

Analysis of The Impact of Fiscal Decentralization on Economic Growth in Indonesia

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Abstract

This study aims to examine the effect of fiscal decentralization on economic growth in Indonesia. The research sample is journals that discuss the effect of fiscal decentralization on Indonesia's economic growth. The data were then analyzed using the Compare method. The results indicated that, first, fiscal decentralization had a positive and significant effect on economic growth. Second, fiscal decentralization has a negative and significant effect on economic growth. Third, there are many aspects that influence the results of fiscal decentralization in every region in Indonesia

Keywords

Impact, Fiscal Decentralization, Economic Growth, Indonesia

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1. INTRODUCTION

Decentralization is an instrument to achieve one of the goals of the state, namely primarily providing better public services and creating a more democratic public decision-making process. Decentralization will be realized by giving authority to lower levels of government to make expenditures, the authority to collect taxes (taxing power), the formation of councils elected by the people, regional heads elected by the people, and assistance in the form of transfers from the central government (Martínez-Vázquez et al., 2017).

Fiscal decentralization is the delegation of responsibilities and the distribution of power and authority for making decisions in the fiscal sector which includes aspects of revenue as well as aspects of expenditure (Rotulo et al., 2020). This fiscal decentralization is associated with the duties and functions of local governments in providing public goods and services. However, many experts provide a definition of fiscal decentralization. Fiscal decentralization described by Bird and Villancourt (2002) includes three different degrees of independence in decision-making by the regions. First, decentralization means relinquishing responsibility within the central government to carry out certain functions on behalf of the government. Second, devolution (delegation) where it is not only implementation that is given to the regions, but also the authority to decide what needs to be done by the regional government (Dent et al., 2021).

The fiscal decentralization policy is a consequence of the political decisions on decentralization or regional autonomy policies taken by the government. The politics of decentralization had actually been discussed and even implemented during the era of President Soekarno to President Suharto with a pilot program of regional autonomy in several level II regions in Indonesia. The politics of decentralization, although only as a pilot project, has been running for a relatively long time since Law Number 5 of 1974 concerning Principles of Regional Government came into effect (Hastuti, 2018).



The implementation of fiscal decentralization in Indonesia during the Reform era officially began on January 1, 2001. The process began with the ratification of Law (UU) Number 22 of 1999 concerning Regional Government and Law Number 25 of 1999 concerning Financial Balance between Central and Regional Governments (PKPD). Until now, these two regulations have undergone several revisions, most recently Law Number 23 of 2014 concerning Regional Government and Law Number 33 of 2004 concerning Financial Balance between the Central Government and Regional Governments. Initially, the implementation of fiscal decentralization in Indonesia was aimed at creating aspects of independence in the regions. As a consequence, the regions then received delegation of authority in all fields, except for authority in the fields of foreign policy, defence, security, justice, monetary and fiscal as well as religion (Haryanto, 2017).

This delegation of authority was also followed by the handing over of funding sources in the form of handing over tax bases and funding assistance through a transfer mechanism to the regions according to the principle of money follows function. The existence of a transfer mechanism to the regions is based on considerations of reducing inequalities that may occur both between regions (horizontal imbalances) and between the central and regional governments (vertical imbalances). One thing that needs to be underlined is that the implementation of fiscal decentralization in Indonesia is decentralization from the expenditure side, not from the revenue side (Maulana, 2019).

The objectives of fiscal decentralization aim to fulfill regional aspirations regarding control over state financial resources, encourage regional government accountability and transparency, increase community participation in regional development processes, reduce inequality between regions, ensure the implementation of minimum public services in each region, and in the end it is expected can improve the welfare of society in general (Sudaryo et al., 2021). This argument is inseparable from the belief that development cannot be achieved only through market mechanisms, but requires the role of the government through its budgetary policies. Meanwhile, if studied further, the fiscal decentralization policy is a consequence of the political decisions on decentralization or regional autonomy politics taken by the government. Regional autonomy is unlikely to succeed if it is not fully supported by fiscal politics through fiscal transfers to the regions (fiscal decentralization) to support the success of regional autonomy

In principle, the emergence of the idea of decentralization is an anti-thesis for a centralized political structure. In other words, because a centralized political structure tends to unify political power in the hands of the central government, decentralization, on the other hand, proposes the idea of dividing political power and/or administrative authority between the central and regional governments. Furthermore, the emergence of attention to decentralization is not only associated with the failure of centralized planning and the popularity of growth with equity strategies, but also the awareness that development is a complex process and full of uncertainty. Which cannot be easily controlled and planned from the center because of this, the pioneers of decentralization confidently put forward a long list of reasons and arguments about the importance of decentralization in planning and administration in third world countries (Primanto, 2020).

Democratic decentralization in Indonesia has resulted in new changes in local government arrangements, but it still faces old structures that hinder decentralization and democracy. Until now, fiscal decentralization and regional autonomy are interesting issues for discussion, this is related to the fact that fiscal decentralization is not only a discussion in the economic realm, but also covers other topics such as politics, administration, and geography. One of the most interesting aspects of decentralization is whether fiscal decentralization has a positive or negative effect on economic growth

2. METHODS

This type of research is library research. Literature study is a research design used to gather data sources related to a particular topic. The criteria used in this study are inclusion criteria, namely: 1) explaining the effect of fiscal decentralization on economic growth 2) having been published as a

journal 3) published between 2010-2022. Source of data by taking based data on Google Scholar. Data analysis using the compare method.

3. FINDINGS AND DISCUSSION

Name	Title	Year	Result
(Galela, 2016)	Desentralisasi Fiskal Dan Pertumbuhan Ekonomi Perluakah Desentralisasi Fiskal Diperluas	2012	Fiscal decentralization can encourage economic growth by arguing that the budget allocation for local public goods is carried out by local governments. The research studies conducted showed different results, some showed a positive correlation, some showed a negative correlation, and the rest showed no correlation. The difference in the results of this study makes it difficult to determine policies regarding the need for expanding or decreasing the delegation of authority to local governments. Regardless of these results, the goal of unifying the nation through fiscal decentralization has been achieved
(Sari, 2014)	Dampak Kebijakan Desentralisasi Fiskal Pada Daerah Tertinggal Di Indonesia	2014	In this study will be used quantitative analysis and qualitative analysis. The results of the study show that the degree of fiscal decentralization in underdeveloped regions is very low, and the increased allocation of DAK to underdeveloped regions has no significant relationship to the economic growth of the people.
(Mahi & Supriyanti, 2019)	Dampak Desentralisasi Fiskal terhadap Volatilitas Belanja Pemerintah Kabupaten/Kota di Indonesia	2019	The volatility of district/city government spending stemming from uncertainty over transfers from the central government to regional governments can worsen the district/city economy. The results show that the higher the degree of fiscal decentralization tends to reduce the volatility of real spending by district/city governments because the fiscal capacity of districts/cities tends to increase after the implementation of the law. Property taxes are a predictable source of regional revenue so that district/city

(Nazikha & Desentralisasi Fiskal Dan 2019
Rahmawati, Inklusifitas Pertumbuhan
2021) Ekonomi Dikabupaten/Kota
Di Ntb

governments can manage their regional expenditures in a more certain and measurable manner

The results of the analysis show that there is no district/city inclusive economic growth in NTB both in terms of reducing poverty, economic inequality and employment. Inclusive economic growth can only be enjoyed by the upper middle class, while the lower class cannot benefit from economic growth. Meanwhile, on the other hand the role of fiscal decentralization through the use of PAD cannot affect inclusive economic growth both in terms of reducing poverty and reducing economic inequality except for increasing employment. Where PAD affects inclusive economic growth through employment. This is due to the small contribution of PAD to economic development which only reached 8 percent during the study period and has not been able to reach all levels of society

(Hidayat, 2016) Analisis Dampak 2018
Desentralisasi Fiskal
Terhadap
Pertumbuhan Ekonomi
Daerah Di Jawa Timur
(Studi Kasus 38 Kab/Kota Di
Jawa Timur)

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(Rahmanda, 2018)	Pengaruh Fiskal Pertumbuhan Daerah Di Provinsi Papua	Desentralisasi Terhadap Ekonomi Kabupaten/Kota	2018	This Research Aims For Research Results Showing Fiscal Decentralization Measured Through Revenue Indicators Have A Significant And Negative Effect On Regional Economic Growth. Whereas Fiscal Decentralization Measured Through Expenditure Indicators and Autonomy Indicators Have the Same Results, Namely Not Having a Significant Influence on Regional Economic Growth in Regencies/Cities of Papua Province
(Sabilla & Jaya, 2014)	Pengaruh Fiskal Pertumbuhan Kapita Regional Di Indonesia	Desentralisasi Terhadap Ekonomi Per Kapita Regional Di Indonesia	2014	The results of the study show that fiscal decentralization has a positive effect on regional per capita economic growth, as well as the workforce. However, international trade has no effect and even has a negative effect on regional per capita economic growth.
(Sasana, 2016)	Dampak Desentralisasi Terhadap Ekonomi Dan Harga Di Indonesia	Implementasi Fiskal Pertumbuhan Dan Stabilitas Di Provinsi Di Indonesia	2015	The results of this study indicate that fiscal decentralization has a positive relationship but statistically has no significant effect on economic growth and inflation. Second, work has a significant positive effect on economic growth.
(Zulkipli, 2018)	Pengaruh Fiskal Pertumbuhan Indonesia	Desentralisasi Terhadap Ekonomi	2017	Research analysis shows that fiscal decentralization has a positive effect on economic growth. DAU and DBH have a positive effect on GRDP. On the other hand, DAK has a negative influence on GRDP. There Are Six Regions That Have Positive Heterogeneity. They are Jakarta, East Java, West Java, Central Java, Banten and North Sumatra. That is, they have higher heterogeneity among others. The regions that have the lowest heterogeneity are the Riau Islands, Papua, West Papua, Maluku and East Nusa Tenggara. Finally, this study suggests that the central government guarantees the continuity of fiscal transfers to regions that have shown good performance in increasing regional economic growth. At the Same Time,

Regional Governments Should Make Better Use of Fiscal Transfers Based on Priority Sectors to Accelerate Regional Economic Growth.

The implementation of fiscal decentralization cannot be separated from the arrangement of the distribution of authority and financial balance between the central and regional governments. The regional government as the authority with full authority over the management of the APBD is expected to be able to use it as a means to improve people's welfare by improving the quality of public services and becoming a support for regional economic growth. This study tries to discuss the extent of the influence of fiscal decentralization through measuring revenue indicators, expenditure indicators, and autonomy indicators on regional economic growth

The Positive Impact of Fiscal Decentralization on Economic Growth in Indonesia

First, the results of the study show that the heterogeneity of each province in Indonesia is very diverse. Provinces in Indonesia that have positive heterogeneity are DKI Jakarta Province, East Java Province, and West Java Province, Central Java Province, Banten Province and North Sumatra Province. This means that the five provinces have an estimation model with a constant value that is higher than the average in Indonesia. Meanwhile, other provinces have negative heterogeneity, or in other words it can be said that these provinces have an estimation model with a constant value that is lower than the average in Indonesia. The provinces that have the lowest heterogeneity values are the Riau Islands Province, West Papua Province, Papua Province, Maluku Province and East Nusa Tenggara Province.

Second, fiscal decentralization in Indonesia is able to influence economic growth, this can be proven through the analysis of multiple linear regression models for the three research areas. For the regions of Sumatra, Java and Bali, DAU and DBH have a positive effect on economic growth. Partial and simultaneous evidence proves that the General Allocation Fund and Revenue Sharing Fund positively affect economic growth. However, the Special Allocation Fund has a negative effect on economic growth, this is because there are several provinces that have not received Special Allocation Funds at all in several years, such as the Riau Islands, Bangka Belitung, DKI Jakarta, West Sulawesi and West Papua.

Third, Economic Growth will increase by 1.85 units for each additional one X1 unit (revenue decentralization). So if decentralized revenues experience an increase of 1 unit, then economic growth will increase by 0.742 units assuming other variables are held constant. Economic growth will decrease by 4.02 units for each additional one X2 unit (decentralization of expenditure). So if the decentralization of spending has increased by 1 unit, then economic growth will decrease by 0.175 units assuming the other variables are held constant. Economic Growth will increase by 1323.631 units for every additional one unit of X3 (Investment). So if investment increases by 1 unit, Economic Growth will increase by 0.136 units assuming other variables are held constant.

Fourth, based on the results of the estimation of fiscal decentralization on inflation in provinces in Indonesia, it shows that the fiscal decentralization variable has a positive direction but is statistically insignificant to economic stability (inflation). This implies that the degree of fiscal decentralization is not the main factor causing the potential for inflation in the regions. The findings in this study are not in line with previous studies, Feltenstein et al (2005) concluded that the shift in fiscal activity from the central government to local governments in China has an impact against inflation. The results of Treisman's research (200) concluded that there is a difference between developed and developing countries, where fiscal decentralization correlates with low inflation for developed countries. Through regional autonomy and fiscal decentralization, local governments have the authority to extract revenue and carry out an allocation role independently in setting development priorities. It is hoped that with the existence of fiscal autonomy and decentralization, development can be more evenly

distributed in accordance with the wishes of the regions to develop regions according to their respective potentials so as to be able to improve the economy and welfare.

Fifth, fiscal decentralization affects people's welfare, unemployment and poverty in the province of NTB due to the dominance of central government transfers in the form of balancing funds such as general allocation funds, tax and non-tax profit-sharing funds and special allocation funds to regional governments in NTB. This situation can be seen from the calculation of the contribution of the balancing funds for the last 3 years from 2014-2016, which almost reached 70 percent of the total regional income, followed by the PAD contribution of 9 percent of the total regional revenue (appendix 2). Although transfers of funds still depend on the central government, local governments can use these funds to improve the quality of life for the people of NTB, such as improving education and health facilities, improving regional infrastructure and a decent standard of living. This can be seen from the HDI, which is a reference for measuring people's welfare, which has increased. In addition, the allocation of transfer funds from the center to the regions is able to reduce the level of income disparity between regions. With the existence of fiscal transfers from the central government to the regional governments, regions that are weak in their fiscal strength can be assisted to cover funding gaps in their regions.

The negative impact of fiscal decentralization on economic growth in Indonesia

First, it is that decentralization will cause macroeconomic instability, which will disrupt economic growth. Thus there is a negative relationship between fiscal decentralization and economic growth. And the third argument says that the impact of fiscal decentralization on economic growth will differ from developed and developing countries. For developing countries the benefits of decentralization are less pronounced. This opinion is based on the fact that institutions in developing countries do not provide incentives for regional governments to use information related to their constituents. The leader may be appointed based on his powers. Another reason is that local governments in developing countries may not have sufficient economic resources and weak human resource skills in managing the budget. According to the authors, the reason for the weakness of regional governments in managing the budget, which causes a negative effect of fiscal decentralization on economic growth, can be understood by the composition of the realization of APBD spending, both provincial and district/city. Then when viewed from a macroeconomic perspective, especially the external effects of the global economy, the negative effect of fiscal decentralization on regional economic growth can be caused by the global financial crisis in 2007. The global financial crisis has presented extraordinary challenges for Indonesia. The existence of the global financial crisis has demanded Indonesia's ability to increase its competitiveness in maintaining and capturing

Second, the coefficient of determination (R^2) measures the ability of the independent variable to explain the dependent variable. The coefficient of determination is zero and one. The greater the value of R^2 , the independent variables provide almost all the information needed to predict the variation of the dependent variable. Based on the estimation results, the coefficient of determination or R^2 is 0.1287. This means that the changes that occur in the current economic growth of 12.87 percent can be explained (caused) by fiscal decentralization and the remaining 87.13 percent can be explained by other factors. The hypothesis testing is seen from the t-statistic value obtained for fiscal decentralization, which is - 3.284, the t-statistical value of fiscal decentralization shows significant results in influencing economic growth. This can be seen from the t-statistical value of fiscal decentralization which is greater than the t-table value ($-3.284 > 1.664$). These results prove that the hypothesis in this study that there is a positive and significant effect of fiscal decentralization on regional economic growth in South Sumatra Province is rejected. The estimation results of the model used indicate that the model in this study is good. This can be seen after testing the statistical criteria and testing the econometric criteria. The statistical criteria test shows that partially fiscal decentralization has a negative and significant effect on economic growth, this is indicated by a probability value of 0.0016 which is smaller than alpha 0.10, assuming a 1 percent increase in the

degree of fiscal decentralization will reduce economic growth by -3.681 percent. This shows that it is not in accordance with the hypothesis in this study that there is a positive and significant effect of fiscal decentralization on regional economic growth in South Sumatra Province

Third, the acquisition of Regional Revenue as a result of limited tax authority. It should be acknowledged that fiscal decentralization in Indonesia is currently not running optimally. Regional governments are only given the authority to carry out a number of service activities and the provision of public goods, while on the tax authority side there are still many strategic taxes collected by the central government, such as land and building taxes and income taxes. As a result, the local government has not been able to fully meet its budget needs by relying on regional revenue sources

Fourth, the issue of readiness of local government apparatus to carry out the authority they have. The centralized government mechanism during the New Order government made local government officials dependent on the central government. Because during the New Order era, local government officials were accustomed to only receiving orders from the central government, all policy implementation needs, starting from the budget, implementation instructions and technical instructions, had been provided by the central government. This can be seen in the cases of handling collapsed school buildings to the slow handling of floods as a result of the weak capacity of local government apparatus. Not to mention the problem of the ability of the regions to prepare financial reports according to the financial reporting standards set by the Ministry of Home Affairs, until now not all Regional Governments have been able to prepare financial reports according to the standards available.

4. CONCLUSION

Fiscal decentralization opens opportunities for better regional economic growth due to the efficiency of local government budget allocations. This efficiency is achieved because local governments have better information about the public goods needs of local communities. However, the problem of inflation, bureaucracy, economies of scale, market fragmentation, and corruption can be the main obstacles to economic growth. To overcome the problems of inflation, bureaucracy, economies of scale, market fragmentation, and corruption which can be the main obstacles to economic growth under fiscal decentralization, there are several efforts that can be made, namely: 1). Bureaucracy. The government can increase the efficiency of local government administration and speed up the licensing process and business development. This can be done through bureaucratic reform and simplification of regional regulations. 2). Economies of scale. The government can develop certain economic sectors in regions that have a comparative advantage and can increase their economic scale. The government can also encourage investment in the area to increase economic growth. 3). Inflation. The government can pay attention to monetary and fiscal policies to control inflation. In addition, the government can strengthen price control and increase the production of goods and services. 4). Corruption. The government can strengthen the monitoring and control system to prevent corrupt practices in local government. In addition, the government can also encourage community participation in monitoring policies and budget allocations in the regions. And 5). Market fragmentation. Governments can reduce market fragmentation by adopting uniform rules and policies for different regions. In addition, the government can also encourage inter-regional cooperation to strengthen regional markets.

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