

# The Regional Bond Policy in the Indonesian Regional Autonomy

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## Abstract:

The research aimed to analyze regional bond policy contained in the Indonesian Act Number 23 of 2014 concerning Regional Government and the Act Number 1 of 2022 concerning Financial Relations between the Central and Regional Government as the regional alternative funding resources used for public crucial infrastructure development. Therefore, the regional bond policy shall be supported by the local community because it facilitates the communities' daily needs. However, it has been more than 2 (two) decades since regional autonomy was implemented, there has not a single Regional Government, whether provincial Government or Regency/Municipal Government has successfully issued regional bonds. Therefore, it is significant to further examine the factors that motivate of the local government tendencies for denying the application of regional bond as a source of development budgeting as well as to study all elements of regional government authority regarding the issuance of regional bond. This study belongs to the normative judicial research applying the deductive - synthesis method. The results are; first, the factors influencing local governments tend not to implement regional bonds in financing development in their regions, in terms of legal system theory, has many weaknesses, both elements of legal substance, institutional structure, and legal culture. Thus, the existing regional bond issuance policy has legal uncertainty. It is unable to represent the goals of regional autonomy, nor to create prosperity for the community. Second, the Regent/Mayor is not authorized to issue regional bonds due to the fact that it is contrary to Article 10 paragraph (2) of Act Number 23/2014 and Constitutional Court Decision Number 36/PUU-X/2012.

**Keywords:** regional bonds, legal uncertainty, sources of financing,

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## 1. Background

1998 Political reformation in Indonesia brought some changes to the Indonesian government system which was originally centralized to become decentralized. This condition was confirmed by the enactment of Act Number 22 of 1999 concerning Regional Government, and Act Number 25 of 1999 concerning Financial Balance between the Central Government and Regional Governments. The implementation of the decentralization system in the administration of the regional government is followed by the application of the principle of regional autonomy which means that regional governments are given the rights, authorities and obligations to manage their own government affairs and the interests of the regional community based on the provisions of the applicable laws.

The formation of the 1945 Constitution of the Republic of Indonesia resulted in changes to the political law of regional autonomy as stipulated in Articles 18, 18 A and 18 B which contain the following principles:<sup>1</sup>

- a. The regional principle regulates and manages its own government affairs according to the principle of autonomy and co-administration, Article 18 paragraph (2): "Provincial, regency and municipal regional governments regulate and manage their own government affairs according to the principle of autonomy and co-administration".
- b. The principle of exercising the widest possible autonomy, Article 18 paragraph (5): "The regional government shall exercise the widest possible autonomy, except for government affairs which are determined by law as the affairs of the Central Government".
- c. The principle of regional specificity and diversity, Article 18 A paragraph (1): "The relationship of authority between the central government and provincial, district and city regional governments, or between provinces and districts and cities, is regulated by law by considering regional specificities and diversity".
- d. The principle of central and regional relations must be carried out in a harmonious and fair manner, Article 18 A paragraph (2): Financial relations, public services, utilization of natural resources and other resources between the central government and regional governments shall be regulated and carried out in a fair and

<sup>1</sup> Ni'matul Huda, 2014, *Hukum Tata Negara Indonesia*, Revised Edition, Radja Grafindo, Jakarta, p. 325.

harmonious manner based on the law”.

- e. The principle of recognizing and respecting customary law community units and their traditional rights, Article 18B paragraph (2): The state recognizes and respects customary law community units and their traditional rights as long as they are still alive and in accordance with the development of society and the principles of the Unitary State of the Republic Indonesia, which is regulated by law”.

The elaboration and implementation of these principles in the practice of administering regional government is currently contained in Act Number 23 of 2014 concerning Regional Government, State Gazette of the Republic of Indonesia of 2014 Number 244, Supplement to the State Gazette of the Republic of Indonesia Number 5587, as amended by Act Number 2 of 2015 concerning Stipulation of Government Regulation in lieu of Law Number 2 of 2014 concerning Amendments to Act Number 23 of 2014 concerning Regional Government to Become Law, State Gazette of the Republic of Indonesia of 2015 Number 24, Supplement to the State Gazette of the Republic of Indonesia Number 5657, as re-amended by Act Number 9 of 2015 concerning the Second Amendment to Act Number 23 of 2014 concerning Regional Government, State Gazette of the Republic of Indonesia of 2015 Number 58, Supplement to the State Gazette of the Republic of Indonesia Number 5679, March 18 2015, hereinafter referred to as the Regional Government Law. This law provides a new nuance for the implementation of local government in Indonesia, replacing the Act Number 32 of 2004 which was valid before.

One of the reasons for the promulgation of Act number 23 of 2014 is that the implementation of regional governance is directed at accelerating the realization of community welfare through improving services, empowerment and community participation, as well as increasing regional competitiveness by considering the principles of democracy, equity, justice and the uniqueness of a region within the system of the Unitary State of the Republic of Indonesia. It was then reaffirmed in the general elucidation of the third paragraph of the Regional Government Law. The third paragraph of the general elucidation of the Regional Government Law states: granting the widest possible autonomy to the Regions is directed at accelerating the realization of social welfare through improving services, empowerment, and community participation. In addition, through broad autonomy, in the strategic environment of globalization, it is expected that the regions will be able to increase their competitiveness by considering the principles of democracy, equity, justice, privileges and specificities as well as the potential and diversity of regions within the system of the Unitary State of the Republic of Indonesia.<sup>1</sup>

Article 18 A paragraph (2) of the 1945 Constitution of the Republic of Indonesia mandates the formulation of a law on financial relations between the Central Government and Regional Governments as well as to support the implementation of Regional Government to be able to run properly, thus the government issued Act Number 1 of 2022 concerning Financial Relations between the Central Government and Regional Governments, State Gazette of the Republic of Indonesia of 2022 Number 4, Supplement to the State Gazette of the Republic of Indonesia Number 6757, which was promulgated on January 5, 2022, hereinafter referred to as the Financial Relations Law which is currently valid replacing the Act number 33 of 2004 concerning Financial Balance between the Central Government and Regional Governments which was previously valid for more than 18 years. Based on the Act Number 1 of 2022 concerning Financial Relations, Regional Governments in carrying out government affairs are given the flexibility to manage their finances as well as to seek alternative sources of regional revenue and financing as stipulated in the law.<sup>2</sup> However, number of local governments experience limited funding.<sup>3</sup> The authorities that were previously carried out by the central government, such as infrastructure development, education and health, become the responsibility of the regional governments. Regional Governments must meet their own funding needs through sources of revenue such as taxes, levies, and local revenue. These sources of income are not sufficient to finance regional needs, especially for regions that have relatively low economic potential.

Arrangements for funding sources allocation for the implementation of government affairs within the framework of financial relations between the Central Government and Regional Governments are not only limited to new sources of local revenue such as intensification and intensification of taxes, but have also developed towards the issuance of capital market instruments. Regional Bonds are one of the capital market instruments explicitly stated<sup>4</sup> in the Law on Financial Relations. In the Act Number 25 of 1999 concerning Financial Balance between the Central and Regional Governments, we can only find the provisions for Regional Bonds in the elucidation section of Article 11. Meanwhile in Act Number 33 of 2004 the provisions for Regional Bonds are regulated in Article 51 paragraph (3), Article 57 to Article 65, but the provisions concerning Regional *Sukuk* have only been mentioned in the provisions of Act Number 11 of 2020 concerning Job Creation, and its

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1 Indonesian Act Number 23 of 2014 concerning Regional Government

2 See Article 2 of Act Number 1 of 2022 concerning Financial Relations between the Central Government and Regional Governments.

3 Indonesian Act Number 1 of 2022 concerning Financial Relations between the Central Government and Regional Governments.

4 Ibid.,

provisions are emphasized in Act Number 1 of 2022 concerning Financial Relations between the Central Government and Regional Governments.

To emphasize the opportunities for regional issuance, several Government Regulations regarding Regional Loans have been issued, including from the Government Regulation Number 107 of 2000 concerning Regional Loans, to what is currently in force, namely Government Regulation Number 56 of 2018 concerning Regional Loans. These government regulations are basically implementing regulations of Article 33 paragraph (3) of Act Number 1 of 2004 concerning the State Treasury, Article 65 of Act Number 33 of 2004 concerning Financial Balance, and Article 302 paragraph (1) of Act Number 23 of 2014 concerning Regional Government. Even though the Act Number 33 of 2004 concerning Financial Balance has been revoked by the Act Number 1 of 2022 concerning Financial Relations, Government Regulation Number 56 of 2018 regarding Regional Loans is still declared valid based on Act Number 1 of 2022 concerning Financial Relations.<sup>1</sup>

One of the provisions in the government regulation explains that the District Head with the approval of the Regional People's Representative Assembly can issue regional bonds after obtaining consideration from the Minister of Home Affairs and approval from the Minister of Finance. Based on these provisions, a Regulation of the Minister of Finance was issued, successively Regulation of the Minister of Finance Number 147/KMK.07/2006 concerning Procedures for Issuing, Accountability and Publication of Regional Bond Information, which was later revoked by Regulation of the Minister of Finance Number 111/PMK.07/2012 concerning Procedures for Issuance and Accountability of Regional Bonds. Furthermore, Minister of Finance Regulation Number 111/PMK.07/2012 was amended through Minister of Finance Regulation Number 180/PMK.07/2015 concerning Amendments to Minister of Finance Regulation Number 111/PMK.07/2012 concerning Procedures for Issuing and Accountability of Regional Bonds, which valid until now. This regulation clearly outlines the procedures for issuing and holding regional bonds accountable, therefore it is expected to assist the regions in obtaining sources of development funding.

To support the policy on regional bonds, the Financial Services Authority (referred to as in Indonesia as OJK) also issued a Financial Services Authority Regulation (referred to in Indonesia as POJK), namely:

1. POJK Number 61/POJK.04/2017 Year 2017 concerning Registration Statement Documents in the Context of Public Offering of Regional Bonds and/or Regional *Sukuk*;
2. POJK Number 62/POJK.04/2017 of 2017 concerning Form and Content of Prospectus and Short Prospectus in the Context of Public Offering of Regional Bonds and/or Regional *Sukuk*;
3. POJK Regulation No. 63/POJK.04/2017 of 2017 concerning Reports and Announcements of Issuers of Regional Bonds and/or Regional *Sukuk* Issuers.

The more complete the choice of bonds that can be issued by Regional Governments, both conventional and Islamic bonds, along with the laws and regulations that govern them, the Regional Government is expected to be able to immediately issue their regional bonds/*sukuk* to support the fulfillment of important infrastructure needs urgently needed by the community. Thus by fulfilling the important infrastructure needed, it can significantly improve the welfare of the regional community as the regional government maintenance purposes.

The Regional Autonomy in Indonesia has been running for more that 22 years since the issuance of the Act number 22 and 25 of 1999 that initiated the existence of regional bonds as one of financial resource alternatives for regional government in overcoming financial deficiencies for development funding in the region. Recently, there has no local government, provincial and district government, implemented regional bonds/*sukuk* to finance the regional development.

The legal problem occurs to these issues are: 1) what is the factor of regional government tendencies for not implementing regional bonds as source of regional development funding? 2) are all the level of regional government, both Provincial and District Governments competent to issue regional bonds ?

## 2. Research Method

The research belongs to juridical normative which applies deductive-synthesis method<sup>2</sup> Deductive method is a procedure to obtain scientific knowledge starting from general matters or issues, and finding a specific conclusion, while synthesis means a way of handling certain scientific objects by combining one understanding with another, which is a priori and also a posteriori.<sup>3</sup> The data of the research are sourced from literatures, especially in the field of the development of theoretical legal thought. Scientific writing materials are dissertations, journal articles, papers, and text books. The collection of materials and the literature study provides mutual verification, correction, equipment, and detailing.

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<sup>1</sup> See Article 188 letter a of Act Number 1 of 2022 concerning Financial Relations between the Central Government and Regional Governments.

<sup>2</sup> Sudarto, 1996, *Metodologi Penelitian Filsafat*, PT. Raja Grafindo Persada, Jakarta, p 59-61.

<sup>3</sup> *Ibid*, h. 59-61.

### 3. Results and Discussion

#### 3.1 The factors of government tendencies for not implementing regional bonds as source of regional development funding in the regions.

##### 1.1 Regional development funding in the regions.

The successful of regional bonds implementations certainly brings some influencing factors. The potential factors of the inability of regional government shall be examined from the legal system aspect. *Lawrence M. Friedman*<sup>1</sup>, stated that there are three integrated components of legal system, namely legal structure, legal substance, and legal culture. These legal components in regard to regional bonds will be clearly elaborated in the following discussions:

##### A. Substantial Problems

In regards to legal substance elements, M. Laica Marzuki stated “*legal substance does not only cover written law principles, but also unwritten customary law theorem.*”<sup>2</sup> Legal substance is the output of legal system in form of regulations and decisions applied by all parties those who regulate and are regulated. As part of the legal system, laws and regulations in the field of regional bonds must be aligned with laws and regulations in other fields within the framework of the Unitary State of the Republic of Indonesia, thus it can be implemented properly.

The harmonization of law developed in the Dutch law is used to show that in the world of law, government policies and the relationship between the two have diversity which results in disharmony. Quoted from Ten Berge and de Waard as written by L.M. Gandhi<sup>3</sup>, that the more diversity develops in initiatives and policy lines, in the organization of agencies authorized to determine these policies, in laws and implementing regulations, in policy rules and in jurisprudence, the diversity results in “*doelmatigheid*” or the results do not fit the objectives, ignorance of applicable laws, and disobedience to laws and Government policies.

In line with L.M. Gandhi, O.K. Mahendra<sup>4</sup> stated that there are 6(six) factors that cause disharmony in laws and regulations, namely:

- 1) Formation is carried out by different institutions and often at different times;
- 2) Officials authorized to form statutory regulations alternate either because they are limited by term of office, transfer of duties or replacement;
- 3) The sectorial approach in formulating laws and regulations is stronger than the systems approach;
- 4) Weak coordination in the process of forming laws and regulations involving various agencies and legal disciplines;
- 5) Public access to participate in the process of forming laws and regulations is still limited;
- 6) the uncertain, standardized and binding methods are not established which are binding on all institutions authorized to make laws and regulations.

OK Mahendra further explains the effects of disharmony on laws and regulations, namely<sup>5</sup> :

1. Different interpretations in its implementation;
2. Legal uncertainty occurrence;
3. Not implementing laws and regulations effectively and efficiently;
4. Legal dysfunction as a guideline for community behavior, social control, dispute resolution and means of social change in an orderly and regular manner.<sup>[1]</sup><sub>[SEP]</sub>

With regard to regional bond issuance policies, disharmony was found between Act Number 8 of 1995 concerning Capital Markets and Act Number 1 of 2004 concerning the State Treasury, and Act Number 15 of 2004 concerning Examination of State Financial Management and Responsibility. It is related to the provisions on who has the authority to audit the financial statements of the Regional Government when regional bond is about to be issued.

Based on Article 68 of Act Number 8 of 1995 concerning Capital Markets it is stated that:

“Accountants registered with Bapepam (OJK) who examine the financial reports of Issuers, Stock Exchanges, Clearing Guarantee Institutions, Depository and Settlement Institutions, and other Parties conducting activities in the Capital Market sector must submit confidential notifications to Bapepam within 3 working days from the discovery of the following matters:

- a. violations committed against the provisions of this Law and or its implementing regulations; or
- b. matters that may endanger the financial condition of the intended institution or the interests of its

<sup>1</sup> Lawrence M. Friedman, *The Legal System, A Social Science Perspective*, translated by M. Khozim, 2009, *Sistem Hukum Perspektif Ilmu Sosial*, Nusa Media, Print II, p. 16.

<sup>2</sup> M. Laica Marzuki, *Legal Human Resources Dalam Konteks Komponen Sistem Hukum*, *Majalah Hukum Varia Peradilan* vol. 13 no. 149 (1998), p. 120.

<sup>3</sup> L.M. Gandhi, *Harmonisasi Hukum Menuju Hukum Responsif*, The speech was delivered at the Inauguration Ceremony of permanent Professorship at the Faculty of Law, University of Indonesia in Jakarta, October 14, 1995, p.5.

<sup>4</sup> A.A. O.K. Mahendra, *Harmonisasi Peraturan Perundang-undangan*, article, Jakarta, March 29, 2010, p. 1 - 2.

<sup>5</sup> *Ibid*, p. 2.

customers”.

It is expressly stated that the party authorized to audit the issuer's financial statements, in the case of the Regional Government as the regional bond issuer, is a public accountant registered with the OJK. On the other hand, pursuant to Article 2 paragraph (2) of Act Number 15 of 2004 concerning Examination of State Financial Management and Responsibility, examination of State financial management (in this case regional government finances in the Regional Revenue and Expenditure Budget) is entirely under responsibility of the Supreme Audit Agency (referred to in Indonesia as BPK). It is also confirmed in Article 56 paragraph (3) of Act Number 1 of 2004 concerning the State Treasury.

The arising of this juridical problem is inline with the provisions of Article 2 paragraph (1) of the Minister of Finance Regulation Number 111/PMK.07/2012 concerning Procedures for Issuance and Accountability of Regional Bonds which states that: Issuance of regional bonds can only be carried out by Regional Governments whose final audit of Financial Statements gets a Qualified Opinion or Unqualified Opinion. This regulatory disharmony is still a problem until now and there has been no change, so that it is one of the reasons for the difficulty in issuing regional bonds by the Regional Government.

A.A. Oka Mahendra<sup>1</sup> offers solutions if disharmony occurs in laws and regulations namely:

- a. Institutions/agencies authorized to revoke/amend disharmonious articles;
- b. Conducting a judicial review of judicial institutions; <sup>[1]</sup><sub>[SEP]</sub>
  - 1) The Constitutional Court examines laws against the Constitution;
  - 2) The Supreme Court examines statutory regulations under the law against the law.
- c. Applying legal principles, as follows:
  - 1). *Lex superior derogat legi inferiori*. Higher level Laws and regulations override lower-level laws and regulations, except if the substance of higher-level laws and regulations stipulates matters determined by law to be the authority of lower-level laws and regulations
  - 2). *Lex specialis derogat legi generalis*. It means specific laws and regulations override general regulations. There are several principles that must be considered in the principle of *Lex specialis derogat legi generalis*:
    - (a) The provisions contained in general laws and regulations remain valid, unless specific provisions have been provided for the special regulations.
    - (b) The provisions of the *lex specialis* must be equal to the provisions of the *lex generalis* (law by law).
    - (c) The provisions of the *lex specialis* must be in the same legal environment (regime) as the *lex generalis*. The Commercial Law Code and the Civil Code are both included in the civil law environment.
  - 3). The principle of *lex posterior derogat legi priori*. The newer laws and regulations override or abolish the old laws and regulations. The principle of *lex posterior derogat legi priori* requires the use of the new law. This principle also contains the following principles:
    - (1) The new rule of law must be equal to or higher than the old rule of law;
    - (2) The new and old laws govern the same aspects. This principle aims to prevent dualism which can lead to legal uncertainty. With the existence of *the Lex posterior derogat legi priori* principle, the provisions governing the repeal of a statutory regulation are actually not that important. By law, similar old provisions will no longer apply when the new legal provisions are valid.

Due to the disharmony of regulations on the authority to audit regional government financial statements between the provisions in Act Number 8 of 1995 concerning Capital Markets and Act Number 1 of 2004 concerning the State Treasury, and Act Number 15 of 2004 concerning Management and Accountability Examination State finances, can be resolved using the principle of *Lex Posterior derogat legi priori*, and the legal principle that if the interests of the state clash with the interests of society or groups, then the interests of the state must be prioritized or protected. The APBD is the legal regime for state finance, while the regulation of the capital market is focused on protecting investors. Therefore, the APBD as a reflection of the interests of the State must take precedence over the interests of investors. Thus, based on the description above, Financial Supervisory Agency (BPK) has the authority to audit the financial reports of the Regional Government when issuing regional bonds based on the provisions of Act Number 1 of 2004 and Act Number 15 of 2004.

## B. Institutional Structure Problems

Structure is one of the basic and tangible elements of the legal system. The structure of a legal system is its bodily framework, it is its permanent form, the institutional body of the system which keeps processes flowing within its boundaries.<sup>2</sup> It is related to the structure of law enforcement officials who determine whether or not the law can be implemented properly. Structure is a sub-system of the legal system with various functions in order to support the operation of the system. This element makes it possible to see how the legal system provides services

<sup>1</sup> *Ibid*, p.2.

<sup>2</sup> Lawrence M. Friedman, *Op Cit*, p. 15 - 16

to the regular processing of legal materials.

Referring to the elements of the legal system opined by Friedman, M. Laica Marzuki explains the elements of the institutional structure as follows:

“...elements of the legal structure are basically related to law enforcement, namely how the substance of the law is upheld and maintained. Thus, the legal structure is institutionalized into legal entities, such as the structure of the court of first instance, court of appeal, and court of cassation, the number of judges and the integrated justice system. The structure of the legal system is related to the justice system which is realized through legal apparatus, such as judges, prosecutors, advocates, bailiffs, police, including the composition of the judiciary and the jurisdictional authority thereof”.<sup>1</sup>

Issuance of regional bonds as a legal system, consists of a substance sub-system in the form of regulations, provisions governing how regional bonds can be issued by the Regional Government which has been described in the previous discussion. The next sub-system is the institutional structure, namely parties authorized by law to issue and manage regional bonds. The structure is the Governor, Regent, or Mayor as Regional Head<sup>2</sup>, and regional bond management units appointed by the Governor, Regent, or Mayor<sup>3</sup>.

In general, there are several problems faced by regional governments that tend not to use regional bonds as an alternative source of development funding in their regions, namely:

1. Local Government's low understanding of regional bonds.

An indication of this low understanding is reflected by the low number of regions that have explored regional bonds as an alternative source of development funding in their regions. Of the 38 Provincial Governments, only 3 Provinces have stated that they are ready to issue regional bonds, even though there are higher numbers stated to meet the requirements.<sup>4</sup> It has an impact on DPRD approval, where this approval is highly important, considering that the APBD must set aside a budget as bailout funds for interest payments to bondholders.

2. The Unpreparedness of Organization and Human Resources for Managing Regional Bonds.

Based on Article 2 paragraph (4), (5), (6), and (7) PMK Number 111/PMK.07/2012 concerning Procedures for Management and Accountability of Regional Bonds, Regional Bonds are managed by a special unit that has an organizational structure, instruments work, and human resource capacity to carry out the Municipal Bond management function. Regional bond management includes:

- a. establishment of Municipal Bond management strategy and policies including risk control policies;
- b. planning and determining the structure of regional loan portfolios;
- c. issuance of Regional Bonds;
- d. sales of Municipal Bonds through auctions for resale;
- e. repurchase of Regional Bonds before due date;
- f. payment at due date; And
- g. accountability

This regional debt management unit can be carried out by an existing work unit or a new work unit. When a new work unit is formed, it is commonly called the Debt Management Unit (DMU), which is a special unit for managing regional debt originating from regional bonds. The DMU, in carrying out its duties, must be able to compile debt levels, plan cost requirements, review alternative principal and interest payments, and prepare the administration of regional bond issuance.<sup>5</sup> Therefore, the position of the DMU is very important in issuing regional bonds, because the Regional Government must be responsible for managing the regional bond proceeds so that public trust, especially investors in the Regional Government, will be stronger.

The unpreparedness of Human Resources and Debt Management Units in almost all Regional Governments in Indonesia, can cause the Central Government to provide less support to Regional Governments to issue regional bonds<sup>6</sup>, and is more inclined to use the Public Private Partnership (PPP) approach<sup>7</sup>, or Regional Loans which are originating from the Central Government, or other schemes as a regional financing solution.

3. Low Regional Government Financial Independence.

Citing Mahmudi's opinion as written by Irfan Sofi, regional independence is the ability of local governments

<sup>1</sup> M Laica Marzuki, Op Cit, p. 120.

<sup>2</sup> See Article 176 point 7 of Act Number 11 of 2020 concerning Job Creation.

<sup>3</sup> See Article 2 paragraph (2) and paragraph (4) of Minister of Finance Regulation Number 111/PMK.07/2012 concerning Procedures for Issuance and Accountability of Regional Bonds

<sup>4</sup> Akhmad Solehudin, *Hambatan dan Resiko Penggunaan Obligasi Daerah Sebagai Alternatif Pembiayaan Daerah*, 15-August 15, 2017, accessed in : <https://inspektorat.tegalkab.go.id/2017/08/15/berita-baru/>

<sup>5</sup> Dewi okta and David Kaluge, 2011, Analisis Peluang Penerbitan Obligasi Daerah Sebagai Alternatif Pembiayaan Pemerintah Daerah, *Journal of Indonesian Applied Economic*, Vol. 5 No. 2, p. 168.

<sup>6</sup> Asian Development Bank, *Strengthening the Local Government Bond Market*, Technical Assistance Number 8753, January, 2020.

<sup>7</sup> DJPK Ministry of Finance: Regional Financing Policy articles

to finance government activities, development and services to the community. The regional financial independence ratio can be calculated by comparing the amount of Regional Original Revenue divided by the total transfer income from the Central and provincial governments as well as from regional loans. The higher the number of this ratio shows the higher the regional financial independence of Regional Government.<sup>1</sup>

It means that the regional government must make innovations to provide financial income for the regional treasury through the Regional Original Revenue (PAD). If the percentage of PAD in a region is high, even greater than transfer income from the central government, then the independence of the region is considered good, and is considered ready to carry out regional bond issuance activities. As an illustration, the financial condition of Central Java Province is presented in the following table during the period from 2013 to 2018.

Table 1: The Independence Ratio of Central Java Province

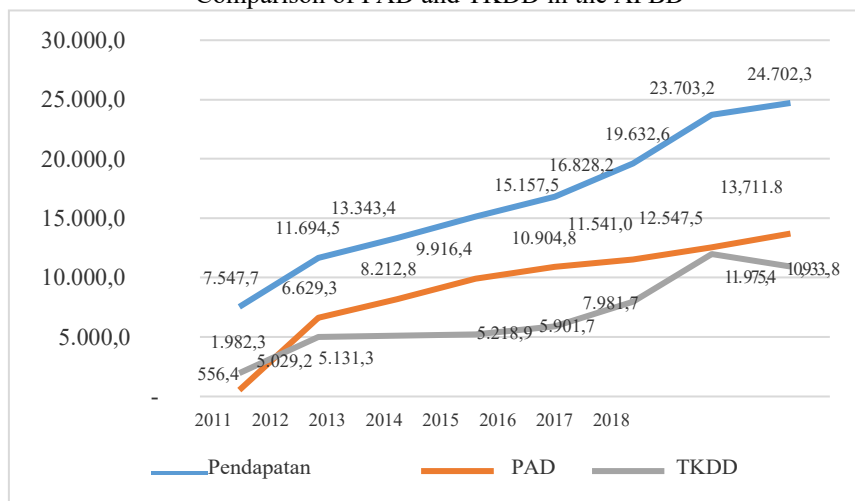
Year	PAD	Total income	Ratio
2013	8.212,00	13.343,39	61,55 %
2014	9.916,39	15.157,46	65,42 %
2015	10.904,83	16.828,15	64,80 %
2016	11.541,03	19.632,58	58,79 %
2017	12.547,51	23.703,17	52,94 %
2018	13.711,84	24.702,32	55,51 %

Source: LKPD of Central Java Province

The above table explains that in the period from 2013 to 2017, the fiscal situation of Central Java Province experienced a downward trend. This trend can be seen from the ratio of regional financial independence from 61.55% in 2013 to 52.94% in 2017 or a decrease of more than 8.61%. In 2018 it has increased even though it is still below the 2016 ratio and below.

Figure 1

Comparison of PAD and TKDD in the APBD

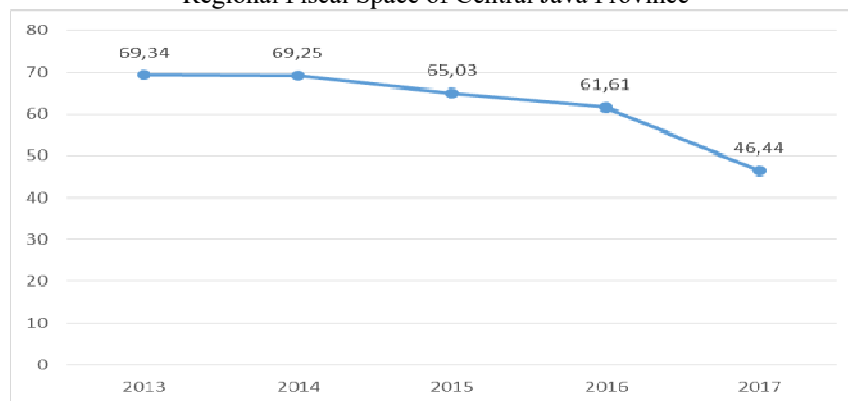


Source : DJPK – Ministry of Finance

The above figure explains that the regional finances of Central Java Province depend on the Transfer to Regions and Village Funds (TKDD) budget, even though since 2012 the amount has been below the amount of PAD generated by the regions. Central Java Province TKDD receipts in 2012 reached Rp. 5.13 trillion while the PAD generated in the same year was Rp. 6.63 trillion. Furthermore, in 2018, the number of TKDD in Central Java Province received was Rp. 10.93 trillion, this amount is also still below the total PAD revenue of the same year of Rp. 13.71 trillion.

<sup>1</sup> Irfan Sofi, 2020, Analisis Kelayakan Penerbitan Obligasi Daerah Provinsi Jawa Tengah Untuk Pembangunan Sistem Penyediaan Air Minum Dan Kontribusinya Terhadap Pendapatan Daerah, *Jurnal Manajemen Keuangan Publik*, p. 2.

Figure 2  
Regional Fiscal Space of Central Java Province



Source: LKPD of Central Java Province

The regional fiscal space of Central Java Province during the same period also experienced a downward trend from 69.34 percent in 2013 to 46.44 percent in 2017 or a significant decrease of 22.90 percent. This decrease causes the flexibility owned by the Provincial Government of Central Java in using funds in the Regional Revenue and Expenditure Budget (APBD) to determine spending priorities is limited. Calculation of Fiscal Space is obtained by subtracting all income with earmarked income and mandatory expenditures such as personnel expenditures and interest expenditures.<sup>1</sup>

### C. Legal Culture Issues

According to Lawrence M. Friedman<sup>2</sup>, legal culture is an element of social attitudes and values. Legal culture is the atmosphere of social thought and social forces that determine how law is being used, avoided or misused. Legal culture is closely related to the legal awareness of society. The higher the legal awareness of the community, the better legal culture will be created, which can open the community awareness on law so far. In more simple terms, the level of public law compliance is an indicator of the functioning of the law.

Regarding the elements of legal culture, Ade Maman Suherman explained that: "...attitudes and values on law along with attitudes and values on behavior related to law and institutions, both positively and negatively".<sup>3</sup> In addition, being connected with each of the elements of the legal system referred to, M. Laica Marzuki stated: "... it is often neglected that no matter how ideal a product of legal substance will be supported by the structure of the legal apparatus, the two components are not more than just a "blueprint" or Legal "design" when it is not supported by the legal culture of community members. The awareness of the citizens (burgers) is a reflection of the legal culture of society".<sup>4</sup>

In the context of regional bonds issuance, its success does not only rely on the quality of Regional Bond Management Unit HR only, but also depends on the level of local community acceptance or support for the Regional Government program to be financed using the regional bonds. Public capital market literacy in this context is an important thing that deserves public attention. Regional bonds are a capital market instrument, thus they must be traded through the capital market mechanism, both the primary and secondary market mechanisms.

The society shall be familiar with or at least understand certain provisions applicable in the capital market to avoid culture gap. It is definitely quite challenging, however it shall be strived for to make a better change for Indonesian nation, namely the common welfare and prosperity as aspired to in Alenia IV of the Preamble of the 1945 Constitution of the Republic of Indonesia.

Based on data of OJK, the total number of investors at the end of Semester II-2021 increased by 92.99% (yoy) to 7,489,337 investors. The number of stock investors increased by 103.60% (yoy) to 3,451,513 investors. The number of Mutual Fund investors increased by 115.4% (yoy) to 6,840,234. while the number of SBN investors increased by 32.75% (yoy) to 611,143 investors<sup>5</sup>.

Observing the OJK data, it is known that the percentage of debt securities investors (SBN, both in the form of Government Bonds and State Sharia Securities) is still a very small percentage, only 8.16% of the total number of capital market investors, especially stock instrument investors. It illustrates that the Indonesian people's understanding of financial instruments in the form of debentures is low and needs to be improved.

<sup>1</sup> *Ibid*

<sup>2</sup> Lawrence M. Friedman, *Op Cit*, p. 17- 18.

<sup>3</sup> Ade Maman Suherman, 2004, *Pengantar Perbandingan Sistem Hukum (Civil Law, Common Law, dan Hukum Islam)*, Rajawali Pers, Jakarta, p.11.

<sup>4</sup> M. Laica Marzuki, *Op Cit*, p. 120.

<sup>5</sup> Directorate of Capital Market Statistics and Information, 2022, *Statistics Semester II – 2021*, Financial Services Authority of the Republic of Indonesia, p. ii.



This condition becomes the moment for the Regional Government to issue regional bonds. In the process of discussing the issuance of regional bonds, the Regional Government must involve the community directly by inviting representatives of community organizations, youth organizations, women's organizations, labor organizations, professional organizations, universities, together with the DPRD, representatives from the Ministry of Finance and OJK.

The discussion on the regional bond issuance plan includes: determining the infrastructure/facility projects needed and prioritized, the total value of regional bonds to be issued, the amount of interest rates, and the issuance/maturity period. Indeed, the local people themselves are expected to act as investors or buyers of these regional bonds.

Furthermore, the Regional Government shall invite the community in supervising the process of building facilities/infrastructure financed by regional bonds. In order that, the community develops a sense of ownership of the facility/infrastructure project. In the final stage, the community is also involved in providing an evaluation of the benefits of the facilities/infrastructure financed by the regional bonds. Regional Government can immediately find a solution if there are still deficiencies or weaknesses in the utilization of these facilities/infrastructure.

Issuance of regional bonds without the participation of the local community is contrary to the essence of regional government administration with its fiscal decentralization. Therefore, by involving the community in the regional bond issuance process, the Regional Government will obtain 3 (three) things at once. First, the limitations of the regional budget for financing public infrastructure have found a way out; Second, there exists a process of educating local communities about regional bonds; Third, the availability of facilities/infrastructure needed and beneficial for the community.

### **3.2 Regional Government Has the Authority to Issue Regional Bonds**

Regarding the Regional Government authority in issuing regional bonds relates to the existence of Article 10 paragraph (2) of Act Number 23 of 2014 on Regional Government. This fact needs to be further examined, bearing in mind that the Regional Government as the legal subject of issuing regional bonds is the Provincial Government or Regency/City Government, where each of these Regional Governments administers different principles. A question arises on which Regional Government from the perspective of regional autonomy law has the authority to issue regional bonds.

From the point of view of the authority to administer regional government, regional autonomy can be divided into broad autonomy, namely the freedom of the region to organize government which includes authority in all areas of government, except foreign policy, defense and security, justice, monetary, fiscal and religion. Furthermore, real autonomy is regional discretion to carry out government authority in certain fields that actually exist and are needed, and grow, live and develop in the region. Then responsible autonomy is in the form of the realization of accountability as a consequence of granting rights, and authorities to the regions in the form of duties and obligations that must be borne by the regions in achieving the objectives of granting autonomy, i.e., in the form of improving services and community welfare, developing democratic life, justice, and equity, as well as maintaining a harmonious relationship between the Center and the Regions to maintain the integrity of the Unitary State of the Republic of Indonesia.

The implementation of regional government must be supported by adequate regional financial capacity. Regional finances<sup>1</sup> are all regional rights and obligations valued by money, as well as everything either in the form of money or in the form of goods that can be owned by the region in connection with the implementation of these rights and obligations.

The regional financial formulation uses an approach on objects, subjects, processes, and objectives.<sup>2</sup>

1. In terms of objects, regional finance includes all regional rights and obligations that can be valued by money, and separate management of regional assets, as well as everything in the form of money or goods that can be owned by the region in connection with the implementation of rights and obligations, but does not include the fiscal and monetary sectors.
2. In terms of subject, regional finance includes all the objects mentioned above owned by the region, and/or controlled by the Regional Government, regional companies, and other bodies that are related to regional finance.
3. In terms of process, regional finance includes a whole series of activities related to the management of the object, starting from policy formulation and decision making to accountability.
4. In terms of objectives, regional finance includes all policies, activities and legal relations related to the ownership and/or control of the objects as above in the context of administering regional government.

Based on the description of the regional financial approach, Harsanto Nursadi stated that the scope of

<sup>1</sup> See Article 1 point 1, vide Article 1 point 2 Act Number 17 of 2003 concerning State Finance.

<sup>2</sup> See general explanation number 3 of Act Number 17 of 2003 concerning State Finance..

regional finance includes<sup>1</sup>:

1. Directly managed regional finance and separated regional wealth;
2. Directly managed regional finance are the regional income and expenditure budget (APBD), and inventory belonging to the region;
3. Separated regional assets are regional funds contained in Regional Owned Enterprises (BUMD), and
4. Regional finance is actually an organization and management of resources or wealth in an area to achieve the desired goals.

In the general elucidation section of number 4 of Act Number 1 of 2022 concerning Financial Relations between the Central Government and Regional Governments, it is stated that the financial capacity of the Regions is still relatively limited in funding the provision of public facilities and infrastructure. Regions, in carrying out development and providing services to the community, can access sources of Regional Debt Funding, both conventional and sharia schemes, including regional bonds and regional *sukuk*.

The region referred to in the General Explanation section number 4 of Act Number 1 of 2022 concerning Financial Relations as described above does not specify which Regional Government or which level of Regional Government is meant to be able to access Regional Debt Funding, both conventional and sharia schemes in the form of regional bonds, and regional *sukuk*. The absence of an explanation on this matter means that this provision applies to all Regional Governments at all levels, both Provincial Governments and Regency/City Governments.

It is known that in running regional government, each level of regional government uses a different principle of autonomy. The Provincial Government is based on the principle of deconcentration and can be decentralized, while the Regency/City Government is based on the principle of decentralization only. Then, in theory, whether the issuance of regional bonds can be carried out by both levels of the Regional Government, and only one level of Regional Government.

The above elaborations become a signal to answer related problems. When the Government issues bonds or Government Securities (SUN), then Article 6 of Act Number 24 of 2002 concerning Government Securities states: In the event that the Government is going to issue Government Securities, the Minister shall first consult with Bank Indonesia. Due to the fact that, the issuance of bonds is intended to (a) finance the deficit of the State Revenue and Expenditure Budget; (b) cover short-term cash shortfalls due to discrepancies between cash flows received and disbursed from the State Treasury Account in one fiscal year; (c) manage the state debt portfolio. All of these objectives are closely related to the national fiscal policy. Fiscal policy is a policy of adjustments in government spending and revenue to improve economic conditions.<sup>2</sup> Fiscal policy is an adjustment in government revenue and spending as stipulated in the state revenue and expenditure budget, abbreviated APBN, to achieve better economic stability and the desired pace of economic development, which is generally stipulated in development plans.<sup>3</sup>

Although the issuance of regional bonds is not intended to cover the APBD deficit,<sup>4</sup> the issuance of regional bonds is closely related to the APBD. Issuance of regional bonds is expected to provide revenue for the APBD, on the other hand the issuance of regional bonds should not result in a larger APBD deficit<sup>5</sup>. From the revenue side, in general the APBD posture consists of Regional Original Revenue (PAD), and receipt of Transfer funds to the Regions (TKD). TKD is a fund sourced from the APBN and is part of state spending that is allocated and distributed to the Regions to be managed by the Regions in order to fund the implementation of Government Affairs which are the authority of the Regions. The existence of the TKD element, which incidentally originates from the APBN in the APBD, is the policy link for regional bond issuance, which is part of the national fiscal policy.

Based on the point of view of the implementation of autonomy, the issuance of regional bonds is basically part of absolute Government Affairs, namely national Fiscal Affairs. It means that the issuance of regional bonds is also part of the national fiscal policy/regime. So the phrase "obtain approval from the Minister who administers government affairs in the financial sector" in Article 176 point 7 of Act Number 11 of 2020 concerning Job Creation, as an amendment to Article 300 paragraph (2) of Act Number 23 of 2014 concerning Regional Government, and Article 157 paragraph (4) of Act Number 1 of 2022 concerning Financial Relations between the Central Government and Regional Governments, confirms or at least serves as an indication that the issuance of regional bonds is part of the national fiscal regime or policy. The analogy given, are: the legal status of a Regional Liability Company is obtained in accordance with the provisions of the law governing limited

<sup>1</sup> Harsanto Nursadi, 2005, *Keuangan Daerah Berdasarkan UU No. 32 Tahun 2004 tentang Pemerintahan Daerah*, *Jurnal Hukum & Pembangunan*, Vol. 35 No. 4, Publishing Board of the Faculty of Law, University of Indonesia, Jakarta. P. 459.

<sup>2</sup> Ani Sri Rahayu, *Pengantar Kebijakan Fiskal*, Bumi Aksara, Ed. 1, Print. 2, Jakarta, 2014, p 1.

<sup>3</sup> I.W. Sudirman dalam *Kebijakan Fiskal dan Moneter: Teori dan Empirikal*, Kencana Prenada, 2014.

<sup>4</sup> See Article 3 paragraph (1) of Minister of Finance Regulation Number 111/PMK.07/2012 concerning Procedures for Issuance and Accountability of Regional Bonds.

<sup>5</sup> see Article 36 paragraph (3) Government Regulation Number 56 of 2018 concerning Regional Loans.

liability companies, meaning that it must obtain the approval of the Minister of Law and Human Rights. Meanwhile, the status of a regional public company legal entity was obtained at the time the regional regulation governing the establishment of a regional public company valid.<sup>1</sup>

This fact is in line with the provisions of Article 10 of Act Number 23 of 2014 concerning Regional Government which regulates absolute government affairs which are the authority of the Central Government, including national monetary and fiscal affairs, namely government affairs which are exempt from being decentralized, but can be delegated based on the principle of deconcentration.

The government's authority in issuing bonds which is an absolute government affair can be interpreted as the right to control the State as stipulated in Article 33 paragraph (2) and paragraph (3) of the 1945 Constitution of the Republic of Indonesia. Then, what does the right to control the State mean? Can the right to control the State be delegated?

A Constitutional Court Decision No. 36/PUU-X/2012 defines the phrase “controlled by the State” listed in Article 33 paragraph (2) and paragraph (3) of the 1945 Constitution of the Republic of Indonesia: “...control by the state in Article 33 of the 1945 Constitution of the Republic of Indonesia has a higher or wider meaning than ownership in the conception of civil law. The conception of control by the state is a conception of public law which relates to the principle of popular sovereignty adhered to in the 1945 Constitution of the Republic of Indonesia, both in the political democracy and economic democracy fields. In the notion of popular sovereignty, it is the people who are recognized as the source, owner, and at the same time the highest authority in the life of the state, in accordance with the doctrine of “from the people, by the people, and for the people”. In this sense of supreme power, the notion of public ownership by the people collectively is also included, that the earth, water and natural resources contained in the jurisdiction of the state are essentially the public property of all the people collectively which is mandated by the state to control them to be used for the greatest common prosperity. Therefore, Article 33 paragraph (3) stipulates “earth and water and the natural resources contained therein shall be controlled by the state and used for the greatest prosperity of the people”.

In the Court's decision, state control is interpreted, the people collectively constructed by the 1945 Constitution of the Republic of Indonesia mandates the state to carry out policies (*beleid*) and management actions (*bestuursdaad*), regulation (*regelendaad*), management (*beheersdaad*), and supervision (*toezichthoudensdaad*) for the greatest prosperity of the people. The management function (*bestuursdaad*) by the state is carried out by the Government with the authority to issue and revoke permits (*vergunning*), licenses (*licentie*), and concessions (*consessie*). The regulatory function by the state (*regelendaad*) is carried out through legislative authority by the DPR together with the Government, and regulation by the Government. The management function (*beheersdaad*) is carried out through a share-holding mechanism and/or as an institutional instrument, through the state, c.q. The government control over these sources of wealth to be used for the greatest prosperity of the people. Likewise, the function of supervision by the state (*toezichthoudensdaad*), c.q. The government, in the framework of supervising and controlling, in order that the implementation of control by the state over the sources of wealth is actually carried out for the greatest possible prosperity of all the people.

The five forms of state control in the decision are placed in the same position. In case the government only perform one of the four functions of state control, for example it only carries out a regulatory function, it can be interpreted that the state has exercised its control over natural resources. In fact, the governing function is a common state function in any country without the need for Article 33 of the 1945 Constitution of the Republic of Indonesia. It means the state control does not achieve the greatest possible goal for the prosperity of the people as meant in Article 33 of the 1945 Constitution of the Republic of Indonesia.

According to the Court, Article 33 of the 1945 Constitution of the Republic of Indonesia requires that state control must have the greatest possible impact on the prosperity of the people. In this case, “the notion controlled by the state” cannot be separated from the meaning for “the greatest prosperity of the people” which is the goal of Article 33 of the 1945 Constitution of the Republic of Indonesia. It has a stronger foundation than the 1945 Constitution of the Republic of Indonesia which in Article 33 paragraph (3) states, “Earth and water and the natural resources contained therein are controlled by the state and used for the greatest prosperity of the people”. “...with the clause “to be used for the greatest prosperity of the people” then the greatest prosperity of the people is the criterion for the state in determining the management, regulation or management of the earth, water and natural resources contained therein. ..” If state control is not linked directly and in unity with the greatest prosperity of the people, it can give an inappropriate constitutional meaning. It means it is possible for the state to fully control natural resources, without providing the greatest benefit to the people's prosperity. The state can demonstrate sovereignty over natural resources, but on the other hand, the people do not necessarily get as much prosperity as possible over natural resources. Therefore, according to the Court, the constitutional criterion for measuring the constitutional meaning of state control is precisely contained in the phrase “for the greatest prosperity of the people”;

<sup>1</sup> See Article 4 paragraph (4) and paragraph (5) of Government Regulation Number 54 of 2017 concerning Regional Owned Enterprises.

Quoting the Constitutional Court opinion in decision No. 36/PUU-X/2012 which states “control by the state in Article 33 of the 1945 Constitution of the Republic of Indonesia has a higher or broader meaning than ownership in the conception of civil law. The conception of control by the state is a conception of public law relating to the principle of popular sovereignty adhered to in the 1945 Constitution of the Republic of Indonesia, both in the political democracy and economic democracy fields used as much as possible for the prosperity of the people”, thus, the state control (read: state authority) in issuing bonds, cannot be delegated to anyone, including local governments (regional bonds) in the context of decentralization, and/or co-administration, but can be within a deconcentration framework. Due to the fact that, the state's authority in the field of state finance as stipulated in Article 23 paragraph (1) of the 1945 Constitution of the Republic of Indonesia is also used as much as possible for the prosperity of the people. Issuance of bonds is essentially part of the state's power in the field of state finance to carry out the mandate of the people as the owner, and at the same time the holder of the highest authority in the life of the state which cannot be given, delegated, handed over, or distributed to anyone. Granting, delegating, surrendering, or distributing authority to regional governments is contrary to the principle of people's sovereignty.

Therefore, the provisions governing the issuance of regional bonds in the Law on Regional Government and the Law on Financial Relations between the Central Government and Regional Governments must be reformulated by making some substantial changes that the issuance of regional bonds can only be carried out by the Provincial Government. If the issuance of the underlying project regional bonds is in a Regency/City, then it can be done, but the issuer of regional bonds is still the Provincial Government.

#### 4. Conclusion

Regarding the analysis previously elaborated in the discussion, it can be concluded that:

1. The factors affecting Regional Government denies the application of regional bonds to finance the development in the region, reviewing from the legal system theory, has several weaknesses be it elements of legal substance, organization structure, and legal culture. Thus, the existing policy of regional bond issuance causes legal uncertainty. It cannot represent the objectives of regional autonomy and provide the greatest prosperity for the people.
2. The Regent/Mayor is not authorized to issue regional bonds due to the fact that it is contrary to the Article 10 paragraph (2) of Act Number 23/2014 and Constitutional Court Decision Number 36/PUU-X/2012.

#### 5. Suggestions

The followings are some important points suggested in relations to the previous discussions, namely:

1. Legislators, the People's Legislative Assembly and the President, should seriously consider the importance of drafting laws on the issuance of regional bonds/*sukuk*, in which the community is involved in every stage, starting from the planning, implementation, reporting and accountability stages, and evaluating the results of issuance regional bonds. The Law on the Issuance of Regional Bonds/*Sukuk* will later become the legal basis for the issuance of regional bonds/*Sukuk* in Indonesia. Therefore, based on the law on regional bonds/*sukuk*, the issuance of regional bonds/*sukuk* can be implemented to meet the needs of the community, especially those related to basic services. Thus the principle of legal certainty, the principle of benefit, and the principle of justice can be realized with the enactment of a law regarding the issuance of regional bonds/*sukuk*.
2. Legislators, the People's Legislative Assembly and the President, should change the provisions by explicitly stating that the Provincial Government has the authority to issue regional bonds. It is in accordance with Article 10 paragraph (2) of Act Number 23 of 2014 concerning Regional Government, and Constitutional Court Decision No. 36/PUU-X/2012.

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