

Reining in Regional Governments? Local Taxes and Investment in Decentralised Indonesia

Simon Butt and Nicholas Parsons*

Abstract

In 2009, Indonesia's national parliament enacted *Undang-Undang Nomor 28 Tahun 2009 tentang Pajak Daerah dan Retribusi Daerah* [Law No 28 of 2009 on Regional Taxes and User Charges] ('2009 Law'). According to Indonesian President Susilo Bambang Yudhoyono, this statute was enacted to address concerns that Indonesia's regional governments were harming the investment climate, particularly by enacting 'problematic' regional regulations. Business groups had long complained about provincial, district and city parliaments and executive officials misusing the lawmaking powers granted to them under post-Soeharto decentralisation reforms. They were, for example, enacting laws imposing onerous taxes on trade, and imposing user charges for services that were unnecessary or not provided. Some commentators had even claimed that some of these imposts were prohibited by national law and were, therefore, illegal. We argue that the 2009 Law is unlikely to improve Indonesia's investment climate for three primary reasons. First, the Law does not effectively restrict the types of taxes that regional governments can impose; its definitions of permissible imposts are broad, particularly in respect of user charges. Second, some local lawmakers are testing the outer limits of their powers under the 2009 Law. We show this using the case of a regional regulation from West Sumbawa, in which imposts are labelled 'commissions', apparently in an attempt to avoid the statute's restrictions. Third, we argue that it is likely that a large portion of new local tax laws will simply not be reported to the national government, meaning that even those regional taxes that clearly breach the 2009 Law might 'slip through'.

I Introduction

For most of former Indonesian President Soeharto's 32-year reign, political power and lawmaking authority was strongly centralised under his control.

* Simon Butt is an ARC Australian Postdoctoral Research Fellow at Sydney Law School; Nicholas Parsons is the Prime Minister's Australia Asia Award Holder for 2011, and consultant for the Australian Agency for International Development (AusAID) on Indonesia's system of review of regional regulations. The authors would like to thank researchers at PSHK (*Pusat Studi Hukum dan Kebijakan Indonesia* — the Centre for Indonesian Law and Policy Studies), particularly Nur Sholikin, for helping us research aspects of regional lawmaking in Indonesia.

Soeharto could initiate national legislation and parliamentary approval was assured: parliamentarians obtained their seats either through direct appointment or through elections manufactured to ensure victory for Soeharto's parliamentary vehicle, *Golongan Karya*, or *Golkar*. Opposition parties were merged, monitored and manipulated so that they could not function effectively. The President could himself issue binding laws and he largely controlled his Ministers' lawmaking. Even government regulations, one of the most common types of Indonesian laws, required his signature. Indonesia's regional governments were permitted to enact laws, albeit of limited scope, and subject to executive fiat. There was no effective check on these lawmaking powers. The judiciary lacked independence and, though the Supreme Court had very limited judicial review powers, it generally refused to exercise them.¹

By May 1998, however, the 1997 Asian Economic Crisis had left Indonesia in economic ruin, drawing social and political unrest, and forcing President Soeharto to resign. His replacement, Bacharuddin Jusuf Habibie, initiated programs and processes that dispersed much of the power that Soeharto had accumulated. One of the most far-reaching of these was decentralisation, called 'regional autonomy' (*otonomi daerah*) in Indonesia.² The decentralisation reforms, implemented with breakneck speed from 2001, aimed to prevent Indonesia from 'Balkanising'. They were prompted by a multitude of discontents, including the central government's appropriation of the spoils of natural resources held in regional areas, stifling bureaucratic controls, and military-led surveillance and human rights violations. Under the decentralisation reforms, wide-ranging lawmaking powers were granted to both the executive and legislative arms of two tiers of regional governments: provinces (of which there are 33); and districts and cities (of which there are 497).³

Early studies highlighted that many regional governments were quick to use their new powers to pass laws to raise revenue. Most of these revenues took the form of either taxes or user charges (fees for government services, referred to as *retribusi* in Indonesian). As Fadliya and McLeod point out, it is, in fact, somewhat surprising that local governments have chosen to enact so many regional tax and user charge laws ('RTUCLs'). The revenue they make from local taxes and charges is dwarfed by the transfers they receive from the central government. And, the more 'own source revenue' they collect, the less they receive from the central government.⁴ Nevertheless, local governments created around 1000 new taxes and user charges in the first year of decentralisation alone, and around 6000 in 1999–2005.⁵ More recent statistics are unavailable, but if this trend has continued, then

¹ Zainal Hoesein, *Judicial review di Mahkamah Agung RI: tiga dekade pengujian peraturan Perundang-undangan* [Judicial review in the Supreme Court of RI: Three Decades of Reviewing Regulations Legislation] (RajaGrafindo Persada, 2009).

² For a comprehensive discussion of the many other reforms, see generally Nadirsyah Hosen, *Human Rights, Politics and Corruption in Indonesia: a Critical Reflection on the Post Soeharto Era* (Republic of Letters Publishing, 2010).

³ Ministry of Home Affairs website <www.depdagri.go.id>.

⁴ Fadliya and Ross H McLeod, 'Fiscal Transfers to Regional Governments in Indonesia' (Departmental Working Paper No 2010/14, Australian National University, 2010) 22.

⁵ Blane D Lewis and Bambang Suhamoko Sjahirir, 'Local tax effects on the business climate' in Neil McCulloch (ed) *Rural Investment Climate in Indonesia* (ISEAS Publishing, 2009) 224, 231.

local governments have introduced more than 10 000 new local taxes or user charges since decentralisation began.

Many of these new RTUCLs have been deeply unpopular. The Indonesian media and business forums are replete with complaints about them from disgruntled citizens, domestic and foreign investors, industry groups, multilateral donors, and even central government officials. Of course, government imposts are unpopular the world over, but governments quite legitimately require revenue to function and provide public services.⁶

The imposition of RTUCLs in Indonesia raises more concerns than the mere desirability of new imposts, however. For example, many regional governments impose taxes and user charges that are beyond their legal power to impose, with significant ramifications for the rule of law. In particular, some complain that having local, provincial and central governments able to impose their own licences and taxes creates complexity and duplicity and, therefore, legal uncertainty.⁷ Another common objection is that these revenue-raising laws create a 'high cost economy', injuring internal trade and investment.⁸ In 2004, the Regional Autonomy Supervision Committee,⁹ a respected non-government organisation, analysed 1600 local laws and concluded that about 30 per cent of them were potentially economically deleterious.¹⁰ In 2009, the Indonesian Investment Coordinating Board identified 5000 bylaws that discouraged investment,¹¹ though the precise extent to which investment was discouraged is unclear and debated.¹² Further, there seems to be a perception that some taxes and user charges are not used for the purposes for which they are imposed, and make their way into the pockets of regional government officials.

For some of these reasons, and to protect its own revenue streams, the national government has always sought to impose limits upon sub-national

⁶ Some argue that that taxation is, in fact, a prerequisite to democracy and good governance: Samuel P Huntington, *The Third Wave: Democratization in the Late Twentieth Century* (University of Oklahoma Press, 1991) 65.

⁷ 'Indonesia failing to cash in on mineral surge: analysts', *Antara* (Jakarta), 12 November 2007; Organisation for Economic and Cultural Development, *OECD investment policy reviews: Indonesia*, (2010) 21.

⁸ Pratikno, 'Exercising freedom: Local autonomy and democracy in Indonesia, 1999-2001' in Maribeth Erb, Priyambudi Sulistiyanto and Caroline Faucher (eds) *Regionalism in Post-Suharto Indonesia* (Routledge Curzon, 2005) 21; Ilyas Saad, 'Implementasi otonomi daerah sudah mengarah pada penciptaan distorsi dan high cost economy' in *Decentralization, regulatory reform, and the business climate* (Agency for International Development, 2003); Bambang Brodjonegoro, 'Three years of fiscal decentralization in Indonesia: its impacts on regional economic development and fiscal sustainability' (Paper presented at the International Symposium on Fiscal Decentralization in Asia Revisited, Hitotsubashi University 20-21 February 2004) 8 <[http://www.econ.hit-u.ac.jp/~kokyo/APPPsympo04/Indonesia\(Bambang\).pdf](http://www.econ.hit-u.ac.jp/~kokyo/APPPsympo04/Indonesia(Bambang).pdf)>; United Nations Development Program ('UNDP'), 'Enhancing Communications, Advocacy and Public Participation Capacity for Legal Reforms (CAPPLER) PHASE II' (2008) 7; Agus Maryono, 'Thousands of bylaws halt investment: Investment board', *Jakarta Post* (Jakarta), 26 October 2009.

⁹ Komite Pemantauan Pelaksanaan Otonomi Daerah (KPPOD).

¹⁰ UNDP, above n 8, 7.

¹¹ Maryono, above n 8.

¹² Bambang Brodjonegoro, 'The Effects of Decentralisation on Business in Indonesia' in M Chatib Basri and Pierre van der Eng (eds), *Business in Indonesia: New Challenges, Old Problems* (ISEAS, 2004) 125.

lawmaking jurisdiction and to reserve for itself powers to review and annul non-compliant regional laws. National statutes enacted in 1999 and 2004 which governed regional autonomy generally,¹³ and a 1997 statute and 2000 Amendment that dealt specifically with RTUCLs, provided such limits and powers.¹⁴ Recent research has shown that, though greatly impeded by capacity constraints and flawed review processes, the central government has used its powers primarily to review and annul RTUCLs: the vast majority of the 1691 laws invalidated by the Ministry of Home Affairs in 2004–09 were RTUCLs.¹⁵

The central government has largely ignored other types of laws regional governments have passed, however, irrespective of the legality of the content of those laws. For example, the central government has not disturbed regional laws that might breach Indonesia's constitutional bill of rights.¹⁶ Some argue that the objectives of decentralisation — one of which, after all, is to bring 'government closer to the people'¹⁷ — might be better served if the central government took the same approach to RTUCLs. Local governments should be permitted to impose a wide range of imposts, but then should face being voted out if citizens believe them to be excessive or otherwise inappropriate. This should ensure that local government tax only to the extent that they think citizens will tolerate. In this article, however, we attempt to avoid, as far as possible, these wider political and economic arguments about decentralisation and tax. As lawyers, we are primarily concerned with the legal issues that RTUCLs raise.

In September 2009, the national parliament enacted a new statute on RTUCLs: *Undang-Undang Nomor 28 Tahun 2009 tentang Pajak Daerah dan Retribusi Daerah* [Law No 28 of 2009 on Regional Taxes and User Charges] ('2009 Law'). Just under a month before its passage, President Susilo Bambang Yudhoyono addressed the *Dewan Perwakilan Daerah* [Regional Representative Council] about the 2009 Law. Apparently in an attempt to address some of the abovementioned complaints about RTUCLs, he said that the 2009 Law sought to improve the regional investment climate and would minimise 'problematic' regional regulations. Acknowledging that regional governments would still be able to use their taxing powers to 'increase their capacity' and 'fund their outgoings', he warned that the 'principles of harmony and jurisdictional [limitations] in the provision of services and the running of local government' needed to be maintained. He also instructed regional governments to 'use the RTUCLs in

¹³ *Undang-Undang Nomor 22 Tahun 1999 tentang Pemerintahan Daerah* [Law No 22 of 1999 on Regional Autonomy] (Indonesia) ('1999 Law') and *Undang-Undang Nomor 32 Tahun 2004 tentang Pemerintahan Daerah* [Law No 32 of 2004 on Regional Autonomy] (Indonesia), ('2004 Law').

¹⁴ *Undang-Undang Nomor 18 Tahun 1997 tentang Pajak Daerah dan Retribusi Daerah* [Law No 18 of 1997 on Regional Taxes and Regional User Charges] (Indonesia) ('1997 Law') and *Undang-Undang Nomor 34 Tahun 2000 tentang Perubahan Undang-Undang Nomor 18 Tahun 1997 Tentang Pajak Daerah dan Retribusi Daerah* [Law No 34 of 2000 on the Amendment of Law 18 of 1997 on Regional Tax and Regional User Charges] (Indonesia) ('2000 Amendment').

¹⁵ Ministry of Home Affairs, above n 3; Simon Butt, 'Regional Autonomy Legal Disorder: The Proliferation of Local Laws in Indonesia' (2010) 32 *Sydney Law Review* 177.

¹⁶ Butt, above n 15.

¹⁷ Vito Tanzi, 'Fiscal Federalism and Decentralization: A Review of Some Efficiency and Macroeconomic Aspects' in Michael Bruno and Boris Pleskovic (eds), *Annual World Bank Conference on Development Economics 1995* (The World Bank, 1995) 295.

accordance with existing guidelines so that excessive burdens do not encumber those participating in the economy'.¹⁸

In this short article, we analyse the *2009 Law* and show that it will almost certainly not reduce business costs or encourage investment because it does not effectively limit the types of RTUCLs regional governments can enact. One of the primary purposes of the *2009 Law* is, in fact, to allow local governments to increase their revenue. President Yudhoyono emphasised this in his speech. To this end, the *2009 Law* allows local governments to tax a wider range of 'objects' than those listed in the *2000 Amendment* (though it does provide a closed list of the types of taxes and user charges that local governments can impose, presumably to prevent the enactment of uncertain new taxes, and set maximum tariffs for those taxes). Further, the *2009 Law* very broadly defines the various permissible regional government imposts, particularly in respect of user charges. We predict that local governments will be able easily to disguise new imposts as user charges, in an attempt to make them 'legal' under the *2009 Law*. There is also evidence that some local lawmakers have labelled new imposts 'commissions' rather than taxes or user charges, apparently in an attempt to avoid altogether the *2009 Law's* restrictions and requirements. Lastly, and perhaps most critically, the *2009 Law* does nothing to address the problems with the existing and highly problematic mechanisms (judicial and otherwise) for the review and revocation of unlawful RTUCLs.

We begin by discussing regional taxation powers under statutes enacted prior to the *2009 Law* and discuss some of the problematic types of RTUCLs issued by regional governments. We then turn to discuss the *2009 Law*. As case studies, we use several RTUCLs that local governments have already enacted under the *2009 Law*, though we do not claim that these Laws are representative of all, or even most, local governments' responses to the *2009 Law*.

II Pre-2009 Regional Taxation Powers

The *1997 Law* was enacted only several months before the Asian Economic Crisis hit. Part of a government deregulation drive, it aimed to achieve 'simplification' (*penyederhanaan*)¹⁹ of the local tax system, including by dramatically reducing the types of taxes and user charges that regional governments could impose.²⁰ Three years later, with decentralisation and other post-Soeharto reforms underway, the national government enacted the *2000 Amendment* to amend the *1997 Law*. The primary aim of the *2000 Amendment* was to allow regional governments to increase their revenue so that they could meet their new responsibilities.²¹ These responsibilities included providing a wide range of high-cost public services such as public works, health services and education.²² To this end, the *2000 Amendment* provided a list of 'objects' over

¹⁸ Susilo Bambang Yudhoyono, Pidato Presiden Republik Indonesia Di Depan Rapat Paripurna Dewan Perwakilan Rakyat Republik Indonesia Agustus 2010 (Jakarta, 2009).

¹⁹ General Elucidation, *1997 Law*.

²⁰ Saad, above n 8.

²¹ General Elucidation, *2000 Amendment*.

²² *1999 Law* art 11(2).

which local governments could impose taxes or user charges and set percentage limits upon the amount of those imposts.²³

In practice, many municipal and city governments, particularly in Indonesia's outer regions, interpreted the *2000 Amendment* to give them *carte blanche* to impose whatever taxes and user charges they liked.²⁴ Critically, the *2000 Amendment* also gave local governments discretion to impose taxes and user charges not listed in the *1997 Law*. This discretion was not unlimited, however. Rather, the *2000 Amendment* made the validity of the impost contingent on it meeting various criteria. For example, the impost could not be against the public interest (art 2(4)(c)) or 'negatively burden' the economy (art 2(4)(f)). It also needed potential to contribute sufficiently to local revenue (art 2(4)(e)), to accommodate local community capacity (art 2(4)(g)), to be fair and to ensure environmental sustainability (art 2(4)(h)). These criteria were, however, so broad and malleable that they were in fact wholly ineffective in restraining local lawmakers and to our knowledge were never employed to bring into question the validity of a local revenue-raising law.

The only relatively clear limitations were that the impost was not an object of national or provincial taxation (art 2(4)(d)); and the 'object' of taxation was located within the lawmaker's jurisdiction and 'served' the local community (art 2(4)(b)).

Similarly, local governments were permitted to impose several types of enumerated user charges, but were free to issue other charges provided that they met somewhat vague conditions. These included that it was 'appropriate to charge a fee for the service' (art 18(3)(a)(4)), for reasons such as the provision of the service being expensive (art 18(3)(c)(3)); and that the charge was 'absolutely necessary to protect the public interest' (art 18(3)(c)(2)). Within limitations provided by the *1997 Law*, regional governments were also granted power to set the tariff of the tax or user charge.

III Types of Taxes and User Charges Imposed under the *2000 Amendment*

As mentioned, local governments used the *2000 Amendment* to create many complained-about taxes and charges. Of particular concern were user fees for government services. These are fees that, theoretically at least, should fund specific government services that the payer, rather than the general public, expects to receive or has received.²⁵ In short, it is '[p]rivate financing of government services on a user-pays cost-recovery basis', where most of the fee

²³ See *2000 Amendment* arts 2, 3.

²⁴ David Ray and Gary Goodpaster, 'Indonesian decentralisation: local autonomy, trade barriers and discrimination' in Damien Kingsbury and Harry Aveling (eds) *Autonomy and Disintegration in Indonesia* (Routledge Curzon, 2003) 75, 83.

²⁵ David Ray, 'Decentralization, regulatory reform, and the business climate' in *Decentralization, regulatory reform, and the business climate* above n 8, 6–7.

should be retained by the institution providing the service.²⁶ User fees have several advantages over tax. They do not burden taxpayers with costs for services that they do not receive, and, if sufficient to cover the costs of providing the service, can help ensure the quality of those services.

Yet, according to Ray, many of the user charges imposed by Indonesian local governments did not have these characteristics. For many user charges, no government services are provided in return, the user charge often being cast as a fee for government ‘monitoring and supervision’ (*pembinaan dan pengawasan*) which is never performed. In other cases, the local government has no capacity to provide the services for which the fees are paid. Fees are often paid into the local coffers and little, if any, is directed back to the agency that was to provide the service. And, even if a service is provided, the fee rarely reflects the cost of providing the service.²⁷ Worse, some are simply payments made to local government in return for winning a procurement contract for goods or services.

Peraturan Daerah Nomor 15 Tahun 2005 tentang Jalan Pengiriman Lisensi [Regional Regulation No. 15 of 2005 on Road Shipping Licences] (Kabupaten Malinau) (the ‘2005 East Kalimantan Regional Regulation’) of Malinau District, East Kalimantan provides an example of one such impost. Of course, it is legitimate and necessary for local governments to raise revenue to maintain roads and it might be more appropriate for trucking businesses, which damage the roads by carrying heavy loads, to help meet the cost rather than other tax payers. However, the way the revenue is obtained seems misguided. It requires one to first obtain a licence before being able to load, transport or unload cargo on roads.²⁸ To obtain these licences applicants need only fulfil various administrative or bureaucratic requirements, such as by providing photocopies of identification, proof of residence and tax-related documents. Applicants are not required to prove their ability to adhere to relevant procedures or to submit themselves to supervision or random inspections to ensure compliance with relevant regulations. The 2005 *East Kalimantan Regional Regulation* appears, therefore, concerned with creating opportunities for revenue raising, rather than achieving policy aims. A far more equitable and efficient way of obtaining the necessary revenue would be to impose fees at weighbridges and to charge a fee determined by the weight of the load (and hence the potential damage to the road). After all, road users already pay vehicle registration, vehicle stamp duty and fuel excise which should be sufficient to cover road maintenance.

Another category of problematic imposts related to trade, thought to hamper the carriage of goods across the jurisdictional boundaries of local governments. These included charges on the loading and unloading of transported goods, import and export fees, and taxes on produce and vehicles. Ray provides two reasons to explain why trade was a primary focus of regional government revenue-raising. First, the 2000 *Amendment* did not allow local governments to tax income or assets. Second, trade taxes were relatively easy to collect, requiring only the positioning of tax officials at strategic locations where goods pass, such as ports,

²⁶ Ibid 7.

²⁷ Ibid 8.

²⁸ See arts 5(1), 14(1), 26(1), 30(1).

borders or bridges.²⁹ One consequence was that the primary sector was disproportionately targeted by the new taxes (around 40 per cent), though services (around 20 per cent) and distribution (around 12 per cent) were also targeted.³⁰

A typical example is *Peraturan Daerah Nomor 4 Tahun 2003 tentang Retribusi Izin Trayek Dan Izin Angkutan Khusus Di Perairan Daratan Lintas Kabupaten/Kota* [Regional Regulation No 4 of 2003 on User Charges for Licences for Routes and Special Transport on Water Boundaries Between Cities and Districts] of South Kalimantan Province. The regulation imposes licence fees for transporting goods and people across sub-provincial water boundaries. It does not set out conditions that applicants must meet to obtain the licence or any other details about the licence. Like many of these types of laws, the regulation provides no policy imperatives or other justifications for imposing the licences. It merely sets the licence fee.

The regulation lists the licence fees and declares that they have been set primarily to recover the costs of managing the licences, including administrative costs connected with the licences, field surveys and inspections (art 6). Presumably, these administrative and inspection costs are similar for the variety of activities for which licenses are required, including to transport people and goods. However, the fees for transport of commercial goods across boundaries are substantially higher than any others (art 7), which seems to indicate opportunism on behalf of the regional government. In short, this regulation seems purely concerned with creating opportunities for revenue-raising, and is almost entirely unconcerned with providing services or achieving policy aims. Indeed, the majority of the regulation deals with procedures to collect the revenue. It is also probably a veiled attempt to bypass the restrictions on taxes by presenting what is essentially a tax as a licence fee. The consequence of the regulation is distortion and impediment to free trade within the province.

IV The 2009 Law on Regional Taxes and User Charges

As mentioned, the 2009 Law is the national legislature's most recent attempt at addressing RTUCLs. Those organisations complaining of the 'high cost' economy caused by RTUCLs will, however, be disappointed. The 2009 Law certainly does not seek to prevent local governments from maintaining and increasing their revenue streams obtained from taxation and user charges, or even from introducing new imposts. In its opening paragraphs, the 2009 Law declares that 'regional taxes and regional user charges are important sources of regional income for funding regional government', and that to increase community service and regional independence... 'the objects of regional taxes and user charges, and discretion in setting tariffs, must be expanded'.

Raising revenue is, therefore, a clearly-stated primary rationale for the statute. Though 'community services' are mentioned, so too, in the same sentence of the 2009 Law, is 'increasing...regional independence', which no doubt refers to

²⁹ Ray, above n 25, 14–15.

³⁰ Lewis and Sjahrir, above n 5, 232.

financial independence from the central government. Then Finance Minister Sri Mulyani Indrawati confirmed this in a press conference held after the Law was enacted. She predicted that the *2009 Law* would lead to a 24 per cent increase in local budget revenues.³¹

Despite being clearly directed at allowing regional governments to increase their revenue, the *2009 Law* seeks to restrain the ‘objects’ of regional taxation by prohibiting regional governments from imposing taxes outside the enumerated list contained in it (art 2(3)). The *2009 Law* provides a fixed list of taxation categories, as had the *1997 Law*, but expands the objects that may be subject to regional taxation. For provincial governments, these now include motor vehicle possession/registration, petrol, stamp duty on the acquisition of motor vehicles, surface water and cigarettes (art 2(1)). City and district governments are given the power to tax restaurants, hotels, entertainment, advertising, electricity, certain minerals, parking, ground water, swallow birds’ nests,³² and village and municipal land and buildings (art 2(2)).

Although the *2009 Law* expands the categories of regional taxes, it seeks to cap the tax rates that local governments can impose. For example, the tax on electricity use (referred to as the ‘street lighting tax’) is not to exceed 10 per cent (art 55(1)). For ‘industry’, including oil and natural gas mining, however, the tariff is to be no more than three per cent (art 55(2)), and for electricity produced by one’s self no more than 1.5 per cent (art 55(3)).

For some taxes, the *2009 Law* requires the local government to use revenue for particular purposes.³³ For example, art 8(5) requires that at least 10 per cent of the revenue from motor vehicle taxes be spent on public transport, road construction and maintenance. At least 50 per cent of the cigarette tax is to be used for public health and law enforcement (art 31).

At time of writing, to the knowledge of the authors, no studies had investigated whether the *2009 Law* has changed local government lawmaking practices. We know that, in 2010, some local governments issued regional regulations revoking their earlier RTUCLs made under the 2000 and 2004 Laws, but no comprehensive studies have revealed whether lawmakers have imposed more or higher taxes, thereby increasing their revenue. Some of the new taxes imposed under the *2009 Law* have, however, caused controversy and attracted media coverage. Regional restaurant taxes have been particularly contentious and labelled unfair, with several regional governments seeking to impose the maximum tariff of 10 percent on the gross income upon those who run roadside stalls (*warung* or *warteg*), most of whom are poor and operate on very small margins.³⁴

³¹ Dion Bisara and Janeman Latul, ‘Indonesia to Rein In Local Levies’, *Jakarta Globe* (Jakarta), 18 August 2009.

³² Nests of the swallow bird, defined in the legislation as birds from the collocalia genus (art 1(36)), are highly valuable in Indonesia and are often used in soups.

³³ Irvan Tisnabudi, ‘Law to Boost Indonesian Businesses by Cutting Regional “Ghost” Taxes: Legislator’, *Jakarta Globe* (Jakarta), 12 October 2009.

³⁴ ‘Gegabah Menggali Pajak Daerah’ [Digging Rash Local Taxes], *Tempo* (online), 9 December 2010; Arientha Primanita and Ulma Haryanto, ‘Jakarta’s Warteg Owners Up in Arms Over New Tax Obligation’, *Jakarta Globe* (Jakarta), 3 December 2010.

Mining Case Study

There is, however, evidence of some teething problems, with local governments apparently testing the outer limits of their powers under the *2009 Law. Peraturan Daerah Nomor 1 Tahun 2010 tentang Komisi Kegiatan Pertambangan* [Regional Regulation No 1 of 2010 on Mining Activity Commissions] (Kabupaten Sumbawa Barat) (the '*West Sumbawa Regulation*') of West Sumbawa provides a good example of this and underlines the potential for regional laws to undermine one of the rationales of the *2009 Law* mentioned above: to attract and keep large-scale foreign investment.

Newmont has, since 2000, operated an open-pit gold and copper mine in West Sumbawa, West Nusa Tenggara through its subsidiary PT Newmont Nusa Tenggara, along with joint venture partners Sumitomo Corporation (Japan) and PT Pukuafu Indah (Indonesia). This mine has been profitable, though Newmont has been embroiled in controversy over divestment obligations and the environmental impacts of its operations in Sumbawa and elsewhere in Indonesia.³⁵

In August 2010, the West Sumbawa regional government enacted the *West Sumbawa Regulation*, about which Newmont has complained. In its opening paragraphs, the *2009 Law* declares that mining companies make large profits, often at the expense of the environment and that it is, therefore, only fair that regions obtain compensation in the form of a commission if the mining causes some form of 'external cost'. The *West Sumbawa Regulation* seeks to impose two types of commissions: the first is one per cent of the gross value of mined metals and rocks; the second is one and one-half per cent of the value of any subcontracts the mining enterprises enter into for the provision of goods or services, including for exploration, construction, mining, manufacturing, purification, transportation and sale and even post-mining activities. 'External costs' are widely defined in the *West Sumbawa Regulation* as 'damage to the environment and infrastructure', and 'negative social and economic effects'. (The *West Sumbawa Regulation* even refers, somewhat elusively, to the 'behavioural impact' of mining activities, which presumably means the perceived cultural damage that foreign presence might cause in a particular area.) If the commission is not paid within 30 days of the transaction, then two percent interest per month accrues on the debt.

The local government estimates that the *West Sumbawa Regulation* will boost its budget by Rp200 billion (US\$22 million) per year. Newmont complains that it was not consulted about the tax and that the commission is not mentioned in its 1986 working contract with the central government which, Newmont claims, continues to govern its investment.³⁶

³⁵ Dominic J Nardi, 'Do Indonesian Judges Need Scientific Credibility? Indonesia v PT Newmont Minahasa Raya and the Use of Scientific Evidence in Indonesian Courts' (2008) 21(1) *Georgetown International Environmental Law Review* 113.

³⁶ Faisal Maliki Baskoro, 'Newmont Protests Mining Tax Levied by Sumbawa', *Jakarta Globe* (Jakarta), 14 January 2011; Masadi Jafar, 'Perda Sumbawa Barat Nomor 1 Tahun 2010 Perlu Dievaluasi' [West Sumbawa Regulation No 1 of 2010 should be evaluated], *Sumbawa News* (online), 16 January 2011 <<http://sumbawanews.com/node/8052>>.

While taxing negative externalities may well be desirable if mining activities cause harm, there are at least three legal problems with the *West Sumbawa Regulation*. First, the commission is probably illegal by virtue of the *2009 Law*. As mentioned, the *2009 Law* adopts a closed list system. Regional governments can impose only the categories of imposts — taxes, user charges and licence fees — that the *2009 Law* mentions. While the *2009 Law* does allow local governments to tax the extraction of a large number of types of minerals, metals are not included (art 57(1)), so local governments are not permitted to tax gold or copper mining.

Further, the *2009 Law* does not mention commissions. Substantively, though, the commission is clearly a tax. The *2009 Law* defines a regional tax as a compulsory contribution paid to the regional government for which no goods or services are directly received, but which is used for public purposes (art 1(10)). The *West Sumbawa Regulation* defines commission as ‘an impost or monetary compensation, calculated as a percentage, on mining activities’ (art 1(6)). It seems reasonable to conclude, then, that the *West Sumbawa Regulation* is an attempt by the West Sumbawa government deliberately to circumvent the *2009 Law* by levying a type of impost that the *2009 Law* does not mention. The very fact that the Regulation cites several relevant national and local laws, but does not mention the *2009 Law*, seems to add weight to this conclusion.

Second, there is no evidence from the *West Sumbawa Regulation* that the West Sumbawa government has calculated the negative externalities by reference to objective criteria. The commission appears to have been set at an arbitrary rate. It is also unclear whether the government has considered whether Newmont has paid for the externalities in the form of central government taxes and fees, of which there are many.³⁷

Third, the *West Sumbawa Regulation* does not ensure that the money raised from the commission goes to offsetting these negative externalities. The commission is paid into West Sumbawa’s public coffers: the government provides no service in return for the imposed commission and no direct compensation to citizens or local businesses affected by the mining.

V User Charges

The *2009 Law* permits regional governments to impose three categories of user charges: user charges on public services, on business services and for licensing. The public services subject to user charges are: health services, cleaning/rubbish disposal services, printing of identity cards and civil registry documents, disposal of corpses, road-side parking, public market facilities, vehicle inspections, fire safety equipment inspections, printing of government-provided maps, public

³⁷ Including mining licence fees, corporate income tax and value added tax. In fact, 80 per cent of mining licence fees collected by the central government is to be given to the relevant regional government: *Undang-Undang Nomor 33 Tahun 2004 tentang Perimbangan Keuangan Antara Pemerintah Pusat Dan Pemerintahan Daerah* [Law No 33 of 2004 on Fiscal Balancing between Central and Regional Governments] (Indonesia), art 14(e). The authors would like to thank Dr Tjip Ismail for his comments on this point.

toilets, sewage management, inspection of weights and measures, education and management of telecommunication towers (arts 110(1), 111–24).

Business services are defined as services provided by the government that the private sector should provide but has not (art 126). Providing these services is, for the government, a commercial endeavour as well as a public service. These services include use of regional government assets and government-owned marketplaces and shops, auction houses, bus terminals and surrounding facilities, car parking, accommodation, slaughter houses, sport and recreation facilities and water transport (art 127).

Regional governments can also charge fees to issue licences required to operate in the construction, public transport and fishing industries; to sell liquor; or to obtain a ‘nuisance permit’ (*izin gangguan*) (art 141). Nuisance permits are required if, during its operations, the business could cause ‘danger, loss or nuisance’ (art 144(1)).

Unfortunately, the *2009 Law* provides very little further detail about the types of activities and enterprises that fall within these various user charge categories. The *2009 Law* requires that the central government issue regulations to add details and fill some of its gaps. To our knowledge, at time of writing, none had been issued.

As the *2009 Law* now stands, any benefits of a fixed list of user charges are undermined by the vagueness with which these user charges are defined. For example, regional governments might attempt to rely on the ‘use of regional assets’ head to impose fees for the exploitation of regional rainforests or minerals. By so doing, they might be able to issue a de facto tax on logging or mining, despite those objects not falling within the categories of taxes permitted by the *2009 Law*. Moreover, if the method of calculating and imposing the user fees is not regulated in more detail, regional governments could levy de facto excises on a wide variety of goods and services produced or offered through the use of government owned assets or facilities. For example, it could impose excise on meat and agriculture produce but label them fees for the use of government slaughterhouses or marketplaces. Protectionist policies could be pursued through discriminatory imposition of fees on government-managed ports or in the granting of ‘public nuisance licences’ for businesses perceived to create ‘danger, loss or nuisance’.

The *2009 Law* even provides some scope for regional governments to obtain power to impose user fees beyond these three categories. Article 150 of the *2009 Law* allows the central government to enact government regulations to add to the categories of user charges that regional governments can impose. To the knowledge of the authors, no such government regulation has yet been issued and,³⁸ if the *2009 Law*’s apparent philosophy of reining in local taxes and user

³⁸ This is despite predictions by the Ministry for Home Affairs that it would have finished the implementing regulation by March 2010: Kementerian Dalam Negeri Republik Indonesia [Ministry for Home Affairs of the Republic of Indonesia], ‘Depdagri Siapkan PP Tindaklanjuti UU Pajak Daerah’ [Ministry of Home Affairs Prepares Regulation as a Follow-Up to Local Tax Law] (Berita Depdagri [Ministry for Home Affairs News], 27 January 2010) <<http://www.depdagri.go.id/news/2010/01/27/depdagri-siapkan-pp-tindaklanjuti-uu-pajak-daerah>>.

charges is followed, then it is unlikely that the central government will add to these categories. Notably, however, the central government delegated these powers to city or district governments under a provision in the *2000 Amendment* almost identical to art 150.³⁹ These categories might, therefore, be expanded in the future.

Furthermore, the *2009 Law* does not explicitly require regional governments to use the fees to provide the service for which they are paid. While art 161(1) of the *2009 Law* ‘requires’ that user charges be ‘prioritised’ to fund the related service, the *2009 Law* leaves it to regional governments to decide how this is to be done and the percentages that would constitute ‘prioritising’ (art 161(2)). It would, therefore, seem open to a regional government to allocate a very small proportion, if any, of the user charge to the service. Alternatively, regional governments might also be able to continue charging fees for nonexistent ‘monitoring and supervision’ services.

At time of writing there is still very little data available on how local governments are using their powers to issue user charges under the *2009 Law*. However, it seems that some regions have, under the *2009 Law*, continued to use their licensing powers purely to raise revenue rather than to achieve intended policy objectives or to provide a service. For example, *Peraturan Daerah Nomor 17 Tahun 2010 tentang Retribusi Izin Gangguan* [Regional Regulation No 17 of 2010 on User Charges for Public Nuisance Licences] (Kabupaten Sigi) (*‘Sigi Regulation’*) of Sigi District, bases the calculation of the licence fee largely on the square metre area of the business requesting the licence (art 6(1)). The calculation also involves a danger index of 1, 2 or 3 (art 6(3)(b)), but the *Sigi Regulation* lists no factors relevant to the determination of the danger index. The rest of the *Sigi Regulation* details the process for imposing and collecting the fees and enforcing payment. The *Sigi Regulation* does not explain why a licence is required. Presumably, one reason could be to protect the public against businesses that have inherent risks of danger or the potential to cause damage to the community. However, nowhere in the regulation is it described how the collected fees will be used to prevent such danger or damage.

VI The Really Taxing Problem: Reviewing RTUCLs

As mentioned, the central government has power to ensure that RTUCLs comply with the *2009 Law* and to invalidate them if they do not. It has, in fact, invalidated many RTUCLs under the *2009 Law* and its predecessors of 1997 and 2000.

The bureaucratic review process under the *2009 Law* is as follows. Regional governments must twice secure approval for their RTUCLs from a higher level government. Provincial governments must send their draft RTUCLs, for preapproval, to the Home Affairs and Finance Ministries within three days of the local parliament and governor agreeing to it (art 157(1)). Similarly, city and district governments must send their draft RTUCLs to their provincial government and the Ministry of Finance (art 157(2)). The drafts are then to be reviewed for compliance

³⁹ *1997 Law* art 6.

with the public interest and higher level laws, including national statutes (art 157(3)–(4)). If the draft is rejected, then it is sent back to the local government, which can revise and resubmit it (art 157(10)). If the draft is accepted then it can be passed into law but, once enacted, RTUCLs must again be sent to the Home Affairs and Finance Ministries (art 158(1)). If they are found to breach the public interest or higher-level laws, they can be invalidated by Presidential Regulation upon the recommendation of the Ministry of Finance, conveyed via the Ministry of Home Affairs (arts 158(2)–(6)). This review process is almost identical to the process under the 2004 Law which had been in operation, to questionable effect, for over four years when the 2009 Law was enacted.

We are not convinced that all — or even most — of the RTUCLs regional governments enact are reviewed under this process, or even that all local governments send their RTUCLs in for review. The result is undoubtedly that many RTUCLs come into force without review. There are myriad possible reasons for this, including deliberate avoidance, ignorance of or confusion about the review process, or lack of central government capacity to conduct reviews. Many of these have been discussed elsewhere and will not be rehearsed here.⁴⁰ One implication of the lack of central government capacity in the face of hundreds of draft and enacted RTUCL per annum is that, in practice, many central government reviews are conducted by reference only to the *title* of the RTUCL under review, rather than their substance. RTUCLs might, therefore, escape review if their title does not include ‘tax’ or ‘user charge’. For example, a local government might be able to ‘get away with’ imposing an excise on the sale of chicken eggs in a ‘Regulation concerning Chicken Eggs’, rather than a ‘Regulation concerning the Tax of Chicken Eggs’. Another example might be imposing a tax on gold mining in a ‘Regulation Concerning Mining Activity Commissions’ rather than ‘Concerning Mining Taxation’.

In our opinion, many features of the 2009 Law, discussed above, make the review process somewhat redundant in any event, at least from a purely legal perspective. For local lawmakers seeking to increase revenue, the 2009 Law’s longer list of permissible objects of taxation and broadly-cast definitions, particularly of permissible user charge categories, leaves ample opportunities to level burdensome, yet *prima facie* legal imposts.

Of course, the central government and local governments will differ on whether a particular RTUCL’s tax or user charge fits within one of the 2009 Law’s definitions or categories. In the first instance, these types of disputes will usually be decided in favour of the national government, because, as mentioned, the 2009 Law gives the central government power to review and invalidate RTUCLs.

However, the Supreme Court usually has the ‘final say’ in such disputes. Like its predecessors, the 2009 Law permits local governments to challenge, in the Court, the invalidation of their regulations by the central government. This positions the Court as a critically important mediator of central-regional relationships and jurisdictions. Yet, its decisions have been unpredictable and very

⁴⁰ Butt, above n 15.

poorly reasoned.⁴¹ It has, until recently, also imposed upon itself an inappropriately short deadline for the submission of review cases. From 1999 until early 2011, internal Supreme Court regulations⁴² prohibited judges from reviewing laws, including Ministerial invalidations, if 180 days had passed since their enactment. In most cases, the Supreme Court threw out requests for reviews by local governments brought after the expiry of that period.⁴³ This deadline was significant, particularly if there were delays in the notification of central government invalidations. Although this 180-day time limitation has now been abolished,⁴⁴ many problems with judicial review at the Supreme Court remain, including the lack of opportunity for parties to present oral submissions and respond to the opposing party's arguments.

Contesting of tax jurisdiction is undoubtedly very common, and legitimate, in many of the world's federal or decentralised democracies, where governments seek to secure and expand their own revenue streams. In these circumstances an impartial arbitrator is needed to enforce the 'rules of the game' as between different tiers of government. This is perhaps where the Indonesian system is at its most uncertain and inefficient. The judicial body charged with resolving such jurisdictional disputes and matters of interpretation — the Supreme Court — has flatly refused to do so, or has consistently failed to do so professionally. Although the Supreme Court has abolished this 180 day deadline, lifting it will expose more central-government invalidations to the Court's erratic decision-making. Current proposals to remove the bureaucratic review process and to give exclusive jurisdiction to the Supreme Court to review and invalidate regional regulations,⁴⁵ are, therefore, in our opinion, ill-advised. Giving jurisdiction to Indonesia's Constitutional Court — which has built a reputation for professionalism — is a far better solution, though it is unlikely given that a constitutional amendment would be required to transfer this jurisdiction to the Constitutional Court.

VII Concluding remarks

The *2009 Law* is unlikely to improve the regional investment climate and minimise 'problematic' regional regulations. As we have shown, it allows regional governments to legally impose a greater number of taxes and user charges and its broad wording seems to provide scope to regional government to create new, legal, imposts. Flawed mechanisms — both bureaucratic and judicial

⁴¹ Ibid.

⁴² *Peraturan Mahkamah Agung Nomor 1 Tahun 1999 tentang Hak Uji Materiil* [Supreme Court Regulation No 1 of 1999 on Judicial Review] (Indonesia) and *Peraturan Mahkamah Agung Nomor 1 Tahun 2004 tentang Hak Uji Materiil* [Supreme Court Regulation No 1 of 2004 on Judicial Review] (Indonesia) art 2(4). These laws have since been replaced by *Peraturan Mahkamah Agung Nomor 1 Tahun 2011 tentang Hak Uji Materiil* [Supreme Court Regulation No 1 of 2011 on Judicial Review] (Indonesia).

⁴³ Butt, above n 15.

⁴⁴ By *Peraturan Mahkamah Agung Nomor 1 Tahun 2011 tentang Hak Uji Materiil* [Supreme Court Regulation No 1 of 2011 on Judicial Review] (Indonesia).

⁴⁵ 'Kewenangan Pemerintah Batalkan Perda Akan Hilang' ['The Government's Power to Revoke Perda Will be No More'] *Hukumonline* (online), 8 February 2011 <<http://hukumonline.com/berita/baca/lt4d516aa8c62f4/kewenangan-pemerintah-batalkan-perda-akan-hilang>>.

— to review and invalidate questionable imposts leave problematic RTUCLs on the books, create uncertainty and no doubt cause tensions between central and regional governments.

The solution, we argue, is less likely to be found in new laws, but rather through improvements to governance standards in the regions and, in particular, regional governments recognising that nuisance imposts are unlikely to sustain their region's long-term development. Of course, regional governments need consistent and sufficiently-high revenue streams in order to operate. Yet, perhaps more important to long-term development, is the need to attract investment, particularly foreign direct investment. Regional governments may, therefore, find themselves needing to act on investors' complaints about legal uncertainty — including the uncertainty that arises because of the imposition of unexpected imposts — and about fees for services that are not provided or needed. Eventually, we hope, regional governments will be forced to maintain business and investor friendly tax policies in order to get re-elected.