

# 42\_Does High Transfer from The Central Government to The Local Government Guarantee High Economic Growth? Evidence From Central Java Province

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## Does High Transfer from The Central Government to The Local Government Guarantee High Economic Growth? Evidence From Central Java Province

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**Abstract.** The implementation of fiscal decentralization in Indonesia has been running for 18 years, marked by the increase in the burden on local governments in carrying out it, and the fact that there are still many local government budgets used for personal expenditure. Nationally, there are still 151 regencies/municipalities out of 416 regencies/municipalities in Indonesia, which have more than 50% of the total regional revenue and expenditure budget. Many local governments rely on transfers of funds from the central government in carrying out the role of fiscal decentralization. The dependence of regional government is reflected in the size of the balancing budget used to finance fiscal decentralization, due to the limited revenue from original local government revenue. This paper aims to see do regencies/municipalities finance fiscal decentralization, what is the local revenue for each region and its relation to economic growth, and what is the employee expenditure allocated to each regional revenue and expenditure budget and its relationship with economic growth. This paper uses cross-tabulation analysis with variables of original local government revenue, the proportion of employee expenditure on regional revenue and expenditure budget, and economic growth in 35 regencies/municipalities in the Central Java region. Local income consists of local revenue, balanced budget, and other legitimate income. Regencies/municipalities consist of local taxes, retributions, the income of regional government corporate and management of separated regional government wealth, and other original local government revenue, while the balanced budget is in the form of tax share, no tax share, general allocation fund, and special allocation fund. Research in Central Java Province because it is a Province with the number of regencies/municipalities the second largest after East Java in Indonesia. The results of this study are that in the province of Central Java, there are still 30 regencies/municipalities (85,7%) whose balance funds exceed 50% of their APBD funds, in other words having very low PAD, and employee expenditure is still high. Transfer of funds from the central government to the regions has also not played a major role in driving economic growth. There are strong indications of the inability of local governments to carry out fiscal decentralization so that improvements are needed in the formulation of their policies. One way to increase local government original income is to diversify local taxes, but by paying attention to the situation and conditions of the region so that it does not harm the economy in general. It could also be by developing productive regional businesses while still prioritizing public services. Besides, the government can also carry out efficiency in running its government, for example by training employees and not increasing the number of employees over the next few years.

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Personal Expenditure · 5 Regional Revenue · 6 Expenditure Budget.

## 1. INTRODUCTION

The implementation of fiscal decentralization began on January 1, 2001, reaching the age of 18 at the end of last year. Strengthening fiscal decentralization is marked by an increase in budget transfers to regions from year to year. Transfers from the central government to local governments called Balancing Budget (DP) which consist of the General Allocation Fund (DAU), Special Allocation Funds (DAK), Revenue Sharing Funds (DBH) for taxes and natural resources. Besides, the Special Autonomy Fund for certain regions only. The central government has agreed to a high level of trust at the center to give delegated authority in all areas of authority in the fields of foreign policy, defense and security, law, monetary and finance, and religion.

Fiscal decentralization based on the regency/municipalities is still not in line with initial expectations because the regional government is very dependent on transfer funds from the central government. The dependence of the Regional Revenue and Expenditure Budget (APBD) on the transfer of funds from the central government is still very large in other words, each region has not been able to obtain high Original Local Government Revenue (PAD), so it can be said that local governments have not been able to carry out fiscal decentralization functions independently.

The regencies/municipalities finances have been heavily burdened by employee expenditure, where there are still 31% of regencies/municipalities in Indonesia that spend more than 50% of the APBD, which is a burden on the regional government. The policy of fiscal decentralization by giving greater authority to the regions can create efficiency and effectiveness to provide public goods because the regions are perceived to better understand their people's preferences. Also, fiscal decentralization policies can encourage accelerated economic development and changes in economic structures that have a broad impact on regions that are considered to be underdeveloped (Arham: 2014). But economic growth since the fiscal decentralization has so far still not been as high as before in Indonesia.

Based on the above, researchers want to see more about the condition of PAD, DP, personal expenditure in Central Java Province and its relation to economic growth. Central Java Province was chosen because in Central Java there is a large area, which is 35 cities/districts. The number of these regions is only inferior to East Java Province which has 38 cities/districts. Likewise, the transfer funds from the central government to the regions are also number two after East Java.

## 2. LITERATURE REVIEW

Fiscal decentralization is the transfer of authority and fiscal responsibility from a higher or central government to the level of government that is under it or in the area. Fiscal decentralization can also be interpreted as giving authority to the regions to explore sources of income, the right to receive transfers from higher government, and determine routine and investment expenditures. In summary, it can be interpreted that the regional government is allowed to determine regulations on the budget (Muryawan and Sukarsa: 2016). Steffensen (2010) states that the objectives of fiscal decentralization can be classified as follows: (i) Increased efficiency, by strengthening the relationship between services and community demand according to their needs, the closer regional governments will be more responsive to local people's preferences, (ii) Increased financial accountability, by bringing government and decisions closer to the community in terms of voting, influence, information exchange, and monitoring and more youth is carried out, and (iii) Increasing

effectiveness, will increase the possibility of strengthening competition in the provision of public services between regions, so that they can mobilize citizen contributions, innovate and others.

Fiscal decentralization makes government spending more efficient than handled by the central government, so it will improve economic efficiency because local governments have a better position than the central government in distributing public services needed by local governments. The existence of fiscal decentralization in its continuation will encourage accelerated economic growth at the regional level and its impact on economic growth nationally. Empirical proof of the positive relationship between fiscal decentralization and economic growth has been carried out by Akai et al (2009), Ding (2007), and Samimi et al (2010). But not all empirical studies show the same pattern, some of which show the opposite, fiscal decentralization has a negative correlation with economic growth, as found by Baskaran and Lars (2009), Jin and Rider (2010). Referring to several theories and corroborated by empirical evidence in several countries, it is increasingly believed that decentralization as a system of government can spur the pace of regional economic development to reduce dependence on the central government, while also developing the principles of democracy and public participation.

Research conducted by Miri et al (2017), shows that fiscal decentralization lead to significant long-term economic growth (especially significant for decentralized income), but in the short term, this leads to a decline in economic growth. Indeed, short-term results show that fiscal decentralization resulted in a very short-term decline in economic growth before improving over time to reach a long-term increase between 2003 and 2014 in Morocco.

While the study conducted by Ding, et al (2019) looking at tax sharing, shows that the reform of the tax-sharing system is successful in increasing the rate of growth and the level of economic activity, this paper remains silent about certain mechanisms responsible for relations this cause and effect. The increase in revenue for the central government brought about by the reform of the Tax Sharing System allows the central government to internalize the externalities associated with the provision of public goods, coordinate economic activities across different regions, provide financial support for macroeconomic stability, and provide insurance in response to asymmetrical shocks. Future work will explore this mechanism in more depth to better understand the optimal level of fiscal federalism in China.

### 3. METHODOLOGY

This paper uses descriptive statistical analysis using cross-tabulation to see the relationship between the variables studied. The variables studied included balancing funds, PAD, employee expenditure, regional budget, and economic growth in 35 regencies/ municipalities in Central Java in 2017.

### 4. RESULT AND DISCUSSION

In the province of Central Java, there are still 30 regencies/ municipalities (85,7%) whose balance funds exceed 50% of their APBD funds, and only 5 cities/regencies (14,3%) are dependent on transfers of funds from the central government under 50%. The five regions are Sukoharjo, Rembang, Purworejo, Magelang, and Semarang City, but have a range of less than 3% of the boundary, and only the city of Semarang has sufficient balance and the lowest is 34%. As shown in Table 1, if it is associated with economic growth, as many as 18 regions (51,4%) have economic growth above the average and 12 (34,3%) regions are below the average. While from 5 regions with balancing funds below 50% of the APBD, there are 3 regions with economic growth above the average and 2 regions experiencing economic growth below the average.

Table 1: Results of economic growth and balance budget crosstabulation

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In Table 2, it is used to see the relationship between PAD and economic growth. Most of the regencies/municipalities in Central Java, which amounted to 31 (88,6%) still had very low PAD, which was below 20% of the APBD, and only 4 regions had PAD greater than 20% of their APBD. The four regions are all cities, namely Magelang, Surakarta, Semarang, and Tegal, while none of the Districts has PAD greater than 20% of the Regional Budget. This is because urban areas have more promising local tax sources, such as hotel, restaurant, earth and building taxes, and entertainment. The regions with low PAD are 31 regions, of which 18 have economic growth above the average and only 13 regions have economic growth below the average.

Table 2: Results of economic growth and local revenue crosstabulation

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Table 3 explains how the relationship between employee expenditure and economic growth. There are 23 regions with employee expenditure below or equal to 40% and as many as 12 regions having personal expenditure above 40% of the APBD. In regions with personnel expenditure below or equal to 40% of the APBD, economic growth is divided into 12 regions with economic growth above the average and 11 regions below the average. While for regions with employee expenditure of more than 40% of the APBD, most have economic growth above the average of as many as 10 regions, and only 2 regions with growth below the average.

Table 3: Results of economic growth and personal expenditure crosstabulation

## 5. CONCLUSION

In the province of Central Java, there are still 30 regencies/municipalities (85,7%) whose balance funds exceed 20% of their APBD funds, and only 5 regencies/municipalities (14,3%) are dependent on transfers of funds from the central government under 50%. The five regions are Sukoharjo, Rembang, Purworejo, Magelang, and Semarang City. Most of the regencies/municipalities in Central Java, which amounted to 31 (88,6%) still had very low PAD, which was below 20% of the APBD, and only 4 regions had PAD greater than 20% of their APBD. The four areas are all cities,



namely Magelang, Surakarta, Semarang, and Tegal, because the city benefits from local taxes such as hotel, restaurant, entertainment, earth, and building taxes. Three of the four cities have economic growth above the average.

There are 23 regions with employee expenditure below or equal to 40% and as many as 12 regions have personnel expenditure above 40% of the APBD, were for regions with low employee expenditure have evenly distributed economic growth, while for regions with high employee expenditure have above-average economic growth. There are strong indications of the inability of local governments to carry out fiscal decentralization so that improvements are needed in the formulation of their policies. One way to increase local government original income is to diversify local taxes, but by paying attention to the situation and conditions of the region so as not to endanger the economy in general. It could also be by developing productive regional businesses while still prioritizing public services. Also, the government can also carry out efficiency in running its government, for example by training employees and not increasing the number of employees over the next few years. It is also possible to make competition between healthy regions also stimulate economic growth, as stated by Blöchliger and Egert (2013), where competition between regions coupled with productivity in the production function of the public sector can help assess the relationship between decentralization and economic growth.

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