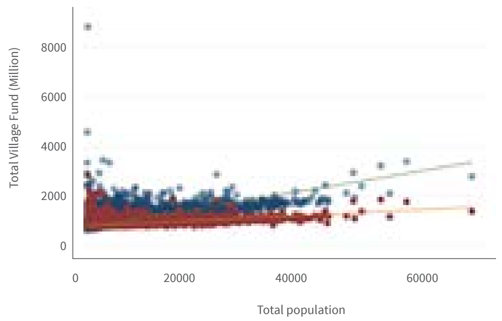
Distribution of Village Funds and Composite Indicators



Source: Analysis result, 2018

Village Population

Population size determines the amount of the AF for each village with a weighting of 25 percent in the period 2015-2017 and 10 percent in 2018. The population size proportionally affects the AF amount and total allocation received by a village, although the effect is greater on the AF than the total allocation.

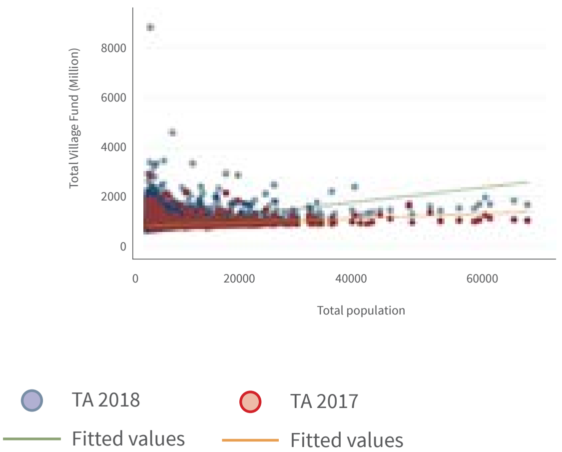


Source: Analysis result, 2018

Village Poverty Rate

The village poverty rate determines the AF amount for each village–with a weighting of 50 percent in 2018 and 35 percent in 2015-2017.

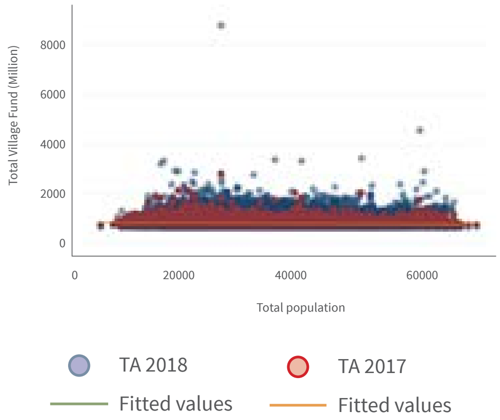
From the figure opposite, the Village Fund AF is more proportional against the village poverty rate–where villages with a higher poverty rate will receive a bigger allocation from the Village Fund.



Source: Analysis result, 2018

Village Area

The village area determines the AF amount for each village with a weighting of 10 percent in 2015-2017 and 15 percent in 2018. An increase in the weighting of 5 percent for the area factor has an implication of an increase in the allocation to villages in general, but specifically to villages with a greater area.



Source: Analysis result, 2018

Geographic Difficulty Index

The last indicator used as a weighting to determine the AF is the IKG. In determining the AF amount for each village, an IKG weighting of 30 percent was applied in 2015-2017 and reduced to 25 percent in 2018. As a result of this adjustment, villages with a high level of geographic difficulty receive lower allocations than previously.

Distribution in Java and Off-Java

The present Village Funds allocation is not yet proportionally distributed to regions with relatively high concentrations of poor villagers. Evaluation results show that Java, Bali and Nusa Tenggara are regions with high concentrations of poor people and tend to receive disproportionately small Village Fund allocations. There needs to be a Village Fund allocation that is more proportional to the population of poor to achieve the target of reducing poverty and inequality.

Changes in the formulation of the Village Funds in 2018 have accommodated this disproportionately allocation problem by allocating more fund to the regions with high poverty rate. Therefore, villages with high poverty rate will receive bigger allocation from Village Fund.

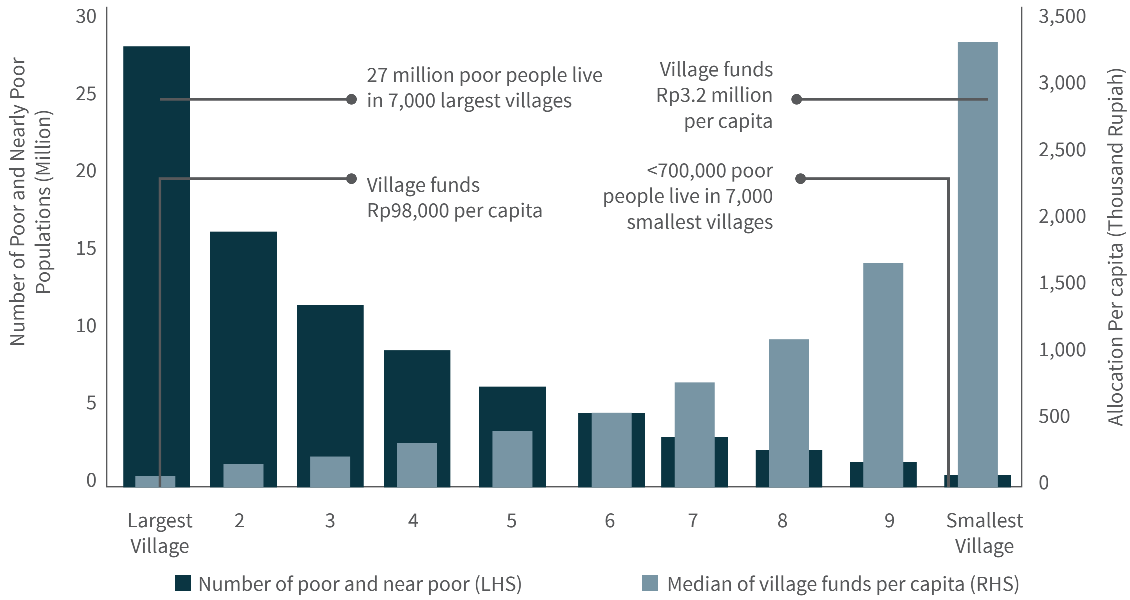
Figure 5: Comparison of Number of Poor Populations with Village Fund Allocation Based on Existing Formula (AD:AF=90:10)

Source: Analysis result, 2018

Inequality of Village Fund Distribution

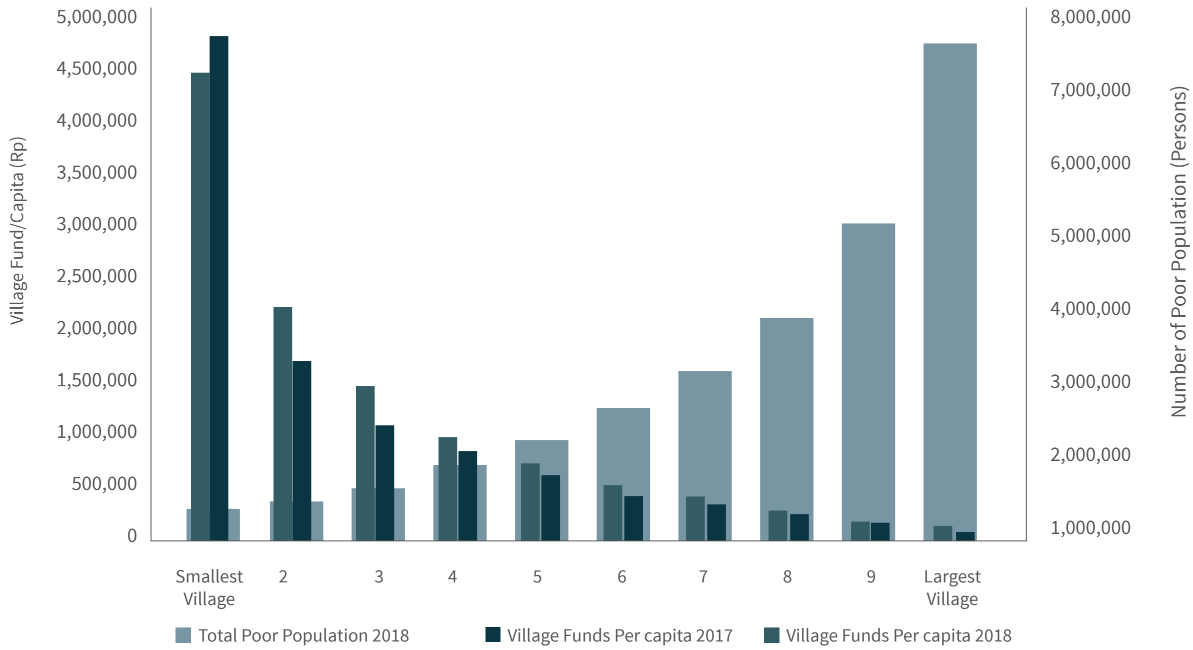
The World Bank considers that the current distribution of Village Funds tends to worsen income distribution, which tends to be greater for villages with relatively small numbers of poor people. Their study showed that the average Village Funds received in areas with a large population of poor is only around Rp 98,000/capita. Meanwhile, in areas with relatively small numbers of poor, the average Village Fund received was Rp 3.2 million/capita. This certainly does not support efforts to improve income equity.

Figure 6: Distribution of Village Funds According to Poor Population (2017)



Source: Inequality and the quality of Village Funds expenditure, World Bank, 2017.

Figure 7: Distribution of Village Funds According to Poor Population (2017 & 2018)



Source: Analysis Results, 2018

Policy Recommendations

Efforts need to be made to improve management effectiveness and the quality of Village Fund use. These efforts should be directed at activities that provide leverage and high added value and have a direct impact on: (i) improving the quality of basic public services in villages; (ii) improving the productive economy; (iii) poverty alleviation; (iv) improving the welfare of village communities; and (v) capacity-building for subdistrict officials, village government officials and village communities through training and mentoring by the government, provincial government and district/city government. In addition, Village Fund distribution that is proportionate to regional conditions and needs is a prerequisite for successful allocations to support development.

Improve Distribution of Fair Allocations

Increase the Proportion of Formula-Based Allocations

There is still room for optimization by reallocating funds from the AD to the AF in stages. This needs to be done to provide better opportunities for disadvantaged villages. **This optimization must consider growth of the total Village Fund allocation in the APBN, inequality in Village Fund allocations between villages, and ensure that no village receives a lower Village Fund allocation than in the previous year.**

Encourage Accountability of Village Fund Utilization Priorities

The utilization of Village Funds needs to be prioritized to finance village activities to improve geographic difficulty indicators. Determining priorities for the use of Village Funds should relate to indicators in every dimension of the IKG.

The Minister of Villages, Development of Disadvantaged Regions and Transmigration should pay attention to the composite index in setting priorities for the use of the Village Fund for development and community empowerment. Furthermore, MoF and MoHA need to issue regulations to support the determination of development priorities every year. Finally, district/city governments should support monitoring and evaluation of the use of funds through a decree or regulation by the district head/mayor.

Priority-Based Planning

Under the existing regulations, village development activities are prioritized to meet village development needs in accordance with the results of village consultations in line with national development priorities. As stipulated in prevailing regulations, the Village Funds can at least be used to fulfill primary needs, basic services, the environment, and community empowerment activities. Using geographic difficulty indicators as a basis for activity planning in the village is one alternative that could be applied, however, this step requires details of the Village Fund budget with indicators that form the basis of development needs. It is hoped that the use of the Village Fund in regions can improve indicators that determine geographic difficulty.

Updating Geographic Difficulty Index and Transparency of Calculations

As stated earlier, the contradiction between indicators that determine the size of the Village Fund and national development goals shows that there is a need to implement an incentive allocation model. Applying an incentive model to the Village Fund is expected to encourage villages to improve the quality and quantity of basic services in their area which will eventually improve indicators of geographic difficulty, without having to worry that Village Funds will decrease due to improved geographical difficulty.

Regular Updates of Village Indicators

It is necessary to have periodic reporting on village characteristics so they become part of the Village Fund disbursement requirements. This is necessary to update the information used as the basis for calculations and to complete information for new villages. The village characteristics report should include at least indicators of IKG, population, number of program recipients, and area size. Based on the village characteristics report, stakeholders should at least obtain two main things: (i) inputs to updates of Village Fund calculation indicators; and (ii) monitoring and evaluation indicators of Village Fund use which is estimated based on a proxy for changes in regional conditions. Problems of data availability, especially data on village expansions as faced for four years in implementation of Village Fund allocations, can be minimized, with each village submitting a report for each Village Fund disbursement period.

Simplification of Geographic Difficulty Index (IKG) Calculations

The method of calculating the IKG needs to be updated by simplifying and adapting it for users at village level. To date, the IKG has been prepared by using statistical methods that are difficult to replicate at program implementer level in the regions. The approach used is Principal Component Analysis (PCA), which basically aims to simplify a series of variables or indicators observed by reducing their dimensions.

PCA has several weaknesses, namely, that it is complicated to use and the results are difficult to interpret, so that if there are regional administrative separations, it could not be easily replicated by local governments. Another disadvantage is the difficulty in connecting improved indicators to the village development process, including monitoring and evaluating of the condition of indicators that have been improved.

One alternative that can be done is to apply an equal weighting approach. This approach uses the value of 1=poor (geographically difficult) and 0=not poor (not geographically difficult) for all index-forming indicators. The total score would indicate the geographic difficulty of a district/city or village. As an illustration, the currently used IKG is formed from 28 factor components (indicators) that consist of the following dimensions: (i) availability of basic services; (ii) condition of infrastructure; and (iii) accessibility/transportation. This leads to 29 IKG value combinations, from the richest with an IKG=0 (all variables are not difficult geographically) to the poorest with an IKG=28 (all variables are difficult geographically).

The resulting IKG value can, therefore, be linked to the planning and budgeting process, the implementation of poverty alleviation programs based on an IKG priority scale, and assist the program monitoring and evaluation process. The process and progress of monitoring and evaluation of village development by using equal weight on IKG can be done every year by observing intervention progress on factor components which are forming indicators.

Improvements in target indicators are undertaken until the indicators improve from a value of 1 (geographically difficult) to a value of 0 (geographically not difficult) in line with priorities set by the Minister of Villages, Development of Disadvantaged Regions and Transmigration (which is included in priorities for use of the Village Fund) or head of district/mayor (which is not included in usage priorities for the Village Fund).

Review of Use of Village Area Indicators as Determinants of Allocations

One alternative solution to reduce inequality in the distribution of Village Funds between regions is to use a density approach. There are three indicators of AF calculation with the potential to be combined into two indicators, namely area, population, and poor population. It is proposed to combine these indicators into population density and poor population density. Both indicators are relevant in describing the needs of the region, where villages with a relatively high population density and density of the poor population will receive proportionately higher AF funds than other villages on average. In addition, merging these three variables would not be in conflict with the Village Law as they still consider village area, population, and poor population as explicitly stated in the regulation.

Building Village Fund Management Institutions

Given the size of Village Fund allocations, the government needs to establish a special institution related to the Village Law to support village development in accordance with the Law. This institution should consist of cross-ministerial elements and be tasked with accelerating rural development at the implementation level, where each ministry focuses on the regulation of rural development.

Bibliography

Badan Pusat Statistik. 2015. Geographic Difficulty Index (IKG) as a Basis for Distribution of Village Fund Allocation Amount, 2014 IKG Manual. Jakarta.

Bappenas. 2017. Appendix of the Presidential Regulation of the Republic of Indonesia No. 79/2017 on Government Work Plans (RKP) in 2019. Jakarta.

Corruption Eradication Commission (*Komisi Pemberantasan Korupsi*). 2015. Study Report on Village Financial Management System: Village Fund Allocation and Village Fund, Directorate of Research and Development, KPK, Jakarta, June 17, 2015.

Kompak. 2016. Policy Analysis of Village Fund Formula and Poverty, Presentation Material, October 26, 2016.

Kompak. 2017. Village Fund, Allocation Distribution and Uses: KOMPAK Overview, Presentation Materials, March 29, 2017.

Law No. 6/2014 on Villages.

Minister of Finance Regulation No. 49/2016: Procedures for Village Fund Allocation, Distribution, Use, Monitoring and Evaluation, Jakarta.

Ministry of Finance. 2017. Exposure Material.

Ministry of Finance. 2017. Book II: Financial Note and National Budget Plan (RAPBN) of 2019, Jakarta.
President of the Republic of Indonesia Regulation No. 11/2015 on Ministry of Home Affairs.

President of the Republic of Indonesia Regulation No. 12/2015 on Ministry of Villages, Development of Disadvantaged Regions and Transmigration.

World Bank. 2017. Inequality and Quality of Village Expenditures in 2017 and 2019, Presentation to the Minister of Finance, February 2017.

THE NATIONAL TEAM FOR THE ACCELERATION OF POVERTY REDUCTION

Office of the Vice President's Secretariat
Jl. Kebon Sirih Raya No.14, Jakarta Pusat, 10110

Telephone : (021) 3912812
Facsmili : (021) 3912511
Email : info@tnp2k.go.id
Website : www.tnp2k.go.id