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The Influence of Fiscal Decentralization on Economic Growth

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Abstract

The purpose of this study is to know and analyze the influence of the local revenue, the balance fund, the capital expenditure and the private investment on economic growth. This research is an exploratory study conducted on 19 regency/city government in West Sumatera Province. Data analysis techniques are descriptive analysis, classical assumption test, and panel data regression analysis. The results of this study found that: 1) The local revenue of the region has no significant effect on economic growth, 2) the Balance fund has a significant positive impact on economic growth, 3) the Capital expenditure has a significant positive effect on economic growth, 4) the Private investment has a significant positive effect on economic growth.

Keywords: The Local Revenue, The Balance Fund, The Capital Expenditure, The Private Investment

Introduction

A vast regional autonomy implementation currently aims to develop the whole existing economic potential so as to spur the increase of economic activity in areas that ultimately improve the national economy (Hermon, 2015). The implementation of a vast regional autonomy which has been outlined in the Act. No. 33 of 2004 requires the presence of a financial balance between Central and Local Government. The financial balance between Central and Local Government is a system of government financing in the framework of the unitary State covering the division of finance between the Central Government and the Local Government, as well as equalization between regions proportionally, fairly, democratic and transparent.

The source of regional income is used for the funding of local government according to Act No. 33/2004 in the implementation of decentralization include: The local revenue (PAD), the Special Allocation Fund (DAK), General Allocation Fund (DAU), Revenue Sharing Fund (DBH), regional loan and other legitimate revenue. In The ACT No. 33/2004 gave authority for areas to improve its revenues, namely broadening the reach of the tax and for the results section of the natural resources by the Central Government.

By doing a fiscal decentralization does not mean local governments can escape from the rule of the Central Government completely (Hermon, 2010; Hermon, 2012; Hermon, 2014). The autonomous areas are still in a whole region of the Republic of Indonesia so that they still have a responsibility in carrying out the task of the construction given by the Central Government (Hermon, 2016; Hermon, 2017). The responsibility of course coupled with funding and assistance from the Central Government in the form of transfer fund.

Fiscal decentralization making local government more creative in finding alternative sources for financing construction in its territory besides the development assistance funds provided by the Central Government. However, the magnitude of the local revenue and the large transfer Fund will also affect the use of the budget inefficiently. Local governments should ideally be able to use those funds with priorities of interests and aspirations of the people. Fiscal decentralization euphoria happened so widely and on the other hand, the well-being of local people tend to not experience a change toward improvement, then the researcher is interested in reviewing any further how the influence of fiscal decentralization against economic growth

Method

This research is a study of the exploration done on 19 of the reign of regency/city in West Sumatra. The technique of data analysis was descriptive analysis, classic assumption test and regression analysis of the data panel.

The Selection of Panel Data Regression Model

The Chow test is a test to determine the model of fixed effect or random effect which is the most appropriate used in estimating the data panel. Based on the results of data analysis for the chow test, the values obtained for probability cross-section F and chi-square is 0.00. The value of the probability is smaller than the alpha (0.00 < 0.05). Based on the results, it is known to the best model in doing the analysis is a model with the Fixed Effects method.Hausman Test is a test used to determine the best method among fixed effects or random effects. Based on the results of data analysis for test Hausman noted that the value of the probability of 0.0039. The value of the probability is smaller than the alpha (0.0039 < 0.05). It means the best method to be used is the fixed effect than the random effect.

The Results Of The Estimation Of The Regression Data Panel

On this research, the hypothesis is tested using a regression analysis of the data panel. Based on the test of Chow and Hausman noted that a good model used in the regression analysis of the data panel is the model of fixed effects. From the results of the data analysis of regional economy equation can be written as follows: $Y = 5{,}75 + 0{,}028\ PAD + 0{,}062\ DP + 0{,}089\ BM + 2{,}282\ IS$

Based on the results of data analysis is known the value of R-squared is 0.6805. This shows great influence of local revenue, balance funds, capital expenditure and private investment against regional economic growth is 68.05% and the remaining 31.95% influenced by other variables which are not entered into the model research. Further, it is noted that the constants of 5.75, may imply that if the local revenue, balance funds, capital expenditure, and private investment value is fixed (constant) then the value is simply economic growth amounted to 5.75%.The regression coefficient of the local revenue variable (X_1) of 0.028 marked positive. The coefficient of the local revenue variable shows a positive influence of the local revenue against economic growth. This means that when the local revenue increased by 1 percent, it would be able to increase the economic growth of 2.8 percent assuming no other variable changes (ceteris paribus). The regression coefficient of the balance funds variable (X_2) of 0.062 marked positive. The regression coefficient of the balance funds variable marked positive shows a positive influence of balance funds against economic growth. This means that if the fund balances increased by 1 percent, it would be able to increase the economic growth of 6.2 percent assuming no other variable changes (ceteris paribus). The regression coefficient of the capital expenditure variable (X_3) of 0.089 marked positive. The regression coefficient of the capital expenditure variable marked positive shows a positive influence of capital expenditure on economic growth. This means that when the capital expenditure increased by 1 percent, it would be able to increase the economic growth of 8.9 percent assuming no other variable changes (ceteris paribus).The regression coefficient of the private investment variable (X_4) of 0.282 marked positive. The regression coefficient of the private investment variable marked positive shows a positive influence of private investment against economic growth. This means that when the private investment increased by 1 percent, it would be able to increase the economic growth of 28.2 percent assuming no other variable changes (ceteris paribus).

The Test of Hypothesis

A hypothesis test is used to find out whether free variables (X_1, X_2, X_3, X_4) partially or altogether influential significantly or not against bound variables (Y). The first hypothesis of this research is the local revenue effects significantly to regency/city's economic growth in West Sumatra. In the first hypothesis testing is known that the probability value of local revenue (X_1) is 0.23. If the value of probability compared to alpha (0.05) then it is evident that the value of the probability is greater than alpha (0.23 > 0.05). This shows that the first hypothesis is rejected at the 95% level of confidence. Thus, it can be said that the local revenue does not affect the regency/city's economic growth in West Sumatra significantly. The second hypothesis of this research is the local revenue effects significantly to regency/city's economic growth in West Sumatra. The first hypothesis testing is known that the probability value of the balance funds variable

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(X_2) is 0.024. If the value of probability compared to alpha (0.05) then it is evident that the value of the probability is smaller than the alpha (0.024 < 0.05). This shows that the second hypothesis is accepted at a confidence level of 95%. Thus it can be said that the balance funds influence the regency/city's economic growth in West Sumatra significantly.The third hypothesis of this research is the capital expenditure effects significantly to regency/city's economic growth in West Sumatra. The first hypothesis testing is known that the probability value of the capital expenditure variable (X_3) is 0.009. If the value of probability compared to alpha (0.05) then it is evident that the value of the probability is smaller than the alpha (0.009 < 0.05). This suggests that the third hypothesis accepted at 95% confidence level. Thus it can be said that the capital expenditure influences the regency/city's economic growth in West Sumatra significantly. The fourth hypothesis of this research is the private investment effects significantly to regency/city's economic growth in West Sumatra. The fourth hypothesis testing is known to the probability value of the private investment variable (X_4) is 0.045. If the value of probability compared to alpha (0.05) then it is evident that the value of the probability is smaller than the alpha (0.045 < 0.05). This shows that the fourth hypothesis is accepted on a confidence level of 95%. Thus it can be said that the private investment influences the regency/city's economic growth in West Sumatra significantly.

Results and Discussion

This discussion section will explain and interpret the results of the analysis obtained. Whether the results of the analysis in accordance with the theories expressed or not. If it is not in accordance with the theories expressed what caused it to happen.Based on the results of the first hypothesis testing noted that the local revenue has no positive significant effect on economic growth. When the local revenue has increased is not necessarily going to increase economic growth. Thus it can be said that the local revenue has a very important role in boosting the economic growth of the region. When an area is having an increase in local revenue, then the fund owned by the Government will increase anyway. This increase will benefit the Government because it can be used to meet the needs of his region to improve the area's economic growth becomes higher.

The local revenue is a source of income obtained from the utilization and management of resources owned by the region. In the era of decentralization, the local revenue is expected to be a driving force in boosting economic growth due to the higher local revenue, surely it will encourage the creation of higher economic growth. The findings of the research are supported by the opinion of Tambunan (2006:72) stated that the local revenue is one of the area's spending source, if the local revenue increases then the fund is owned by local government will be more and the level of independence of the region will also increase, so that the local government will have the opportunity to build its economy so it will create a high level of economic growth.

Based on the results of the second hypothesis testing noted that the balance funds have a positive significant effect on economic growth. When the balance funds have increased of course it will boost economic growth.Much or little the balance funds received by local governments from the Central Government, will affect the growth rate of the economy of a region because of the balanced fund is sourced from the state budget allocated to the region for funding needs of the region in the framework of the implementation of the decentralization and boost economic growth. The balance of funds given to the region aimed at reducing fiscal disparities between the Central Government and local governments and among local governments and is aimed at the development of the local economy so that economic growth can be improved.

Based on the results of third hypothesis testing noted that capital expenditures do not affect significantly to economic growth. When capital expenditures increase turns out to have not been able to increase economic growth. Local governments which can improve the composition of the capital expenditures for capital facility construction will contribute positively toward economic growth. In other words, capital expenditures carried out in the framework of the establishment of a capital in nature adds to the fixed assets/inventory, which provides benefits for more than one accounting period, as with increasing the capacity and quality of the assets owned by the region will encourage the creation of economic growth. Research findings are not supported by the opinion of Halim (2001) stating that demands to change the structure of the shopping are becoming increasingly powerful, especially in those areas that are experiencing lower fiscal capacity. Areas of low fiscal capacity tend to experience strong fiscal pressure. Low of fiscal capacity indicates a low level of regional self-reliance. The area required to optimize its potential, and one of them is by giving a larger portion of regional spending for productive sectors that can spur economic growth.

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Based on the results of the fourth hypothesis testing noted that private investment significantly positive effect against economic growth. If private investment is having an increase surely will boost economic growth. Private investment has a crucial role in the economic development process in particular about the dual role of belonging to investment. First, investment has a dual role which can create an income, and second, investment enlarges the production capacity of the economy by way of increasing the stock of capital. This means that the higher the level of private investment in a region will contribute positively towards the economic growth of the area. The findings of the research supported by the opinion of Purwanto (2012:128) stating that the policies of the Government in terms of improving the investment climate through the efforts of a decrease in value of ICOR, government spending on capital construction for each sector of the field efforts, and taxation, have the capability of increasing the value of nominal GDP, GDP per capita, and the level of productivity.

Economic growth can be defined as a process of continuous change from a condition of the economy towards a better (Todaro, *et al*, 2006). According to Sukirno (2006), economic growth is a quantitative measure which illustrates the development of an economy in a given year when compared with the previous year. An economy is said to be growing in case of an increase in output per capita in the long term, economic growth as a quantitative measure that illustrates the development of an economy in a given year when compared with the previous year.Economic growth is the process by which happens to increase real gross national product or real national income. So the economy is said to be growing or developing real output growth if there is. Another definition of economic growth is that economic growth occurs when there is an increase in output per capita. Economic growth illustrates the increase in standard of living as measured by real output per person.

In this research, the author will analyze the impact of fiscal decentralization on economic growth. Fiscal decentralization in this research is measured by the ability of the region to increase the local revenue, manage and utilize the balance funds (DAU, DAK, DBH), allocate capital expenditure for development and activate private investment. According to Sidiq (2002) that one of the main goals of fiscal decentralization is the creation of independence of the region. Local governments are expected to multiply local financial resources, in particular through the local revenue. The region having the high local revenue area has the potential to be able to encourage the emergence of economic growth.The local revenue is the source of income obtained by the local government through the utilization and management of resources owned by the region. In the era of decentralization, the local revenue is expected to be a catalyst for the growth and development of an economy in the region. (*Abimanyu dan Megantara*. 2009).

Sidik (2004) said that balance funds are the fund sourced from the state budget allocated to the region in order to fund the needs of the region in the framework of the implementation of decentralization. The balance funds aims to reduce fiscal disparities between the Central Government and local governments and among local governments and also objected to developing the local economy thus regional economic growth can be improved. Adi (2005) stated that local governments which can improve the composition of capital expenditures for the construction of capital facilities will contribute to economic growth. Lin dan Liu (2000) stated that the Government needs to increase capital investment in order to boost the economic growth of the region. Martínez and McNab (2001) explained that most studies that examine the direct relationship of fiscal decentralization and economic growth applying *Barro's Endogenous Growth Model* in which a producing function consists of a variety of inputs including private capital and the public expenses.

Based on the empirical experience of the developed countries (USA, Germany, Japan), Wagner suggested that in an economy, if income per capita increases, Government spending will also increase relatively. Nevertheless, Wagner realized that by growing the relationship of the economy between industries, the industry's relationship with the community and so on are becoming increasingly complicated or complex. The weakness of Wagner's law is the law is not based on a theory regarding the selection of public goods, but based on the organic theory of state considering the Government as individuals are free to act, apart from other community members.

The local revenue is a source of income obtained from the utilization and management of resources owned by the region. In the era of decentralization, the local revenue is expected to be a driving force in boosting economic growth due to the higher local revenue, surely it will encourage the creation of higher economic growth. Much or little balance funds received by local governments from the Central Government will affect the growth rate of the economy of a region because the balance funds are sourced from the state budget allocated to the region for funding the needs of the region in order to the implementation of decentralization and boost economic growth. The balance funds are given to the region aimed at reducing fiscal disparities between the Central Government and local governments and among local

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governments and is aimed at developing the local economy so that the economic growth can be improved. Local governments can improve the composition of the capital expenditures for constructing the capital facilities will contribute positively toward economic growth. In other words, capital expenditure carried out in order to establish a capital in nature adds to the fixed assets/inventory, which provides benefits for more than one accounting period, as with increasing the capacity and quality of the assets owned by the region will encourage the creation of economic growth. Private investment has a crucial role in the economic development process in particular about the dual role belonged to the investment. First, investment has a dual role which can create the income. Second, investment enlarges the production capacity of the economy by way of increasing the stock of capital. This means that the

Conclusion

The local revenue does not affect significantly toward economic growth. That is, the local revenue has not been able to increase economic growth because of the amount of the local revenue is too small. The balance funds significant positive effect on economic growth. If the balance funds having an increase surely it will boost economic growth. The capital expenditure influences significantly to economic growth. If the capital expenditure has increased, it will boost economic growth. The private investment significant positive effect on private investment against economic growth. If private investment experienced an increase surely will boost economic growth

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