

Analysis of Agency Problems in Development Plan Alignment: An Indonesia-Malaysia Comparative Study

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Abstract: Development plan alignment of local and national development plan has become an important issue for developing countries not only for unitary state, but also for federal state. The objectives of this study are to compare agency problems faced by Indonesia and Malaysia in aligning development plan and to critically review Indonesia and Malaysia policies to address such problems in order to ensure development plan alignment. Research method used in this study was comparative case study – analyzing the agency problems of development plan alignment of two countries – Indonesia and Malaysia. It is found from this study that the degree of agency problem in development plan alignment in Indonesia is higher than that in Malaysia. The design of decentralization in Malaysia is more centralized than that in Indonesia, particularly in three aspects: organizational design of development planning agencies, mechanism and process of development planning, and budgeting system (inter-government financial transfer). These three aspects have significant contribution to the agency problems. The research finding suggest that to achieve the alignment of local development plan with national development plan in Indonesia, government should redesign the organizational development planning organization, improve mechanism and process of local development planning and integrate planning control into Bappenas, and consider the degree of alignment in allocating financial transfer to local government.

Keywords: *Agency Problem, decentralization, Development Planning, Development Plan Alignment, Federal state.*

Administrative system of a state, whether federal or unitary, is divided into several levels. Indonesian administrative system which applies unitary system comprises three levels: central government, provincial government, and regency/city government. Malaysian administrative system is divided into three levels: federal government, state government and local government. Generally, from the level of administrative system point of view, a cascade of development plan can be identified. National development plan formulated by federal or central government is broken into state or province level. Based on this principle, state or province governments have to align their development plan with national development plan.

Development plan has been the topic of previous researchers. Mohamed and Appalanaidu (1998 : 610) and Yaakup and Sulaiman (no year)' studies focused on the information systems for

development planning in Malaysia. Omar and Leh, (2009:30-36) analyzed public participation in development planning process, particularly Kuala Lumpur Structure Plan 2020. Nong (1986:28) conducted comparative research on the effectiveness of Municipalities as local planning authorities in Malaysia. Little attention has been paid to the development plan alignment, particularly local development plan with national development plan. Even, there has been very limited research on the topic that employed cross-country comparative approach.

Even though many studies focused on federal-state relationship, e.g, federalism and conflicts over principalship (Josselin, 2004:282), accountability problems under partial decentralization (Joanis, 2009:2), political economy of Malaysian federalism (Jomo & Hui, 2003:441-456), there is very rare study which has analyzed agency problem. With reference to deficiencies of previous research, what

remains to be studied is how agency problem and to what extent policies have affected the alignment of local development plan.

Development Plan Alignment refers to the degree and the extent state/ provincial development plans refer to and are consistent with national development plan so state/province contribution to national development performance can be identified in order to ensure the attainment of national development goals. The alignment idea/issue is based on the logical implication of cascading system. State/province development plan is an integrated part of national development plan. It is not surprising that development plan alignment, particularly from level of administrative government perspective, has become an importance issue for developing countries.

To address the issue of development plan alignment, developing countries have introduced policies and measures including institutional aspect, mechanism and process aspect, and budgeting aspects. Unfortunately, developing countries including Indonesia, have been facing development plan alignment problems. The alignment of local development plan should meet with national development plan and it is a requirement for achieving national development goals. Even though development plan alignment is not a simple matter, it is necessary to ensure the alignment.

This study are to compare agency problems faced by Indonesia and Malaysia in aligning development plan and to critically review Indonesia and Malaysia policies to address such problems in order to ensure development plan alignment. Two main questions addressed in this study are (1) to what extent do agency problems faced by Indonesia compared to Malaysia in development planning? and (2) to what extent do the effectiveness of policies implemented by Indonesia and Malaysia in solving such agency problems? Three policies involved in the latter question are institutional policy (development planning agency), mechanism and process of development planning policy, and inter-government financial transfer policy.

Decentralization in Federalism and Unitary System

According to Gamper (2005:1299), it is sometimes difficult to understand the terminology of

federalism because the meaning differs according to the perspectives of constitutional law, political science or economics. Furthermore, Gamper states “all theories agree that federalism is a principle that applies to systems consisting of at least two constituent parts that are not wholly independent but together form the system as a whole. It implies that federalism combines the principles of unity and diversity (“*concordantia discors*”).”

Boucher and Migue (as cited in Sharma, 2003:173) argued that “federalism is decentralization”. In federalism, centralization is seen basically as negative policy measure. Moreover, federalism has been regarded as “a critical theoretical component of decentralism”. Thus, such ideas have reinforced the federal-decentralized versus unitary-centralized dichotomy. The idea of federalism indicates that there is distribution and delegation of authority to constituent units or “sub-national government”. This is why, as Gamper (2005:1300) stated, “there are the principles of co-ordination, co-operation and subsidiarity, three principles in federalism. Subsidiarity gives an additional value to the principle of federalism in so far as powers should not be just shared between various levels, but be shared according to the criteria of efficiency, suitability and interest”.

Delegation of authority, development planning, and Agency Problems

Decentralization policy, both in federal and unitary state, whether in term of politics (devolution) or management, refers to the concept of delegation of authority from federal or central government to local government. According to Lupia (2001:1), delegation occurs when some people or organization ask others to perform tasks on their behalf. Governments use delegation to increase the range of services that they can provide. With delegation, by contrast, national governments can address a wide range of social issues simultaneously.

According to Jones (2007:95), “subunit orientation” is one of challenges in decentralization. There is a tendency to view one’s role in the organization strictly from the perspective of the time frame, goals, and interpersonal orientations of one’s subunit. Therefore, integration is important idea. Inte-

gration is the process of coordinating various tasks, functions, and divisions so that they work together and not at cross-purpose. In terms of decentralization, there are at least two types of coordination: vertical coordination among tiers of government and horizontal coordination among the states (Spahn, 2009:5).

As described earlier that the principle of subsidiarity in decentralization implies that there is a hierarchy, what Jones (2007:93) call as vertical differentiation. Regardless of the government system (federalism or unitary), according to the principle of subsidiarity, states or provinces are subordinate of federal or central government. Therefore, as a “subsidiary”, states or provinces have to follow federal or central government as “headquarter.” In other words, states or provinces’ goals and activities must be in line with federal or central government’s interests. The principle of subsidiarity also implies that authorities of states or province government are delegated by federal or central government.

Authority is the power to hold subordinates accountable for their actions and to influence directly what they do and how they do it (Jones, 2007:92). Based on this definition, federal or central government delegates to states or provinces the legal authority and responsibility to use the organization’s resources to create value and meet national goals. Furthermore, agency relationship arises whenever one person (principal) delegates decision-making authority or control over resources to another (the agent).

The classical principal-agent relationship derived from the relationship between ownership and “managership” in large firms. According to Lin & Hsu (2000:5), hired to provide the service that the principal required, the manager (agent) enjoys expertise and information advantage while the owner do not. However, the concept of “principal” and “agent” in the agency theory varies across cases. In the case of the politics of Taiwan and Main Land China, Lin & Hsu (2000:5) positioned society as principal and government as agent.

Eisenhardt (as cited in Mathieu, 1997:1) argued that in every delegation there is agency problem potential, i.e. people or institutions who receive delegated power or authority (agent) do not act ac-

ording to the interest of people or institutions who give delegated authority (principal). There are two kinds of agency problem: adverse selection and moral hazard.

In the context of development planning, federal or central government delegate authority of planning to local governments while requiring them to align their development plan with national development plan. Relating to this principle, Usui & Alisjahbana (2004:87) argued that :

Decentralization, by its nature, gives the highest priority to local government to respond to local demands. At the same time, local development plans need to be consistent with those on provincial and central governments. However, even with decentralization fully in place, some elements of top-down intervention are needed to ensure the priority of higher levels of government is considered at the local level.

The danger of delegation is that the people to whom power is delegated will abuse the power they receive (Lupia, 2001:2). Jones (2007:39) argued that in delegating authority to managers an agency problem arises. Agency problem is a problem in determining managerial accountability. Lupia (2001:3) introduced the term of agency loss. According to Lupia:

Agency loss is the difference between the consequences of delegation for the principal and the best possible consequence. Agency loss is zero when the agent takes actions that are entirely consistent with the principal’s interests. As the agent’s actions diverge from the principal’s interests, agency loss increases. When the agent does things that are bad for the principal, agency loss is high.

Lupia (2001:4) founded that agency loss is minimized when two statements are true: (1) the principal and agent *share common interests* – the principal and agent desire the same outcomes, and (2) the *principal is knowledgeable* about the consequences of the agent’s activities – principals know enough about their agents’ actions to determine whether or not these actions serve their interests.

Jones (2007:40) argued that in agency theory, the central issue is to overcome the agency problem by using governance mechanism, or forms of control that align the interest of principal and a agent so that

both parties have the incentive to work together to maximize organizational effectiveness. Further, in the context of private/business organization, the principal roles are: (1) to monitor top managers' activities, (2) to question their decision making and strategies, and (3) intervene, when necessary. Research also suggested that reinforce and develop the organization's code of ethics are important measures to prevent abuses of power.

The next step in solving the agency problem is to find the right set of incentives to align the interest of managers and shareholders. In the context of private/business organization, Jones (2007:40) argued that the most effective way of aligning interests between management and shareholders is to make managers' rewards contingent on the outcomes of their decisions, that is, contingent on organizational performance. With adaptation and adjustment, these approaches may also relevant to solve agency problems in public sector, particularly in the case of development plan alignment.

According to Jones (2007:96-99), there are six mechanisms to achieve integration and alignment in an organization: (1) hierarchy of authority – a ranking of employees integrates by specifying who report to whom, (2) direct contact – managers meet face to face (between people in different subunits) to coordinate activities, (3) liaison roles – a specific manager is given responsibility for coordinating with managers from other subunits on behalf of his or her subunit, (4) task force - managers meet in temporary committees to coordinate cross-functional activities and one person from each function joins a task force, (5) team – managers meet regularly in permanent committees to coordinate activities, and (6) integrating role or department – a new role or department is created to coordinate activities of functions or division.

As mentioned earlier, the idea of balancing the contrasting forces of centralization and decentralization are central to both federal and unitary state. According to Wildasin (as cited in Sharma, 2003, p.176), "the right degree of decentralization depends on what it is we are considering decentralizing and on the particular economic, historical, political and other circumstances within which decentralization is contemplated. The crucial issue is to identify which

level of decentralization is appropriate for each kind of activity".

METHOD

This paper based on comparative-case study under the constructive paradigm. It focuses on the alignment of Five-Year plan of Province of Jakarta, Indonesia and State of Johor, Malaysia development plan with Five-Year National Development Plan. Even though this paper used library research, data are also collected through conducting interview with officials of several institutions who are responsible for or related to planning process and alignment. In Malaysia case, information was collected from Economic Planning Unit (EPU), Malaysian Administrative Modernization and Management Planning Unit (MAMPU), and Johor State Economic Planning Unit (SEPU). In Indonesia case, information was collected from Development Planning Agency of Jakarta Province, and Ministry of Home Affairs. In line with the paradigm and method employed, interpretative approach was used in analyzing data.

RESULT

Administrative system: a brief description. *Indonesia*

Indonesia is a republic with a presidential system of government. The president is assisted by a cabinet. Ministers are directly responsible to the president. The main features of government are prescribed by the 1945 Constitution. Four amendments have been made since 1999. As a unitary state Indonesia has three-level administrative government (central government, 33 Province governments, and 497 Regency/City governments).

Based on Law No. 25/2004 on National Development Planning System, development plan in Indonesia is categorized into three: Long-term, Medium-term and Short-term Development Plan. However, the planning horizon has been implemented since 1969. Starting from New Order Era under Soeharto presidency, Indonesia had three Long-term Development Plan:

1. First Long-term Development Plan, 1969/1970 – 1993/1994;

2. Second Long-term Development Plan, started from 1995/1996.
3. Long-term Development Plan 2005 – 2025, RPJP, 2005 – 2025).

Indonesia’s Medium-term development Plans started from the New Order were as follows:

Table 1: Development Plan in Indonesia: Past and Present

No.	Title of Development Plan Document	Period
1.	Rencana Pembangunan Lima Tahun (Repelita) I	1969/1970 – 1973/1974
2.	Rencana Pembangunan Lima Tahun (Repelita) II	1974/1975 – 1978/1979
3.	Rencana Pembangunan Lima Tahun (Repelita) III	1979/1980 – 1983/1984
4.	Rencana Pembangunan Lima Tahun (Repelita) IV	1984/1985 – 1988/1989
5.	Rencana Pembangunan Lima Tahun (Repelita) V	1989/1990 – 1993/1994
6.	Rencana Pembangunan Lima Tahun (Repelita) VI	1994/1995 – 1998/1999
7.	Rencana Pembangunan Jangka Menengah (RPJM) 2004-2009	2004 – 2009
8.	Rencana Pembangunan Jangka Menengah (RPJM) 2010-2014	2010 – 2014

Based on Article 150 Law No. 32/2004 on Local Government, Local Development Plans, comprising Long-term, Medium-term, and Short-term Development Plan, must be an integrated part of and aligned with National Development Plan. In addition to the administrative-government level development, it is stipulated in this law that all sectoral agencies in each administrative-government level – ministry in central government and department in province and regency/city – has to formulate 5-year Strategic Plan which is aligned with respective medium-term plan.

Malaysia

Malaysia is a constitutional elective monarchy. The state is headed by the *Yang Dipertuan Agong* (King) chosen for five years among the nine sultans. The Malaysian government system is the combination of the federal principle and the system of parliamentary democracy with constitutional monarchy. Cabinet headed by a Prime Minister is appointed by the King from Member of Parliament, and is collectively responsible to Parliament.

Malaysia’s administrative system consists of thirteen states (Johor, Kedah, Kelantan, Malacca, Negeri Sembilan, Pahang, Perak, Perlis, Penang, Sabah, Sarawak, Selangor, Terengganu) and three Federal Territories (Kuala Lumpur, Labuan, Putrajaya). The three federal territories, including capital

Kuala Lumpur, are governed directly by the Ministry of Federal Territories. The system of government at the state level is quite same as that at the national. Stage government is led by Chief Minister (*Menteri Besar* in Sultanates) and by *Ketua Menteri* for Federal Territories). State legislatures are unicameral Assemblies. At the lower municipality level, officials are appointed by state government.

Development planning in Malaysia has a three-tiered cascading planning horizon, covering the long, medium and short term planning horizons as follows:

- Long-term Development Plan:
 - First Outline Perspective Plan - OPP1 (1971 – 1990),
 - Second Outline Perspective Plan - OPP2 (1991- 2000),
 - Third Outline Perspective Plan - OPP3 (2001-2010), and
 - Vision 2020 (1991 – 2020);
- Medium-term development Plan:
 - Five-year development plans, such as the Ninth Malaysia Plan (2006-2010);
- Short Term Planning:
 - Annual Budget.

On state level, there are three types of development plan: (1) State Five-Year Development Plan, (2) Regional/structure Plans, and (3) Sectoral Policies/Plans. On local level, there are Local Plan and special Area Plan. Figure 1 depicts Development Plans of the three government levels in Malaysia.



Figure 1. Malaysia’s Three-Level of Development Planning Source: Economic Planning Unit (EPU)

Agency Problems in Aligning Local Five-Year Development Plan with National Five-Year Development Plan

Province of Jakarta's current five-year development plan is *Rencana Pembangunan Jangka Menengah Daerah - RPJMD* (Medium-term Development Plan) 2007-2012 (Province of Jakarta Regulation No. 1/2008). When Local Development Planning Agency (*Badan Perencanaan Pembangunan Daerah*, Bappeda) of Province of Jakarta formulated the plan, it should refer to *Rencana Pembangunan Jangka Menengah Nasional - RPJMN* (National Medium-Term Development Plan) 2004-2009. However, empirical data indicated that Province of Jakarta's RPJMD 2007-2012 is solely based on elected governor's vision. Furthermore, that plan is only focused on the context of Province of Jakarta. Without referring to RPJMN 2004-2009 made the Province of Jakarta's RPJMD 2007-2012 is not an integrated part of national development plan. The consequence is that it cannot be identified the contribution of the province of Jakarta to the achievement of national medium-term development plan goals. Presidential election in 2009 had a result of a new government and the new RPJMN has already formulated (RPJMN 2010-2014). Based on Law No. 25/2004 on National Development Planning System, RPJMD formulation has to refer to RPJMN. Empirical data showed that Bappeda Jakarta did not review Jakarta RPJMD 2007-2012 in order to make justification toward RPJMN 2010-2014.

In the case of State of Johor, there has been no significant agency problem in the context of development planning. Johor development plan follows Malaysia Ninth Plan 2006-2010. Empirical data showed that such phenomenon is as a result of development planning system in Malaysia. Moreover, because there is a close relationship between *Unit Perancang Ekonomi - UPEN* (State EPU) Johor and federal EPU, and clear thrust, UPEN Johor can easily follow and align Johor development plan with Malaysia Ninth Plan 2006-2010. In addition, according to UPEN Johor, one of the most important factors is budgeting system. To get budget for development, programs and projects have to be in line with federal development plan.

However, not all programs and projects are financed by federal government. Each state also has state own revenue. State of Johor has its own objectives that are achieved partly under the budget coming from State own revenue. In this case, several programs or projects have not been totally aligned with national development plan.

Government Measures to Address Agency Problems in Aligning State/Province Development with National Development Plan

Organizations/ institutions involved in development planning

Designing organization for development planning is one of important factor in alignment of local development plan with national development plan. Suitable organizational design, including degree of vertical, horizontal, and spatial differentiation as well as formalization, enables federal/central government to synchronize, integrate and control organization units.

The government of Indonesia establishes the National Development Planning Agency (*Badan Perencanaan Pembangunan Nasional - Bappenas*) as an institution which has authority to formulate, coordinate, and evaluate national development plan, including in the context of the implementation and evaluation of the effectiveness of national development plan. The Bappenas is responsible directly to President.

At national level, each ministry and other government agencies have Development Planning Unit which is responsible to formulate and propose sectoral development plan to Bappenas. Moreover, based on Government Regulation No. 65/2005 on The Guideline on Minimum Service Standard (*Standar Pelayanan Minimum - SPM, obligatory services*), each ministry and other government agencies have to formulate SPM containing the minimum service scope, performance indicators and performance target will be achieved within five year. The SPM, then, becomes a basis for local government (province and regency/city) in formulating development plan.

Another institution involved in national-level development planning system is Ministry of Home

Affair (MOHA). Relating to development planning system, MOHA has two functions: to coordinate ministries and other government agencies particularly in formulating SPM and to foster, coordinate, monitor, and evaluate local governments' development plan.

In the context of local government, each province and regency/city has Local Development Planning Agency (*Badan Perencanaan Pembangunan Daerah – Bappeda*). As Bappenas does, Bappeda coordinate all sectoral development plan proposed by all department within a local government. There is no hierarchical relationship between Bappeda and Bappenas. In other words, Bapeda is not subordinate of Bappenas. Figure 3. 2 shows the absence of the line hierarchy.

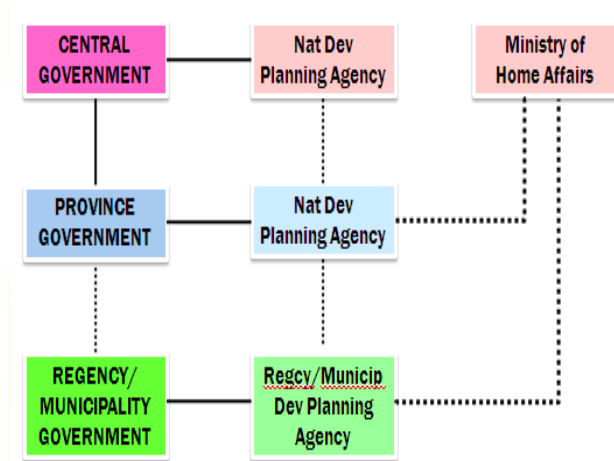


Figure 2. The absence of line hierarchy among National Development Planning Agency (Bappenas), Province and Regency/Municipality Development Planning Agency

In the case of Province of Jakarta, based on Province of Jakarta Regulation No. 10/2008 on Organizational Structure of the Government of Province of Jakarta, Bappeda of Jakarta is responsible for formulating development planning, monitoring development plan implementation and evaluating development plan effectiveness. However, in the regulation there is no explanation about the relationship between Bappeda of Jakarta and Bappenas.

Compare to Indonesia, Malaysia establishes more organizations for development planning, coordination, and evaluation. Figure 3 depicts the

machinery of development planning, coordination, and evaluation in Malaysia.

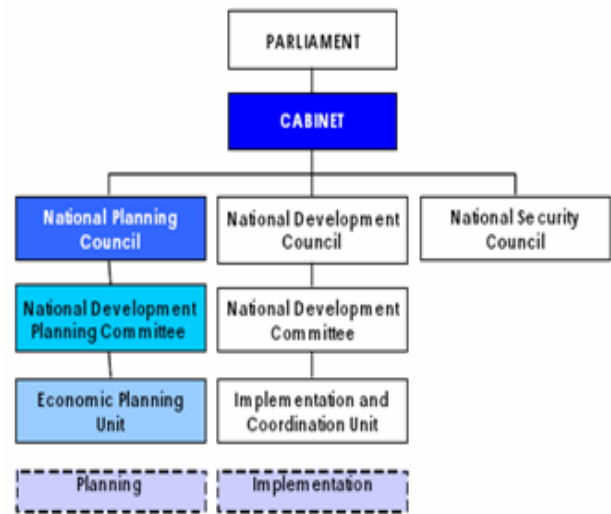


Figure 3. Malaysia's Development Planning, Coordination, and Evaluation Machinery (Source: EPU, 2004:5)

In Malaysia, the National Planning Council (NPC), the economic arm of the Cabinet holds the highest level of decision-making authority in the economic and socio-economic matters. Members of the NPC comprise the ministers of key economic ministries, such as finance, international trade and industry, domestic trade, entrepreneur development, commodities and agriculture.

At the Federal level, development planning is undertaken by EPU, Ministry of Finance and the Central Bank as well as the planning cells of the various ministries and agencies. The functions of EPU are supported by two other central agencies under the Prime Minister's Department, namely, the Implementation and Coordination Unit (ICU) and the Malaysian Administrative and Modernization Planning Unit (MAMPU).

At state level, there are two organizations responsible for formulating state development strategies and coordinating the preparation of state development programs and projects: (1) State Economic Planning Units and (2) the State Development Offices. However, there are committees involved in state development planning and implementation, as shown in Figure 4.

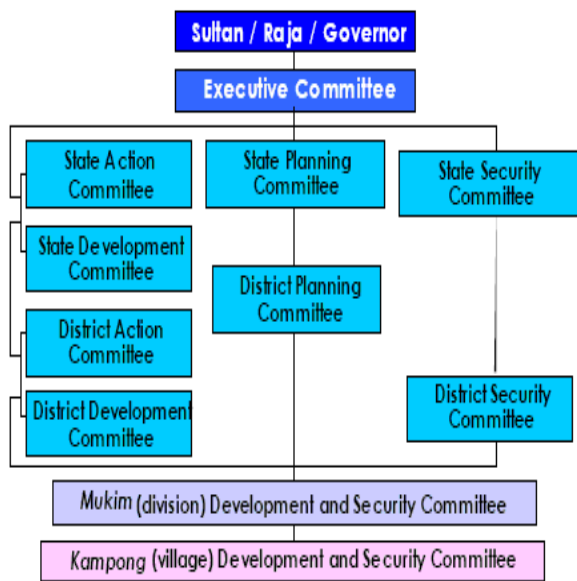


Figure 4. State Government Development Planning, implementation, and Security Machinery (Source: EPU, 2004:7)

Based on SEPU Johor, SEPU is a state institution so that it is not a subordinate of Federal EPU. However, SEPU has close relationship with and is coordinated by Federal EPU.

Development Planning Process and Mechanism

Development planning mechanism and process in Indonesia is regulated in the Law No. 25/2004 on National Development Planning System. At national level, National Five-year Development Plan has to be formulated within three months after President is elected. Based on President’s vision presented in the presidential campaign, Bappenas formulates a brief draft of National Five-year Development Plan. Based on the brief draft, all ministries and other government agencies formulate draft of five-year strategic plan and submit it to Bappenas. By considering the draft of strategic plans, Bappenas formulates draft of National Five-year Development Plan and discusses it in the National Conference on National Five-year Development Plan.

Province Five-year Development Planning is identical with National Five-year Development Planning, as depicted in Figure 5.

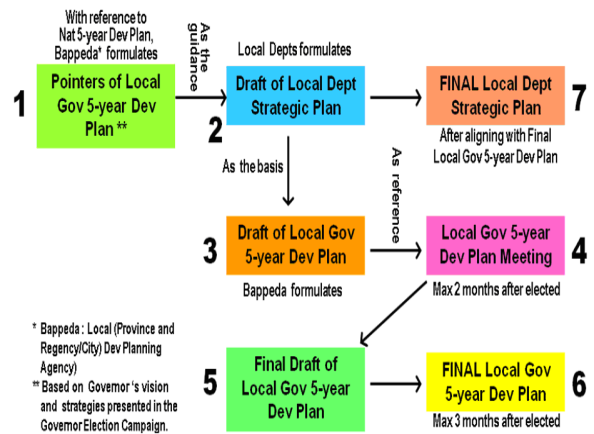


Figure 5. Province Five-year Development Planning Mechanism (Source: adapted from Law No. 25/2004 on National Development Planning System)

As stipulated in Law No. 25/2004 on National Development Planning System, in formulating pointer or brief draft of Province Five-year Development Plan, Bappeda has to refer to National Five-year Development Plan. In the case of formulation of Jakarta Five-year Development Plan 2007-2012, empirical data indicated that there is no guideline on how Bappeda and all local departments refer to National Five-year Development Plan.

Moreover, based on Government Regulation No. 65/2005 on The Guideline on Minimum Service Standard (*Standar Pelayanan Minimum – SPM, minimum obligatory services*), each ministry and other government agencies have to formulate SPM containing the minimum service scope, performance indicators and performance target will be achieved within five year. The SPM, then, becomes a basis for local government (province and regency/city) in formulating development plan.

Government Regulation No. 65/2005 on The Guideline on Minimum Service Standard Formulation and Implementation. SPM is firstly introduced in Law No. 22/1999 on Local Government (was replaced with Law No. 32/2004 on Local Government). According to Government Regulation No. 65/2005, the SPM which is formulated by ministries is the definition of obligatory function and quality or performance of basic services provided by government. In essence, SPM document contains nation-wide performance target of a certain

sector development referring to National Medium Development Plan.

To implement Government Regulation No. 65/2005 on The Guideline on Minimum Service Standard Formulation and Implementation, especially in the local government context, Ministry of Home Affairs (MoHA) has enacted Minister Regulation No. 79/2007 on Guideline on the Minimum Service Standard (SPM) Attainment Plan. According to this regulation, local government has to formulate Minimum Service Standard (SPM) Attainment Plan in each obligatory function and align it with the nation-wide Minimum Service Standard.

As described earlier that in essence SPM is an operationalization of sectoral National Five-year development Plan. Therefore, if a local government formulates Minimum Service Standard (SPM) Attainment Plan, it automatically aligns local Five-year development Plan with National Five-year development Plan.

In Malaysia, development planning is a two-way interactive process between the EPU and the line ministries and agencies. This top-down and bottom-up processes ensure that national policies and strategies are realized and development concerns at sub-regional level are fully integrated into the overall national development thrusts. Figure 6 depicts development planning mechanism in Malaysia.

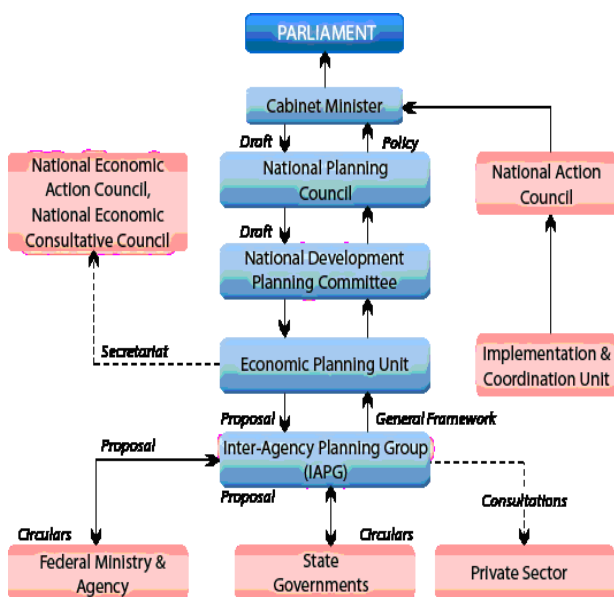


Figure 6. Malaysia Development Planning Mechanism (Source: EPU, 2004:8)

EPU describes that planning from the top which is confined to setting macro level parameters is determined in the context of the Inter- EPU Agencies Planning Groups (IAPGs). The EPU is the secretariat for each of the IAPGs whose work precedes the formulation of any development plan. Whereas, planning from the bottom essentially involves the line ministries, agencies and the state governments which translate the sectoral master plans into specific programs and projects. This plays the key role in matching the micro-level programs and projects with the macro-level plans for each economic sectors.

In terms of project approval process, EPU assesses and prioritizes development projects proposed for the various five-year development plans based on the project proposals by ministries and agencies. It consults with the ministries, agencies, and state governments to review past performance and identify issues, problems, or areas of focus. As part of this effort, the EPU evaluates targets, concepts and programs proposed, and determines the overall objectives, scope and costs of each programs.

Inter-government financial transfer

Inter-government financial transfers, especially vertically from national to sub-national government has been practiced by both federal and unitary state. Besides reducing vertical and horizontal financial imbalance, federal and central government develop a transfer system to control and coordinate local governments’ development plan and implementation in order to ensure the achievement of national development goals.

In Indonesia, decentralization program began in the early 2000s which was implemented under the Law 22/1999 on Regional Government and the Law 25/1999 on Central and Local Fiscal Balance. The two laws have been replaced by Law 32/2004 and the Law 33/2004 respectively. Based on the new Laws, there are three principles employed in the fiscal decentralization program: devolution, de-concentration, and co-administration task.

Law 33/2004 stated that there are three components of intergovernmental fiscal transfers: (1) Revenue Sharing (from natural resources and taxes), (2)

General Purpose Grant (*Dana Alokasi Umum* or DAU), and (3) Specific Purpose Grant (*Dana Alokasi Khusus* or DAK). This policy based on financial capacities of local government is intended to address the problem of vertical imbalance between central and sub-national governments, and horizontal imbalances among local governments. In essence, the DAU block grant meaning local government use it according to their purpose. Whereas, DAK is allocated to specific regions and certain sectoral programs.

Table 2: Indonesia's Sub-national Spending in National Budget 2006-2011

Year	National Revenue (Rp)	National Spending (Rp)	Sub-National Spending (Fiscal Transfer) (Rp)	% of National spending
2006	639,115,256,135,000	478,249,290,655,000	220,849,845,400,000	46.17881296
2007	694,087,881,512,000	498,172,161,830,000	254,201,014,938,000	51.02674023
2008	894,990,546,173,000	697,071,006,390,000	292,422,800,083,000	41.93021703
2009	870,998,991,279,000	691,535,743,610,000	309,308,178,072,000	44.72772101
2010	992,398,789,998,000	781,533,546,832,000	344,612,929,480,000	44.09445134
2011	1,104,901,964,236,000	836,578,166,827,800	392,980,298,478,200	46.97472562

Source: Ministry of Finance, Indonesia.

Furthermore, Table 5 shows that the amount of the national spending for the sub-national is big enough (around 46% of national spending. In 2005, Total sub-national Revenue was Rp 180.01 trillion, 43.83% and 12.07% of it was received from Central Government in the form of DAU and DAK respectively. The relative same condition is shown in 2009. Of Rp 381.47 trillion the total sub-national revenue, 48.82%, was DAU and 6.59% was DAK. The data indicates that the financial transfers from the central government, which consist of shared revenue, general allocation fund (DAU) and special allocation fund (DAK), are the major sources of funding for local governments have been sub-national financial dependency on the central government.

In Malaysia, specific provisions for the transfer of financial resources from the Federal to State is stipulated in the Federal Constitution. The grants are allocated to the States based on origin of collections, population, State Gross Domestic Prod-

uct and other social and economic indicators and actual cost of projects. The grants are classified into three major categories: (1) tax-sharing grants, (2) general purpose grant, and (3) specific-purpose grant. Tax-sharing grants include 10 percent of export duties on tin, iron, and other materials that are extracted in the State.

Table 3 shows the Malaysia's State Governments Consolidated Revenue and operating Expenditures, 2004-2008:

Table 3: Malaysia's State Governments Consolidated Revenue and operating Expenditures (RM Million)

	2004	2005	2006	2007	2008 ³
Hasil ² Revenue ¹	9,995 (17.0)	11,969 (19.7)	12,742 (6.5)	13,498 (5.9)	14,086 (4.4)
Punca negeri State sources	7,543	9,264	9,494	10,378	10,417
Pemberian persekutuan Federal grants	2,417	2,642	3,145	3,064	3,574
Bayaran ganti persekutuan Federal reimbursements	35	63	103	56	95
Perbelanjaan mengurus ³ Operating expenditure ¹	5,612 (5.7)	6,144 (9.5)	6,673 (8.6)	7,157 (7.3)	7,707 (7.7)

Amounts in parentheses are annual % changes.

Source: http://www.treasury.gov.my/pdf/economy/er/0304/jp4_10.pdf

Table 3 indicates the increase of the Federal Grant to State government. It also shows that the amount of the Federal Grant is lower than State sources. In average, the contribution of Federal grant to state revenue is 23.67%.

DISCUSSION

This study found that the degree of agency problems in aligning local five-year development plan with national five-year development plan in Indonesia is higher than those in Malaysia. In the case of Province of Jakarta, when Jakarta's Bappeda formulated Jakarta Five-year Development Plan 2007-2012, the plan has only been based on the elected governor. This is in line with Law No. 25/2004 on National development Planning System that Prov-

ince Five-year Development Plan has to be based on elected governor's vision and strategy presented in the campaign. The issue is how to ensure that governor's vision is in line with president's vision in terms of development.

Another factor affecting the agency problem is that each governor has his or her own interest. In his or her five-year service as a governor, he tries achieve high performance eagerly for pragmatic reason: to win the next governor election. Or, in case the ruling party will not choose him or her becomes governor candidate for next election, by achieving high performance, he or she tries to ensure that his or her party will win the election. This phenomenon can be explained with agency theory. Agency theory, according to Jones (2007:39) describes that the problem is that in the principal-agent relationship there may be a divergence in the goals and interests principal and agent, in this case central and local government. As Jones state "when these two conditions exist so that (1) principal finds it very difficult to evaluate how well the agent has performance because the agent possesses an information advantage, and (2) the agent has an incentive to pursue goals and objectives that are different from the principal's, a moral hazard problem exists, agents have the opportunity and incentive to pursue their own interests.

Based on the above explanation, it can be concluded that the political party difference between a governor and President of Indonesia is not relevant to the agency problem in aligning province's five-year development plan and national five-year development plan. It means that misaligned development plan (province with national) is not because of the different ruling party between a province and central government.

However, with scrutiny we can conclude that the Law No. 25/2004 on The System on National Development Planning is based on the assumption that there is the same period of development planning among central government and all provinces and regencies/municipalities. In other words, the Law assumes that general elections of central and all local government are conducted in the same time. In reality, the general elections are and will not be in the same time. As a result, there is difference among

central and local government development plan in term of period of plan. Without a comprehensive effort, it will be difficult to align the local development plan with national development plan.

From organization perspective, Indonesia and Malaysia are quite the same in terms of the relationship between local and national development agency. In both countries, there is no line hierarchy between local and national development agency. Even, the patterns of the terminology they use are the same. In Indonesia, Bappeda for local agency and Bappenas for national agency. In Malaysia, State EPU at state level and EPU at federal level. However, in Indonesia, the absence of hierarchical relationship between Bappeda and Bappenas (Bappeda is not subordinate of Bappenas) has made complicated development planning coordination. Bappenas has no formal authority to manage, give order to and ask report from local development planning agencies. From legal perspective, there is no specific, clear, and strict description about the function or role of Bappenas in relating to Bappeda. In term of Province of Jakarta, Province of Jakarta Regulation No. 10/2008 on Organizational Structure of the Government of Province of Jakarta does not mention about the relationship between Bappeda of Jakarta and Bappenas. Coordination mechanism between Bappeda and Bappenas in the form of periodic meeting, however, has failed to solve agency problem in aligning local with national development plan.

In Malaysia, it is clear to mention in the Federal Constitution about the relationship between Federal and state government. Even, as mentioned earlier, the constitution also defines the federal-state relationship in term of development planning. This relationship affects the position of federal and state government in term of development planning. Even though there is line hierarchy between State EPU and Federal EPU, this has not become problem to EPU to coordinate and integrate state five-year development plan. This condition has significant impact on the degree of alignment between state and federal five-year development plan. This fact can be understood because in terms of delegation of authority to local government, as Jomo and Hui (2003:454) found, the federation of Malaysia had a

centralized administration. Centralization has advanced over the years within the context of a federal system. In addition, according to Mohamed and Appalanaidu (1998:1) study, the information systems for decentralization of development planning in Malaysia contributes to the quality and effectiveness of the delegation of authority by the central government to the state and district level government in planning.

It is interesting what Kuppusamy (2008:82) described regarding the position of federal, state and local government in Malaysia. Figure 8 depicts position of all government level in terms of sovereignty. The figure reflects the federal-state relationship. It can be understood why federal government is able to coordinate all state, including development plan.

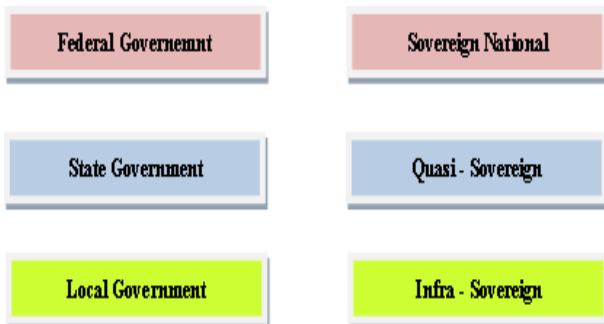


Figure 7. The position of Malaysian government level in terms of sovereignty (Source: Kuppusamy, 2008:82)

The lack of development plan alignment in Indonesia can be analyzed also from procedural or mechanism perspective. Development planning mechanisms as stipulated in Law No. 25/2004 on National Development Planning System does not define how to align and integrate development planning arranging for Regency/municipality government to central government. The Law regulates more on central government development planning. This can be traced by examining its derivative regulation.

In 2004 Government of Indonesia enacted two Government Regulations: No. 20/2004 on (Central) Government Annual Plan and No. 21/2004 on Ministry/National Agency Annual Plan and Budget. The most recent regulation on development planning is Chief of National Development Planning Agency (Bappenas) Regulation No. 5/2009 on Guideline for Formulation of Strategic Plan of Min-

istry and National Agency. However, the Guideline is only for central government context. Unfortunately the Guideline does not stipulate how to ensure the alignment of local with national development plan.

The reason why Bappenas does not regulates local development planning may because all regulation concerning local government, including development planning, are under the Ministry of Home Affairs's (MoHA) authority. In other word, in Indonesia, development planning affairs have been regulated by two institutions: (1) Bappenas for nation-wide development planning (but in reality more focuses on the development planned by Ministry and national agencies) and (2) MoHA for local development planning. This means that there has been no integrated laws and regulations that enables central government (i.e. Bappenas) to ensure the alignment of development plan.

As described earlier, Indonesia has tried to make the development planning alignment between local and national level by enacting Government Regulation No. 65/2005 on The Guideline on Minimum Service Standard (*Standar Pelayanan Minimum – SPM*) Formulation and Implementation. Ironically, the implementation of the regulation has not been coordinated by Bappenas, but by MoHA. This situation reflects that Bappenas has limited authority in ensuring development plan alignment.

Another fact is the enactment of Guideline on the Minimum Service Standard (SPM) Attainment Plan. The Guidelines is enacted by Minister of Home Affairs Regulation No. 79/2007), again, not by Bappenas.

Another factor of affecting the development plan alignment is the dependency to inter-government finance transfer, particularly from federal or central government to local government. Decentralization policies are based not only on administrative and political considerations but also on economic decisions. Therefore, decentralization should be viewed from many different perspectives. Based on this understanding of decentralization, it is not surprising that fiscal decentralization has become importance issue. According to Gamper (2005:1313), "fiscal federalism describes the financial relations between all tiers of a federal state and consequently the distribution of competences. The

financial relationship between the central unit and the lower tiers are of paramount importance to the federal system as a whole. Financial stability and equalization as well as co-operation between the tiers are the basis for an effective federal system”.

As described earlier, local government in both Indonesia and Malaysia shares the same characteristic, that is, local government in Indonesia and Malaysia are quite dependent on fiscal/financial transfer from central and federal government respectively. In Indonesia, the current local revenue framework specifically defines four principle revenue categories (1) Regional Own Revenues, consisting of tax and non-tax revenues; (2) the intergovernmental transfers, consisting of the shared taxes and revenues, the general allocation grant (DAU) and the special allocation grant (DAK); (3) loans and other forms of local borrowing; and (4) other local revenues. Among the revenue instruments, the DAU still remain the main source of local government revenues. The current system relies primarily on general allocation fund (DAU) over which local governments have full discretion. Under the policy on decentralization, that system and combined with regional own revenues management has contributed significantly to the problem of the alignment of local with national development plan.

Compare to Indonesia, The Malaysian Federalism is highly centralized in terms of revenue powers, expenditure responsibilities and borrowing power (Anuar, 2000:85). Further, he stated that General-purpose grants consist of capitation grants, growth revenue grants, State Reserve Fund grants and special grants. Specific-purpose grants include road grants, economic development grants, services charge grants and cost reimbursement grants. The Federal-State grant structure is dominated by the state road grants, capitation grant, revenue growth grant and State Reserve Fund.

However, several limitations of the study should be noted are (1) it focused only on the alignment of Province/State Mid-Term Development Plan with National (not include national Annual – Mid – Long-term Plan, and sector/ministry with national), (2) it was more a library research based on documents (policies), limited empirical data (interview), (3) it focused on one province

(Jakarta)/state (State of Johor) – comparative case study, so the findings cannot be generalized or do not reflect condition of development plans formulated by all state government in Malaysia as well as by all province government in Indonesia, (4) comparison between Malaysia (Federal) and Indonesia (Unitary) may not be a perfect comparative study.

CONCLUSION

This study placed federal government and central government as principal and state and province as agent. In the context of development planning, federal or central government delegate planning authority to local governments while requiring them to align their development plan with national development plan.

The study found that the degree of agency problem in development plan alignment in Indonesia is higher than that in Malaysia. In the period of 10 years with decentralization policy in Indonesia, one of crucial problems are that Indonesia faces lack of alignment between local and national development plans.

The administrative system of Malaysia, particularly in the context of decentralization design is more centralized than that of Indonesia. This study saw this aspect at least in three aspects: organizational design of development planning agencies, mechanism and process of development planning, and budgeting system (inter-government financial transfer).

Regarding organizational design of development planning agencies, even though there is resemblance with pattern of institution in Indonesia (Bappenas at national level and Bappeda at local level) and in Malaysia (EPU at federal level and SEPU at state level) there is no hierarchical relationship between local and national development agency. In addition the degree of vertical relationship in Malaysia is higher than that of Indonesia.

Further in the Indonesia, system, processes and mechanisms of development planning in Indonesia have been supported with more comprehensive and detailed legal framework. Law No. 25/2005 on National Development Planning System has become basic legal framework for development plan-

ning, including at the local level. Besides Bappenas and Ministry of Home Affairs involved in managing (to coordinate, to control, to monitor and to evaluate) local development planning and implementation, line (sectoral) ministries also have significant role, as asserted in Government of Indonesia. Government Regulation No. 65/2005 on Guidelines for Formulating and Implementing Minimum Service Standard (*Standar Pelayanan Minimum* – SPM) and Minister of Home Affairs Regulation No. 79/2007 on the Guideline of Minimum Service Standard Attainment Plan. However, the given process and mechanism as well as legal frame of local development planning are not able to assure the alignment of local with national development plan.

Based on the above description, particularly on inter-government financial transfer it could be concluded that local government in Indonesia and Malaysia are quite dependent to national government. While with state government Malaysia has more discretion over local financial management (budgeting) compared to Indonesia. With more centralized in terms of development finance, Malaysia has been able to minimize agency problem in aligning state with federal development plan.

Three major implications for development planning research and policy are offered based on the results of and limitation in this study. Firstly, principal-agent relationship (agency theory) which comes from economics and has been used in many political researches is important approach in analyzing development planning problems particularly in aligning local with national development plan. This line of inquiry may be complemented and expanded by using quantitative approach to address nationwide agency problem. Secondly, as local government and bureaucracy values have significant role in conducting development planning, future study shall identify what values and analyze how they affect the development planning, process as well as outputs. Finally, for Indonesia government, it is necessary: (1) to centralize policies on development planning and implementation to one institution (i.e., Bappenas) – only one institution has authority to issue regulation on development planning, and (2) to redesign organization structure of development planning institution (Bappenas and Bappeda) in order to en-

sure coordination and integration and in turn to achieve the alignment of local with national development plan.

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