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THE ROLE OF LOCAL GOVERNMENT EXPENDITURE ON ECONOMIC GROWTH: A REVIEW OF PANEL DATA IN INDONESIA

Agus Tri Basuki^{1*}, Yunastiti Purwaningsih², Mulyanto³, A. M. Susilo⁴

¹PhD Student on Economics and Business Faculty, Universitas Sebelas Maret Surakarta, Indonesia and Lecturer on Economics and Business Faculty Universitas Muhammadiyah Yogyakarta, Indonesia, ^{2,3,4}Lecturer on Economics and Business Faculty Universitas Sebelas Maret Surakarta, Indonesia.

Email: *agustribasuki2020@gmail.com

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Abstract

Purpose of the study: This research aims to empirically prove the composition of local government expenditure (education, health, marine and fisheries, agriculture, and general allocation fund) on economic growth in 18 provinces in Indonesia from 2010 to 2015.

Methodology: The model used in this research is panel data regression. The use of panel data in regression can provide more information that cannot be provided by cross-section or time-series data, and provides the best solution for inferring dynamic changes than cross-section data.

Main Findings: The findings in this study are foreign investment has no influence on economic growth. Fiscal policies that are carried out are not effective in encouraging economic growth, and the use of the General Allocation Fund is not on target.

Applications of this study: Foreign investment must be a trigger for the local economy and the national economy by means of foreign investment in Indonesia which is prioritized using raw materials and local labour, so that dependence on imported raw materials can be minimized. To overcome leakage of development budget must implement a budgeting system that is oriented towards organizational output and is very closely related to the organization's vision, mission, and strategic plan. The use of general allocation funds needs to be monitored by certain institutions and prioritizing public interest.

Keywords: *Economic Growth, Data Panel, Government Expenditure, Fiscal Policy.*

JEL: H3 O1 C3

INTRODUCTION

In the effort of achieving its national goal, Indonesia has to encounter three main problems, they are: (1) declining state dignity; (2) weakening national economic constituents; and (3) dispersing intolerance and national identity crisis. The weakening national economic constituents could be seen in unsettled poverty issues, social inequality, inter-region inequality, environmental damage resulting from excessive natural resources exploitation, and dependence in such fields as foods, energy, finance, and technology. The state does not seem to be capable of utilizing the huge natural resources this country has for its people's welfare. The expectation for those national economic constituents to strengthen is getting far away when the state has no power in providing security on proper health and quality of life for its people, fails in minimizing national income inequality and unevenness resulting from dependence on foreign debts and food provision relying on import, and fails in dealing with energy crisis issue thanks to the global production equipment and corporate capital as well as the decreasing national oil reserves it owns.

Government spending can affect economic activity, not only creating a development process but also functions as a component of aggregate demand that can increase products. [Aruwa \(2010\)](#) research results find that there is a long-term correlation between government expenditure and national revenue, and public expenditure and revenue for Nigeria's case. Meanwhile, [Hendarmin \(2012\)](#) tests the influence of government capital expenditure on economic growth, resulting in its finding that there is a positive, yet insignificant correlation between them.

The government's seriousness in developing their regions is measured from the existence of a governmental system known as Regional Autonomy. To support this, the government issues Law Number 22 of 1999 concerning Regional Government which is then amended into Law No. 32 of 2004 and Law Number 25 of 1999 concerning Revenue Sharing of Central and Regional Governments which is then amended further into Law Number 33 of 2004.

The law serves as a basis for any region to develop their region independently, relying more on the ability and potential the said region owns. This law also provides the regional government with a greater authority (local discretion) to design various development programs that suits what the local society wants (local needs).

Indonesia is a developing country. Most of the population's livelihood depends mainly on primary production, namely the agricultural sector and the mining sector. Increasing the population and labor force create difficulties in the agricultural sector. This difficulty is caused because agricultural land is limited and the agricultural system is still traditional, giving rise to underemployment in the agricultural sector. Population development can be a factor driving economic growth if

population growth is followed by increased education and increased employment in the industrial sector, thus making the workforce that has high competitiveness and has an impact on increasing economic growth.

Foreign investment as a driver of economic growth comes from traditional neoclassical opinion. According to this analysis foreign investment is considered to be something that can fill the gap between savings raised from within the country, foreign exchange reserves, government revenue and the number of funds needed to achieve development goals (Todaro and Stephen, 2015). If the country concerned can fill the gap with foreign financial sources, the country will be able to achieve its growth targets well, thus foreign investment has a role in contributing to the economic growth of a country.

The issue of slow economic development is also influenced by state officials who have the power to use the corrupt state budget. Corruption is generally more a negative impact on the national economy, corruption will reduce economic growth. However, in the view of microeconomics, the act of corruption can actually increase the level of efficiency and support its business. However, while the opinion of economists there still debates about the effects of corruption on economic growth.

This study aims to analyze the influence of local government spending on education, health, agriculture, maritime affairs, general allocation funds, population and foreign investment, and the opinion of the Supreme Audit Board (BPK) in promoting economic growth.

LITERATURE REVIEW

Economic growth relates tightly to the process of goods and services production increase process in society's economic activities. It is safe to say that economic growth deals with single-dimension development and it are measured from the increase in production output and revenue. In economic growth, it has been common to review the production processes which involve a number of product types using certain means of production (Djojohadikusumo, 1994). In this relationship, the quantitative sharing relationship between means of production in one hand and the entire production outputs on the other is shown. In one or other way, it could be expressed in a mathematical formal framework. Models regarding economic growth need to be tested using empiric-quantitative measurement.

The development has a greater meaning to it than economic growth, while an increase in production is definitely one of the main characteristics in the development process. In addition to a quantitative production increase, development processes include such changes to production components, productive resources utilization pattern (allocation) among economic activity sectors, property, and revenue distribution pattern among economic player groups, and to the institutional framework in the social life thoroughly.

A highly important matter in development processes is the increasingly widening opportunities for employment of productive nature (productive employment). Economic development ought to bring about active participation in productive activities for all members of society desiring to play some role in the economic process. Productive economic activities result in numerous positive impacts, such as increasing real income for most members of the population. It could in turn qualitatively and quantitatively increase their consumer purchasing power.

According to Adam Smith, economic development is a mixed process of population growth and technology advancement (Suryana, 2000). Meanwhile, Todaro (2000) defines development as a multi-dimensional process involving major changes in social structure, community attitudes, national institutions and accelerating economic growth, reducing inequality and eliminating absolute poverty. Economic development and strong political stability without significant changes in the quality of life of the people is a wrong development. High growth performance without community participation is clearly economic growth without development (Todaro and Stephen, 2015).

According to Rostow (1962), economic development or transformation of traditional societies into modern societies is a multi-dimensional process. Economic development is related to the process that causes it; changes in the orientation of economic organizations, changes in society, changes in investment methods, changes in the way people determine the status of individuals which are then based on their ability to do their jobs, and shifts in people's trust.

The definition of economic development according to Simon Kuznets Suryana (2000) is a long-term increase in a state's ability to provide increasingly more varied economic goods to its people. This ability grows along with their technological advancement and institutional and ideological adjustments they need. This definition has 3 (three) components: firstly, a country's economic growth could be seen from the supply of the continuously increasing goods; secondly, advanced technology is a factor in economic growth which determines the degree of ability growth in providing various goods to the people; and thirdly, the wide and efficient use of technology requires an adjustment to institutional and ideological aspects so that the innovation created by human science could be utilized appropriately.

Boediono (1999) defines economic growth as a process of output increase in the long term. This definition includes three aspects, namely process, output per capita, and long term. According to Sadono (2006), economic growth and economic development have different definitions, i.e. economic growth is a process of the continuous increase in output per capita in the long term. This economic growth constitutes one of the successful development indicators.

Arsyad, (2014) defines multidimensional economic development that covers various aspects of people's lives, not just one aspect. Economic development can be defined as any activity carried out by a country in order to develop economic

activities and the standard of living of its people. Given these limitations, economic development, in general, can be defined as a process that causes an increase in real income per capita of a country's population in the long run accompanied by an improvement in the development system.

Based on the expert definitions above, it could be concluded that Economic Development is defined as a process that causes the population's output per capita of a society to increase in the long run. From this definition, three elements can be drawn; (1) economic development as a process means continuous changes within which elements of strength have been contained for new investments; (2) an effort of increasing output per capita; (3) increased output per capita should last in a long run.

PREVIOUS STUDIES

Research conducted by [Gisore, et. al., \(2014\)](#), [Mamingi and Perch \(2013\)](#), [Ali, S., Ali, A., and Amin, A. \(2013\)](#) and [Dao \(2012\)](#), concluded that population growth has a positive influence on economic growth. Research by [Headey and Hodge \(2009\)](#) and [Sylwester \(2000\)](#) concluded that population growth impedes economic growth. While [Rustan's research, A. \(2013\)](#) concluded that population growth has no influence on economic growth.

Fiscal policy is an economic policy taken by the government in managing state finances (through spending on education, spending on health, spending on agriculture, etc.) to overcome economic conditions leading to improvement. Fiscal policy is rooted in state revenue from tax and non-tax and is allocated in the form of government expenditure as stated in its Budget.

Research on the effect of government spending on education on economic growth was conducted by [Mekdad, et. al., \(2014\)](#), [Dada \(2013\)](#), [Idrees and Siddiqi \(2013\)](#) concluded that government spending on education has a positive influence on economic growth. Research conducted by Al-Shafti (2014) and [Sylwester \(2000\)](#) concluded that government spending on education has no influence on economic growth. [Sylwester's research \(2000\)](#) concludes that government spending on education has no influence on economic growth.

Research on the relationship between government spending on health on economic growth was conducted by [Kurt \(2015\)](#), Al-Shafti (2014), [Dada \(2013\)](#), [Muthui, Kosimbei, Maingi, and Thuku \(2013\)](#), [Olabisi and Oloni \(2012\)](#). They concluded that government spending on health has a positive influence on economic development.

The role of agriculture in economic development is only seen as a supporting element. Development is defined as a structural transformation from an economy based on agricultural activities to an economy of goods and services industries. The role of government is needed especially in encouraging activities in agriculture through the provision of agricultural facilities and infrastructure (such as irrigation, fertilizer, and seeds). Results [Oyinbo, et. al., \(2013\)](#) concluded that government spending in agriculture has no influence on economic growth in the long run. Research [Mursidah, et al., \(2017\)](#), [Shuaib, et al., \(2015\)](#), [Chidinma, and Kemisola \(2012\)](#) and [Armas, et al., \(2012\)](#) concluded that government spending on agricultural allocation has a positive influence on economic growth.

Research on the relationship between government spending on maritime economic growth was conducted by [Huda et al. \(2015\)](#), [Novianti, et al. \(2014\)](#) and [Agustine, et al. \(2013\)](#). They concluded that government spending allocated for the development of marine infrastructure could drive economic growth.

Research on the relationship between general allocation funds for economic growth conducted by [Nurhemi and Suryani \(2015\)](#), [Tajuddin, et al., \(2014\)](#), Ahma (2011) and [Manik, et al., \(2010\)](#) concluded that general allocation of funds in several provinces in Indonesia have a positive influence on economic growth. The [Muti'ah Study \(2017\)](#) concludes that the balanced fund in the form of a General Allocation Fund has no influence on economic growth. While [Astria \(2014\)](#) in South Sumatra, the results of his research concluded that general allocation funds have a negative influence on economic growth.

Research on the effect of foreign investment on economic growth conducted by [Agrawal, G \(2015\)](#), [Melnyk, Kubatko, and Pysarenko \(2014\)](#), [Nawatmi \(2013\)](#) and Mehana (2011) concluded that foreign investment has a positive influence on economic growth through its role infill the lack of resources between targeted investment and mobilization of domestic savings. Research [Kolawole \(2015\)](#), [Abala, D, O, \(2014\)](#), and [Louzi & Abadi \(2011\)](#) concluded that foreign investment has no influence on economic growth.

Research on the effect of corruption on economic growth was conducted by [Grabova, P., \(2014\)](#), [Nawatmi \(2013\)](#) and [Ahmad, et. al., \(2012\)](#). The results of the study concluded that the level of corruption has a negative influence on economic growth. While [Mauro \(1995\)](#) found that there is a negative influence.

METHODOLOGY

Model Specification

Based on available data, a regression model suitable for this study is panel data regression. The function of GRDP is as follows:

$$\text{LOG (GDRP)} = \beta_0 + \beta_1 \text{LOG(EDUC)} + \beta_2 * \text{LOG(HEALTH)} + \beta_3 * \text{LOG(AGREXP)} + \beta_4 * \text{LOG(MAREXP)} + \beta_5 * \text{LOG(DAU)} + \beta_6 * \text{LOG(PMA)} + \beta_7 * \text{LOG(POP)} + \beta_8 * \text{OPN} + \varepsilon_t \dots\dots\dots 1$$

Description :

GDRP is defined as regional economic growth, EDUC is defined as local government expenditure for education, HEALTH is defined as local government expenditure for health, AGREXP is defined as local government expenditure for agriculture, MAREXP is defined as local government expenditure for marine and fisheries, DAU is defined as general allocation fund from central government to regional governments, PMA is defined as foreign investment, POP is defined as total population in respective region and OPN is defined as Supreme Audit Agency’s appraisal of Regional Government’s Financial Statements.

Stages of Panel Data Regression

The stages of compiling the panel data regression analysis can be seen in Figure 1.

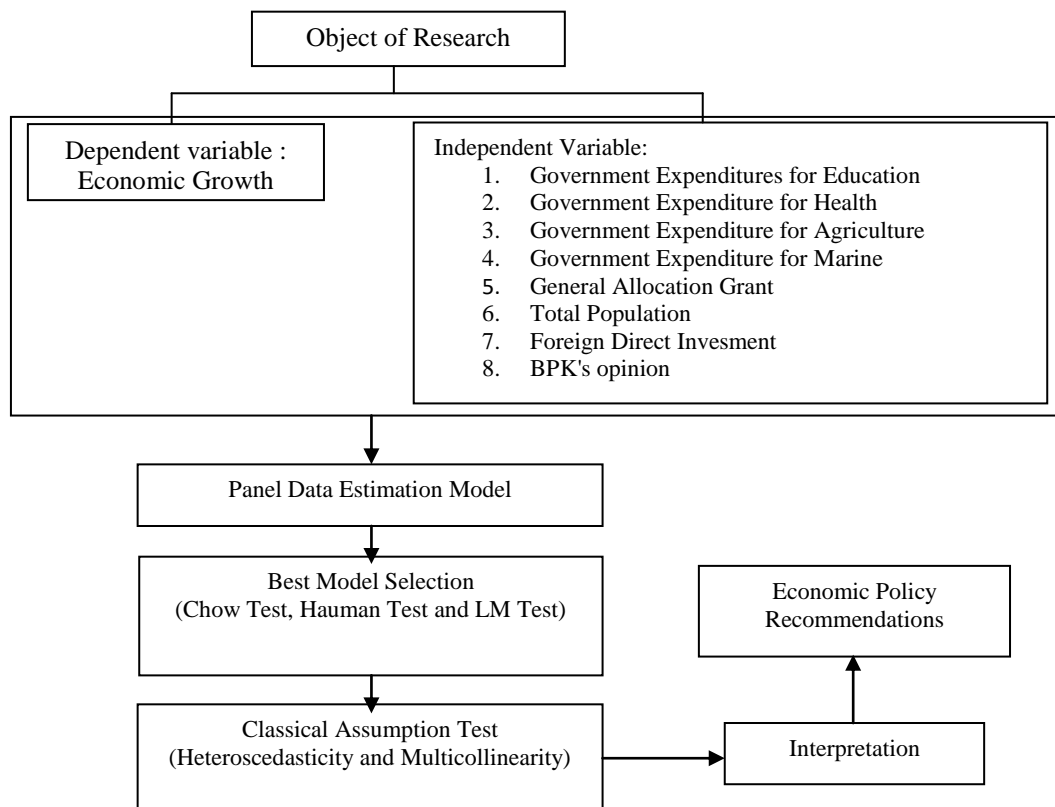


Figure 1: Stages of Panel Data Regression Analysis

Source: [Gujarati, 2003](#)

The data that has been obtained is regressed using the regression model in equation 1 and produces a common equation model, fixed effects and random effects. The regression model estimation method using the data panel could be performed through three approaches, such as:

1. Common Effect Model

The *common effect* model is the simplest data panel approach. This model does not consider individual and time dimensions, thus it is assumed that the behaviors among individuals are the same within various periods of time. This model only combines *time series* and *cross-section* data in the form of a *pool*, estimating it using *pooled least square* ([Gujarati, 2003](#)).

2. Fixed Effect Model

The *Fixed effects* model assumes that there are different effects among individuals. This difference could be accommodated through the difference in their intercepts. Therefore, in the *fixed-effects* model, every model is an unknown parameter and it will be estimated using *dummy* variable technique which could be written as follows ([Gujarati, 2003](#)):

$$\text{Log(PDRB}_{it}) = (\alpha + i\alpha_{it}) + \beta_1\text{Log(EDUC}_{it}) + \beta_2\text{Log(HEALTH}_{it}) + \beta_3 \text{Log(AGREXP}_{it}) + \beta_4 \text{Log(MAREXP}_{it}) + \beta_5\text{Log(DAU}_{it}) + \beta_6\text{Log(PMA}_{it}) + \beta_7\text{Log(POP}_{it}) + \beta_8\text{OPN}_{it} + \varepsilon_{it} \dots\dots\dots 2$$

$$\begin{bmatrix} GDRP_1 \\ GDRP_2 \\ \dots\dots\dots \\ GDRP_n \end{bmatrix} = \begin{bmatrix} \alpha \\ \alpha \\ \dots \\ \alpha \end{bmatrix} + \begin{bmatrix} i & 0 & 0 \\ 0 & i & 0 \\ \dots & \dots & \dots \\ 0 & 0 & i \end{bmatrix} \begin{bmatrix} \alpha_1 \\ \alpha_2 \\ \dots \\ \alpha_n \end{bmatrix} + \begin{bmatrix} EDUC_{11} & EDUC_{21} & EDUC_{p1} \\ HEALTH_{12} & HEALTH_{22} & HEALTH_{p2} \\ \dots & \dots & \dots \\ OPN_{1n} & OPN_{2n} & OPN_{pn} \end{bmatrix} \begin{bmatrix} \beta_1 \\ \beta_2 \\ \dots \\ \beta_n \end{bmatrix} + \begin{bmatrix} \varepsilon_1 \\ \varepsilon_2 \\ \dots \\ \varepsilon_n \end{bmatrix}$$

Such a technique above is called *Least Square Dummy Variable (LSDV)*. In addition, to be applied to each individual's effects, this LSDV could also accommodate the time effect which is of systemic nature. This is possible by adding the *dummy* variable time in the model.

3. Random Effect Model

Unlike the *fixed effect model*, the specific effect of each individual is treated as a part of the *error* component of random nature and not correlated with the observed explanatory variables, and such a model is called the *random effects model* (REM). This model is frequently called an *error component model* (ECM). Hence, the equation of the *random effects* model could be written as follows:

$$\text{Log(PDRB}_{it}) = \beta_0 + \beta_1\text{Log(EDUC}_{it}) + \beta_2\text{Log(HEALTH}_{it}) + \beta_3 \text{Log(AGREXP}_{it}) + \beta_4 \text{Log(MAREXP}_{it}) + \beta_5\text{Log(DAU}_{it}) + \beta_6\text{Log(PMA}_{it}) + \beta_7\text{Log(POP}_{it}) + \beta_8\text{OPN}_{it} + W_{it} \dots\dots\dots 3$$

Description :

- i = Aceh, Sumut,....., Papua
- t = 2010, 2011, 2012, 2013, 2014,2015
- $w_{it} = \varepsilon_{it} + u_i$; $E(w_{it}) = 0$; $E(w_{it}^2) = \alpha^2 + \alpha_u^2$;
- $E(w_{it}, w_{jt-1}) = 0$; $i \neq j$; $E(u_i, \varepsilon_{it}) = 0$;
- $E(\varepsilon_i, \varepsilon_{is}) = E(\varepsilon_{it}, \varepsilon_{jt}) = E(\varepsilon_{it}, \varepsilon_{js}) = 0$

Despite the homoscedastic nature of error w_t component, it is obvious that there is a correlation between w_t and w_{t-1} (equicorrelation), i.e. : $\text{Corr}(w_{it}, w_{i(t-1)}) = \alpha_u^2 / (\alpha^2 + \alpha_u^2)$.

Then from the 3 models produced the best model was selected using the Chow test and the Hausman Test. If the Chow test and Hausman test produce the same conclusion accepting the best-fixed effect model, then the LM test is not needed. But if the results of the Chow test and Hausman test are not consistent then the LM test is performed to determine the best model. The results of selecting the best model meet the criteria for the classical assumption requirements, then the model is called the best linear estimator (BLUE). This best model will be used for decision making and making economic policy recommendations.

RESULTS AND DISCUSSION

Provide logical, and scientific analysis of findings of the study. Present pieces of evidence to support your analysis by citing the work of earlier researchers or existing theories.

Classical Assumption Test

Econometrics experts suggest several methods to be able to detect whether or not there is a heteroscedasticity issue in an empirical model, they include [Park and Bera \(2009\)](#), [White test \(1980\)](#), [Sumodiningrat \(1994\)](#) and [White \(1980\)](#).

Here is the output of Heteroscedasticity Test results using Park test as shown in the following table:

Tabel 1: Heteroskedastisitas Test by using Park test

Log(Resid ²) is Independent Variable	Coefficient	Log(Resid ²) is Independent Variable	Coefficient
LOG(EDUC)	-0.4471 (1.0203)	LOG(DAU)	-1.3658 (1.2190)
LOG(HEALTH)	0.8193 (1.2952)	LOG(PMA)	-0.0528 (0.3652)
LOG(AGREXP)	-1.1277	LOG(POP)	9.2992

	(1.3142)		(7.6959)
LOG(MAREXP)	1.4796	OPINI	-0.2689
	(1.0957)		(0.3871)

Sources: The data processed

Description: *** = significant 1% ** = significant 5% * = significant 10%

From table 1, it could be concluded that the data used as independent variables are free from heteroscedasticity issues. It can be seen from the fact that no independent variables are significant at α 5 %.

Multicollinearity test aims at testing whether in this regression the correlation is found. When multicollinearity occurs, then the regression coefficient from the independent variables will be insignificant and have high standard error. The less the correlation among independent variables, the better the regression model would be. From the calculation, the correlation coefficient value among variables are not greater than [0.9], hence the data in this research have no multicollinearity issues.

Table 2: Multicollinearity Testing

	GDRP	EDUC	HEALTH	AGREXP	MAREXP	PMA	POP	DAU
GDRP	1,0000	0,3512	0,6435	0,4215	0,2001	0,3807	0,8663	0,1511
EDUC	0,3512	1,0000	0,6601	0,7669	0,7517	0,1936	0,1534	-0,050
HEALTH	0,6435	0,6601	1,0000	0,7251	0,5662	0,2802	0,5604	0,2898
AGREXP	0,4215	0,7669	0,7251	1,0000	0,9065	0,1243	0,3321	0,3082
MAREXP	0,2001	0,7517	0,5662	0,9065	1,0000	0,0065	0,1351	0,3066
PMA	0,3807	0,1936	0,2802	0,1243	0,0065	1,0000	0,1396	0,0201
POP	0,8663	0,1534	0,5604	0,3321	0,1351	0,1396	1,0000	0,3920
DAU	0,1511	-0,050	0,2898	0,3082	0,3066	0,0201	0,3920	1,0000

Sources: The data processed

Best Model Analysis

In data panel model analysis, there are three approaches used, namely ordinary/pooled least square approach, fixed effect approach, and random effect approach. The results of the regression could be seen in table 3. The statistical tests used to determine whether a random effect model or fixed effect model should be used in making panel data regression are the Hausman test and the Chow test. Based on the Hausman Test table (Table 3), the random cross-sectional probability value is 0.0001 which is less than Alpha 0.05, and thus the null hypothesis is rejected. Therefore, according to the Hausman test, the best model to be used is the model using the Fixed Effect method. Based on the Chow Test table (Table 3), the Cross-Section F probability value is 0.00000, which is less than Alpha 0.05, and therefore the null hypothesis is rejected. The best model that will be used is the model that uses the Fixed effect method.

Table 3: The Result of the Regression Model

Log(GDRP) is Dependent Var.	Panel Model		
	None	Random	Fixed
LOG(EDUC)	0.2863*** (0.0310)	0.0251 (0.0206)	-0.0016 (0.0126)
LOG(HEALTH)	-0.1066*** (0.0394)	0.0457** (0.0266)	0.0391*** (0.0146)
LOG(MAREXP)	0.0187 (0.0466)	0.0993*** (0.0226)	0.0918*** (0.0172)
LOG(AGREXP)	0.1874 (0.0599)***	0.0760*** (0.0263)	0.0845*** (0.0119)
LOG(DAU)	-0.2935*** (0.0279)	-0.0244 (0.0236)	0.0648*** (0.0265)
LOG(PMA)	0.1413*** (0.0112)	0.0093 (0.0074)	0.0017 (0.0039)

LOG(POP)	0.8608*** (0.0266)	0.8874*** (0.0877)	0.4176*** (0.102024)
OPINI	0.0112 (0.0159)	-0.0206*** (0.0078)	-0.01105*** (0.0056)
C	1.536176*** (0.4903)	1.1908 (1.2501)	7.5515 (1.4149)
R-squared	0.9814	0.8086	0.9995
F-statistic	648.5879	51.7689	7653.52
Hausman Test		32.5978***	
Chow Test			327.7136***

Sources: The data processed

Description: ***= significant 1% ** = significant 5% * = significant 10%

Based on the test selection of the best regression model that will be used is the Fixed Effect Model. The estimation results of the fixed effect model regression (Table 4) with observed objects numbered 18 provinces in the 2010-2015 period.

From the estimation results in table 4 above, in reference to the 6 fixed effect models and at a confidence rate of 95 percent, almost all variables have a significant influence on economic growth. The significantly influencing variables are characterized by the prob t-statistic which is less than 0,05. Meanwhile, the variables education budget allocation and foreign investment have no influence on economic growth. And the model could explain almost 99 percent variances occurring in the variable GDRB (R-squared).

The Government Expenditure for Education has no influence on regional economic growth. It means that education allocation cannot increase education quality and quantity; rather it merely increases teachers' welfare. This means that increased education fund allocation is mostly used for teacher certification and school operation. The false ideas have been implemented in several provinces in Indonesia which state that the creation and expansion of opportunity to obtain quantitatively fast education is the main key to bringing about successful national development. They believe that the more educational opportunities available, the faster the development process would be. Departing from this idea, regions take up the race to expand their education within a relatively short time, making the field more sensitive politically. Every time an election for regional leaders is held, free education has always been a common topic. The rapid expansion of educational opportunity has consumed substantial costs, yet the society surprisingly experiences in average development inequality.

Table 4: The Result of the Fixed Effect Model

Variable	Fixed Effect Models					
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
LOG(EDUC)	-0.0100 (0.0119)	0.00022 (0.0120)	-0.0022 (0.0123)	-0.0080 (0.0122)	-0.0069 (0.0128)	-0.0017 (0.0126)
LOG(HEALTH)	0.0471*** (0.01192)	0.0359** (0.0132)	0.0398*** (0.0142)	0.0449*** (0.0123)	0.048*** (0.0149)	0.0392*** (0.0146)
LOG(MAREXP)	0.0668*** (0.01219)	0.0737*** (0.0111)	0.087*** (0.0114)	0.0626*** (0.0127)	0.0943 (0.0117)	0.0918*** (0.0172)
LOG(AGREXP)	0.0992*** (0.0179)	0.0849*** (0.0174)	0.0903*** (0.0170)	0.0997*** (0.0178)	0.1115*** (0.0155)	0.0846*** (0.0119)
LOG(DAU)	0.1333*** (0.02598)	0.1013*** (0.0255)	0.0660*** (0.0260)	0.1325*** (0.0263)		0.0648*** (0.0265)
LOG(PMA)				0.0036 (0.0044)	0.00346 (0.0041)	0.0017 (0.0039)
LOG(POP)		0.3569*** (0.1121)	0.4176*** (0.1015)		0.5069*** (0.0973)	0.4176*** (0.102)
OPINI			-0.011*** (0.006)		-0.016*** (0.005)	-0.011*** (0.0056)

C	13.043*** (0.2283)	8.184*** (1.5489)	7.5506*** (1.4097)	13.045*** (0.2296)	6.6843*** (1.4005)	7.5516*** (1.4149)
R-squared	0.999606	0.999589	0.999576	0.999625	0.999538	0.999577
F-statistic	9805.987	8886.889	8062.845	9747.273	7395.315	7653.52

Sources: The data processed

Description: ***= significant 1% ** = significant 5% * = significant 10%

Indonesia is encountered with two main alternatives for their policies in the effort of dealing with education problems, i.e. firstly; expanding formal education system quantitatively in the form minor modifications to the curriculum, teaching methods, and evaluation without amending the education policies which take too many costs and institutional structures of its manpower market. Secondly; they try to reform their entire education system, followed with changes to the demand and supply for schooling opportunities and direct back the curriculum for it to suit the actual national needs. The evidence shows that the first alternative would only worsen such problems as unemployment, poverty, income distribution inequality, and village economic stagnancy.

The results of this research confirm the studies conducted by [Olabisi \(2012\)](#), [Gisore et al. \(2014\)](#) and [Al-Shatti \(2014\)](#) which suggest that education expenditure has no correlation with economic growth.

The government expenditure for health has a positive influence on regional economic growth as proven by the fact that increased health expenditure will result in decreased infant and maternal mortality rate, hence capable of driving economic growth. In addition, the healthy Indonesia program could improve productivity, which in turn will drive economic growth.

Government spending on marine and fishery allocations has a positive influence on regional economic growth. This is because the vast majority of Indonesia is marine, leading to optimal utilization of marine resources and fisheries when government spending is allocated to it. Most ports in Indonesia can not be used for leaning large ships and loading and unloading of fish catches in the sea, and directly exported to other countries, this has an impact on the provision of fish catches in the local market and the low contribution of regional economic growth from the yield fish catch. To overcome this, the government issued a regulation through the Minister of Maritime Affairs and Fisheries Regulation No. 58/Permen/KP/2014 on the discipline of civil state apparatus officials in the Ministry of Marine Affairs and Fisheries in the implementation of the policy of temporary suspension of business permit of capture fishery, sea cargo transfer and the use of the captain foreign ship. The impact of this policy has increased economic growth through the contribution of marine and fisheries, as well as stabilizing fish prices in the domestic market.

The development expenditure for agriculture has an influence on economic growth in 18 provinces in Indonesia. The objective of agriculture development in Indonesia is to improve the village community level of life by increasing their income, total production, and small farmer productivity. Therefore, the first thing the government should do is to identify the main sources of agriculture advancement and the basic condition which possibly influences the achievement of successful development in the agriculture sector. All these important elements clearly relate to one another, making a highly complex relation. The development of agriculture and the village sector could only succeed in bringing about benefits for a lot of people when the government together with all farmers do something harmoniously, particularly regarding the provision and improvement of entitlement or utilization of lands to each farmer. When the land reform program could actually be implemented and applied effectively by the government, then a robust foundation for output and life standard improvement for village farmers would manifest.

The general allocation fund has a positive influence on regional economic growth. The general allocation fund (DAU) is a number of funds allocated for each Autonomous Region (province) in Indonesia every year as a development fund. DAU is one of the expenditure components in the State Budget, and it is one of the revenue components in the Regional Government Budget. DAU aims to be a financial power distribution among regions to fund the autonomous regional needs in the effort of implementing decentralization. DAU is used by regional governments in promoting economic growth, particularly to supplement the fund in regional development.

Foreign investment has no relation to regional economic growth. It can be seen in the fact that so far foreign investments in Indonesia are mainly dealing with natural resources exploration, and those regions relying merely on their natural resources experience low average economic growth. This has made the government pass policies to increase the value-added of their natural products in order to enable the maximally optimized investment role. This research confirms [Louzi and Abadi \(2011\)](#) who suggest that investment has no influence on economic growth.

Criticisms have been widely addressed to foreign investments, particularly regarding its impact on development in Indonesia which is highly unevenly distributed and in many cases foreign investment company activities strengthen the dualistic economic structure and worsen revenue distribution. They will transfer their resources from its utilization to produce food materials into its utilization to produce sophisticated goods and satisfy only certain groups and tend to worsen the inequality of economic opportunity between rural and urban areas with many of them operating in urban areas and accelerate the urbanization flow from villages to cities. Foreign investment companies tend to produce those goods

many find unsuitable for them (consumed only by certain groups), thus promoting extravagant consumption patterns through advertisement and the goods they produce tend to use capital intensive technology. Therefore, domestic resources tend to be allocated to those socially non-beneficial projects.

Population growth could promote economic growth in many provinces in Indonesia. Traditionally, population growth serves as a positive factor in reference to economic growth. A large population is a potential market to be sources of demand for various goods and services which then sets various economic activities in motion and finally creates a scale of economy. Results from this research confirm the studies performed by (Sylwester, 2000) and (Gisore et al., 2014).

The policy to decelerate population growth rate is addressed in a long run to reduce absolute poverty, minimize income distribution unevenness, expand the opportunity to pursue education particularly for women, increase employment opportunities, increase health facilities and infrastructures and create social services in a more evenly distributed manner.

The opinion of the Supreme Audit Board on Regional Government Financial Reports has a negative relationship with regional economic growth. So far, local governments have not optimized performance-based budgets. What has been done is only limited to the absorption of the budget, and this has not yet impacted the results of each program implemented. This study confirms Mauro (1995), which states that corruption can encourage government employees to work harder. Those who were previously not so motivated to complete their routine will be directed to work hard thanks to incentives for the services they provide. To avoid corruption, it is necessary to optimize the Corruption Eradication Commission. After the formation of the Corruption Eradication Commission, there is an increasing trend in many cases of corruption brought to justice and the imposition of severe penalties for corruptors, which involves many high-ranking state officials.

CONCLUSION

From the results of analysis of the influence of government expenditure composition (education, health, marine and fisheries, agriculture, and general allocation fund), it could be interpreted: Firstly, that from all government expenditure components, the one for marine and fisheries has the greatest contribution in promoting economic growth in Indonesia, and this just suits the shape of its territory with 2/3 of it consisting of waters. Secondly, the government expenditure component for agriculture gives the second greatest contribution after expenditure for marine and fisheries. This really supports the fact that 35 percent of employment absorption in Indonesia is in the agriculture sector, thus, the agriculture development priority or “back to village” program the government has implemented has been appropriate.

Government spending on education has no effect on regional economic growth in the short term. Almost all developing countries have quality and quantity problems of human resources caused by the low quality of education. This is indicated by the existence of low literacy rates, low educational equality, and relatively inadequate standard of the education process. The mandate of the 1945 Constitution in Indonesia requires long-term education to be the most effective way to get out of the misery of the economic conditions so that the central and local governments focus on improving the quality of schools and commit to raising each child to 9-year basic education by 2015 and 12 years by 2020. The relationship of human resource investment (education) with economic growth is two links. However, growth will not grow well even if improvements in the quality of education or quality of human resources are undertaken, if there is no clear program on improving the quality of education and a clear economic program.

Foreign investment has no influence on economic growth. Foreign investment companies tend to produce products consumed only by certain groups, thus promoting extravagant consumption patterns through advertisement and the goods they produce tend to use capital intensive technology.

The Supreme Audit Agency’s opinion on the regional government’s financial statements has a negative relationship on regional economic growth. It means that in Indonesia all matters related to public interests should be settled using money and this motivates people working in the field to work harder. To rectify the condition, the regional government role should be optimized through monitoring and evaluation of expenditure budget, i.e. that the money coming from Regional Government Budget is people’s money, thus, it should be used as optimal as possible for the greater good of the people. So far, the regional government has not optimized a performance-based budget. What has been implemented is limited merely to budget absorption, and this has not had any impact yet on the outcome of each program being implemented. In addition to optimization through monitoring and evaluation of a performance-based budget, the government needs to make everything regarding their financial policy to be transparent. Transparency allows the society to participate in giving positive contributions to the government policy in budget and to fund development programs, as well as to settle various issues in the government. Transparency ensures the rights for any information which could help prevent it from being misused by individual or groups for their personal interest, for their political or economic benefits.

LIMITATION

The use of a static panel model has limitations, namely the influence of a dependent variable on rare independent variables that are instantaneous. Very often the dependent variable reacts to the independent variable with a time interval. The time interval is called lag (Gujarati, 2003). The existence of the lag cannot be ignored. Regression analysis is done by paying attention to the lag. In other words, realized in a form of dynamic models. The formation of dynamic models is an important process because it is related to time changes. Dynamic models are needed because variations in endogenous

variables in the applicable period are not only determined by variations in exogenous variables in the same period. Endogenous variables need time lag to respond to exogenous variables. Dynamic models are able to make static theories dynamic by explicitly calculating the time element.

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The Role of Local Government Expenditure on Economic Growth: A Review of Panel Data in Indonesia

by Agus Tri Basuki, Yunastiti Purwaningsih, Mulyanto, Am Soesilo

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THE ROLE OF LOCAL GOVERNMENT EXPENDITURE ON ECONOMIC GROWTH: A REVIEW OF PANEL DATA IN INDONESIA

Agus Tri Basuki^{1*}, Yunastiti Purwaningsih², Mulyanto³, A. M. Susilo⁴

¹PhD Student on Economics and Business Faculty, Universitas Sebelas Maret Surakarta, Indonesia and Lecturer on Economics and Business Faculty Universitas Muhammadiyah Yogyakarta, Indonesia, ^{2,3,4}Lecturer on Economics and Business Faculty Universitas Sebelas Maret Surakarta, Indonesia.
Email: *agustribasuki2020@gmail.com

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Abstract

Purpose of the study: This research aims to empirically prove the composition of local government expenditure (education, health, marine and fisheries, agriculture, and general allocation fund) on economic growth in 18 provinces in Indonesia from 2010 to 2015.

Methodology: The model used in this research is panel data regression. The use of panel data in regression can provide more information that cannot be provided by cross-section or time-series data, and provides the best solution for inferring dynamic changes than cross-section data.

Main Findings: The findings in this study are foreign investment has no influence on economic growth. Fiscal policies that are carried out are not effective in encouraging economic growth, and the use of the General Allocation Fund is not on target.

Applications of this study: Foreign investment must be a trigger for the local economy and the national economy by means of foreign investment in Indonesia which is prioritized using raw materials and local labour, so that dependence on imported raw materials can be minimized. To overcome leakage of development budget must implement a budgeting system that is oriented towards organizational output and is very closely related to the organization's vision, mission, and strategic plan. The use of general allocation funds needs to be monitored by certain institutions and prioritizing public interest.

Keywords: Economic Growth, Data Panel, Government Expenditure, Fiscal Policy.

JEL: H3 O1 C3

INTRODUCTION

In the effort of achieving its national goal, Indonesia has to encounter three main problems, they are: (1) declining state dignity; (2) weakening national economic constituents; and (3) dispersing intolerance and national identity crisis. The weakening national economic constituents could be seen in unsettled poverty issues, social inequality, inter-region inequality, environmental damage resulting from excessive natural resources exploitation, and dependence in such fields as foods, energy, finance, and technology. The state does not seem to be capable of utilizing the huge natural resources this country has for its people's welfare. The expectation for those national economic constituents to strengthen is getting far away when the state has no power in providing security on proper health and quality of life for its people, fails in minimizing national income inequality and unevenness resulting from dependence on foreign debts and food provision relying on import, and fails in dealing with energy crisis issue thanks to the global production equipment and corporate capital as well as the decreasing national oil reserves it owns.

Government spending can affect economic activity, not only creating a development process but also functions as a component of aggregate demand that can increase products. Aruwa (2010) research results find that there is a long-term correlation between government expenditure and national revenue, and p.67 c expenditure and revenue for Nigeria's case. Meanwhile, Hendarmin (2012) tests the influence of government capital expenditure on economic growth, resulting in its finding that there is a positive, yet insignificant correlation between them.

The government's seriousness in developing their regions is measured from the existence of a governmental system known as Regional Autonomy. To support this, the government issues Law Number 22 of 1999 concerning Regional Government which is then amended into Law No. 32 of 2004 and Law Number 25 of 1999 concerning Revenue Sharing of Central and Regional Governments which is then amended further into Law Number 33 of 2004.

The law serves as a basis for any region to develop their region independently, relying more on the ability and potential the said region owns. This law also provides the regional government with a greater authority (local discretion) to design various development programs that suits what the local society wants (local needs).

Indonesia is a developing country. Most of the population's livelihood depends mainly on primary production, namely the agricultural sector and the mining sector. Increasing the population and labor force create difficulties in the agricultural sector. This difficulty is caused because agricultural land is limited and the agricultural system is still traditional, giving rise to underemployment in the agricultural sector. Population development can be a factor driving economic growth if



population growth is followed by increased education and increased employment in the industrial sector, thus making the workforce that has high competitiveness and has an impact on increasing economic growth.

Foreign investment as a driver of economic growth comes from traditional neoclassical opinion. According to this analysis foreign investment is considered to be something that can fill the gap between savings raised from within the country, foreign exchange reserves, government revenue and the number of funds needed to achieve development goals (Todaro and Stephen, 2015). If the country concerned can fill the gap with foreign financial sources, the country will be able to achieve its growth targets well, thus foreign investment has a role in contributing to the economic growth of a country.

The issue of slow economic development is also influenced by state officials who have the power to use the corrupt state budget. Corruption is generally more a negative impact on the national economy, corruption will reduce economic growth. However, in the view of microeconomics, the act of corruption can actually increase the level of efficiency and support its business. However, while the opinion of economists there still debates about the effects of corruption on economic growth.

This study aims to analyze the influence of local government spending on education, health, agriculture, maritime affairs, general allocation funds, population and foreign investment, and the opinion of the Supreme Audit Board (BPK) in promoting economic growth.

LITERATURE REVIEW

Economic growth relates tightly to the process of goods and services production increase process in society's economic activities. It is safe to say that economic growth deals with single-dimension development and it are measured from the increase in production output and revenue. In economic growth, it has been common to review the production processes which involve a number of product types using certain means of production (Djojohadikusumo, 1994). In this relationship, the quantitative sharing relationship between means of production in one hand and the entire production outputs on the other is shown. In one or other way, it could be expressed in a mathematical formal framework. Models regarding economic growth need to be tested using empiric-quantitative measurement.

The development has a greater meaning to it than economic growth, while an increase in production is definitely one of the main characteristics in the development process. In addition to a quantitative production increase, development processes include such changes to production components, productive resources utilization pattern (allocation) among economic activity sectors, property, and revenue distribution pattern among economic player groups, and to the institutional framework in the social life thoroughly.

A highly important matter in development processes is the increasingly widening opportunities for employment of productive nature (productive employment). Economic development ought to bring about active participation in productive activities for all members of society desiring to play some role in the economic process. Productive economic activities result in numerous positive impacts, such as increasing real income for most members of the population. It could in turn qualitatively and quantitatively increase their consumer purchasing power.

According to Adam Smith, economic development is a mixed process of population growth and technology advancement (Suryana, 2000). Meanwhile, Todaro (2000) defines development as a multi-dimensional process involving major changes in social structure, community attitudes, national institutions and accelerating economic growth, reducing inequality and eliminating absolute poverty. Economic development and strong political stability without significant changes in the quality of life of the people is a wrong development. High growth performance without community participation is clearly economic growth without development (Todaro and Stephen, 2015).

According to Rostow (1962), economic development or transformation of traditional societies into modern societies is a multi-dimensional process. Economic development is related to the process that causes it; changes in the orientation of economic organizations, changes in society, changes in investment methods, changes in the way people determine the status of individuals which are then based on their ability to do their jobs, and shifts in people's trust.

The definition of economic development according to Simon Kuznets (Suryana (2000)) is a long-term increase in a state's ability to provide increasingly more varied economic goods to its people. This ability grows along with their technological advancement and institutional and ideological adjustments they need. This definition has 3 (three) components: firstly, a country's economic growth could be seen from the supply of the continuously increasing goods; secondly, advanced technology is a factor in economic growth which determines the degree of ability growth in providing various goods to the people; and thirdly, the wide and efficient use of technology requires an adjustment to institutional and ideological aspects so that the innovation created by human science could be utilized appropriately.

Boediono (1999) defines economic growth as a process of output increase in the long term. This definition includes three aspects, namely process, output per capita, and long term. According to Sadono (2006), economic growth and economic development have different definitions, i.e. economic growth is a process of the continuous increase in output per capita in the long term. This economic growth constitutes one of the successful development indicators.

Arsyad. (2014) defines multidimensional economic development that covers various aspects of people's lives, not just one aspect. Economic development can be defined as any activity carried out by a country in order to develop economic



activities and the standard of living of its people. Given these limitations, economic development, in general, can be defined as a process that causes an increase in real income per capita of a country's population in the long run accompanied by an improvement in the development system.

Based on the expert definitions above, it could be concluded that Economic Development is defined as a process that causes the population's output per capita of a society to increase in the long run. From this definition, three elements can be drawn; (1) economic development as a process means continuous changes within which elements of strength have been contained for new investments; (2) an effort of increasing output per capita; (3) increased output per capita should last in a long run.

PREVIOUS STUDIES

Research conducted by [Gisore, et al., \(2014\)](#), [Mamingi and Perch \(2013\)](#), [Ali, S., Ali, A., and Amin, A. \(2013\)](#) and [Dao \(2012\)](#), concluded that population growth has a positive influence on economic growth. Research by [Headey and Hodge \(2009\)](#) and [Sylwester \(2000\)](#) concluded that population growth impedes economic growth. While [Rustan's research, A. \(2013\)](#) concluded that population growth has no influence on economic growth.

Fiscal policy is an economic policy taken by the government in managing state finances (through spending on education, spending on health, spending on agriculture, etc.) to overcome economic conditions leading to improvement. Fiscal policy is rooted in state revenue from tax and non-tax and is allocated in the form of government expenditure as stated in its Budget.

Research on the effect of government spending on education on economic growth was conducted by [Mekdad, et al., \(2014\)](#), [Dada \(2013\)](#), [Idrees and Siddiqi \(2013\)](#) concluded that government spending on education has a positive influence on economic growth. Research conducted by [Al-Shafti \(2014\)](#) and [Sylwester \(2000\)](#) concluded that government spending on education has no influence on economic growth. [Sylwester's research \(2000\)](#) concludes that government spending on education has no influence on economic growth.

Research on the relationship between government spending on health on economic growth was conducted by [Kurt \(2015\)](#), [Al-Shafti \(2014\)](#), [Dada \(2013\)](#), [Muthui, Kosimbei, Maingi, and Muku \(2013\)](#), [Olabisi and Oloni \(2012\)](#). They concluded that government spending on health has a positive influence on economic development.

The role of agriculture in economic development is only seen as a supporting element. Development is defined as a structural transformation from an economy based on agricultural activities to an economy of goods and services industries. The role of government is needed especially in encouraging activities in agriculture through the provision of agricultural facilities and infrastructure (such as irrigation, fertilizer, and seeds). Results [Oyinbo, et al., \(2013\)](#) conclude that government spending in agriculture has no influence on economic growth in the long run. Research [Mursidah, et al., \(2017\)](#), [Shuaib, et al., \(2015\)](#), [Cinma, and Kemisola \(2012\)](#) and [Armas, et al., \(2012\)](#) concluded that government spending on agricultural allocation has a positive influence on economic growth.

Research on the relationship between government spending on maritime economic growth was conducted by [Huda et al. \(2015\)](#), [Novianti, et al. \(2014\)](#) and [Agustine, et al. \(2013\)](#). They concluded that government spending allocated for the development of marine infrastructure could drive economic growth.

Research on the relationship between general allocation funds for economic growth conducted by [Nurhemi and Suryani \(2015\)](#), [Tajuddin, et al., \(2017\)](#) [Ahma \(2011\)](#) and [Manik, et al., \(2010\)](#) concluded that general allocation of funds in several provinces in Indonesia have a positive influence on economic growth. The [Muti'ah Study \(2017\)](#) concludes that the balanced fund in the form of a General Allocation Fund has no influence on economic growth. While [As \(2014\)](#) in South Sumatra, the results of his research concluded that general allocation funds have a negative influence on economic growth.

Research on the effect of foreign investment on economic growth conducted by [Agrawal, G \(2015\)](#), [Melnyk, Kubatko, and Pysarenko \(2014\)](#), [Nawatmi \(2013\)](#) and [Mehana \(2011\)](#) concluded that foreign investment has a positive influence on economic growth through its role in fill the lack of resources between targeted investment and mobilization of domestic savings. Research [Kolawole \(2015\)](#), [Abala, D. O. \(2014\)](#), and [Louzi & Abadi \(2011\)](#) concluded that foreign investment has no influence on economic growth.

Research on the effect of corruption on economic growth was conducted by [Grabova, P., \(2014\)](#), [Nawatmi \(2013\)](#) and [Ahmad, et al., \(2012\)](#). The results of the study concluded that the level of corruption has a negative influence on economic growth. While [Mauro \(1995\)](#) found that there is a negative influence.

METHODOLOGY

Model Specification

Based on available data, a regression model suitable for this study is panel data regression. The function of GRDP is as follows:

$$\text{LOG (GDRP)} = \beta_0 + \beta_1 \text{LOG(EDUC)} + \beta_2 * \text{LOG(HEALTH)} + \beta_3 * \text{LOG(AGREXP)} + \beta_4 * \text{LOG(MAREXP)} + \beta_5 * \text{LOG(DAU)} + \beta_6 * \text{LOG(PMA)} + \beta_7 * \text{LOG(POP)} + \beta_8 * \text{OPN} + \varepsilon_t \dots\dots\dots 1$$

Description :

GDRP is defined as regional economic growth, EDUC is defined as local government expenditure for education, HEALTH is defined as local government expenditure for health, AGREXP is defined as local government expenditure for agriculture, MAREXP is defined as local government expenditure for marine and fisheries, DAU is defined as general allocation fund from central government to regional governments, PMA is defined as foreign investment, POP is defined as total population in respective region and OPN is defined as Supreme Audit Agency's appraisal of Regional Government's Financial Statements.

Stages of Panel Data Regression

The stages of compiling the panel data regression analysis can be seen in Figure 1.

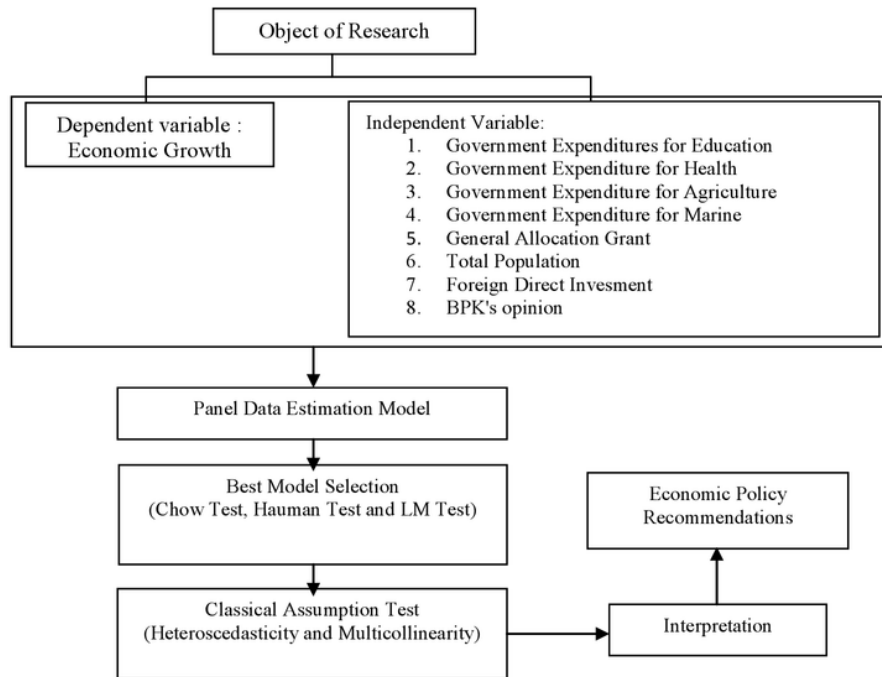


Figure 1: Stages of Panel Data Regression Analysis

Source: Gujarati, 2003

The data that has been obtained is regressed using the regression model in equation 1 and produces a common equation model, fixed effects and random effects. The regression model estimation method using the data panel could be performed through three approaches, such as:

1. Common Effect Model

The *common effect model* is the simplest data panel approach. This model does not consider individual and time dimensions, thus it is assumed that the behaviors among individuals are the same within various periods of time. This model only combines *time series* and *cross-section data* in the form of a *pool*, estimating it using *pooled least square* (Gujarati, 2003).

2. Fixed Effect Model

The *Fixed effects model* assumes that there are different effects among individuals. This difference could be accommodated through the difference in their intercepts. Therefore, in the *fixed-effects* model, every model is an unknown parameter and it will be estimated using *dummy* variable technique which could be written as follows (Gujarati, 2003):



$$\text{Log(PDRB}_{it}) = (\alpha + i\alpha_i) + \beta_1 \text{Log(EDUC}_{it}) + \beta_2 \text{Log(HEALTH}_{it}) + \beta_3 \text{Log(AGREXP}_{it}) + \beta_4 \text{Log(MAREXP}_{it}) + \beta_5 \text{Log(DAU}_{it}) + \beta_6 \text{Log(PMA}_{it}) + \beta_7 \text{Log(POP}_{it}) + \beta_8 \text{OPN}_{it} + \varepsilon_{it} \dots\dots\dots 2$$

$$\begin{bmatrix} \text{GDRP}_1 \\ \text{GDRP}_2 \\ \dots\dots\dots \\ \text{GDRP}_n \end{bmatrix} = \begin{bmatrix} \alpha \\ \alpha \\ \dots \\ \alpha \end{bmatrix} + \begin{bmatrix} i & 0 & 0 \\ 0 & i & 0 \\ \dots & \dots & \dots \\ 0 & 0 & i \end{bmatrix} \begin{bmatrix} \alpha_1 \\ \alpha_2 \\ \dots \\ \alpha_n \end{bmatrix} + \begin{bmatrix} \text{EDUC}_{11} & \text{EDUC}_{21} & \text{EDUC}_{p1} \\ \text{HEALTH}_{12} & \text{HEALTH}_{22} & \text{HEALTH}_{p2} \\ \dots & \dots & \dots \\ \text{OPN}_{1n} & \text{OPN}_{2n} & \text{OPN}_{pn} \end{bmatrix} \begin{bmatrix} \beta_1 \\ \beta_2 \\ \dots \\ \beta_n \end{bmatrix} + \begin{bmatrix} \varepsilon_1 \\ \varepsilon_2 \\ \dots \\ \varepsilon_n \end{bmatrix}$$

Such a technique above is called *Least Square Dummy Variable* (LSDV). In addition, to be applied to each individual's effects, this LSDV could also accommodate the time effect which is of systemic nature. This is possible by adding the *dummy* variable time in the model.

3. Random Effect Model

Unlike the *fixed effect model*, the specific effect of each individual is treated as a part of the *error* component of random nature and not correlated with the observed explanatory variables, and such a model is called the *random effects model* (REM). This model is frequently called an *error component model* (ECM). Hence, the equation of the *random effects* model could be written as follows:

$$\text{Log(PDRB}_{it}) = \beta_0 + \beta_1 \text{Log(EDUC}_{it}) + \beta_2 \text{Log(HEALTH}_{it}) + \beta_3 \text{Log(AGREXP}_{it}) + \beta_4 \text{Log(MAREXP}_{it}) + \beta_5 \text{Log(DAU}_{it}) + \beta_6 \text{Log(PMA}_{it}) + \beta_7 \text{Log(POP}_{it}) + \beta_8 \text{OPN}_{it} + W_{it} \dots\dots\dots 3$$

Description :

i = Aceh, Sumut,....., Papua

t = 2010, 2011, 2012, 2013, 2014, 2015

$$w_{it} = \varepsilon_{it} + u_i ; E(w_{it}) = 0; E(w_{it}^2) = \alpha^2 + \alpha_u^2;$$

$$E(w_{it}, w_{jt+1}) = 0; i \neq j; E(u_i, \varepsilon_{it}) = 0;$$

$$E(\varepsilon_{it}, \varepsilon_{is}) = E(\varepsilon_{it}, \varepsilon_{jt}) = E(\varepsilon_{it}, \varepsilon_{js}) = 0$$

Despite the homoscedastic nature of error w_{it} component, it is obvious that there is a correlation between w_{it} and w_{it-1} (equicorrelation), i.e. : $\text{Corr}(w_{it}, w_{it-1}) = \alpha_u^2 / (\alpha^2 + \alpha_u^2)$.

Then from the 3 models produced the best model was selected using the *low test* and the *Hausman Test*. If the *Chow test* and *Hausman test* produce the same conclusion accepting the best-fixed effect model, then the *LM test* is not needed. But if the results of the *Chow test* and *Hausman test* are not consistent then the *LM test* is performed to determine the best model. The results of selecting the best model meet the criteria for the classical assumption requirements, then the model is called the best linear estimator (BLUE). This best model will be used for decision making and making economic policy recommendations.

RESULTS AND DISCUSSION

Provide logical, and scientific analysis of findings of the study. Present pieces of evidence to support your analysis by citing the work of earlier researchers or existing theories.

Classical Assumption Test

Econometrics experts suggest several methods to be able to detect whether or not there is a heteroscedasticity issue in an empirical model, they include *Park and Bera (2009)*, *White test (1980)*, *Sumodiningrat (1994)* and *White (1980)*.

Here is the output of Heteroscedasticity Test results using *Park test* as shown in the following table:

Table 1: Heteroskedastisitas Test by using *Park test*

Log(Resid ²) is Independent Variable	Coefficient	Log(Resid ²) is Independent Variable	Coefficient
LOG(EDUC)	-0.4471 (1.0203)	LOG(DAU)	-1.3658 (1.2190)
LOG(HEALTH)	0.8193 (1.2952)	LOG(PMA)	-0.0528 (0.3652)
LOG(AGREXP)	-1.1277	LOG(POP)	9.2992



	(1.3142)		(7.6959)
LOG(MAREXP)	1.4796	OPINI	-0.2689
	(1.0957)		(0.3871)

Sources: The data processed

Description: *** = significant 1% ** = significant 5% * = significant 10%

From table 1, it could be concluded that the data used as independent variables are free from heteroscedasticity issues. It can be seen from the fact that no independent variables are significant at α 5 %.

Multicollinearity test aims at testing whether in this regression the correlation is found. When multicollinearity occurs, then the regression coefficient from the independent variables will be insignificant and have high standard error. The less the correlation among independent variables, the better the regression model would be. From the calculation, the correlation coefficient value among variables are not greater than [0.9], hence the data in this research have no multicollinearity issues.

Table 2: Multicollinearity Testing

	GDRP	EDUC	HEALTH	AGREXP	MAREXP	PMA	POP	DAU
GDRP	1,0000	0,3512	0,6435	0,4215	0,2001	0,3807	0,8663	0,1511
EDUC	0,3512	1,0000	0,6601	0,7669	0,7517	0,1936	0,1534	-0,050
HEALTH	0,6435	0,6601	1,0000	0,7251	0,5662	0,2802	0,5604	0,2898
AGREXP	0,4215	0,7669	0,7251	1,0000	0,9065	0,1243	0,3321	0,3082
MAREXP	0,2001	0,7517	0,5662	0,9065	1,0000	0,0065	0,1351	0,3066
PMA	0,3807	0,1936	0,2802	0,1243	0,0065	1,0000	0,1396	0,0201
POP	0,8663	0,1534	0,5604	0,3321	0,1351	0,1396	1,0000	0,3920
DAU	0,1511	-0,050	0,2898	0,3082	0,3066	0,0201	0,3920	1,0000

Sources: The data processed

Best Model Analysis

In data panel model analysis, there are three approaches used, namely ordinary/pooled least square approach, fixed effect approach, and random effect model. The results of the regression could be seen in table 8. The statistical tests used to determine whether a random effect model or fixed effect model should be used in making panel data regression are the Hausman test and the Chow test. Based on the Hausman Test table (Table 3), the random cross-sectional probability value is 0.0001 which is less than Alpha 0.05, and thus the null hypothesis is rejected. Therefore, according to the Hausman test, the best model to be used is the model using the Fixed Effect method. Based on the Chow Test table (Table 3), the Cross-Section F probability value is 0.00000, which is less than Alpha 0.05, and therefore the null hypothesis is rejected. The best model that will be used is the model that uses the Fixed effect method.

Table 3: The Result of the Regression Model

Log(GDRP) is Dependent Var.	Panel Model		
	None	Random	Fixed
LOG(EDUC)	0.2863*** (0.0310)	0.0251 (0.0206)	-0.0016 (0.0126)
LOG(HEALTH)	-0.1066*** (0.0394)	0.0457** (0.0266)	0.0391*** (0.0146)
LOG(MAREXP)	0.0187 (0.0466)	0.0993*** (0.0226)	0.0918*** (0.0172)
LOG(AGREXP)	0.1874 (0.0599)***	0.0760*** (0.0263)	0.0845*** (0.0119)
LOG(DAU)	-0.2935*** (0.0279)	-0.0244 (0.0236)	0.0648*** (0.0265)
LOG(PMA)	0.1413*** (0.0112)	0.0093 (0.0074)	0.0017 (0.0039)



LOG(POP)	0.8608*** (0.0266)	0.8874*** (0.0877)	0.4176*** (0.102024)
OPINI	0.0112 (0.0159)	-0.0206*** (0.0078)	-0.01105*** (0.0056)
C	1.536176*** (0.4903)	1.1908 (1.2501)	7.5515 (1.4149)
R-squared	0.9814	0.8086	0.9995
F-statistic	648.5879	51.7689	7653.52
Hausman Test		32.5978***	
Chow Test			327.7136***

Sources: The data processed

Description: ***= significant 1% ** = significant 5% * = significant 10%

Based on the test selection of the best regression model that will be used is the Fixed Effect Model. The estimation results of the fixed effect model regression (Table 4) with observed objects numbered 18 provinces in the 2010-2015 period.

From the estimation results in table 4 above, in reference to the 6 fixed effect models and at a confidence rate of 95 percent, almost all variables have a significant influence on economic growth. The significantly influencing variables are characterized by the prob t-statistic which is less than 0,05. Meanwhile, the variables education budget allocation and foreign investment have no influence on economic growth. And the model could explain almost 99 percent variances occurring in the variable GDRB (R-squared).

The Government Expenditure for Education has no influence on regional economic growth. It means that education allocation cannot increase education quality and quantity; rather it merely increases teachers' welfare. This means that increased education fund allocation is mostly used for teacher certification and school operation. The false ideas have been implemented in several provinces in Indonesia which state that the creation and expansion of opportunity to obtain quantitatively fast education is the main key to bringing about successful national development. They believe that the more educational opportunities available, the faster the development process would be. Departing from this idea, regions take up the race to expand their education within a relatively short time, making the field more sensitive politically. Every time an election for regional leaders is held, free education has always been a common topic. The rapid expansion of educational opportunity has consumed substantial costs, yet the society surprisingly experiences in average development inequality.

Table 4: The Result of the Fixed Effect Model

Variable	Fixed Effect Models					
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
LOG(EDUC)	-0.0100 (0.0119)	0.00022 (0.0120)	-0.0022 (0.0123)	-0.0080 (0.0122)	-0.0069 (0.0128)	-0.0017 (0.0126)
LOG(HEALTH)	0.0471*** (0.01192)	0.0359** (0.0132)	0.0398*** (0.0142)	0.0449*** (0.0123)	0.048*** (0.0149)	0.0392*** (0.0146)
LOG(MAREXP)	0.0668*** (0.01219)	0.0737*** (0.0111)	0.087*** (0.0114)	0.0626*** (0.0127)	0.0943 (0.0117)	0.0918*** (0.0172)
LOG(AGREXP)	0.0992*** (0.0179)	0.0849*** (0.0174)	0.0903*** (0.0170)	0.0997*** (0.0178)	0.1115*** (0.0155)	0.0846*** (0.0119)
LOG(DAU)	0.1333*** (0.02598)	0.1013*** (0.0255)	0.0660*** (0.0260)	0.1325*** (0.0263)		0.0648*** (0.0265)
LOG(PMA)				0.0036 (0.0044)	0.00346 (0.0041)	0.0017 (0.0039)
LOG(POP)		0.3569*** (0.1121)	0.4176*** (0.1015)		0.5069*** (0.0973)	0.4176*** (0.102)
OPINI			-0.011*** (0.006)		-0.016*** (0.005)	-0.011*** (0.0056)



C	13.043*** (0.2283)	8.184*** (1.5489)	7.5506*** (1.4097)	13.045*** (0.2296)	6.6843*** (1.4005)	7.5516*** (1.4149)
R-squared	0.999606	0.999589	0.999576	0.999625	0.999538	0.999577
F-statistic	9805.987	8886.889	8062.845	9747.273	7395.315	7653.52

Sources: The data processed

Description: ***= significant 1% ** = significant 5% * = significant 10%

Indonesia is encountered with two main alternatives for their policies in the effort of dealing with education problems, i.e. firstly; expanding formal education system quantitatively in the form minor modifications to the curriculum, teaching methods, and evaluation without amending the education policies which take too many costs and institutional structures of its manpower market. Secondly; they try to reform their entire education system, followed with changes to the demand and supply for schooling opportunities and direct back the curriculum for it to suit the actual national needs. The evidence shows that the first alternative would only worsen such problems as unemployment, poverty, income distribution inequality, and village economic stagnancy.

The results of this research confirm the studies conducted by [Olabisi \(2012\)](#), [Gisore et al. \(2014\)](#) and [Al-Shatti \(2014\)](#) which suggest that education expenditure has no correlation with economic growth.

The government expenditure for health has a positive influence on regional economic growth as proven by the fact that increased health expenditure will result in decreased infant and maternal mortality rate, hence capable of driving economic growth. In addition, the healthy Indonesia program could improve productivity, which in turn will drive economic growth.

Government spending on marine and fishery allocations has a positive influence on regional economic growth. This is because the vast majority of Indonesia is marine, leading to optimal utilization of marine resources and fisheries when government spending is allocated to it. Most ports in Indonesia can not be used for leaning large ships and loading and unloading of fish catches in the sea, and directly exported to other countries, this has an impact on the provision of fish catches in the local market and the low contribution of regional economic growth from the yield fish catch. To overcome this, the government issued a regulation through the Minister of Maritime Affairs and Fisheries Regulation No. 58/Permen/KP/2014 on the discipline of civil state apparatus officials in the Ministry of Marine Affairs and Fisheries in the implementation of the policy of temporary suspension of business permit of capture fishery, sea cargo transfer and the use of the captain foreign ship. The impact of this policy has increased economic growth through the contribution of marine and fisheries, as well as stabilizing fish prices in the domestic market.

The development expenditure for agriculture has an influence on economic growth in 18 provinces in Indonesia. The objective of agriculture development in Indonesia is to improve the village community level of life by increasing their income, total production, and small farmer productivity. Therefore, the first thing the government should do is to identify the main sources of agriculture advancement and the basic condition which possibly influences the achievement of successful development in the agriculture sector. All these important elements clearly relate to one another, making a highly complex relation. The development of agriculture and the village sector could only succeed in bringing about benefits for a lot of people when the government together with all farmers do something harmoniously, particularly regarding the provision and improvement of entitlement or utilization of lands to each farmer. When the land reform program could actually be implemented and applied effectively by the government, then a robust foundation for output and life standard improvement for village farmers would manifest.

The general allocation fund has a positive influence on regional economic growth. The general allocation fund (DAU) is a number of funds allocated for each Autonomous Region (province) in Indonesia every year as a development fund. DAU is one of the expenditure components in the State Budget, and it is one of the revenue components in the Regional Government Budget. DAU aims to be a financial power distribution among regions to fund the autonomous regional needs in the effort of implementing decentralization. DAU is used by regional governments in promoting economic growth, particularly to supplement the fund in regional development.

Foreign investment has no relation to regional economic growth. It can be seen in the fact that so far foreign investments in Indonesia are mainly dealing with natural resources exploration, and those regions relying merely on their natural resources experience low average economic growth. This has made the government pass policies to increase the value-added of their natural products in order to enable the maximally optimized investment role. This research confirms [Louzi and Abadi \(2011\)](#) who suggest that investment has no influence on economic growth.

Criticisms have been widely addressed to foreign investments, particularly regarding its impact on development in Indonesia which is highly unevenly distributed and in many cases foreign investment company activities strengthen the dualistic economic structure and worsen revenue distribution. They will transfer their resources from its utilization to produce food materials into its utilization to produce sophisticated goods and satisfy only certain groups and tend to worsen the inequality of economic opportunity between rural and urban areas with many of them operating in urban areas and accelerate the urbanization flow from villages to cities. Foreign investment companies tend to produce those goods



many find unsuitable for them (consumed only by certain groups), thus promoting extravagant consumption patterns through advertisement and the goods they produce tend to use capital intensive technology. Therefore, domestic resources tend to be allocated to those socially non-beneficial projects.

Population growth could promote economic growth in many provinces in Indonesia. Traditionally, population growth serves as a positive factor in reference to economic growth. A large population is a potential market to be sources of demand for various goods and services which then sets various economic activities in motion and finally creates a scale of economy. Results from this research confirm the studies performed by (Sylwester, 2000) and (Gisore et al., 2014).

The policy to decelerate population growth rate is addressed in a long run to reduce absolute poverty, minimize income distribution unevenness, expand the opportunity to pursue education particularly for women, increase employment opportunities, increase health facilities and infrastructures and create social services in a more evenly distributed manner.

The opinion of the Supreme Audit Board on Regional Government Financial Reports has a negative relationship with regional economic growth. So far, local governments have not optimized performance-based budgets. What has been done is only limited to the absorption of the budget, and this has not yet impacted the results of each program implemented. This study confirms Mauro (1995), which states that corruption can encourage government employees to work harder. Those who were previously not so motivated to complete their routine will be directed to work hard thanks to incentives for the services they provide. To avoid corruption, it is necessary to optimize the Corruption Eradication Commission. After the formation of the Corruption Eradication Commission, there is an increasing trend in many cases of corruption brought to justice and the imposition of severe penalties for corruptors, which involves many high-ranking state officials.

CONCLUSION

From the results of analysis of the influence of government expenditure composition (education, health, marine and fisheries, agriculture, and general allocation fund), it could be interpreted: Firstly, that from all government expenditure components, the one for marine and fisheries has the greatest contribution in promoting economic growth in Indonesia, and this just suits the shape of its territory with 2/3 of it consisting of waters. Secondly, the government expenditure component for agriculture gives the second greatest contribution after expenditure for marine and fisheries. This really supports the fact that 35 percent of employment absorption in Indonesia is in the agriculture sector, thus, the agriculture development priority or "back to village" program the government has implemented has been appropriate.

Government spending on education has no effect on regional economic growth in the short term. Almost all developing countries have quality and quantity problems of human resources caused by the low quality of education. This is indicated by the existence of low literacy rates, low educational equality, and relatively inadequate standard of the education process. The mandate of the 1945 Constitution in Indonesia requires long-term education to be the most effective way to get out of the misery of the economic conditions so that the central and local governments focus on improving the quality of schools and commit to raising each child to 9-year basic education by 2015 and 12 years by 2020. The relationship of human resource investment (education) with economic growth is two links. However, growth will not grow well even if improvements in the quality of education or quality of human resources are undertaken, if there is no clear program on improving the quality of education and a clear economic program.

Foreign investment has no influence on economic growth. Foreign investment companies tend to produce products consumed only by certain groups, thus promoting extravagant consumption patterns through advertisement and the goods they produce tend to use capital intensive technology.

The Supreme Audit Agency's opinion on the regional government's financial statements has a negative relationship on regional economic growth. It means that in Indonesia all matters related to public interests should be settled using money and this motivates people working in the field to work harder. To rectify the condition, the regional government role should be optimized through monitoring and evaluation of expenditure budget, i.e. that the money coming from Regional Government Budget is people's money, thus, it should be used as optimal as possible for the greater good of the people. So far, the regional government has not optimized a performance-based budget. What has been implemented is limited merely to budget absorption, and this has not had any impact yet on the outcome of each program being implemented. In addition to optimization through monitoring and evaluation of a performance-based budget, the government needs to make everything regarding their financial policy to be transparent. Transparency allows the society to participate in giving positive contributions to the government policy in budget and to fund development programs, as well as to settle various issues in the government. Transparency ensures the rights for any information which could help prevent it from being misused by individual or groups for their personal interest, for their political or economic benefits.

LIMITATION

The use of a static panel model has limitations, namely the influence of a dependent variable on rare independent variables that are instantaneous. Very often the dependent variable reacts to the independent variable with a time interval. The time interval is called lag (Gujarati, 2003). The existence of the lag cannot be ignored. Regression analysis is done by paying attention to the lag. In other words, realized in a form of dynamic models. The formation of dynamic models is an important process because it is related to time changes. Dynamic models are needed because variations in endogenous



variables in the applicable period are not only determined by variations in exogenous variables in the same period. Endogenous variables need time lag to respond to exogenous variables. Dynamic models are able to make static theories dynamic by explicitly calculating the time element.

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Judul Karya Ilmiah (artikel) : The Role Of Local Government Expenditure Economic Growth : A Review Of Panel Data In Indonesia

Jumlah Penulis : 4 Orang (Agus Tri Basuki, Yunastiti Purwaningsih, Mulyanto, AM Soesilo)

Status Pengusul : ~~Penulis pertama~~ / penulis ke 3 / ~~penulis korespondensi**~~

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- a. Nama Jurnal : **Humanities and Social Sciences Reviews**
- b. Nomor ISSN : **2395-6518**
- c. Volume,nomor,bulan,tahun : **Vol. 7, Issue. 5, September 2019**
- d. Penerbit : **GIAP Journals**
- e. DOL artikel (jika ada) :
- f. Alamat web Jurnal : <https://giapjournals.com/index.php/hssr/article/view/hssr.2019.75168/2018>
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Lukman Hakim.,SE.,M.Si.,Ph.D

NIP 196805182003121002

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