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PROCEEDING

THE 14th IRSA INTERNATIONAL CONFERENCE 2018

Strengthening Regional and Local Economies

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THE IMPACT OF FISCAL DECENTRALIZATION, GENERAL ALLOCATION FUND, SPECIAL ALLOCATION FUND AND REVENUE SHARING FUND ON ECONOMIC GROWTH IN REGENCIES/CITIES OF CENTRAL JAVA PROVINCE 2011 TO 2015.

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ABSTRACT

This paper aims to the impacts fiscal decentralization, General Allocation Fund, Special Allocation Fund, Revenue Sharing Fund for economic growth in Central Java Province. Economic growth is one of the most important indicator to look at economic development sector in each country. It can be seen with GDP. The Regency/Cities with high economic growth, can be realized with decentralization fiscal policy. It assignment of authority from central to local government. That policies have been set in Law No.23 of 2014 and started in 2001. Fiscal decentralization enough to speed up development regional, poverty reduction, and boost economic development regional. In addition, fiscal decentralization policies has been implemented in Indonesia expected to grow regional independence to organize and make programs that support population necessary in each region.

This paper use secondary data from statistics Indonesia and Departement Finance in Central Java from 2011 to 2015. Analysis use panel Fixed Effect Model approach with Stata program 13. The results shows that probability value from Fiscal Decentralization is 0.012<α (0.05), it means this variable effect positively positively and significance to economic growth. Then, probability value from General Allocation Fund variable is 0,008<α (0.05), it means this variable effect positively and significance to economic growth. Then, probability value from Special Allocation Fund variable is 0.042<α (0.05) it means Special Allocation Fund variable effect positively and significance to economic growth. While Revenue Sharing Fund variable probability values is 0,52>α (0.05), it means that have no effect positively and significance to economic growth. The conclusion from this results is between Decentralization Fiscal, General Allocation Fund, Special Allocation Fund have the largest contribution is General Allocation Fund variable.

The conclusion from this paper is decentralization fiscal policy authority is giving freedom to local government. It means local government can improve their potential of natural or human resources. The Region Own Source Revenue in Central Java province also needs to

be improved in order to achieve a higher GDP. There are several ways that can be done by increasing the local tax revenue and other areas of the original.

Keyword : Fixed Effect Model, Economic Growth, Central Java Province.

1. INTRODUCTION

Economic growth is one of economic development indicators in a country that measured by Gross Regional Domestic Bruto (GRDP). In Indonesia, economic development is formed by regional autonomy policy that officially implemented since 1 January 2001. Regional autonomy policy or fiscal decentralization regulated in law no 13 of 2014 on Regional Government. The goal of regional autonomy is to boost prosperity and welfare.

Fiscal decentralization can be an opportunity to a region to increase its regional potential to boost economy. The aim of regional decentralization policy is to provide better public services, to stimulate regional independence to manage their finances, as well as develop programs that support the needs of people in the region. The result concluded that fiscal decentralization policy provides authority to government to increase regional economy as well as the potential of natural resources as well as human resources.

Some studies conducted by Oates (1993); Bird (1993), Bird, Ebel, and Wallich (1995); Martnez dan McNab (2001); World Bank (1997a); Bahl and Linh (1992); and Gramich (1993) suggest that decentralization or authority delegation to regional government can also boost public services efficiency as well as economic growth (Saputra, 2013).

World Bank (2997a); Matinez dan McNab (2001) emphasized that fiscal decentralization can be negatively affect economic growth. It is because decentralization boost macroeconomic instability. In the end, it can inhibit

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economic growth. Previous studies conducted by Philips and Woller (1997), and Davodi and Zao (1997) in developing countries (in Saputra, 2013) proved that fiscal decentralization negatively affect economic growth.

In Indonesia, according previous studies according to Situngkir et al (2014), fiscal decentralization negatively affect economic growth. From revenue indicator, fiscal decentralization negatively affect economic growth. Meanwhile, from expenditure indicator, when there is no calculation on revenue generated from balance funds, fiscal decentralization did not significantly affect economic growth in North Sumatera Province.

Figure 1.1 below explains the effect of fiscal decentralization to economic growth in Central Java Province that can be seen from the average value of GRDP percapita.

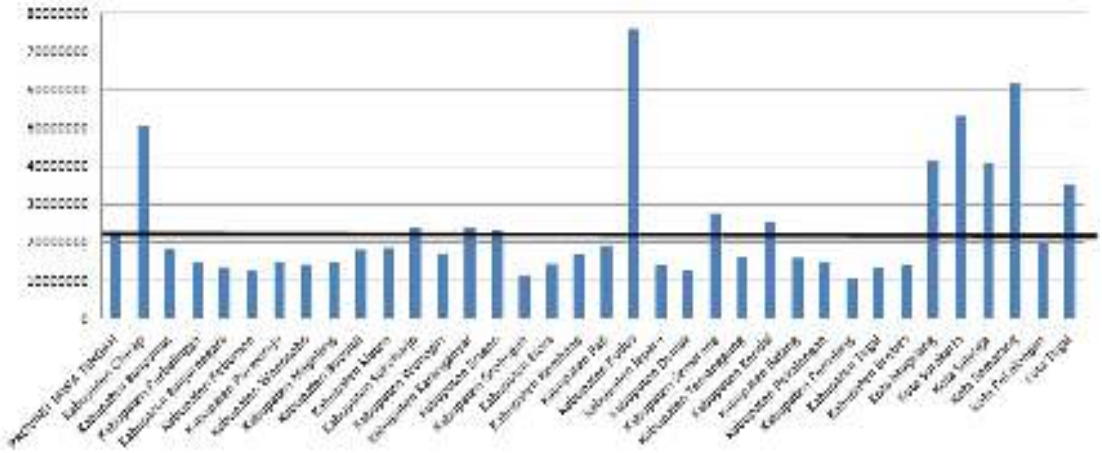

Figure 1.1 Average Percapita Income Regencies/Cities in Central Java Province from 2011 to 2015 (in million Rupiah)

Source: Statistic Indonesia 2011-2015

Figure 1.1 reveals the GRDP percapita average value of regencies/cities of Central Java Province from 2011-2011. The highest GRDP percapita average value

are in Kudus Regency, Semarang City, and Surakarta City. In addition, there are several regencies/cities that have higher GRDP percapita average value than Central Java Province, that are Cilacap Regency, Magelang City, Salatiga City, Tegal City, Semarang Regency, Kendal Regency, Sukoharjo Regency, Karanganyar Regency, and Sragen Regency. Thus, this study asseses the impact of fiscal decentralization, general allocation fund, special allocation fund and revenue sharing fund to economic growth in regencies/cities in Central Java Province from 2011-2015.

2. THEORETICAL FRAMEWORK

a. Theoretical Framework

1) Economic Growth Theory

a) Modern Theory of Economic Growth

According to Kuznet, a country's economic growth defined as a long-term rise in capacity to supply increasingly diverse economic goods to its population. That growing capacity based on advancing technology and the institutional and ideological adjustments that it. Kuznet stated that there are 6 characteristics of economic growth process, that are (Todaro, 2000) :

- the high rates of growth of per capita product and of population
- the rise of rate in productivity
- the rate of structural transformation of the economy is high
- the closely related and extremely important structures of society and its ideology have also changed rapidly.
- the economically developed countries have the propensity to reach out to the rest of the world

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- Limited spread of economic growth that reaches about one third of the world's population.

b) Classical Economic Growth

According to Adam Smith, there are two main aspects in economic growth that are (Arsyad, 1992) :

- Total Output Growth

There are three production factors in production system in a country :

- Natural resources
- Population
- Capital

- Population Growth

According to Adam Smith, wage rate that is higher than subsisten rate will boost population. At the prevailing rate, wage is determined by the attractiveness between the forces of demand and supply of labor, while labor demand is determined by the stock of capital and the level of output of population. Adam Smith added that demand will determined by capital and output growth rate.

c) Neoclassical Economic Growth

According to Arsyad (1992), neoclasical economic growth theory was developed in the late 1950s. In this theory, economic growth determined by production factors that are population, labor, and capital accumulation as well as technological progress.

2) Fiscal Decentralization

Fiscal decentralization is a budget distribution process from higher levels of government to the lower levels of government to support

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government functions and duties as well as public services according to the number of delegated authorities (Saragih, 2003). According to Mulyanto (2007) revenue fund sources that used to implement fiscal decentralization are :

a) Local Own Source Revenue

Local Own Source Revenue is revenue generated from Regional Tax Income, Regional Retribution Income, the separated regional resource management, etc. Local-own source aims to provide discretion to the region.

b) Balance Fund

Balance Fund according to Mulyanto (2007 : 25) is regional fund sourced from state budget consist of Revenue Sharing Fund, General Allocation Fund, and Special Allocation Fund.

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b. Conceptual Framework

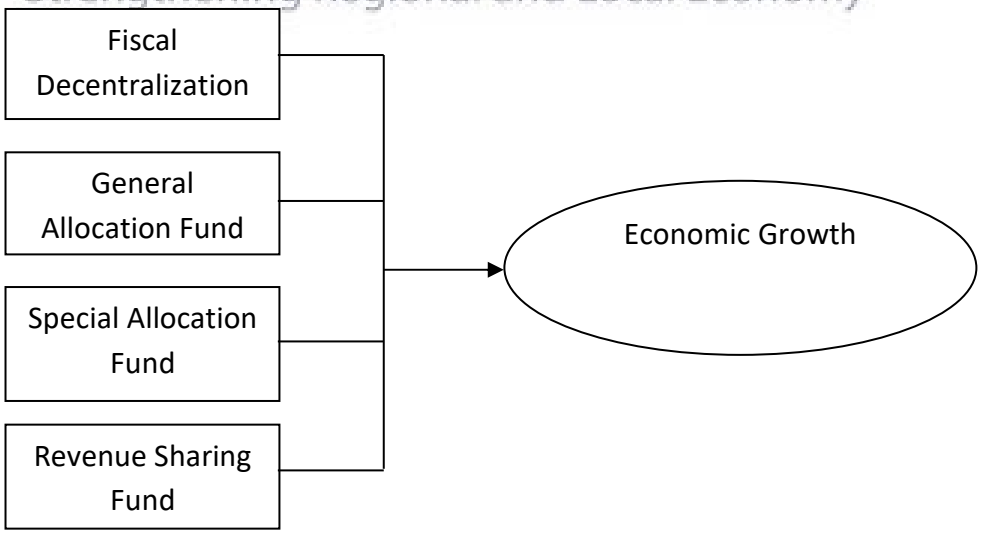

Figure 1.2 Theoretical Framework

Economic growth basically is a description of economic condition in one region in certain period. One of successful development indicators is the increasing of economic growth. However, economic growth is macroeconomic issue in long-run. A nation can be named as developed country when its percapita income is increasing. The instrument used to measure economic growth is Gross Regional Domestic Product (GRDP). GRDP explains the condition of economy in certain region.

General Allocation Fund, Special Allocation Fund, and Revenue Sharing Fund is revenue source or region fund to implement fiscal decentralization in Indonesia. The allocation of General Allocation Fund, Special Allocation Fund, and Revenue Sharing Fund aim to regional finance distribution as well as to finance regional needs in order to implement fiscal decentralization. Fiscal decentralization is expected to increase economic growth in every region in Indonesia. Thus, regional government should have allocation fund source to implement fiscal decentralization to boost prosperity.

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c. Hypothesis

1) The first hypothesis argues that fiscal decentralization positively affect economic growth in regencies/cities of Central Java Province.
2) The second hypothesis argues that General Allocation Fund positively affect economic growth in egencies/cities of Central Java Province.
3) The third hypothesis argues that Special Allocation Fund positively affect economic development in regencies/cities of Central Java Province.
4) The fourth hypothesis argues that Revenue Sharing Fund negatively affect economic growth in regencies/cities of Central Java Province.

3. RESEARCH METHOD

a. Research Scope

This study observes 35 regencies/cities of Central Java Province between 2011 and 2015. This present study relied on the data of GRDP, ocally Generated Revenue, Total Regional Revenue, General Allocation Fund, Special Allocation Fund, and Revenue Sharing Fund. This study aims to examine the effect of fiscal decentralization General Allocation Fund, Special Allocation Fund, and Revenue Sharing Fund to economic growth.

b. Data

This study employs secondary data and utilizes panel data regression. The estimation is runned by Stata 13. The data generated from Statistic Indonesia and Ministry of Finance budget information.

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c. Method

1) Panel Data Regression Analysis

To examine the effect of fiscal decentralization, General Allocation Fund, Special Allocation Fund, and Revenue Sharing Fund to economic growth in Central Java Province from 2011-2015, this paper utilizes panel data regression to run the analysis with the equation as follows :

$$Y = \beta 0 + \beta 1\ X1it + \beta 2\ X2it + \beta 3\ X3it + \beta 4\ X4it + e \ldots\ldots.(3.1)$$

Spesification :

Y = Economic Growth

X1 = Fiscal Decentralization (FD)

X2 = General Allocation Fund (GAF)

X3 = Special Allocation Fund (SAF)

X4 = Revenue Sharing Fund (RSF)

i = number of provinces

t = year

e = error term

2) Selection of Panel Data Regression Model

This study relied on the panel data. Panel data combines features of both time series and cross-section data. According to Widarjono (2007), there are several advantages from panel data. First, panel data is a combination of time series and cross-section data. Panel data is able to provide more data that can generate bigger degree of freedom. Second, the combination of time series and cross-section data information is able toovercome the problem of *omitted-variable*. According to Widarjono (2007), there are three methods commonly used to estimate panel data, that are :

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a) *Common Effect Model* (OLS)

Common effect model (OLS) combines cross section data and time series data using OLS to estimate the data panel (Widarjono, 2009).

b) *Fixed Effect Model* (FEM)

According to Gujarati (2012) *fixed effect model* (FEM) is a model with different *intercept* for each subject (cross section). However, each subject slope so not change over time. The *Intercept* in this model differently assumed with each subject. Meanwhile, this model assumes there is difference iver subject but the slope is still same over subject. According Kuncoro (2011), dummy variable is employed to to differ one

subject to other subject. The model is known as *Least Square Dummy Variables* (LSDV).

c) *Random Effect Model* (REM)

Widarjono (2007) stated that *random effect* model is performed to overcome *fixed effect model* weakness which uses dummy variable. Random effect model assumes error randimly. There is assumption in *random effect* that is the number of *cross section* should be larger than the variables of the research.

3) Model Determination

The best model determination between *common effect model, fixed effect model* and *random effect model* is estimated by two models that are *Chow test* and *Hausman test*. *Chow test* is performed to choose between *common effect* or *fixed effect model*. Meanwhile, *Hausman test* is performed to choose the best model to estimate oanel data regression that are between *fixed effect* atau *random effect model*.

a) *Chow test*

Chow test is performed to compare *common effect model and* dengan *fixed effect model* (Widarjono, 2007). Chow test hypotheses are as follows :

H_0 : *Common Effect Model*

H_a : *Fixed Effet Model*

H_0 is rejected when the value of Prob. F < α value. Meanwhile, H_0 is accepted when the value Prob. F > α value. The α critical value is 10%.

b) *Hausman test*

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Hausman test is employed to compare *fixed effect* model and *random effect* model to determine the proper regression panel data model. (Gujarati, 2012). There are two hypotheses used :

H_0 : *Random Effect Model*

H_a : *Fixed Effect Model*

The test rejects H_0 when Prob. F value > α value. The test accepts H_0 when Prob. F value < α value.The critical value of α is 10%.

4) Statistic Test

a) T-Test (Partial Test)

T-test is performed to show each independent variables that affect dependent variable (Kuncoro, 2011). This test employed hypotheses as follows (Utomo, 2015) :

- Hypothesis Formula :

  H_0 : Independent variable-i does not affect significantly

  H_a : Independent variable-i does affect significantly

- Level of significance (α)
- Testing criteria

  H_0 is rejected if t < α

  H_0 is accepted if t > α
- Conclusion :

  H_0 is rejected if t < α

  H_0 is accepted if t > α

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b) F test (Simultaneous Test)

F-test is performed to reveal how well the impact of independent variables on dependent variable simultaneously. The test is performed by comparing $F_{calculate}$ and $F_{table.}$ The decision to reject H_0 or accept H_0 is as follows :

a) H_0 is rejected when the significance statistic is $F < \alpha$

b) H_0 is accepted when the significance statistic is $F > \alpha$

c) Coefficient Determination (R^2 test)

According to Ghozali (2009) Coefficient Determination (R^2) test is employed to measure how well a model explains the variation of dependent variable. The range value of R^2 is from 0 to 1. Widarjono (2007) stated that a good model is when the R^2 value is close to 1. On the contrary, when the R^2 value is close to 0, the model is not good.

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4. DISCUSSION

a. Panel Regression Result

This study employed panel data that analyzed by three method that are *Common Effect Model (OLS), Fixed Effect Model (FEM)* and *Random Effect Model (REM).*

1) Common Effect Model (OLS)

Table 4.1 *Common Effect Model* (OLS) test result

	Constanta	FD (X1)	GAF (X2)	SAF (X3)	RSF (X4)
Coefficient	5.9062	-0.0170357	0.0000000306	-0.00000976	-0.00000507
Std Error	0.2357486	0.0171146	0.000000289	0.00000378	0.00000185
Prob $p > \|t\|$	0.000	0.321	0.29	0.011	0.007
Prob > F					0.0003
R-Squared					0.1148

Source : estimation result run by Stata 13

2) *Fixed Effect Model* (FEM)

Table 4.2 *Fixed Effect Model* (FEM) test result

	Constanta	FD (X1)	GAF (X2)	SAF (X3)	RSF (X4)
Coefficient	7.379004	-0.0778406	-0.00000132	-0.00000919	0.00000303
Std Error	0.7423732	0.0304876	0.00000493	0.00000447	0.00000477
Prob $p > \|t\|$	0.000	0.012	0.008	0.042	0.526
Prob > F					0.0101
R-Squared overall					0.0369

Source : estimation result run by Stata 13

3) *Random Effect Model* (REM)

Table 4.3 *Random Effect Model* (REM) test result

	Constanta	FD (X1)	GAF (X2)	SAF (X3)	RSF (X4)
Coefficient	6.061418	-0.000000187	-0.00000710	-0.00000302	-0.00000302
Std Error	0.3201336	0.0194247	0.000000302	0.00000281	0.00000238
Prob $p > \|t\|$	0.000	0.286	0.536	0.063	0.205
Prob > F					0.0184
R-Squared					0.0953

Source : estimation result run by Stata 13

4) *Hausman Test*

Table 4.4 *Hausman Test*

Test Summary	Chi 2 (2)	Prob.
Cross-section random	7.43	0.0594

Source : estimation result run by Stata 13

Hausman test result in table 4.4 reveals that the probability value is 0,0594 or less than α (0,10). It means, if the probability value of Hausman Test is less than 0,10, *Fixed Effect Model* will be utilized. *Fixed effect model* estimation results are as follow :

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Table 4.5 *Fixed Effect Model (*FEM) test

	Konstanta	FD (X1)	GAF(X2)	SAF (X3)	RSF (X4)
Coefficient	7.379004	-0.0778406	-0.00000132	-0.00000919	0.00000303
Std Error	0.7423732	0.0304876	0.00000493	0.00000447	0.00000477
Prob $p > \|t\|$	0.000	0.012	0.008	0.042	0.526
Prob > F					0.0101
R-Squared overall					0.0369

Source : estimation result run by Stata 13

Table 4.5 revelas the *fixed effect model* test result based on the probability value of P > | t |. On fiscal decentralization, the probability value is 0,012 < α (0,10). It means that fiscal decentralization positively and significantly affect economic growth. The probability value of General Allocation Fund is 0,008 < α (0,10). It means that General Allocation Fund positively and significantly affect economic growth. The probability value of Special Allocation Fund is 0,042 < α (0,10). It means that Special Allocation Fund positively and significantly affect economic growth. Meanwhile, the probability value of Revenue Sharing Fund is 0,52 > α (0,10), it means that Revenue Sharing Fund does not positively and significantly affect economic growth.

b. Statistic Test

1) T-test (Partial Test)

T-test is performed to examine independent variables (decentralization, general allocation fund, special allocation fund and revenue sharing fund) affect dependent variable (economic growth). The results of T-test are as follow :

Table 4.6 T-Test Result

Variables	P>|t|
FD	0.012
GAF	0.008
SAF	0.042
RSF	0.526

Source : Estimation result run by Stata 13

T-test result shows that the value of P>|t| of fiscal decentralization is 0,012 or less than α value (0,05). It means that Fiscal Decentralization positively and significantly affect economic growth. The value of P>|t| of General Allocation Fund is 0,008 or less than α value (0,05). It means that General Allocation Fund positively and significantly affect economic growth. The value of P>|t| of Special Allocation Fund less than α value (0,05). It means that Special Allocation Fund positively and significantly affect economic growth. Meanwhile, the value of P>|t| of Revenue Sharing Fund is 0,526 or greater than α value (0,05). It means that Revenue Sharing Fund does not positively and significantly affect economic growth.

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2) F-Test (Simultaneous Test)

Simultaneous test or F-test is a test to examine independent variables (fiscal decentralization, General Allocation Fund, Special Allocation Fund, Revenue Sharing Fund) simultaneously affect dependent variable (economic growth). The F-test result is as follows :

Table 4.7 F-Test Result

Prob > F	0,0000

Source : Estimation result run by Stata 13

F-test estimation shows Prob > F is 0,0000 or less than α value (0,05). It means that fiscal decentralization, general allocation funds, special allocation fund and revenue sharing fund simultaneously affect economic growth.

3) Coefficient of Determination Test (R^2)

Coefficient of Determination Test (R^2) is was run to measures the proportion or percentage of the total variation in dependent variable explained by inependent variable. The estimation result of Coefficient of Determination Test is as follows :

Tabel 4.8 Coefficient of Determination (R^2) Test Result

R-Sq : Within	0,0922

Source : Estimation result run by Stata 13

Coefficient of Determination (R^2) test result shows value of 0,0922. It means that 9,22% of fiscal decentralization, general allocation fund, special allocation fund, and revenue sharing fund are able to affect economic growth in regencies/cities of Central Java Province from 2011 to 2015. Meanwhile, the rest of 90,78% are affected by other variables.

5. CONCLUSION AND SUGGESTION

a. Conclusion

1) Based on panel data test, this study employs three method that are *Common Effect Model, Fixed Effect Model, and Random Effect Model*. Next, Hausman test is conducted to choose which one is the best model between *Fixed Effect Model* and *Random Effect Model*. Hausman Test result shows

Probability value of 0,0594 or less than α value (0,10). It means that Fixed Effect Model does fit in.

2) The result from *Fixed Effect Model* reveals that fiscal decentralization, general allocation fund, and special allocation fund positively and significantly affect economic growth, whereas revenue sharing fund does not affect economic growth positively.

b. Suggestion

1) Fiscal decentralization policy provides authority to government to increase the potential of natural resources as well as human resources. The authority is an opportunity to increase prosperity and welfare of the people.
2) For next research, the addition of new variables is necessary in order to generate more relevan result.

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