An Empirical Study of Tax as an Instrument of Democratization

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Abstract. This article proposes two focuses on the discussion on fiscal decentralization carried out by the government and the important role that taxation in bringing about the process of economic democratization. Taxation is one of the most crucial factors in the strengthening of the role of the government especially the role of tax in budgetary issues. The two issues are strategic for a mutual relationship between the state and its citizen, the state in its legal authority to collect tax from its citizens and on the other hand the citizens to pay taxes as part of its submission to the existing law.

Keywords: fiscal decentralization, taxation, state and citizen

INTRODUCTION

There are already some literatures on the study of taxation in the context of relationship between the Central and Local government, even prior to the implementation of fiscal decentralization policy. The study has shed lights on the issue of administration, economy, law and dynamics of taxation policy. However, none of the research views tax as a political reality. There have not been serious efforts to review taxation as means for democratization.

Bawazier and Kadir (2004) once conducted a research on the budgetary relationship between the local and central government in Indonesia. The research is published as a dissertation he defended at the University of Maryland with the title Central-Local Fiscal in Indonesia. Data used in the research is collected from the hyper-centralistic government of President Soeharto when the local government only has little authority in managing taxes. Local government barely has authority and control over the baseline and ceiling value of taxation as both was controlled by the central government. In the end, the local government is heavily dependent on the central government. In his conclusion, the author said that the fiscal relationship between the central and local government has not been particularly good. However, the research focuses only on the economic sector and failed to take into account non-economic variable, the author for instance was oblivious to the fact why the local government never had control or complete authority over baseline or ceiling value of taxation—something that it should have control over.

The fiscal relationship between the local and central government has also been the subject of research “Financial Relationship between the Central and Local Government in Indonesia: Study case of Nanggroe Aceh Darussalam, East Java and Jakarta. In the research the author found out that the only a semblance of authority in managing taxes is given to local government by the central government. In conclusion, the degree of fiscal decentralization in Indonesia is among the lowest among the developing countries.

Tanzi (2002) may have gone far into explaining fiscal decentralization but the author seems to be falling into the same trap of looking only at the technocratic side of it. The author only focused on the capability of local government in relations to its ability to provide public service. The study fails to see the political dimension of tax and is oblivious to the response and the role of the public as objects of taxation policy. Another researcher who has also investigated the implementation of decentralization and regional autonomy in the Soeharto era since the passage of Law No. 5/1974 (Utomo, 1996). Finding from the research found out that decentralization was never seriously implemented at the regency/municipal level.
Utomo (2003) found out that five issues contributed to the failing in the implementation of decentralization at the regency/municipality level (1) the over learning process or unnecessary trauma on the troubled history of rebellion or secession of some regions (2) adherence to classical hierarchical models which only bring excessive reliance to central government, (3) patron client relationship which brings about subservience to higher authority, (4) the central government taking over much of sources of revenue of the local government, and (5) differing interests between the central and provincial government on the implementation of decentralization on the regency/municipal level.

One of the proposed solutions is the need for tax sharing/tax levy for regions with big tax revenue. Tax management that gives more benefit to local region is important especially for region that contributed greatly to the central government. This research seems to apply state administrative perspective and shied away from shedding light on a wider political dimension in tax sharing. The fundamental changes in the relationships pattern between the central and local government after the implementation of Law No. 22/1999 which has also been replaced by Law No. 32/2004 on the local government and Law No. 25/1999 has also been replaced by Law No. 33/2004 on the Financial Balancing between local and central government tackles the issue of sharing of revenue from tax which also has implication on the intergovernmental financial system in the country. The passage of the law sparked the interests of Azis et al. (2001) to conduct a research on the dynamics in the fiscal relationship between the central and local government on the issue of the disbursement of financial aid from the central government to fill in the fiscal gap experienced by the local government. In the survey, published by the Bulletin of Indonesian Economic Studies (BIES) found that the fiscal transfer process is nothing new for Indonesia. The New Order government has introduced the president-approved aid (Banpres) to ensure the realization of government projects.

In theory, the government has taken steps to meet the demands of democratization including the amendment of Law No. 22/1999 on local government and followed with the passage of Law No. 32/2004 on local government. The rationale behind the amendment is so that the local government could improve its competitive edge by taking into account democratic principles, fairness, uniqueness and the potentials of local regions. The potentials and uniqueness of local regions have in fact created fiscal disparity. By taking into account the fiscal disparity and efforts to reduce it, the government passed Law No. 25/1999 which is then replaced with Law No. 33/2004 on the financial balancing between the local and central government. The thinking behind the law is that the implementation of regional autonomy; the devolution of power to the local government should be followed with regulations that would implement the fair allocation of resources including the leveling out of finance between the local and central government (Law No. 33/2004). This means that an autonomous local government would need support in the form of authority to fully carry out the collection of fund from the public.

This is a new policy in that the disbursement of general allocation fund could be carried in a transparent manner, both in its planning and execution stage. The byproduct of action is that the relationship between the local and central government. It is expected that the performance of the local government could improve for the combination of these factors (1) fairness in the fiscal transfer process and (2) the high and robust demand for accountability from the local community which is part of the decentralization design. Unfortunately, the research does not shed light on how the transparency and accountability transpired between the local government and members of the public. Other researchers are interested in looking at the conflict in the financial conflict between the local and central government since the implementation of Law No. 22/1999 and Law No. 25/1999. In research on the implementation of regional autonomy in East Kalimantan between 2001 and 2002 and concluded that the local governments both the regency and provincial administration only commands little power in looking for new sources of revenue.

However, the research comes with its shortcoming as it focuses only on two years early period of regional autonomy. The short span fails to capture the complexity in the relationship between the local and central government in managing the finance. The researcher also does not look into the limit that is put into the authority of the local government which becomes the source of conflict between the central and local government. The research has also only focuses on the fiscal aspect with emphasis on financial capability. The political aspect of tax is not considered as an independent variable, preventing the research from addressing the main problems of vertical fiscal imbalance in the country. The fiscal decentralization in Indonesia has also prompted a new phenomena in a more intensive effort from the local government to come up with tax and local retribution. The argument they used is the financial need should be covered by tax and retribution so that the local revenue will increase.

But a study, conducted by Lewis (2001) produced different evidence. The study finds that there are no supporting evidence to support the argument that the problem of fiscal capacity push the local government to
draw up new tax regulation. In fact, of 1000 local bylaws on tax up until 2001, only 40 percent is reviewed by the central government and the remainder is enacted without consultation with the Central government. It appears that much of study on the management of tax in the period after the enacting of fiscal decentralization is heavy on the legal aspect. The study only review the legal-formal basis on the local bylaws on tax. As a result, Lewis’ conclusion is an oversimplification of the dynamism of local bylaws on tax.

Lewis also give misguided recommendation in that the government need to give more guidance in enacting the fiscal decentralization process. The central government is required not only to make design and promote its policy but also monitor the implementation of the regulation. The problem of fiscal decentralization in general and taxation policy in particular is seen only as a problem between the central and local government. The involvement of the public is insignificant and is not the subject for formulation, implementation, monitoring and evaluation of local taxation policy.

Pardede (2004) in his study found that in North Tapanuli and Medan Municipality in North Sumatra (1) the decreasing capacity of local revenue and revenue sharing in the two regions surveyed. (2) The two regions surveyed show the tendency of getting more reliant on funding from the central government. One of the primary indicators of such dependence is the increasing contribution of general allocation fund in local budget. In the survey, Pardede admitted about shortcoming of his work of excluding inter-regional fiscal capability from the list of variables analyzed. Pardede focuses only on the economic side of taxation and shies away from political side of fiscal decentralization policy by the central government.

From discussion of some of research on decentralization above, we can conclude that researchers agree that taxation has not gotten the full attention from the central government in the fiscal decentralization policy. All researchers focus their attention on the economic side of the policy and only one researcher take politics into account-albeit only on a superficial level.

Such an omission shows that academics and researchers fail see taxation as a political reality and is part of democratization project. Discussion on taxation and democratization is still mutually exclusive. Discussion on taxation is preoccupied only in economic, administrative, and legal aspects of it. Study on democracy on the other hand has not treated taxation as a serious subject worthy of serious investigation. This study will break a new ground in the study.

RESEARCH METHODS

This research used a qualitative approach. Qualitative research seeks to understand a given research problem or topic from the perspectives of the local population it involves. Qualitative research is especially effective in obtaining culturally specific information about the values, opinions, behaviors, and social contexts of particular populations. In this study, to collected primary data obtained through in-depth interviews and observation. In the secondary data collection was done by reviewing a number of books, papers, documents or records relating to this research.

RESULT AND DISCUSSION

Political decentralization or devolution constitutes a response and strategic choice on the part of the government to democratically run the government. By bringing the power close to the people, the state expects to have a constant relationship with the citizens by dint of intensive political communication the state and its citizens.

The regional government could also claim its rights as a manager of local regions so that local potentials could be managed on the foundation of local culture. Model of decentralization has widely been seen as one of effective ways to improve the welfare of people in the local regions (Karim, 2003).

According to Cheema and Rondinelli (1983) and Silverman (1970) decentralization can take a variety of forms. At least there are four types of decentralizations, as following: (1) Deconcentration or the relinquishing of the authority from the national government to sub-national authorities to carry out managerial and administrative tasks; (2) Delegation or the form of decentralization given to semi-autonomous government institutions or state-run enterprises to manage and provide public sectors; (3) Devolution, in theory the political legitimacy belongs to the national government, so what’s needed is a political decision to give authority and responsibility to subnational governments. The process is followed by the transfer of fiscal autonomy to subnational government so that it not only have administrative and political autonomy but financial autonomy as well; (4) Privatization, state institutions divested on its authority in the implementation of policy and providing infrastructure and service; (5) Democracy is believed to be able to strengthen democracy at the local level for a number of reasons.

First, decentralization constitutes political education which is the rightful obligation of the central government.
Second, it could serve as a training ground for local politicians who want to pursue career in politics. Career in the government is a preparatory stage to prepare for future career—especially political career in the government—at the national level. Third, decentralization helps create political order. National stability should first be created at the local level. A number of countries are politically unstable because the central governments don’t treat the local regions right and show the tendency of becoming centralistic (Smith, 1985).

Decentralization policy is also preferable because it can produce the following conditions: (1) Political equality. Local community just like people in the centre of administration, will have time to get involves in the decision making process—this political equality is possible because the central administration already recognized the rights of its citizens; (2) Accountability. Holders of public offices are obliged to give accountability to the public who has given him trust in running the office; (3) Responsiveness. Local government could give more attention and answer effectively against demands from the public because the public officers has better understanding over the social, economic and political conditions of people in the region (B.C. Smith, 1985).

Decentralization has numerous and complex objectives, not only the transfer of authority in the management of day-to-day government jobs to the local government but also concerns so many aspects including that of taxation. Cheema and Rondinelli (1983) identify rational motives behind decentralization which is considered consistent with the character of the society: (1) The planning stage can be carried out by taking into account the needs of the local people, which is diverse in nature; (2) Cutting the red tape; (3) In deciding on sending government officials to the regions, the central government will have a better understanding of local and remote areas; (4) Better outreach from the national government towards local and remote regions; (5) Better representation from various groups in the planning of development strategy; (6) Opportunity for people in the local regions to improve leadership and technical capacity; (7) A more efficient central government; (8) The central government can have a better and effective coordination of its program down to the village level; (9) Institutionalization of public role in the planning and execution of development program; (10) Improving the clout and oversight on actions from local officials; (11) Government’s administrative function could be more flexible, innovative and creative; (12) Provide more effective service for the public, integrating remote and disadvantaged regions, oversee and better evaluate the implementation of development project; (13) Achieve political stability and national integrity; and (14) Providing goods and service at the local level at an affordable cost.

From the points above it is obvious that the spirit of decentralization—in terms of administrative or fiscal and taxation policy—is to provide maximum service for the public, open up room for public participation. The inclusion of public participation in social and political process covers the inclusion of the public in taxation policy in the context of decentralization. According to B.C. Smith (1985) the three objectives of decentralization are (1) creating political equity. Decentralization enables the public to take part in political process at the local level; (2) Local accountability. Decentralisation improves the capacity of local government to meet the demands of its public; and (3) local responsiveness. Local governments are generally thought to be able to cope with problems afflicting its population.

Decentralization is undoubtedly more salient than a centralistic government. Decentralization is not one size fits all policy but it somehow has more benefits. This is what the World Bank said about decentralization:

“But decentralization is not a panacea... Decentralization may not be always be efficient, especially for standardized, routine, network-based services. It can result in the loss of economies of scale and control over scarce financial resources by the central government. Weak administrative or technical capacity at local levels may result in services being delivered less efficiently and effectively in some areas of the country. Administrative responsibilities may be transferred to local levels without adequate financial resources... Decentralization can sometimes make coordination of national policies more complexs and may allow functions to be captured by local elites. Also, distrust between public and private sectors may undermine cooperation at the local levels” (World Bank Report, 2001/2002; Ratnawati, 2006).

The political devolution should be concurrent with fiscal decentralization which should come naturally as every authority devolved should come with the granting of financing capability. Fiscal decentralization is a inevitable consequence in the adoption of political devolution as basically money follows function. We can imagine the difficulty faced by the local governments if they don’t have enough resources.

Fiscal decentralization refers to the transfer of resources to local government or subnational administration through the strengthening of fiscal roles and the granting of discrentional authority in the delivery of public service. Fiscal decentralization does not concern only about transfer of resources but also include the improving of the capacity of subnational admnistration and to a considerable extent improvement in its fiscal capacity and
other capacities pertaining to the use and management of local resources (UNDP, 2005). Fiscal decentralization is also closely related with the determination of local source of income and its allocation (Sidik, 2002). In the context of the relationship between Central-Regional government fiscal decentralization is closely tied with matters related with distribution of revenue and taxation as well as the financing authority as well as autonomy holds by subnational governments (DickKovick, 2004).

In theory, fiscal decentralization policy is aimed at boosting the fiscal independence from local government as part of its autonomy. Fiscal centralization has failed to stimulate the acceleration of local economic growth as a precondition for tax revenue, which constitutes means of social justice (Bird and Vaillancourt, 2000). Fiscal policy covers all policies related to State Budget (Seda, 2004) both for spending of the central and local government. Fiscal policy not only affects local economies as well as the economy in the form of government’s spending and revenue (Djojosubroto, 2004). The general issue in fiscal policy concerns the amount of revenue and spending (deficit and surplus) and its source could come from tax, debt or othes.

According to Mackintosh and Roy (1999) the shifting of economic paradigm reinforce the idea of fiscal decentralization based on two thinkings; First, based on the Oates Theorem assumption, the option for local government will tend to be in line with that of the individual choice when it decides on political decision rather than basing its decision on the wish of the national government because in theory the variation of preference at the local level tend to be lower than that of the national government. Second, the decentralization of decision making process will proceed smoothly if the preference at the local level is more homogenous. This situation of homogeneity resembles the condition of a local workshop which supply public goods to its members.

On a more practical level, idea on fiscal decentralization only gains ground in the 1980s. The main impetus for fiscal decentralization is Law No. 5/1974 on Local Administration which is consistent with Article 18 which in reality is a fiscal centralization (Wiralaga, 2005). This fiscal centralization was enacted because of the steep earning from oil and gas revenue in 1970s. The Central Government has the capability to control the budget down to the local level (Sondakh, 2005). On the other hand, there seemed to be a reluctance from them central government to devolve the authority in fiscal management given the emphasis from the central government on the political stability during the New Order regime (Kuncoro, 1995).

Fiscal decentralization policy so far has not been very effective, especially since the taxation reform kicked off in the 1980s. The central government can only implement decentralization policy starting April 25, 1995 in a trial period in 26 regencies and the whole 27 provinces except for Jakarta. The implementation of the program had nothing to do with the failure of the centralized planning and growth with equity program, but it has more to do with the uncertainty over whether the central government could hold the reign in its implementation (Kuncoro, 1995).

The fiscal policy reform is urgent so that the local administration can improve its fiscal capability. According to Davey et. al. (1988) the reform in fiscal system and taxation has three objectives; first to streamline the local taxation system, second, accumulating more revenue so that the local government is not dependent on giveaway from the central government and third to change the taxation system that is related with the authority of local government.

By taking into account the issues above and understanding the spirit behind the public participation in the budgeting process, fiscal decentralization policy is the most appropriate policy to meet the public demand and transfer of values to the public. There should be an improvement in the relationship between the local and central government especially in the post New Order period, especially on issues pertaining to the sharing and distribution of sources of revenue between the Central and Local government because in spite of the fact that the central government provides funds to be transferred to the local government, it does not have the capability to reign in the local government. According to McAndrews and Amal (2000), transfer of funding to the local region does not only cover the need for developmental budget but also has to take into account the tax effort and tax capability. The providing of the fund should also be conducted in two approach, the need-based approach and the relative deprivation approach. Others should also take into account the tax effort and the tax capability. It is hoped that the system could help the local government explore its potentials to the fullest.

Fiscal decentralization is also closely related with determining the source of revenue for the local government (Sidik, 2002). The transfer of local revenue sources is the direct implication of the governance reform. The authority of the local governance could be implemented through the governance reform. The authority of the local government to levy taxes is regulated in Law No. 34/2000 which is an ammendment to Law No. 18/1997 on local taxation. This law is implemented through Government Regulation 65/2001 on local taxation and Government regulation 66/2001 on local retribution.

The fiscal decentralization policy has been adopted
by almost all countries in the world both federal or unity government, for different reasoning. Vito Tanzi said (2002) that there are a number of reasons state adopt fiscal decentralization program. Firstly, the consolidation of democracy as given voice to the community and local government to pursue their interests and that there’s no denying to the local preference. The widely held belief is that if fiscal policies are drawn up at the local level chances are that it would accommodate local interests and preference.

Secondly, the deepening of the economic globalization in the past two decades has given a push for the creation of market area which is not always identical with the nation-state. In an autarkic system, the economic structure of a state is a closed one in which the market is identical with the majority of individuals or businesspeople residing within the state. In the globalized era, a certain region within the state could be more proximate with the market than others. This enables the region to distance itself away from the Central government.

In the economy speak, decentralization is a kind of superior good which is wanted more if there’s an income raise. The richer a region is, the more it will demand for decentralization. If this assumption is correct then we can safely assume that the demand for fiscal decentralization will be stronger in the future.

Fourth, these rich regions will only realize the urgency of the reform in taxation system and mechanism in the redistribution of national wealth. This new awareness will only dawn on local governments concomitant with the strengthening of their financial clout and the better flow of information.

However, the policy of fiscal decentralization is adopted not only as a response to the demands from local regions, but also a thought-out formulation that has been deliberated so that the fairness principle could be upheld in the unification of the national economic power as well as giving fiscal authority to the local government to a considerable extent, the authority is devolved so that it will give a shortcut to the providing of service to the public.

Fiscal decentralization, however, is not simple things to do. The decentralization in authority if not coupled with accountability will only give rise to the deteriorating in the quality of public service. On the contrary, if local government has more revenue than spending, this will give rise to the low mobilization of local budget and the macroeconomic imbalance will re-occur (Bird and Vaillancourt, 2000).

Fiscal decentralization can also improve the capability of local government to pay for its spending. First, fiscal decentralization not only increase domestic revenue from non-oil revenue, but it also leads to a fairer taxation system. Second, fiscal decentralization could lead to less regulation, less administrative costs and illegal levies, cutting the subsidy and open up the economy. Third; fiscal decentralization will lead to the leveling out between regions (Davey et al, 1988).

The only important issue in the fiscal decentralization policy is one pertaining to the authority and responsibility in the assignment of taxes and expenditures. The assignment of expenditures refer to issues related to the division of such assignment between the central and local government. The assignment of taxes refers to issues related with the local government’s authority to manage their spending using their own resources (Tanzi, 2002).

Fiscal decentralization should be implemented with the devolution in taxing power from the national government to the local government. Taxation decentralization should be one of the most pertinent issue in the reformulation of the fiscal relationships between the local and central government. The power sharing arrangement in taxation could be implemented by adopting piggybacked system and surcharge system as an alternative policy in a decentralized national policy (cif. Hyman, 1999; Brojonegoro, 2003). This system enables the Central and Local government to concurrently holds authority in taxation, its objects, types and in its substance.

Piggybacked or surcharge systems has four merits. First, it could create independence for the local government as it gives it authority to collect its own monet so that the allocation of budget is implemented consistent with the general principles of taxation (Bird, 2000). Second, fiscal decentralization could push the economic growth in the local regions as the legal certainty over taxation policy could reduce the incidence of illegal levies which could have a high cost on the economy. Third, it could reduce the burden of the central government as the local government could pay for itself without a transfer of resources from the central government (Sidik, 2003). Fourth, the proximity between the taxation authority and taxpayers will make it easy for a social control in the implementation of taxation policy which will require the taxation bureaucracy to work more transparent, accountable and efficient (cif. Thoha, 2003; Mardiasmo, 2001).

The power sharing in taxation authority between the central and local government is considered a success seen from the following yardsticks. First, yield; the adequacy of revenue from taxes in relation to programs that it finances; its stability, and the ease with which local government could predict its result; and the elasticity between the tax collection with the inflasi, population growth as well as the ratio between the taxation result and its cost. Second, Equity; the argument for taxation should
not be arbitrary; it should be applied on the principle of horizontal fairness meaning that the burden of taxation should be applied evenly between people from different groups with similar economic positions; it should also be vertically fair meaning that groups that have a greater economic resources should give more contribution than what the less disadvantaged groups have to pay. Taxation should also be fair across location, or at least it should not have variation between regions, there should be no arbitrary treatment in the taxation policy, such difference is allowed only when it reflects difference in the dispensing of public service. Third, economic efficiency; taxation should push for the use of effective use of resources in the economic life so that the consumers and producers could make an informed decision and not reluctant to save or Third, economic efficiency; taxation should push for the use of effective use of resources in the economic life so that the consumers and producers could make an informed decision and not reluctant to save or work, as well as reducing the burden of taxation. Fourth, ability to implement; a taxation policy should be consistent with the amount of political will that the government has as well as the administrative capability. Fifth; suitability as a local revenue sources; it should be clear where the tax should be paid to and which institution will collect it (Davey, 1988). Theoretically, taxation decentralization will be beneficial to local government, as Davey (1988) asserts, first the distribution of tax revenue collected by the central government, second the regional government could apply additional taxation (open, surcharge) on tax collected by the central government. Third, the benefits from tax collection could be kept home by the regional government.

In the taxation decentralization scheme the central government transfer money to regional government to stimulate the local economic growth. Transfer covers two schemes, conditional grants which is determined in its allocation by the central government and unconditional grants in which the local government is given the freedom to allocate the disbursement (Rosenbloom, 2005). The two conditions will be conducive to the synchronizing of taxation policy which will yield a better political communication and political preference between the central and local government and between the state and its citizens.

Fiscal decentralization will be effective and influential for democracy only if a shifting in paradigm occurs not only in the definition and functions of taxation. Fiscal decentralization should also go together with the shifting of taxing power from the central government to local government. Tax on fixed assets is the type of taxation that should be left to the local government in other word, this is the type of taxation that could be decentralized.

Furthermore, study on democracy and democratization in Indonesia is preoccupied with the issue of democratic procedures and grand narrative. Theories on transition are focused on the power of individuals (actors) to replace the existing system with a more democratic one. The role of money and financial interaction is negligible. Efforts have been scant in looking democratization through the lens of instrumentalism which sees the reality of democratization as the manifestation of day-to-day politics.

What kind of argument that can explain tax as a political reality and not merely legal and economic reality. A legal and economic viewpoint is nothing new in the study of law and economy, but the efforts to approach taxation through the lens of politics is not the usual path although it constitute a more substantial effort to understand the existence of taxation. By using a political vantage point taxation should be seen as part of understanding state as a contractual relationships. The state is part of the efforts from the people to create an arena for the social contract to enshrine basic rights like rights to dignified life, social and political equality as well as the freedom to make choice in life (cf. Heather, 1983)

The existence of the state depends much on the commitment of the people to maintain its integrity. Basically, the state is the arena for the public to realize themselves with agreed upon rules of the game that should be observed with no exception or discrimination (Chandroke, 1995). This way, the state needs a political support and legitimacy from its people. In practice, political support is not enough to run a government, economic support is also indispensable. In other words, state capacity should be based on two issues political and economic capacity.

The form of political support from the people usually take the form of political support for the state’s whole activities in running the government and managing the public goods devoted only to the people’s welfare. People give a political legitimacy to the political elite by taking part in regular elections, conducted freely and fairly. The form of economic support for the state is the contribution of economic resources to the government in the form of taxation (cf. Musgrave and Musgrave, 1993; Devas et. al, 1989; Mardiasmo, 2004).

After receiving political and ethical support from the people, the state should realized the will of the public and the only hope for its realization is through the state. The relationship can be considered mutual. The state, with the myriads of authority that it controls should carry out a number of obligations mandated by the law. Consistent with the wish of the people, the state should have a political agenda to fight for the people’s interests.
The primary political agenda is to run the government as a manifestation of the state’s determination to give public service to the people (Dahl, 1989).

The state as the governing institution has the authority to determine the agenda of the government and design a program and budget for its implementation. It is almost impossible to have a well-functioning government without the availability of sustainable funding (Devas, 1989). This is where the tax comes in.

There may be a number of countries that don’t rely on tax, known as rentier state, but their sustainability is highly questionable. Most economists believe that the cheapest and sustainable source of funding is tax. Tax then becomes the main choice (cf. Musgrave and Musgrave, 1993; Mardiasmo, 2004). Tax therefore is the most obvious political reality and choice. Tax should not only be understood as the government’s economic instrument, implemented only as a budgetary means. Tax has also become a political instrument when used by the government to carry out its regulatory function, limiting the ownership of resources by the rich and empowering the poor through assets distribution (Irianto and Jurdi, 2005). Tax is the most appropriate instrument to end the conflict of interests between the rich and the poor that has been prognosticated by Marxists.

Tax is the tool by which the government could ensure the allocation, distribution and retribution of resources (Devereux, 1996). More than that, the tax could be the incentive and disincentive for the citizens to do something to support the development project as well as the preservation of certain social values. A number of public financing expert describe tax as one of the most sources revenue of the government and here’s the reasoning; (1) it is compulsory, (2) paid by certain group and (3) not related with certain direct services.

Tax and retribution is a source of financing, as well as the source of funding for service to the public. Other functions of the tax is the instrument for the government to carry out its main roles (1) distribution; the yield from tax should be used to subsidize others as in progressive taxation, (2) stabilization; tax should function to maintain the sustainability, efficiency, and social order, (c) allocative function; tax is the primary instrument to shift the role of the government in managing the public goods and (d) incentive and disincentive; tax is one of the government’s instrument to prod the public into doing or not doing something like cigarette tax, liquor tax and disincentives on consumption like tax holiday or tax free. This is an expansion of the role that taxation play. Tax no longer the a budgetary role, namely to put as much cash as possible to the government’s coffers or only in its regulatory role or non-budgetary/non-fiscal only (cf. Brotodiharjo, 1981; Ismail, 2005).

Financial resources from tax and/or revenue from natural resources is the most reliable sources compared to others like foreign aid. The two most important sources can give the government the ability to pay for the public service which will in turn satisfy the need of every individuals (Soemitro, 1986). The people-based financing should be managed by the government to the best interests of the people and that’s what give the government the rights to collect taxes. By understanding the details of the state financing we can understand how the government collect taxes and designs the development agenda that will meet the demand from the people. Money from the tax should not only be allocated for government spending but also for development projects. In this context, the function of taxation should also be practical for pushing the agenda of democratization – especially in the context of relations between the state and the governed. Tax as a means to democratization only if it is considered as a means of political contract between the state and the governed. The consequence is that we need to change our view of taxation to make it consistent with the spirit of the social contract.

Reform of the taxation system is necessary to improve the performance of a number of instruments that stand in the way of the reconstitution of tax as a political contract. Taxation should be allocated for social objectives like employment opportunity, road maintenance, infrastructure project, and welfare programs (Boediono, 2004). As part of political contract, tax should be oriented towards improving economic justice, political fairness and social justice. Taxation should also help push the creation of welfare for all because the main objective of taxation is to provide foundation for welfare, economic redistribution and social justice (Musgrave and Musgrave, 1993). The allocation of tax should be made to create an healthy and transparent public service that will give universal benefit (Bird and Vaillancourt, 2000).

The public participation in taxation policy is an important indicator of whether or not a country is democratic. It is not the only indicator but public participation in taxation policy is a push towards democratization in the modern world (Herb, 2003) because the participatory process involves bargaining mechanism and public consultation in the decision making process. The process of tax and resource allocation is not the domain of the state anymore. The public participation in the taxation policy should become an indicator on how democratic the government and this is based on two reasoning; (1) in the democratic governance, everybody should mechanism to arrive at cooperation, consensus and harmony. In a participatory
Participation in taxation is different from political participation. Participation in taxation is part of the implementation of formal function of politics. The citizens who pay taxes should not only remain passive in paying their taxes. This is different from political participation in general where citizen could either be passive or active depending on the political context. Voters could choose to be active in certain political process but sit out of the process in other. In the context of taxation, the citizen should take part actively not only on issues related to paying taxes but also on the issue of planning and other taxation policy in general.

Such a participatory taxation should also take into account the issue of ownership. Not every citizen has the same amount of responsibility in paying taxes and take part in the decision making process. In theory, taxation can be used to hold the rein on the haves and protecting the have-nots, balancing between the rich and the poor (Irianto and Jurdi, 2005) and this should be the emphasis on taxation policy. Tax is only applied to those with income, wealth and material possession subject to taxes according to the law.

To arrive at a more effective participation in taxation we need to have a common objective so that it could effectively achieve these objectives; (1) conviction on the saliency of the objective; (2) knowledgeable about the appropriate methods (3) problem solving (4) high expectation on success and (5) cost effective (Andrian, 1992). Participatory approach to public services could be based on these four models (1) despotism benevolent (2) fiscal exchange model; (3) fiscal transfer model; and (4) leviathan model of government. The participation from the public should take into account the political decision from the regime. According to Hidayatullah (2006), public participation from should be based on (1) the government’s willingness to accommodate demands from the public such as demands for jobs and socio-political security; (2) willingness to simplify taxation policy. By rectifying taxation policy, the public participation in the politics of taxation can be improved.

Public should not only be required to pay taxes but should also be included in its management. Tax is revenue that comes from the public and it should come naturally that it should be managed in a democratic and transparent manner. The public should have a say in deciding how the tax should be used, in the planning and decision making process. Such participation could guard against negative perception from the public concerning the management of tax money—it is common in any country that public tend to have cynicism on how the money is spent. According to Soemitro (1998), public tends to be suspicious of the government as tax is burden added to them without any rewards.

The cynicism towards how tax is managed springs from the wrong perception that the public has on the benefit of tax collection, they just understand that money from tax is well spent. These taxpayers just want their money pay for public services according to policies made by the ruling government. Tax does not yield immediate incentives to taxpayers but according to the Ministry of Industry (2006) tax can in fact be an incentive. Taxation could serve as incentive for the business/industry to set a high priority in the economic development as well as attracting foreign investment. Tax incentives could be spent for instance for improving the investment climate, developing pioneer industry, developing strategic industry, developing disadvantaged regions and improving the small-and-medium scale industry.

The government could also used tax money to finance some strategic programs like fixing the highway, improving education, health programs to improve life expectancy and lowering mortality rates (Musgrave and Musgrave, 1993). To come up with good policy, the government should get input from the public before spending the money from tax. The government should also spend the money for public interests ranging from (1) basic services from education, health, infrastructure and irrigation, (2) public service beneficial for people of other regions (3) public service as a consequence of activities of people in other regions; (4) poverty eradication; (5) infectious disease eradication; (6) providing infrastructure in resettlement area; (7) providing infrastructure in resettlement, disadvantaged, isolated, border regions; (9) forest regreening campaigning and (10) campaign for improving the efficiency of local taxation (Sudibyo,
The idea of substantive democracy is better suited as basic foundation for the governance in Indonesia, including the fiscal decentralization policy. The idea of democracy does not concern only the institution building but also the materialization of democratic substance—which means that democracy does not mean only as the involvement of voters in the election of public officials, but also include then in a political decision making process and this is commonly known as direct democracy. Without doubt, the strengthening of mechanism and deliberative instruments in public space is a must. With deliberative democracy, it is possible for the public to engage in a discussion as part of social process. The public space for dialogue should also be allocated on the issue of tax as this is also part of the public participation. The choice of deliberative democracy is an alternative instrument to get around the ineffectiveness of representative democracy—especially its voting mechanism in polls—to accommodate the demands from the public. Deliberative democracy could accommodate the principles of equality, human rights, civil rights and liberty and fair play.

To arrive at a democratic system first a political system should go through the installation of democracy. Democratization could also mean as a process to create a democratic regime from a non-democratic regime. A genuine democratization should mean to the deepening of democracy which involves the strengthening of formal democratic institution concurrent with the reinforcement of political instruments and institutions. In other words, democratization is part of the devolution of absolute and centralistic powers which shows the tendency to revert to authoritarianism.

The primary requisite for democracy is economic equality in terms of equality between its people and among members of the government. Without economic equality as a symbol of affluence, democracy is hard to come by as political instability could easily sets of social conflict. Regional economic development is also a prerequisite for economic growth among regions in the country. The local government therefore should be empowered and one of the steps to improve their performance is by giving them the rights to improve their standing in dealing with investors especially on the issue of taxation.

The policy on taxation is determined much by the state constitution, the paradigm of elites in the local and central government as well as the authority of tax collecting agencies. Having said this, taxation should be considered as political reality. Taxation should not only function as state budgetary means but also as a regulatory means; the state’s authority to put a curb on the strong and protect the weak.

Based on the multilevel government system, the authority in taxation should reflect the relationship between the central and local government in terms of financing authority. The mechanism taken should take into account the proportionality in the authority for taxation between the central and local government. Fiscal decentralization is an inevitable consequence from the adoption of devolution of political authority. Under this principle the system applied is money follows function. However, the implementation of fiscal decentralization depends much on certain country’s political system, unitary, confederation and federal systems. Indonesia adheres unitary system under which the sole authority lies with the national government.

Fiscal decentralization is aimed at creating justice with aims of uniting the national economy as well as giving fiscal authority to local government to a considerable extent. Fiscal decentralization does not only touch on the issue of local budget but also cover the aspect of revenue assignment and taxing power. Fiscal decentralization can only be effective and can only serve as a means for democratization only if there’s a paradigm shift not only on the definition and function of tax but also on the distribution of taxing power from the central to the local government. The shifting of authority from central to local government in the long run will not only diminish the dependence of the local government on the money from the central government. The independence will create an autonomous local government and this will lead to democratic governance. The most rational way of doing it is by giving the taxing power to the local government. Among taxing power devolved to local governments are tax on fixed assets like property tax or in the case of Indonesia land and building tax, value added tax on private citizen based on surcharges system.

A formula for a more proportional taxation authority could in fact shift the paradigm among taxation authority, from thinking that taxation only as revenue to thinking that taxation is a political reality (budgetary and regulatory roles). The shifting in the paradigm could in fact open a political communication among the public which in fact could lead to novel political participation from the public in that they are willing to pay taxes to the government. Public participation in the deliberation of taxation policy is not the only indicator of how democratization progresses (Herb, 2003). In the participatory process, a bargaining process and public consultation prevails in the decision-making process like the tax allocation and sources of tax, which should not be the domain of the government.

The inclusion of the public in the decision making process could give a significant political weight to the policy outcome as it reflects the aspiration and the will
of the people. By giving the people a say in the decision making process, the people—will at least have enough understanding on why they have to pay taxes and they can also get the benefit from the tax they pay, because tax is paid back by the government in the form of development allocation, through public financing.

The implementation of political decentralization (devolution) is a response and strategic choice of the state to organize a more democratic governance so that they can closely interact with the people. By bringing the power closer to the people, the government expects to have a more intensive political communication between the state and its citizens. A more concrete political interaction could manifest in the amiable relationships on the issue of taxation in which the government could communicate its political preference to taxpayers. But such a shift is conditional upon two issues, the orientation of taxation authority and the shifting of value among members of the society. The chart below describes the theoretical underpinning of democratization of taxation. Taxation could serve as a means of democratization because it manifest in the intra-level correlation between government functions as well as correlation between the state and its citizens. On the intra-level relationship, such democratization manifest in the involvement of local government in the decision-making process related to authority of taxation between the local and central government. Taxation democratization in the relationship between the state and the public manifest in the political communication on the issue of taxation and the willingness on the part of the government to give political preference to people who pay taxes.

Do the potentials exist here in Indonesia? The main impetus is the new social commitment existing since 1998 which made democracy as the new collective value seriously institutionalized in the country’s political interactions. If the essence of democracy is the rule of the people, then the real manifestation of democracy should be visible in the relationship between the state and the governed. Such a collective agreement is an opportunity and impetus for democratization of taxation in Indonesia. Another related issue is the political devolution policy. Political devolution in essence is part of an effort to rearrange and redistribute the power between the central and local government. Consistent with the principle of money follows function, political devolution should go together with fiscal decentralization. The fiscal decentralization process naturally produces the taxing power sharing between the central and local government.

CONCLUSION

Expectation of fundamental changes in fiscal management began to emerge along with the enforcement of regional autonomy policy which was accompanied by the restructuring of fiscal relationship between the Central Government and the Regions. Law No. 25 Year 1999 which was replaced by Law No. 33 Year 2004 seemed to be a proper access for the reaffirmation of the good will to implement fiscal decentralization. In accordance with the basic principles of politics “money follows function”, the process of existing political decentralization (devolution) should be followed with the fiscal authority decentralization. Various affairs handed over or delegated as regional affairs (provinces or regency/city) should be supported by sufficient financing. Thus, the Regions should be given a free space for managing fiscal dynamics of the regions more autonomously without the intervention of the Central Government.

However, this expectation is not immediately realized. Fiscal decentralization – including taxation policy – seems to be a decentralization of fiscal administration than a decentralization of fiscal authority. The Central Government remains a dominant force in determining the dynamics of fiscal policy in the context of Central-Regional relations. The opportunities of the regions to manage and develop their fiscal capacity autonomously are not so free.

There are at least four reasons why the efforts of decentralization of fiscal management authority in the context of relationships between the Central Government and the Regions never works, i.e. first, mindset of status quo which is still dominant in the elite of taxation authority. Even though transformative ideas have emerged to strengthen the decentralization of fiscal authority among the elite of taxation authority holders in the Central Government, until now the old mindset which view taxation as the authority of the Central Government remains quite strong in the minds of the policy makers in the Government. They assume that there is no strong reason to decentralize the existing taxation authority.

Second, the Government still has an interest in holding the fiscal authority for the post-crisis recovery of national economy. Various multidimensional crises which were started by monetary crisis by the end of 1997 destroyed various foundation of national economy which had been established for three decades, and bequeathed relatively large foreign debts. Consequently, the Government is demanded to build it again and renovate the entire national economy—especially, macro economy—so that the nation could attain economy stability and growth as expected. The last hopes are the achievement of social welfare and the settlement of foreign debts so that it will not be a long-term burden for the nation. Thus, the dominant roles of the Central Government in fiscal management and authority compared to the Regions are considered to be a rational option in order to attain those expectations.

Third, horizontal fiscal disparities are still very wide.
Regional autonomy does not immediately reduce the disparities among regions. Referring to the annual gross regional domestic product as a simple indicator, today tremendous disparities can be observed between rich and poor regions. The regions of Java, Bali, Madura, and Sumatera are still experiencing rapid economic growth, while in other regions the economic growth has not changed much (that is not to say that it is stagnant). Therefore, a strong fiscal authority should remain in the hand of the Central Government to ensure the redistribution of the national economy so that the horizontal fiscal balance can be maintained.

Fourth, weak institutional capacity in fiscal management in the regions. The effort of fiscal decentralization is not sustained by adequate capacity building of the Regional Governments that it results in the lack of institutional capacity in the regional fiscal management. Instead of establishing a regional economic growth and social welfare, the Regional Governments face complicated issues in the fiscal management such as maladministration, corruption, squandering, and so on.

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